European Fund for Sustainable Development (EFSD) Guarantee

Title: Investment Window - Sustainable Agriculture, Rural Entrepreneurs and Agribusiness

1. Policy Rationale

Background analysis: Potential Investment Windows in this area will contribute to achieving the United Nations Sustainable Development Goal #1 on ''Ending poverty in all its forms'', Goal #2 on ''Ending hunger, achieving food security and improved nutrition and promoting sustainable agriculture'', as well as Goal #12 on ''Responsible consumption and production'', Goal #13 on ''Taking urgent action to combat climate change and its impacts'' and Goal #15 on ''Terrestrial ecosystems''. This window will target sectors such as agriculture, forestry and other land use enhancing food security and sustainable development while addressing climate risks and helping countries deliver on their commitments to implement the Paris Agreement on climate change.

Agriculture provides the main source of income for around half a billion smallholders in the world today. An estimated 25 % of the global population (1.6 billion people) depends on forests for their subsistence, livelihood, employment and income. Agriculture is a major sector in the economic fabric of all EU Eastern Neighbourhood countries as it employs a large part of their population. Many of the countries of that region have large rural populations relying to some extent on small and fragmented land plots and the use of communal or state-owned pasturelands for their livelihoods. Major challenges relate to land and soil degradation, water scarcity, erosion of genetic resources, harvest and postharvest losses and inefficient farm management. In the Neighbourhood South, the economic importance of the agricultural sector varies considerably among the different countries: it represents between 2 % and 4 % of the gross value added of Israel, Jordan and Lebanon respectively but a little over 15 % in Morocco and 20 % in Syria. Nevertheless, there was a broad decline in the economic importance of agriculture in the region in recent years[1].

In Africa, agricultural production has increased steadily over the last 30 years. However, there has been very little improvement in production factors (including labour and land tenure). Agricultural growth in Africa is generally achieved by cultivating more land and by mobilising a larger agricultural labour force, which produces very little improvement in yields. More so than in other continents, Africa is dominated by family farming, 33 million farms of less than 2 hectares, account for 80% of all farms[2].

[1] Eurostat: http://ec.europa.eu/eurostat/statistics-explained/index.php/Agriculture_statistics_North_Africa_and_Eastern_Mediterranean.
[2] NEPAD, Agriculture in Africa, transformation and outlook, 2013.

Agriculture contributes one-quarter to one-third of African gross domestic product (GDP) but employs 65-75% of the labour force. It is the main source of income for some 90% of the African rural population. Agriculture can absorb large numbers of new job seekers; the opportunity is real but still unrecognised or inaccessible to most young people. In order to make the sector attractive for young people, there is a need to promote responsible investments in a higher-value agriculture that will use services more intensively, creating job opportunities (demand for transport and logistics, plant protection, veterinary services, machinery, technical advice, etc.). Access to capital and skills will be critical to accelerate job creation in agribusiness.

In this context, EU cooperation and trade policies have already been supporting agriculture in a way that reinforces the justification for this investment window. Efforts include also building trading and export capacity, support compliance with sanitary and phytosanitary measures (SPS) and certification requirements, Deep and Comprehensive Free Trade Areas (DCFTA) and improve agribusiness's ability to take advantage of preferential trade arrangements.

The agriculture sector is highly vulnerable to climate change and is coming under pressure from growing water scarcity, poor natural resource management, soil degradation, deforestation, desertification and other climate change related impacts that can affect production. Particular attention should be paid to deforestation and other land use change with an overall concern to ensure sustainability. These pressures imply that agricultural production will increasingly need to adopt sustainable and climate-smart and circular production methods which make more efficient use of resources, reduce greenhouse gases emissions and preserve soils and ecosystems. Agriculture is not only affected by climate change but has a significant effect on it, as globally agriculture, land-use change and forestry are responsible for 19-29% of greenhouse gases emissions. Forests can have a central role in climate change mitigation and adaptation. Thus investment seeking to increase production will need to reflect these concerns by focussing on sustainable climate-smart production systems and methods as drivers of growth in the agriculture sector in parallel with improved productivity of production factors. Investments should also follow recognised guidelines on responsible investment practices.

Resilience to climate change and adverse weather events also needs to be enhanced both at the enterprise and country level.

