



Report and Recommendation of the President to the Board of Directors

Project Number: 47305-004
Loan Number: 3471-UZB
May 2018

Proposed Loan for Additional Financing Republic of Uzbekistan: Horticulture Value Chain Development Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 12 April 2018)

Currency unit	–	sum (SUM)
SUM1.00	=	\$0.00012
\$1.00	=	SUM8,109.81

ABBREVIATIONS

ADB	–	Asian Development Bank
CBU	–	Central Bank of Uzbekistan
ESMS	–	environmental and social management system
GDP	–	gross domestic product
ha	–	hectare
m ³	–	cubic meter
PAM	–	project administration manual
PFI	–	participating financial institution
RRA	–	Rural Restructuring Agency

NOTE

In this report, “\$” refers to United States dollars.

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 47305-004	
Project Name	Horticulture Value Chain Development Project (Additional Financing)	Department /Division	CWRD/CWER
Country	Uzbekistan	Executing Agency	Rural Restructuring Agency
Borrower	Ministry of Finance		
2. Sector		ADB Financing (\$ million)	
✓ Finance	Small and medium enterprise finance and leasing		130.00
Agriculture, natural resources and rural development	Agricultural policy, institutional and capacity development		2.00
	Agro-industry, marketing, and trade		48.00
	Land-based natural resources management		18.00
		Total	198.00
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Adaptation (\$ million)	50.00
Environmentally sustainable growth (ESG)	Eco-efficiency Global and regional transboundary environmental concerns Natural resources conservation	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Client relations, network, and partnership development to partnership driver of change	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Knowledge sharing activities Pilot-testing innovation and learning		
Partnerships (PAR)	Implementation Private Sector		
Private sector development (PSD)	Promotion of private sector investment		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	Yes	Rural	High
Household Targeting	No	Urban	Low
SDG Targeting	Yes		
SDG Goals	SDG5, SDG8, SDG9		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: FI Involuntary Resettlement: FI-C Indigenous Peoples: FI-C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		198.00	
Sovereign Development financing institution (DFI) (Concessional Loan): Ordinary capital resources		198.00	
Cofinancing		0.00	
None		0.00	
Counterpart		128.00	
Beneficiaries		60.00	
Government		68.00	
Total		326.00	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Republic of Uzbekistan for the additional financing of the Horticulture Value Chain Development Project.¹

2. The proposed additional financing will help the Government of Uzbekistan to scale up the existing project's support to horticulture value chain development in all 12 regions nationwide and in the Republic of Karakalpakstan. It will increase the outreach of participating financial institutions (PFIs) and improve access to market-based bank finance for horticulture enterprises (farmers, agro-processing enterprises, owners and operators of cold storage facilities, and trading and logistics service suppliers). These will include both additional enterprises not financed under the existing project and enterprises already financed under the existing project to enable them to expand operations. The additional financing will enhance the impact of the existing project and further increase farm productivity, improve processing and storage capacity, and reduce post-harvest losses through upgrading and establishing intensive orchards; modern and efficient greenhouses; and processing, storage, and refrigeration facilities. This will, in turn, promote long-term economic and environmental sustainability, and enhance profitability for farmers and agribusiness enterprises.

II. THE PROJECT

A. Rationale

3. **Sector performance.** Uzbekistan's economy grew consistently during 2010–2016, when gross domestic product (GDP) grew at an average annual rate of 8.0%, reaching \$63.4 billion in 2016.² The economy has proved resilient to the downward pressures exerted from 2008 onwards on other economies by the global financial crisis. Despite an economic downturn in the Russian Federation (Uzbekistan's major trading partner and source of remittances), the Uzbek economy achieved GDP growth rates of 7.8% in 2016 and 5.3% in 2017. GDP growth is expected to be 7.3% in 2018.³ According to national poverty line estimates, overall poverty declined from 27.5% of the population in 2001 to 12.8% in 2016 as a result of rapid economic growth.⁴ Along with overall economic growth, agriculture GDP in Uzbekistan grew at an average annual rate of 6.7% during 2012–2016. There was however, a slowdown in 2017 when the sector grew by only 2.0%. The higher rate of growth in other sectors resulted in a decline in the agriculture sector's contribution to GDP, from 34.4% in 2000 to 19.2% in 2017. Agriculture's contribution to GDP has traditionally derived from the production of cotton and wheat, which the government has regarded as strategic crops and supported through preferential access to land, inputs, and finance. However, there has been a shift in the contribution of these crops to GDP since 2000. The share of cotton production in GDP declined from 3.6% in 2000 to 2.3% in 2016. Over the same period, the contribution of grains to GDP fell from 3.4% to 2.4%, while the combined share of fruit and vegetables increased from 5.2% to 10.6%.⁵

4. Despite its declining share of GDP, agriculture remains an important sector. In 2017, it accounted for 27% of total employment. It is also a key income source in rural areas, where 49%

¹ The design and monitoring framework is in Appendix 1.

