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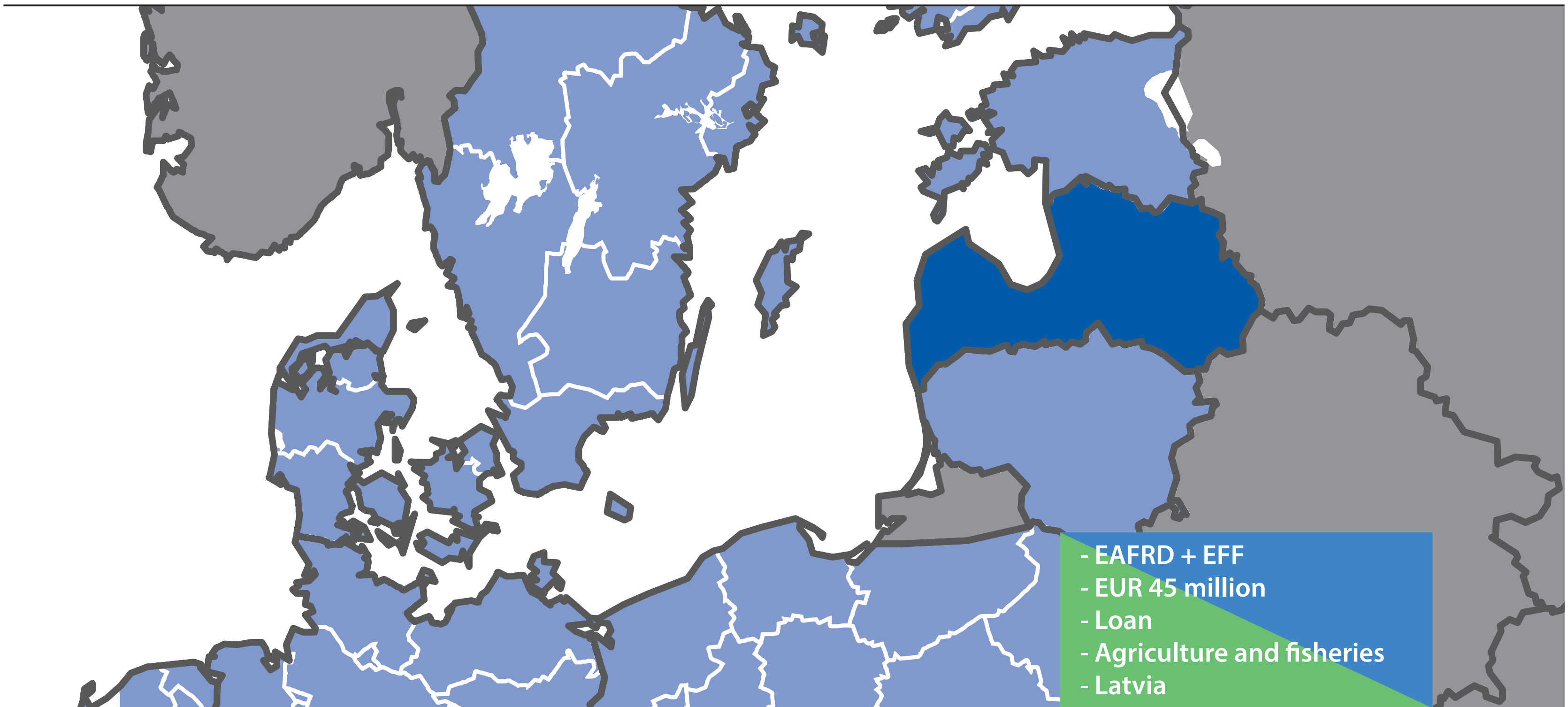

- EAFRD + EFF
- EUR 45 million
- Loan
- Agriculture and fisheries
- Latvia

… stimulating investment in agriculture and fisheries …

The Latvian Credit Fund

Case Study

European Commission

European Investment Bank

The EU bank

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The authors of this study are a consortium of three companies: t33 (lead), University of Strathclyde – EPRC and Spatial Foresight.

