

Document of
The World Bank

Report No: 35935

IMPLEMENTATION COMPLETION REPORT
(TF-29677 IDA-32360)

ON A

CREDIT

IN THE AMOUNT OF SDR 22.2 MILLION (US\$ 30 MILLION EQUIVALENT)

TO THE

REPUBLIC OF AZERBAIJAN

FOR AN

AGRICULTURAL DEVELOPMENT AND CREDIT PROJECT

December 30, 2005

CURRENCY EQUIVALENTS

(Exchange Rate Effective December 30, 2005)

Currency Unit = Azerbaijan Manat (AZM)

AZM 1 = US\$ 0.0002

US\$ 1 = AZM 4,593

FISCAL YEAR

0 6

ABBREVIATIONS AND ACRONYMS

ADCP	Agricultural Development and Credit Project
APL	Adaptable Program Lending
AR	Nakhchivan Autonomous Republic
AZM	Azerbaijan Manat
BG	Borrowing Group
CAS	Country Assistance Strategy
CU	Credit Union
ESC	Extension Support Center
GNI	Gross National Income
GOA	Government of Azerbaijan
IA	Implementing Agency for Rural Finance Component
IAC	Information and Advisory Center
IDA	International Development Association
ICR	Implementation Completion Report
IMF	International Monetary Fund
LFI	Local Financial Institutions
MFI	Microfinance Institution
MT	Master Trainers
NBA	National Bank of Azerbaijan
PIU	Project Implementation Unit
PA	Private Advisors
RAC	Regional Advisory Center
RCC	Regional Cadastral Centers
SA	Social Assessment
SDI	Subsidy Dependence Index
SLCC	State Land and Cartography Committee
SVS	State Veterinary Service
TA	Technical Assistance
TACIS	Technical Assistance for Commonwealth of Independent States
VFU	Veterinary Field Units

Vice President:	Shigeo Katsu
Country Director	Donna Dowsett-Coirolo
Sector Manager	Juergen Voegele
Task Team Leader/Task Manager:	Rufiz Chirag-zade

**AZERBAIJAN
AGRICULTURAL DEVELOPMENT AND CREDIT PROJECT**

CONTENTS

	Page No.
1. Project Data	1
2. Principal Performance Ratings	1
3. Assessment of Development Objective and Design, and of Quality at Entry	2
4. Achievement of Objective and Outputs	6
5. Major Factors Affecting Implementation and Outcome	14
6. Sustainability	15
7. Bank and Borrower Performance	16
8. Lessons Learned	17
9. Partner Comments	18
10. Additional Information	18
Annex 1. Key Performance Indicators/Log Frame Matrix	19
Annex 2. Project Costs and Financing	22
Annex 3. Economic Costs and Benefits	24
Annex 4. Bank Inputs	31
Annex 5. Ratings for Achievement of Objectives/Outputs of Components	33
Annex 6. Ratings of Bank and Borrower Performance	34
Annex 7. List of Supporting Documents	35
Annex 8. Financial Ratios and Portfolio Quality of CUs	36

<i>Project ID:</i> P035813	<i>Project Name:</i> AZERBAIJAN AGRICULTURAL DEVELOPMENT AND CREDIT
<i>Team Leader:</i> Rufiz Vakhid Chirag-Zade	<i>TL Unit:</i> ECSSD
<i>ICR Type:</i> Core ICR	<i>Report Date:</i> May 30, 2006

1. Project Data

Name: AZERBAIJAN AGRICULTURAL DEVELOPMENT AND CREDIT

L/C/TF Number: TF-29677; IDA-32360

Country/Department: AZERBAIJAN

Region: Europe and Central Asia Region

Sector/subsector: Micro- and SME finance (43%); Agricultural extension and research (32%); Sub-national government administration (17%); Central government administration (8%)

Theme: Land administration and management (P); Rural policies and institutions (P); Small and medium enterprise support (P); Rural services and infrastructure (P); Decentralization (S)

KEY DATES

PCD: 09/15/1998
Appraisal: 02/26/1999
Approval: 06/08/1999

	<i>Original</i>	<i>Revised/Actual</i>
<i>Effective:</i>	09/08/1999	12/21/1999
<i>MTR:</i>	03/15/2002	11/07/2003
<i>Closing:</i>	03/31/2004	06/30/2006

Borrower/Implementing Agency: REPUBLIC OF AZERBAIJAN/STATE AGENCY FOR AGRICULTURAL CREDITS

Other Partners:

STAFF	Current	At Appraisal
<i>Vice President:</i>	Shigeo Katsu	Johannes Linn
<i>Country Director:</i>	D-M Dowsett-Coirolo	Ishrat Husain
<i>Sector Manager:</i>	Juergen Voegelé	Laura Tuck
<i>Team Leader at ICR:</i>	Rufiz Chirag-zade	Van Roy Southworth
<i>ICR Primary Author:</i>	Samir Suleymanov	

2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S
Sustainability: L
Institutional Development Impact: M
Bank Performance: S
Borrower Performance: S

	QAG (if available)	ICR
<i>Quality at Entry:</i>	S	U
<i>Project at Risk at Any Time:</i>	Yes	

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

Background

The Government of Azerbaijan (GOA) requested World Bank support for the Agricultural Development and Credit Project (ADCP) during the period when the drastic decline in the agricultural sector following the collapse of the USSR had just reversed and started gaining momentum. The Government's land privatization and other market oriented efforts had produced almost a million of new small family farms in place of about 2,000 state and collective farms at the time when historic rural infrastructure and support services had collapsed, and the emerging rural entrepreneurs searched for access to finance and new technologies to adjust factors of production and change the scale of operations.

The Government reforms were fundamentally and rapidly transforming the agricultural sector, with emerging family farmers facing daunting tasks. Farmers who played no role in technical and managerial decisions on large state farms became owners and managers of small farm lands, often of few hectares. Emerging farmers immediately faced a challenge of switching the objective of farming from yield maximization to profit maximization with no experience, access to information, or advice. The agricultural research system, scientific in nature, was losing its relevance in this new reality and virtually collapsed due to lack of funding. Establishment of land markets, considered one of the cornerstones of the rural economy and the main asset of a farmer, was lagging, with good progress on issuing land title, but no procedures in place for registration of land transactions. In addition, the structural reforms were not yet advanced, and Government's capacity to formulate rural policy to assure that the emerging farm structure remained competitive in face of developments in the oil sector was nonexistent.

During the Project preparation in 1999, the financial sector was undergoing its own significant consolidation and restructuring process, not completed up until now. The transformation of the socialist banking system was marred by a colossal crash of credibility and confidence towards the sector. First, the collapse of the numerous and sizable pyramid schemes in 1994 quickly erased the promising trust of the population towards the emerging commercial banks. This was followed by the Russian financial crisis of 1998 that exacerbated the commercial banks' hesitance in all lending, but particularly in agricultural lending - at the time of project preparation, no banks had rural branches. On top of all this, alternative pilots for providing badly needed rural finance did not produce satisfactory results. TACIS's effort to recycle funds raised by the sale of emergency food through hurriedly established credit unions did not sustain itself, and the majority of the credit unions established did not survive.

Against this background, the GOA requested multi-phased Adaptable Program Lending (APL) support over 10 years with a total indicative financing plan of US\$133.7 million (with Bank financing of US\$100 million) to address the medium term development agenda of the agricultural sector. Considerations above determined the approach to the design of the program, which had implications throughout implementation. The program supported a multiple number of related interventions, each of which has the complexity of a stand-alone project, as no single intervention was deemed sufficient to spur growth in rural areas. The underlying concern that influenced the design of the core rural finance activities was to induce a proper credit culture amongst the rural population, and ensure that emerging financial intermediaries would not pose any risks to public interests.

Project Objectives

This Project is the first phase of a three phase Program. The objective of the Agricultural Development and Credit Program is to return Azerbaijan's farming areas to former levels of productivity under a new system characterized by private family and group farms operating in private markets through development nationwide of: (i) an accessible, secure and unified system for registering all rights in real estate; (ii) a network for financial services in rural areas consisting of local financial institutions to provide private farms and other rural enterprises with market-based financial services; (iii) mixed public and private advisory services for rural enterprises; and (iv) Government capacity to formulate appropriate policy responses to the impact of the anticipated build-up in oil revenues on the competitiveness of the rural economy.

Within these Program objectives, the main objectives of the Project were for private family and group farms and other private rural entrepreneurs to (i) begin to register land transactions in large numbers, (ii) use information and advisory services, and (iii) expand investment in their farms and other rural businesses. Thus, the four-year *APL I* Project (extended to a six-year term during implementation) focused on completing the land titling and improving land transaction services nationwide; testing mechanisms for a unified real estate registration system encompassing rural and urban land and buildings in a pilot region (Nakhchivan AR); establishing and testing new relations between emerging entrepreneurs and service suppliers in five pilot regions; demonstrating and testing the feasibility of financial intermediation in rural areas through local membership based institutions; and building capacity in the Government to formulate a new assistance strategy in the evolving rural sector.

Building upon lessons learned in the first phase, the two subsequent phases (*APL II and APL III*), would intensify and expand the Program agenda by: rolling out a model for a unified real estate registration system nationwide; expanding the coverage of rural advisory activities nationwide; implementing overall reforms of agricultural research in the country; increasing the number of local financial institutions in rural areas; and engaging commercial banks as financial intermediaries in rural areas.

The first phase of the APL for US\$30 million was approved on June 8, 1999, signed on October 4, 1999, and became effective on December 21, 1999. The objectives reflected the essential priorities of the Government, aimed at ensuring non-oil sector economic growth and preventing the loss of competitiveness of the agricultural sector, employing 45% of the workforce, in light of the potential appreciation of the real exchange rate due to the rapid development of oil resources. The objectives were also consistent with the Bank's Country Assistance Strategy of 1996 that emphasized agriculture in the context of enhancing competitiveness in critical sectors and providing opportunities for expanding incomes of Azerbaijan's poor. Specific CAS objectives directly supported by the project were developing the land market within an appropriate legal framework and providing a rural credit scheme and advisory services for new private farmers.

These objectives are still very relevant today, reflected in the country's Poverty Reduction Strategy Paper, known as the State Program on Poverty Reduction and Economic Development (SPPRED) and the Bank's Country Assistance Strategy for the period of 2003-2005 which describes rural development in the context of decreasing the disparity between the capital and the rural population, managing the oil boom, and generating growth in non-oil sectors as agriculture still employs 40% of the workforce.

Given the piloting nature of Phase I, the objectives were described somewhat flexibly to allow for adjustments during implementation, although these could be presented with more clarity against the later

and ultimate objectives of the whole Program. A specific set of triggers was prepared to measure the Program's achievements for advancing from Phase I to subsequent phases. The objectives of the APL I were somewhat ambitious for a four-year project, both in terms of institutional changes and reforms sought in its geographical coverage with various project activities to be implemented in 45 out of 66 raions (administrative districts) of the country.

3.2 Revised Objective:

The objectives remained unchanged.

3.3 Original Components:

Real Estate Registration Component (US \$5.44 million, of which US \$5.1 IDA) had two subcomponents: (i) *Implementation of a Cadastre and Land Registration Systems* through the State Land and Cartography Committee (SLCC) was designed to support land market development in the country specifically through decentralization measures; and (ii) *Pilot Unified Cadastre and Registration System for Land and Buildings in Nakhchivan AR* to be rolled out nationwide in subsequent phases of APL.

Information and Advisory Services Component (US \$10.00 million, of which US \$9.3 IDA) included the following activities: (i) *Strengthen the existing Extension Support Center (ESC)*; (ii) *Develop public and private sector capacities to provide advisory services* through establishing rural advisory centers (RACs) in five pilot regions; (iii) *Support agricultural research and technology transfer* through a competitive grant scheme for on-farm experimentation and demonstration; (iv) *Introduce private veterinary services* through establishment of twenty-five Veterinary Field Units (VFUs) in the five pilot regions. The component was designed to meet the immediate information needs of the farmer through information campaigns, develop capacity for information provision both in the public and private sectors, assemble useful information, and test delivery mechanisms. The component prescribed mechanisms for partial cost-recovery of private advisory services. Recognizing the need for the Government to subsidize such farmer education activities, the component was expected to develop a subsidy category schedule for extension services for the MOA to support such services in the long run.

Rural Finance Component (US \$15.29 million, of which US \$12.99 IDA) was the largest in the project. It was designed to pilot market-based credit and deposit services for rural households, enterprises and farms and included: (i) *Creation of a distribution network of local financial institutions (LFIs)* in rural areas consisting of approximately 80 credit unions (CUs) and 200 (informal) groups of jointly liable borrowers (BGs); and (ii) a *rural credit line* to the participating LFIs for allocation of sub-loans to their members, implemented through an institution with sufficient international experience and financial means to co-finance 20 percent of each loan to LFIs, manage the credit line, and provide TA. The *Rural Credit Facility (RCF)* was envisaged to disburse loans to, and collect repayments from participating LFIs. This Facility was not planned as an actual physical entity, but rather as a temporary Agency and Co-financing Agreement between the Ministry of Finance (MOF) and the selected implementing agency.

