Document: EB 2014/LOT/P.9
Date: 1 August 2014
Distribution: Public
Original: English

E

Investing in rural people

President's report

Proposed loan to Georgia for the Agriculture Modernization, Market Access and Resilience Project

Note to Executive Board representatives

Focal points:

Technical questions:

Dina Saleh
Country Programme Manager
Tel.: +39 06 5459 2780
e-mail: d.saleh@ifad.org

Dispatch of documentation:

Deirdre McGrenra
Head, Governing Bodies Office
Tel.: +39 06 5459 2374
e-mail: gb_office@ifad.org

For: **Approval**

Contents

Abbreviations and acronyms

AMMAR	Agriculture Modernization, Market Access and Resilience Project
APMA	Agriculture Project Management Agency
CSA	climate-smart agriculture
GEF	Global Environment Facility
GEL	Georgian Lari
GILMD	Georgia Irrigation and Land Market Development project
RADF	Rural and Agriculture Development Fund
VC	value chain

Map of the project area

Georgia

Agriculture Modernization, Market Access and Resilience Project

IFAD

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

Map compiled by IFAD | 12-06-2014

Georgia

Agriculture Modernization, Market Access and Resilience Project

Financing summary

Initiating institution:	IFAD
Borrower:	Georgia
Executing agency:	Ministry of Agriculture
Total project cost:	US$31.3 million
Amount of IFAD loan:	SDR 8.61 million (equivalent to approximately US$13.3 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 five years, starting from the date of approval by the Executive Board.
Cofinancier:	Global Environment Facility (Special Climate Change Fund), subject to approval
Amount of cofinancing:	US$5.3 million
Terms of cofinancing:	Grant
Contribution of Borrower:	US$2.4 million (estimated)
Contribution of beneficiaries:	US$9.76 million
Convergence with other programmes	US$0.5 million (IFAD grant – Capacity-Building for Enhancing Agricultural Resilience and Competitiveness (CBEARC) – approved in December 2013)
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed loan to Georgia for the Agriculture Modernization, Market Access and Resilience Project, as contained in paragraph 53.

Proposed loan to Georgia for the Agriculture Modernization, Market Access and Resilience Project

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Georgia is currently a lower middle-income country (GNI was US$3,290 per capita in 2012) with a population of about 4.5 million, of which 2.1 million live in rural areas (46.2 per cent),equivalent to about 550,000 households with an average of 3.75 people per household. The national poverty headcount, based on the national poverty line, was 20.9 per cent in 2010 and had declined to 14.8 per cent in 2012. Poverty rates are 80 per cent higher in rural areas than in urban areas: 18.8 per cent versus 10.5 per cent respectively in 2012.

2. Development in the agriculture sector has been hindered by the inadequacy or lack of basic and productive infrastructure, particularly irrigation; limited off-farm opportunities; critical gaps in value chains; reduced human and social capital; rural-urban migration especially of youth; and lack of government support. The situation has been exacerbated by the land privatization reform that resulted in smallholdings, whereby approximately 75 per cent of households ended up with less than 1 hectare of land. Land fragmentation combined with limited organizational capacity contributed to the development of subsistence farming and an overall decline in agriculture as a profitable business. The downward trend in agrarian production went hand in hand with a growing incidence of rural poverty. Currently agriculture accounts for 45 per cent of rural household income, a further 28 per cent comes from social payments and pensions, and only 27 per cent from salaried work.

3. Since 2010, after 15 consecutive years of neglect, the long-term decline in agriculture has begun to reverse. By 2013, agricultural sector output had grown by 40.3 per cent over 2010 levels in nominal terms. The state budget for agriculture has increased by over 350 per cent since 2010: it accounted for 3.8 per cent of the overall state budget in 2014, up from 1.3 per cent in 2010. Increased allocations to agriculture began under the previous government, suggesting a growing consensus across the political spectrum on the need for renovation of the sector.

4. An important ongoing development is the strengthening of relations between Georgia and the European Union, with the signing in June 2014 of the Association Agreement, which includes the Deep and Comprehensive Free-Trade Area framework. This creates new market opportunities in many higher-value markets, compelling Georgian producers and exporters to make significant progress on quality and productivity in order to be competitive.

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

5. The Agriculture Modernization, Market Access and Resilience Project (AMMAR) is consistent with the results-based country strategic opportunities programme (RB-COSOP) for Georgia which is aimed at improving the productive capacity of the

rural poor, enhancing their access to markets and conserving natural resources. It also addresses IFAD's strategic objectives of strengthening the capacity of the rural poor, and improving their equitable access to productive natural resources, markets and financial assets. The project is fully in line with the Government's Strategy of Agriculture Development in Georgia (SAGD) – giving high priority to the revitalization of irrigated agriculture and value chain development.

6. AMMAR is aligned with the SAGD in four main directions, namely (a) increase the competitiveness of agricultural production; (b) ensure equitable increases in rural incomes to enable sustainable livelihoods and food security; (c) maintain the safety of food supplies to protect the public and improve access to domestic and international markets; and (d) promote environmental sustainability to protect natural resources for the future.

7. The key development opportunity for AMMAR is created by the radical policy shift in Georgia and renewed interest in the revitalization of the agricultural sector – particularly with respect to irrigated agriculture and value chain development. Of the development agencies active in Georgia, IFAD has the longest history of supporting agricultural development in the country. The urgent need to address rural poverty provides the rationale for IFAD to deepen its involvement in Georgia. IFAD is well positioned to capitalize on its niche role in the Caucasus and add value to policy engagement and capacity-building of stakeholders, particularly in opening and maintaining dialogue at multiple levels, i.e. with the private sector, the Government and farmers.

8. The value chain approach mainstreamed in AMMAR will respond to the changing market and support diversification, and is therefore well-suited to the current country context. The provision of matching grants is expected to stimulate agricultural investments particularly in the rural financial sector.