Abbreviations

EAFRD	European Agricultural Fund for Rural Development
EFF	European Fisheries Fund (2007-2013)
EFF OP	Operational Programme for the Latvian fisheries sector 2007-2013
EMFF	European Maritime and Fisheries Fund (2014-2020)
FI	Financial instrument
OP	Operational Programme
PA	Paying Agency
RDF	Rural Development Fund
RDP	Rural Development Programme

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1 Summary

This case study provides an overview of how EUR 44.7 million from EAFRD and EFF provided advantageous loans to farmers and fishermen in Latvia through the Credit Fund, a financial instrument. This Credit Fund was particularly important to counteract negative effects of the 2008-2009 financial crisis, such as access to finance for agricultural and fishery projects. For instance, with a loan from the Credit Fund, farmer Mairis could build a new cowshed and more than double his farm's milk production. Furthermore, the financial instrument's innovative use in the fisheries sector helped an aquaculture project and a fish processor obtain advantageous loans.

The financial instrument was set up in order to fill a market gap in financing for EAFRD and EFF grant recipients. Many projects, such as that of Mairis, were eligible for a grant but could not use it because grants were only given on project completion. Before this financial instrument, commercial credit was the only option many farmers and fishermen could consider in financing their projects. However, banks were reluctant to lend to such high-risk projects, especially during the financial crisis. The Credit Fund adequately filled this market gap, financing 58 projects and disbursing 71% of its allocated funds.

This case study is an example of how market gaps in finance for agriculture or fisheries projects can be counteracted using EAFRD and EFF funds through financial instruments complementing grants. The Credit Fund loans were very important to help projects get started at a time when the commercial lending sector was very reluctant to provide loans. The money repaid from EAFRD and EFF loans was returned to the RDP and the EFF OP in order to finance other projects. The practice of pre-financing grants with loans from a financial instrument is no longer allowed in the 2014-2020 programming period.

An important feature of this case is how the financial instruments approach could flexibly be extended beyond EAFRD. The financial instrument was initially suggested for the RDP and was replicated in the EFF OP a few months later under the same broad structure. This was possible since the instrument addressed the same market gap and because public and private stakeholders cooperated closely.

Name

Credit Fund financed by EFF and EAFRD – Latvia

Funding source

RDP (EAFRD) / OP for the Latvian fisheries sector (EFF)

Type of FI

Loans supplementing EAFRD and EFF grants

Financial size

EUR 44.7 million, of which EUR 7.2 million from the EFF and EUR 37.61 million from the EAFRD

Absorption rate

71% (as at 30 September 2014)

EU leverage

1

Re-investment rate

None. Loan repayments are returned back to the OPs.

Thematic focus

Modernisation of agricultural holdings; adding value to agricultural products; enterprise creation and development; development of tourism activities; productive investments in aquaculture; processing and marketing of fishery and aquaculture products.

Type of final recipient

Farmers, fisheries, rural SMEs or SMEs involved in the processing sector, tourism activities.

Partners involved

Ministry of Agriculture (Managing Authority); Rural Support Service (Paying Agency); State Joint Stock Company 'RDF' (Fund Manager); Financial intermediaries (banks). For publicity purposes, beneficiaries' associations are involved. Soft support could be received from the Latvian Rural Advisory and Training Centre, which is financed from the Latvian RDP.

Timing

July 2010 until the end of the 2007-2013 programming period.

Main results

Credits to finance 58 projects:

- 51 to modernise agricultural holdings;
- 4 to add value to agricultural products;
- 1 for developing tourism activities;
- 2 for fisheries: aquaculture infrastructure and processing infrastructure.

2 Objectives

The Credit Fund was introduced as a supplement to the EAFRD and EFF investment grants to solve liquidity problems faced by potential grant recipients. The 2008-2009 economic crisis greatly reduced the ability of Latvian farmers and fishermen to obtain loans. Potential grant recipients thus lacked funds to cover their contribution to projects and to ensure liquidity during project implementation. The Ministry of Agriculture proposed a new financial instrument, the Credit Fund, to increase the number of applications for investment grants. The Credit Fund addressed the lack of loans on the market by lending at reduced interest rates. This ensured the funds to implement projects. Alongside the Credit Fund, there was a state-funded guarantee instrument for the recipients, but it was rarely used in combination with Credit Fund loans. The Ministry proposed the Credit Fund as the most effective instrument after an analysis of similar financial instruments in other EU Member States, such as Lithuania, Romania and Germany.

