BMAU BRIEFING PAPER (11/13)

THE REPUBLIC OF UGANDA

JULY, 2013

The Agriculture Credit Facility: What is constraining its effective implementation?

Overview

The Agricultural Credit Facility (ACF) was set up by Government of Uganda (GoU) in 2009 and its main objective is to commercialize agriculture through provision of medium and long term financing for projects engaged in agriculture, agro processing, modernization and mechanization.

As at 31 March 2013, a total of 169 projects had been financed accounting for Shs.102 billion contributed by both the GoU and the Participating Financial Institutions (PFIs).

The Budget Monitoring and Accountability Unit (BMAU) monitored ACF loans/investments worth UShs.29, 869,206,289 for 35 beneficiaries. Of these, 80% of the farmers mentioned challenges related to terms and conditions of the fund to have limited access and usability of loans received.

This brief highlights the terms and conditions that have hindered effective implementation of the ACF by reviewing some of the financed projects. It also then suggests ways as to how government with other stakeholders can enhance implementation of the facility.

Key Issues

- Stringent terms and conditions limited effective implementation of the ACF loaned projects.
- The limited beneficiaries' knowledge of the terms has exacerbated the problem.
- Provision of sub standard equipment made operations very costly and repayment of loans close to impossible.

Introduction

In order to achieve the agricultural sector's mission of transforming subsistence farming to commercial agriculture, Government of Uganda among other interventions is supporting agricultural financing. It partnered with financial institutions[1] to set up the Agricultural Credit Facility.

The scheme is administered by the Bank of Uganda (BoU) and has a revolving pool of loanable funds amounting to UShs 60 billion. The GoU is contributing UShs30 billion (50% risk cover) while the PFIs cover the other UShs30 billions. The facility had had four phases namely:

- ACF I terms (FY 2009/10): 50% equal contribution to loan pool by GoU and PFIs; 10% interest rate
- ACFII terms (FY 2010/11): 33.3% contribution to loan pool by GoU and 66.7% contribution by PFIs; 12% interest rate.
- ACF III terms (FY 2011/13) 50% equal contribution to loan pool by GoU and PFIs; 10% interest rate.
- ACF IV; commenced March 2013 to date. 50% equal contribution to loan pool by GoU and PFIs; 12% interest rate

1 Uganda Development Bank Ltd (UDBL), Micro Deposit Taking Institutions (MDIs) and other Credit Institutions

Terms and conditions of the loan phases include;

Terms and conditions of the ACF

Loan amount: The maximum loan amount to a single borrower was up to UShs2.1billion. This amount can be increased up to Ushs 5billion on a case by case basis (for eligible projects that add significant value to the agriculture sector and the economy).

Loan Term: The maximum loan period should not exceed 8 years and the minimum should be 6 months.

Grace Period: The grace period is up to a maximum of 3 years.

Interest Rate The interest rate to the final borrower is up to a maximum of 10% per annum. This was revised up to 12% in 2010. The 50% GoU contribution is disbursed to the PFIs at zero interest (interest free).

Facility fees: Facility fees charged by PFIs to eligible borrowers should not exceed 0.5% of the total loan amount. Legal documentation and registration costs are borne by the borrower.

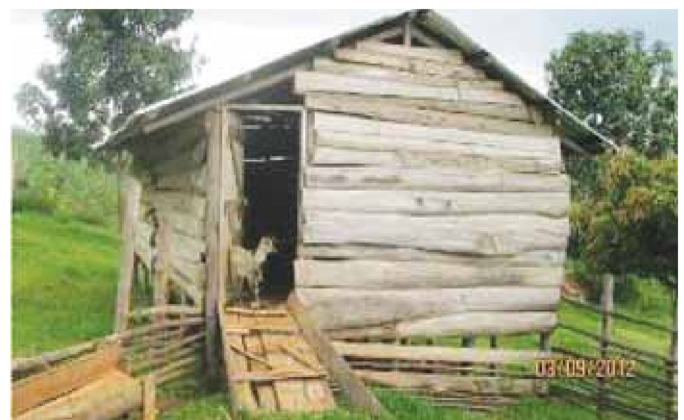
Terms and Conditions constraining implementation of the Agriculture Credit Facility

High interest rates: Under the ACF phase 1, interest rate to the final borrower was up to a maximum of 10%. On consultations with PFIs in 2012, the rate was revised to 12% in 2013. PFIs argued that the costs associated with the loan appraisal, recovery and monitoring were high and not commensurate with loan pricing. Farmers visited under ACF 1 and II noted that 10% interest was very high in fact, Pearl Mixed Farm, in Kashagama village; Kashagama sub county of Lyantonde district, and Formula feeds in Wakiso district intended to liquidate some of the farm assets to repay the loans in time.

Changes in interest rates not only made it difficult for existing farmers to apply for top up loans to revamp their investments, but also discouraged potential ACF loan applicants. Offering loans at high interest rates mean that borrowers who do not manage to earn at least a 12% rate of return could actually end up poorer or lose their investments.