9. Georgia is a climate-sensitive country in which soil and water conservation practices are still underdeveloped. There is a major need to enhance the adaptive capacity of rural people to address climate change and its potential impact on the agricultural sector. Grant funding from the Global Environment Facility, if provided, will kick-start measures to respond to climate-related impact. In particular, AMMAR will address the climate change adaptation priorities identified by the Government for the agricultural sector, and the adaptation options proposed by the Regional Programme on Reducing Vulnerability to Climate Change in Southern Caucasus Agricultural Systems.

II. Project description

A. Project area and target group

10. The project will be implemented throughout Georgia. The geographical focus will be determined by climate change vulnerability and presence of value chains. Priority will be given to poor rural populations in areas possessing agricultural and irrigation development potential. The AMMAR will seek to reach segments of the rural population with productive potential. Nevertheless the touchstone of AMMAR's targeting strategy is inclusiveness and will combine a demand-driven modality with self-targeting and pro-poor eligibility criteria.

11. The primary target group will be productive poor smallholder farmers. The secondary target group will consist of other value chain actors including agribusinesses, cooperatives or service providers. The targeting strategy will be consistent with that of the ongoing Agricultural Support Project, which pursues geographical targeting, self-targeting and direct targeting, but will be refined and adapted as necessary ensuring that all technical and economic parameters are satisfied and aligned to the priorities identified through the participatory multistakeholder processes in each value chain.

B. Project development objective

12. The project goal is to sustainably increase incomes and reduce poverty for women and men in rural Georgia.

13. The development objective is to stimulate investment in climate-smart agricultural value chains to increase the incomes and strengthen the resilience of smallholder farmers.

14. Key performance indicators for the project will be: (a) increase of more than 20 per cent in real household farm income for more than 10,000 supported households; (b) 20 per cent increase in total value (relative to reference market prices) of surplus agricultural production of targeted products sold by participating producers, traders and agribusinesses; and (c) 50 per cent of trained smallholder producers adopting one or more climate-smart best agricultural practices or technologies promoted by the project.

C. Components/outcomes

15. **Project outcomes** are cross-cutting and will be achieved through the implementation of activities under both component 1 and 2. Expected outcomes are: (i) rural agricultural livelihoods improved and rural people's resilience to climate-change is enhanced; and (ii) inclusive climate-smart value chains are expanded, providing improved market opportunities for smallholders.

16. The project will be organized into two mutually supportive components, coordinated by a project management component.

17. **Component 1: Irrigation and agricultural value chain investment.** This component shall support investment in secondary/tertiary off-farm irrigation as well as productive value chain infrastructure (subcomponent 1.1). It will also stimulate private investment by smallholder farmers and agribusinesses in climate-smart production methods and value chain activities through a partial matching grant scheme (subcomponent 1.2). Investments under this component will primarily be driven by a participatory approach with smallholder farmers and agribusinesses through multistakeholder processes.

18. **Component 2: Climate-smart agriculture and value chain development.** The main activities to be implemented under this component will benefit investments throughout the entire project and will include: (i) an initial value chain screening and prioritization process; (ii) an ongoing multistakeholder process of facilitation in each value chain to identify critical constraints and ways to remove such constraints; and (iii) climate-smart best agricultural practices and technology transfer, training and promotion including practical field training on small-scale technology plots.

19. **Component 3: Project management.** Project management will be the responsibility of the Ministry of Agriculture, through the Rural and Agriculture Development Fund (RADF) a non-profit legal entity chaired by the Prime Minister, with the Minister of Agriculture serving as deputy chairperson.

III. Project implementation

A. Approach

20. Inclusive market development is at the core of the project approach. The project will work with primary and secondary actors – farmers and producers' groups and agribusinesses and other key service providers – to tackle critical constraints along the value chains, from primary production through to collection, processing and marketing. In addition, the project will foster agricultural production systems that can prosper under the predicted future climatic patterns in each region to ensure the development of sustainable, competitive and vibrant value chains.

21. The project will stimulate increased private investment (by farmers, producers' groups, agribusinesses and service providers) in prioritized agricultural value chains that offer sound market opportunities and potential for competitive and profitable participation by Georgian smallholder farmers. Specifically, the project will tackle actual and perceived risks to investment by farmers, agribusinesses and other value chain actors. This will be achieved by providing packages of technical support alongside partial matching grants for "first mover" private investments (farmers and agribusinesses – including cooperatives), and by facilitating commercial linkages between producers, buyers, processors and traders along value chains and beyond, to the end markets.

22. The project will also support direct investment in "public good" productive and value chain infrastructure – on the basis of the priorities of the value chains actors themselves. Such infrastructure will include small-scale secondary and tertiary irrigation, wholesale rentable storage, and development of industry standards which can unlock private investment by farmers or agribusinesses. The project implementation period will be four years.

B. Organizational framework

23. The Ministry of Agriculture will be the lead project agency, working through the RADF. The RADF will be composed of distinct technical units, including one for IFAD, one to manage the forthcoming World Bank-financed Georgia Irrigation and Land Market Development project (GILMD), as well as other units for donor-supported projects.

24. RADF will be substantially strengthened to manage the forthcoming projects. Certain management and staff positions will be shared between AMMAR and GILMD for efficiency and coordination reasons (especially in areas of finance, procurement and administration). Among other functions, the RADF will select and appoint technical staff or contract local service providers, as required, to:

(i) Provide expertise on climate-smart agriculture promotion and landscape restoration;

(ii) Facilitate local multistakeholder processes in each value chain;

(iii) Provide monitoring support and technical backstopping for farmers' training and technology plots;

(iv) Advise farmers on farm plans;

(v) Conduct follow-up meetings with farmers who are recipients of grants made available under the project;

(vi) Act, or designate the Agriculture Project Management Agency (APMA) and/or other entities acceptable to the Fund to act, as a small grants administrator and manage the small grants scheme for smallholders under window 1 – climate-smart primary production – of subcomponent 1.2;

(vii) Act, or designate APMA and/or other entity(ies) acceptable to the Fund to act as large grants administrator and manage the large grants scheme for agribusinesses and cooperatives under window 2 – value chain development – of subcomponent 1.2; and

(viii) Enter into a subsidiary agreement, as appropriate, with APMA and/or entities referred to in subparagraphs (vi) and (vii) above, setting forth the terms of the implementation of the activities assigned thereto.