The Credit Fund focuses on the following six measures envisaged in the RDP for Latvia 2007-2013 and the OP for the Latvian fisheries sector 2007-2013: (a) modernisation of agricultural holdings; (b) adding value to agricultural products; (c) enterprise creation and development; (d) development of tourism activities; (e) productive investments in aquaculture; (f) processing and marketing of fishery and aquaculture products. Some of the funding from each measure was reallocated to the Credit Fund, though originally these measures were designed only to provide grants.

These measures contributed to the objectives of the RDP and EFF OPs to: (a) improve the competitiveness of agricultural and forestry businesses; (b) diversify and develop business in rural territories and improve existing rural infrastructure; and (c) enhance the competitiveness of fishery and aquaculture product processing.

In general, the recipients could also receive financial support from national instruments including state guarantees for securing loans and loans for financing working capital or microcredits from a state bank. Through its low-interest loans, the Credit Fund supplemented these instruments by giving grant recipients the finance to implement their investment project. The practice of pre-financing grants with loans from a financial instrument is no longer allowed in the 2014-2020 programming period.

Dairy farm supported by the financial instrument

A dairy farm in southern Latvia is one example of a funded project. Before the project, Farmer Mairis kept around 50 cows and 50 heifers in an old cowshed and was selling milk to a local enterprise. The old cowshed was not big enough to increase the number of cows. Furthermore it did not ensure optimal living conditions for the cows, so milk production was under par. Therefore, Farmer Mairis considered building a new cowshed to increase the number of cows and to improve their living conditions.

Maris found out that he could receive a grant to cover a substantial part of his investment costs. However, he would also need a loan to start and implement the project, since grants could be paid only after the project's completion. At that time he could not get a commercial loan from the bank. After receiving a Credit Fund loan of EUR 1 million in 2012, he built a new cowshed that had all the necessary equipment, including automated cow feeders.

3 Set up of the financial instrument

The Credit Fund began operations in October 2010 to address the huge financing gap for agricultural and fisheries projects that had been brought about by the crisis. Various institutions worked together to get EUR 44.7 million in loans to farmers and fishermen.

3.1 Preceding events

The 2008-2009 economic crisis created an important gap between the demand for loans to finance investment projects and the availability of such financing on the market. This market gap reduced the number of projects being implemented under the EAFRD and EFF measures. To encourage new projects, the Ministry of Agriculture, as managing authority, proposed a new financial instrument – the Credit Fund.

In December 2009, the EAFRD Monitoring Committee decided to establish the Credit Fund under the RDP, and in February 2010 the EFF Monitoring Committee implemented the Credit Fund under the EFF OP. This addressed the lack of loans on the market by offering reduced interest rate loans for investment projects receiving grants. Four months later Credit Fund support under the EAFRD and EFF was approved.

The state-owned RDF was appointed as fund manager, taking into account its institutional experience with similar functions. In September 2010, the Ministry of Agriculture, as managing authority, signed a contract with the RDF and the Rural Support Service, the Paying Agency.

The RDF had already been working on a daily basis with banks, and national regulations enacted in 2010 allowed all banks in Latvia to participate in the implementation of the Credit Fund. Three banks expressed their interest and became financial intermediaries accepting the conditions of the scheme. Most banks had little interest in implementing the financial instrument due to the relatively modest remuneration in comparison to the workload and also due to the required uniform interest margin for all debtors, regardless of their credit risk.

