PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA25534

Project Name	Land Bank Financial Intermediation Loan (P150008)
Region	AFRICA
Country	South Africa
Sector(s)	General finance sector (30%), General agriculture, fishing and forestry sector (20%), SME Finance (50%)
Theme(s)	Rural markets (50%), Other Financial Sector Development (50%)
Lending Instrument	Investment Project Financing
Project ID	P150008
Borrower(s)	Land and Agricultural Development Bank of South Africa
Implementing Agency	Land Bank
Environmental Category	F-Financial Intermediary Assessment
Date PID Prepared/Updated	28-Apr-2015
Date PID Approved/Disclosed	08-May-2015
Estimated Date of Appraisal Completion	05-Jun-2015
Estimated Date of Board Approval	30-Jul-2015
Appraisal Review Decision (from Decision Note)	

I. Project Context

Country Context

Twenty years after the end of apartheid, unemployment, poverty and inequality remain important development challenges in South Africa, despite substantial progress in overcoming the legacy of the past. While total employment increased from 9 million in 1996 to 15.3 million in 2014, the unemployment rate has stayed stubbornly high in the range of 20-25 percent. A 30 percent increase in per capita GDP since the late 1990s and a sharp expansion of the social grant coverage enabled a significant decline in the poverty rate—from 43.5 percent of the population living below R219 (inflation-adjusted) a month in 2000 to 37 percent (or 18.5 million people) living below R501 in 2011. Nevertheless, pockets of poverty remain deeply entrenched, mostly among the historically disadvantaged population. With a relatively stagnant income Gini coefficient of around 0.69 in 2011 (versus 0.72 in 2006 and expenditure Gini of 0.65 in 2011 (versus 0.67 in 2006), South Africa has one of the highest inequality rates in the world. Land distribution, in particular, is one of the most unequal in the world.

Recent developments in economic activity are not indicative of major improvements in growth or employment. In 2014 South Africa’s annual GDP only increased by 1.5 percent compared to 2.2

percent in 2013, a result of continuing labor unrest which compounded structural constraints. This weak growth is well-below the projected 5 percent growth needed to drive down unemployment. By year-end unemployment hovered just above 24 percent. At the same time, inflationary pressures are starting to creep up again (4 percent as of March 2015, after falling to a four-year low of 3.9 percent in February), leading the Reserve Bank to maintain the repurchase rate at 5.75 percent.

A substantial reduction in poverty and inequality will be hard to achieve without a major success in rural development. As stated by South Africa's National Development Plan (NDP), the main challenge for rural development in South Africa is to "combat the marginalization of the poor". While the rural share of poverty fell from 70 percent in 1993 to 58.3 percent in 2011, partly due to migration of the poor to townships and informal settlements around urban centers, rural areas remain characterized by greater poverty and inequality than urban areas.

Agriculture development and successful land reform are key pillars of the strategy laid out by the NDP for integrated and inclusive rural development. South Africa's agriculture sector is characterized by dualism: a modern, market-oriented capital intensive farming sector consisting of a small number of large commercial farms (around 40,000 farming units) and a large number of subsistence and small-scale or emerging farms, many in the former homeland areas. In addition, there is growing consolidation in the industry with a number of mergers taking place and the acquisition of smaller players. While improving economies of scale, this consolidation may also lead to lower competition in the market. Around 2006, over 80 percent of South African farmers worked on a piece of land of one hectare or smaller, and another 11 percent on one to five hectares. Only 3 percent had access to land of larger than 20 hectares. It is estimated that there are 2.5 – 3.5 million households engaged in subsistence farming, about 350,000 – 700,000 who can be classified as emerging farmers, producing part of their output for the market, and between 11,000 – 15,000 small to medium scale farmers who are commercially oriented.

