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RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
AGRICULTURAL POST-PRIVATIZATION ASSISTANCE 2
(APL PHASE 2) PROJECT
LOAN 4763 KZ
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TO THE
REPUBLIC OF KAZAKHSTAN
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ABBREVIATIONS AND ACRONYMS

AMFOK	Association of Microfinance Organizations of Kazakhstan
APPAP II	Second Post-privatization Assistance Project
MFI	Microfinance Institution
PAD	Project Appraisal Document
PFI	Participating Financial Institution
PMFI	Participating Microfinance Institution
SLA	Subsidiary Loan Agreement
TA	Technical Assistance
TOC	Team of Consultants

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KAZAKHSTAN
AGRICULTURAL POST-PRIVATIZATION ASSISTANCE 2 PROJECT
(APL PHASE 2)

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**AGRICULTURAL POST-PRIVATIZATION ASSISTANCE 2 PROJECT
(APL PHASE 2)**

RESTRUCTURING PAPER

SUMMARY

This Restructuring Paper seeks approval for the partial cancellation of the project financing for the Second Agricultural Post-privatization Assistance Project (APPAP II) and to make corresponding changes to the Performance Monitoring Framework. It is proposed to cancel US\$19,590,725 from the original amount of US\$35,000,000. The project is 15 months from its Closing Date of December 31, 2011 and full disbursement of the original project amount during the remaining period of the project is deemed unfeasible.

PROJECT STATUS

APPAP II was approved by the Board on December 13, 2004 and became effective on February 28, 2006. The project's revised closing date is December 31, 2011 and will not be affected by this restructuring.

Project's Development Objective. APPAP-II's principal objective is to enhance the access to commercial financial services by farmers and small/medium size rural enterprises. APPAP-II builds on APPAP-I achievements by: (a) building capacity for viable rural businesses through strengthening and expanding the rural advisory services program; (b) supporting agricultural risk management initiatives; (c) facilitating the development and implementation of new financial instruments by commercial banks and leasing companies for deepening rural financial outreach; and (d) supporting sustainable rural micro-finance schemes for providing financial services to rural micro entrepreneurs that are currently excluded from the formal banking sector.

The project has five components: (i) Rural Financial Advisory Services, (ii) Agricultural Risk Management, (iii) Rural Outreach by the Mainstream Financial Institutions, (iv) Rural Micro Finance Development, and (v) Project Management.

The Project Amount (excluding contributions from beneficiaries and co-financing by participating financial institutions) is US\$71.4 million of which US\$35 million (or 49%) is provided by the International Bank for Reconstruction and Development (IBRD), and US\$36.4 million (51%) is from the Republic of Kazakhstan (hereinafter referred to as Borrower). The IBRD finances part of the credit lines for banks, leasing companies, and micro finance institutions (MFIs), while the Government co-finances the credit lines

(US\$31.1 million) and fully finances all technical assistance (US\$5.3 million) under the Project.

Implementation results to date may be summarized as follows: (i) under Component 1, 660 rural financial advisors have been trained and have started providing services to rural entrepreneurs; (ii) under Component 3, about 800 staff of the PFIs have been trained in 'Investment Lending and Leasing in Agriculture' and 'Structured Finance in Agriculture'; and (iii) under Component 4, 300 microfinance specialists from over 100 MFIs have been trained in various microfinance-related subjects, and four MFIs have qualified for participation in the implementation of the microfinance credit line.

During the remainder of the project period, the project will focus on activities under Component 2, as well as the two credit lines under Components 3 and 4. However, due to significant delays experienced with the implementation of the two credit lines, it has been determined that these will not be fully disbursed by the project's closing date. Past delays have been primarily due to: (i) late approval of initially selected PFIs caused by a conflict between the selection conditions and the budget legislation; (ii) unattractive conditions of the credit line during the exceptionally strong economic growth of 2007-2008 when commercial banks enjoyed high liquidity and rapid growth of credit portfolio; (iii) diminishing enthusiasm of commercial banks due to cumbersome procedures and administrative delays; and (iv) the implications of the financial crisis of 2008. The situation began improving in late 2009 – 2010 following the revision of the conditions of the credit line and improvements in the financial health of the banking sector.