² World Bank estimate in dollars. <http://www.worldbank.org/en/country/uzbekistan> (accessed 1 January 2018).

³ Asian Development Bank (ADB). 2017. *Asian Development Outlook 2017*. Manila.

⁴ On the basis of \$1.90 purchasing power parity criterion, an estimated 68.1% of the population was below the poverty line in 2012. ADB. 2017. *Basic 2017 Statistics*. Manila.

⁵ Government of Uzbekistan, State Committee on Statistics. 2017. *Statistical Report 2017*. Tashkent.

of the population resides, and which account for 75% of people living below the poverty line. About 4.7 million rural households operating *dehkan* (small-scale) farms derive their income from agriculture. *Dehkan* farms, which operate independently of government support, account for the production of 66% of vegetables, 76% of potatoes, 54% of fruit, and 49% of grapes on farms of 0.35–0.50 hectares (ha).

5. The shift in production from cotton and wheat to horticulture is also reflected in exports. Agricultural exports grew at an annual average rate (in current dollar terms) of 12.5% during 2000–2013, while cotton exports grew by an annual rate of only 2.0%. During 2010–2017, cotton exports declined from \$1.5 billion to \$477.1 million, while the share of cotton exports in total exports fell from 27.5% in 2000 to 3.4% in 2017. By comparison, the share of food products in exports rose from 5.00% in 2000 to 6.35% in 2017.⁶ Fruit and vegetable exports grew from \$68.7 million in 2000 to \$1.45 billion in 2016, equating to an average annual growth rate of 21%, while the share of fruit and vegetables in total exports increased from 2% to 9%. In 2016, the value of fruit and vegetable exports exceeded that of cotton exports by more than 30% (\$600 million).

6. **Binding constraints.** Although it is expected to continue to grow, the agriculture sector is characterized by low productivity and remains labor intensive. The horticulture subsector is constrained by limited access to quality land, specialized horticulture machinery, appropriate inputs, and, in particular, finance. Limited access to either equity or long-term debt financing for producers and enterprises throughout the value chain constrains development. The horticulture subsector does not receive preferential financing under government programs, as is the case for cotton and wheat production. Financial institutions have a largely negative perception of the profitability and creditworthiness of the agriculture sector, exacerbated by an undeveloped regulatory framework for the use of movable assets as loan collateral, and a lack of acceptable collateral among many small-scale producers or collateral with low realizable values among agribusiness enterprises. Further, access to information on potential borrowers is limited as the credit information system is not efficient. Financial institutions have yet to develop credit policies and loan products appropriate to the needs of horticulture producers and enterprises, including cash-flow-based loan appraisal suitable for horticulture investment and seasonality of production.

7. The high cost of funds, perceived risks, and administrative costs associated with lending to individuals and small businesses require banks to charge interest rates of 11%–25% for local currency loans and 6%–15% for foreign currency loans. Individuals and small businesses are generally required to borrow at the higher end of these ranges.⁷ Deposit mobilization is undermined by public mistrust in banks and is compounded by administrative hurdles in withdrawing cash from bank accounts. Bank loans are mainly short-term, with an average maturity of 18 months. While there is a high demand for medium- and long-term loans, banks are not able to finance due to their lack of equivalent medium- and long-term funding sources. Moreover, access to finance for private individuals and enterprises is constrained by weak rural branch networks and limited mobile banking services. Family, friends, and informal sources fund 80% of small businesses.⁸ In addition, farmers and agribusiness enterprises have poorly developed business and managerial skills and generally low financial literacy.

⁶ Ministry of Foreign Economic Relations, Investment, and Trade. <http://www.mfer.uz> (accessed 1 January 2018).

⁷ Under the existing project, PFIs receive ADB loan funds via the Ministry of Finance at 3%. To this PFIs add 2.5–3.5 percentage points based on their normal credit and risk management policies.

⁸ World Bank. 2014. *Business Environment and Enterprise Performance Survey, 2012–2014*. Washington, DC.

8. **Opportunities.** The potential of a growing and more sophisticated consumer demand for both fresh and processed products in domestic and export markets is not being realized because of such constraints. Significantly larger volumes of produce with improved quality could be marketed if better post-harvest logistics, notably cold storage and transport, existed.⁹ Of the 20 million tons of horticultural output in 2016, only 15% was processed. Of the 3 million tons of fruit produced, 69% are consumed fresh, 20% are processed, and 11% are exported, while for the 10 million tons of vegetables, 81.0% are consumed fresh, 11.3% are processed, 4.3% are used for seeds, and 3.4% are exported. This indicates a significant opportunity for improved value addition from increased processing and exports of both fresh and processed products. The revealed comparative advantage analysis by ADB staff suggests that Uzbekistan produces more specialized horticultural products than many other countries, indicating potential to expand exports.