Rural Policy Component (US \$0.78 million, of which US \$0.72 IDA) would establish a Rural Policy Unit to assist the Government to develop a strategy to maintain the competitiveness of agriculture in face of the potential impact on the real exchange rate of developments in the oil sector and related issues of agricultural sector management.

Project Management (US \$2.14 million, of which US \$1.89 IDA) would finance the additional staff, equipment, technical assistance and training required by the Project Management Unit (PMU) for the Farm

Privatization Project so that it can assume responsibility for the implementation of the new project.

The design of the Project components is clearly linked to its main objective of initiating the establishment of new market relations for emerging small farmers and entrepreneurs in rural areas, following the comprehensive privatization and reform process. It was recognized that a multi-component approach adds considerable complexity to the design of the project, from the point of view of technical supervision required, local implementation capacity needed, and institutional coordination it calls for (Prime-Minister's Office, Ministry of Agriculture, Ministry of Economic Development, Ministry of Finance, National Bank, State Land and Cartography Committee – are all engaged in supervision / implementation of various activities). Yet, given the prevailing conditions in rural areas at the time, and the intricacy of issues to be addressed to achieve the stated objectives, all activities seem warranted. All of Project's interventions were essential for building new market relations in rural areas, though ideally they would have been carried out separately to have a less complex project design. Improved land registration services would facilitate the legal basis for full private land ownership and development of land markets, including sale, leasing, gift-giving and inheritance. The capacity to formulate modern rural policy would help the reformed Government structures in determining the future nature of public investment and public services, including advisory, veterinary, etc. Advisory and extension services were meant to provide essential access for new small-holders to knowledge and technology in order to make informed and efficient investment decisions. All of this demonstrates a clear interconnectedness of various Project activities, and synergy which were even further enhanced during project implementation, mainly by linking the advisory services to rural finance activities, as discussed in proceeding sections.

Many alternatives for selecting the modality for each activity were carefully analyzed. Special attention in the design of modalities was given to the issue of commercialization and cost recovery of services, wherever possible. Thus, the components include suggestions and action plans for cost recovery measures for advisory, veterinary services, and title registration services.

Nevertheless, several shortcomings can be noted in the design of the Rural Finance Component, specifically:

(i) *Nature of Implementing Agency (IA).* Given the less than favorable developments in the finance sector in general, as described above, the Government was mainly concerned about ensuring the diligent and cautious screening of financial intermediaries, and absolute enforcement of the credit culture. One of the reasons for unsuccessful implementation of a TACIS credit line for Credit Unions in 1999 was often cited to be a lack of incentive on the part of the corresponding implementing agency to ensure timely repayments. Thus, the innovation proposed by the Project was to make the Implementing Agency assume 20% of every loan to any of the LFIs. This was expected to make the IA responsible both for providing the quality technical assistance to the evolving sector (local rural financial institutions), and also ensuring recovery of its own investment. This approach posed a great risk that no interested bidders for a role of an IA would show both a willingness to invest 20% contribution and capacity for providing the necessary qualified TA. It shall be noted that this risk was explicitly recognized at the appraisal, and analyses for alternative approaches and shortcomings were fairly presented.

(ii) *Exit Strategy for IA.* The IA is solely responsible not only for the TA and capacity building, but also for providing institutional management under the Rural Finance Component. The PAD is almost silent on transition steps for the institutional withdrawal of the IA. It is not discussed who would collect outstanding loans from BGs; provide institutional support for CU establishment; and assume the role of the Rural Credit Facility. This also by default focuses the IA's efforts on ensuring the collection of its investment share. It shall be noted that a longer term vision for replacing the IA was considered and

presented at appraisal in the form of an Apex for CUs, a vision currently being adopted by the Government, but without specifics regarding the transition period. This shortcoming was addressed during project implementation, as the IA has prepared an Exit Strategy as discussed in following sections.

3.4 Revised Components:

The components were not formally revised, but few changes were made to the design of the unified real estate registration and cadastre sub-component. Specifically, aerial photography was replaced by satellite imagery to produce base mapping. Also, due to long delays in the start up of the rural finance component, some adjustments were made in original targets and triggers for credit unions. These are discussed in Section 4.1 below. The time originally allowed for completion of the project was unrealistically short and the project was extended first by 18 months to September 2005 and then by 9 months to June 2006. The second extension was required for testing some additional activities that are consistent with the original project objectives and likely to be continued through the APL 2, and for continuing essential project activities to ensure smooth transition from APL 1 to APL 2. In November 2004 and September 2005 there were reallocations of funds to Consultants' Services and Goods mainly from Unallocated and Sub-loans Categories.

3.5 Quality at Entry:

A QAG review was carried out for the Project and rated its Quality At Entry as Satisfactory with notable excellent features, such as Social Assessment and poverty targeting, and some weaker elements, such as lack of a qualified IA selected prior to appraisal.

This ICR rates the Project's Quality At Entry as Unsatisfactory. While the project design (i) is notable for its consistency with rural development priorities of the country, Bank's assistance strategy, and poverty alleviation; (ii) was based on a rigorous analyses of relevant experience in other project, and assessment of various implementation modalities; and (iii) provides for cost-recovery mechanisms for advisory, land transactions, and veterinary services, it also contains few important shortcomings. The most important weaknesses of the project design, as described in sections above, relate to the nature and exit strategy for the IA, and the ambitious set of institutional reforms expected. In fairness, it should be mentioned that seven out of twelve identified Critical Risks for achieving project objectives were rated as High at appraisal, yet all of the risks were fairly and comprehensively identified and presented.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

The Project objectives are still within the priorities of the Government in regards to management of the oil boom (which includes ensuring competitiveness of non-oil sectors), generating growth in the non-oil sector, and alleviating poverty that is most evident in rural areas. Agriculture still employs 40% of the workforce compared to 45% at the time of Project approval. According to IMF assessment, the financial sector is still underdeveloped even by the standards of transition economies, with deposits and credits equivalent to about 12% and 11% of GDP respectively as of end 2004.

Banks have not been interested in the provision of financial services to economy at large, especially to SMEs and the poor, and those in rural areas. The penetration is extremely low with fewer than 100 branches in the non-Baku area. Continued weak confidence in the banking sector is evidenced by low capitalization of banks and the prohibition to take deposits during the first two years of operations. Non-Bank financial institutions (MFIs, CUs, and informal borrowing groups) in this situation play an

essential role by providing access to credit for small businesses, especially in rural areas.

Achievement of the overall objectives under the Project is *satisfactory* and in line with the general Program objectives, despite problems experienced in implementation of the Rural Finance Component. The Project has been an essential bearer of change in rural areas and the largest effort by the Government in the past several years to increase agricultural production.

Assessing the Project Development Objectives (it shall be noted that the data presented in the ICR are as of June 30, 2005, twelve months before the closing date of the Project):

(i) *Family and group farms and entrepreneurs begin to record land transactions in large numbers:* land titling has been completed timely and efficiently with more than 867,000 original titles registered, and land transactions are being seen in large number, exceeding 27,000 over the last three years and a half.

(ii) *Family and group farms and entrepreneurs begin to use advisory and information services:* the outreach of the Advisory Services activities has been impressive, directly affecting around 50% of the rural population of five regions where the services were offered, amounting to about 243,000 people.

(iii) *Family and group farms and entrepreneurs begin to expand investment in their operation:* the Project shows impressive results in expanding investments in rural areas with over 27,500 small loans issued to about 20,300 people (over a period of two years and a half) for a total amount of US \$11.7 million. This represents a significant outreach for a pilot initiative, especially as it engaged economically active people previously excluded from formal banking sector, thus contributing to overall economic growth in the pilot areas. It shall be noted that the Project was cited as a good example of fair beneficiary targeting by Operations Evaluation Department (OED) in 2003 review of Projects with Lines of Credit for its broad potential audience that still avoided lending to otherwise highly creditworthy clients, who would have been likely to obtain credit anyway.

Assessment of APL Triggers

All of the triggers for moving into APL II were met, albeit some were revised to accommodate factors beyond the control of the Government. One of the triggers calling for an "agreement on the institutional framework for nationwide implementation of a unified real estate registration system" has been met only partially at the time of ICR completion as explained in Annex 1. There was an adjustment following the Mid-Term Review to the Outcome Indicators of the Project Development Objectives under the Rural Finance Component, described in the Letter of Development Policy for the APL. The reasons for downscaling the expected outcomes were the considerable delay in the contracting of the IA for the component, delay in agreeing with the IA on a philosophy, approach, and methodology for the component, and regulatory changes for credit unions that had occurred after the project was approved, such as high licensing fees and high capital adequacy ratio. Yet further delay was caused by the time consumed in reaching an agreement with the IA over a new financial model for CUs, acceptable to the World Bank, necessitated by the prohibition on savings. On March, 2004 it was agreed with IDA that the PDO indicators under the Rural Finance Component would be revised to decrease the number of CUs from 60 as expected at appraisal to 30. For the same reason, the trigger that called for at least 75% of the established CUs to show a Subsidy Dependence Index of less than 50% has also been only partially met. The remaining triggers have been materially and substantially met justifying advancing to Phase II on the core activities of the Project. Annex 1 contains more detailed information on the triggers for Phase I.

4.2 Outputs by components:

Real Estate Registration Component (IDA: US \$5.1 million at appraisal; US \$4.37 million actual, as of June 30, 2005): This component is rated *satisfactory*. It already achieved its *physical* objectives by establishing ten efficiently operating Regional Cadastral Centers (RCCs) for State Land and Cartography Committee (SLCC). Significant initial delays were caused by unwillingness of the SLCC to decentralize its functions, despite the agreements reached during project negotiations. The authority to conduct and complete land transactions locally was eventually transferred to the RCCs after engagement of the Cabinet of Ministers on the matter. They have expedited the issuance of land titles following the privatization of kolkhozes and sovkhozes, and issued some 50,000 of such titles. Since their establishment in 2002, the RCCs also issued 98% (or 394,000) land certificates for private household plots previously issued only by the central SLC. This function was not expected to be assumed by the RCCs at appraisal. And at last, the RCCs have carried out the bulk of secondary land transactions (purchase/sales, leases, gifts, inheritance, and exchange of land parcels). All of this has resulted in significant *economic* impact, i.e. volume increase, improved transparency, and efficiency gains in land transactions as the landowners do not have to travel to the capital for this purpose. Overall the time for land transactions has been cut to less than 10 days (from 30 before the project), and access to timely and reliable land data has become available. The RCCs have contributed considerably to acceleration of the land privatization process and expansion of the land market in rural areas. The fee structure adopted under the Project for land transaction services resulted in nearly 50% cost recovery already for the established regional centers, thus reducing the burden on state financing of such services. This figure reflects the full costs of the RCCs that were mainly incurred by the issuance of land titles and certificates associated with the land privatization program (see Annex 3 for details). Another subcomponent was to pilot a Unified Cadastre and Registration System (UCRS) for rural and urban land and buildings in Nakhchivan AR. The pilot UCRS test consisted of several parts including the start-up of the compilation of graphical cadastral maps across a defined area based on metric digital ortho-rectified maps commissioned under the Project. Registration and cadastre software has been installed and the UCRS has been piloted in one small urban and one rural area on Nakhchivan. The next step involves the expansion of the system throughout the Nakhchivan by the end of the Project. The outcome of the pilot was judged by all parties as successful and the system is suitable for the use with appropriate adaptation in other parts of Azerbaijan. The new Law on State Real Estate Register adopted by the Parliament in May 2004 provides for the creation of an institutional framework for a unified registry system which is one of the objectives of the Project. The Law did introduce the State Service for Registration of Real Estate (SSRRE) which will takeover the registration of all real estate nationwide, but the cadastre aspects of the registration process were not clearly stipulated in the Law. In addition, the Government had approved the supporting regulations in regard to the Law which authorize SSRRE to undertake the function of a unified real estate cadastre. Yet, there is a need to harmonize all relevant prior legislative acts with the consequences of the new Law and clarify mandates of the relevant agencies concerning the real estate cadastre.

A satisfactory rating is justified because of the successful pilot project particularly the achievement of a transfer of technology in terms of awareness creation, the acceptance and adoption of orthophoto mapping techniques by all agencies, as well as the implementation of registration and cadastre operational computer system. The scale up of the system was originally planned to be part of Phase II. However, the Bank and the Government agreed that a standalone and larger project for FY 07 would be more appropriate to roll-out the pilot cadastre and registration system nationwide.

Overall, there have been economic gains from the unified system in Nakhchivan (following the pilot) and then potentially nationwide. It would lead to the future modernization and unification of the present

fragmented real estate registry system in the country.