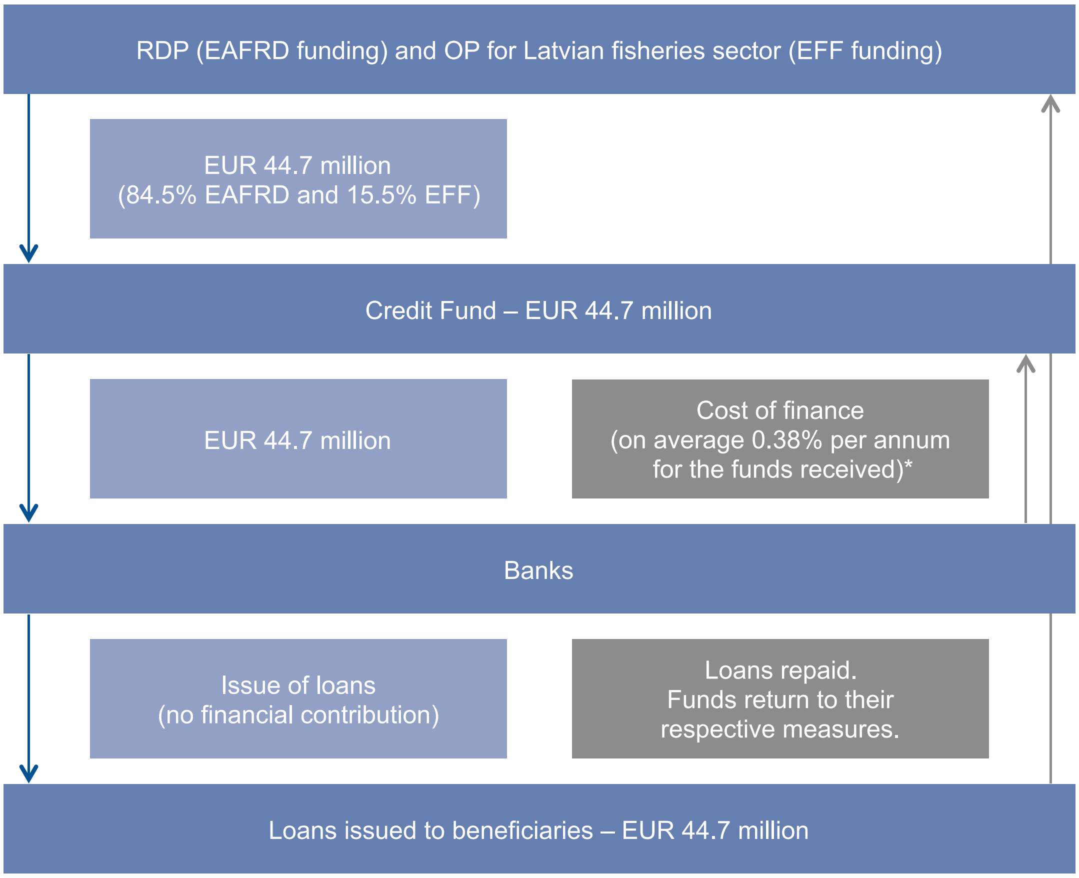
In October 2010 the first loan was issued, with the last loan in March 2012. Only 71% of the allocated amounts were actually delivered by October 2014 because commercial loans became more accessible (both in terms of price and availability) and the grants supplemented by the financial instrument came to an end.

3.2 Funding and partners

The Credit Fund involves a number of players with different roles. The Ministry of Agriculture is the **managing authority** and is responsible for detailing national regulations. The Rural Support Service is the **paying agency** responsible for: (a) evaluating business plans submitted by the Credit Fund; (b) transferring funds to the Credit Fund; (c) evaluating project applications submitted by beneficiaries in compliance with EU and national regulation; and (d) supervising the use of funds within the Credit Fund. RDF, the **fund manager**, evaluates financial intermediaries, transfers funds to **financial intermediaries**, establishes a budget and keeps records for the Credit Fund. Finally, financial intermediaries (banks) approve loan applications and report to the RDF and to the Paying Agency. These financial intermediaries are the Mortgage and Land Bank of Latvia (Latvijas Attīstības finanšu institūcija, or 'ALTUM' from 1 January 2014), AS Swedbank and AS 'Latvijas Krājbanka'.

Associations of beneficiaries were important for raising awareness, since they publicised information about Credit Fund loans. In terms of 'soft' support, the **Latvian Rural Advisory and Training Centre** helped potential recipients to apply for loans. This assistance was financed by the Latvian RDP. As shown in the figure below, because of the financial instrument's design, this was entirely financed by EU Funds.