9. Continued diversification from cotton and wheat production toward horticulture also offers significant environmental benefits as it could decrease demand for irrigation water. Climate change projections for Uzbekistan from 2005 to 2050 indicate that (i) water supply will decrease from 57 billion cubic meters (m³) to 52–54 billion m³, (ii) water demand will increase from 59 billion m³ to 62–63 billion m³, and (iii) the water deficit will increase by more than 500% from about 2 billion m³ to 11–13 billion m³.¹⁰ Horticulture crops typically use less water than cotton and are more efficient in water use than grain crops. In Uzbekistan, 4,426 m³ of water is required to grow 1 ton of cotton and 2,068 m³ of water is required for 1 ton of wheat.¹¹ By comparison, grape production per ton requires about 2,400 m³ of water and apples 820 m³. Diversification of fruit and vegetable production from field to greenhouse cultivation, which is specifically supported under the project, also offers significant water use efficiency and environmental management benefits.

10. **Government's sector strategy.** The government aims to take more steps to increase agriculture production.¹² Measures include (i) further structural reforms in agriculture and diversification of agricultural production; (ii) mechanization of agriculture, improvement of infrastructure, and development of agribusiness; (iii) more productive use of land and water; (iv) greater financial stability of farm entities; and (v) more market-oriented agricultural policies. The government's sector development plan up to 2020 includes further reductions in cotton and wheat production and an increase in horticulture production. The strategy for further land reallocation will result in the following production area increases: 36,000 ha for potatoes, 91,000 ha for vegetables, 18,000 ha for fruit orchards, and 11,200 ha for vineyards.¹³ The strategy will also aim at improving logistics and processing to boost exports of agricultural products, including horticulture.¹⁴

11. In the finance sector, the government has implemented programs to support small businesses and banking industry growth, and has increased access to finance. To improve the

⁹ Staff estimates indicate that post-harvest losses are up to 45.0% of the harvested crop, and that existing cold storage will only be able to store 2.3% of the total forecast horticulture output by 2020.

¹⁰ World Bank. 2010. *Uzbekistan: Climate Change and Agriculture Country Note*. Washington, DC.

¹¹ M. M. Aldaya, G. Munoz, and A. Y. Hoekstra. 2010. Water Footprint of Cotton, Wheat, and Rice Production in Central Asia. *Value of Water Research Report Series*. Number 41. Delft, the Netherlands: UNESCO-IHE Institute of Water Education.

¹² Government of Uzbekistan. 2015. *Presidential Decree No. UP-4707*. Tashkent. Under this decree, a program of measures on structural reforms, modernization, and diversification of production for 2015–2019 was adopted.

¹³ Under the farm size optimization program approved by the Cabinet of Ministers on 29 December 2015.

¹⁴ Government of Uzbekistan. 2016. *Presidential Decree PP-2505*. Tashkent. Under this decree, a program on measures to further develop the raw material base; expand the processing of horticulture, meat, and dairy products; and increase production and export of foodstuffs during 2016–2020 was adopted.

capacity of the banks to assess borrower creditworthiness, the Law on Credit Information, promulgated in 2011, has established a public credit bureau. To facilitate registration of movable assets as loan collateral, the 2013 Law on Collateral Registry supports establishing an electronically secured transactions registry. Laws enacted in the late 1990s need to be improved to facilitate the use of movable property as collateral. Assisted by the International Finance Corporation, the government prepared draft legal amendments for enactment in 2017. The government's development strategy is consistent with the country partnership strategy, 2012–2016 of the Asian Development Bank (ADB) for Uzbekistan and is included in ADB's country operations business plan, 2016–2018.¹⁵

12. Development partners have supported agriculture and horticulture through a variety of projects and technical assistance. The World Bank has implemented two rural enterprise restructuring projects that included the provision of credit to farmers and food processing enterprises. The World Bank is also implementing a horticulture development project with total financing of \$650 million (including \$500 million additional financing approved in January 2018).¹⁶ This project includes (i) providing credit lines to PFIs, (ii) improving financial literacy and business planning skills for horticulture farmers and agribusiness enterprises, (iii) establishing a national network of private growers through training and technical assistance, and (iv) strengthening state research institutes and plant protection services. The International Fund for Agricultural Development (IFAD) is implementing a \$30 million horticulture development project.¹⁷ Other development partners have also provided broad support to enhance the business environment and capacity building for financial institutions and small businesses.¹⁸ Despite the recent injections of long-term finance (estimated at \$0.9 billion) in horticulture through these World Bank and IFAD projects and ADB's ongoing project, there remains significant unmet demand for long-term finance in the horticulture subsector. The Rural Restructuring Agency (RRA), which is implementing these projects, estimates the demand for additional investment finance during 2018–2022 to be in the range of \$0.8 billion–\$1.0 billion.