The progress of land reform has been slow and a large number of land reform beneficiaries are not using the land productively. The Government committed itself to transfer 30 percent of the 82 million hectares of agricultural land owned by whites in 1994 to blacks by 2014, a total of 24.5 million hectares, through both land restitution and land redistribution. According to the Twenty Year Review published by the Presidency, only 9.4 million hectares have been redistributed since 1994 through both land restitution and redistribution. Achieving the objective of "productive use" of redistributed and restituted land requires even greater efforts and innovation. Land reform in South Africa to date has involved the transfer of relatively large commercial farms in their entirety to groups of beneficiaries. Land reform beneficiaries are typically resource-poor, risk-averse, and inexperienced black farmers. Support provided to them after their takeover of the land, i.e., post-settlement support, has been inadequate. Land reform beneficiaries have experienced numerous problems accessing services, such as credit, training, technology extension, transport, plowing services, veterinary services, and marketing services. The well-developed agribusiness sector that services large-scale commercial agriculture has not been seen extending its operations to new farmers who, in most cases, would be cash-strapped and incapable of paying for such services anyway.

Support for small-scale farmers is equally crucial to job creation. Employment in the formal agriculture sector declined from 1.1 million in 1992 to 739,000 in 2014 despite output growth. Nevertheless, the NDP believes that with successful rural development and land reform the agriculture sector has the potential to create 1 million new jobs by 2030. The NDP counts on small-scale/ emerging farmers for over 35 percent of the job creation target, in addition to a 10 percent share from subsistence farmers, a 10 percent share expected from better use of the land that has already been redistributed or restituted to land reform beneficiaries, and a 30 percent share from expansion of labor intensive commercial farming.

Sectoral and institutional Context

South Africa's financial sector is the most developed in Sub-Saharan Africa and is significantly larger and more diversified compared to regional and income-group peers. It is supported by an elaborate legal and financial infrastructure and a generally effective regulatory framework. South Africa's financial system totaled approximately South African Rand 8 trillion in assets as of year-end 2012 (US$ equivalent of 945 billion). As of end 2013, the banking sector constitutes almost 40 percent of the financial system assets, with pension funds and long-term insurers each contributing roughly 20 percent.

The banking sector is highly concentrated, but at the same time commercially driven and professional. The 'big four' banks in South Africa, two of which are foreign owned, account for over 83 percent of total banking assets. This concentrated ownership structure has led to limited competition and distorted incentives for these banks to serve the lower end of the market, especially micro, small, and medium-sized enterprises and the low-income population. Nevertheless, the banking system generally is highly professional and commercially driven, and does not suffer from distortionary policies.

Provision of agricultural finance and support

One of the main challenges for rural and agriculture development is affordable access to working capital for emerging farmers and medium to long-term finance for small and medium-sized agricultural enterprises. While the financial services needs of the large commercial farms are generally well catered for by the private sector, farmers in rural areas experience many of the challenges faced by their peers in other African countries, ranging from difficulties in accessing markets, poor infrastructure, and little or no physical assets that could be used as collateral for accessing financing. With few exceptions, emerging and small-scale farmers are unable to use the land that they farm on as collateral given that the state owns most of the land in the former homelands. FinScope's 2010 Small Business Survey estimates that of the roughly 700,000 emerging and small commercial farmers, only 5.6 percent used formal credit services and only 2.5 percent from a bank. In contrast, nearly half of those farmers used formal savings and/ or payments services and about 30 percent formal insurance.

Without adequate collateral, rural farmers face challenges in accessing credit from traditional commercial banks. While the 'big four' commercial banks have made efforts to become more inclusive, their business models and cost structure do not lend themselves to serving the agricultural sector. Some banks are funding value chain off-take agreements with large processors and retailers for on-lending to smaller farmers, but such lending is small compared to the overall loan book of commercial banks. According to the Department of Agriculture, Forestry and Fisheries (DAFF), total farming debt amounted to ZAR 88,779 million (US$10,482 million) in 2012, out of which ZAR 48,352 million (US$5,709 million) was from commercial banks and ZAR 26,202 million (US $3,094 million) from the Land and Agricultural Development Bank of South Africa (henceforth Land Bank). Compared to total commercial bank loans and advances of ZAR 2,753 billion (US

$325 billion), agricultural lending amounts to less than 1 percent of their total loan book.

