Document of

COMMON FUND FOR COMMODITIES

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DRAFT APPRAISAL REPORT

Stadhouderskade 55
1072 AB Amsterdam
The Netherlands
Tel: +31 – 20 – 575 4949
Fax: +31 – 20 – 676 0231

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ANNEXES

Abbreviations and acronyms

AGF	Agri-Guarantee Fund
ACRN	African Coffee Research Network
BPR	Banque Populaire Rwanda
CABI Africa	CAB International – Africa Regional Centre
CORNET	Coffee Research Network
CTA	Coffee and Tea Authority
DRC	Democratic Republic of Congo
ETB	Ethiopian Birr
GDP	Gross Domestic Product
ICO	International Coffee Organisation
MDG	Millennium Development Goal
MFI	Micro Finance Institutions
MoARD	Ministry of Agriculture and Rural Development – Ethiopia
NPSC	National Project Steering Committee
OCIBU	Office de Cafés Industrielles de Burundi
OCIR Café	Office de Cafés Industriels du Rwanda
ONC	Office National du Café (ONC)
PEA	Project Executing Agency
PIA	Project Implementing Agency
RIAS	Rabo International Advisory Services BV
SB	Supervisory Body
SSCWS	Small-Scale Coffee Washing Station
USAID	United States Agency for International Development
USD	United States Dollar

Logical Framework

Narrative summary	Objectively Verifiable Indicators	Means of verification	Assumptions
Broad goal: Improved sustainable livelihoods of small-scale coffee farmers in Ethiopia and Rwanda	▪ At least 50% of smallholder coffee farmers in Ethiopia and Rwanda living on more than 1 dollar a day ▪ Vulnerability of smallholder farmers in Ethiopia and Rwanda to fluctuations in world coffee prices reduced ▪ Increased export earnings secured from coffee	▪ Annual reports of research institutions in the collaborating countries ▪ Impact assessment reports ▪ IACO reports ▪ ICO reports ▪ National statistical data	▪ Socio-economic stability prevails ▪ Political commitment to support the coffee sector
Project Purpose: Access to finance for investment in coffee improved	▪ Credit guarantee scheme for coffee operational in Ethiopia and Rwanda ▪ Target farmers and cooperatives servicing at least 90% of their short term investment fund requirements through guaranteed loans ▪ Improved processing practices scaled up/out in at least 20% of the coffee growing districts in each country through guaranteed loans	▪ Project annual reports ▪ IACO reports ▪ IACO reports ▪ Mid-term evaluation report ▪ End of project report	▪ Prevailing conditions of the world coffee market remains stable or improves ▪ Consumers willing to pay premiums for superior quality coffee ▪ Commitment of the farmers and exporters to the project sustained throughout the project period ▪ Commercial banks willing to develop products targeted to smallholder coffee farmers ▪ Favourable weather conditions prevail
Outputs			
Appropriate credit guarantee scheme developed and rolled out	▪ Participating banks increase their lending to primary cooperatives and individual farmers ▪ Loan disbursement and recovery procedures for smallholder farmers and	▪ Project annual and progress reports ▪ Mid-term review and other external appraisal report ▪ Ministry of Agriculture reports	▪ Newly enlisted farmers adopt new technologies and new practices ▪ Interest of coffee exporters in the project is

	cooperatives developed and agreed upon within the first quarter of the project lifespan ▪ Capacity of farmers, cooperatives and banks to administer and/or effectively use the scheme enhanced within six months of project initiationAt least 95% repayment rates realised by the end of year 3Capacity building training for loan officers in the banks undertaken at least once before the onset of any coffee season.	▪ Reports of financial institutions ▪ End of project report	sustained ▪ Government policies remain conducive to liberalised coffee marketing ▪ Farmers willing to adopt new technologies and ways of conducting business ▪ Financing from all sources is made on a timely basis in line with proposed activities and Annual Work-plan/Budget ▪ The PEA, collaborating institutions co-ordinate & execute the project efficiently and effectively. ▪ Commercial banks willing to engage with smallholder farmers
Impact of improved coffee processing practices as identified through the **CFC funded pilot project reference CFC/ICO/22** scaled up and out	▪ Facilities for enhanced coffee processing through commercial loans and installed in at least 20% of the coffee producing districts of Ethiopia and Rwanda ▪ Economic benefits of producing high quality coffee through improved primary processing promoted in at least 20% of the coffee producing districts of Ethiopia and Rwanda ▪ Awareness seminars for policy makers and other key stakeholders conducted in all districts targeted for up-scaling ▪ Program to improve coffee processing entrenched in the coffee development programs of the beneficiary countries		
Primary cooperatives and unions in the project areas strengthened	▪ At least 60% of the cooperative societies running as profitable entities ▪ At least 90% of cooperative members sell their coffee through their respective societies ▪ At least 60% of the cooperatives involved in the		

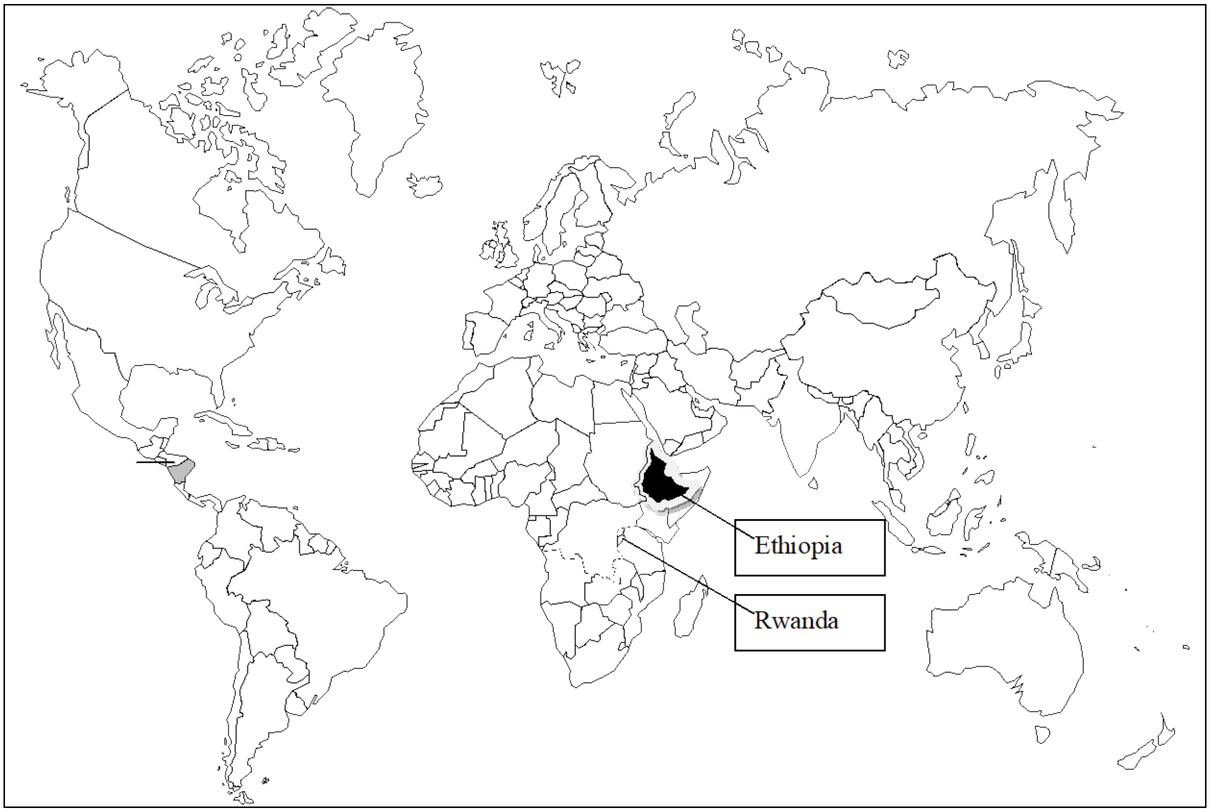
	project run by professional managers ▪ The role of day to day management of the cooperative societies separated from the functions of the board and undertaken by the society manager ▪ Capacity building training for farmers and cooperative managers undertaken regularly based on identified needs		
Access to production and market information by producers, marketers and policy makers enhanced	▪ Information on coffee quality available within CLU digitalised ▪ Digital information dissemination system based on hand held devises and mobile phones developed and rolled out to development agents, extension workers and smallholder coffee farmers		
Project executed effectively and efficiently	▪ Project outputs achieved within agreed budget and timeframe		Collaborating organisations fulfil commitments

Inputs: Activities	**Financial requirements**		
1.1 Assess the existing system used by the bank to advance and recover loans from the clients 1.2 Identify challenges to existing loan disbursement and recovery system and design remedial measures 1.3 Support the expansion of the coffee finance portfolio under the Credit Guarantee Scheme 1.4 Enhance farmers' capacity to sustainably access financial services both individually and as farmer groups 1.5 Undertake capacity building training for loan officers in the banks 2.1 Conduct baseline surveys of	Component 1: (US$) 4,229,480 Component 2: (US$) 3,029,170 Component 3: (US$) 366,910 Component 4: (US$) 127,840 Component 5: (US$) 394,090 Grand Total = US$ 8,147,490	1. Mid term (6mo) and final technical report 2. Annual Audit Report 3. Discussion documents at each draft stage 4. Interim country reports including workshop reports 5. Assessment and survey reports	1. Financing from all sources is made on a timely basis in line with proposed activities 2. Representatives of different stakeholder categories participate actively in project implementation 3. All project participants remain committed to project purpose.

coffee production and processing practices in the new areas targeted for scaling up/out of improved processing practices			
2.2 Identify and select suitable areas and farmer groups to be enlisted in the scaling up/out of the improved processing practices and popularise the economic benefits associated with good agronomic and processing practices			
2.3 Purchase, and install machinery, equipment and facilities for improved dry and wet processing			
2.4 Train producers, extension agents and owners/operators of the equipment on good production and processing practices and the use and maintenance of the processing equipment			
2.5 Monitor and evaluate costs and efficacy of the improved processing facilities			
2.6 Evaluate cup and green coffee quality by liquorers and exporters			
3.1 Undertake capacity building training for farmers and cooperatives to effectively use the scheme			
3.2 Assessment of technical assistance & financial Needs of co-ops in Rwanda/Ethiopia			
3.3 Develop templates for good governance and design effective and efficient coffee delivery and payment system			
4.1 Document the information needs (type, form, frequency etc) for various players in the coffee value chain, identify key players in the generation and use of information and formulate options for addressing the needs			
4.2 Digitalise the production and			

marketing information available in the coffee Liquoring Unit (Ethiopia) and at the coffee board Rwanda (OCIR CAFÉ)			
4.3 Undertake capacity development on management and use of production and marketing information for both farmers and the designated custodians of the information			
4.4 Develop and implement modalities for accelerated and timely access to the market information			
5.1 Organise project inception and annual planning workshops			
5.2 Establish and implement effective communication channels between PIA & PEA			
5.3 Strengthen and modernise administration and accounting procedures established during phase one of the project			
5.4 Develop detailed annual work-plans and budgets			
5.5 Provide regular technical support to PIAs			
5.6 Establish effective M&E process			
5.7 Prepare six monthly, annual and end of project reports			
5.7 Organise supervision missions for ICO/CFC			
Inputs: Types of resources a. CABI technical, scientific and administrative support; b. Management & technical staff from PIAs; c. technical support from Rabobank d. Resources to set up loan guarantee facility e. Machinery & equipment d. Farmer groups/associations for ownership of SSCWS; f. Field sites for location of machinery & equipment.			

MAP



The colours, boundaries, denominations, and classifications in this map do not imply, on the part of the Common Fund for Commodities or its Members, any judgement on the legal status of any territory, or any endorsement or acceptance of any boundary. The projections used for maps may distort shape, distance, and direction.

Project Summary

TITLE OF THE PROJECT	Sustainable Credit Guarantee Scheme to Promote Scaling up/out of enhanced Coffee Processing Practices in Ethiopia and Rwanda
SUBMITTING ICB:	International Coffee Organisation
DURATION:	5 years
LOCATION:	Rwanda and Ethiopia
NATURE OF PROJECT:	The project seeks to design and implement a credit guarantee scheme to empower smallholder farmers to access commercial loans. The loans will assist farmers to purchase and install improved processing equipment and will enable the cooperative societies to more effectively purchase and export the resulting high quality coffee produced through the improved processing practices. At the same time, the project will respond to the emerging challenges to sustainable production of high quality coffee by providing technical assistance to promote good agronomic and processing practices, accelerated flow of market information to all players in the coffee chain, and will promote good governance of the cooperative societies.
TOTAL COST:	USD 8,147,494
CFC FINANCING:	USD 1,240,270 (Grant) USD 2,000,000 (Loan/Guarantee)
CO-FINANCING	USD325,874– Grant – Rabobank Foundation USD 4,250,000 – Loan - Rabo Bank and Local Banks
COUNTER PART CONTRIBUTION:	USD 331,350

PROJECT EXECUTING AGENCY:	CABI Africa and Rabo International Advisory Services (RIAS) BV
COLLABORATING INSTITUTIONS:	Ministry of Agriculture and Rural Development Extension and marketing departments, Addis Ababa, Ethiopia and the Office des Cultures Industrielles du Rwanda (OCIR-Café), Kigali, Rwanda, Office du Café du Burundi (OCIBU), Office National du Café (ONC), Illy café SPA, Rabobank through Rabo Foundation, Rabo Agri-Guarantee Fund and Rabo International Advisory Services (RIAS) BV
SUPERVISORY BODY:	International Coffee Organisation, London, United Kingdom
ESTIMATED STARTING DATE:	2010

I. INTRODUCTION AND BACKGROUND

A. Project Background

The project was reviewed at the forty fifth meeting of the The Consultative Committee of the Common Fund at which it was noted that the project was a follow up to the project on "Improving Coffee Quality in East Africa Through Improved Processing Practices" (CFC/ICO/22). The project was based on collaboration between Rabobank Foundation, Rabobank Agri-Guarantee Fund, Rabobank International Advisory Services (RIAS) BV and the Common Fund.

1. The Committee noted that the Common Fund has received commitments from Rabobank Foundation and Rabobank Agri-Guarantee Fund to jointly participate and test the credit guarantee scheme in Africa in a pilot commercial setting. The Committee felt that the core concept of the project was sound, but to maximise the benefits of the project for coffee producers, the following needs to be taken into account:

- any improvement of coffee productivity targeted by the project should not be at the expense of quality, as it could erode the main competitive advantage of African coffees. Furthermore, given the duration of the project, it would not be realistic to use its resources for re-planting coffee trees. It was understood that productivity improvement would be mainly achieved by following good agricultural practices;
- the credit delivery mechanisms for farmers need to be carefully considered, particularly in the context of Ethiopia. The Committee felt that there was considerable scope for technical assistance from Rabobank to enhance the capacity of rural saving cooperatives (RUSACCOs) in credit delivery and management. Without such assistance, the project would miss out on an important and efficient channel of financing coffee producers;
- the use of the loan portion of the budget needs to be clarified. The Committee agreed that loan should be used as guarantee stimulating lending by financial institutions for coffee production and processing. However, it should not be used to finance either current or capital direct expenditures.

The points raised by the CC were addressed by the project sponsors in collaboration with the CFC Secretariat and the project was subsequently approved by the Executive Board of the Common Fund at its 49th sitting.

B. <u>Project Concept</u>

2. A three year pilot project on improving coffee quality in East and Central Africa through enhanced primary processing practices was launched in Ethiopia and Rwanda in July 2004 with funding from the Common Fund for Commodities (CFC) and co-financing from Illycafé.

3. The purpose of the project was to improve the quality of coffee in Ethiopia and Rwanda. The specific objectives were: 1) demonstrate the economic viability and popularise a sustainable mechanism of producing higher quality coffee, 2) build capacity amongst farmers, extension staff, managers and traders to ensure sustainability of the new

coffee processing technologies, 3) increase the farmers' income by enabling them to produce and sell coffee of higher market sales values, 4) encourage private sector operators to invest in improved technology for the production of washed sun-dried coffees and 5) reduce environmental pollution arising from excessive use of water at fully-washed coffee stations.