13. **Assessment of the existing project.** The existing project was approved in November 2016 and became effective in April 2017. Overall, implementation progress is rated *highly satisfactory*. As of February 2018, cumulative fund release was \$151.7 million, accounting for 98.5% of total loan proceeds (\$154.0 million). A total of \$151.4 million has been released to PFIs for subloan financing, of which \$130.2 million has been disbursed by PFIs to subborrowers. The remaining \$21.2 million has also been committed to eligible subprojects. Cumulative liquidated subloans amount to \$82.1 million, accounting for 63% of total loan proceeds versus 22% of project implementation time elapsed. The project has supported 124 horticulture subprojects through subloans. Fifty-four of the subprojects financed to date, with a subloan value of \$66.4 million, have been for production, and 70 subprojects, with a subloan value of \$63.8 million, have been for post-harvest storage and processing. The project has helped (i) establish 2,753 ha of intensive orchards and 109 ha of water- and energy-saving greenhouses, (ii) increase the refrigerated storage capacity by 39,150 tons and post-harvest processing capacity by 7,224 tons, (iii) establish packaging material manufacture of 12 million square meters, and (iv) procure 171 units of agricultural machinery. Given the nature of subprojects financed, in both production and modern post-harvest facilities, the project will have a positive effect on the production, marketing, branding, and export of Uzbek horticultural produce.¹⁹

¹⁵ ADB. 2012. *Country Partnership Strategy: Uzbekistan, 2012–2016*. Manila; ADB. 2015. *Country Operations Business Plan: Uzbekistan, 2016–2018*. Manila.

¹⁶ World Bank. 2018. *Project Appraisal Document for Uzbekistan Horticulture Development Project*. Washington, DC.

¹⁷ IFAD. 2013. *Project Design Report for Uzbekistan Horticulture Development Project*. Rome.

¹⁸ Development Coordination (accessible from the list of linked documents in Appendix 2).

¹⁹ Summary of Project Performance (accessible from the list of linked documents in Appendix 2).

14. Compliance with safeguard policy requirements has been rated *satisfactory*. All PFIs have been implementing environmental and social management systems (ESMSs) and will be required to further strengthen their ESMS and staff capacity during the remaining project implementation period. Risk management arrangements are satisfactory. PFIs have assigned staff to the existing project who are able to effectively appraise subloan financing, subproject safeguards, and social and gender development aspects. Other than in certain limited cases, all PFIs are compliant with Central Bank of Uzbekistan (CBU) prudential regulations and ADB loan covenants. Subproject risks are further mitigated by screening of PFIs' advance requests, demand projections, and individual subloan applications by the RRA, which is well staffed and is capable of undertaking subproject appraisal and monitoring functions. The project performance rating is *on track* since April 2017, when the project became effective.

15. The rapid disbursement of existing project funds reflects the high level of demand within the horticulture subsector for long-term finance. PFIs and the RRA estimate that demand exists for financing of a further \$1 billion. The scaling up of the existing project through additional financing rather than a separate stand-alone project represents the most effective and fastest way to meet such demand. The PFIs engaged in the existing project will also participate in the proposed additional financing project. These PFIs have well-established systems and procedures for subloan identification, appraisal, disbursement, and monitoring. The PFIs concerned also continue to satisfy ADB's financial intermediary eligibility criteria, and the existing project meets ADB's criteria for additional financing.²⁰

16. **ADB's value addition and lessons.** The project will help enhance private sector participation in the agriculture value chains to increase efficiency gains while reducing the fiscal burden on the state. Moreover, through enhanced access to long-term finance, PFIs will be able to sustainably increase their outreach into horticultural business as a high-potential niche. Expanded export of horticultural produce will help increase overall price and income transmission to small-scale producers and small and medium-sized agribusinesses. Capacity development activities under the existing project will enhance subborrowers' technical capacity for their proposed investments. Implementation results of the existing project suggest that the success of projects of a similar nature lies in PFIs proactively identifying a diverse potential clientele (or subborrowers) with financing demand for export-oriented horticulture value chain activities. Seven qualified PFIs have undertaken an inventory of potential clientele, the preliminary demand estimates of which indicate that the proposed additional financing loan of \$198 million can be fully utilized by December 2021.²¹

B. Impact and Outcome

17. The impact and outcome for the overall project will be the same as for the existing project. The overall project is aligned with the following impact: improved contribution of the horticulture subsector to inclusive economic growth and rural employment (footnote 12). The overall project will have the following outcome: increased production and marketing of horticultural products, which also remains unchanged from the existing project.

²⁰ ADB. 2011. Additional Financing. *Operations Manual*. OM H5/BP. Manila.

²¹ Lessons and Synergies (accessible from the list of linked documents in Appendix 2).

C. Output

18. The proposed additional financing will scale up the existing project's output. The incremental output will be increased finance to the horticulture subsector. PFIs will receive credit lines from the ADB loan to extend subloans to interested and qualified subborrowers for horticulture operations, including planting materials, processing and storage equipment, and mechanical equipment.²² Capacity building, training, and technical support will be provided through the management and implementation budget of the existing project to (i) PFIs in subloan appraisals and environmental safeguards compliance; and (ii) subborrowers in business planning, horticulture agronomic techniques, post-harvest operations, and export market penetration. The existing project management office based in the RRA will continue to oversee implementation activities.