The project underwent a 3rd Order restructuring in January 2009 to reflect the following changes: (i) introduction of an advance disbursement mechanism for the participating financial intermediaries; (ii) provision of working capital financing among the financial products offered under the Credit Line; and (iii) increase in the sub-loan size under the Credit Line from US\$100,000 to US\$1 million. These changes to the implementation modalities have resulted in faster processing of the Credit Facility funds and enhanced capability to finance the agricultural production cycle.

Since the restructuring of the credit line, disbursement under the credit lines improved for both Components 3 and 4. To date, US\$5.4 million (18% of the US\$30 million provided by the IBRD for the component) have been disbursed under Component 3. US\$0.4 million have been disbursed out of the US\$3.65 million credit line allocated for microfinance under the Component 4. In view of the renewed interest in credit line facilities, the Borrower requested extension of the project implementation period, to which the IBRD concurred, and in September 2009 the project's Closing Date was extended until December 31, 2011.

However, overall disbursements under the credit lines continue to remain slow. During the last mission in March 2010, it was deemed that at the current pace of disbursements, full disbursement of the credit line by the closing date was highly unlikely. Ratings for progress with both implementation and achievement of PDO were downgraded to ***Unsatisfactory***. The project team also recommended that the Government consider partial cancellation of the IBRD funds allocated for the credit lines.

Financial Management Status. The project has no significant financial management issues. The project audit report for 2009 with an unqualified (clean) opinion has been received. It has been reviewed by the Bank’s FMS and deemed satisfactory.

PROPOSED CHANGES

1) *Partial Cancellation of the Project Funds.* It is proposed to cancel US\$19,590,725 under the project. A letter from the Borrower, dated August 4, 2010 was received requesting the partial cancellation of the IBRD funds in the amount of US\$19,590,830. It should be noted that the amount proposed to be cancelled is lower than that requested by the Borrower by US\$105 as in Category 2 the remaining undisbursed balance is smaller than the amount requested by the Borrower to be cancelled from this Category.

2) *Changes to the Indicators of the Two Affected Components.* The impact of the proposed partial cancellation on the results and indicators of the two affected components is reflected in Annex 1 to this Paper. To ensure consistency between the PAD and the Supplemental Letter on Performance Monitoring Indicators for the two affected components, some indicators have been added, dropped or revised. The draft revised Supplemental Letter on Performance Monitoring Indicators is attached as an Annex to the Notification to the Borrower on Partial Cancellation.

The Project Costs will change as follows:

Project Costs (US\$m.)*		
Components/Activities	Current	Proposed
Rural Financial Advisory Services	1.68	1.68
Agricultural Risk Management	1.93	1.93
Rural Outreach by Mainstream Financial Institutions	60.60	45.60
Rural Microfinance Development	5.37	2.13
Project Management	0.46	0.46
Unallocated/Contingencies	1.35	0.00
Total	71.39	51.80

* The Project Costs exclude contributions by Beneficiaries and PFIs.

The Expenditure Categories (Schedule 1 to the Loan Agreement) will be affected as follows:

Expenditure Category	As Per Loan Agreement, US\$	Proposed, US\$
(1) Sub-loans and Lease Financings under Part C.2 of the Project	30,000,000	15,000,000

(2) Micro-Sub-loans under Part D.2 of the Project	3,650,000	409,275
(3) Unallocated	1,350,000	0
TOTAL	35,000,000	15,409,275

Revised Disbursement timeline:

Fiscal Year	Annual	Cumulative
2010		4.15
2011	8.0	12.15
2012	3.25	15.4
	Total	15.4

ANNEX 1:
KAZAKHSTAN: AGRICULTURAL POST-PRIVATIZATION ASSISTANCE 2 PROJECT (APL PHASE 2)