While investment in agriculture in countries in Africa and in the Neighbourhood regions is slightly increasing, initiatives to support the investment capacity of small producers and rural MSMEs remain largely insufficient. This is not only due to the inherent high risk in agricultural production (climate change, environmental conditions, quantity and quality of produce, prices), but also to higher risks associated with small producers (limited technological and innovative capacities, market inefficiencies and disruptions, limited access to financial services and markets, etc.), as well as the high cost of doing business in small rural markets. Traditional banks and financial institutions also have less experience in providing financial services in this sector and often lack the appropriate tools to assess smallholders' creditworthiness. Across both regions, liquidity for working capital purposes and long-term capital expenditure financing is lacking as a result of the absence of suitable policy frameworks and financing instruments. Capital access has proven a persistent challenge over the years – lending to the 33 million smallholder farms in Sub-Saharan Africa, amounts to $700 million per year, thus around $21 per farm. Of this $600 million is provided by microfinance institutions and only $100 million by State Banks[3]. Less than a quarter of the financing needs of smallholder farmers in developing countries are met, leaving an annual financing gap of more than US$150 billion (according to the Initiative for Smallholder Finance[4]). It is indicative that only 4% of equity investments in Africa between 2011 and 2016 were in the food and agriculture sector[5].

Investment windows developed in this area will respond to the lack of financing mechanisms adapted to farmers and agri-entrepreneurs, particularly for smallholders, cooperatives and agricultural MSMEs, in the aim of fostering a transformative shift towards a competitive low-carbon and climate-resilient green economy, in line with the Paris Agreement. The potential windows may also explore mechanisms to increase the availability and affordability of insurance solutions for farmers as well as mechanisms to enhance food security at country level.

EU Policy objectives: In line with EU policy commitments concerning food security challenges[6], resilience[7], nutrition[8] and sustainable agriculture and food security[9], environment and climate change[10] and gender equality[11], support under this window will promote the emergence of investments designed to create decent jobs in agriculture and income-generating activities in rural and peri-urban areas, and addressing relevant risks in order to ease and extend access to capital and increase investments (including climate friendly investments that would generate a measurable, beneficial social and/or environmental impact), and respect fiscal standards.

A value chains approach will be adopted, focussed upon income-generating activities for private sector operators and job creation in rural and peri-urban areas, developing and diversifying agricultural production, and promoting the accompanying local skills. Sustainability of investments represents an integral part of the actions, and special attention will be paid to climate-smart approaches integrating the three dimensions of

[3] Initiative for Smallholder Finance: A roadmap for growth: positioning local banks for success in smallholder finance", 2013.
[4] Initiative for Smallholder Finance, RAF Learning Lab, and Dalberg, "Inflection Point: Unlocking growth in the era of farmer finance," 2016.
[5] A growth engine: Trends and outcomes of private equity in Africa, The Economist Corporate Network, 2017.
[6] COM(2010)127 final, "An EU policy framework to assist developing countries in addressing food security challenges".
[7] COM(2012)586 final, "The EU approach to Resilience: Learning from Food Security Crises".
[8] COM(2013)141 final, "Enhancing Maternal and Child Nutrition in External Assistance: an EU Policy Framework"
[9] COM(2017) New European Consensus on Development
[10] COM(2017) New European Consensus on Development; Council conclusions on climate change following the United States Administration's decision to withdraw from the Paris Agreement)June 2017). At least 20% of the EU budget will be spent on climate action by 2020.
[11] COM(2017) New European Consensus on Development

sustainable development: economic, environmental and social. This includes full respect of due diligence requirements, such as those relating to climate change, including land tenure, soil preservation and biodiversity conservation.

Geographic area: Sub-Saharan Africa and the Eastern and Southern Neighbourhood regions. The inclusion of LDCs/landlocked/fragile and conflict affected countries within proposals will be positively viewed.

Domain: All agriculture-based production in its broader meaning can be covered, notably including agriculture, livestock, forestry, fisheries, aquaculture and related agricultural MSMEs.

Sectors of intervention: The value chain forms an important element of the operations to be funded under this window. Proposals should reflect investment opportunities for the private sector arising at any point on the value chain, provided that the investment promotes sustainable, low-carbon, climate-resilient and inclusive growth. This allows for a broad view of eligible sectors and a comprehensive approach to eligible activities, including production, post-harvest, agri-food processing and marketing, as well as trade facilitation and promotion, with links to smallholders and agricultural MSMEs. Cooperative sector development and domestic-oriented production agriculture will also be supported. Financial instruments proposed should go clearly beyond partner financial institutions traditional product ranges, including potentially insurance solutions.

2. Operational Concept

The EFSD guarantee shall be structured in such a way as to promote innovative financing solutions promoting private funding sources, in order to ensure sustainable production, climate resilience and increased food security across Sub-Saharan Africa and the Neighbourhood regions.

The guarantee seeks to bring in private and cooperative sector investment with both its skills and funds. The level of coverage provided to individual operations could be differentiated to reflect a focus on the disadvantaged, the young and women, or certain geographic areas which are considered more difficult to service.