D. Investment and Financing Plans

19. The project is estimated to cost \$326 million (Table 1).

Table 1: Project Investment Plan
(\$ million)

Item	Current Amount ^a	Additional Financing ^b	Total
A. Base Cost^c			
1. Finance to horticulture subsector	231.9	318.0	549.9
2. Project management and implementation	2.6	0.0	2.6
Subtotal (A)	234.5	318.0	552.5
B. Contingencies^d	0.4	0.0	0.4
C. Financing Charges During Implementation^e	6.1	8.0	14.1
Total (A+B+C)	241.0	326.0	567.0

ADB = Asian Development Bank.

^a Refers to the original amount and ADB's minor change in financing plan per memo dated 6 July 2017. Includes taxes and duties of \$30.6 million financed from government resources and \$0.2 million financed from ADB loan resources.

^b Includes taxes and duties of \$60 million financed from government resources.

^c In January 2018 prices.

^d Contingencies are not applicable to the additional financing since the entire loan proceeds will be onlent to participating financial institutions, which will withdraw on a demand basis. The budget of the existing project will be sufficient to cover project management and implementation expenses associated with the additional financing.

^e Includes interest charges during implementation for ADB's Ordinary Capital Resource concessional loan financed from government resources.

Source: Asian Development Bank estimates.

20. The government has requested a concessional loan of \$198,000,000 from ADB's ordinary capital resources to help finance the project. The loan will have a 25-year term, including a grace period of 5 years; an interest rate of 2.0% per year during the grace period and thereafter; and such other terms and conditions set forth in the draft loan and project agreements. Subborrowers will contribute \$60 million as their equity contribution for subprojects financed by the loan, and the government will contribute \$68 million, comprising \$60 million through exemptions of taxes and duties for imported goods and \$8 million for interest charges during implementation.²³ The financing plan is in Table 2 and is further detailed in the project administration manual (PAM).²⁴

²² Eligibility criteria for PFIs, subborrowers, subprojects, and subloans are detailed in the project administration manual (PAM) (accessible from the list of linked documents in Appendix 2).

²³ PFIs will determine subborrower equity contributions based on the nature of the credit risk, which, depending on each PFI's credit policy, would be equivalent to at least 25% of the subproject cost.

²⁴ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

Table 2: Financing Plan

Source	Current		Additional Financing		Total	
	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)
Asian Development Bank						
ADF (loan)	154.0	63.9	0.0	0.0	154.0	27.2
OCR (concessional loan)	0.0	0.0	198.0	60.7	198.0	34.9
Subborrowers' contributions	50.3	20.9	60.0	18.4	110.3	19.5
Government	36.7	15.2	68.0	20.9	104.7	18.4
Total	241.0	100.0	326.0	100.0	567.0	100.0

ADF = Asian Development Fund, OCR = ordinary capital resources.

Source: Asian Development Bank estimates.

21. The government will onlend the loan proceeds in dollars to PFIs through subsidiary loan agreements that satisfy ADB's eligibility criteria set out in the PAM and the loan and project agreements.²⁵ The government is expected to onlend the loan proceeds to PFIs for a tenor of 20 years and a grace period of 3 years. The government's onlending rate will be the interest rate charged by ADB for the loan plus a margin to cover administrative and risk costs.²⁶

22. PFIs' subloans may be issued in dollars and/or local currency and priced by PFIs at market rates that cover risks related to foreign exchange, credit, maturity, and interest rates. Subloan repayment may be in dollars and/or local currency subject to the subborrowers' demand and subprojects' revenue streams, as well as specific agreements between PFIs and subborrowers. Subloans extended by PFIs will have a tenor of up to 10 years. PFIs will revolve subloan repayments to finance additional subloans during the 20-year tenor of loans received from the government. PFIs will determine the creditworthiness of subborrowers and assume the full credit risk. The maximum subloan size will be \$5 million based on demand of PFIs' clientele.

23. **Participating financial institutions.** Seven of eight PFIs implementing the existing project expressed their interest to participate in the project. They are Asaka Bank, Davr Bank, Ipak Yuli Bank, Ipoteka Bank, National Bank of Uzbekistan, Turon Bank, and Uzpromstroybank. These PFIs underwent comprehensive due diligence by ADB, and for the most part comply with CBU prudential regulations and meet ADB's eligibility requirements for financial intermediaries and ADB-determined financial covenants.²⁷ Areas of marginal noncompliance improvements and action plans for PFIs to ensure compliance with CBU regulations and ADB financial covenants are indicated in the PAM.²⁸

E. Implementation Arrangements

24. The implementation arrangements are summarized in Table 3 and detailed in the PAM. The additional financing will not alter the existing implementation arrangements substantially, except that (i) Hamkorkbank, one of the PFIs in the existing project, will not participate in the

²⁵ Based on each PFI's absorptive capacity, tentative allocation of loan proceeds is as follows: Asaka Bank \$40 million, Davr Bank \$6 million, Ipak Yuli Bank \$20 million, Ipoteka Bank \$22 million, National Bank of Uzbekistan \$50 million, Turon Bank \$40 million, and Uzpromstroybank \$20 million.