Information and Advisory Services Component (IDA: US \$9.3 million at appraisal; US \$8.97 million actual, as of June 30, 2005): The implementation of the component is *highly satisfactory*. Important institutional achievements of the component include: immediate access to technology and information granted to farmers; demonstrated effectiveness of service provision by the private sector; and introduction of private veterinary practices.

The component has achieved impressive results in physical outreach. The component has been implemented by the Information and Advisory Center (IAC), and includes a number of Master Trainers (MTs) providing training to local advisors based on 110 modules prepared so far. The IAC coordinated preparation of more than 600 media broadcasts and materials and 900 publications communicated through eight intensive information campaigns on various technical and managerial topics. Five Regional Advisory Centers (RAC) (2 as public entities, and 3 through contracts with private service providers) maintain and coordinate the network of 115 village based Private Advisors (PAs) who have been trained by MTs and participated in overseas study tours. Advisory services were provided to some 243,000 people, or nearly 50% of the population in the five regions covered by RACs. The surveys conducted by the project team show that the beneficiaries have been adopting many of the improvements recommended by advisory services and already demonstrate improved management and increased yield. Cost recovery mechanisms for PA services have been introduced. PAs have also played an essential role in the formation and advising of BGs under the Rural Finance Component. As envisaged, 25 Veterinary Field Units were created, and have served more than 48,000 livestock owners so far (more than 30,000 than estimated at appraisal). Notable revenues (US 122,000 as of June 30, 2005) generated by the VFUs for the services demonstrates a demand for private veterinary services and high level of satisfaction by the beneficiaries. The Competitive Grant Scheme, not meant to overhaul the agricultural research system in the country, focused on providing immediate solutions to farmers by introducing a competitive and transparent mechanism for delivering available new technologies to farmers. It institutionalized a new approach to research in general: priorities for research to be determined by beneficiaries through an independent Grant Board and contracted to research institutes; research to be “applied”, based on on-site experiments, and brought to a farmer. The Scheme supported 52 experimental research activities and an estimated 11,000 farmers have visited these demonstration sites for research or practical training. This number is expected to increase by the end of Project, as only 35 grants have been fully implemented.

Economic benefits from the component are substantial, and mainly derived from efficiency gains from improved farming, application of new technologies, knowledge, and inputs. Based on the IAC surveys, around 76% of farmers participating in advisory services activities indicated that their family incomes had increased since the program started, compared with only 35% who had not received the advisory services. While many other factors, such as increase of market prices for fruits and vegetables, better access to financial recourses have certainly contributed to this increase, it can be at least partially attributed to the impact of extension services. A sectoral achievement has been the demonstration of the value of the information and of the feasibility of private provision of veterinary services, verified by the steadily increasing rate of paid services by PAs and VFUs.

Rural Finance Component (IDA: US \$12.99 million at appraisal; US \$12,54 million actual, as of June 30, 2005): The implementation of this component has been marred by problems, and was rated unsatisfactory from 2001 until December 2004 (with a brief period of upgrade in 2003), first due to delays in contracting of the IA, then due to poor performance of the IA. The component was a subject of Mid-Term Quality Enhancement Review, and has been consistently improving thereafter. In December 2004, the component rating was upgraded to Satisfactory. While the first identified IA to manage the

implementation and co-financing of the component dropped out during project design, the first round of procurement also failed for reasons outside of Borrower's control. The second round of protracted procurement procedures ultimately procured an IA only in May 2002. The judgment of the independent evaluator hired by the Borrower was that the firm indeed met the qualifications. However, soon after, the Bank's apprehension at the appraisal about the possibility for poor performance of the component due to weak qualifications of the IA proved justified. The selected IA acted successfully in creating BGs, but displayed little understanding about the difficulties involved in building strong grass-roots organizations, such as credit unions. Its methodology was inconsistent with the best practice. Having invested its own resources into every sub-loan under the component, the IA supported a top-down approach that relied on excessive controls and burdens at the expense of empowerment, training, self-imposed financial discipline by CUs, reduced bureaucracy, and local ownership. After the implementation began, changes in the legal framework for CUs further complicated the situation. For example, a very high licensing fee for establishment of CUs (US\$5,600) was introduced by the Cabinet of Ministers, although it was later reduced to US\$ 125. It should also be noted that while CUs were allowed to mobilize deposits at the time of project design, the Law on Credit Unions passed during project implementation prohibited deposit mobilization for CUs, even from their members, and forcing them to rely on the share capital and on borrowed funds. The impact of this action was that the disbursement to credit unions was postponed until IA and IDA agreed on a new financial model for credit unions, different from the one developed at project design that was based on deposit mobilization assumptions. All of these factors served to delay smooth implementation of the component. Disbursement to BGs and CUs took place only in November 2002 and November 2003 respectively, almost three and four years into Project implementation.

As a result of the shortened implementation period, the indicator for the number of CUs created to advance to the Phase II of the Program was reduced from 60 to 30, to focus more on ensuring the quality and sustainability of the ones created. Under the close supervision of the Bank and with the Government's efforts, the performance of the Component considerably improved. The international TA team has adopted new methodologies, training modules, MIS and engaged qualified consultants in the team. The IA was also able to develop a financial model for CUs that showed their operational sustainability from the first year of operation. In response to a large and underserved demand for financial services in rural areas, the BGs were created in larger number than originally estimated, especially as the outreach of the CUs remained limited. As of June 30, 2005, the number of BGs totaled 905 (with target of 200 and trigger indicator for Phase II of 120 in the PAD); disbursement to BGs reached \$9.1 million with a loan recovery performance of 95 percent. The number of CUs reached 30; lending by CUs reached \$3.1 million with repayment rate of 96.7 percent. Total active membership of around 10,700 and 1,800; total number of credits of more than 24,400 and 3,000 with average sizes of \$370 and \$1,000 for BGs and CUs respectively represents a significant achievement in terms of breadth (number of borrowers) and depth (small size of loans). For reference, as of June 2005 microfinance institutions in Azerbaijan were serving over 54,000 clients and had outstanding loan portfolios of over US\$45 million, still mainly in urban areas and with larger average loan sizes that project beneficiaries. Below are the general portfolio indicators for sub-loans disbursed both through the CUs and BGs. It should be noted that the disbursements to BGs started two and a half years ago and to CUs about one and a half years ago. The total outstanding portfolio of BGs and CUs combined was around US \$4.9 million as of June 30, 2005. Annex 8 of the ICR provides detailed analyses of the financial standing of the CUs and contains additional financial information.

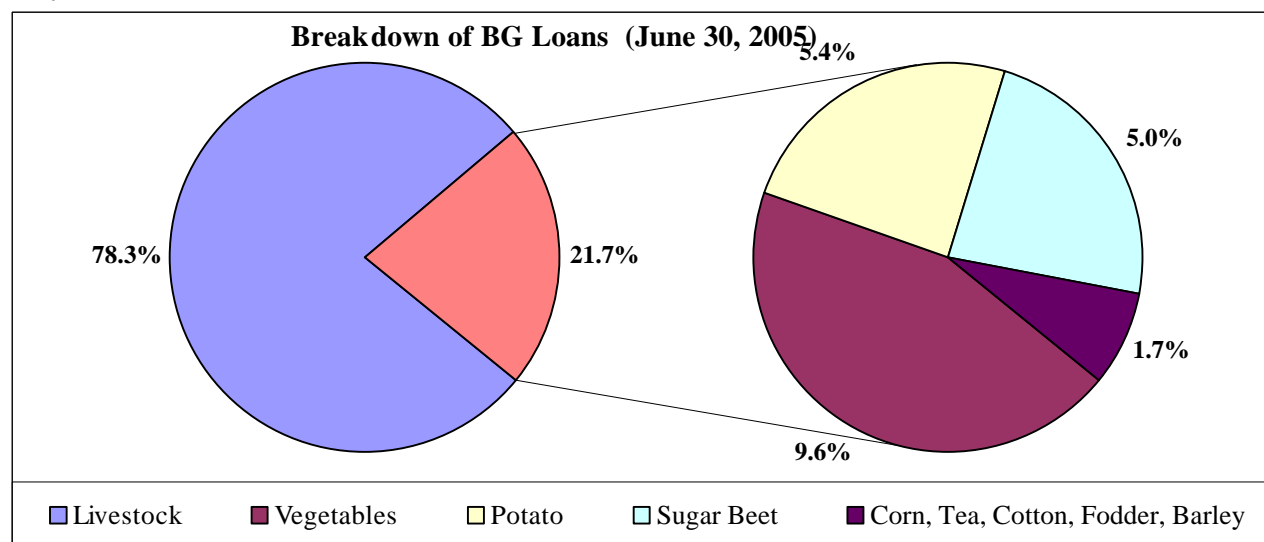
General Portfolio Indicators

As of June 30 2005	CUs	BGs
Number of Loans Disbursed	3,074	24,474
Amount of Loans Disbursed	\$3,082.196*	\$9,128.35
Loan Portfolio Outstanding	\$1,731.23	\$3,184.17
Active Borrowers	1,828	10,766
Average Loan Amount	1,002	373
Repayment Rate	96.7%	95%
PAR 30	5.78%	
Average Interest Rate	25%	25%
Gross National Income (GNI) per Capita in 2004 (USD; World Bank Stats)	950	
Depth of Outreach (average loan / GNI per Capita)**	105%	39%

* Including \$2,156.850 of IDA credit line

** To measure whether microfinance services actually reach the poor, the microfinance industry often uses the ceiling of 250 percent for the ratio of loan size over per capita income. The respective figures illustrated in the table above show that the average size of loans provided was considerably below this 250 percent benchmark, indicating that the credit line was able to target the poor.

The breakdown of the credits for BG members for June 30, 2005 demonstrates that the largest portion of the credits is for livestock (around 76%), followed by vegetables, potato, and sugar beet farming. The share of livestock though still dominating, has been steadily decreasing and is 9% lower already compared to the last year.



BGs were not designed as financially sustainable institutions from the point of view that they relied on external sources of funds only, but expected to recover full costs of their operation. BGs are playing an important role in building a credit culture, especially with smaller rural borrowers. Some BGs have engaged in a second and third round of borrowing, slowly establishing a credit history for its members.

Some banks, such as PARA Bank and Debut Bank, have already replicated the social collateral-based lending model of the BGs with their own funding. Adjustments to interest rate policy made during implementation have ensured cost-recovery and operational sustainability of lending to BGs, while loan collection enforcement and principles of social solidarity-based lending have proved productive as demonstrated by BGs that were created and dissolved without major payment arrears. The data of previous years show that on average only 25% of the BGs created consist mainly of previous BG group members; the bulk of BGs involve new clients. A good share of CUs' membership consists of former BGs members - a clear demonstration of the BG system achieving its primary objective of preparing target beneficiaries for longer term relations with established financial institutions.

The IA has also prepared an "Exit Strategy" for ensuring the institutional sustainability of the component achievements once the international consultants withdraw from the Project. The Strategy has been finalized by the Government at the time of ICR preparation. The Strategy outlines the mechanisms for providing institutional support to CUs and managing the credit line, after the contract with the international TA team closed in June 2005. It also proposes an approach for establishing a credit unions' apex institution to represent the interests of the cooperative system and ensure continued funding to newly established institutions that have no access to other sources, nor can collect deposits. The role of the IA has been transferred to the Azerbaijan Credit Union Association that will function as a national credit union apex organization. It was also agreed that the ACUA will collect loans from BGs until the start of the Phase II. The transition has been smooth and the new local management has made tremendous strides in increasing lending while maintaining a sound portfolio. While the data presented in this report are as of June 30, 2005 it is worth indicating that as of December 30, 2005, the total disbursement reached AZM 97,41 billion (US\$ 20,43) of which AZM 37,9 (US\$ 8,22) has been disbursed during six months since the international TA team departure. This represents 39 percent of overall disbursement since the beginning of the Project. The total number of direct beneficiaries reached was 40,216, of which 12,119 were repeat clients. The numbers and the scope of outreach continue to expand. Notwithstanding these achievements, ACUA still needs to improve managerial and technical performance and develop a medium/long term growth strategy.

Sectoral achievements of the component include demonstration of the feasibility of providing rural finance, promoting an understanding the principles of grassroots self-governed financial institutions, and demonstration of the importance of repaying credit. Main economic benefits include intensification of agricultural production, demonstration of mechanisms for channeling funds to rural sector. Notable institutional changes the component induced include (i) approval of prudential norm and licensing rules for CUs developed under the project, which caused licenses from 80 underdeveloped CUs (established outside of the Project) to be revoked thus strengthening financial discipline as well as minimizing risks in the financial sector in the country; and (ii) wide use of simple promissory notes to secure agricultural credits first introduced under the Project. Overall, support provided under the Project was critical in catalyzing growth in primary production, and thereby increasing the demand for rural financial services and further consolidating the environment for increased and profitable rural lending.