4. A mid-term evaluation jointly conducted by CFC, the International Coffee Organisation (ICO), Illycafé and CABI in February 2007 revealed that the project was set to achieve all its objectives and had already resulted into significant improvement in the quality of the fully washed, semi-washed and sun-dried coffees in Ethiopia and Rwanda. In addition, the study results indicated that the enhanced coffee processing practices advocated by the project were viable in both countries. The review further revealed that the direct beneficiaries of the pilot project, namely, the smallholder farmers in the project areas, were already receiving higher price premiums in excess of 30% above the prevailing local prices for high quality coffees produced by project farmers.

5. Despite the positive impacts realised by the project, spontaneous out-scaling of the improved processing technologies to the non project farmers and regions was slow. The main reason for the slow pace in scaling out of the positive results of the pilot project is inadequate access to affordable credit

6. Access to affordable credit, is crucial if spontaneous up-scaling of the project results is to take place. This is because the smallholder coffee farmers in both Ethiopia and Rwanda are resource-poor and do not have savings which could be used to pay for the cost of technology such as to acquire and install equipment for improved coffee processing.

7. Other factors limiting rapid scaling out of the improved processing practices include 1) limitations associated to land ownership, 2) weak farmer associations 3) inadequate access to markets by smallholder farmers and 4) poor flow of production and market information. These constraints were largely similar to those identified in an earlier study jointly undertaken by CFC, ICO and the World Bank in 2000, on marketing and trading systems in selected coffee producing countries.

8. Although there are a number of financial institutions which could provide credit to farmers, lending to resource-poor smallholder farmers has not been attractive to such institutions for a number of reasons. As individuals, farmers are not able to provide viable collateral which could be used as insurance in case of default in loan repayment. In the case of Ethiopia, this is aggravated by the land ownership policy whereby farmers do not own the land on which they live and farm, meaning that farmers cannot use land as collateral.

9. A related issue is the lack of structures which facilitate loan recovery from the beneficiaries. Since coffee is sold at farm-gate, there is no centralised way of ensuring that the outstanding loans are deducted at source and remitted as per the agreed schedule. This makes lending to smallholder coffee farmers appear too risky for the commercial banks. Inadequate understanding of the coffee production cycle by the banking industry is yet another constraint hindering access to loans by smallholder farmers. Consequently, the loan products available in the market do not take account of the coffee production cycle and are therefore not attractive/suitable to smallholder farmers.

10. Weak farmers' cooperatives is another factor which limits the rate of up-scaling of project results. The effect of weak farmer associations is two-fold. In the absence of viable coffee-based farmers' cooperatives, it is not possible to have rural savings and credit schemes which could provide alternative and affordable credits to members. Besides, effective farmers associations would facilitate the production of adequate quantities of coffee to provide warrantable lots of various categories of quality and grades thereby facilitating access to markets by farmers. By producing adequate quantities of high quality coffee, it is possible for farmers and primary cooperatives to effectively participate in the coffee auctions thereby having a better bargaining voice.

11. The question of market transparency is pertinent in sustainable production of high quality coffee. A number of factors prevailing both in Ethiopia and Rwanda militate against effective participation of the smallholder farmers in the coffee marketing chain in the two countries. Inadequate access to market information undermines the smallholders' capacity to effectively negotiate in the supply chain. Information is important in planning future production and scheduling of product release into the market. At the same time it is important in helping the producers to have an insight on the value of the produce they are offering to the market.

12. Coupled with effective bonded warehousing, market information should help the farmers plan the release of their produce into the market such that the value of the produce is maximised. From the exporters/importers stand point, effective information management could be used as a marketing tool, helping the importers have a more transparent view of the supply side, providing timely information on the availability of the various quality categories and hence helping the importers plan their purchases accordingly.

13. During the mid-term review, it was observed that the Coffee Liquoring Unit holds a massive database of the various quality categories available from the various regions of Ethiopia. However the information is kept as hard copies and is therefore not freely accessible to potential end users such as the coffee importing fraternity, the extension service and policy makers. The recommendation that the information should be made more retrievable and used to market Ethiopian coffee was therefore timely and should be pursued through an initiative like the one currently proposed.

14. In addition to enhancing productivity and quality, implementation of Good Agricultural Practices by farmers should help demonstrate the extent of compliance by the producers to requirements of various more restrictive market segments such as the specialty coffee markets thereby increasing the value of the producers' coffees and even enhancing market access to such niches. This project intends to address the question of farmer compliance to sustainable coffee production by building the capacity of the producers in good agronomic and processing practices.

15. In order to expand the outcomes of the pilot project both in scale and scope, it will be necessary to put in place activities to facilitate dissemination of project findings to other parts of the countries which did not benefit from the pilot phase. This will ensure that the smallholder farmers in these areas are given equal opportunity to validate the improved processing practices and adapt the processing practices to their own unique environments. This is particularly important in Ethiopia given the vastness of the country and the regional

specificity of the country in terms of coffee production environments, varieties and product differentiation.

16. While a number of these interventions will require financing by the farmers themselves through commercial loans, external financing will be necessary to support technical assistance activities including capacity building to upgrade farmers skills and knowledge on good production practices, improved entrepreneurial skills to facilitate better management of cooperatives and to facilitate timely generation, dissemination of production and marketing information and for monitoring of project progress against set objectives.

17. This proposal is therefore developed in response to the need for expedited scaling up and out of the good agronomic and processing practices in Ethiopia and Rwanda. More particularly, the proposal will be leveraging the outcomes of the pilot phase as a basis for responding to some of the recommendations of coffee stakeholders in Ethiopia and Rwanda concerning the way forwards for revolutionising coffee processing practices in the two countries. A critical aspect will be to mobilise in-country capital by facilitating the establishment of a loan guarantee and loan recovery system to foster better access to commercial loans. The overall goal of the proposed intervention builds on the goal of the pilot project (CFC/ICO/22) to improve livelihoods of small-scale coffee farmers in East and Central Africa.

18. The goal will only be realised if widespread adoption of the improved processing practices by smallholder farmers is achieved, resulting in sustainable increase in the quality and quantity of sun-dried, semi-washed and fully washed Arabica coffee in Ethiopia and Rwanda respectively. Empowering farmers to acquire improved coffee processing technologies and the requisite knowledge and skills is crucial for this to be achieved.

19. The purpose of the project is therefore to design and implement a credit guarantee scheme aimed at empowering smallholder farmers to more effectively access commercial loans necessary to acquire and install improved processing equipment and to facilitate the purchase and export of the resulting high quality coffee produced through the improved processing practices.

II. OVERVIEW OF THE COFFEE SECTOR

A. The World Coffee Market

20. Coffee is one of the world's largest traded commodities produced in more than 50 countries and is the mainstay of a majority of these countries, accounting for over 75% of their total export earnings. It provides a livelihood for some 25 million coffee farming families around the world. The world coffee prices have seen appreciable recovery from the rock bottom levels experienced during the late 90s and early 20s, with the current world coffee prices estimated at 120 US cents/lb. Prospects for the prices remaining at current levels is optimistic.

21. The world's supply and demand are presently in very tight balance, with a lot of new consumption coming up, and production not necessarily keeping pace in the coming 10 years. Statistic from the ICO indicates that production from the African continent has

actually shown declining trends since the year 2000. This is also manifested in declining share of the continents coffees in the world market, falling from a high of 32% of total world exports to the current level of 12%. Revitalisation of coffee production and quality from countries such as Ethiopia and Rwanda where the commodity plays a significant role in the economy is therefore necessary to take advantage of the surging prices by enhancing the quality of their produce. This will enable the countries to capture and retain a substantial part of the emerging market, attract premiums prices and improve the household income of the smallholder coffee farmers.

B. Coffee Production in Africa

22. Coffee is produced by twenty-five African countries and is central to the economies of at least ten of these. It is an important source of foreign currency in the producer countries and plays a major role of wealth creation among rural families. Millions of rural poor derive their livelihoods either directly or indirectly from coffee. In Ethiopia, for example, an estimated 1.2 million smallholder farmers are engaged in coffee production, with more than 15 million households deriving their livelihoods directly or indirectly from the commodity. Coffee is the primary source of income for more than 800,000 households in Burundi, and contributes over 80% of the country's export earnings, whilst in Rwanda, it is second only to tea in terms of its contribution to foreign exchange earnings.

23. Coffee is therefore an important commodity in the fight against extreme poverty in Africa, and is key in achieving the Millennium Development Goal (MDG) number 1 of the United Nations which aims at eradicating extreme poverty and hunger by reducing by half the number of people living on less than one dollar a day.

24. Africa is home to Arabica and Robusta coffees, with a diverse germplasm base, giving the continent a competitive edge over the other renowned world producers. Besides, the continent enjoys a great diversity in both soil and climate, making it feasible to target increased production of high quality differentiated coffees both for the gourmet and mainstream markets. This natural potential could be leveraged by adopting improved processing technologies to enhance sustainable production of premium-grade coffees.

25. Despite its natural endowment of the continent, the performance of the coffee industry in Africa has declined substantially. The value of coffee exported from Africa has declined, from a high of 30% of the value of global coffee exports (US$ 3.5 billion) in 1977 to a mere 10% (US$ 0.7 billion) in 2005. Export from the continent has similarly declined, falling from 15 million bags in 1977 (31.5% share) to 10.3 million bags in 2005 (11.8% share). This calls for renewed efforts to revamp both the volume and quality of coffee from the continent thereby increasing the flow of export revenue to the region. The proposed intervention is meant to address the issue by promoting the production of high quality coffee in Ethiopia and Rwanda.

26. It is generally agreed that the quality of coffee is determined by about 40% in the field, 40% at primary processing, and 20% at secondary/export processing. The importance of primary processing in enhancing the quality and subsequent value of coffee has indeed been recently demonstrated during the pilot phase of the quality coffee project for which up-scaling is being requested. Revitalising the quality of coffee from the African region is

therefore expected to enhance and stabilise income of the resource-poor smallholder farmers who depend on the commodity for their livelihoods. The arising increase in disposable income would then provide resources to be reinvested in rehabilitating the farms and facilities abandoned during the prolonged period of low world prices experienced in the late 90s and early 20s.

C. Importance of Coffee to the National Economies

Ethiopia

27. The Eastern and Central African region is home to Arabica coffee with Ethiopia being the birth place of the species. The crop is at the heart of Ethiopian culture, used to be responsible for 65% of the country's foreign currency earnings before falling to about 40% in the recent years. The crop is nevertheless still the leading export commodity. The commodity also accounts for ~10% of the gross domestic product. Over 25% of the population of Ethiopia, representing 15 million people, are dependent on coffee for their livelihoods, including 8 million people directly involved in coffee cultivation and 7 million in the processing, trading, transport, and financial sectors. The country grows a wide variety of highly differentiated, exemplary coffees, most of which are shade-grown without chemical inputs. Almost 95% of the Ethiopian coffee is produced by about 1.2 million small-scale farmers, with an average farm-size of 0.5ha. An improvement in coffee quality, and therefore income, has a direct impact on the livelihoods of a large number of resource-poor people in the rural populations.

28. As reviewed in the Appraisal document ref ICO/CFC/22, the majority of Ethiopian coffee is prepared using a dry processing (natural/sun-dried) system, which means cherries are harvested and sun-dried as a whole. After drying, the cherries are sold to local collectors (sebsabis), traders (akrabis), or co-operatives, who operate the secondary processing facilities. Around 75-80 % of the coffee is processed using this method. The sun-dried method which is practised by the majority of farmers can cause fermentation process to take place, due to slow or poor drying systems, and as a result may spoil the natural characteristics, i.e. aroma and sweetness of the coffee. This in turn reduces income to the small-scale farmers as the price paid for coffee dried by the currently used methods is very low compared with coffees processed using improved processing methods.

29. The second method of processing is the washed method where cherries are pulped immediately after picking. The washing stations are generally operated by state farms, who process their own production, or in the case of small-holder cherry, by co-operatives, or individuals. After washing, parchment coffee is fermented, washed and dried, ready for transport to Addis Ababa, where it is sold in the auctions (still in parchment form).

30. During the pilot phase of this project, a third method of coffee processing was validated in Ethiopia. The method involves the use of hand pulpers to remove the coffee pulp while leaving mucilage intact. Red cherries are pulped immediately after harvest and resulting mucilage-coated parchment taken straight to the drying beds. The method circumvents the fermentation and washing stages thereby minimising the use of water and avoids the problems associated with fermentation.

Marketing

31. Most of the Ethiopian coffee exports are channelled through the Ethiopian Coffee Exchange. The auction is a spot market, and only goods which are physically delivered to the institutions bonded warehouses may be sold in the auction. This reduces the risk of incorrect deliveries or non-performance by the akrabis (suppliers), as there is no forward delivery contract available in the market. However, it does increase the marketing risk of the suppliers in the internal market, who run the price risk from purchase from grower through to sale in the auction, which may take up to 4 or 5 weeks. This also applies to the exporters, who frequently need to sell coffee 3 – 6 months ahead in order to satisfy their international buyers' requirements, and have no mechanism for purchasing the coffee forward.

32. The individual exporters market the coffee overseas to their network of buyers, both roasters and importers. In the past minimum export prices for each grade were fixed by the National Bank each day, based on differentials against the prior day's New York market close. However, since November 2002 the export pricing is entirely determined by the market, though contracts still have to be registered, and the National Bank continually monitors prices for each grade. Before export, the Ministry of Agriculture and Rural Development - Ethiopia (MoARD) draws samples of each lot for quality certification purposes. The coffee is generally loaded in open trucks at Addis Ababa, directly at the exporters' warehouses, and containerised in Djibouti, the port of shipment.

33. Ethiopia is unique in Africa in that it has a very strong domestic market for coffee. Exporters generally sell part of their auction purchases to the overseas markets, and part into the local market for domestic consumption. Most of the washed coffees are exported.

Rwanda

34. In Rwanda, 95% of the population depends on agriculture and agri-business, which together represent about 40% of GDP. Coffee has in recent years been about 60% of foreign exchange earnings, and is grown in about half the 106 divisions of the country covering approximately 33,000 hectares. There are an estimated 450,000 (about 50%) rural households representing about 2.7 million rural-based people who grow coffee. The average holding is estimated at about 0.1 hectares, about 100 – 150 trees.

35. The highest production by the country occurred in 1986 when an estimated 43,000 tons of green coffee was realised. Both Production and quality fell in the year that followed, with quality falling from 48% of standard coffee in 1986 to 0.32% in 1992 (OCIR CAFÉ 2005). The situation was further aggravated by the civil unrest of 2004, leading to collapse of the quality of Rwanda coffee. Ocir CAFÉ attributes the fall in quality to a number of reasons of which the most important ones include insufficient and poorly managed washing stations, absence of an effective quality control system with a feedback effect, inadequate access to credit for investment and for the working capital and insufficiency of basic infrastructures (water, electricity, roads) for the establishment of washing stations. The proposed initiative aims to address most of these constraints thereby realise sustainable increase in quality and value of Rwanda coffee and hence improve the household income of the more than 450,000 resource poor households, thereby contribute to the achievement of the country's vision 2020.

Burundi

36. Over the last 25 years, Burundi has developed a fully-washed production of coffee, which now accounts for about 2/3rds of the total production of the country. The annual exports vary from year to year between an average of 15,000 to 35,000 tonnes due to the cyclical nature of the production, a total of 17,000 tonnes was exported in 2006. The one third of the output which is still processed using traditional methods needs to be modernised, and in a manner which conserves the limited water resources in certain areas and minimises pollution of rivers.

37. It is believed that, in the longer term, it would be appropriate to design interventions for the improvement of the quality of this part of the production. This could be achieved by means of the ecological pulping units which are being manufactured in Latin America, and which have been introduced for use in neighbouring Rwanda within the framework of the project for which up/out-scaling is being sought. Burundi participated in the pilot phase of the project, taking part in the dissemination of information on the operation of the ecological washing units.

The Democratic Republic of Congo

38. Coffee has been produced in Kivu for over 75 years, and the small-holder farmers have a long tradition and good understanding of production. The volume has declined in recent years due to certain internal difficulties and is currently estimated at about 8.4 tonnes. The system of production in DRC comprises three categories of holdings: the farmers who have under 2 ha on average, the growers with about 20 ha and industrial plantations with approximately 100 ha. The average of the village fields is 1.5 hectare per family. The productivity varies on average from 500 to 800 kg/ha. According to estimates by the Office National du Café (ONC), a total of 406,703 ha of the coffee plantations are currently in operation of which Arabica coffee covers 50,661 ha (12%) and Robusta, including Kouillou, covering 356,042 ha (88%). The village sector accounts for approximately 86% of the total surface of the coffee plantations in our country and the industrial sector is getting increasingly rare.