²⁶ The government will charge the interest on the ADB loan plus 1% per year to the PFIs. The PFIs' interest rates carry the cost for (i) loan origination, (ii) provision of foreign exchange to service the ADB loan, and (iii) credit risks.

²⁷ Based on seven eligibility criteria set out in para. 8 of ADB. 2008. Financial Intermediation Loans. *Operations Manual*. OM D6/BP. Manila.

²⁸ Areas of marginal noncompliance improvements for Asaka Bank, Davr Bank, Turon Bank, and Uzpromstroybank include foreign currency exposure, cost-income ratio, return on assets, and return on equity. Action plans include measures to address noncompliance and to enhance financial, accounting, and risk management training.

additional financing project; and (ii) there will be no procurement or consultant recruitment related to project management.

Table 3: Implementation Arrangements

Aspects	Arrangements
Implementation period	June 2018–December 2021
Estimated completion date	31 December 2021 (loan closing date 30 June 2022)
Management	
(i) Executing agency	RRA ^a
(ii) Key implementing agencies	PFI: Asaka Bank, Davr Bank, Ipak Yuli Bank, Ipoteka Bank, National Bank of Uzbekistan, Turon Bank, and Uzpromstroybank
(iii) Implementation units	Project management office under RRA and one project implementation unit in each PFI
Procurement	Not required
Consulting services	Not required
Advance contracting	Not required
Disbursement	The loan proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and arrangements agreed upon between the government and ADB.

ADB = Asian Development Bank, PFI = participating financial institution, RRA = Rural Restructuring Agency.

^a The RRA was established under the Ministry of Agriculture and Water Resources in the form of an incorporated agency as part of the government to facilitate the implementation of certain agriculture projects. As part of the ongoing reforms, the ministry was divided into the Ministry of Agriculture and the Ministry of Water Resources in February 2018. The government issued a decree on 17 April 2018, which decides, among other things, to reorganize the RRA. Specifically, effective from 1 July 2018, the RRA and Center for Implementation of Investment Projects in Agriculture and Water Sectors will be merged to form the "Agency for Implementation of Projects in Agro-Industrial and Food Sectors". The newly-established agency will be under the Cabinet of Ministers of the Republic of Uzbekistan. The decree also states that the new agency will be the legal successor of the RRA and the Center for Implementation of Investment Projects in Agriculture and Water Sectors on their rights, obligations and contracts.

Source: Asian Development Bank.

25. Based on portfolio analysis and loan utilization of PFIs under the existing project, subborrowers have procured equipment with associated works and services from the Russian Federation and Iran because of the suitability of technologies and reasonably low costs. It is envisaged that potential subborrowers of PFI subloans will procure goods, works, and consulting services from both member and nonmember countries of ADB. A request to ADB's Board of Directors is being made, pursuant to Article 14(ix) of the Agreement Establishing the Asian Development Bank, to approve procurement of goods, works, and consulting services from non-ADB member countries by subborrowers using loan proceeds under the project in appropriate circumstances.²⁹ This request reflects the market-based nature of the project, subborrowers' demand, and procurement history. The Board of Directors must approve the waiver by a vote representing not less than two-thirds of the total voting power of the members of the Board.

III. DUE DILIGENCE

A. Economic and Financial

26. The proposed project will help improve horticulture subsector productivity and value addition in line with the government strategy. By addressing the horticulture subsector constraint of accessing long-term finance, the proposed project will facilitate and spur investment in intensive energy- and water-efficient technologies for fruit and vegetable production and post-harvest storage, processing, and marketing facilities. This will increase the volume and enhance the

²⁹ ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

quality of Uzbek horticulture produce for both domestic and export markets. All subprojects, subborrowers, and subloans to be financed under the proposed project will be required to meet technical and financial eligibility criteria established under the existing project as defined in the PAM. Analysis of a sample of representative production and agribusiness investments financed by the existing project indicates that such investments are both financially and economically viable.³⁰

27. The seven proposed PFIs satisfy ADB's financial intermediary criteria and eligibility criteria established under the existing project as defined in the PAM, and have experience in lending to the agriculture sector, with varying levels of agricultural loan portfolios. They have all been assessed as financially sound. Financial projections for the project implementation period indicate the PFIs will continue to perform well and comply with CBU regulations and loan financial covenants. The maximum value of project-financed subloans is projected to range from 0.2% to 2.0% of PFIs' gross loan portfolios during project implementation in 2018–2021. Borrowing under the proposed project is, therefore, well within the absorptive capacity of each PFI.³¹

B. Governance

28. Financial and integrity due diligence has been undertaken on each PFI. The overall premitigation financial management risk is classified *moderate*. An action plan for each PFI to address financial management issues has been prepared and will be implemented up to the second quarter of 2019. A financial management assessment of the RRA did not identify any issues that would adversely affect its project management role. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, the RRA, and PFIs. The specific policy requirements and supplementary measures are described in the PAM.