Figure 1: Funding for the Credit Fund



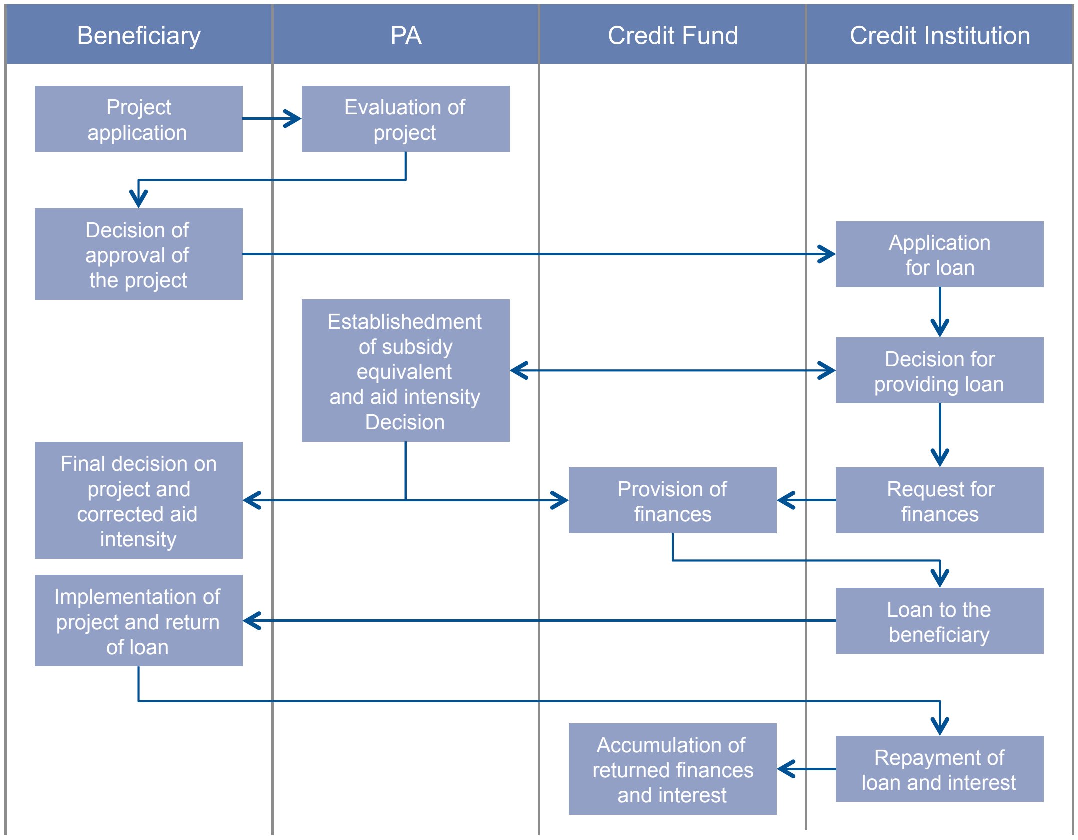
** This fee is used to cover management costs incurred by RDF (fund manager)*

3.3 Implementation

The financial instrument was launched in 2010 and implemented via the fund manager, RDF, with three financial intermediaries. Separate sub-accounts for EAFRD and EFF were opened by the fund manager to implement this instrument. The banks were designated as financial intermediaries to assess the credit risk of potential beneficiaries and to issue the loans.

The instrument's implementation structure is shown below. The fund manager transfers funds to financial intermediaries and keeps the records of the Credit Fund. Financial intermediaries disburse loans and report on these to the RDF and the Paying Agency. The financial intermediaries bear the risk of debtor default. Since the loans were used to finance projects applying for EAFRD and EFF grants, the paying agency made the final project approval.

Figure 2: Implementation structure of the Credit Fund



Source: Managing Authority

3.4 Governance

The managing authority, the fund manager and the paying agency signed a contract in September 2010, specifying responsibilities, monitoring and targets.

Financial intermediaries bear the full risk of loans defaulting: whenever a loan or part of a loan is not paid back, financial intermediaries do not receive any compensation from the Credit Fund or from OP allocations. Instead, they must take credit risk into account before granting loans. The interest rate they receive, therefore, reflects this risk premium.

4 Strategy

Given the decrease in farming and fisheries applications due to reduced access to commercial loans, the financial instrument's strategy of offering low-interest loans was attractive. The managing authority, associations of recipients and other partners were very good at passing on information about this opportunity to potential recipients.

4.1 Investment strategy

The Credit Fund addressed the lack of financing for investment projects receiving grants from support measures in the RDP and the EFF OP. The grant was paid only after the project was implemented. Without a loan the projects would not have been completed. Loans had reduced interest rates and much longer repayment periods.

Eligible expenditure included construction[1] and reconstruction costs; machinery and equipment planned in construction/reconstruction projects and preparation costs. VAT was not eligible.

4.2 State Aid

Assistance came from a grant and a financial instrument, which both had to comply with State Aid regulations. Some measures were for investments falling under the de minimis regulation with a ceiling of EUR 200 000 per recipient (granted over a period of three years). The general *de minimis* regulation covered aid for:

- 'Development of tourism activities', of which one project was financed from the Credit Fund loan; and
- 'Enterprise creation and development' (no Credit Fund loans were issued for projects supported by this measure).