39. Despite the recent drastic decline in coffee production in the Democratic Republic of Congo (DRC), the commodity still occupies a central place in the country's economy with fairly active internal market. It still occupies first place in agricultural export and is equal to many essential food crops such as corn, cassava, rice, etc. Coffee is ranked third in export earnings after copper and cobalt, representing approximately 9% of the country's export earnings, and approximately 60-65% of the total value of Agricultural exports. With the problems of transport, farmers have very few alternative cash-crops. The non-perishable nature of coffee continues to make it a very important factor in the cash economy in the region.

40. Primary processing of arabicas is usually done on the farms, with traders purchasing from the growers and selling to exporters, who handle the secondary processing and export. The internal market has been entirely liberalised since the late 1970's. Due to local difficulties, the primary processing is often fairly rudimentary, and is greatly in need of investment, training and practical inputs.

D. Coffee Financing Activities of Local Banks in Ethiopia and Rwanda

41. In the case of Ethiopia, a number of banks and Micro Finance Institutions (MFI) are already involved in lending for Agro-based Small to Medium Enterprises (SMEs). The Oromia MFI, the 2nd largest MFI in Ethiopia for example, has a total exposure of US$ 64 million of which 95% is related to agriculture. Their exposure in coffee accounts for 10-15% of total exposure. In the coffee sector, the MFI mainly focuses on individual farmers and cooperatives (with maximum loan amount to an individual limited to about US$ 500 on group methodology and US$ 100,000 to cooperatives. In rural financing, Oromia MFI applies the Granin MFI model which is based on group loan methodology (cross guarantee system).

42. The Cooperative Bank of Oromia is the main bank in Ethiopia involved in financing of primary cooperatives. The Oromia Cooperative Union (one of the main coffee exporters of Ethiopia) is one of its shareholders. The bank was established to provide access to finance to cooperatives that were traditionally shunned by general commercial banks. Originally started as bank for Oromia province it is now expanding into a nation-wide bank with 34 branches. They boast a recovery rate of 97/98% on primary cooperatives due to strict screening, monitoring and close cooperation with the Government body regulating cooperatives. Total exposure of the bank is some ETB 600 (USD 48 million) of which USD 30 million relates to coffee financing (comprising 150 coffee clients). Sixty percent (60%) of coffee financing relates to financing of Unions (i.e. secondary cooperatives) and 40% to primary cooperatives. Main bottleneck for growth is lack of liquidity since bank funding is mainly through deposits. Therefore a cash element in the proposed CFC guarantee scheme (especially in USD or EUR) would be critical to meeting full financing demand of cooperatives currently estimated at 2 billion Birr and for which the bank is only able to meet 50% of the total financing demand.

43. Dashen Bank is providing loans to coffee collectors and exporters but not to cooperatives and farmers. They have a network of 54 branches mainly in rural towns. They have an existing guarantee agreement with USAID of USD 10 million for SME financing (30% utilised). The underutilisation of the USAID scheme is due to the criteria of SME borrowers. Dashen prefers to deal with larger companies since SMEs often cannot offer the 50% collateral cover (matching the 50% USAID guarantee). Dashen is considering financing the coffee Unions (exporters) but not the primary cooperatives or individual farmers.

44. Ethiopian Development Bank (EDB) is a policy bank focusing on project finance and new business developments. It has 32 branches all over the country. Its focus sectors are agriculture, manufacturing and export industries. It did finance washing stations but to a limited extent. The bank still has a carry-over of Non Performing Loans (NPLs). The bank provides working capital loans only as a package with investment finance. EDB asks a minimum contribution of 25% equity and conducts strict screening of its prospective clients (feasibility study). EDB expressed interest in participating in the proposed credit guarantee scheme but would need sign-off of the Ministry of Finance.

45. United Bank is mainly focusing on export financing. 20% of its portfolio relates to exporters of which a third is associated with the coffee sector. They aim at large private exporters and not on collectors and middlemen. They have nevertheless financed one

primary cooperative in the past. It is however expected that the collectors and middlemen will become a new segment once the Warehouse Receipt Finance program is launched in 2010. It has 41 branches mainly in regional towns. They were interested to cooperate in the CFC Scheme but funding needs will be mainly related to working capital.

46. The National Bank is very much supportive of the idea of a guarantee scheme in the coffee sector. The bank has launched one guarantee scheme related to export products but this scheme excludes the coffee sector. The reason is that coffee would take a dominant position under the scheme leaving no room for other export products. The total scheme amounts to ETB 5 million (USD 400k). The National Bank views the Cooperative Bank of Oromia as most suitable candidate for the CFC portfolio scheme due to its focus on primary cooperatives and the coffee sector. The bank confirmed that CFC could be able to open a foreign currency account with the banks to place a deposit. However, the CFC would have to obtain prior approval to repatriate any remaining deposits after expiry of the guarantee scheme.

47. Banque Populaire du Rwanda (BPR) has been financing the coffee sector for over 5 years. It has financed 27 primary coffee cooperatives during this period. The current coffee portfolio comprises 13 cooperatives. The total coffee portfolio of BPR amounts to some USD 2.9 million of which USD 2.3 million WC and USD 0.6 million investment finance. Of the 13 cooperatives only 5 are fully meeting the repayment schedule. The others have overdue instalments.

48. The problems started in 2008/2009 due to the fall of the world market prices. Inadequate monitoring of exports and fund repatriation is another cause of the noncompliance. There has been at least one cooperative that diverted its export proceeds outside BPR to make sure it had sufficient working capital for next crop. This means that BPR has to strengthen its monitoring of the goods flow and of the cash flow to avoid side selling outside BPR.

49. For 2009/2010 BPR is in the process of restructuring its coffee financing activities. So far coffee financing was part of the corporate department. However, as per 1 January 2010, BPR will establish a dedicated agri-department hiring dedicated agri-finance specialist. Coffee financing will be part of this new department which should ensure stronger risk management and stricter monitoring of coffee clients.

50. In addition, BPR is about to enter into a partnership with Technoserve to increase the technical assistance to its coffee cooperatives thereby potentially taking over 13 washing station investment loans of Technoserve in Rwanda (subject to further due diligence) totalling USD 200,000. Possibly, BPR will also take over part of the working capital financing of these 13 cooperatives. Besides Technoserve, BPR is also in talks with OCIR CAFÉ to finance a group of 20 selected coops. As a result of these initiatives, the coffee finance portfolio could strongly increase in 2010.

51. BPR is facing the following hurdles in expansion of coffee financing activities:

i. Insufficient sector knowledge at BPR (to be improved due to new agri-department)
ii. Coordination and control HQ vs. branches

iii. Lack of adequate management information, lack of collateral and most of farmers/cooperative have land but lacking the title
iv. Commodity price risk (Coffee)
v. Weather risk
vi. Weak repayment discipline
vii. High transaction cost due to fragmentation
viii. Weak cooperative structures with lack of capital
ix. Lack of well functioning Warehouse Receipt System

III. PROJECT DESCRIPTION

A. Project Objectives and Rationale

<u>Broad Objectives</u>

52. The overall goal of the project is to improve processing practices by smallholder farmers which will result in sustainable increase in the quality and quantity of sun-dried, semi-washed and fully washed Arabica coffee in Ethiopia and Rwanda respectively. Empowering farmers to acquire improved coffee processing technologies and the requisite knowledge and skills is crucial for this to be achieved.

53. The purpose of the project is therefore to design and implement a credit guarantee scheme aimed at empowering smallholder farmers to more effectively access commercial loans necessary to acquire and install improved processing equipment and to facilitate the purchase and export of the resulting high quality coffee produced through the improved processing practices.

<u>Specific Objectives</u>

The specific objectives of the project are:

(a) Design and operationalise a credit guarantee scheme for primary cooperatives, unions and commercial farmers to support short term investments in coffee production, processing and marketing
(b) Build the capacity of farmers, managers of cooperative societies and banks to more efficiently and effectively undertake their roles in the coffee supply chain
(c) Develop an effective system for generation, storage and dissemination of production and market information.
(d) Catalyse the adoption of improved coffee processing practices throughout the coffee growing districts of Ethiopia and Rwanda

Rationale

54. A three year pilot project on improving coffee quality in East and Central Africa through enhanced primary processing practices was conducted in Ethiopia and Rwanda during the period July 2004 and February 2008 with funding from the Common Fund for Commodities (CFC) and co-financing from Illycafé.

55. A mid-term evaluation of the project undertaken in February 2007 revealed significant improvement in the quality of the fully washed, semi-washed and sun-dried coffees in Ethiopia and Rwanda arising from the adoption of the improved processing practices championed through the pilot study. In the case of Ethiopia, the semi-washed coffees produced through the pilot study was considered a novel product in the Ethiopian market and has since been given recognition by the Ethiopian Commodity Exchange as one of the traded coffee categories.

56. The resulting improvement in quality translated into increased price premiums of between 30% and 70% above the prevailing local prices offered for the coffees produced using traditional processing methods.

57. In addition, the pilot project showed that the enhanced coffee processing practices promoted through project were viable in both countries. An economic analysis of the commercial viability of the hand pulpers in Ethiopia showed that if the farmers use 40% of the installed processing capacity in year 1, 70% in year 2 and 100% in the subsequent years, then the farmers would be able to repay any loans used in establishing the processing facilities within a period of 5 years. Loan repayment period could be significantly reduced if the capacity utilisation of the processing plants is optimised in the first year. This observation justifies the development of a loan scheme. We are therefore proposing the establishment of a guarantee scheme as a financing mechanism in both Ethiopia and Rwanda to facilitate access to credit by smallholder coffee farmers.

58. Despite the positive impacts of the pilot project and their demonstrated economic viability, spontaneous out-scaling of the improved processing technologies to the non project farmers and regions has been slow. The main reason for the slow pace in scaling up/out the positive results of the pilot project is inadequate access to affordable credit. The smallholder coffee farmers in both Ethiopia and Rwanda are resource-poor and do not have savings which could be used to pay for the cost of technology such as to acquire and install equipment for improved coffee processing.

59. Although there are a number of financial institutions which could provide credit to farmers and primary cooperatives, lending to resource-poor smallholder farmers and primary cooperatives has not been attractive to such institutions for a number of reasons. As individuals, farmers are not able to provide viable collateral which could be used as insurance in case of default in loan repayment. In the case of Ethiopia, this is aggravated by the land ownership policy whereby farmers do not own the land on which they live and farm, meaning that farmers cannot use land as collateral. Even in cases where farmers already operate as cooperative societies, access to credit is still hindered since the primary cooperatives often lack sufficient capital base and collateral to attract financing on a stand-alone basis. Besides, cooperatives are often inefficient due to weakness in their managerial skill, further undermining their capacity to successfully repay any loans extended to them and to operate as profitable entities.

60. A Credit Guarantee Scheme based on 50/50 risk sharing could partly compensate the lack of collateral at farm/cooperative level thereby significantly enhancing borrowing. However, it should not be seen as a complete substitute for collateral but only as a form of credit enhancement.

61. In both countries, the problem of collateral at smallholder and cooperative levels is well recognised. Credit guarantee schemes have subsequently been put in place by the respective governments as a means to enhance borrowing, particularly by the smallholder farmers and those involved in small and medium enterprises. However due to the existing liquidity constraints, banks are not able to service all the financial needs of the smallholder-based agribusiness. The schemes subsequently do not give adequate focus to coffee, commensurate with the contribution of the commodity to the economy of the two countries. Besides, the emphasis of these schemes has been on export promotion, leaving farmers and cooperative societies to finance production activities through on their own.

62. A credit guarantee scheme involving cash deposit in the local banks could augment the liquidity of the banks, thereby enabling the credit institutions to provide more loans to the farmers and farmers' cooperatives. In this respect, the proposed credit guarantee scheme will complement the respective governments' efforts to enhance access to credits by smallholder producers. Banks in both Ethiopia and Rwanda prefer this aspect of the proposed credit guarantee scheme as opposed to the alternative situation where funds are transferred to the accounts of the local banks only in the event of default.

63. Under the local banking regulations in both Ethiopia and Rwanda, it is possible for CFC to place a cash deposit in either the United Sates Dollars or Euros at the Ethiopian or Rwandese bank to back up the guarantee. It is also possible to repatriate any remaining surplus after the expiry of the guarantee agreement back to the Netherlands. The existence of this crucial policy provision makes it possible to set up a credit guarantee involving cash deposits in the local banks. However, as a formality, prior approval by the National Bank in the case of Ethiopia is required.

64. In addition to government sponsored credit guarantee schemes, there are a number of existing schemes available for financing of SME's in the coffee sector in both Ethiopia and Rwanda. These schemes are usually based on risk sharing. In Ethiopia for example, USAID operates a guarantee scheme for Agri SMEs. The scheme charges a utilisation fee to the beneficiary as opposed to the Agri Guarantee Facility in Rwanda managed by the government for which no utilisation fee is charged.

65. One of the key factors determining the success and sustainability of a loan guarantee scheme in coffee is the ability to utilise most of the installed processing capacity. Capacity utilisation of installed facilities remained low during the pilot phase due to inadequate delivery of cherry to the processing facilities. The underlying cause for the farmers' inability to consistently produce adequate quantities of superior coffees is sub-optimal agronomic practices by the farmers. Productivity of smallholder farms remain low and loss of coffee through insect damage and disease infestation is high. The use of improved agronomic practices to enhance productivity and limit infestation by diseases and pests will therefore form major technical assistance areas and are proposed for support through CFC and Rabobank financing. The proposed project proposes to address these problems by empowering the farmers to increase the capacity of their coffee fields to produce more coffee per unit area. Capacity building through training is therefore crucial to ensure that producers have the necessary skills, information and knowledge on good production practices such as pruning, rejuvenation scheduling and weeding.

66. The use of basic inputs such as fertiliser and crop protection agrochemicals is an integral part of increased crop productivity per unit of land. In Rwanda, the issue of coffee diseases, particularly the coffee leaf rust, is a major challenge. Production fields are also impoverished, making it necessary to apply fertiliser to improve productivity and quality. Access to operational funds to finance the purchase of agro-inputs is therefore an important component of the proposed loan guarantee scheme.

67. Provision of loans to finance working capital is currently not favoured by the financing institutions in both Ethiopia and Rwanda. In the case of Ethiopia, commercial banks tend to focus mainly on coffee exporters rather than on the production end of the coffee supply chain. The situation is the same in Rwanda where loans extended to the cooperatives are mainly to facilitate the purchase of cherries and, in some instances, to undertake factory improvements. Provision of operational loans is therefore complementary to the existing loan guarantee facilities in the two countries.

68. Incorporating a credit component to facilitate access to operational funds and the inclusion of technical support to farmers, cooperative societies and banks as an integral part of a loan guarantee scheme is therefore novel and would significantly improve the borrower compliance in loan repayment. This is particularly important given that the conventional extension systems either do not work within the coffee sub-sector in the target countries or are non-existent. Indeed, the proposed Technical Assistance (TA) to borrowers under the Credit Guarantee Scheme is very much welcomed by Banque Populaire du Rwanda (BPR), the most suitable bank to operate the proposed guarantee scheme in the country. BPR views any TA at farm level as extra mitigating factor against performance risk of the farmers/cooperatives. In addition, it would catalyse enhanced relationship between the bank and the cooperative/farmers.

69. Sustainable production of high quality coffee would be enhanced if the producers have a transparent view of the market requirement for such coffees. Furthermore, the producers would be better committed to the production of high quality coffee once they are able to associate high quality with better prices premiums. These two aspects of farmer empowerment requires an effective information system which facilitates access to production and marketing information while at the same time, feeding back information on available products in terms of quality and volumes to the prospective buyers. Effective information management could be used as a marketing tool, helping the importers have a more transparent view of the supply side, providing timely information on the availability of the various quality categories and hence helping the importers plan their purchases accordingly. It is with this in view that the scheme has incorporated a component on information management to facilitate generation and delivery of production and market information to the respective players in the coffee production and marketing chain.

70. The proposed credit guarantee scheme works best through farmer groups and therefore targets the Primary Cooperatives and Unions as the main clients. The farmers cooperatives in the two countries are however weak, lacking skills and knowledge on enterprise management on good governance. For instance, the cooperative system for coffee producers in Rwanda is still weak and mainly left in the hands of the management committees with limited or no participation of the producer members. Strengthening of the farmer associations and cooperatives is therefore an important consideration in the successful implementation of the proposed credit guarantee scheme**.** In addition to

reducing the possibility of default, effective farmers associations would facilitate the production of adequate quantities of coffee to provide warrantable lots of various categories of quality and grades, thereby facilitating access to markets by farmers. By producing adequate quantities of high quality coffee, it is possible for farmers to effectively participate in the coffee auctions thereby having a better bargaining voice.