A wide range of programs have been implemented by the Government to provide financial support to land reform beneficiaries and small-scale farmers. In 1994 the Government introduced the Settlement/Land Acquisition Grant (SLAG) to enable individuals and groups to finance the purchase of land from a willing seller. Until 2000, redistribution policy centered on the provision of a grant of ZAR 16,000 (~US$1391) to qualifying households with an income of less than ZAR 1,500 (~US$130) a month. In 2001 the Land Redistribution for Agricultural Development (LRAD) Grant was introduced to establish and promote emerging farmers. LRAD offered higher grants, paid to individuals rather than to households, and made greater use of loan financing through institutions such as Land Bank to supplement the grant. A few years later, the slow pace of land reform led to the introduction of the Proactive Land Acquisition Strategy (PLAS) in 2005-06. The use of grants for land acquisition was discontinued and the focus was shifted to the acquisition of strategically located land through PLAS by the state. Since its inception, PLAS has become the biggest single program area within redistribution, in terms of both budget and land area.

There are also initiatives designed to provide post-settlement support to land reform beneficiaries. The LRAD policy for example sets out to close the post-settlement support gap that prevailed under SLAG. In addition, the Comprehensive Farmer Support Program (CFSP) provides two grants, one for capacity building and one for on-farm infrastructure. In order to access on-farm infrastructure grants ranging from a minimum of ZAR 5,000 to a maximum of ZAR 100,000 (~ US$435 to 8,696), beneficiaries must make an ‘own contribution’ along a sliding scale similar to that of the LRAD grant program. It is a once-off support package designed for LRAD beneficiaries. The Comprehensive Agricultural Support Program (CASP) supported by DAFF offers grants to support short-term operating expenses and small operating needs such as machinery. These grants are managed at the provincial level and come from funds that are transferred from the national to the provincial level. Combined land acquisition grants, both for redistribution and restitution, totaled ZAR13 .6 billion (US$1.61 billion) between 2008 and 2012 while grants for movable equipment and fixed improvements amounted to ZAR 3.4 billion (US$1.58 billion) between 2004 and 2012 (DAFF). Borrowing for working capital needs to operate and expand farms has been one of the most acute challenges for emerging and small farmers as well as land reform beneficiaries due to the reasons mentioned above.

Land Bank

In addition to government grants, financing from Land Bank has been expected to play a critical role in land reform and agriculture development. Land Bank was established in 1912 and is governed by the Land and Agricultural Development Bank Act of 2002. Land Bank was given a mandate of 11 aspects, which fall into five broader areas: (i) access of the historically disadvantaged population to land, (ii) agriculture productivity, growth and job creation; (iii) gender equity; (iv) environmental sustainability; and (v) food security. The NDP published in 2011 continues to call for a key role of Land Bank in providing financial support to land reform beneficiaries and to help them overcome difficulties in entry into commercial farming.

As the leading development financial institution in the rural and agriculture sector in South Africa, Land Bank has a 31 percent market share in agricultural financing as of March 2014. The bank has achieved a remarkable turnaround during the past five years. It is now on a sustainable trajectory with profits of ZAR 261 million (US$22 million) in 2013/14 (up 69 percent from 2012/13), and a

Return on Average Assets of 0.8 percent and a Return on Average Equity of 4.7 percent. Total assets stood at ZAR 35.6 billion (US$3.1 billion) in 2013/14 with a performing loan book of ZAR 33 billion (US$2.9 billion). Non-performing loans (NPLs) under Land Bank methodology were at 3.2 percent in 2013/14 and the cost-to-income ratio was 59.5 percent. Fitch Ratings upgraded Land Bank from AA to AA+ in January 2014. The bank is not taking general deposits and funds itself mainly through issuing promissory notes. The bank aims at achieving a 35 percent market share in agricultural financing by 2016/17.