Results Framework and Monitoring

Project Development Objective (PDO): APPAP II's principal objective is to enhance the access to commercial financial services by farmers and small/medium size rural enterprises. APPAP II will build on APPAP I achievements by: (a) building capacity for viable rural businesses through strengthening and expanding the rural advisory services program; (b) supporting agricultural risk management initiatives; (c) facilitating the development and implementation of new financial instruments by commercial banks and leasing companies for deepening rural financial outreach; and (d) supporting sustainable rural micro-finance schemes for providing financial services to rural micro entrepreneurs that are currently excluded from the formal banking sector.											
Revised Project Development Objective: N/A											
PDO Level Results Indicators*	Core	D=Dropped C=Continue N= New R=Revised	Unit of Measure	Baseline	Cumulative Target Values**				Frequency	Data Source/ Methodology	Responsibility for Data Collection
					YR 1	YR 3	YR 5	YR 7			
Indicator One: Growth in rural lending due to the project	<input type="checkbox"/>	C	%	0	-	5%	10%	10%	Annual	Portfolio reports by PFIs	TOC
INTERMEDIATE RESULTS											
Intermediate Result (Component One): Number of farmers using the private consultants											
Revised Intermediate Result (Component One): N/A											
<i>Intermediate Result indicator Two:</i> Number of farmers using the private consultants	<input type="checkbox"/>	C	Number	0	-	3,000	5,000	7,000	Quarterly	Consultant reports	TOC
Intermediate Result (Component Two): The crop insurance program is operational; Commodity Exchanges start to grow											
Revised Intermediate Result (Component Two): N/A											
<i>Intermediate Result indicator One:</i> Number of crop insurance contracts issued	<input type="checkbox"/>	C	Number	0	-	2,500	4,000	7,000	Annual	Statistical data	TOC

<i>Intermediate Result indicator Two: Number of contracts traded on the Commodity Exchange</i>	<input type="checkbox"/>	C	Number	0	-	5,000	10,000	15,000	Annual	Statistical data	TOC
Intermediate Result (Component Three): Growth in long-term rural lending											
Revised Intermediate Result (Component Three): N/A											
<i>Intermediate Result indicator One: Number of loans and leases disbursed from the credit facility</i>	<input type="checkbox"/>	R	Number	0	-	20	100	200	Quarterly	Reports from PFIs	TOC
<i>Intermediate Result indicator Three: Repayment rate of 98%</i>	<input type="checkbox"/>	C	%	0	-	98%	98%	98%	Quarterly	Reports from PFIs	TOC
<i>Intermediate Result indicator Four: Volume of Bank Support – lines of credit to SMEs</i>	Yes	R	US\$ mil	0	-	3.0	8.0	30.0	Semi-annual	Reports from PFIs/TOC	TOC
<i>Intermediate Result indicator Five: Volume of Bank Support – Institutional Development - SME</i>	Yes	R	US\$ mil	0	-	0.15	0.32	0.32 ¹	Semi-annual	Reports from TOC	TOC
Intermediate Result (Component Four): Growth in MFI rural outreach											
Revised Intermediate Result (Component Four): N/A											
<i>Intermediate Result indicator One: Number of MFIs that graduate into superior performance where they qualify for borrowing from commercial sources</i>	<input type="checkbox"/>	R	Number	0	-	1	3	4 ²	Quarterly	Reports from AMFOK	TOC
<i>Intermediate Result indicator Two: Repayment rate of 95%</i>	<input type="checkbox"/>	C	%	0	-	95%	95%	95%	Quarterly	Reports from PMFIs	TOC

¹ The Cumulative Target Value here represents the actual amount spent on training of banks and leasing companies on SME lending.

² The Cumulative Target Value here represents the actual number of MFIs which have been qualified for borrowing from commercial banks upon completion of the TA program.

<i>Intermediate Result indicator Three: Volume of Bank Support – lines of credit to Microfinance</i>	Yes	R	US\$ mil	0	-	0.2	0.4	1.5 ³	Semi-annual	Reports from PFI/TOC	TOC
<i>Intermediate Result indicator Four: Volume of Bank Support – Institutional Development - Microfinance</i>	Yes	R	US\$ mil	0	-	0.20	0.53	0.53 ⁴	Semi-annual	Reports from TOC	TOC

***Please indicate whether the indicator is a Core Sector Indicator (see further <http://coreindicators>)**

****Target values should be entered for the years data will be available, not necessarily annually**

³ The Cumulative Target Value here represents the actual amount disbursed under the project for on-lending to MFIs from the IBRD funds (with the reminder to be cancelled), and the allocation from the budget of the Republic of Kazakhstan for the same purpose.

⁴ The Cumulative Target Value here represents the actual amount spent on training of microfinance institutions.