In summary, the component registered several notable accomplishments, principally: (i) it successfully resuscitated a credit culture that had been asphyxiated by former Soviet practices of massive subsidies and Government transfers; this is exemplified by repayments of up to 96.7 percent; (ii) it successfully reached the poor as demonstrated by its small average loan sizes of \$370 –\$1,000; (iii) although the initially intended number of CUs was not attained, the project still reached a significant number of clients, as the shortfall in total CUs created was more than compensated for through BGs which grew to more than 4.5 times the original target; (iv) it successfully demonstrated the viability of member owned and operated grassroots institutions as a credible option to increasing access to credit in rural areas, with the CUs established under the project achieving operational sustainability in their first year, (v) it refined the

methodology for establishing successful credit unions (where previous attempts had failed), including putting in place suitable operational and management information systems, as well as developing training programs; (vi) it successfully piloted and refined the group lending methodology, which has spurred interest in down-scaling into micro-lending among traditional commercial banks, a major externality of the project; (vii) similarly, it successfully piloted simple innovations, like the use of simple promissory notes to secure agricultural loans, which has contributed to maintaining a healthy loan portfolio among small borrowers, with a potential for spreading to mainstream commercial banks engaged/intending to engage with such small rural clients; (viii) it considerably contributed to the CU institutional framework, including the development of CU licensing rules, as well as integrating the Project CUs into the Azerbaijan Credit Union Association, which now services the CUs through its wholly-owned subsidiary – Credit Implementing Agency. These are indeed remarkable successes, which have laid a solid foundation for CU consolidation and scaling up under Phase II, and for CU promotion by other agencies. Despite all these quite significant achievements, the component is rated *marginally satisfactory* because of its wobbly beginning, and the subsequent inability to achieve its initial ambitious target of 80 credit unions, which are much more sustainable institutions for providing rural financial services than borrower groups.

Rural Policy Component (IDA: US \$0.72 million at appraisal; US \$0.81 million actual, as of June 30, 2005): The component is rated *satisfactory*. An important institutional impact has been the improved capacity of the Government to formulate a strategy for the sector, both through technical assistance and a unique study tour at Oklahoma University on the Dutch disease. A Policy Unit established in the Government and staffed with qualified experts carried out a rigorous analyses of the issues facing the rural sector and prepared a comprehensive and detailed Rural Strategy Document with Investment and Financing Plan, currently under discussion with stakeholders. It sets out a set of policies for the agricultural sector over the medium term (to 2010) that are grounded in strengthening the role of the private sector as the leading force, with the public sector concentrating on providing an adequate and supportive regulatory environment for private sector development. The Document prescribes a set of strategic interventions for maintaining the competitiveness of the agriculture sector in the country in light of expected sharp increase in oil revenues and possible Dutch disease syndrome. The document is already playing an important role in restructuring of the agricultural management system, with the reorganization of the Ministry of Agriculture. The draft Investment Program and Financing Plan (IPFP) outlines an investment program in support of the proposed strategy for the period 2006-10. The IPFP covers investments in five major areas: Institutional Development, Agriculture and Agro-industries, Irrigation and Amelioration, Income Generating Activities, and Rural Finance.

Project Management (IDA: US \$1.89 million at appraisal; US \$1.77 million actual, as of June 30, 2005): The component is rated *satisfactory*. In 2000 the Government designated the PMU of the Farm Privatization Project as the Agency for the Support of Development of Private Sector Agriculture (ASDPSA), and charged it with the management of the ADCP. In April 2005 the Agency was liquidated by a presidential decree and its responsibilities were integrated into a newly established State Agency for Agricultural Credits (SAAC) under the Ministry of Agriculture. The Government decided to merge the project implementation functions with the relevant line ministry in an attempt to limit duplication of tasks within the same sector. In essence, with the closing of the Agency responsible for ADCP implementation, the project was at a standstill for a brief period, but transition was completed swiftly to resume satisfactory project implementation.

First ASDPSA and then PIU within SAAC have satisfactorily coordinated this multi-activity Project, carried out procurement, submitted timely project reports made available necessary information to the Bank and Government agencies, facilitated audit exercises, and took corrective actions when necessary.

Social Impact Monitoring and Beneficiary Assessment. A comprehensive Social Assessment (SA) was carried out at appraisal to ensure that the Project supported interventions that were high priorities for the target beneficiaries, ensured wide stakeholder participation, and provided for a participatory monitoring and evaluation process. The SA was followed up by a Monitoring activity carried out by AFCon Management (UK) in June of 2003, and by periodic monitoring of the PMU. The SA confirmed that agriculture is the key dominant of rural incomes and poverty, and that almost 86% of the subject rural population received at least some income from agriculture. The main constraints to increase agricultural productivity related to lack of access to farm equipment, agricultural inputs (mainly seeds), financing, information, and infrastructure. The Project has addressed the most important of these constraints, namely by (i) enhancing access of rural poor to finance, as proven by the impressive outreach achieved within a short period of time; (ii) public information campaigns that reached 22% of all rural households and training provided to some 243,000 farmers; and (iii) research grants that led to provision of improved seed varieties to estimated 10,000 farmers. Surveys under the Project showed that nearly 73% of the farmers who received training and other types of advisory services believed they actually benefited from these services. Other parallel activities such as the Rural Investment Project of the World Bank have been initiated to deal with the remaining constraints of the rural population. The financial and economic analyses of the Project (Annex 3) demonstrate the improved yields and profits from agriculture resulting from Project interventions. These analyses were based on data from M&E activities and an assessment of BG beneficiaries through surveys carried out at the time of ICR preparation by the project implementation unit. A specific social issue identified during appraisal was ensuring that the project also benefits women. Based on Social Monitoring Report by AFCon, women's participation in agriculture increased by 85% in targeted raions as a result of the Project. As of June 30, 2005, 8 out of 115 PA were women; and an impressive 30% of all loans by CUs and BGs were provided to women clients. The same report measured the satisfaction level amongst beneficiaries towards various project interventions at 71%. In addition, the same report stated that the migration from rural to urban areas decreased in project areas by 80% compared to the baseline, and 30% compared to non-project areas, though these figures should be treated with caution as many other factors could have contributed to migration.

In addition, the official statistics of the State Statistics Committee show significant increases in productivity for selected crops in Project areas. These can be at least partially attributed to the aggregated impact of various project activities.

Yield and Production Increases of Selected Crops 2000-2005

	2000			2005			2005/2000 (%)		
	ADCP regions	Non-ADCP regions	Azerbaijan	ADCP regions	Non-ADCP regions	Azerbaijan	ADCP regions	Non-ADCP regions	Azerbaijan
Wheat									
Yield, t/ha	2.3	2.4	2.4	2.6	2.6	2.6	113.1	108.3	108.3
Production, ton	507,930	666,784	1,174,714	683,825	881,988	1,565,813	134.6	132.2	133.2
Corn									
Yield, t/ha	3.1	3.8	3.3	4.6	5.2	4.7	148.4	136.8	142.4
Production, ton	71,562	31,965	103,527	113,656	37,733	151,389	158.8	118	146.2
Vegetables									
Yield, t/ha	15.4	11.2	13.3	16.7	11.5	13.9	108.4	102.6	104.5
Production, ton	440,766	340,070	780,836	618,198	470,511	1,088,709	140.3	138.3	139.4
Potato									
Yield, t/ha	9.4	6.5	8.4	16.5	9.2	14.8	175	141	175
Production, ton	387,976	81,033	469,009	904,290	147,323	1,051,613	233	181.8	224.2

4.3 Net Present Value/Economic rate of return:

Due to very limited distortion in the economy, there is no need for different calculations of economic and financial returns. Findings from beneficiary assessments (AFCon Consulting Group, UK, 2003; and Information Advisory Center) and field visits conducted at the time of ICR demonstrated that significant economic benefits have resulted under the Project, discussed specifically for each component in Section 4.2 (also, see Annex 3 for details). These included gains in productivity and yields from farming due to improved access to new technology, knowledge, and finance; reduced transaction costs for land registration and titling; etc.

4.4 Financial rate of return:

The high repayment of sub-loans, at a rate of over 95 percent, and the positive real term interest rates indicated that the sub-projects were commercially viable and able to generate sufficient returns for timely payments. It is estimated that average net income per farmer from adopting new varieties and technologies developed under the Project increased by about \$741. Sub-projects supported under the Rural Credit Component show increase of net income of up to 119%, and increase in rate of return of up to 37%. Annex 3 contains more detailed information on financial analyses of sub-projects, and also contains cost-effectiveness data for other activities. Annex 8 contains detailed information on financial performance and ratios for CUs.

4.5 Institutional development impact:

The Project's institutional development impact has been significant, with the most notable effects being:

- (i) Support of the Government's land reforms and privatization process, and development of a national legal and institutional framework for initiating a unified registration system for urban and rural lands and buildings, essential for prosperity of the real estate market; decentralization of the authority to conduct land transactions from the central SLCC to regional centers; adoption of a fee structure for land transactions acceptable to IDA resulted in reduced transaction costs and time for registering land transactions.
- (ii) Proven feasibility of private extension and veterinary services, and formulation of the state's role in this respect regarding providing continued public funding for farmer education and access to modern research and technology; establishment of the Veterinary Doctors Association as a lobbying body and Agricultural Research Board; preparation of a plan with full Government backing and commitment for comprehensive modernization of the agricultural research in the country.
- (iii) The establishment of a solid understanding and commitment at the highest level of the Government for creating sustainable grassroots financial service providers. In addition, the role of the IA supporting the operations of the CUs has been transferred to Azerbaijan Credit Union Association (ACUA) which will function as an Apex for credit unions. The agreement by the Project counterparts to entrust the management of the Rural Finance Component to the credit unions' national association is a significant factor in ensuring establishment of the sustainable institutional set-up for CU system in the country with strong local institutions and capacity.
- (iv) Development of procedures and instruments required to supervise the compliance of CUs together with reporting requirements, supervisory triggers, prudential norms, and licensing steps at the NBA;

(v) Re-enforcement of the Government's solid policies for retail financial services in rural areas based on principles of market interest rates and competition;

(vi) Building of the capacity in the Government to prepare the only strategic document with detailed and through recommendations for rural sector development policy to mitigate the impact of the possible currency appreciation on the competitiveness in the real sectors of economy.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:

Several events have indirectly influenced the Project, with mixed results. A series of events in the banking sector, starting from collapse of the Soviet banking system, followed by collapse of local banks and pyramid schemes in 1993 – 1995, and the 1998 Russian financial crisis had on one hand fostered a profound mistrust of banks, and on another exacerbated the commercial banks' hesitance in all lending, but particularly in agricultural lending. These events led the Government to take an extraordinarily cautious approach towards the Project, both limiting the types of financial intermediaries to be engaged, and not allowing savings mobilization by CUs. Besides its impact on the financial sector, the Russian financial crisis also affected the agricultural sector of Azerbaijan, and depressed its output due to decreased imports (in 1997, Russia accounted for 25% of Azerbaijan exports). This slowed down establishment of export oriented value chains, where chain consolidators such as processors could pre-finance production inputs, and further highlighted the need for supporting individual family farms and provision of microfinance in rural areas.

Significant impact on the performance of the Project was caused by the delay in contracting the IA, due to a large extent to procurement related problems out of control of the Government:

- Certainly the requirement that the IA needed to finance 20% of the lending portfolio, and put its own capital at risk, limited the pool of potentially qualified and interested agencies. This was anticipated as a risk during design, and measures were taken to mitigate it, namely personal visits by half a dozen acceptable agencies and letters of intent to bid from at least three of them.
- However, external events conspired to reduce the already small applicant group; for example, a highly qualified candidate suspended operations in Azerbaijan out during design when the Kosovo crisis led its management team to shift priorities and resources out of the Caucasus and into the Balkans; the first procurement round failed when the winning and only responsive bidder refused to establish and operate an independent implementing agency as called for in the bidding documents; in the second procurement round, potential US bidder refused to bid right after September 11, 2001 while the bid of another well qualified candidate was en route to Baku when it got impounded in a container at Heathrow airport, and missed the procurement deadline. It should be noted that the late bid was delivered to the PIU shortly after the deadline. However, Bank's recommendation to keep the late bid unopened until the evaluation of the proposals received before the deadline has been completed and cleared with the Bank was not the most practical decision and eventually excluded the proposal of the most credible candidate from the evaluation which has resulted in less meaningful procurement process.

5.2 Factors generally subject to government control:

In November 2002, the Cabinet of Minister introduced a very high fee (US\$5,600) for licensing of credit unions. This high fee had a negative impact on the project and served as a deterrent to creation of credit unions. The issue was ultimately rectified in August 2003 with reduction of the licensing fee to US\$125. Implementation delays were also caused by unwillingness of the counterparts involved in the Real Estate

Registration Component to decentralize land transaction related functions of the SLCC at the beginning of the project implementation. This was eventually successfully overcome by engaging the Cabinet of Ministers in agreeing and implementing a time-bound action plan to remove legal uncertainties causing concerns by the SLCC to decentralize.