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

25. The annual workplan and budget (AWPB) will be the main planning tool for AMMAR. The first AWPB will be prepared, together with the procurement plan, for the initial 18 months of the project. To allow for the full participation of project stakeholders,

the process of AWPB preparation should start with consultation at the local level and then be consolidated at RADF level.

26. Project monitoring and evaluation (M&E) will be conducted in accordance with established IFAD procedures and will be carried out by the project team with support from IFAD. The M&E system will generate quantitative and qualitative verifiable information on the project's performance in a form that will assist the Ministry of Agriculture and RADF to plan and finance their activities, compare actual progress against the planned targets and allow timely remedial action to be taken to correct problems encountered during implementation.

27. It is foreseen that the project will play a knowledge-generating role that will allow for piloting of innovative models for climate-smart agriculture and value chain development in the Georgian rural context. This piloting process will be supported by a well-focused series of workshops and joint learning events and will be undertaken in coordination with active in-country development partners such as the European Union, United Nations Development Programme (UNDP), Swiss Agency for Development and Cooperation and United States Agency for International Development (USAID). Links will be established with local farmers' forums and civil society organizations to enable discussion and sharing of emerging experiences.

D. Financial management, procurement and governance

28. **Country context and risk rating.** The inherent risk is related to governance. The corruption perceptions index has a medium rating of 49, placing the country among the most corruption-free in the region. According to the latest Public Expenditure and Financial Accountability assessment report (2013), Georgia has significantly enhanced its budgetary and financial management systems since the previous assessment report of 2008. The financial management performance of past IFAD- and World Bank-funded projects implemented by the Ministry of Agriculture has been rated as satisfactory. In addition, the AMMAR has been assessed in accordance with IFAD guidelines and has been given a low initial risk rating, provided that the mitigation actions outlined in the paragraphs below are implemented in a timely manner.

29. **Financial management.** The RADF will be staffed with a finance manager and two accountants who will be responsible for financial management and disbursements. The RADF will maintain a full set of accounts in accordance with IFAD's requirements and internationally accepted accounting standards. For that purpose, the RADF will install an appropriate financial management and accounting system. The RADF will prepare quarterly interim financial reports and annual project financial statements in a format acceptable to IFAD, according to International Public Sector Accounting Standards.

30. **Accounts.** A designated account will be maintained by the State Treasury within the single foreign exchange account held in the National Bank of Georgia, from which payments will be made to cover eligible expenditures in both United States dollars and in Georgian Lari (GEL). In addition, entities selected to implement activities related to grants under component 1 will maintain a separate account to receive project funds in a bank acceptable to the Fund or at the State Treasury as appropriate. No funds will be disbursed by IFAD to finance the matching grants until the related implementation and financial management arrangements have been finalized and investment guidelines acceptable to IFAD have been duly formalized.

31. **External audit.** RADF shall appoint an independent auditor to audit the accounts of the entire project on an annual basis, following international auditing standards. The auditor will examine the documentation related to expenditures appearing in the statement of expenditures, provide an opinion on the operation of the designated account and examine the documentation related to procurement. A

separate audit opinion will be issued to cover expenditures incurred by the entities selected to implement activities related to grants under component 1. An audited consolidated financial statement together with a management letter on audit observations on internal controls will be submitted annually to IFAD no later than six months after the end of the fiscal year.

32. **Procurement.** Given Georgia's excellent track record in improving its public procurement systems (as assessed by Transparency International, the World Bank and the Support for Improvement in Governance and Management initiative, jointly led by the European Union and the Organisation for Economic Co-operation and Development [OECD]), procurement of goods below the threshold of US$100,000, will be carried out under shopping procedures using the electronic procurement system of Georgia with minor modifications. Further modifications are being made to the public procurement systems with the support of the World Bank to enable their use for more complex international competitive bidding and national competitive bidding procurement processes. Until such time, procurement of goods, works and services financed by the loan will be carried out in accordance with the provisions of IFAD's Project Procurement Guidelines.

33. **Governance.** In 2013, Georgia scored 49 on Transparency International's Corruption Perceptions Index and was ranked 55th out of 177 countries. In 2014, the International Finance Corporation/World Bank ranked it eighth out of 189 countries on the Ease of Doing Business index. The financial performance of previous IFAD- and World Bank-funded projects implemented by the Ministry of Agriculture has been rated as highly satisfactory.

E. Supervision

34. The project shall be supervised by IFAD (under its direct supervision framework and guidelines). A supervision mission will be mobilized at least once a year. Additional implementation support from IFAD on specifically identified issues will be provided if considered necessary by the Government and IFAD or recommended by the supervision mission. A midterm review will be completed during the third year of project implementation, for which quantitative and qualitative data on project performance and impacts will be collected and analysed.

IV. Project costs, financing, benefits

A. Project costs

35. The total investment and recurrent project costs, including physical and price contingencies, are estimated at about US$31.3 million over a four-year implementation period. Funds allocated to project management are about 2.5 per cent of total project costs.