[1] *Vessel construction is not eligible*

Most Credit Fund loans were for bigger projects not falling under de minimis. These were:

- modernisation of agricultural holdings;
- adding value to agricultural products;
- productive investments in aquaculture;
- processing and marketing of fishery and aquaculture products.

For the financial instrument, the difference in interest rates from market rates is treated as a subsidy equivalent. Since the Credit Fund loan is financed by the same support measure as the grant, the subsidy equivalent falls under the same aid type as the grant. The benefits from a lower interest rate combined with the grant amount constitute the 'gross-grant equivalent'. The grant amount may need to be rectified by the paying agency to remain below de minimis ceilings or correct the aid intensity.

4.3 Financial products and terms

A loan from the Credit Fund is not a pre-condition to receive a grant: The recipient can use other sources to finance the project. Upon approval of the project by the paying agency, the recipient receives a loan from the financial intermediary to implement the project. After project completion and an eligibility check, recipients receive their grant, which must be used to repay the loan (this practice is no longer allowed in the 2014-2020 programming period).

Credit Fund loan interest rates were, on average, two percent lower than commercial rates. Under this financial instrument, banks were required to have uniform interest margins for all debtors regardless of their credit risk. The Credit Fund also offered repayment of up to 15 years, which is much longer than commercial loans.

As with commercial loans, collateral was requested by financial intermediaries, who would bear any losses. If beneficiaries did not have enough collateral, a state-funded guarantee was available. The guarantees, part of a separate national instrument, were issued by the RDF and the Latvian Guarantee agency. However, such guarantees were rarely used to secure Credit Fund loans.

Information provided by one financial intermediary indicates that the average time to receive a loan was two months after submission of the application, 8 to 10 days longer than the average for commercial loans.

The Credit Fund did not include 'soft support', but recipients could receive free assistance from the Latvian Rural Advisory and Training Centre, which was financed by the Latvian RDP. This included support to comply with administrative requirements such as preparing a business plan. However, some recipients used other sources of assistance such as accountants to fill in the forms.

EUR 17.6 million has already been repaid by the recipients. These funds were returned to the support measures.

4.4 Final recipients targeted

The target group was recipients of grants from RDP and EFF OP support measures for investing in agricultural and aquaculture/fishery businesses and the diversification of rural economic activities. Recipients were predominantly farmers, but also fishermen, willing to improve the competitiveness of their businesses.

To inform potential recipients about the Credit Fund, the managing authority organised conferences with non-governmental organisations such as farmers' associations, and with potential recipients. The associations further spread this information. Credit Fund information was also available on the websites of the managing authority and other partners involved, such as the banks and the paying agency.

4.5 Project types

Most of the recipients used the money for investing in milk and cattle (beef production) farms; a smaller number invested in arable farms. For fish, one loan was for an aquaculture project and funded a bio filter pump and an industrial building. Another funded a fish waste processing factory, including equipment and specialised trucks. Together, both projects received EUR 4.6 million from the Credit Fund.

According to the financial intermediary that provided the most loans, amounts varied from EUR 37 000 to EUR 1 million. The average repayment period was 11.3 years.

4.6 Changes in Strategy

There were no substantial changes to strategy during implementation. There was a change in the interest rate paid by financial intermediaries from floating (0.38% on average) into fixed interest rates (0.5%). The absence of substantial changes may be because the Credit Fund was well designed to meet the needs of target groups.

Dairy farm supported by the financial instrument

Farmer Mairis received information on the availability of Credit Fund loans from the farmer's association. Although the loan was a supplement to the EAFRD grant, he had to submit two business plans – one to the paying agency to get a grant, and another to the financial intermediary to access the Credit Fund loan. This administrative burden was outweighed by: (a) the need for the loan. Since he was not able to get a commercial loan; and (b) the price of the loan. In 2012, a fixed interest rate of 4% for loans in Latvian lats, Latvia's former currency, was seen as attractive. The farmer overcame this challenge with the help of an accountant, who helped fill in the forms.

Another challenge was the fact that the farmer did not have enough property that could be pledged to secure the loan. This was overcome by a state guarantee securing the remaining part of the loan. Since the interest rate of the loan was lower than the market rates, the difference was treated as subsidy equivalent. After calculating the subsidy equivalent, the grant amount was amended to be in line with aid scheme provisions.