5.3 Factors generally subject to implementing agency control:

While the quality of the TA for Rural Finance Component was essential for its success, the PIU did not have adequate capacity and experience to closely monitor the poor performance of the TA provider, link payments for TA to its deliverables, and take timely corrective actions. The situation was mitigated by close supervision of the Bank team.

5.4 Costs and financing:

The Project cost estimates were very close to final costs, except for the Rural Finance Component. Only US \$2 million or 17% of the credit line was disbursed by the original closing date of the Project. It is difficult however to determine to what extent this can be attributed to delays in implementation, or to overestimated outreach of CUs in the project design. By the date of this report, the original IDA credit line in the amount of \$9.2 million has been almost fully utilized. Overall, as of June 30, 2005 US \$28.7 million has been disbursed which represents 92 percent of ADCP credit funds. Note that the favorable SDR-USD exchange rate has increased the IDA credit funds for about US \$1 million. It is expected that the remaining credit will be fully utilized by the extended closing date of the Project.

6. Sustainability

6.1 Rationale for sustainability rating:

The sustainability of the Project's achievements is rated *likely* as long as there is continued support under the Program in key areas without any time gap as originally intended. While being a pilot in nature, the Project has produced notable results that must now be consolidated during Phase II into sustainable systems and processes. Specifically:

- The ever increasing focus during the implementation of the Project was on sustainability of established CUs, and financial sustainability (with regard to their interest rate policy) of the BGs that by definition are temporary institutions. There is now a solid understanding on behalf by the Government of the main principles of a sustainable financial cooperative system. Based on the *Exit Strategy* of the IA, Phase II shall immediately follow the Project by consolidating the achievements of Phase I and strengthening the Azerbaijan Credit Union Association to ensure its longer-term sustainability as a national credit union Apex organization.
- While the RACs and VFUs were not expected to become financially self-sustainable during the Project, there has been quite significant cost recovery for services, as planned. The idea behind this approach was to test the demand and willingness to pay for various types of services in order to systematically estimate the amount of subsidy required to support these services with public funding. Two shortcomings in this regard are worth mentioning:
 - Implementation focused on maximizing cost recovery efforts to improve financial sustainability of the services, at the expense of developing a standardized approach towards interaction of the public/private/community interests, or institutional sustainability. This was

mainly due to insufficient capacity at the borrower's side to oversee development of such standardized approaches. At project appraisal, the borrower's capacity to design and implement such approaches was somewhat overestimated. Phase II shall institutionalize the experience of the Project under a standardized sustainable mechanism in which beneficiaries are free to choose a service provider, and contribute part of the cost of the service, and the Government covers the rest through a transparent mechanism on a sustainable basis.

- In general, expectations of cost recovery in the Project seem overly optimistic, both for veterinary and extension services. The PAs have been increasing the amount of revenues they receive from paid services at the same time they are reducing their payrolls from the project. They are mainly financed by a 1% fee charged for forming and servicing BGs. As BGs are a temporary structure under the Project, the Government needs to ensure an adequate compensation to PAs in case income from BGs drops sharply without equivalent increases in other paid services. The expectation at appraisal that much of the VFUs costs would be recovered was also overly optimistic, and as shown in Annex 3, by the end of the year 2004 the total revenues from 25 VFUs made up less than 18 % of their annual cost of operations. This again highlights the need for continued significant public support for PA and VFU services.

6.2 Transition arrangement to regular operations:

Since the Project was the first part of a three phase APL and was intended largely as a learning experience, transition arrangements to regular operations will involve preparation and implementation of the subsequent phases. The APL II has already been listed as FY07 operation in the CAS and preparation had already begun at the time of ICR. The Phase II would support strengthening of the rural credit union system, expanding the outreach of the rural advisory and veterinary services established under ADCP I and modernizing selected agricultural research institutions. Expansion of the immovable property registration pilot of the first phase will be handled in a separate immovable property registration project scheduled for FY 07. A timely APL II would capitalize on the Project's achievements to date, and based on the lessons learned ensure long-term sustainability, focusing more on institutional framework, as described above.

7. Bank and Borrower Performance

Bank

7.1 Lending:

The Project identification and overall design were based on a thorough assessment of preliminary needs, available choices, and competent sector and social analysis. Due to insufficient discussion of the institutional framework and sustainability issues for Rural Finance Component and of the cost recovery assumptions for Advisory Services Component the Bank lending performance is rated unsatisfactory.

7.2 Supervision:

The Bank's supervision performance is rated satisfactory. Due to the complexity of the Project and high volume of day-to-day supervision issues, the management of the overall Project was decentralized, while ensuring engagement of sufficient number of qualified specialists in each of the project's fields. Overall, 12 Supervision Missions took place up to June 30, 2005, with 4 people on a team on average. Bank's management has been frequently engaged in implementation, joined the Supervision Missions on numerous occasions, and following a comprehensive Mid-Term Mission, held a Quality Enhancement Review meeting. Routine back-up support from the Bank Country Office on various aspects of project implementation was appreciated by the PIU.

7.3 Overall Bank performance:

Based on the above, and taking into account the effort of the Bank to enhance the achievement of the Project during implementation, the overall Bank performance is rated satisfactory.

Borrower

7.4 Preparation:

The Government had expressed its commitment to developing the agricultural sector in the Letter of Development Policy and actively participated in the preparation of the Project. The effectiveness of the Project was timely.

7.5 Government implementation performance:

As discussed in Section 5.2, a number of actions by the Government have caused implementation delays. Yet, the main project counterparts have performed well and were responsive to the issues raised during implementation, and most of the reasons for delays were reversed. For example the regulation requiring US \$5,600 fee for licensing CUs was cancelled and capital adequacy requirements for CUs were reduced from 0.25 to 0.20 after the first year of operation. Also, mainly due to the overall oversight over the Project remaining with the Cabinet of Ministers office through most of the implementation period, coordination and cooperation amongst various agencies engaged in the Project activities was satisfactory.

7.6 Implementing Agency:

Taking into account the complexity of the project design, multiple number of project activities, and pioneering nature of most of the interventions never applied in the country before, the performance of the project implementation unit was satisfactory.

7.7 Overall Borrower performance:

Based on the above, the overall Borrower performance is rated satisfactory.

8. Lessons Learned

The Project provides the following relevant lessons that should be taken into account for subsequent APL phases and other rural finance operations in the future:

- In order to manage complicated technical assistance effectively and efficiently, it is important to first develop a capacity and understanding within the PIU of the main features of the TA, and expose the PIU to the international best practice on the subject matter. This is especially true for interventions that are piloted in the country for the first time, and deal with building long-term sustainable systems, as the risk of failure due to poor TA is great.
- The Project needs to be selective in the number of monitoring indicators, progress indicators, APL triggers, targets, etc., as management of the too complex monitoring system becomes a cumbersome and time-consuming project activity in itself.
- For objectives that involve change in the mentality or attitude of the Government agencies, projects should better utilize the international experience sharing opportunities through study tours or conferences, focusing on most relevant regional best cases.
- Advantages of a credit line managed by a third party with risk-sharing and co-financing

arrangement includes: (i) transparency of implementation; (ii) careful screening of potential borrowers and thus high repayment rates; (iii) no Government or political influence. There are also disadvantages: (i) desire to shift disbursement towards the end of the Project in order to minimize its own risk; (ii) some initiatives are legitimate from the point of view of co-financier as a commercial company, but not acceptable to the Project's philosophy or methodology; and co-financing requirement necessarily focuses the efforts of the implementing agency on the collection of its investments at the expense of institutional aspects.

- The implementation of the Project reconfirmed some of the usual lessons from many other projects, such as (i) a very complicated project design consisting of multiple activities should be avoided as it dilutes the focus on the most essential outcome the project attempts to achieve, and makes supervision and implementation extremely costly and time consuming; (ii) preparation of the project design should not be short-cut, as any flows in the design ultimately undermine the quality of project implementation and achievements; and (iii) expectations for implementation periods of conceptually innovative activities should be based on more realistic assumptions.

9. Partner Comments

(a) Borrower/implementing agency:

Letter from the Minister of Agriculture, dated May 10, 2006 addressed to the Country Manager in Baku.

We appreciate your providing the draft Implementation Completion Report for the Agricultural Development and Credit Project. On behalf of the Government, the Ministry of Agriculture agrees with the assessment of Project effectiveness presented in the ICR. The report objectively reflects both positive aspects and problematic issues being arisen in the course of the project implementation.

The Ministry of Agriculture rates the project effectiveness as satisfactory. Overall, the project has been completed in a satisfactory manner and its main objectives can be considered as accomplished. In fact, this complex project has a great importance for the country in terms of poverty reduction and development of agricultural sector which is a key non-oil sector of economy. The projects' achievements to date are likely to be sustainable.

Despite some delays and problems encountered at the start-up phase, the rural finance component which is considered as the projects' major activity has made sufficient progress with the establishment of a network of credit unions and borrowers groups. The components' main goals to support rural entrepreneurs by providing financial services through local financial institutions were achieved. We are pleased to note that the disbursements under the rural finance component has now exceeded the original indicator for more than twice reflecting high demand for these credit services. At the same time, we recognize that more work is required to strengthen the entire network to ensure its sustainability. Overall, the implementation of credit line through credit unions and borrower groups proved to be viable and should continue through subsequent phases of the Project.

It should be noted that the project had played an important role in developing legal and regulatory framework for credit unions. In particular, licensing rules and prudential norms developed under the project have considerable contributed to credit union institutional framework. Use of

promissory notes to secure agricultural loans and private veterinary practices first time in the country has also been introduced under the project. Finally, decentralization of land transaction services to the regions and successful pilot of unified real estate registration system have contributed to the acceleration of land market and further development of real estate market.

The project has also established foundations of an efficient rural advisory services infrastructure and development and field demonstrations of new agricultural technologies through Competitive Grant Program; built capacity for study of comparative advantages in agriculture, and development of alternative policies to mitigate impact of manat's appreciation and alternative mechanisms of subsidizing agriculture; and formulated agricultural policy framework. It is critical now to build on these achievements and expand the network of rural advisory services nationwide under the second phase of the program.

In general the Ministry is satisfied with the Bank's supervision over the implementation of the project. The reasons hampering the Project execution were identified, and recommendations on resolution of the arising problems were developed. The World Bank used to regularly inform the respective state bodies of the country on the outcomes of the supervisions conducted.

Experience accrued during the project was crucial for setting up priorities of second phase of the program. The Ministry of Agriculture expresses its deep interest in continuing a fruitful cooperation with the Bank and believes that all necessary prerequisites for continuation of the program are already in place. On its part, the Ministry of Agriculture is willing to do everything possible in order to ensure smooth implementation of second phase of the program.

The Ministry of Agriculture believes it possible to submit the Implementation Completion Report for the ADCP for consideration of the IDA Board of Directors.

(b) Cofinanciers:

(c) Other partners (NGOs/private sector):

10. Additional Information

None.

Annex 1. Key Performance Indicators/Log Frame Matrix

1 A. Project Outcome / Impact Indicators

Indicator/Matrix	Actual/Latest Estimate
Farmers benefiting from advisory activities demonstrate behavioral changes, improved farm management and diversified activities over the duration of Phase I	Surveys show that 55% of farmers have already adopted many of the improvements recommended by advisory services, demonstrate improved farm management and increased output.
Farmers with access to private veterinary services sponsored by the project use them and have high satisfaction levels	Increased number of paid services demonstrates a demand and public satisfaction with the quality of services.
Credit unions and borrowers groups begin to operate allowing farming households and other rural entrepreneurs to gather investment capital, to adopt new technologies, change their input/output combinations and increase the scale of their activities.	27 credit unions began to operate and some 905 BGs have been established with about half of them engaging in a second and third round of borrowing. Another 3 newly established CUs are planned to become operational by end of 2005. Almost all borrowers made profits from the project credit line and show increase in net income and rate of return. 90% of borrowers claimed to reinvest their profits for business expansion needs.
Ensuring limited subsidy dependence of Credit Unions as indicated by Subsidy dependence Index, expected to be less than 75% after 2 years of operations.	19 out of 27 operational CUs show the SDI of less than 75% as of June 30, 2005. It should be noted, that only 11 CUs have received credit for more than a year and all others have been in operation less than 1 year.
All demand for land transactions are recorded on a timely basis (within ten days of receipted documents) and easily accessible by the public in regional cadastral centers	With the establishment of regional cadastral centers and decentralization of land transaction services to the regions, the landowners no longer have to travel to capital to conduct land transactions. This has resulted in significantly reduced cost and time in conducting land transactions. All demand for land transactions are recorded on a timely basis.
50% recovery level for transaction costs in regional cadastral centers by the end of Phase I	A fee structure for land transactions adopted under the project has yielded near 50% cost recovery already for the established regional centers. Note that a significant part of operational costs of regional centers is associated with the issuing of land titles under the land reform program. If only costs associated with land transaction are considered, the cost recovery level would equal to 82%.