Table 1
Project costs by component and financier
(Thousands of United States dollars)

	IFAD loan	*IFAD grant*	*GEF Grant*	*Beneficiaries (both in cash and in kind)*	*Borrower/ counterpart*	*Total*
Component	*Amount*	*Amount*	*Amount*	*Amount*	*Amount*	*Amount*
1. Irrigation and agricultural value chain investment	12,794.2	-	4,089.2	9,760.8	2,359.2	29,003.4
2. Climate-smart agriculture and value chain development	-	500.0	1,002.6	-	38.1	1,540.7
3. Project management	505.8	-	208.2	-	60.3	774.3
Total	**13,300.0**	**500.0**	**5,300.0**	**9,760.8**	**2,457.6**	**31,318.3**

B. Project financing

36. Project financing is foreseen from the following sources: the IFAD loan, US$13.3 million (42.5 per cent of total costs), which will finance component 1 (US$12.8 million) and project management (US$0.5 million). The GEF grant of US$5.3 million (16.9 per cent of total project costs), if approved, will finance component 1 (USD$4.1 million), component 2 (US$1 million) and project management (US$0.2 million). The IFAD grant – Capacity-Building for Enhancing Agricultural Resilience and Competitiveness – of US$0.5 million will finance only component 2. Beneficiaries (through financial institutions) are expected to contribute about US$9.76 million. The Government contribution is estimated not to exceed US$2.45 million from taxes and duties forgone, but is more likely to be in the order of US$1.8 million.

Table 2
Project costs by expenditure category and financier
(Thousands of United States dollars)

	IFAD loan		*IFAD grant*		*GEF grant*		*Beneficiaries (both in cash and in kind)*		*Borrower/ counterpart*		*Total*
Expenditure category	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*
I. Investment costs											
Training	17.9	13.5	69.7	52.4	25.5	19.2	-	-	20.0	15.0	133.1
Equipment and materials	26.0	24.8	-	-	59.7	57.2	-	-	18.8	18.0	104.5
Grants and subsidies	4,019.9	25.6	324.0	2.1	2,307.1	14.7	9,076.5	57.7	0.0	-	15,727.6
Consultancies	69.6	6.4	44.8	4.2	950.2	88.0	-	-	15.3	1.4	1,079.9
Vehicles	-	-	-	-	66.0	82.0	-	-	14.5	18.0	80.5
Works	8,524.1	65.5	-	-	1,462.3	11.2	684.2	5.3	2,342.3	18.0	13,013.0
Total investment costs	12,657.5	42.0	438.5	1.5	4,870.9	16.2	9,760.8	32.4	2,410.9	8.0	30,138.6
II. Recurrent costs	-	-	-	-	-	-	-	-	-	-	-
Salaries and allowances	510.6	56.7	-	-	390.0	43.3	-	-	-	-	900.6
Operating costs	120.7	50.1	61.5	25.5	18.0	7.5	-	-	41.0	17.0	241.1
Other operating costs	11.2	29.5	-	-	21.1	55.5	-	-	5.7	15.0	38.0
Total recurrent costs	642.5	54.5	61.5	5.2	429.1	36.4	-	-	46.7	4.0	1,179.7
Total	**13,300.0**	**42.5**	**500.0**	**1.6**	**5,300.0**	**16.9**	**9,760.8**	**31.2**	**2,457.6**	**7.8**	**31,318.3**

C. Summary benefit and economic analysis

37. **Irrigation and value chain infrastructure models.** The main benefit will be generated by maintaining the existing production and yield increase achieved through restoring irrigation. The "without project" scenario assumes a cropping pattern of 6 ha of wheat, 1.2 ha of plum orchards and 4.8 ha of potato, generating a net annual benefit of around US$1,284 (GEL 2,248). The "with project" scenario assumes a 50 per cent increase in yields. The model records a net present value (NPV) of US$15,940 (GEL 27,896) over a 20-year period and an internal rate of return (IRR) of 17.2 per cent, which is well above the opportunity cost (10 per cent).

38. **Matching grant models.** Matching grants will support private investments that address identified value chain constraints and/or demonstrate replicable innovations aligned with each value chain strategy and action plan jointly developed with the value chain stakeholders. Several models were prepared to analyse the financial and economic impact of introducing climate-smart agriculture technologies for smallholders.

39. For legume grains, the model records an NPV of US$2,173 (GEL 3,804) over a 10-year period and an IRR of 74 per cent. Another model for small grant financing shows how attractive the production of off-season vegetables can be for small farmers and records a financial NPV of US$10,220 (GEL 17,885 over a 10-year

period and a very high financial IRR of 103 per cent. The next model reflects the introduction of crop rotation involving cultivation of legume crops in the first year followed by two years of wheat, which results in an NPV of US$271 (GEL 475) over a 10-year period and an IRR of 22.2 per cent. The bee-keeping model indicates that the household benefits would be improved by at least US$1,206 (GEL 2,111) per year.

40. A further two models illustrate agricultural businesses likely to be pursued by farmers' groups, cooperatives and associations. These are: (i) cold storage, where the IRR on the incremental net benefits is 72 per cent – well above the 10 per cent opportunity cost of capital. The rationale for cold storage investment is to obtain higher prices during the off-peak season and reduce losses; and (ii) fruit/vegetable dryers, for which total investment in the first year was assumed to be US$195,000 (GEL 341,250). The model records an NPV of US$ 206,214 (GEL 360,876) over a 15-year period and an IRR of 34.3 per cent.

41. **Economic analysis.** The period of analysis is 20 years to account for the phasing and gestation period of the proposed interventions. The scenario presented in the economic analysis is conservative. The analysis attempts to identify quantifiable benefits that directly relate to the activities undertaken following the implementation of the components, or that can be attributed to the project's implementation.

42. The incremental economic costs have been calculated by the removal of price contingencies and taxes/duties. The total economic cost of the project amounts to about US$27.2 million. The base case economic rate of return (ERR) is estimated at 20.6 per cent. The base case net present value of the project's net benefit stream, discounted at 10 per cent, is US$7.5 million.