5 Achievements

In total, the Credit Fund financed 58 projects with 71% of the EUR 44.7 million allocation.

5.1 Output

The 58 final recipients implemented:

- 51 projects modernising agricultural holdings;
- 4 projects adding value to agricultural products;
- 1 project developing tourism activities;
- 2 fisheries projects, infrastructure for aquaculture and fishery product processing.

Dairy farm supported by the financial instrument

The main accomplishment of this project was a newly constructed cowshed with the necessary equipment, such as automated cow feeders. This led to an increase in the number of cows from around 50 to 120 and heifers from around 50 to 100. These cows now have improved living conditions with more space and more comfort, and they produce more milk.

As a result, the farmer more than doubled milk sales, due to the increased number of cows and the higher milk production per cow.

Without the Credit Fund, Farmer Mairis could not get a loan, thus the project would not have been implemented or would have been implemented much later when the banking sector recovered from the crisis and made commercial loans for farmers more available.

6 Lessons learned

Financial instruments can overcome liquidity shortages on the financial markets, especially if they are well designed. The Credit Fund's implementation was based on a good match between the financial offer and the needs of the target groups. It also used existing institutional relationships and effective awareness-raising campaigns.

6.1 Main success factors

The most important factor is that the Credit Fund **matched the needs of the target group**. Its price and availability proved efficient during the crisis, allowing banks and rural businesses to overcome the constraints of limited financial liquidity. Credit Fund loans supplemented the EAFRD and EFF investment grants by ensuring liquidity and recipient contributions. While this approach is no longer permitted under the 2014-2020 ESIF regulations, this case shows that market gaps can be addressed by combining traditional forms of support such as grants with more sustainable financing through financial instruments. The instrument itself could be supplemented by state guarantees to secure Credit Fund loans, if there was a lack of collateral.

Many of the achievements would not have been possible without proper organisation. The institutions were already working in the same field and **existing institutional relationships** ensured a quicker start and better implementation of the Credit Fund.

Effective awareness-raising was also an important feature. The Ministry of Agriculture, as managing authority, organised conferences with associations of recipients, who spread this information further among their members.

The transferability of the instrument allowed it to be replicated in the EFF OP, after it was first suggested in the RDP. This is important, given that both instruments addressed the same market gaps, but in different sectors. Even though the instrument under the EFF only funded two projects, it shows that financial instruments can be replicated and adapted to new needs.

6.2 Main challenges

The implementation mechanism involves a **complicated system of decision-making and project assessment** (business plans) in different institutions, which created administrative burden and delays. In the future, a 'one-stop-shop' could streamline procedures and reduce cross-checking, thus making it easier for final beneficiaries to obtain financing.

Another challenge was related to the **uniform interest margin for all debtors regardless of their credit risk**. This financing was limited to very small farms with higher risk, since financial intermediaries would have to bear any losses if the loan was issued without a state guarantee. The uniform interest rate and a relatively modest ratio between the reward and the workload meant that few banks were interested in implementing the scheme. The introduction of a shared risk principle between the financial intermediaries and the Fund could provide help for clients with higher risks.

6.3 Outlook

The Managing Authority is satisfied with the results of the Credit Fund and, subject to the results of the ex-ante assessment, plans to continue implementation of a similar financial instrument in the 2014-2020 programming period adapted to the new legislative framework using EAFRD funds, as well as EMFF funds at a later stage. The associations of recipients are also demanding that the Credit Fund activities continue.

Currently regular commercial loans are available, thus in the 2014-2020 period smaller recipients and business start-ups in rural areas that face more challenges in getting finance should receive more attention.

Some modifications to the approach will be introduced, taking into account the lessons learned and the new legal framework.

- The practice of pre-financing grants with loans from a financial instrument is no longer allowed in the 2014-2020 programming period.
- An ex-ante assessment will be carried out to establish the need for the FI.
- Experience shows that credit institutions are more willing to provide loans to clients with a solid credit history, so preference was given to large projects. The managing authority plans to provide more support for small beneficiaries, with a turnover of less than EUR 70 000, and for business start-ups in rural areas.
- 'Soft' support for applicants and beneficiaries will be combined with the Credit Fund, e.g. support for the preparation of business plans.
- The administrative burden should decrease if institutions are merged into a 'one-stop-shop'.

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