Land Bank is fully owned by the South African Government and supervised by the National Treasury. It follows prudential guidelines as issued by its Board of Directors. It is consequently not prudentially supervised by the South African Reserve Bank (SARB). The bank is audited by the Auditor General. Land Bank is engaged in both wholesale lending through intermediaries as well as direct retail lending. Intermediaries are mainly credit providers, cooperatives, or agri-businesses. Land Bank has three main business lines: Retail Emerging Markets (REM), Retail Commercial Banking (RCB), and Business and Corporate Banking (B&CB). In 2013/14, B&CB accounted for 83 percent of the bank's loan book, RCB accounted for 16 percent, and the remaining 1 percent was composed of loans provided under REM.

Land Bank launched the REM business line – which is exclusively focused on lending to emerging farmers for development purposes – in 2010/11. Farmers supported under this line typically have no access to commercial funding and little or no collateral, but can be commercially sustainable and viable with financing support. Subsistence farmers are not supported under REM. Lending is based on cash-flows and non-financial support (end to end on-farm support) is provided by Land Bank intermediaries and agricultural specialists based in Land Bank branches. REM uses wholesale as well as direct lending and offers production financing, installment sale finance, and medium-term loans. The six current intermediaries are engaged in sugar cane, grain, citrus, and livestock, and distributed across five provinces.

The REM book is a successful and innovative approach for reaching emerging farmers using capable intermediaries, but sustainability, eventual scope and time horizon questions have to be carefully addressed. Land Bank made an important decision on REM pricing during project preparation, moving the business line toward financial sustainability. Going forward, Land Bank will grow its REM book in a financially sustainable way which will allow the bank to at le ast cover its costs of funds. Land Bank's Asset and Liability Committee decided in August 2014 that new REM agreements will follow a pricing policy that will allow for the recovery of funding costs while honoring already existing REM agreements. Land Bank is in the process of updating the REM pricing policy accordingly. It was agreed that interest rates below the average cost of funds will only be offered to emerging farmers if the difference will be assumed by the Government. Any such transfers would need to be transparently allocated and come directly from the Government budget. The decision shows Land Bank's commitment to move towards a sustainable business model while at the same time balancing the needs of fulfilling its developmental mandate by providing favorable financing conditions to previously disadvantaged farmers. In addition, Land Bank has developed a clear growth and development plan for the REM book, including a REM scope and time horizon target plan leading to eventual graduation of farmers in the REM program. This involved a projection of financial returns over the planned time horizon, demonstrating an eventual financial breakeven upon graduation of the REM program, as well as an evaluation of the economic benefits of the REM program.

Intensive and high-quality extensions services under the REM program are effectively provided by Land Bank's intermediaries. These intermediaries have a comparative advantage in providing these services due to their close interaction with the beneficiaries. The non-financial complementary services, especially extension services, are critical for emerging farmers to develop. The costs for the extension services are embedded in the overall cost structure under REM and are borne by the intermediaries. While the provision of extension services is costly, especially for new emerging farmers, intermediaries can generate profits from these clients over time due to the long-run and comprehensive nature of engagement between intermediaries and their clients. The current model of providing extension services is considered to be of high quality according to the assessment carried out during project preparation.

B&CB is the commercial part of the bank while the focus under RCB is exclusively on direct lending to commercial farmers. Lending under B&CB takes place primarily through intermediaries (cooperatives and agri-businesses) and generates high profits. B&CB operates through two offices in Pretoria and Cape Town. Lending under RCB takes place through 27 Agriculture Finance Centers (AFS) with a wide variety of products. RCB's competitiveness and long-term viability is questionable. RCB was loss-making in 2012/13, had high NPLs, and faces considerable administrative costs as a result of a large branch network and a more labor intensive loan approval process compared to wholesale lending. In addition, RCB is losing clients to commercial banks who have started to lend in that space and can offer a wider range of products. While the project as an investment loan cannot influence the future of the RCB business line directly, discussions with Land Bank have been held on a strategy to address these issues. The project will not support the RCB business line but the future of RCB will form part of the policy dialogue and will form part of the organizational review of Land Bank.