C. Poverty and Social

29. The existing project supports poverty reduction indirectly through horticulture value chain development. With 32% of the total workforce in agriculture, the proposed project will help many horticulture farmers and entrepreneurs boost their investments, maintain and expand employment, and provide stable incomes for themselves and their employees and suppliers. The proposed project is classified as "effective gender mainstreaming." Gender actions will help enhance female entrepreneurship in the horticulture subsector.³² ADB conducted due diligence and confirmed that core labor standards were complied with within the horticulture subsector. The loan and project agreements include covenants on labor standards and safety.

D. Safeguards

30. The project is classified as "financial intermediation" for environment and category C for involuntary resettlement and indigenous peoples' safeguards. Subprojects that are identified in ADB's Prohibited Investment Activities List in ADB's Safeguard Policy Statement (2009), classified category A for environment, and classified category A or B for involuntary resettlement or indigenous peoples' safeguards are not eligible for project financing. In addition, eligible subprojects will comply with all applicable national regulations. ADB carried out due diligence on PFIs' implementation of ESMSs. All PFIs have been implementing ESMSs under the existing project in accordance with the requirements of ADB's Safeguard Policy Statement.

³⁰ Economic Analysis (accessible from the list of linked documents in Appendix 2).

³¹ Financial Analysis (accessible from the list of linked documents in Appendix 2).

³² Subprojects financed by the existing project have reportedly employed over 20% female workers.

E. Risks and Mitigating Measures

31. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.³³ The overall project risk is rated *moderate*. The integrated benefits and impacts are expected to outweigh the costs.

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Local currency depreciation against the dollar adversely affects PFIs' credit risk profile and subborrowers' debt service capacity.	PFIs have asset–liability management functions in place and follow prudent lending policies, considering devaluation impact on the subborrowers' debt service capacity.
Increased loan loss provisions based on the CBU's capital adequacy standards require additional capital.	PFIs will conduct stress testing and internal capital adequacy assessment, and increase capital as required
PFIs incur credit risks.	PFIs were selected based on their financial track records.

CBU = Central Bank of Uzbekistan, PFI = participating financial institution.

Source: Asian Development Bank.

IV. ASSURANCES AND CONDITIONS

32. The government has assured ADB that implementation of the project shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents.

33. The government has agreed with ADB on certain covenants for the project, which are set forth in the loan and project agreements. As a condition for loan disbursement for relending to a PFI, the government and the RRA shall enter into a tripartite subsidiary loan agreement with each PFI, in form and substance satisfactory to ADB.

V. RECOMMENDATIONS

34. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$198,000,000 to the Republic of Uzbekistan for the additional financing of the Horticulture Value Chain Development Project, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 2.0% per year during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

35. I also recommend that the Board approve the proposal in para. 25 of this report to permit procurement in nonmember countries of ADB of goods, works, and services.

Takehiko Nakao
President

18 May 2018

³³ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

REVISED DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned with			
Current project Contribution of horticulture subsector to inclusive economic growth and rural employment improved (Presidential Decree UP-4707) ^a			
Overall project Unchanged			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome			
Current project Production and marketing of horticultural products increased	Current project By 2022: a. Exports of horticultural produce increased: (i) vegetables to 630,000 tons (2015 baseline: 286,600 tons); (ii) melons to 16,900 tons (2015 baseline: 7,700 tons); (iii) fruit to 239,140 tons (2015 baseline: 108,700 tons); and (iv) grapes to 326,300 tons (2015 baseline: 186,900 tons) b. Value of horticultural produce exports increased to \$1.3 billion (2015 baseline: \$0.6 billion)	a–b. National Statistics Committee, Ministry of Economy, RRA monitoring reports, customs data, and Uzagroexport reports	Local currency depreciation against the dollar adversely affects PFIs' credit risk profile and subborrowers' debt service capacity. Increased risk provisions based on the CBU's capital adequacy standards require additional capital.
Overall project Unchanged	Overall project By 2022: a. Exports of horticultural produce increased: (i) vegetables to 1,000,000 tons (2015 baseline: 286,600 tons); (ii) melons to 30,000 tons (2015 baseline: 7,700 tons); (iii) fruit to 400,000 tons (2015 baseline: 108,700 tons); and (iv) grapes to 600,000 tons (2015 baseline: 186,900 tons) b. Value of horticultural produce exports increased to \$2.1 billion (2015 baseline: \$0.6 billion)	a–b. National Statistics Committee, Ministry of Economy, RRA monitoring reports, customs data, and Uzagroexport reports	