Limited or no grace period on interest payment; Individual ranchers in Mbirizi village, Lwengo district were given UShs.256million to construct a water distribution and storage system. There were not granted grace period yet the loan was to be invested in a long term venture that would not yield immediate returns to facilitate payment in the short run. The bank started deducting interest from their account before the first transaction was made.

Facility fees; some PFIs took advantage of the beneficiaries' ignorance and charge facility fees higher than the recommended 0.5%. For example, a female beneficiary in Bulambe village, Bushenyi district applied for a loan of UShs.100 million to expand her farm by purchasing land, 200 goats, 100 cows, poultry and piggery and improving the existing banana plantation. She received only UShs.94 million and the rest was withheld as processing, insurance cover and audit fees and therefore could not undertake the investment as planned. The business failed as shown in photo below. Nsooba Slaughterhouse Limited in Kampala spent close to Ugshs.11million to access a 1.6 billion loan.



One goat left from the stock purchased under ACF

Limited investment portfolio: The ACF caters mostly for fixed assets for value addition and agricultural machinery, with working capital not exceeding 20%. This has not only limited farmer's investments to production and input based ventures but has also hindered many from accessing the loan, forcing them to take up commercial loans that are more expensive and characterized by overwhelmingly high interest rates of up to 30%. Global traders of Nwoya district were forced to take up a commercial loan with higher interest rates to scale up production of seed oil since the ACF loan that had been acquired was limited to purchase of seed oil processing machinery.

Collateral or loan securities: Farmers are required to present collateral that is almost equivalent to the loan applied for. Many farmers don't have sufficient collateral and therefore continue to receive limited or no funds to undertake substantial investments. The problem is compounded by unclear land tenure systems, gender issues regarding access and ownership of resources like land. Global traders in Nwoya district received a loan less by UShs.92 million due to lack of viable collateral.

Issuance of loans in Uganda Shillings leading to exchange losses; Loans are issued in Uganda shillings notwithstanding the fact that some transactions are made in foreign currency leading to incredible losses. Buhweju Tea Factory registered a loss of USD 500,000 on importation of machinery while Savannah commodities in Kampala lost USD 300,000 in exchange losses. The latter applied for UShs.2.1 billion loan at an exchange rate of UShs.2100. The loan was received more than a year later when the dollar had shot up to UShs.2900. No adjustments were made to minimize these losses hence affecting cash flows of both entities. Management at Savannah Commodities was devastated by the loss.

Formula Feeds Limited in Wakiso district had received a loan worth UShs.2, 831,040,000 to purchase a state of the art automated feed mill to step up manufacturing capacity to 240tonnes per day. This investment suffered enormous exchange losses pushing them out of business. By September 2012 management was considering abandoning the business and selling the feed mill to avoid further losses on the loan.

Other factor constraining the ACF implementation

Provision of substandard equipment: Some tractors given to farmers were noted to be of poor quality with frequent mechanical breakdowns and high operational costs. For example Masindi Cooperative Farming Society pays UShs.800, 000 on monthly tractor repairs.

Tractor received by Masindi Cooperative under the ACF

Conclusions

The ACF was a good strategy for agricultural financing in Uganda and close to 169 farmers with 212 projects across the country have benefited from this initiative, however, it is doesn't cover things like research, it is limited to only 20% of agricultural inputs of the total project cost, yet there very crucial in the agricultural production value chain.

The facility has also been blamed for credit market distortion by financial institutions leading to further tightening of its terms and conditions for example; interest rates have been reviewed from 10% in 2012 to 12% in 2013. Government needs to put measures in place to relax the facility terms and conditions to foster accessibility and enhance effective implementation of loaned investments.

Recommendations to effective implementation of the ACF

- Bank of Uganda through commercial banks should consider undertaking *financial futures contracts* with agricultural machinery suppliers to avoid future exchange losses. This means a standardized contract is reached and signed between two parties to buy or sell specified assets of standardized quantity and quality at a fixed price.

- Government of Uganda should consider transforming all the various agricultural financing initiatives including the ACF into a rural or agricultural development bank with favourable loan terms and conditions. This Rural or agricultural development bank should provide different products for different farmer groups at different levels covering the entire agricultural value chain.

- Bank on Uganda together with Commercial banks should critically assess the foreign exchange market, forecast, and guide farmers to make appropriate decisions. Loans should also be issued in a currency for which transactions are to be made.

- The facility should institute effective monitoring mechanisms to curb provision of sub standard equipment to the farmers.

References:

Agriculture Credit Facility Progress Report

Q3 FY 2012/13

http://www.bou.or.ug

Budget Monitoring Report for Q4 FY

2011/12

Budget Monitoring Report for Q2 FY

2011/12

Budget Monitoring and Accountability Unit (BMAU)
Ministry of Finance, Planning and Economic Development
P.O. Box 8147 Kampala
Telephone: 0414 707202
www.finance.go.ug