All business lines contain a development portfolio with "development" referring to a focus on supporting the historically disadvantaged population in line with Broad-Based Black Economic Empowerment (BBBEE). Overall, Land Bank aims at growing its exposure to the developmental side of its business to ZAR 4.5 billion (US$391 million) by 2016/17 from ZAR 1.9 billion (US$165 million).

With full commitment to its developmental mandate, Land Bank is making renewed efforts to maximize its development impact while maintaining financial sustainability. Its strategy for 2016/17 envisages an increase of the REM business line from ZAR 391 million (US$34 million) to about ZAR 1 billion (US$87 million). The REM business line is the only business line supporting emerging farmers and is entirely classified as developmental according to Land Bank's criteria. In addition, Land Bank aims at increasing its developmental focus in B&CB and RCB as well and aims at strengthening the wholesale side of its business. International experience with development banks suggests that wholesale lending is more likely to be successful than retail lending. The key reason is that wholesale lending does not require a large branch network which is costly to build and maintain but rather leverages the networks already built by other financial service providers. Wholesale lending is also more market enabling and does not aim at competing with the private sector. The project will therefore focus on supporting Land Bank in scaling up its REM business as well as its wholesale portfolio. Using long-term financing to fill existing funding gaps will additionally help Land Bank meet its investment needs as well as improve its asset liability management.

II. Proposed Development Objectives

The project's development objective is to scale up Land Bank's wholesale financing, specifically to emerging farmers.

III. Project Description

Component Name

Line of Credit for Agricultural Financing

Comments (optional)

This component will finance wholesale lending by Land Bank for its REM and B&CB business lines. Land Bank will on-lend the funds to participating financial intermediaries (PFIs) which comply with eligibility criteria agreed with the World Bank. The PFIs will on-lend funds to eligible agriculture enterprises, farmers including emerging farmers, communal property associations and other eligible borrowers supported under the REM and B&CB business lines.

IV. Financing *(in USD Million)*

Total Project Cost:	100.00	Total Bank Financing:	100.00
Financing Gap:	0.00		

For Loans/Credits/Others	**Amount**
Borrower	0.00
International Bank for Reconstruction and Development	100.00
Total	100.00

V. Implementation

The project is a financial intermediary loan (FIL) of US$100 million to Land Bank as the borrower and implementing agency with a guarantee of the Republic of South Africa. The project has one component: a Line of Credit for Agricultural Financing in the amount of US$100 million.

The loan will be extended to Land Bank as the borrower and implementing agency with a guarantee of the Republic of South Africa. Land Bank will use the funds for on-lending to Participating Financial Intermediaries. Land Bank will be responsible for project implementation and monitoring. Dedicated staff in Land Bank has been identified for managing all aspects of the project, including reporting on implementation progress and monitoring and evaluation, ensuring compliance with environmental and social safeguards as well as with financial management and procurement arrangements.

Land Bank will report on the PDO and intermediate indicators on a semi-annual basis. The data will come from Land Bank's internal reports and from information provided by the PFIs. Land Bank will prepare quarterly Interim Financial Reports for the project. The specific reporting templates will be defined in the Project's Operational Manual. Land Bank's financial performance will be audited annually by the Auditor General.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01		✗
Natural Habitats OP/BP 4.04		✗
Forests OP/BP 4.36		✗

Pest Management OP 4.09		×
Physical Cultural Resources OP/BP 4.11		×
Indigenous Peoples OP/BP 4.10		×
Involuntary Resettlement OP/BP 4.12		×
Safety of Dams OP/BP 4.37		×
Projects on International Waterways OP/BP 7.50		×
Projects in Disputed Areas OP/BP 7.60		×

Comments (optional)

VII. Contact point

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