43. **Sensitivity analysis.** Economic returns were tested against changes in benefits and costs and for various lags in the realization of benefits. In relative terms, the ERR is equally sensitive to changes in costs and in benefits. In absolute terms, these changes do not have a significant impact on the ERR, and the economic viability is not threatened by either a 20 per cent decline in benefits or a 20 per cent increase in costs. An increase in total project costs of 20 per cent would reduce the base ERR to about 18.9 per cent. A one-year delay in project benefits reduces the ERR to 18.7 per cent.

D. Sustainability

44. Sustainability will be achieved in the different dimensions of the project through several complementary mechanisms:

(a) Screening to identify value chains for specific agricultural products that are adapted to current and future climatic conditions.

(b) Promotion of specific climate-smart agricultural production practices among smallholder farmers in target value chains.

(c) AMMAR will build on the approach being pursued by the World Bank-financed GILMD project to re-establish viable operation and maintenance systems.

(d) Landscape restoration will be conducted around target irrigation schemes to reduce the risk of silting and similar types of deterioration.

(e) Matching grants will be used selectively to stimulate initial private investments that can be replicated and scaled-up by others using mainstream finance.

(f) Continued private investment will be facilitated through partnerships with established financial institutions.

(g) Institutionally, the project will work through and with existing service providers – public/private – in delivering demand-driven services to farmers.

E. Risk identification and mitigation

45. The project strategy specifically aims to reduce the risks faced by smallholder farmers through coordinated public sector investment and support that will stimulate greater private investment to upgrade agricultural value chains with growth potential. Notwithstanding the value of the RADF to project delivery, the main potential risks to project success and mitigation strategies are summarized below.

Risks	*Mitigation*
Low private-sector interest in co-investing in priority value chains	Value chains will only be prioritized for project support where the screening process identifies specific confirmed interest in the value chains from buyers and producers based on direct discussions and meetings.
Political interference could undermine the selection of infrastructure investments	Use of participatory mechanisms to identify priority areas and needs for infrastructure investment combined with clear and transparent criteria for the final decision on awards for particular schemes.
A lack of sound operation and maintenance (O&M) of irrigation schemes caused by weak O&M management arrangements and financing	The recently approved World Bank-financed project will support the preparation of a national irrigation and drainage strategy which will define the Government's role and responsibilities.
Scarcity of experienced institutions serving farmers; few functioning farmers' groups and associations; only recently re-established Ministry of Agriculture district teams; and relatively new farm service centres and mechanization centres	This risk will be managed by: (i) applying an inclusive approach to identifying and partnering with potential local service providers; (ii) building the technical capacity of local service providers and provision of a set of climate-smart agriculture (CSA) technologies relevant to each of the priority value chains; and (iii) partnering with a credible national partner/experts organization with a proven track record in CSA technology transfer.

V. Corporate considerations

A. Compliance with IFAD policies

46. The project approach and implementation modalities are fully consistent with IFAD strategies and policies. Specifically, it supports IFAD's fiduciary compliance and is aligned with the IFAD Strategic Framework 2011-2015; Rural Finance Policy; technical note on matching grants; Climate Change Strategy; Environment and Natural Resource Management Policy; Private-Sector Strategy; Policy for Gender Equality and Women's Empowerment; and Policy on Targeting.

B. Alignment and harmonization

47. The project is aligned with COSOP priorities. It is also in line with the Government's SADG and Economic Development and Poverty Reduction Programme for 2003-2015. The project is harmonized with the United Nations Development Assistance Framework 2011-2015 and the European Neighbourhood Programme for Agriculture and Rural Development (ENPARD). It is proposed that ENPARD be the framework for multilateral cooperation and for supporting partner countries in promoting long-term agricultural and rural development strategies more effectively.

C. Innovations and scaling up

48. AMMAR is a progressive investment in the modernization of agriculture in Georgia and is closely aligned with the Ministry of Agriculture's strategy and action plans. It places demand-driven climate-smart investments at the centre of its value chain approach and builds on best practices within the Georgian experience. It prioritizes funding for hard investments to upgrade neglected public and private productive assets and infrastructure. In addition, to achieve greater impact and sustainability, these hard investments are supplemented by international best practices in

inclusive value chain development, selected from IFAD and other relevant experience. This combination of investments provides a coherent, implementable investment project that should deliver sustainable benefits to more than 10,000 smallholder farmers.

D. Policy engagement

49. The project design draws on the lessons learned from past IFAD interventions and from the experience of other donors, such as: (i) Government ownership and leadership must be emphasized and ensured from the onset; (ii) project management arrangements should be handled through a semi-autonomous unit, with employment conditions that attract and retain competent staff; (iii) weak public institutional capacity has been a constraint on project implementation effectiveness; (iv) the project should be kept simple and realistic in terms of scope and implementation arrangements; and (v) previous projects lacked a well-functioning M&E system, hindering timely action in taking corrective measures.

VI. Legal instruments and authority

50. A project financing agreement between Georgia and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A copy of the negotiated financing agreement is attached as an annex.

51. Georgia is empowered under its laws to receive financing from IFAD.

52. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the policies and criteria for IFAD financing.

VII. Recommendation

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

> RESOLVED: that the Fund shall provide a loan on blend terms to Georgia in an amount equivalent to eight million six hundred and ten thousand special drawing rights (SDR 8,610,000), 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
"Agriculture Modernization, Market Access and Resilience Project"

(Negotiations concluded on 4 July 2014)

Loan Number: [ ]

Project Title: Agriculture Modernization, Market Access, and Resilience (the "Project")

Georgia (the "Borrower")

and

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

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

hereby agree as follows:

WHEREAS, the Fund has agreed to extend a loan to the Borrower on the terms and conditions set forth in this Agreement;

WHEREAS, the competent authorities of the Borrower have applied for a grant (the "GEF Grant") from the Global Environment Facility ("GEF") approximately in the amount of five million three hundred thousand United States dollars (USD 5 300 000) to partially finance the Project, on terms and conditions to be set forth in a grant agreement between the Borrower and the Fund (the "GEF Grant Agreement");

NOW THEREFORE, the Parties hereto hereby agree as follows:

Section A

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

2. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, 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 except as specified in Section E.5 below. 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 to the Borrower (the "Financing"), which the Borrower shall use to implement the Project in accordance with the terms and conditions of this Agreement.