1 B. Project Output Indicators

Indicator/Matrix	Actual/Latest Estimate
Issuance of all (790,000) land titles; their storage in designated registry with public access	867,000 land titles (99 % of total) for privatized agricultural land have been issued and distributed to landowners. All titles are registered in district officers of SLCC. Also, some 394,000 certificates of private household plots have been issued.
Raising awareness among 100,000 farming	On average, 194,000 households, or 22% of total number of

households via TV programs and 10,000 households receive leaflets and other printed materials.	rural households, have been reached by each of seven information campaigns. This number includes participants of seminars; landowners received info materials and reached through TV and radio. Surveys conducted to determine the effectiveness of the campaign indicate that knowledge of various topics of information campaigns increased from an average of about 16 to 53%.
Formation of private veterinary services in 5 regions, providing veterinary access to 16-20,000 farmer households	All 25 veterinary field units have been established in 5 project regions and are operating satisfactorily, providing access to more than 16,000 livestock owners on an annual basis.
Stability of LFIs proved and regulated by the following indicators: 1. Utilization of project supported rural finance services by 12,000 individuals at the end of Phase I; 2. Providing credit services for total amount of 10 million US\$.	Over 27,500 small loans were issued to 20,300 individuals by June 30, 2005; Lending has reached \$12.2 million by June 30, 2005;
Development of agricultural strategy by the Rural Policy Units, discussion within government and other stakeholders	A comprehensive agricultural strategy document, investment plan and associated financing plan have been developed by the Rural Policy Unit and discussed with stakeholders. The documents are being reviewed by the Government.

1 C. Achievement of Triggers for Phase II of APL

Triggers	Status
Real Estate Registration Component	
I. Establishment and satisfactory performance of regional cadastral centers.	<i>Trigger has been met:</i> Ten regional cadastral centers have been established and authorized to conduct and complete all types of land transactions. This has resulted in significantly reduced costs and time in conducting transactions. Number of registered land transactions is increasing.
II. Registered land transactions and inquiries reach at least 10,000 per year.	<i>Trigger has been met:</i> 9,968 land transactions were recorded in 2004, of which 96 percent by RCC. In 2005, the number of transactions by RCC is expected to exceed 11,000.
III. Promulgation by Parliament of a unified real estate registration law satisfactory to IDA.	<i>Trigger has been met.</i> This trigger was designed to ensure the promulgation of the Law in Nakhchivan AR that would allow testing of a unified cadastre and registration system. During the project implementation, it became evident the testing could be carried out without passage of a new law, but with temporary rules in support of existing legislation. Thus, the purpose of the trigger has been served, meaning that the testing was enabled, while the mechanisms for meeting trigger did not literally correspond to the language of the trigger – testing was enabled by rules not by Law. Thus the language of the trigger is not relevant.

<p>IV. Agreement on the institutional framework for nationwide implementation of a unified real estate registration system</p>	<p><i>The trigger has been partially met:</i> A Law on the State Real Estate Register was adopted by the Parliament and enacted in August 2004 without direct contribution or assistance of the Project. The Law did provide for establishment of a consolidated real estate registration system and agency and thus the objective of the trigger has been materially met. The State Service for Registration of Real Estate (SSRRE) has been established and its charter has been approved at the time of ICR preparation. However, there is a need to clarify functions of all relevant agencies in regard to the real estate cadastre and bring all related prior legislative acts into the harmony with the new Law. Therefore, at this stage, the trigger is met only partially.</p>
<p>Rural Finance Component</p>	
<p>I. Satisfactory implementation of the rural finance component indicated by at least:</p>	
<p>a) 60 CUs and 160 groups of borrowers established; and This trigger was revised because of implementation delays caused by factors beyond the control of the government. Specifically, number of CUs was revised to 30</p>	<p>Revised trigger has been met: 30 CUs and 905 BGs have been established by June 30, 2005.</p>
<p>(b) delivery of lending services amounting to at least \$8.0 million;</p>	<p><i>Trigger has been met:</i> Lending has reached \$12.2million; \$20 million are forecast by the end of the Project</p>
<p>II. Satisfactory performance and proven sustainability of LFIs measured by at least:</p>	
<p>(a) 22 * (instead of 45) CUs with a Subsidy Dependence Index of less than 50 percent and declining for the prior two years; and</p>	<p><i>Expected to be met:</i> As the number of CUs has been reduced to 30, the number of CUs to meet SDI and prudential regulations is prorated to the new total. The SDI expectations at appraisal were to be met once the CUs have been in operation for at least two years. First disbursements to oldest two CUs took place only in November 2003. Thus, as CUs are mainly young, and have been in operation less than 2 years, the estimates made at appraisal are of little relevance. Yet, 19 CUs show the SDI of less than 75%, including 7 CUs with SDI of below 50%.</p>
<p>b) 22 * (instead of 45) CUs in full compliance with prudential regulations,</p>	<p><i>Revised Trigger has been met:</i> All operational CUs are in compliance with prudential regulations.</p>
<p>(c) 120 borrower groups with loan recoveries of more than 85 percent of amounts due;</p>	<p><i>Trigger has been met:</i> Out of 905 BGs established, 461 have engaged in the second and third round of lending. Thus, the total number of contracts with BGs has reached 1,366. The overall repayment rate for all BGs is over 95%, exceeding expectation of the trigger.</p>
<p>III. Sufficient outreach of LFIs indicated by at least 12,000 outstanding loans.</p>	<p><i>Trigger has been met:</i> Over 27,500 small loans issued to 20,300 individuals, with 12,600 outstanding loans as of June 30, 2005.</p>
<p>* Only the total number of CUs to be created has been formally reduced to 30; the number of CUs to meet SDI and prudential</p>	

<i>regulations is prorated to the new total.</i>	
Information and Advisory Component	
I. Successful establishment and operation of the Regional Advisory Centers as indicated by at least 10,000 farmers receiving training and advice annually, and at least 3,000 visits to demonstration sites annually.	<i>Trigger has been met:</i> Five Regional Advisory Centers (RACs) have been established. They are operating highly satisfactorily. Some 50% of the farmers in targeted regions have participated in extension services provided by the RACs. Increased knowledge, especially on technical topics, has contributed to improved farm management, increased production and diversification of activities. Some 40,000 farmers receive training and other type of advisory services annually and demonstration site visits total 8,000 annually.
II. Successful operation of the Competitive Grant Scheme.	<i>Trigger has been met:</i> The competitive grant scheme has been successfully implemented with some 52 projects awarded. New technologies have been successfully demonstrated and an assessment of completed projects indicates that farmers have already adopted improved practices.

Annex 2. Project Costs and Financing

Project Cost by Component (in US\$ million equivalent)

Component	Appraisal Estimate US\$ million	Actual/Latest Estimate US\$ million	Percentage of Appraisal
Real Estate Registration	5.44	4.65	85.6
Rural Finance	15.29	15.56	101.7
Information and Advisory Services	10.00	11.10	111
Rural Policy	0.78	0.87	112
Project Management Unit	2.14	2.34	109.3
Total Baseline Cost	33.65	34.52	
Total Project Costs	33.65	34.52	
Total Financing Required	33.65	34.52	

Project Financing by Component (in US\$ million equivalent)

Component	Appraisal Estimate			Actual/Latest Estimate			Percentage of Appraisal		
	Bank	Govt.	CoF.	Bank	Govt.	CoF.	Bank	Govt.	CoF.
Real Estate Registration	5.10	0.34		4.56	0.09		89.4	26.5	
Rural Finance	12.99	0.00	2.30	13.28	0.01	2.26	102.2	0.0	98.3
Information and Advisory Services	9.30	0.70		10.41	0.69		111.9	98.6	
Rural Policy	0.72	0.06		0.82	0.05		113.9	83.3	
Project Management Unit	1.89	0.25		1.99	0.35		105.3	140.0	

Annex 3. Economic Costs and Benefits

Due to very limited distortion in the economy, there is no need for different calculations of economic and financial returns. No attempt was made at appraisal to calculate an overall economic/financial rate of return for the Project as a whole because it was impossible to determine what new productive activities would be financed or encouraged by the various components. It was expected that as long as the portfolio of activities financed by the Project performed well, this could be taken as a reasonable indication that the rate of return to the Project exceeds the opportunity cost of capital. Thus, the ICR will: (i) assess the principle sources of economic benefits expected at the appraisal; (ii) present brief financial analyses of the farm level impact of sub-loans; (iii) present cost-effectiveness analyses for remaining activities; and (iv) summarize the main outcomes of the beneficiary survey carried out at the time of ICR preparation. The official statistics of the State Statistics Committee shows significant increases in productivity for selected crops in Project areas, which can be at least partially attributed to the aggregated impact of various project activities (Section 4, *Table on Yield and Production Increases of Selected Crops 2001-2004*).

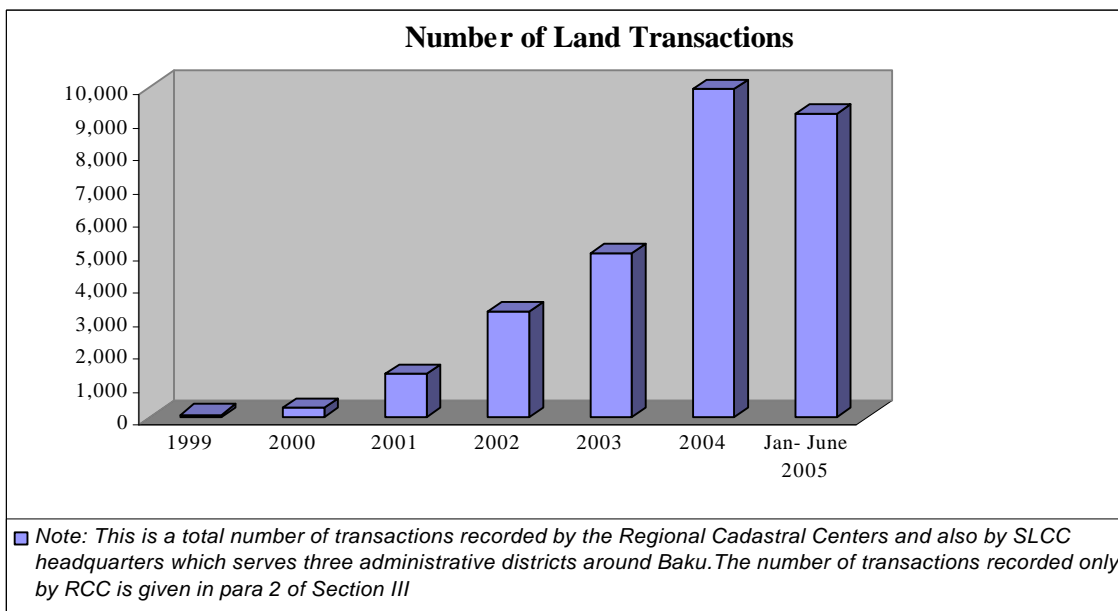
I. Economic Benefits. Findings from beneficiary assessments (AFCon Management (UK), 2003; and Information Advisory Center) and field visits conducted at the time of ICR demonstrated that significant economic benefits have resulted under the Project. Principle demonstrated sources of economic benefit include:

1. Real Estate Registration Component:

Use of land as collateral: while the lending in rural areas is still limited due to an under developed financial system, around 85% of the surveyed rural population indicated that they were ready and planning to use their land as loan collateral (AFCon Management, Impact Monitoring Survey, 2003).

Savings in transactions cost: land owners do not have to travel to Baku to conduct their transactions any more; and transaction processing time cut from 30 to 10 days.

Enhancement of the land market: increasing volume of secondary land transactions (see Graph below) due to improved efficiency and transparency is an additional demonstration of the economic impact of the Project.



2. Information and Advisory Services Component:

Farmers informed on their rights and obligations: 8 extensive training programs; 1,500 media events and publications distributed;

Creation of a cadre of trained extension specialists: 115 trainers locally available.

Farmers trained on more efficient farm operations: 243,000 farmers have participated in the Component.

Farmers who participated in the training show higher productivity compared to national average: 76% of farmers participating in advisory services activities indicated that their family incomes had increased since the program started, compared with only 35% who had not received advisory services (IAC Surveys).

Qualified veterinarians released from collective farms into the privatized farm economy lead to higher livestock productivity: 25 VFUs are available.

Farm research provides cost-effective technologies: Based on the data collected by the Competitive Grant Scheme Secretariat from the grant recipients and field visits, new technologies and varieties developed by research grants have increased the yields of participating farmers by around 186% and profitability by 277% on average. Already one year before the end of the Project, the total incremental net profit to farmers who adopted the technologies from the Grant Program was 2.5 times more than the total amount of grants awarded. On average, each participating farmer has generated around \$741 more profit from farming than he/she did before adopting the new technology. Total economic benefits from the Program are extremely high, especially if one accounts for increasing adoption rate of technologies by other farmers, and 7 to 10 years benefit period. While these estimates may seem high, they are explained by extremely low level of technology applied by farmers prior to project and lack of any other recent agricultural research in the country.