71. Lack of appropriate storage facilities is another factor which compromises the ability of the farmers to optimise the returns from their produce. In the absence of good storage facilities, farmers are forced to keep their coffee within the domestic house, with limited provisions for ventilation. Re-wetting is therefore common, acquisition of foreign flavour e.g. through smoking and spillage of agrochemicals used, for instance, in managing cattle, may also occur. Investment in simple storage facilities will increase the quality of coffee leading to better prices and could therefore be financed through the scheme.

72. In addition to reducing the chances of inadvertent loss of quality due to the factors mentioned above, proper storage facilities will enable farmers to hold their parchment coffee for prolonged periods without deterioration in quality. This would allow the farmers to sell their coffee only at the time when the market prices are good thereby increase their returns. Buyers are currently taking advantage of the inability of the farmers to hold on their produce to negotiate lower prices than would otherwise be the case.

73. The proposed project intends to address the challenge associated with storage by working in collaboration with the producers, the relevant government ministries and other relevant private sector stakeholders to strengthen a warehouse receipt system for the smallholder coffee growers. In addition, the project proposes to develop small hermetic storage system relevant to small farmer groups in the areas remote from the bonded warehouses. Once rolled out, the system would provide the farmers with the opportunity to bulk their coffee to warrantable quantities and boost their capacity to consistently meet their contract obligations. This would boost the smallholder farmers' capacity to negotiate, being able to sell their coffee only when the prices offered are remunerative.

74. One of the reasons why mainstream financial institutions are reluctant to lend to the coffee sub-sectors relates to their poor understanding of the production end of the coffee supply chain and the dynamics of the primary cooperative societies.

75. Provision of technical assistance to the banks taking part in the project has therefore been included to improve the banks understanding of the coffee production and processing cycle and to harmonise the expectations of the banks and the cooperatives in respect to loan disbursement and recoveries. Both in Rwanda and Ethiopia local banks can benefit from agri-credit training (specified to the coffee sector) to improve the agri-credit skill set of commercial officers, credit officers and general management and to improve risk management in agri & coffee financing. This will enhance the ability of the bank to recognise the specific risks associated with coffee financing and to come to effective risk mitigating solutions.

76. A second aspect for development is benchmarking. It would make sense for banks financing many coffee cooperatives to build up a data basis with technical and financial indicators. This could significantly increase the speed and effectiveness of the credit assessment of new cooperatives. It will immediately be clear if the cooperative is scoring

above or below the sector average and in what aspects its performance should be improved.

77. Benchmarking is the pillar under the agri-retail financing of Rabobank in the Netherlands and is one of the reasons for the high recovery rate in agri-financing in the Netherlands.

78. It would also be recommendable to assess the credit chain of the banks that participate in the CFC Scheme in order to identify the weak spots and to advise improvements where relevant. This element of technical assistance to the banks will also include establishing an effective monitoring process and the system for early warning signs. In the end this should improve the risk profile of coffee financing by the banks and decrease the losses under the proposed Scheme.

79. To be able to sell their produce at farm-gate based on the quality of the produce, the farmers should be able to assess and monitor the quality of coffee at farm level during processing and storage. The producers should also be able to add value to their produce at farm level by differentiating their coffee parchment based on quality. Parchment grading at farm level operates in countries with advanced processing practices such as Kenya. At present however, both the farmers and middlemen in the project countries are not able to determine the quality of parchment coffee at farm gate except through visual appraisal of parchment.

80. Visual evaluation of parchment provides only partial and indirect assessment of the quality of green beans. Consequently, farmers are not able to bargain at farm gate on the basis of quality of green beans. On the other hand, the buyers understate the price to cushion them against the potential of reduced value in case the otherwise clean looking parchment turns out to produce green beans of inferior quality. The project therefore proposes to empower farmers to assess their produce for green bean quality at farm gate by providing moisture meters and small hullers to facilitate the assessment of the quality of green beans on-farm and to guide processing and drying. Training on how to use the facilities to sample and assess coffee during drying and storage will be offered to the farmers. In addition, a system for evaluating coffee for its liquor quality prior to any sale will be put in place.

81. Timely availability of relevant market information is important to both the producers and the exporters/importers. In an earlier regional planning workshop, the buyers of Ethiopian coffee indicated that Eco-pulped Arabica was a new product in the Ethiopian market. Information on the quality and availability of this new product is therefore crucial in facilitating competitive marketing of the product. In the same strength, timely availability of market information such as the prevailing and anticipated coffee prices at a given point in time is important. Access to appropriate information will therefore be an essential component of the proposed intervention and will involve digitalisation of the available production and quality information, particularly for Ethiopia and avail the same information in retrievable formats through a website to be established in the case of Ethiopia or strengthened in the case of Rwanda.

82. This proposal is therefore developed in response to the need for expedited scaling up and out of the good processing practices in Ethiopia and Rwanda. The concept note is

developed with due recognition of the fact that the pilot phase was limited to demonstrating the benefits associated with improved processing practices but did not set the stage for expanded impact by ensuring rapid scaling out/up of the best practices and lessons learned. In this regard, the project aims at catalysing enhanced access to affordable credit by developing sustainable loan guarantee and loan repayment scheme thereby enable smallholder farmers to more effectively access commercial loan services. In addition, the concept note is expected to leverage the outcomes of the pilot phase and recommend to the coffee stakeholders in Ethiopian and Rwanda concerning the best bet alternatives for revolutionising coffee processing practices in the two countries. The overall goal of the proposed intervention builds on the goal of the pilot project (CFC/ICO/22) and is to improve livelihoods of small-scale coffee farmers in East and Central Africa.

B Project Components

83. The project forms a logical continuation of the pilot phase of project Ref. CFC/ICO/22 which introduced, on a pilot basis, wet-processing of coffee in Rwanda and Ethiopia and promoted improved sun-drying practices in Ethiopia. It aims to expand the impact of the good results realised during the pilot phase to a wider smallholder community by providing a more holistic approach to sustainable production of high quality coffee by addressing key issues of productivity, quality, institutional strengthening at farmer level and better access to markets and market information. While a significant change in the mindset of the farmers and policy makers has already been realised through the pilot project, it is necessary to build the confidence of a significant population of the smallholders as a means towards ensuring faster scaling up and out. The project will therefore provide basic processing equipment and facilities to farmers in geographical locations not covered during the pilot phase and build capacity of the producers to efficiently use the facilities. All these activities will be consolidated in five components as follows:

Component 1 will promote better access to credit and baking services by smallholder farmers by designing and implementing a credit guarantee scheme amenable to the smallholder coffee production system

Component 2 relates to the broadening of the impact of the pilot project to the wider community of smallholder coffee producers by catalysing spontaneous scaling out of the results of the pilot project. The component will also promote good agronomic practices for enhanced productivity and to reduce on-farm crop and quality loss due to damages related to pest infestation.

Component 3 is aimed at strengthening primary cooperatives and unions in the project areas. The component will concern itself with formation of cohesive cooperative societies and capacity building in good governance and microenterprise management.

Component 4 targets better information generation and delivery to the end users thereby facilitating timely access to production and market information by various players in the coffee production and marketing chain

Component 5 describes the overall co-ordination of the project by the Project Executing Agency.

Component 1: Access to commercial loans by smallholder

<u>Objective:</u> To promote better access to credit and banking services by smallholder farmers

Output: Appropriate credit guarantee scheme developed and rolled out

Activity 1.1: Assess the existing system used by the bank to advance and recover loans from the clients

84. An effective loans system requires an efficient loan appraisal system which takes into account the uniqueness of the crop for which the loan is sought. In the case of coffee, loan disbursement is compounded by the fact that the crop is perennial and has a long gestation period making the farmers of the commodity amenable to most of the vagaries of nature. These facts need to be taken into consideration when developing procedures for determining the bankability of the prospecting loan beneficiaries. The first activity under this component is aimed at addressing this fact by developing efficient criteria for identifying compliant loan applicants, taking consideration of uniqueness of the coffee enterprise.

85. Another factor which is critical in an effective loan disbursement system for coffee is the loan processing duration. Late disbursement of coffee loans can translate into a full year's loss due to the fact that one coffee cycle covers a full twelve calendar months. Part of the loan disbursement system should therefore address the factors which lead to delayed disbursement of loans to coffee farmers.

86. Given the perceived risks associated with coffee production, most banks impose stringent collateral requirements on the prospecting loan beneficiaries. In many instances, the coffee farmers, farmer cooperatives or coffee farmers are unable to raise such stringent collaterals. This component is aimed at addressing this constraint within the framework of activity one by analysing the collateral requirement and such requirement can be addressed in order to ensure that they do not become an impediment to sustainable access to credit by coffee farmers.

87. In line with the nature of coffee business, the number of non-compliance in loan repayment by coffee farmers is not insignificant. It is therefore necessary to put in place an appropriate risk assessment system and criteria for determining premiums associated with the various risk categories but without making such assessment criteria to be an impediment to the coffee producers, cooperatives and Unions in accessing the needed loans for development and working capital. It is therefore necessary to document the main causes of non compliance in loan repayment and to identify or/and design workable mitigating approaches. This will likewise be addressed within the framework of Activity 1.1. The philosophy in this component is to contribute to the loan portfolio of the collaborating banks by transforming the non/semi-compliant applicants into fully compliant applicants.

88. Predisposing factors for non-compliance in loan repayment can be detected early if the lending system is founded on a firm monitoring and evaluation system. As a pre-emptive strategy, this component will develop an effective and efficient tracing system providing information on the expected turnover of the loan beneficiaries based on the crop

and sales realisations. This aspect will be covered within the Monitoring and Evaluation activities of this component.

Activity 1.2: Identify and address challenges to existing loan disbursement and recovery system

89. Once the credit disbursement criteria are identified under activity 1.1 above, it will be necessary to understand the farmers' perception of the existing loan process, identify reasons why farmers do not take advantage of the services and how the services could be modelled to fit with the expectations of the farmers. At the same time, it will be necessary to understand why the mainstream financial service providers such as the commercial banks are reluctant to give funds to smallholder farmers and broker a platform for common understanding between the banks and the smallholder farmers. This will pave the way for negotiating with the existing financial institutions to develop loan processes which facilitate access by smallholder farmers through their cooperative societies.

90. This activity will therefore require a baseline enquiry into the bank operations to reveal the past and current challenges associated with the existing loan disbursement and recovery system. The information will then be used to design an appropriate loan disbursement and recovery system amenable to the proposed project. The information relevant to this activity will be collected in tandem with Activity 1.1 above.

Activity 1.3 Support the expansion of the coffee finance portfolio under the Credit Guarantee Scheme

91. This activity will be initiated by documenting the current coffee loan portfolio of the collaborating banks and to identify the underlying reasons as to why the portfolio has been cupped at the current levels. Information on the bank's coffee portfolio expansion plans (5 – 10 years) and how such plans relate to existing untapped potential. This will require an in-depth assessment of the existing untapped potential and the reasons why the potential loan beneficiaries are currently not accessing loans from the banks and how can such potential clients be made to benefit from the loan opportunities. The activity will subsequently design and administer a loan portfolio expansion pathway for the participating banks.

92. The initial task to be undertaken as part of this activity will be to map out periods when smallholder farmers in Ethiopia and Rwanda are financially insecure and relate this to the farming/investment calendar of the farmers. This will be followed by participatory development of modalities for a feasible loan guarantee scheme to take care of the perceived additional risk associated with lending to smallholder coffee farmers. A systematic loan recovery system for the beneficiaries of the scheme will be developed and agreed upon with the relevant stakeholders to facilitate recovery of the funds disbursed through the scheme or commercial banks participating in the pilot project. Appropriate loan and banking products and services will then be developed to facilitate sourcing of investment funds from local commercial banks.

93. To ensure increased compliance, the farmers in both countries will access the credit facility through groups constituted legally. The beneficiary farmers will have to undertake to jointly take risk as Cooperatives and as individuals within their respective cooperative

societies before any loans can be advanced to them. This arrangement will provide three levels of loan guarantee – guarantee through cash deposit at the Bank, letter of guarantee from the ministry indicating the Government's commitment to enforce compliance and social guarantee through membership to the beneficiary cooperatives. In the case of the social responsibility, the members of the group will be held responsible and share and repay to the bank in case one of the members of the group fails to repay. In which case, the members of a cooperative/group will act as collaterals for each other. Organisation of farmers into viable groups will therefore be an important aspect of the project.

Activity 1.4: Enhance farmers' capacity to sustainably access financial services both individually and as farmer groups

94. Lending to agriculture is normally viewed as risky venture by a number of financial institutions. The risks become higher when dealing with smallholders with no clearly organised legally recognised grouping. More so, the volatility of the coffee market makes lending to the sub-sector less attractive to commercial banks. Farmers are hesitant to commit their property (usually family land) as collaterals given the uncertainty of the coffee prices associated with high market volatility. In countries such as Ethiopia, land ownership is also a major constraint since farmers do not own the land on which they live. This activity therefore aims at 1) design a sustainable loan guarantee scheme design alternative forms of collateral 2) brokering participatory development of financial products where farmers and the banking institutions jointly develop loan and banking products amenable to smallholder coffee systems 3) design alternative forms of collateral, including assessment of crops in the field as a basis for awarding advances to farmers (cherry advance) and 4) develop loan repayment schedules which takes into account the crop cycle and annual coffee productivity levels and farm-based cash flows of the farmers 5) build farmers capacity to comply with loan regulations thereby minimise the rate of defaults. A key area of capacity building will be financial management.

Activity 1.5: Undertake capacity building training for loan officers in the banks.

95. One of the factors constraining access to credit by smallholders is the poor understanding the coffee production cycle by the loan officers in the commercial banks. The poor understanding of the coffee production cycle makes it difficult for the loan officers to develop loan products amenable to primary cooperatives and contribute to poor monitoring of the loan facilities hence leading to increased loan default. This activity is aimed at building the capacity of the loan officers in coffee production and marketing cycle to enable them strengthen their loan evaluation and monitoring process.

96. Likewise, capacity building in management of the farmers groups will be a major focus, with emphasis on good governance. In this respect, the project will have to collaborate closely with the respective government bodies concerned with the regulation of the cooperative societies in the two countries. For example, the ministry of Agriculture and Rural development in Ethiopia and the Cooperative Commission of Oromia will be an important partner in Ethiopia. Another important element of the credit scheme will concern the choice of the farmers groups and cooperatives to benefit from the project. In this regard, it will be necessary to define effective criteria for identifying the groups. For example, the members of the beneficiary cooperatives will have to agree to take risk jointly or individually for securing loan to be extended to their members, members must

demonstrate adequate cohesiveness in terms of saving and mobilisation of resources and membership should be open to all gender

Component 2: Scaling up and out improved coffee production and processing practices

<u>Objective:</u> Catalyse expedited scaling up and out of improved coffee processing practices throughout the coffee growing districts of Ethiopia and Rwanda

Output: Impact of improved processing practices as demonstrated in the pilot phase expanded to at least 20% of the coffee growing districts in the collaborating countries.

Activity 2.1: Conduct baseline surveys of coffee processing practices in the new areas targeted for up/out-scaling of improved processing practices

97. Surveys will be undertaken in the identified up-scaling districts during the first year of the project to characterise and document the existing coffee production and processing practices and the associated costs, document the existing production, processing, marketing and financing services and the existing coffee marketing channels. The outcome of the survey will provide a baseline upon which the impact of the project can subsequently be measured. A final survey will be undertaken towards the end of the project to quantify the impact of the project.