Type of operations: The EFSD Guarantee may be used to cover the risks for loans, guarantees, counter-guaranties, capital market instruments, and any other form of funding or credit enhancement, insurance, and equity or quasi-equity participations. Different types of eligible operations may be considered, including but not limited to:

- Credit enhancement for investment funds attracting private institutional investors into developing country investments in climate-smart sustainable agricultural value chains as well as support to cooperatives, including forestry and agroforestry.
- Risk mitigation mechanisms for commercial banks and non-banking financial institutions for medium-long term lending towards investments in agricultural (including forestry) value chains.

- Financial guarantees to cover part of the portfolio risk of an investor or group of investors promoting comprehensive value chain investments, combining TA for skill development and financing mechanisms.
- Guarantees to mitigate risk attached to launching new financial tools for sustainable agricultural (including forestry) investment promotion.
- Guarantees to mitigate risk attached to development of insurance mechanisms to enhance resilience of farmers against climate risks.

The operations listed above are indicative and non-prescriptive/exhaustive. Priority will be given to innovative initiatives and climate-smart-entrepreneurship clearly going beyond existing products available in the market and optimising leverage and cost efficiency, mobilising private funding sources and in countries/regions where private sector participation is low. Cooperative sector development will also be encouraged to help small holders or landless farmer mutualise risks. One of the conditions of the support should be the respect of principles in line with responsible agricultural investments principles agreed by the Committee on word food security (RAI principles of the CFS).

Measures for aligning the interests of the different stakeholders - including fund managers and investors - should be considered in line with relevant market practice. Such measures shall be transparent and will take into account the policy and financial objectives of the relevant instrument.

Proposals under this window should consider a fair repartition of costs, risks and benefits between the various parties associated in the operation and demonstrate the catalytic effect of the EU financial support, allowing for replication and scaling up of the operation.

Type of risks: Risks to be mitigated may include: i) Commercial risks (payment risk, off-taker payment no honoured, off-take bankruptcy, etc.), ii) Political and country risk (expropriation, coup d'état, civil war, etc.), iii) Legal and regulatory risk (change in law, cancellation of license, tariff adjustments, etc.), iv) Currency risks (e.g. exchange rate fluctuation, convertibility, transferability, etc.), v) Climate change and environmental risks (e.g. droughts, flooding, extreme weather events, temperature rises, etc.) and vi) Disease and pests; sanitary and phytosanitary risks.

Expected Additionality*:* i) Improved potential to mobilise both local and international private sector investments; ii) Catalysing and demonstrating the effect of sector reforms; iii) Improved project sustainability via project structures designed to facilitate the commercial scale up and replication of financially sustainable projects; iv) Innovation through the demonstration of the viability of new climate-smart and environmentally sustainable business models, practices/techniques or technologies, lowering market barriers and changing entrenched behaviours; v) Decent job creation with the promotion of good labour standards, gender equality and improved working conditions in the sector; vi) new linkages between small farmers and the market; and vii) sound due diligence procedures promoted.

Envisaged Impact: i) Increased agricultural yields, output and income; ii) Increased and better distributed added value in national, regional and global value chains; iii) Low-carbon and climate-resilient inclusive growth and decent job creation; iv) Gender Equality v) Improved sustainable agricultural practices (reduced greenhouse gases emissions and local pollution, natural resources management, climate adaptation measures including improved land and water use, management and conservation) helping countries to achieve their international climate change pledges; vi) Increased agri-entrepreneurship; and vii) Improved food security. A results framework will be developed to monitor the impacts achieved.

When relevant, indicators as approved in the context of EUBEC Platform and included in the list in Annex 2 will apply; additional indicators will be agreed at the level of specific proposals. Disaggregation by gender (when applicable and feasible) shall be pursued.

Complementarity/Risk of potential overlapping with other Investment Windows: This window is closely linked to the window addressing ''MSME Financing'', which can equally address some activities relating to agricultural value chains, as well as ''Digital for Development''. Outreach to these windows will be ensured.

Private Sector Involvement: at least 60% of final investment volumes, on a portfolio (PIP) basis, are expected to be financed by the private sector (including commercial banks).

3. Supporting policy actions

Links should be established to adequately coordinate between the investment pillar (pillar 1) and enabling policies (pillar 3) to foster a conducive business environment and investment climate as well as technical assistance (pillar 2).

The most relevant policy actions may include:

- A wider framework conducive to private sector investment, including both regulatory aspects in order to facilitate private investment, as well public investment policies, such as for improved market access and skills development.
- Implementation of a robust framework for analysing and monitoring value chains (Value Chain Analysis for Development), established by the Commission and implemented through a network of European knowledge centres and universities. In that framework a more complete set of performance indicators will be available informing the 3 pillars / priorities of sustainable development:
  - Economic Pillar: Financial Accounts Global Operating Account, Value Added Generated, Income Distribution, Nominal Protection Coefficient, Domestic Resource Cost…
  - Environmental Pillar: Climate change, (adaptation and mitigation), Climate Resilience, Ecotoxicity, Toxicity, Eutrophication, Acidification, Fresh Water

Deprivation (based on Life Cycle Assessment Method which aims at quantifying effects on Human Health, Resources Use and Ecosystems Quality including biodiversity) effective Prevention of Desertification and Land Degradation and large-scale Land Use Change.