Impact Assessment Data on 19 Completed Projects

	Number of Farms Adopting Technology	Yield Increase	Profitability Increase	Total Grant Amount	Total Incremental Net Profits	Net Profits per Farmer
Wheat	574	177%	307%	\$188,084	\$315,141	\$549
Potato & Other Vegetables	367	198%	214%	\$114,948	\$426,016	\$1,162
Cotton	376	189%	283%	\$106,885	\$116,996	\$311
Livestock	136	200%	370%	\$15,000	\$213,007	\$1,561
Irrigation Technology	211	187%	296%	\$98,880	\$112,833	\$535
Other (Chickpea; Maize; Fodder)	232	177%	222%	\$50,105	\$220,515	\$952
TOTAL	1,895*	186%	277%	\$573,902	\$1,404,508	\$741

* Note: Out of more than 7,000 farmers who visited the demonstration sites of 19 projects during the implementation, 1,895 have actually adopted the developed technology. It is estimated that in total, about 10,000 farmers nationwide have adopted these technologies outside of the farm visits supported by the component, through farmer-to-farmer transfer.

3. Rural Finance Component:

Increased farm output, income and reduced poverty: Sub-projects supported under the Rural Finance Component show increase of net income of up to 119%, and increase in rate of return of up to 37%.

Mobilization of rural savings: none.

Reduced economic distortions in rural credit markets, principally arising from incomplete markets and segmentation of the market between formal and informal sectors: BG and CU mainly engaged clients that were excluded from formal financial system. Average loan sizes were 105% and 36% of the GNI per capita under CUs and BGs respectively, which considerably below the international benchmark of 250% for poverty outreach of microcredit operations. A small survey of beneficiaries carried out during preparation of the ICR demonstrated that almost all respondents made profits from investments funded through the project's credit line, and 90% of respondents claimed to reinvest their profits into productive assets / business expansion needs. Section IV of this Annex contains more detailed information from the beneficiary survey.

Capacity for development of the credit union network, which will eventually provide flexible channels for intermediation of funds between the formal financial sector and the farmer: institutional framework has been developed as part of the Exit Strategy; human capital is mostly available.

II. Financial Rate of Return under Sub-Loans.

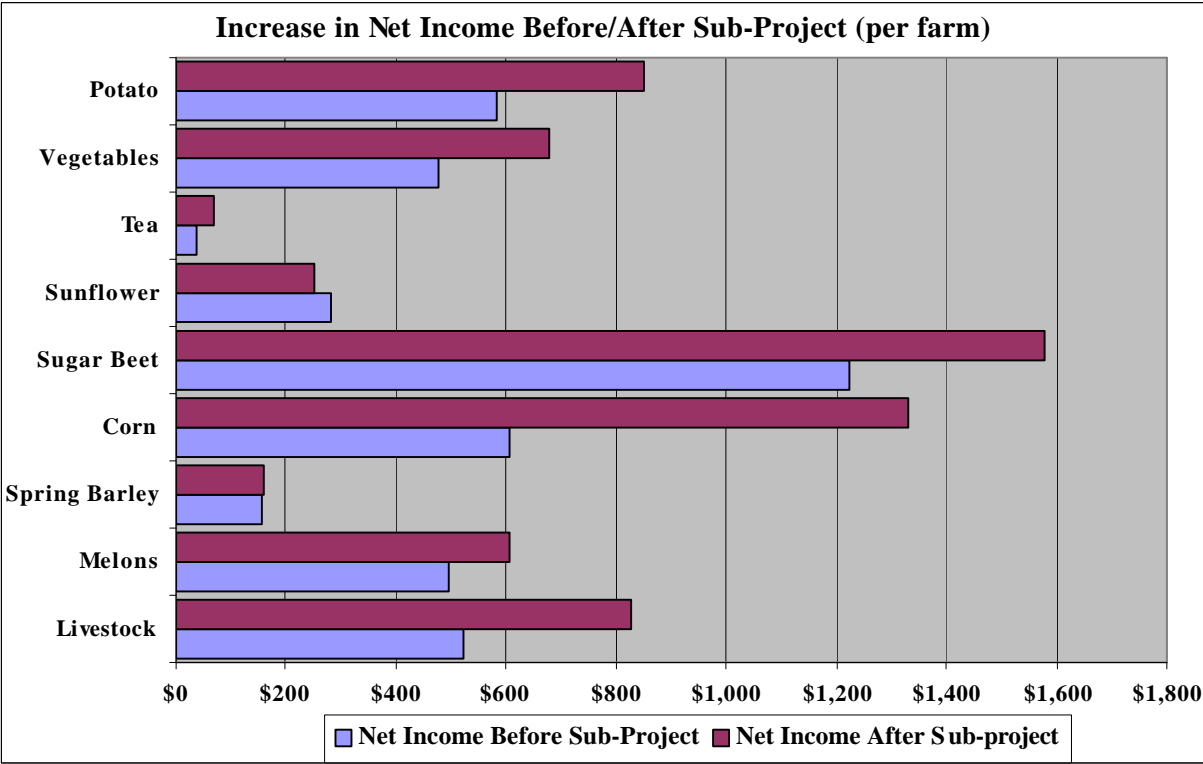
Beneficiary surveys of 179 recipients of credits from BGs were carried out by the Project Implementing Agency in February of 2005. The survey indicates increased rates of return and net income from most of the farming activities, as shown in the table below.

Rates of Return under BG Sub-Loans

	Number of Respondents	Number of Loans (June 30'05)	% of Total Number of Loans	Loan Funds as % of Total Portfolio	Change in Net Income	Increase in Rate of Return
Potato	22	1,313	5.36%	5.07%	45%	27%
Vegetables	20	2,353	9.64%	9.01%	42%	37%
Tea	4	60	0.25%	0.15%	75%	12%
Sunflower	4	16	0.00%	0.05%	-11%	-9%
Sugar Beet	19	1,222	4.99%	5.52%	29%	20%
Corn	19	184	0.75%	0.91%	119%	20%
Spring Barley	4	17	0.00%	0.22%	2%	-1%
Melons	4	40	0.16%	0.13%	23%	8%
Livestock	83	19,169	78.32%	78.53%	58%	14%
Cotton*	-	60	0.25%	0.35%	-	-
Fodder*	-	40	0.16%	0.22%	-	-
Total / Average	179	24,474	100%	100%	54%	18%

* Note: No data on financial returns is yet available as these loans were approved recently.

Based on the results of the survey, highest increase in net income was obtained from corn production, and highest rate of return on investment from vegetable production. Small share of loans was obtained for sunflower and spring barley - activities which resulted in small decrease in net incomes and rate of return. It shall be noted that for these varieties, there was no technological research or farm demonstration carried out under the CGS. Also, the decreased financial return still allowed for repayment of the credits. Graph below illustrates changes in net income per farmer by types of investments.



III. Cost Effectiveness of other Activities:

1. Information and Advisory Services: The cost effectiveness of the Information and Advisory Services Component is addressed as follows:

Information Services

At appraisal, it was estimated that information campaigns will reach beneficiaries at less than US \$1 each: US \$0.68 million was spent on information campaigns, with estimated outreach of 194,000 people each (some 22% of total number of rural households), which transfers into US \$0.44 per beneficiary. It shall be noted that the calculations are conservative, as 194,000 represents the number of household heads only, and not total number of people in households; 22% refers to percentage of affected households within total number of families in the regions covered by campaigns. The methodology for computing the outreach of information campaigns (specifically by TV and radio) had been agreed with the Bank.

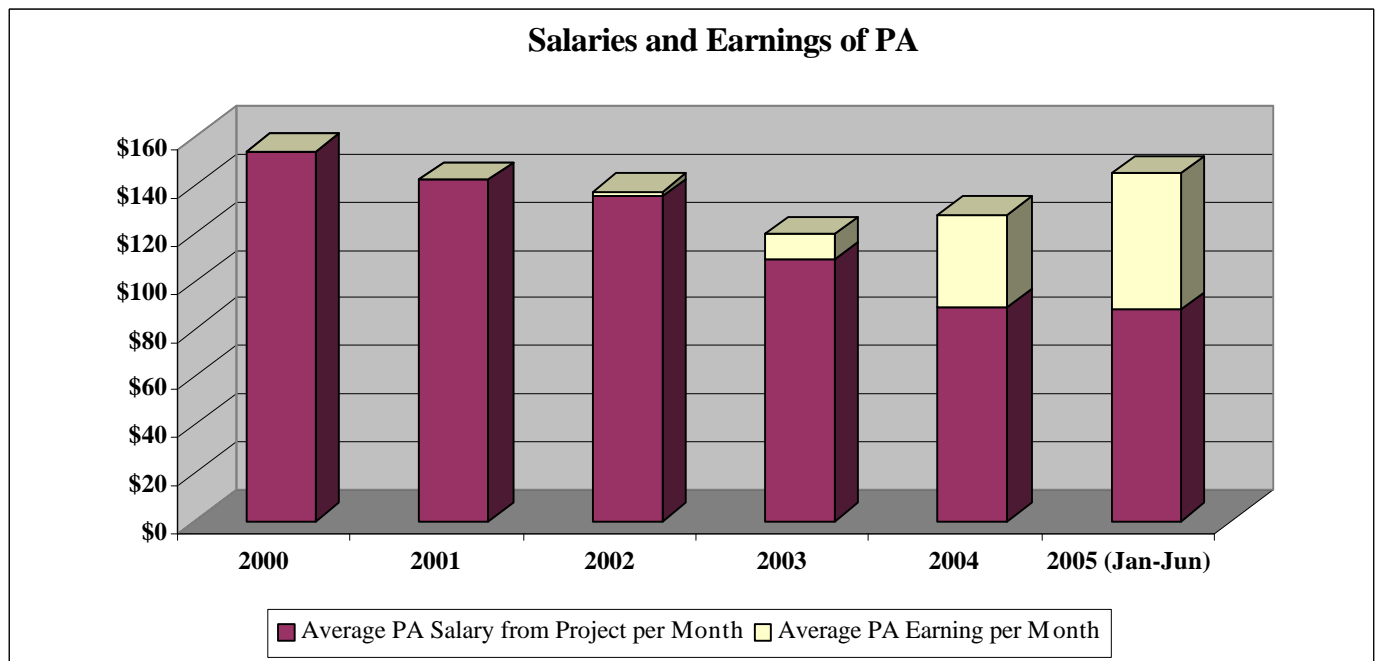
Advisory Services

The advisory services had reached tremendous outreach during implementation, exceeding the estimates at appraisal. The RACs provided three types of services (Group Extension Services; Two-Day Training; Individual Services) to total of 317,500 farmers, only 73,798 out of which were repeat customers. The average cost per service provided was about \$10.1.

Information on Advisory Services

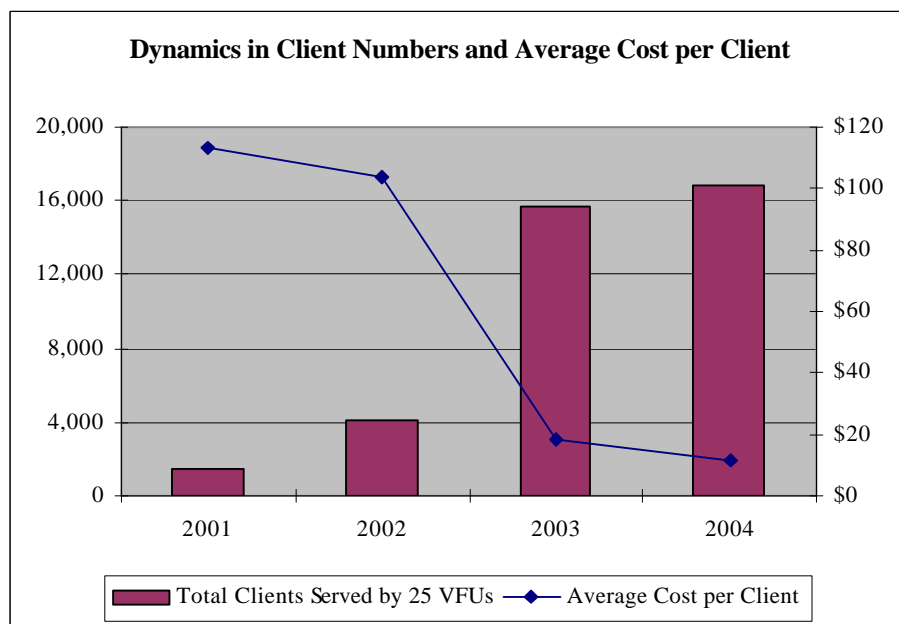
	2000	2001	2002	2003	2004	2005 Jan-June	Total
Number of Farmers Received Extension Services	9,544	29,095	58,400	82,669	90,667	47,128	317,503
Amount Disbursed under Component	\$109,030	\$421,510	\$667,660	\$849,330	\$794,940	\$368,740	\$3,211,210
Average Cost per Service	\$11.4	\$14.5	\$11.4	\$10.3	\$8.8	\$7.8	\$10.1

The Project made an effort to maximize cost recovery of the advisory services. It should be noted that full cost recovery for advisory services was not an original objective of the Project. While the overall cost recovery indicators improved significantly over time (as illustrated in the graph below), it should be noted that around 88% of the payments earned by the PAs in year 2004 in addition to payments provided under the Project came from services related with formation of BGs.

