PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC9147

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 (60%), Other Financial Sector Development (40%)
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	27-Jun-2014
Date PID Approved/ Disclosed	27-Jun-2014
Estimated Date of Appraisal Completion	
Estimated Date of Board Approval	19-Mar-2015
Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and 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 million in 2013, 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 50.8 percent of the population living below R422 a month in 2000 (in constant 2009 ZAR) to 34.5 percent in 2010. Nevertheless, pockets of poverty remain deeply entrenched, mostly among the historically disadvantaged population. With an income Gini coefficient of around 0.70 in 2008 and consumption Gini of 0.63 in 2009, South Africa has one of the highest inequality rates in the world. The top decile of the population accounts for 58 percent of the country’s income, while the bottom decile accounts for 0.5 percent and the bottom half for less than 8 percent. Land distribution, in particular, is one of the most unequal in the world.

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 57 percent in 2008, 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 – 600,000 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 agriculture declined from 1.1 million in 1992 to 706,000 in 2013 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

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 $3094 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$1,525) to qualifying households with an income of less than ZAR 1,500 (~US$143) 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 the 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$477 to 954), 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.

In addition to government grants, financing from the Land Bank has been expected to play a critical role in land reform and agriculture development. The Land Bank was established in 1912 and is governed by the Land and Agricultural Development Bank Act of 2002. The Land Bank was given a mandate of eleven 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 the Land Bank in providing financial support to land reform beneficiaries and to help them overcome difficulties in entry into commercial farming.

The Land Bank is fully owned by the South African Government and supervised by the National Treasury. The bank is audited by the Auditor General. The 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. The Land Bank has three main business lines: Retail Emerging Markets (REM), Retail Commercial Banking (RCB), and Business and Corporate Banking (B&CB).

The 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. Lending is based on cash-flows and non-financial support (end to end on-farm support) is provided by the Land Bank intermediaries and agricultural specialists based in Land Bank branches.

Relationship to CAS

The proposed operation is fully aligned with the Country Partnership Strategy (CPS) for South Africa for the Period of FY2014-17. The operation has been requested by the National Treasury and the Land Bank and carefully calibrated to their specific needs. It is anchored, through the role of the Land Bank in rural and agriculture development, to the Government's NDP objectives of eliminating poverty, reducing inequality and improving job creation. It is expected to contribute to all the three pillars of the CPS. First of all, it supports the reduction of inequality by increasing the access to finance for the historically disadvantaged population. Secondly, it catalyzes private investment in rural development and agriculture through financing solutions provided by the Land Bank. Thirdly, it helps strengthening institutional capacity of the Land Bank on agricultural financing as well as asset-liability management, its intermediaries, as well as other institutions that may be involved in the operation.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The project’s development objective is to scale up Land Bank’s wholesale financing, specifically to emerging farmers, and to strengthen its institutional capacity.

Key Results (From PCN)

The PDO will be achieved by providing long-term financing for Land Bank as well as technical assistance. This will facilitate a broader and deeper financial intermediation by Land Bank and diversify its funding sources away from Government.

The achievement of the objectives and outcomes of this project will be measured through the following PDO results indicators:

• Increase in the percentage of REM loans in total Land Bank loan portfolio (volume and number).
• Increase in the percentage of wholesale loans in total Land Bank loan portfolio (volume and number).
• Increase in the percentage of Land Bank liabilities that are long term (over 1 year) (%)
• Volume and number of loans disbursed under the project (separately for REM and B&CB) (amount US$).
• Number of beneficiaries financed under the project (separately for REM and B&CB).

Intermediate results indicators will be as follows:

• Increase in medium to long term loans (over 1 year) granted under the project (%).
• Outstanding loan portfolio (REM and B&CB) of Land Bank (amount US$).
• Number of active loans (REM and B&CB).
• Total volume and number of loans disbursed by Land Bank during the project.
• % of loans to women.
• Total NPL rate under the credit line (%).
• Land Bank Return on Assets/ Equity (%).

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Final beneficiaries of the project will be the target beneficiaries under REM and B&CB as detailed in the respective credit policies. REM focuses on historically disadvantaged South Africans in primary agriculture fulfilling certain criteria, such as a maximum asset size of ZAR 3 million (~us$ $286,00), access to land, farming on a full-time basis, difficulties in accessing traditional financing due to a lack of security, and existing off-take agreements or contracts in place. B&CB clients are either historically disadvantaged or other clients engaged primarily in secondary agriculture. According to the B&CB credit policy, they must be solvent, have viable business plans, and adequate security, among others.

III. Preliminary Description

Concept Description

The proposed project will be a financial intermediary loan (FIL) of about US$100 million to Land Bank as the borrower and implementing agency with a guarantee of the Republic of South Africa. The project has the following two components:

Component 1: Line of Credit (LOC) for Agricultural Financing (US$99 million). The objectives of the LOC component are to:

• Support Land Bank in refocusing its operations on wholesale lending. Land Bank uses both wholesale and direct lending under the Retail Emerging Markets (REM) and Business and Commercial Banking (B&CB) business lines, while Retail Commercial Banking (RCB) is exclusively focused on direct lending. Given Land Bank's limited branch network, wholesale lending is more sustainable because it helps Land Bank leverage the network of financial intermediaries without incurring significant operating costs. In addition, wholesale lending allows Land Bank to play a market enabling role because it permits agricultural borrowers to build credit history with financial intermediaries and improve their financial records for commercial loans, thus improving their ability to gain access to credit.

• Help expand the REM business line of Land Bank, which focuses on improving access to credit along with extension services for emerging farmers, in a sustainable manner. The REM business line – which is exclusively focused on lending to emerging farmers for development purposes currently accounts for about 1 percent of Land Bank lending. The LOC will help Land Bank in expanding this segment. This will also help in scaling up the provision of non-financial services, such as agricultural extension services that are being effectively delivered by Land Bank intermediaries.

To achieve the above objectives, 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. The LOC will help Land Bank expand financing particularly under REM.

Component 2: Capacity Building to strengthen Land Bank's institutional capacity (US$1 million). The objective of this component is to support Land Bank in expanding its share in agriculture financing in a sustainable manner and to strengthen Land Bank's asset-liability management.

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IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	**Yes**	**No**	**TBD**
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		✗	

V. Financing (in USD Million)

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

Financing Source	Amount
Borrower	0.00
International Bank for Reconstruction and Development	100.00
Total	100.00

VI. Contact point

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