Section B

1. The amount of the Loan is Eight million six hundred and ten thousand Special Drawing Rights (SDR 8 610 000).

2. The Loan is granted on blend terms and shall be 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 and shall have a maturity period of twenty-five years, including a grace period of five years, starting from the date of approval by the Executive Board.

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

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

5. Principal, interest and service charge shall be payable on each 15 February and 15 August.

6. There shall be a Designated Account in USD maintained by the State Treasury within the Treasury single FX account held in the National Bank of Georgia from which payments shall be made to cover Eligible Expenditures under the Project in both USD and in Georgian Lari (GEL). In addition, each of the entities selected to implement activities related to grants under the Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project shall maintain a separate account to receive Project funds, in a bank acceptable to the Fund or at the State Treasury as appropriate.

7. The Borrower shall provide counterpart financing to cover taxes and duties for the Project, estimated at USD 1 800 000.

Section C

1. The Lead Project Agency shall be the Ministry of Agriculture through its Rural and Agriculture Development Fund (RADF).

2. The following are designated as additional Project Parties: (i) the entity(ies) selected to implement activities related to grants under the Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project; and (ii) such other party(ies) as may be agreed by the Fund and the Borrower.

3. The Project Completion Date shall be the fourth anniversary of the date of entry into force of this Agreement.

Section D

The Loan shall be administered and the Project shall be supervised by the Fund.

Section E

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

(i) The right of the Borrower to withdraw the proceeds of the GEF Grant under the GEF Grant Agreement, to the extent this has entered into force, has been suspended;

(ii) The Project Implementation Manual (PIM) referred to under paragraph 7, Section II of Schedule 1 hereto or any provision thereof has been waived, suspended, terminated, amended or modified without the prior agreement of the Fund and the Fund, after consultation with the

Borrower, has determined that such waiver, suspension, termination, amendment or modification has had, or is likely to have, a material adverse effect on the Project, and the Borrower has not taken any measures to remedy the situation; and

(iii) The Investment Guidelines to be prepared by the RADF and adopted by each of the entities selected to implement activities related to grants under the Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project or any provision thereof has been waived, suspended, terminated, amended or modified without the prior agreement of the Fund and the Fund, after consultation with the Borrower, has determined that such waiver, suspension, termination, amendment or modification has had, or is likely to have, a material adverse effect on the Project, and the Borrower has not taken any measures to remedy the situation.

2. The following is designated as additional grounds for cancellation of this Agreement: The right of the Borrower to withdraw the proceeds of the GEF Grant, under the GEF Grant Agreement to the extent this has entered into force, has been cancelled.

3. The following are designated as additional general conditions precedent to withdrawal:

(i) The Designated Account referred to in Section B.6 above shall have been duly opened; and

(ii) The Project Implementation Manual (PIM) referred to under paragraph 7, Section II of Schedule 1 hereto shall have been adopted by the RADF.

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

(i) no withdrawals shall be made in respect of expenditures for smallholders and agribusiness grants under Category III (Grants and Subsidies) of the allocation table set forth in paragraph 1 of Schedule 2 hereto until:

(a) The RADF shall have entered into a subsidiary agreement acceptable to the Fund with each of the entities selected to implement activities related to grants under the Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project covering, among other things, budgeting, flow of funds, accounting, financial reporting, internal controls and external audit arrangements;

(b) The Investment Guidelines to be prepared by the RADF and adopted by each of the entities selected to implement activities related to grants under the Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project shall have been approved by the Fund; and

(c) Any one of the entities referred to in Section B.6 above shall be maintaining a separate account to receive Project resources at the State Treasury or in a bank acceptable to the Fund, as appropriate, and shall have communicated to the Fund the names and titles of the persons authorised to operate such account.

5. As an exception to Section 7.05 (Procurement) of the General Conditions, the procurement of goods, works and services financed by the Financing shall be carried out in accordance with the provisions of IFAD's Project Procurement Guidelines.

6. This Agreement is subject to ratification by the Borrower and shall enter into force on the date the Fund receives an instrument of ratification.

7. 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
16, Vakhatang Gorgasali Street
0114, Tblisi, Georgia

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.

GEORGIA

____
[ ]
[ ]

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

____
Kanayo F. Nwanze
President

Schedule 1

Project Description and Implementation Arrangements

I. Project Description

1. *Project Area*. The Project shall be implemented throughout the Borrower's territory while the actual geographical focus shall be determined by its climate change vulnerability and supported value chains. Priority shall be given to poor rural populations in areas where there is agricultural and irrigation development potential.

2. *Target Population*. The primary target group of the Project shall be the productive poor smallholder farmers. The secondary target group for the Project shall be other value chain actors including agribusinesses, cooperatives, or service providers.

3. *Goal*. The overall goal of the Project is to sustainably increase incomes and reduce poverty for women and men in rural Georgia.

4. *Objective*. The development objective of the Project is to stimulate investment in climate smart agricultural value chains to increase incomes and strengthen resilience of smallholder farmers.

5. *Components*. The Project shall have three Components: (1) Irrigation and Agricultural Value Chain Investment; (2) Climate Smart Agriculture and Value Chain Development; and (3) Project Management.

5.1. *Component 1: Irrigation and Agricultural Value Chain Investment*. This Component shall support investment in secondary/tertiary off-farm irrigation and value chain infrastructure (Sub-component 1.1). Moreover, the Component shall stimulate private investment by smallholder farmers and agribusinesses in climate smart production methods and value chain activities through a partial matching grant scheme (Sub-component 1.2). Investments under this Component shall primarily be driven by a participatory approach with smallholder farmers and agribusinesses through multistakeholder processes.