Activity 2.2: Identify suitable areas and farmer groups for scaling up and out of the improved processing practices and popularise the economic benefits associated with good agronomic and processing practices

98. A number of districts were identified during the pilot phase of the project for potential up/out scaling of the improved processing practices. This activity will target these districts and identify, in close consultation with the farmers, government authorities and other interested parties, suitable locations for the installation of the processing facilities and formation of farmers' groups for demonstrating the beneficial aspects of the improved processing practices. The demonstration and learning sites will be selected to optimise access by project and non-project farmers. The choice of sites will also be determined by the proximity of already installed facilities for coffee processing, environmental acceptability and potential for adequate coffee production to optimise the use of the facilities and sustain the project. Management of the facilities will be done by the farmers themselves. The project will therefore work with the beneficiaries to formulate simple but transparent community based management structures which would oversee the use of the facilities and promote group marketing of the products and facilitate access to other services by the group members. Agreements on the use of the facilities will be entered between the farmers and the PIAs. For the newly enlisted districts for up-scaling, the economic benefits of producing high quality coffee through improved primary processing as demonstrated during the pilot phase of the project Ref CFC/ICO/22 will be promoted. In the case of Ethiopia, the project will target Woredas which have been identified by stakeholders for up-scaling. These include Illubabor Zone - Alle, Yayu and Chora districts, Jimma Zone - Limu Kossa, W/wollega – Haru, Kellem Wollega – Anfilo, Guji - Kercha and Uraga, W/ Hararghe - Daro lebu and Kuni, E/Harerghe - Melka Bello 12 districts,

SNNP regions in Oromiya Region and Sheka – Yeki, Keffa – Ginbo, Gamogofa – Kemba, Debub Omo- Debub Ari and Semen Ari, Basketo - special district, KT zone -Kacha Bira, Wolayita - Bolo Sore 10 districts in Bench Maji Zone - Sheko and Debub Bench

Activity 2.3: Purchase and install machinery, equipment and facilities for improved dry and wet processing

99. This activity will be undertaken based on the experience of the pilot phase of the project. The type and quantities of the project per sight and per country will be in line with the performance of such facilities during the pilot phase. Potential for adjustment such as having motorised pulpers to accommodate higher quantities of coffee will be undertaken in close consultation with the beneficiaries and the government authorities. In addition to the facilities for coffee processing, the project will purchase equipment for monitoring of moister content during draying and in storage and for hulling of small samples. This will facilitate quality assessment on-farm thereby fostering coffee sales based on quality. Prompt installation will be undertaken.

100. In this up-scaling phase, two categories of equipment and implements will be installed. For the farmers who participated in the pilot phase and whose knowledge and skills in coffee processing are already upgraded, the emphasis will be on equipment and facilities for post harvest handling, namely, storage facilities and equipment for quality monitoring during storage. In addition rigorous training on good agronomic practices will provided to this category of farmers to improve their coffee productivity levels and to minimise crop loss due to insect pests and disease. The aim here will be to improve capacity utilisation of the installed processing facilities and to optimise resource utilisation. Any additional processing equipment installed among this category of farmers will be through revolving fund, commercial loans or self generated resources. For the farmers in the newly enlisted districts, facilities for enhanced coffee processing will be introduced through the grant provided through this project. Training to improve farmers’ skills and knowledge on appropriate processing practices will be undertaken at the same time as training on good agricultural practices. This two pronged, holistic approach to improving productivity and quality will ensure that progress on both fronts are realised concurrently. Awareness creation seminars for policy makers and other key stakeholders will be conducted in all districts targeted for up-scaling to accelerate the scaling-up process and to enhance acceptability of the project among the opinion leaders.

Activity 2.4: Train producers, extension agents and owners/operators of the equipment on good production and processing practices and the use and maintenance of the processing equipment

101. This activity will target farmers, extension agents and processing factory operators in the newly enlisted sites which did not benefit from the same capacity building exercise during the pilot phase. In addition, the farmers in the sites which were part of the pilot phase will receive training on how to improve productivity through good agronomic practices and to construct storage facilities using local materials, management of coffee during storage and the use the moisture meters and small hullers to monitor moisture during drying and in stores. Quality assessment on the farm and preparation of samples for liquor determination will form part of the training.

Activity 2.5: Monitor and evaluate costs and efficacy of the improved processing facilities

102. Training will be provided to the operators of the improved processing facilities in the newly enlisted districts to enable them keep accurate records related to the cost and efficiency of processing using the improved methods. The data will subsequently be used to monitor the efficient use of the facilities in the new areas and to determine the economic viability of the facilities in the newly identified areas.

Activity 2.6: Evaluate cup and green coffee quality by liquorers and exporters

103. The quality of both the green coffee and liquor will be assessed alongside control samples by liquorers and exporters in the local market. The result of the quality assessment will be used for two purposes. The first purpose will be to facilitate the marketing of the coffees at the auctions or through direct contracting with payments based on the quality. The second use of the quality assessment results will be to identify and map eco-topological (Eco-topos) combination which produces coffees of unique quality characteristics. The accrued information will subsequently be used as a tool for promoting and marketing coffee from Ethiopia and Rwanda.

Component 3: Strengthening of Primary cooperatives and unions

<u>Objective:</u> Facilitate the formation of cohesive cooperative societies and unions based on good governance principles.

Output: Primary cooperatives and unions in the project areas strengthened

Activity 3.1: Undertake capacity building training for farmers and cooperatives to effectively use the scheme.

104. As a means to integrate the farmers in the coffee input and output markets, the project will aim at catalysing the formation of viable farmer groups. In close consultation with farmers, district administration and other key players in the coffee value chain, the most viable and more direct channels for marketing the improved coffees will be identified and agreed upon. To enhance the producers' ability to bargain with the buyers as equal partners, modalities for group marketing of coffee will be developed and agreed upon by members of the associations and other key stakeholders. It is important that farmers identify and agree on who will coordinate the coffee marketing immediately the crop becomes ready. Currently, the farmers in the project districts depend on the ministry of Agriculture staff to coordinate marketing on their behalf. This is however not sustainable.

Activity 3.2: Assessment of technical assistance & financial Needs of co-ops in Rwanda/Ethiopia

105. The activity is aimed at laying the ground for capacity building activities for the banks both in terms of technical capacity as well as financial capability to sustainability provide loans to farmers. It is aimed at documenting existing bank capacity in developing

and delivering sustainable loan schemes for coffee farmers, cooperatives and unions in Ethiopia and Rwanda. Technical gaps limiting the banks capacity to deliver sustainable loan scheme to coffee farmers will be identified as part of this activity. Likewise, the activity will provide information on the nature of financial assistance required by the participating banks and develop potential means to bridge such gaps.

Activity 3.3: Develop templates for good governance and design effective and efficient coffee delivery and payment system

106. In most cooperative societies, there is limited separation of roles between the management of the societies and the governing boards. This leads to conflict of interest in the day to day management of the societies. The result is poor efficiency and enhanced overhead costs leading to poor payments to farmers for coffee delivered. Farmers subsequently prefer to sell coffee to middlemen instead of selling to the society. The activity aims at realising better managements of the cooperatives by developing and applying instruments for better governance.

107. Due to cash flow problems experienced by smallholder farmers in the two countries, the preferred mode of payments for cherry delivered to the cooperatives is the cash on delivery system. This means that farmers sell their coffee without due reference to the finally quality of the coffee produced from the cherry delivered. The consequence is that producers of high quality coffee are not rewarded by way of premium payments for the high quality coffee produced. Consequently producers of high quality coffee are discouraged since it takes greater investments and efforts to produce premium grade coffees. This activity aims at developing systems that facilitate traceability of farmers coffee up to the point of sale to promote payment of bonuses to farmers based on the price fetched by their coffees.

Component 4: Enhanced access to production and market information

Objective: To facilitate timely access to production and market information by various players in the coffee production and marketing chain

Output: Access to production and market information by producers, marketers and policy makers enhanced

Activity 4.1: Document the information needs (type, form, frequency etc) for various players in the coffee value chain, identify key players in the generation and use of information and formulate options for addressing the needs

108. Timely availability of information is crucial to all stakeholders in the coffee value chain. Framers require information on the coffee prices and other production information whereas the local coffee buyers and exporters require information on the quality and availability of various types of coffee. This activity aims at consolidating the information needs of the various stakeholders to form the basis for a more robust information system for the collaborating countries. Key players in the generation and use of information will be identified and the types of information generated by the various players characterised in terms of form, content and appropriate storage media.

Activity 4.2: **Digitalise the production and marketing information available in the coffee Liquoring Unit (Ethiopia) and at the coffee board Rwanda (OCIR Café)**

109. In the mid-term review, it was noted that a wealth of information exists within the CLU and other coffee departments but this information is not easily accessible since most of it is in hard form. This activity will concern itself with two things: 1) Digitalisation of all the quality and production statistics in Ethiopia and Rwanda and 2) Timely provision of the quality and production statistics in retrievable formats through well designed websites. The website will be used as a tool for promoting the high quality coffees produced as a result of the project interventions as well as to facilitate dissemination of information to all players in the coffee production and marketing chains. The activity will therefore develop, in collaboration with stakeholders, a framework for consolidating information for the various actors in the coffee value chain and agree on the custodian of such information and how such information can be secured from interference from non-target user. The activity will also digitalise the production and marketing information already available in the coffee Liquoring Unit (Ethiopia) and at the coffee board Rwanda (OCIR Café). Digital information dissemination system based on hand held devises and mobile phones will be developed and rolled out to development agents, extension workers and smallholder coffee farmers. This will bridge any gaps which might be left through the use of websites and to make information more accessible to the more remote parts of the countries where mobile communication is more relevant.

Activity 4.3: **Undertake capacity development on management and use of production and marketing information for both farmers and the designated custodians of the information**

110. To facilitate access, both the custodians and end users of the information need to be empowered to efficiently manage the information source. Farmers will require awareness creation and training on how to interrogate the information sources, the type of information available and the arrangements required to better access the information. The custodians of the information will also require capacity development to more clearly understand the needs of the various end users in terms of form and content to enable them cope with the demand from a variety of users.

Activity 4.4: **Develop and implement modalities for accelerated and timely access to the market information**

111. The website developed under this component will provide an efficient way to access production and market related information and will therefore be an important aspect of promotion in Ethiopian and Rwanda coffee.

Component 5: Project co-ordination, supervision and monitoring

<u>Objective:</u> Co-ordinate the project (execution, monitoring, financial and administration, etc.) effectively

Output: Project executed effectively and efficiently

Activity 5.1: Undertake project coordination, monitoring and evaluation Organise

112. This activity will concern itself with elements of the project which ensures effective and efficient implementation of the project as whole. A project inception workshop will be undertaken at the beginning of the project to formally launch the project. Thereafter, there will be annual planning workshops will be undertaken to develop detailed annual work-plans and budgets and review progress made during the preceding years. Effective communication channels between PIA & PEA will be established to facilitate monitoring of the project. Administration and accounting procedures established during pilot phase of the project will be strengthen and/or modernised. Regular technical support to PIAs will be provided as part of the backstopping activities of the PEA. Effective Monitoring and evaluation (M&E) will be put in place, part of which will include organising supervision missions by the International Coffee Organisation ICO and the Common Fund for Commodities (CFC).

C. Loan Guarantee Schemes: Ethiopia and Rwanda

A summary of the Loan Guarantee scheme is presented below, while a more extensive coverage is provided at Annex 2.

Loan Guarantee Scheme: Ethiopia

a. Structure of Partial Credit Guarantees Scheme for Ethiopia

113. Two levels of credit guarantees are proposed for Ethiopia and one level for Rwanda. A portfolio guarantee scheme financed mainly by the CFC is proposed as a financing mechanism for primary cooperatives in Ethiopia. In addition, an Agri-guarantee (AGF) fund is proposed as a funding mechanism for the cooperative unions in the country as well as large commercial farmers and will be funded mainly through Rabobank. Since the cooperative societies in Rwanda are smaller and not organised into unions, the relevant credit guarantee scheme for the country will be portfolio guarantee scheme financed both by the CFC and Rabobank funds.

b. Coffee Credit Guarantee Scheme (portfolio guarantee)

114. A Coffee Credit Guarantee Scheme (the "Scheme") is useful when providing many small loans (portfolio approach) rather than a few large loans which is the case under the AGF. When there are multiple small loans, it is not practical to obtain approval from the Guarantor for each and every loan separately but rather to agree on the borrower and loan criteria beforehand with the Guarantor. This also assumes that the Guarantor(s) (CFC & Rabobank in case of Rwanda and CFC in case of Ethiopia) should feel comfortable with the lending and recovery processes of the bank. It also requires prudent record keeping and regular reporting on the loan portfolio quality by the bank to the Guarantor(s). In principle, the financing under the guarantee scheme will follow the normal banking procedures.

115. The structure of the proposed Guarantee Scheme is similar for Rwanda and Ethiopia (except that Rabobank is not included as Guarantor in Ethiopia):

i. The Guarantor signs the Risk Participation Agreement thereby transferring a FX cash deposit to the dedicated Guarantee Account with the local bank. The FX cash deposit equals the amount of the guarantee and can be utilised by the bank in case of any losses incurred by the Bank under the Scheme. In the case of Ethiopia, prior approval by the National Bank needs to be obtained by the bank to repatriate any remaining FX surplus of the cash deposit back to CFC after expiry of the Scheme.

ii. The bank provides working capital and investment loans to SMEs active in coffee production and exports whereby the bank follows the normal lending procedures.

iii. All loans and borrowers should meet the eligibility criteria of the Scheme to become a qualifying loan

iv. The bank should keep records of all loans and provide an update on the loan quantity and quality of the portfolio to the Guarantor on a quarterly basis in the agreed format ("the Schedule").

v. The bank should pay a utilisation fee to the Guarantor equalling 2% (per annum) of the average usage of the guarantee during the last 6 months. Payment dates are 31 March and 30 September. 2% is considered as a fair premium and is also used by other guarantee schemes e.g. USAID.

vi. In the event of a loss the bank can debit the pro-rata risk share of the Guarantor in the unpaid principal from the guarantee account to its own account including any unpaid interest due (for up to 1 year).

vii. Any recoveries from liquidation of collateral shall be divided between the bank and the Guarantor on a pro-rata basis.

viii. Individual loan tenors can be up to 4 years with the total Guarantee Scheme expiring in 5 years.

Documentary requirements necessary to operate the Guarantee Schemes

i. The guarantee scheme agreement between the bank and the guarantor
ii. Loan contract agreement between the bank and target clients/borrowers

Loan Guarantee Scheme: Rwanda

a. Coffee Credit Guarantee Scheme model for Rwanda

116. Based on the information received from the client, the commercial officer determines if the cooperative is sufficiently creditworthy. This includes determining if the client does not have other loans at other (sub) branches of Banque Populaire Rwanda (BPR) and/or other banks. If the outcome is positive a credit proposal is drafted detailing the loan/credit facility and specifying the repayment plan for the loan taking into account the client's situation and the project's cash flow. The commercial officer subsequently asks for a valuation of the client's collateral. Each branch has external experts recognized by head office to make those valuations. The expert gives a valuation report to the bank which is added to the client's loan application. The commercial officer visits the site of the project to verify the information provided by the client. In case the loan requires authorization at branch or head office level, the completed credit application is sent to the

credit officer at the Branch for analysis. The credit officer includes his opinion and sends the loan application form to the Risk Branch Head for review.

117. Loans are sent to the applicable credit committee, as specified in the Credit Policy. If the loan application is above branch limits, the file is sent to head office for analysis and approval from Head Office Credit Committee or Board Credit Committee (as necessary).

118. After the decision of the credit committee, the credit officer drafts the loan contract. Only in case of sub branch approval, is the contract drawn at the sub branch under responsibility of the Sub Branch Manager. In all other cases, the credit officer draws the contract.

b. Suitable partners

119. In Ethiopia, The Cooperative Bank of Oromia appears to be the most suitable candidate for the Portfolio Guarantee Scheme due to its strong focus on primary cooperatives and its knowledge about the coffee sector. In addition, it is one of the few banks involved in financing of washing stations (most other Ethiopian banks only finance the coffee trade). The Cooperative Bank of Oromia is keen to work with the CFC and Rabobank under the Guarantee Scheme and was quick in responding to any questions by RIAS/CABI on its loan policies.

120. In Rwanda, the preferred partner is Banque Populaire du Rwanda. They have the strongest rural network (18 branches, 109 sub-branches and 61 outlets), 1386 staff members and about 1 million clients in rural areas.

Agri Guarantee Fund

121. The Agri-Guarantee Fund is especially helpful when local banks want to start financing an exporting Coffee Union or plantation farmer, or when they already reached the maximum single borrower limit on a Union/plantation. In the first case, the 90% cover ratio of AGF in year 1 helps in mitigating the credit risks that can be especially high in the beginning of a new relationship. In the second case, AGF can enable growth of exposure on a single Union that would not have been possible without the AGF.