<p>Output</p> <p>Current project Finance to the horticulture subsector increased</p> <p>Overall project Unchanged</p>	<p>Current project By 2021: 1a. 332 subloans extended to horticulture development:^b (i) 181 for production, and (ii) 151 for storage improvement and processing</p> <p>1b. Subprojects financed by PFIs' subloans employ at least 20% female workers</p> <p>Overall project By 2021: 1a. 370 subloans extended to horticulture development:^b (i) 190 for production, and (ii) 180 for storage improvement and processing</p> <p>1b. Unchanged</p>	<p>1a–b. PFIs' progress reports and RRA monitoring reports</p> <p>1a–b. PFIs' progress reports and RRA monitoring reports</p>	<p>PFIs incur credit risks.</p>												
<p>Key Activities with Milestones Finance to the horticulture subsector increased</p> <p>1.1 Establish environmental and social management systems at PFIs (Q1 2017) (unchanged)</p> <p>1.2 Sign additional financing subsidiary loan agreements between the MOF, RRA, and PFIs (Q3 2018) (changed)</p> <p>1.3 Disburse PFIs' loans to horticulture farms and enterprises (Q2 2017–Q4 2021) (unchanged)</p> <p>1.4 Disburse PFIs' loans from the additional financing loan to horticulture farms and enterprises (Q1 2019–Q4 2021) (changed)</p>															
<p>Project Management Activities</p> <p>Set up project management office with required staff by Q1 2017 (unchanged)</p> <p>Establish project implementation unit at each PFI by Q1 2017 (unchanged)</p> <p>Set up project performance management system by Q1 2017 (unchanged)</p> <p>Provide technical support to PFIs and subborrowers (Q2 2017–Q4 2021) (unchanged)</p> <p>Prepare project completion report by Q4 2021 (unchanged)</p>															
<p>Inputs</p> <table border="1" data-bbox="175 1352 1445 1486"> <thead> <tr> <th data-bbox="175 1352 607 1388">Asian Development Bank</th> <th data-bbox="607 1352 1024 1388">Government of Uzbekistan</th> <th data-bbox="1024 1352 1445 1388">Subborrowers</th> </tr> </thead> <tbody> <tr> <td data-bbox="175 1388 607 1423">\$154,000,000 (current)^b</td> <td data-bbox="607 1388 1024 1423">\$ 36,700,000 (current)</td> <td data-bbox="1024 1388 1445 1423">\$ 50,300,000 (current)</td> </tr> <tr> <td data-bbox="175 1423 607 1459">\$198,000,000 (additional)^c</td> <td data-bbox="607 1423 1024 1459">\$ 68,000,000 (additional)</td> <td data-bbox="1024 1423 1445 1459">\$ 60,000,000 (additional)</td> </tr> <tr> <td data-bbox="175 1459 607 1495">\$352,000,000 (overall)</td> <td data-bbox="607 1459 1024 1495">\$104,700,000 (overall)</td> <td data-bbox="1024 1459 1445 1495">\$110,300,000 (overall)</td> </tr> </tbody> </table>				Asian Development Bank	Government of Uzbekistan	Subborrowers	\$154,000,000 (current) ^b	\$ 36,700,000 (current)	\$ 50,300,000 (current)	\$198,000,000 (additional) ^c	\$ 68,000,000 (additional)	\$ 60,000,000 (additional)	\$352,000,000 (overall)	\$104,700,000 (overall)	\$110,300,000 (overall)
Asian Development Bank	Government of Uzbekistan	Subborrowers													
\$154,000,000 (current) ^b	\$ 36,700,000 (current)	\$ 50,300,000 (current)													
\$198,000,000 (additional) ^c	\$ 68,000,000 (additional)	\$ 60,000,000 (additional)													
\$352,000,000 (overall)	\$104,700,000 (overall)	\$110,300,000 (overall)													
<p>Assumptions for Partner Financing Current project: Not applicable Overall project: Unchanged</p>															

CBU = Central Bank of Uzbekistan, MOF = Ministry of Finance, PFI = participating financial institution, Q = quarter, RRA = Rural Restructuring Agency.

^a Government of Uzbekistan. 2015. *Presidential Decree No. UP-4707*. Tashkent. Under this decree, a program of measures on structural reforms, modernization, and diversification of production for 2015–2019 was adopted.

^b Asian Development Fund (loan).

^c Ordinary capital resources (concessional loan).

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=47305-004-3>

1. Loan Agreement: Special Operations
2. Project Agreement: Rural Restructuring Agency
3. Project Agreement: Participating Financial Institutions
4. Sector Assessment (Summary): Agriculture, Natural Resources, and Rural Development
5. Project Administration Manual
6. Summary of Project Performance
7. Contribution to the ADB Results Framework
8. Development Coordination
9. Financial Analysis
10. Economic Analysis
11. Country Economic Indicators
12. Summary Poverty Reduction and Social Strategy
13. Gender Action Plan
14. Financial Intermediary: Environmental and Social Management System Arrangement
15. Risk Assessment and Risk Management Plan

Supplementary Documents

16. Detailed Sector Assessment: Agriculture, Natural Resources, and Rural Development
17. Detailed Project Economic Analysis
18. Detailed Social and Gender Assessment
19. Lessons and Synergies