5.2. *Component 2: Climate Smart Agriculture and Value Chain Development*. Main activities to be implemented under this Component for the benefit of investments under the entire Project shall include: (i) an initial value chain screening and prioritization process; (ii) an ongoing multistakeholder process of value chain facilitation in each value chain to identify critical constraints thereof and ways to remove such constraints; and (iii) climate-smart good agricultural practices and technology transfer, training and promotion including practical field training at small-scale technology plots.

5.3. *Component 3: Project Management*. Project management shall be the responsibility of the Ministry of Agriculture, through the RADF.

II. Implementation Arrangements

6. The Rural and Agricultural Development Fund (RADF)

6.1. The RADF shall select and appoint such technical staff or contract local service providers, as required, to:

(i) provide expertise on climate smart agriculture promotion and landscape restoration;

(ii) facilitate local multistakeholder processes in each value chain;

(iii) provide monitoring and technical back-stopping for farmers' training and technology plots;

(iv) advise farmers on farm plans;

(v) conduct follow-up meetings with farmers who are recipients of grants made available under the Project;

(vi) act, or designate the Agriculture Project Management Agency (APMA) and/or any other entity(ies) acceptable to the Fund to act, as small grants administrator and manage the small grants scheme for smallholders under Window 1 (Climate Smart Primary Production) of Sub-component 1.2 of the Project;

(vii) act, or designate APMA and/or any other entity(ies) acceptable to the Fund to act, as large grants administrator and manage the large grants scheme for agribusinesses and cooperatives under Window 2 (Value Chain Development) of Sub-component 1.2 of the Project; and

(viii) enter into a subsidiary agreement, as appropriate, with APMA and/or any of the entities referred to in sub-paragraphs (vi) and (vii) above setting forth the terms of the implementation of the activities in respect of the Window under Sub-component 1.2 respectively assigned thereto.

7. Project Implementation Manual

7.1. The Project shall be implemented in accordance with the PIM, the terms of which shall be prepared and adopted by the RADF in the form substantially non-objected to by the Fund. The PIM shall include, among other things:

(a) Terms of reference, implementation responsibilities and appointment modalities of all Project staff and consultants;

(b) Project operating manuals, investment guidelines and procedures;

(c) Monitoring and evaluation systems and procedures;

(d) A detailed description of implementation arrangements for each Project component;

(e) Selection criteria for investments under Component 1;

(f) Modalities for the selection of service provider(s) and Project Parties to be based on transparent and competitive processes; and

(g) Financial management arrangements including flow of funds, reporting arrangements, accounting, approval of payments, internal controls, fixed asset management, as well as internal and external audit arrangements for the entire Project.

8. *Mid-Term Review*. The Lead Project Agency and the Fund shall jointly carry out a review of the Project implementation during the third year of Project implementation (the "Mid-Term Review"). Among other things, the Mid-Term Review shall consider the performance and financial management of contracted implementing partners, the efficacy of technical assistance and capacity building activities, the overall achievement of Project objectives and the constraints thereon and recommend such reorientation as may be required to achieve such objectives and remove such constraints within the agreed timeframe.

Schedule 2

Allocation Table

Allocation of Loan Proceeds.

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

Category		Loan Amount Allocated in SDR	per cent of Eligible Expenditures to be financed
I.	Works	4 645 000	100 per cent net of Government Contributions in the form of duties and taxes, Co-financing and beneficiaries' contributions
II.	Consultancies	60 000	100 per cent net of Government Contributions in the form of duties and taxes, Co-financing and beneficiaries' contributions
III.	Grants and Subsidies	2 605 000	100 per cent net of Government Contributions in the form of duties and taxes, Co-financing and beneficiaries' contributions
IV.	Operating Costs	440 000	100 per cent net of Government Contributions in the form of duties and taxes, Co-financing and beneficiaries' contributions
Unallocated		860 000	
TOTAL		**8 610 000**	

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

Category I "Works" means Eligible Expenditures related to: i) Irrigation and ii) Value Chain infrastructure including infrastructure design and supervision.

Category II "Consultancies" means Eligible Expenditures related to Technical Assistance, Staff Training, Project Audit and other advisory services under the Project.

Category III "Grants and Subsidies" means Eligible Expenditures related to i) Smallholder grants and ii) Agribusiness Grants, incurred in accordance with the Investment Guidelines, as approved by the Fund.

Category IV "Operating Costs" means Eligible Expenditures related to i) recurrent costs including Travel and Logistics under the Project, ii) salaries of Project staff hired by the RADF and iii) Office and Information Technology equipment, as well as furniture under Component 3.

Schedule 3

Special Covenants

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

1. *Taxes*. The Borrower shall ensure that all goods, civil works, and services procured are exempt from duties, exercise taxes, and value added taxes (VAT). Any duties, exercise taxes, VAT which the Project is obliged to pay shall be promptly reimbursed by the Borrower.

2. *Insurance of Project Personnel*. The RADF shall insure Project personnel against health and accident risks to the extent consistent with its customary practice in respect of its national civil service.

3. *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 Project of which it has knowledge or become aware.

4. *Gender Focus*. The Borrower shall ensure that the Project benefits poor rural women by providing them with opportunities to express their development priorities and putting in place mechanisms to monitor the impact of the Project on poor rural women's incomes and assets. The Borrower shall ensure that: (i) poor rural women are sensitized about the goal and objectives of the Project provided in Schedule 1 of this Agreement; (ii) poor rural women shall participate in the Project's Annual Stakeholder Review and Planning Workshops; (iii) women shall have a 30 per cent minimum representation in all Project activities.

5. *Resource Protection*. The Borrower shall take all reasonable measures to ensure that existing laws are enforced to safeguard water, forest and wildlife resources in the Project Area. The Borrower shall take all measures to ensure sustainability of the Project without any detriment to the environment and shall promote natural resources' sustainability.