122. AGF offers (1) partial credit-guarantees and (2) funded risk participation as risk-mitigating instruments in favour of local financial institutions. These instruments will enable local commercial banks to offer commercial finance at better pricing (market conform) and conditions (adequate collateral requirements) than would be possible without the risk mitigating instruments of the AGF.

123. Through the structure of the AGF, the banks are challenged to offer short term finance, backed with short term assets, for purchasing, processing and trading commodities in the international market on commercial and sustainable terms. This makes it possible for the coops / companies to better structure their funding requirements and use their fixed assets as security for their long term financial needs.

D. Benefits and Beneficiaries

124. The major focus and purpose of this project is to improve and stabilise the livelihoods of the smallholder coffee farmers in Africa through sustainable production of high quality coffee. By producing high quality and differentiated coffees, the smallholder coffee farming communities will be able to attract premium prices in the world coffee market. This will lead to positive growth in the overall household income, and at the same time, stabilise the income, hence reducing the vulnerability of smallholders to coffee price volatility. The additional disposable income at the household level is expected to trickle down to all family hierarchy. Thus all the smallholder coffee dependent family units in the target countries are the primary beneficiaries of the proposed project.

E. Project Costs and Financing

The Total Project Cost is estimated at USD 8,147,494 as shown in summary form in Table I. The Project will be financed by a grant of USD 1,240,270 from the CFC, co-financing from Rabobank of USD 325,870, loans by local banks of USD 6,250,000, and counterpart contributions (in cash and kind) of USD331,350 from the participating countries. The risk exposure for the loans will be shared between CFC, the Rabo Agri Fund and the local banks through (i) cash collateral in the form of a reimbursable grant of USD 2,000,000 in the case of CFC, (ii) guarantees of totally USD 1,250,000 by the Rabo Agri Fund, and (iii) unsecured loans for a total value of USD 3,000,000 from the local banks. The reimbursable grant provided by the CFC will be deposited in a Dutch bank account with Rabobank. The formal beneficiary of the grant will be the Rabo Agri Fund; the grant serving strictly as cash collateral against possible losses on the part of the Agri Fund under a risk participation scheme it will enter into with the local banks with a maximum liability of the Agro Fund of USD 2,000,000. This risk participation scheme will be additional to and separate from the abovementioned guarantees to be provided by the Agri Fund for its own account. The Rabo Agri Fund will set up the risk participation scheme, negotiate and sign the appurtenant documentation with the banks, administer the cash collateral and, by itself and/or through other branches of the Rabobank group, monitor the underlying loans and report to the CFC, for an agreed fee. A summary of the cost and associated financing plan is shown in Table II, below, while more detailed cost and financing tables are provided at Annex 3.

Table I: Summary Project Cost by Category of Expenditure (USD)

	Category	Total Cost	CFC Grant Contribution
I	Vehicles, Machinery and Equipment	2,335,000	60,000
II	Civil Works	0	0
III	Materials and Supplies	91,000	60,600
IV	Personnel	383,763	266,063
V	Technical Assistance and Consultancy	376,739	174,095
VI	Duty Travel	93,885	78,405
VII	Dissemination and Training	685,235	394,235

VIII	Operational Costs	4,126,872	151,872
	Sub-total	8,092,494	1,185,270
IX	Supervision, Monitoring and Evaluation	55,000	55,000
X	Contingencies		
	Grand total	**8,147,494**	**1,240,270**

Table 2- Summary of Financing Plan by Component and Source (USD)

	Proj Comp	**CFC**		**Rabobank**		**Local Banks**	**Counterpart Contb.**	**Total**
		Grant	**Loans with CFC collateral**	**Grant**	**Loans with Rabobank Guarantee**	**Loans without guarantee**		
1	Access to commercial loans by small-holder farmers, plantation farmers, cooperatives and unions	175,700	600,000	53,230	375,000	3,000,000	25,550	4,229,480
2	Scaling up and out improved coffee production and processing practices	551,870	1,400,000	0	875,000	0	202,300	3,029,170
	Undertake capacity building traning for farmers and co-operatives to effectively use the scheme	76,870	0	272,640	0	0	17,400	366,910
	Enhanced access to production and market information	75,940	0	0	0	0	51,900	127,840

	Project co-ordination, supervision and monitoring	359,890	0	0	0	0	34,200	394,090
	Total Finance	1,240,270	2,000,000	325,870	1,250,000	3,000,000	331,350	8,147,490
	% of Total Finance	15%	25%	4%	15%	37%	4%	100%
	% of Total Loan Guarantee		32%		20%	48%		100%

F. Procurement, Disbursement, Accounts and Audit

125. **Procurement:** will be in accordance with procedures acceptable to the Fund.

126. **Disbursements:** against the purchase of items with a value of USD 500 or more will be fully supported by copy documentation. Other expenditures will be disbursed against certified Statements of Expenditures (SOE). The Fund will make an initial deposit of the equivalent of USD 100,000 into a bank account designated for that purpose by the PEA. This Project Account will be replenished in accordance with the Fund's procedures for operating a Project Account.

127. **Accounts and Audit:** The PEA and the collaborating institution will maintain independent and appropriate financial records and accounts in accordance with internationally acceptable accounting practices. All financial records and statements, including those for the Project Account, will be audited annually by independent auditors acceptable to the Fund. The audited accounts and the auditor's report, including separate opinions on the Statement of Expenditure and on the utilization of the funds in the Project Account, will be submitted to the Fund and the Supervisory Body within three months after the end of the project's fiscal year.

G. Project Organisation and Management

128. The project will be implemented based on the following institutional arrangements:

Supervisory Body

129. The International Coffee Organisation (ICO), with headquarters located in London, maintains the statistics concerning world coffee production, trade and consumption. It also provides a forum for meetings between representatives of coffee producing and consuming countries and acts as a centre for the collection, exchange and publication of economic and technical information on coffee.

Address: 22 Berners Street
London, W1T 3DD
Tel: +44 (0)20 7580 8591

Fax: +44 (0)20 7580 6129
Email: info@ico.org

130. The International Coffee Organization will receive progress reports every six months from the Project Executing Agency (PEA) in the CFC format. ICO will review the reports and assess the progress made with the Annual Work Plan and set performance indicators before forwarding the report to the Common Fund with their comments as the Supervisory Body. Budgets and financial statements shall be attached to each progress report. Detailed guidelines are provided in the CFC Financial Procedures Manual.

Project Executing Agency

131. CABI, an international, intergovernmental, not-for-profit organisation, with a track record of spanning several years of implementing coffee projects in Africa will be the Project Executing Agency. Currently, CABI staff have a combined 75 person-years of experience in the coffee sector and over the past twenty years have implemented more than 30 projects and consultancies in 25 countries. Our staff also provide regular advice and information to national and international organisations on coffee production. CABI will be responsible for the overall execution of the project and will be responsible for disbursement of funds and implementation of the project. It will work through its regional centre, CABI Africa, which will coordinate the project on behalf of the Inter-African Coffee Organisation and the International Coffee Organisation, and provide overall co-ordination of the initiative. CABI Africa will work directly with the relevant ministries and ministry arms in the participating countries such as the coffee Liquoring Unit in Ethiopia and OCIR Café in Rwanda, as well as the Coffee Research Institutions and selected Coffee Exporters' Associations operating in the target countries, African Coffee Research Network (ACRN), Coffee Research Network (CORNET), and Café Africa

Address: CABI Africa
ICRAF Complex, Gigiri, United Nations Avenue
P.O. Box 633-00621,
Nairobi, Kenya
Tel: +254 20 7224450
Fax: +254 20 7122150
Email: c.agwanda@cabi.org
Contact: Dr. Charles Agwanda (Coordinator Commodities)

Collaborating Institutions (CIs)

Ethiopia: Ministry of Agriculture and Rural Development, Extension and marketing departments, Addis Ababa

132. The former Coffee and Tea Authority (CTA) was dissolved and institutions dealing with coffee development were affiliated to the MoARD since May 2004 following the restructuring of the ministry and creation of MoARD. At present, two departments and one center/unit are dealing with coffee development, quality evaluation and marketing aspects. After the recent restructuring of the departments, Extension department is responsible for the development aspects of the sector, while the marketing is addressed by the marketing

Department. The former is reporting to the state minister for the Agricultural sector, while the later is overseen by the state minister for Marketing and Inputs. In addition to the aforementioned departments, the Coffee Liquoring Unit, under the Marketing and Input sector, is dealing with coffee quality evaluation and auction activities. Although all the three structures have been involved in the implementation of the project, the Extension department is in charge of overall implementation of the project activities. Moreover, although the above mentioned institutions take a leading role, there are many other institutions/agencies that are expected to have direct and indirect role and involvement in the implementation of the project.

Address:	Extension Department P.O. Box 62347 Addis Ababa Ethiopia
Tel:	+251-1-5517067
Fax:	+251-1-5512984
E-mail:	moav@telecom.net.et Esake21@yahoo.com
Contact:	Esayas Kebede (National Coordinator)

Rwanda: Office des Cultures Industrielles du Rwanda (OCIR-Café), Kigali

133. OCIR Café is the Government organisation under the Ministry of Agriculture which is charged with the regulation, monitoring and control of the coffee sector in Rwanda. It has a number of agronomic staff working in the field, and from its office in Kigali. OCIR café works closely with all the different stakeholders in the industry, to promote coffee production, quality and export business, in the context of a privatised and liberalised industry.

Address:	OCIR Café B.P. 104, Kigali Republic of Rwanda
Tel:	+250 575600/575398
Fax:	+250 573992
E-mail:	ocircafe@rwanda1.com
Contact:	Director General, OCIR Café Mr Pontien Munyankera (Head of Production Department)

134. For purposes of liaison, information dissemination and training in Burundi and D.R. Congo, the PEA will work with:

Burundi: Office du Café du Burundi (OCIBU), Bujumbura

135. OCIBU is the Government organisation in charge of the coordination and development of the coffee industry. Its main tasks are to guarantee and promote the

coffee's quality throughout the world, and the regulation and control of prices. OCIBU runs the coffee auctions in Bujumbura each week, and regulates and monitors exports.

Address: OCIBU
279, Boulevard de Tanzanie
P O Box 450
Bujumbura
Tel: +257 224017/217742
Fax: +257 225532
E-mail: ocibude@cbinf.com

Contact: Déogratias Nduwimana (Director General)

Democratic Republic of Congo: Office National du Café (ONC), Kinshasa

136. ONC is the Government organisation which regulates and promotes the development of coffee in the country. With agencies across the country, in all the major producing regions, the ONC quality department issues quality certificates for all exports, publishes weekly 'mercurial' (or minimum export) prices, keeps the statistics for the industry, and prepares and implements the 5 year plan for the coffee sector in the country. The ONC has the following main aims and objectives:

- the promotion (in all its aspects) of the cultivation of coffee trees
- the provision of technical help to planters
- the monitoring of quality and packaging
- to support and finance research work on the coffee tree

Address: ONC
B.P. 8931 Kinshasa
Democratic Republic of Congo
Tel: (+243 12) 71143/144
Fax: (+1 212) 376 9539
E-mail: jm_mukunak@yahoo.fr

Contact: Director General

137. The Collaborating Institutions would have the responsibility of managing the project in their respective countries. This would include:

a. liaison with the PEA
b. seeking co-financing/counterpart funding
c. facilitating the baseline study
d. identification of farmer groups and location for installation of machinery
e. training of technical staff
f. monitoring the quality of production – liquoring and quality evaluation
g. supervising the ownership/lease-hire agreements for the machinery
h. procuring goods, works and services according to CFC procedures
i. running the project within budget

j. calling meetings of the National Project Steering Committee (NPSC),
k. preparation of regular technical and financial reports to the NPSC and PEA
l. facilitating loan processes,
m. organizing and holding meetings and national workshops,
n. promoting project coffee and carrying out market linkage,
o. facilitating experience sharing among farmers and extension staff,
p. Preparing and submitting timely reports.

Technical Assistance to Banks

Rabo International Advisory Services (RIAS) BV

138. RIAS was established in 1989 for the specific purpose of transferring pertinent banking know-how to financial institutions in various transition and emerging market countries throughout the world (notably in Central and Eastern Europe, Asia, Latin America and Africa). RIAS in recent years has carried out projects sponsored by all major international organisations, including the World Bank, IFC, EBRD, ADB, FAO, PSO and the EU (Tacis, Phare). RIAS' headquarters is based in the Netherlands, and additionally RIAS disposes over offices in India and Singapore.

139. RIAS has built-up a solid track-record in coffee projects in Africa (incl. for the CFC) over the last few years especially related to warehouse receipts financing and cooperatives, often in relation to the RD partner banks (e.g. NMB Tanzania). Moreover, RIAS has negotiated various Credit Guarantee Schemes for the RD partner banks with external financing parties include the Alliance for Green Revolution in Africa (AGRA).

140. As a subsidiary of Rabobank, RIAS has at its disposal all expertise and knowledge available within the group. RIAS provides consulting services and management support covering three main areas:

- Banking
- Agriculture and food processing
- Co-operative development.

141. RIAS also has a crucial function in the capacity building of our partner banks under Rabo Development. RIAS provides senior management to the banks and organises technical assistance to develop the banks' critical functions. The Agribusiness Team of RIAS provides specific support to develop the banks' agri-finance capacity through WHR financing projects, cooperative capacity building, outgrower schemes and other supply chain projects.

Rabo International Advisory Services (RIAS) BV
Croeselaan 18
Postbus 17100
3500 HG Utrecht
Tel +31 (0)30 21630073
Fax +31 (0)30 2163677
j.j.bogaard@rn.rabobank.nl

Contact: Hans Bogaard

142. The PEA will have the overall responsibility for executing the project including overall co-ordination of implementation, planning, budgeting, accounts and procurement.

143. The project will be implemented based on annual work programme and budget consistent with the project budget approved by the Supervisory Body and the Fund. The PEA, in close collaboration with the participating agencies, will prepare a draft work programme and budget including task assignments to be undertaken by the respective collaborating agencies. This draft work programme will cover in sufficient detail, the activities to be carried out during the period by the respective agencies and the PEA. The programme will include a schedule of reporting by the collaborative agencies. This draft work programme and budget will be cleared by ICO and made available to the CFC with their comments, two months before the start of each year. The CFC will review and approve the final annual work programme and budget

H. Monitoring, Supervision and Evaluation

144. The PEA shall review with each CI at the start of the project existing knowledge as well as prepare and finalise year one work plans and budgets.

145. With the collaboration of all project participants the PEA will prepare and submit detailed work plans specifying components and activities to be carried out over the year, with a related budget, not later than two months before the start of implementation

146. The PEA will arrange for a Technical Adviser to be based in Nairobi, who will liaise with both countries on the progress of the project. The Technical Advisor will be the back-shopping officer based in CABI Africa. A Project coordinator will be located in one of the project countries and will spend part of the year in each country (Ethiopia and Rwanda).

147. The PEA will organize an inception workshop during which detailed workplans for the first year will be agreed upon. Subsequent workshops will be organised in each country to review the project during the second, third and fourth year, one of which will coincide with a mid-term evaluation of the project by independent consultants

148. Each PIA will produce reports relating to project activities undertaken that will be submitted to the PEA to serve as the basis of six-monthly progress reports to be prepared by the PEA for the SB and CFC. A consolidated annual report will also be submitted to the SB and CFC within 3 months of the close of the reporting period.

149. Within three months of the conclusion of the project, the PEA will submit to the SB and CFC a project completion report along with full audited accounts.

National Project Steering Committee (NPSC)

150. In addition to the institutions within the countries participating in the project, a National Project Steering Committee (NPSC) will be formed in Ethiopia and Rwanda, with representation from the PIA, as well as the private sector, farmer associations and groups, the research organisations, and other stakeholders. The NPSC should have a maximum of 9 members.

151. The NPSC will be an Advisory Body, which will give advice to the project and assist with the promotion of the project ideas. It will assist with monitoring to ensure that the project is efficiently implemented, within the budget, and achieving the goals and objectives set out. In addition, it would be through the NPSC that other stakeholders in the industry and in the project would be informed of the progress of the project. NPSC would be a forum to discuss important issues relating to the project. The National Project-Coordinator will prepare an agenda for the meeting and prepare a report of the meetings. CFC and SB will be informed of the meetings and will be provided the agenda for such meetings three weeks in advance. CFC and SB will be invited at attend the meetings. No sitting fee or allowance would be admissible for attending such meetings.

Activities

152. A NPSC would be established in each country for purposes of supervising the project. The NPSC would meet to launch the project, then have one annual meeting with all the national stakeholders in the project, as well as other meetings during the year to review progress on the project and report to the PEA on progress.