  – Social pillar: Working Conditions, Land and Water Rights, Gender, Food and Nutrition Security, Social Capital and Access to Basic Services / Infrastructure.

- Technical capacity building may be included at the proposal stage, reflecting the main risks to the success of the investment.
- Addressing synergies and inter-linkages between climate change, agriculture (including forestry and land-use) and food security, including the implementation of the National Determined Contributions (NDCs) in line with the National Development Plans and the SDGs.
- Technical assistance to support the integration of climate change (adaptation and mitigation) and environment in agricultural, forestry and land use policies.
- Working towards progressive alignment of the agricultural and forestry products standards with the EU quality, technical, sanitary and phytosanitary standards, market demand (voluntary carbon markets, Sustainable Forest Management certification, fair-trade, organic etc.), as well as with climate-smart and environmental protection measures, thereby benefiting local customers and boosting exports to the EU and beyond.

ANNEXE 1: Examples

Structured Fund in Agriculture

The AATIF has been founded in 2011 as a public-private partnership dedicated to uplift Africa's agricultural potential for the benefit of the poor. To reach this goal, AATIF is providing dedicated financing in form of loans and guarantees, either directly to companies along agricultural value chains, or indirectly via the financial sector. As a regional Fund, AATIF can be active in all Sub-Saharan countries in Africa. AATIF is managed by a dedicated team within Deutsche Bank AG. The Fund has received junior equity (first loss tranche) from BMZ (via KfW) in the amount of € 49.7 million and from the Common Fund for Commodities (USD 2 million). This junior tranche provides a risk cushion for more risk-averse investors since losses are written off against this tranche until, theoretically, these shares are depleted. With these contributions it was possible to attract additional capital from DFIs and private investors: KfW and Deutsche Bank have both contributed EUR 20 million to the mezzanine tranche of the fund, while the Austrian Development Bank has signed a Commitment Agreement for the amount of USD 25 million in the mezzanine and senior tranche. Private investors (family offices, foundations, pension funds) have moreover contributed to the senior tranche with USD 28 million.

In addition, the Board of the CDI Blending Framework has approved a EU financial contribution of EUR 30 million that will allow the fund to grow further and leverage additional EUR 60 million to the mezzanine and senior tranches.

The Fund will provide financings to cooperatives as well as to small and 40 medium-size enterprises - either directly or indirectly through local banks and established private-sector enterprises, which represent an important link in Africa's agricultural value chain, improving food security and providing additional employment and income to farmers, entrepreneurs and labourers.

ANNEX 2: Indicators

OUTPUT INDICATORS	UNIT	DEFINITION
Agricultural production	Tons per yr	For the main productions impacted by the project, measured yearly
Area under cultivation	Ha per yr	For the main productions impacted by the project, measured yearly
Due diligence report of projects that affect land and property rights	Yes/No	Based on the guidelines developed by the Agence Française de Développement (AFD) and in line with the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (VGGT)
OUTCOME INDICATORS	**UNIT**	**DEFINITION**
Additional added value created	Euros (constant value) per yr	For the main productions impacted by the project, measured yearly
Added value going to farmers	Euros (constant value) per yr	For the main productions impacted by the project, measured yearly
Net employment creation (gender differentiated)	Nr. per yr	Informal and formal jobs, measured yearly
Minimum Dietary Diversity Score	Score	Minimum number of food groups consumed by an individual over a reference period. Ref.: FAO Manual Minimum Dietary Diversity in Women (in preparation).

CROSS SECTOR INDICATORS (Application subject to current practices and methodologies by Financial Institutions)		
INDICATORS	**UNIT**	**DEFINITION**
Jobs sustained / created	Number (FTE)	Jobs sustained / created as a result of the project (methodology used to be made transparent)
Total number of beneficiaries	Nr.	estimated number of people with improved access to services (financial services, social and economic infrastructure, etc.)
Number of beneficiaries living below the poverty line (whose living conditions are improved by the project)	Number (and/or %)	sub-group of the above (if applicable), (to be made transparent which reference point has been used, e.g. national or international definitions of poverty)
Variation CO_2 / Greenhouse gases	CO_2 ktons equivalent / year	Amount of CO_2 / GHG emissions generated for a typical year of operation by a project compared with the baseline scenario.