6. *Use of Project Vehicles and Other Equipment*. The Borrower shall ensure that all vehicles and other equipment transferred to or procured under the Project are dedicated solely to Project use.

7. *External Auditors.* The Borrower, through the RADF, shall appoint independent auditors acceptable to the Fund, under terms of reference cleared by the Fund annually and in line with the IFAD Guidelines for Project Audits. An audited annual consolidated financial statement for the entire Project, together with a management letter on audit observations on internal controls, shall be submitted to the Fund within six (6) months of the end of the Fiscal Year.

8. *Audit of the entities selected to implement activities related to grants under the Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project.* The Borrower shall ensure that the subsidiary agreement entered into by the RADF with each entity selected to implement activities related to Irrigation and Agricultural Value Chain Investment Component (Component 1) of the Project shall specify that independent auditors are required to provide a specific opinion on the procedures employed by such entity, the adequacy of the documentation in support of relevant fund transfers, and whether Project resources have been used in accordance with the Investment Guidelines as approved by the Fund.

Logical framework

Narrative Summary	Key Performance Indicators (All household/farmer level indicators to be disaggregated by gender and age)	Means of Verification	Assumptions (A) / Risks (R)
Goal:			
Sustainably increase incomes and reduce poverty for women and men in rural Georgia	▪ 10,000 supported households increase their asset index by at least 10 per cent	▪ Baseline survey & Impact Assessment ▪ Project completion	▪ Continued political stability (A) ▪ Marco-economic conditions remain stable or improve to promote investment(A) ▪ Global prices for agricultural commodities and food do not decline significantly (R)
Project Development Objective:			
Stimulate private investment in climate-smart agricultural value chains to increase incomes and strengthen resilience of smallholder farmers in selected project areas.	▪ Increase of more than 20 per cent of real net household farm income for at least 80 per cent of the 10,000 supported households ▪ More than 20 per cent increase in total value (relative to reference market prices) of surplus agricultural production of targeted products sold by participating producers, traders and agribusinesses Climate-smart agricultural production practices are adopted by 50 per cent of trained smallholder farmers.	▪ Baseline & Impact Surveys ▪ Government data ▪ Value chain interviews/focus groups ▪ RIMS surveys ▪ M&E reports	▪ Policies and programmes for agricultural development and rural finance allow to operate efficiently (A) ▪ Sufficient numbers of farmers are willing to be involved in value chain development activities (A)
Outcome 1: Rural population agricultural livelihoods improved and their resilience to climate-change enhanced	▪ At least 4750 farmers have improved soil conditions and/or on farm water availability ▪ Diversification of farming systems is increased by at least 3000 farmers, with 20 per cent increase over baseline in farmers practicing appropriate crop rotation, inter-cropping or similar soil/nutrition enhancement systems	▪ Baseline & Impact survey ▪ Interviews/focus groups ▪ Studies and surveys ▪ RIMS surveys ▪ M&E reports ▪ Government Data (GEOSTAT)	▪ Smallholders are willing to engage in value chain development activities (A) ▪ Farmers are willing to engage in efficient water/ land management techniques (A) ▪ Aging farming population (R) ▪ Climatic changes are in line with current predictions (A)

Narrative Summary	**Key Performance Indicators** (All household/farmer level indicators to be disaggregated by gender and age)	Means of Verification	Assumptions (A) / Risks (R)
Outputs: 1.1 Productive infrastructure rehabilitated/constructed 1.2.Management and operation arrangements for the rehabilitated infrastructure set-up 1.3. Landscape restoration (LR) plans developed and implemented where needed for rehabilitated irrigation schemes. 1.4. Training programmes on CSA designed and delivered to farmers and farmer groups. 1.5. On-farm demonstration sites set-up where efficient irrigation and CSA production systems are validated and promoted.	▪ At least 4750 ha receiving reliable irrigation water supply from properly maintained and rehabilitated irrigation schemes. Up to 10 VC related infrastructure constructed. ▪ Up to 150 landscape restoration plans implemented on irrigation scheme ▪ Up to 1000 small grants made to farmers and at least 30 grants made to agribusinesses and processors in target value chains	▪ Infrastructure completion/ status survey reports ▪ Interviews/focus groups ▪ RADF/supervision mission reports ▪ Training reports ▪ Studies and reports ▪ Financial institutions reports ▪ Studies and survey ▪ RIMS surveys ▪ M&E reports	▪ Lack of funding to operate and maintain productive public rural infrastructure (R) ▪ Agricultural products are competitive (A) ▪ Willingness of farmers to participate/ contribute to matching grants scheme (A) ▪ Difficulties in implementing the restoration plans (R).
Outcome 2 Inclusive climate-smart value chains (VCs) are expanded providing improved market opportunities for smallholders	▪ Private investment in inclusive VC reaches USD 9 million for farmers, agribusinesses and service providers ▪ The volume of services and inputs from private service providers and used by farmers in target VC clusters increases by 20 per cent over current levels	▪ Interviews/focus groups ▪ Lending reports from partner FIs ▪ Grant monitoring reports ▪ Value chain interviews/focus groups	▪ Market options foster profitable partnership between farmers and contractors (A).
Outputs 2.1. Climate-smart value chain screening and prioritization conducted 2.2. Strengthen commercial linkages facilitated between smallholders and agribusinesses.	▪ 25 VC facilitation events held with a total of over 1000 farmers, agribusinesses and input/service providers participating ▪ Up to 3000 smallholder farmers trained in CSA technology options and practices ▪ 50 staff of local service providers and regional MOA officers receive ToT/refresher training on CSA for target VC production	▪ Project progress and activity reports ▪ Grant monitoring reports M&E reports ▪ RIMS surveys	▪ Lack of qualified service providers to act as intermediaries for the project (R). ▪ The quality of agriculture practices and output meet minimum Good Agricultural Practices (GAP) standards (A).