I. Project Risks

153. Apart from unforeseen natural disasters, social and political instability, there are no major risks anticipated in the implementation of the project. The main risk comes from the unpredictability of the coffee prices. If coffee is not profitable farmers will move out of coffee production despite the investments. It is assumed that current good coffee prices in the world coffee market will be sustained over the project period.

J. Environmental Aspects

154. As a component of sustainable production, the project will endeavour to mainstream production and processing approaches which improve or maintain the quality of the environment. It is therefore expected that the project will have a positive overall effect on the environment.

K. Intellectual Property Rights Publications

155. Technologies, processes and copyrights emanating from this project will be the intellectual property of the Common Fund for Commodities.

Annex 1.**Overall Operational plan of activities**

Activities	Year of operation			
	1	2	3	4
Component 1: Access to financial services by smallholder				
Assess the existing system used by the bank to advance and recover loans from the clients				
Identify and address challenges to existing loan disbursement and recovery system				
Support the expansion of the coffee finance portfolio under the Credit Guarantee Scheme				
Enhance farmers' capacity to sustainably access financial services both individually and as farmer groups				
Undertake capacity building training for loan officers in the banks				
Component 2: Scaling up and out improved coffee production and processing practices				
Conduct baseline surveys of coffee production and processing practices in the new areas for up-scaling				
Identify and select suitable areas and farmer groups for scaling up of the improved practices				
Purchase and install machinery, equipment and facilities for improved dry and wet processing				
Train producers, extension agents and owners/operators of the equipment on good production and processing practices and the use and maintenance of the processing equipment				
Monitor and evaluate costs and efficacy of the improved processing facilities				
Evaluate cup and green coffee quality by liquorers and exporters				
Component 3: Strengthening of Primary cooperatives and unions				
Undertake capacity building training for farmers, cooperatives and unions to effectively use the scheme				
Assessment of technical assistance & financial Needs of co-ops in Rwanda/Ethiopia				
Develop templates for good governance and design effective and efficient coffee delivery and payment system				
Component 4: Enhanced access to production and market information				
Document the information needs (type, form, frequency etc) for various players in the coffee value chain, identify key players in the generation and use of information and formulate options for addressing the needs				
Digitalise the production and marketing information available in Ethiopia and Rwanda				
Undertake capacity development on management and use of production and marketing information for both farmers and the designated custodians of the information				
Develop and implement modalities for accelerated and timely access to the market information				
Component 5: Project co-ordination, supervision and monitoring				
Undertake project coordination, monitoring and evaluation Organise				

Annex 2. - Loan Guarantee Scheme: Ethiopia and Rwanda

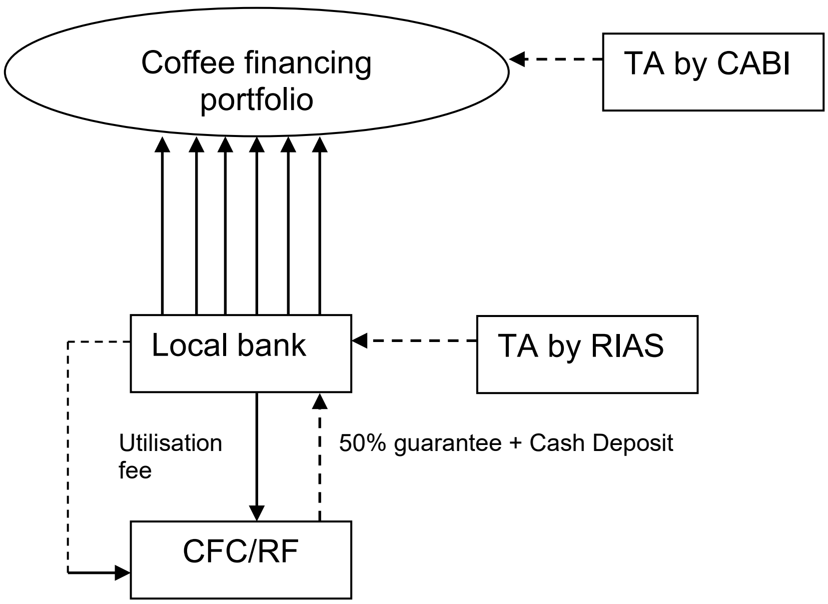
(a.) Structure of Partial Credit Guarantees Scheme for Ethiopia

157. Two levels of credit guarantee are proposed for Ethiopia and one level for Rwanda. A portfolio guarantee scheme financed mainly by the CFC is proposed as a financing mechanism for primary cooperatives in Ethiopia. In addition, an Agri-guarantee (AGF) fund is proposed as a funding mechanism for the cooperative unions in the country as well as large commercial farmers and will be funded mainly through Rabobank. Since the cooperative societies in Rwanda are smaller and not organised into unions, the relevant credit guarantee scheme for the country will be portfolio guarantee scheme financed both by the CFC and Rabobank funds.

Coffee Credit Guarantee Scheme (portfolio guarantee)

158. A Coffee Credit Guarantee Scheme (the "Scheme") is useful when providing many small loans (portfolio approach) rather than a few large loans which is the case under the AGF. When there are multiple small loans, it is not practical to obtain approval from the Guarantor for each and every loan separately but rather to agree on the borrower and loan criteria beforehand with the Guarantor. This also assumes that the Guarantor(s) (CFC & Rabobank in case of Rwanda and CFC in case of Ethiopia) should feel comfortable with the lending and recovery processes of the bank. It also requires prudent record keeping and regular reporting on the loan portfolio quality by the bank to the Guarantor(s). In principle, the financing under the guarantee scheme will follow the normal banking procedures.

Structure chart & explanation



159. The structure of the proposed Guarantee Scheme is similar for Rwanda and Ethiopia (except that Rabobank is not included as Guarantor in Ethiopia):

ix. The Guarantor signs the Risk Participation Agreement thereby transferring a FX cash deposit to the dedicated Guarantee Account with the local bank. The FX cash deposit equals the amount of the guarantee and can be utilised by the bank in case of any losses incurred by the Bank under the Scheme. In the case of Ethiopia, prior approval by the National Bank needs to be obtained by the bank to repatriate any remaining FX surplus of the cash deposit back to CFC after expiry of the Scheme.

x. The bank provides working capital and investment loans to SMEs active in coffee production and exports whereby the bank follows the normal lending procedures.

xi. All loans and borrowers should meet the eligibility criteria of the Scheme to become a qualifying loan

xii. The bank should keep records of all loans and provide an update on the loan quantity and quality of the portfolio to the Guarantor on a quarterly basis in the agreed format ("the Schedule").

xiii. The bank should pay a utilisation fee to the Guarantor equalling 2% (per annum) of the average usage of the guarantee during the last 6 months. Payment dates are 31 March and 30 September. 2% is considered as a fair premium and is also used by other guarantee schemes e.g. USAID.

xiv. In the event of a loss the bank can debit the pro-rata risk share of the Guarantor in the unpaid principal from the guarantee account to its own account including any unpaid interest due (for up to 1 year).

xv. Any recoveries from liquidation of collateral shall be divided between the bank and the Guarantor on a pro-rata basis.

xvi. Individual loan tenors can be up to 4 years with the total Guarantee Scheme expiring in 5 years.

(b.) Coffee Credit Guarantee Scheme model for Ethiopia

Eligibility Criteria

Borrower criteria:

160. Any SMEs active in coffee production, processing and trading, such as coffee farms, coffee farmer groups, associations or cooperatives, created and duly registered with any competent Registry or Authority, or in the process of being created or holding a license or any equivalent authorization, or having a private practise with the required authorizations, is eligible to become a Borrower. In addition, the following criteria currently applied by the Cooperative Bank of Oromia shall apply for cooperatives and individual farmers respectively:

Cooperatives

i. Legal Certificate.
ii. Decision of general assembly for primary societies & decision of boards for cooperative unions.
iii. Support letter from cooperative promotion office (cooperative registrar).
iv. Letter of undertaking by coffee exporter cooperative union for its member primary cooperative societies.
v. Updated/audited financial statements
vi. All other required legal documents.

Private Individuals

i. Trade & Investment license either as exporter or supplier
ii. Business plan
iii. Physical asset Collateral
iv. Updated/audited financial statements

v. Principal registration certificate etc.

Loan criteria:

Each Qualifying Loan shall meet the following criteria:

i. Its maturity date shall fall at least 120 days before the Expiry Date of the Guarantee Agreement
ii. Tenor of maximum 4 years
iii. The purpose is to finance working capital or investments in coffee processing equipment
iv. They are granted as overdrafts (working capital) or repayable loans (e.g. washing stations)
v. The relevant credit facility is not in default

(c.) Disbursement mechanism from local banks to cooperatives

161. The approved loan is sent to the concerned branch & the branch checks the conditions set before disbursement. If the loan is secured by physical collateral the offered collateral is registered before the disbursement of the loan.

162. Unions receive pre-export finance and cooperatives receive working capital to source the coffee from its members and investment finance for washing stations. Unions are not required to pledge export contracts to the bank neither are cooperatives required to pledge collateral to the bank for working capital finance. On the other hand, cooperatives do need to pledge collateral for investment finance. However, in case of agri-input financing, the banks receive a government guarantee since input finance is considered as too risky.

163. Loans can be divided in 9 month/1 year working capital loans (average WC loan of EUR 250,000) and loans for washing station investments (4-5 year with annual instalments). Equity contribution in investment loans should be 50% as a minimum.

164. Monitoring will be undertaken by the concerned branches following-up the borrowers regularly. The head office organ & Board credit review committee will be responsible for visiting key borrowers and beneficiaries of the scheme whose loans have fallen in areas. The follow-up activities will be undertaken at least quarterly for the repayment success of the clients

(d.) The loan repayment mechanism

165. The repayment schedule depends up on the analysed cash flow statements. Most of the time the scheduled repayment term is on quarterly or semi-annually or annually basis.

The local recovery mechanism (in case of default)

166. The first level recovery action involves renegotiation of the loan terms with the borrower and re-financing the borrower's business if necessary. The 2nd level action involves the issuance of warning letters and if no improvement the last option is foreclosure of the collateral / security offered.

(e.) MIS relevant to the Guarantee Schemes

167. Following documents will be key MIS tools under any Guarantee Scheme:

i. Financial statement reports of the bank
ii. Credit reports
iii. Performance reports & other relevant documents & information.

Documentary requirements necessary to operate the Guarantee Schemes

iii. The guarantee scheme agreement between the bank and the guarantor
iv. Loan contract agreement between the bank and target clients/borrowers

<u>Loan Guarantee Scheme: Rwanda</u>

(a). Coffee Credit Guarantee Scheme model for Rwanda

(b). Disbursement mechanism from local banks to cooperatives

168. Based on the information received from the client, the commercial officer determines if the cooperative is sufficiently creditworthy. This includes determining if the client does not have other loans at other (sub) branches of Banque Populaire Rwanda (BPR) and/or other banks. If the outcome is positive a credit proposal is drafted detailing the loan/credit facility and specifying the repayment plan for the loan taking into account the client's situation and the project's cash flow. The commercial officer subsequently asks for a valuation of the client's collateral. Each branch has external experts recognized by head office to make those valuations. The expert gives a valuation report to the bank which is added to the client's loan application. The commercial officer visits the site of the project to verify the information provided by the client. In case the loan requires authorization at branch or head office level, the completed credit application is sent to the credit officer at the Branch for analysis. The credit officer includes his opinion and sends the loan application form to the Risk Branch Head for review.

169. Loans are sent to the applicable credit committee, as specified in the Credit Policy. If the loan application is above branch limits, the file is sent to head office for analysis and approval from Head Office Credit Committee or Board Credit Committee (as necessary).

170. After the decision of the credit committee, the credit officer drafts the loan contract. Only in case of sub branch approval, is the contract drawn at the sub branch under responsibility of the Sub Branch Manager. In all other cases, the credit officer draws the contract.

The financing structure including security and covenants

171. For loans with a mortgage, (e.g. washing station financing) the collateral must be legalized by the public notary and registered at the applicable authority. The borrower can give as soft collateral his movable assets.

172. The commercial officer is responsible for monitoring the loan. He has to monitor:

i. The regular repayment by the client.

ii. The right use of funds disbursed. In case of embezzlement of funds, the loan is denounced and the total repayment is immediately required.
iii. The good management of collateral presented by the client to the bank.

173. In the case of coffee financing, BPR will put more emphasis on tracking the coffee flows and resulting export cash flows. In 2009, there has been at least one cooperative that diverted export proceeds through other banks than BPR. Tighter monitoring of the coffee flows by using Office de Cafés Industriels du Rwanda (OCIR CAFÉ) information has been discussed with OCIR CAFÉ and will be formalised for next season. The intention is that OCIR CAFÉ only issues the certificate of quality and quantity to clients of BPR that have given clear instruction on the export contract to pay into the BPR account (practical details to be further discussed).

(c.) The loan repayment mechanism

Working Capital

174. The repayment of working capital loans by coffee cooperatives comes straight through the export proceeds ("self liquidating loans"). The foreign buyer of the coffee pays into the account of the cooperative at BPR. The proceeds are set-off against the debt service with any surpluses transferred by BPR to the cooperative.

Investment loans

175. Investment loans are repaid in 3-4 annual instalments from the surplus cash flow of the cooperative.

The local recovery mechanism (in case of default)

176. BPR applies the client classification of the Central Bank:

- Class 1: Regular loan with less than 30 days over due
- Class 2: Overdue of 30-89 days.
- Class 3: Overdue of 90-179 days.
- Class 4: Overdue of 180-360 days.
- Class 5: Overdue of more than 360 days or the maturity date of the contract has been exceeded.

177. Normally (according the recovery policy) files are handed over to the recovery unit once they are in class 3-4 whereas class 5 is the responsibility of the legal department. The recovery unit either restructures the loan (if the business is still deemed economically viable) or starts the collateral liquidation process (if the business is not deemed economically viable any longer).

178. The BPR procedure is to send a reminder after 15 days overdue, a last warning after 30 days overdue and declare the client in default after 60 days overdue.

(d.) MIS relevant to the Guarantee Schemes

i. Qualifying Loan Schedule (Schedule 1 of the Risk Participation Agreement)
ii. Internal loan monitoring systems

Documentary requirements necessary to operate the Guarantee Schemes

i. Guarantee Agreement
ii. Loan contract

(e.) Target segment

179. Both in Ethiopia and Rwanda primary cooperatives form the main target segment since coffee production is largely organised through cooperatives in both countries and cooperatives are the main investors in washing stations. Individual farm financing is also eligible under the Scheme but in many cases these loans may be too small for the local banks and are more suitable for MFI financing. The only exception concerns the 140 commercial coffee farms in Ethiopia that have sufficient scale for commercial bank financing.

(f.) Suitable partners

180. In Ethiopia, The Cooperative Bank of Oromia appears to be the most suitable candidate for the Portfolio Guarantee Scheme due to its strong focus on primary cooperatives and its knowledge about the coffee sector. In addition, it is one of the few banks that is involved in financing of washing stations (most other Ethiopian banks only finance the coffee trade). The Cooperative Bank of Oromia is keen to work with the CFC and Rabobank under the Guarantee Scheme and was quick in responding to any questions by RIAS/CABI on its loan policies.

181. In Rwanda, the preferred partner is Banque Populaire du Rwanda. They have the strongest rural network (18 branches, 109 sub-branches and 61 outlets), 1386 staff members and about 1 million clients in rural areas.

Agri Guarantee Fund

182. The Agri-Guarantee Fund is especially helpful when local banks want to start financing an exporting Coffee Union or plantation farmer, or when they already reached the maximum single borrower limit on a Union/plantation. In the first case, the 90% cover ratio of AGF in year 1 helps in mitigating the credit risks that can be especially high in the beginning of a new relationship. In the second case, AGF can enable growth of exposure on a single Union that would not have been possible without the AGF.

183. AGF offers (1) partial credit-guarantees and (2) funded risk participation as risk-mitigating instruments in favour of local financial institutions. These instruments will enable local commercial banks to offer commercial finance at better pricing (market conform) and conditions (adequate collateral requirements) than would be possible without the risk mitigating instruments of the AGF.

184. Through the structure of the AGF, the banks are challenged to offer short term finance, backed with short term assets, for purchasing, processing and trading commodities in the international market on commercial and sustainable terms. This makes it possible for the coops / companies to better structure their funding requirements and use their fixed assets as security for their long term financial needs.

185. Key is the phasing-in phasing-out principle. The partial credit guarantees or funded risk participations will be decreased year-on-year, and the local bank is expected to increase its share in the risk in a period of approx. 3 to 4 years. The local bank will build-up a track

record with a client whereby after 3 to 4 years, full risk will be taken by the local bank. An ideal process will be as follows (flexible):

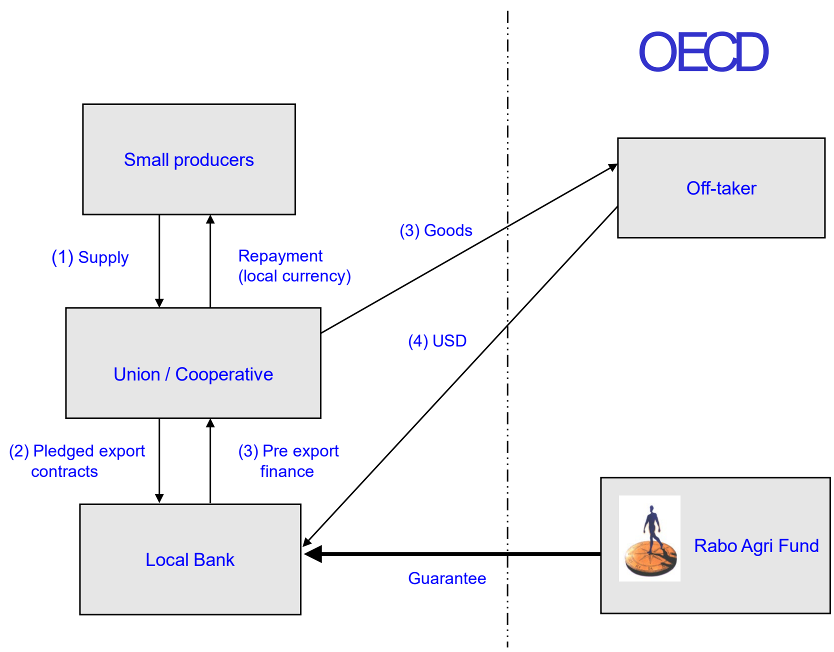
1st year: 80% risk by AGF;
2nd year: decrease to 60%;
3rd year: decrease to 40%;
4th year: full risk for local bank.

186. As indicated the Rabobank AGF offers (1) partial credit-guarantees and (2) funded risk participation as risk-mitigating instruments. For Ethiopia, option 2 will be worked-out as preferable structure. During RAIS/CABI visits and discussions with the selected local banks, the National bank, Ministry of Agriculture and Rural Development and potential clients (the coffee Unions) we reviewed all the details necessary to implement this structure. Most important conclusions are:

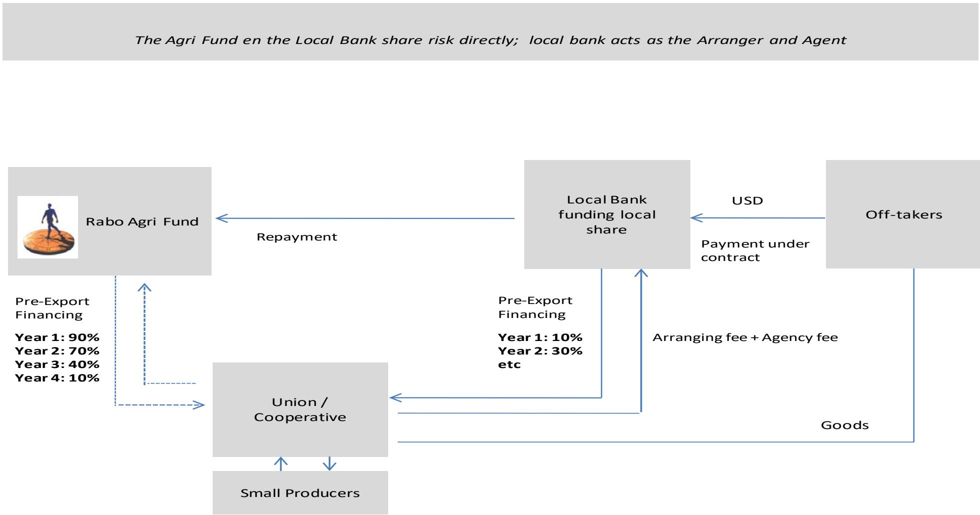
- Local regulation and local banks acceptance of sales contracts as collateral for pre-export finance (confirmed by the local banks and the National bank of Ethiopia);
- Local banks having experience with financing based on sales contracts. However not for new clients; for these clients the guarantee structure can play an important role, enabling the local banks to build-up a track record in several years;
- (USD) repayments (outside the country) can be solved by obtaining prior approval from the National Bank;
- Lack of access of finance (even with sufficient liquidity in the banks) is a major problem for the coffee Unions. Social lenders are not (as in other countries) present, mainly due to the exchange risk and the problem of getting the money out of the country.

187. We described below as well the partial credit guarantee, as it could be a scenario to elaborate in case of unforeseen issues with the Club-deal structure.

Structure chart & explanation Partial Credit Guarantees



Structure chart & explanation Agri Fund Club deal (preferred option)



Criteria

188. At the level of the small producer / social impact: Instruments of the AGF can only be used to provide financing to Cooperatives/Unions that respect enhanced social and environmental standards. At the end, the small coffee producers should benefit of the access to finance offered to their cooperative / Union.

Target segment

189. The target segment of the Rabobank AGF, exporting companies and membership based entities (cooperatives, Unions, Federations), are ‘bankable’ and creditworthy clients, with in general more than 3 years of export experience and having sustainable relationships with well-known buyers in OECD countries. The scheme’s target group for Ethiopia will be the coffee Unions, exporting directly. There are 6 big Unions. In a later phase and if enough volume, cooperatives could be direct clients of the AGF as well. We visited 3 Unions: Yirgacheffe, Sidama and Oromia. All showed interest in increased / improved access to local finance. Some of mentioned Coffee Unions already have access to local finance however with considerable limitations regarding the loan amounts and tenors of the facility, despite their total financial needs based on their coffee supply, sales projections and thus sales contracts with well-known buyers. Other Unions do not have access to local finance due to insufficient collateral requirements and lack of a credit history with a local bank.

Suitable partner

190. A suitable partner should be a local commercial bank that engages itself to pre-finance the target group on a long-term basis, approaching them as commercially interesting clients and being able to grow with their business objectives. A bank with sufficient experience in trade finance, having branches in the rural areas, understanding or willing to understand the cooperative structure. The scheme would preferably work with one single bank, selected as well for the implementation of the Coffee Finance Portfolio Guarantee scheme. This because of the added value of bank advisory / technical assistance and the complementarities of

financing the whole value (supply) chain: the Portfolio Guarantee scheme will focus on the cooperatives affiliated to the Unions. Of the 4 banks visited (Oromio Credit and Saving Share Company / United Bank / Cooperative bank of Oromia / Development Bank of Ethiopia) from the Rabobank AGF perspective, the cooperative bank of Oromia and the Development Bank of Ethiopia seems most suitable. The selected bank will be the direct client, as beneficiary of the risk-mitigating instrument and as the strategic and long-term partner of the scheme.

Rwanda

191. AGF concluded that due to the fragmentation of the sector and the lack of concentration in export flows Rwanda is not (yet) suitable for the AGF scheme. However in case in Rwanda there is additional need for pre-export financing with smaller amounts (not comparable with Ethiopia), Rabobank AGF can in future consider issuing a portfolio guarantee to BPR exclusively for offering pre-export finance (based on export contracts) to the smaller cooperatives.

192. We are seeking an assistance of US$ 8,217,309 to enable us realise the purpose stated above by catalysing wide scale adoption of enhanced processing practices by smallholder farmers in Rwanda and Ethiopia in a sustainable basis.

Annex 3: Detailed Cost Tables

Table 1: Summary Cost Table by Component (000 USD)

Sustainable Credit Guarantee Scheme to promote scaling up/out enhanced coffee processing practices in Ethiopia and Rwanda

	Project component	Total Cost	CFC Grant Contribution
1	Access to commercial loans by small-holder farmers, plantation farmers, cooperatives and unions	4,229,475	175,695
2	Scaling up and out improved coffee production and processing practices	3,029,173	551,873
3	Undertake capacity building traning for farmers and co-operatives to effectively use the scheme (CABI)	366,914	76,870
4	Enhanced access to production and market information	127,840	75,940
5	Project co-ordination, supervision and monitoring	394,092	359,892
	Total	**8,147,494**	**1,240,270**

Table 2: Summary of Financing Plan by Component and Source (000 USD)

Sustainable Credit Guarantee Scheme to promote scaling up/out enhanced coffee processing practices in Ethiopia and Rwanda

	Project component	CFC		Co-financier A (RABO)		Counterpart Contribution	Total Cost
		Grant	Loan	Grant	Loan		
1	Access to commercial loans by small-holder farmers, plantation farmers, cooperatives and unions	175,695	600,000	53,230	3,375,000	25,550	4,229,475
2	Scaling up and out improved coffee production and processing practices	551,873	1,400,000	0	875,000	202,300	3,029,173
3	Undertake capacity building traning for farmers and co-operatives to effectively use the scheme (CABI)	76,870	0	272,644	0	17,400	366,914
4	Enhanced access to production and market information	75,940	0	0	0	51,900	127,840
5	Project co-ordination, supervision and monitoring	359,892	0	0	0	34,200	394,092
	Total Financed	**1,240,270**	**2,000,000**	**325,874**	**4,250,000**	**331,350**	**8,147,494**
	% Financed	**15%**	**25%**	**4%**	**52%**	**4%**	**100%**

Table 3: Summary Project Cost by Component and Year (000 USD)

Sustainable Credit Guarantee Scheme to promote scaling up/out enhanced coffee processing practices in Ethiopia and Rwanda

	Component	PY1	PY2	PY3	PY4	PY5	Total cost
1	Access to commercial loans by small-holder farmers, plantation farmers, cooperatives and unions	1,117,978	1,084,607	1,013,445	1,013,445	0	4,229,475
2	Scaling up and out improved coffee production and processing practices	858,212	730,776	721,659	718,526	0	3,029,173
3	Strengthening of primary co-operatives and unions	253,922	45,357	35,318	32,318	0	366,914
4	Enhanced access to production and market information	53,370	22,690	22,690	22,690	6,400	127,840
5	Project co-ordination, supervision and monitoring	86,429	86,429	116,429	81,804	22,999	394,092
	Total	**2,369,912**	**1,969,859**	**1,909,541**	**1,868,783**	**29,399**	**8,147,494**

Table 4: Summary Project Cost by Category of Expenditure (000 USD)

Sustainable Credit Guarantee Scheme to promote scaling up/out enhanced coffee processing practices in Ethiopia and Rwanda

	Category	Total Cost	CFC Grant Contribution
I	Vehicles, Machinery and Equipment	2,335,000	60,000
II	Civil Works	0	0
III	Materials and Supplies	91,000	60,600
IV	Personnel	383,763	266,063
V	Technical Assisatance and Consultancy	376,739	174,095
VI	Duty Travel	93,885	78,405
VII	Dissemination and Training	685,235	394,235
VIII	Operational Costs	4,126,872	151,872
	Sub-total	8,092,494	1,185,270
IX	Supervision, Monitoring and Evaluation	55,000	55,000
	Grand total	**8,147,494**	**1,240,270**

Table 5: Summary Project Cost by Country and Year (000 USD)

Sustainable Credit Guarantee Scheme to promote scaling up/out enhanced coffee processing practices in Ethiopia and Rwanda

	Country	PY1	PY2	PY3	PY4	PY5	Total cost
1	Ethiopia	1,347,568	1,296,634	1,292,501	1,290,934	3,200	5,230,838
2	Rwanda	530,301	478,448	475,335	473,768	3,200	1,961,053
3	PEA (CABI) & RIAS	492,043	194,777	141,705	104,080	22,999	955,604
	Total	**2,369,912**	**1,969,859**	**1,909,541**	**1,868,783**	**29,399**	**8,147,494**

Table 6: Detailed Cost Table by Category and Item of Expenditure (000 USD)

Sustainable Credit Guarantee Scheme to promote scaling up/out enhanced coffee processing practices in Ethiopia and Rwanda

	1		2	3	4	5	6	7	8	9	10	11	12
	Category of Expenditure		**Sub-category of Expenditure**	**USD PY1**	**USD PY2**	**USD PY3**	**USD PY4**	**USD PY5**	**Total Cost**	**CFC**		**Financier A**	
										Grant	**Loan**	**Grant**	**Loan**
I	Vehicles, Machinery and Equipment	I.1	Vehicles & Machinery	568,750	568,750	568,750	568,750	0	2,275,000	0	1,400,000	0	875,000
		I.2	Equipment	60,000	0	0	0	0	60,000	60,000	0	0	0
				628,750	**568,750**	**568,750**	**568,750**	**0**	**2,335,000**	**60,000**	**1,400,000**	**0**	**875,000**
II	Civil Works												
				0	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
III	Materials and Supplies	III.3	Materials and Supplies	32,242	21,408	18,475	16,975	1,900	91,000	60,600	0	8,050	0
				32,242	**21,408**	**18,475**	**16,975**	**1,900**	**91,000**	**60,600**	**0**	**8,050**	**0**
IV	Personnel	IV.1	Local staff	142,082	82,585	79,548	79,548	0	383,763	266,063	0	45,700	0
				142,082	**82,585**	**79,548**	**79,548**	**0**	**383,763**	**266,063**	**0**	**45,700**	**0**
V	Technical Assistance and Consultancy	V.1	International TA Time	212,974	41,426	0	0	0	254,400	109,200	0	145,200	0
		V.2	Local TA Consultancy	32,394	10,206	0	0	0	42,600	20,400	0	22,200	0
		V.3	International Travel and DSA	60,571	19,168	0	0	0	79,739	44,495	0	35,244	0
				305,938	**70,801**	**0**	**0**	**0**	**376,739**	**174,095**	**0**	**202,644**	**0**
VI	Duty Travel	VI.1	International travel costs	18,031	7,091	7,091	7,091	0	39,305	33,825	0	5,480	0

		VI.2	Local travel costs	9,858	8,692	7,125	7,125	0	32,800	22,800	0	8,500	0
		VI.3	DSA	7,920	5,940	3,960	3,960	0	21,780	21,780	0	0	0
				35,810	**21,723**	**18,176**	**18,176**	**0**	**93,885**	**78,405**	**0**	**13,980**	**0**
VII	Dissemination and Training	VII.1	Workshop	60,299	49,801	39,800	35,000	0	184,900	59,400	0	55,500	0
		VII.2	Training	105,334	105,334	105,334	105,334	0	421,335	293,335	0	0	0
		VII.3	Other	26,083	16,083	16,083	14,750	6,000	79,000	41,500	0	0	0
				191,716	**171,218**	**161,217**	**155,084**	**6,000**	**685,235**	**394,235**	**0**	**55,500**	**0**
VIII	Operational Costs	VIII.1	Other (Development & Commercialization)	993,750	993,750	993,750	993,750	0	3,975,000	0	600,000	0	3,375,000
		VIII.2	Audits	15,000	15,000	15,000	15,000	0	60,000	60,000	0	0	0
		VIII.3	Overheads	18,374	18,374	18,374	18,374	18,374	91,872	91,872	0	0	0
				1,027,124	**1,027,124**	**1,027,124**	**1,027,124**	**18,374**	**4,126,872**	**151,872**	**600,000**	**0**	**3,375,000**
	Total PEA budget			**2,363,662**	**1,963,609**	**1,873,291**	**1,865,658**	**26,274**	**8,092,494**	**1,185,270**	**2,000,000**	**325,874**	**4,250,000**
IX	Supervision, Monitoring and Evaluation	IX.1	CFC/ICO monitoring & Supervision	6,250	6,250	6,250	3,125	3,125	25,000	25,000	0	0	0
		IX.2	Mid term review	0	0	30,000	0	0	30,000	30,000	0	0	0
				6,250	**6,250**	**36,250**	**3,125**	**3,125**	**55,000**	**55,000**	**0**	**0**	**0**
X	Contingencies		Contingencies - 5%										
	TOTAL BUDGET			**2,369,912**	**1,969,859**	**1,909,541**	**1,868,783**	**29,399**	**8,147,494**	**1,240,270**	**2,000,000**	**325,874**	**4,250,000**