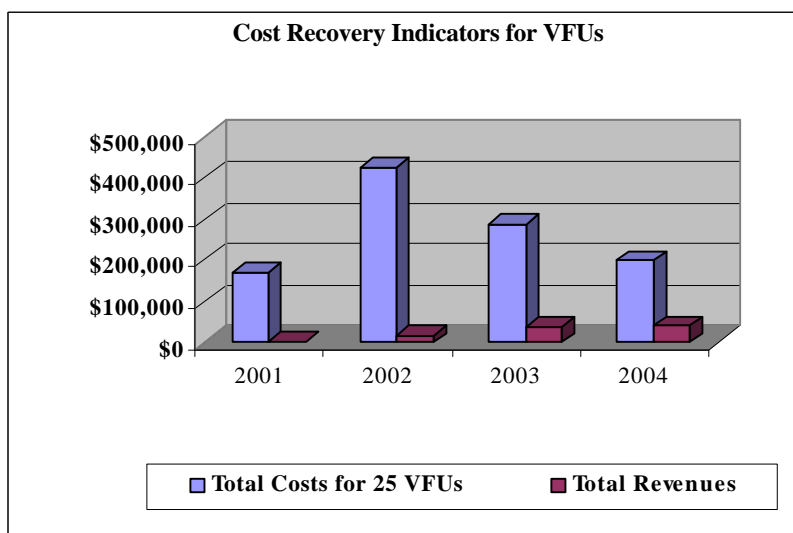


Veterinary Services

The Veterinary Field Units were designed to provide services such as disease control (brucellosis, anthrax, and foot and mouth diseases) which are essentially public goods, and drugs and vaccines for livestock outside of Government's responsibility, to be paid by beneficiaries. The cost of establishing and equipping the veterinary field units and training and contracting the staff in the five regions was estimated at about \$55,000 annually per region. This translated into an average cost of about \$10 to \$15 per expected client served. By the end of the year 2004, the average cost per client served has decreased to about \$ 14.2 due to steady increase in customers. Thus, the efficiency of service provision has already met the estimated indicators. The indicator is expected to improve further as no large investments are expected into the VFUs in immediate future.



In terms of cost-recovery, the payments collected by all 25 VFUs totaled US \$39,760 during 2004, which is about 17% of the total annual operating costs of the VFUs, including training, salaries, office rent, etc., but excluding cost of drugs which are fully charged and accounted separately. The Graph below shows the actual data for Year 2001-2004. Costs are considerably higher in 2002 and 2003 as most of the fixed investments were made during these years (veterinary equipment, disinfectant units, and refrigerators) for more than \$450,000 along with initial sets of drugs. In 2004, the expenses only included office rent and supplies, training, salary, and operational costs. The cost recovery indicator is expected to significantly improve as: (i) number of clients is expected to be increased by some 20% in 2005; (ii) ; (ii) with completion of the licensing veterinarians as private entrepreneurs, they can now charge negotiated market rates for their services, that are expected to be higher than the fee structure used by the State Veterinary Services; and (iii) VFUs are considering to offer additional services (such as artificial insemination and selling of vet pharmacies) which could increase their revenue streams.



2. Real Estate Registration: Cost effectiveness of this component was addressed in the design of its sub-components:

Land Registry

At appraisal, the RCCs were expected to recover 50% of operating costs by the end of Project, with proposed transaction charge of \$12. The operating costs of the RCCs were projected based on the assumption that the RCCs would only handle secondary land transactions occurring at the time of transfer of ownership. During the project implementation and due to demonstrated benefits of RCCs, the Government also charged the RCCs with issuance of remaining land titles from privatization of kolkhozes and land certificates for privatization of household plots. Following is cost recovery data for 10 RCCs established under the Project.

Cost Recovery Data for Regional Cadastral Centers

	2002	2003	2004	<i>Forecast for 2005</i>
Number of Land Certificated for Household Plots and Land Titles for Kolkhoz Privatization	147,394	88,950	140,344	<i>126,000</i>
Number of Secondary Land Transaction recorded by RCC	202	1,930	9,554	<i>11,000</i>
Revenues of 10 RCCs (Million AZM)	10	95	471	<i>505</i>
Total Expenses of RCCs (Million AZM)	644	645	1,005	<i>919</i>
<i>Cost Recover Ratio</i>	1.6%	14.7%	46.9%	<i>55.0%</i>

The Table shows that by the end of 2004 the RCCs recovered almost 50% of their operational costs. These figures shall be considered taking into account the following important factors:

The 50% ratio was expected to be achieved “by Project end”, and the cited figures for until the end of 2004, while the Project is closing on June 30, 2006. Thus the ratio of 46.9% will further

improve as number of transactions is growing. For 2005, the RCCs will recover at least 55% of total expenses.

The calculation above accounts for the total cost of the RCCs, significant part of which are occurred in the account of issuing land titles and certificated, which was not expected at the appraisal. If only costs associated with secondary land transactions are considered (the assumption at the appraisal), the RCC recovery rate would equal **82%**.

The Fee Schedule (approximately \$10 per transaction) was approved by the Government in agreement with the World Bank and was proposed in the amount that does not slow down the land transactions due to prohibitive costs, yet allows for significant cost recover.

Unified Cadastre

A unified registration system involving urban land and buildings as well as rural properties usually experience a far greater number of transactions than rural land registries and are often the source of considerable Government revenues. The cost-effectiveness of the pilot would be analyzed before devoting the substantial resources required for implementation of national system.

IV. Results of the Beneficiary Survey:

As mentioned above, a small survey was carried out at the preparation of the ICR by the PIU amongst target population for BGs in project regions. The main outcomes of the survey are presented below:

<i>BG Loan Generated Profit:</i>	
Yes	99.45%
No	0.55%
<i>Profit is Expected to be Spent on:</i>	
Business Expansion	84.10%
Consumption	8.72%
Both of the Above	7.18%
<i>Overall Impact of ADCP:</i>	
Weak (not affected)	5.49%
Satisfactory	58.79%
Good	35.71%
<i>Plan to Continue Participation in Credit Program:</i>	
Yes	92.31%
No	0.00%
Not Decided	7.69%

Table below demonstrates the improved perception of the beneficiaries on availability of accessible credit lines in the region, and the increasing share of CUs in provision of rural microfinance:

<i>Awareness on Accessible Credit Lines before ADCP</i>	
Yes	48%
No	52%
If Yes, which institutions:	
Commercial Bank	9.2%
MFI	100%
CUs	0%
<i>Awareness on Accessible Credit Lines with ADCP</i>	
Yes	82%
No	18%
If Yes, which institutions:	
Commercial Bank	6.7%
MFI	69%
CUs	91%

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating		
	Month/Year	Count	Specialty	Implementation Progress	Development Objective
Preparation		15	1 Team Leader, 1 Operations Officer, 3 Land Registration Experts, 4 Rural Finance Experts, 1 Extension Expert, 1 FMS, 1 Procurement Officer, 1 Economist / Rural Finance, 2 Social Scientists		
Supervision					
	02/22/2000	4	1 Team Leader, 1 Project Officer, 1 Extension Specialist, 1 Land Registration Specialist	S	S
	10/04/2000	2	1 Extension Specialist, 1 Land Registration Specialist	S	S
	05/06/2001	3	1 Team Leader, 1 Operations Officer, 1 Consultant	S	S
	11/16/2001	3	1 Team Leader, 1 Extension Specialist, 1 Land Registration Specialist	S	S
	06/28/2002	6	1 Team Leader, 1 Land Registration Specialist, 1 Social Scientist, 1 Financial Analyst, 1 Agricultural Officer, 1 Animal Health Officer	S	S
	12/20/2002	5	1 Team Leader, 1 Procurement Officer, 1 Extension Specialist, 1 Land Registration Specialist, 1 Microfinance Specialist	S	S
	06/27/2003	8	1 Team Leader, 1 Ag Research, 1 Extension Specialist, 1 Land Registration Specialist, 1 Social Scientist, 1 Financial Analyst, 1 Animal Health Officer, 1 Microfinance Specialist	S	S
	11/25/2003	8	1 Team Leader, 1 Rural Finance Specialist, 1 Ag Research, 1 Operations Officer, 1 Financial Analyst, 1 Extension Specialist, 1 Land Registration Expert, 1 Rural Policy Expert	U	U
	02/23/2004	2	1 Team Leader, Senior Microfinance Specialist	U	U
	06/03/2004	2	1 Team Leader, 1 Senior Microfinance Specialist	U	U

ICR	06/24/2004	4	1 Team Leader, 1 Financial Analyst, 1 Agricultural Officer, 1 Consultant	U	U
	12/08/2004	7	1 Team Leader, 1 Rural Finance Specialist, 1 Financial Analyst, 1 Rural Policy Expert, 1 Extension Services Expert, 1 Land Registration Expert, 1 Operations Officer	S	S
	05/24/2005	6	1 Team Leader, 1 Rural Finance Specialist, 1 Ag Research, 1 Financial Analyst, 1 Extension Specialist, 1 Animal Health Officer	S	S

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US\$ ('000)
Preparation		807.6
Supervision		815.3
ICR		25.0
Total		1,647.8

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	<u>Rating</u>				
<input checked="" type="checkbox"/> <i>Macro policies</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Sector Policies</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Physical</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Financial</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Institutional Development</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Environmental</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA

Social

<input checked="" type="checkbox"/> <i>Poverty Reduction</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Gender</i>	<input checked="" type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Other (Please specify)</i>	<input checked="" type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA

Outreach

<input checked="" type="checkbox"/> <i>Private sector development</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Public sector management</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input checked="" type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA

Rural Microfinance

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance

Rating

- | | | | | |
|---|-----------------------------|---------------------------------------|---------------------------------------|-----------------------------|
| <input checked="" type="checkbox"/> Lending | <input type="checkbox"/> HS | <input type="checkbox"/> S | <input checked="" type="checkbox"/> U | <input type="checkbox"/> HU |
| <input checked="" type="checkbox"/> Supervision | <input type="checkbox"/> HS | <input checked="" type="checkbox"/> S | <input type="checkbox"/> U | <input type="checkbox"/> HU |
| <input checked="" type="checkbox"/> Overall | <input type="checkbox"/> HS | <input checked="" type="checkbox"/> S | <input type="checkbox"/> U | <input type="checkbox"/> HU |

6.2 Borrower performance

Rating

- | | | | | |
|---|-----------------------------|---------------------------------------|---------------------------------------|-----------------------------|
| <input checked="" type="checkbox"/> Preparation | <input type="checkbox"/> HS | <input type="checkbox"/> S | <input checked="" type="checkbox"/> U | <input type="checkbox"/> HU |
| <input checked="" type="checkbox"/> Government implementation performance | <input type="checkbox"/> HS | <input checked="" type="checkbox"/> S | <input type="checkbox"/> U | <input type="checkbox"/> HU |
| <input checked="" type="checkbox"/> Implementation agency performance | <input type="checkbox"/> HS | <input checked="" type="checkbox"/> S | <input type="checkbox"/> U | <input type="checkbox"/> HU |
| <input checked="" type="checkbox"/> Overall | <input type="checkbox"/> HS | <input checked="" type="checkbox"/> S | <input type="checkbox"/> U | <input type="checkbox"/> HU |

Annex 7. List of Supporting Documents

1. Project Appraisal Document for Agricultural Development and Credit Project, Report Number 19290 AZ, May 10, 1999;
2. Agreed Minutes of Negotiations between the World Bank and the Government of Azerbaijan;
3. Letter of Agricultural Development Policy, May 7, 1999;
4. Development Credit Agreement (DCA) for ADCP between Azerbaijan Republic and IDA, Loan Number 3236, October 4, 1999;
5. Supplemental Letter to DCA on Performance Monitoring Indicators, October 4, 1999;
6. Amendment to DCA, June 16, 2003, and September 27, 2005;
7. Notification of Extension of Closing Date of DCA, March 30, 2004;
8. Social Assessment Report for ADCP, AFCon Management Consultants, December 2001;
9. Social Impact Monitoring Report for ADCP, AFCon Management Consultants, May 2003;
10. Country Assistance Strategy for Azerbaijan Republic, Report Number 15948, September 22, 1996;
11. Country Assistance Strategy for Azerbaijan Republic, Report Number 19892, November 29, 1999;
12. Country Assistance Strategy for Azerbaijan Republic, Report Number 25790, April 29, 2003;
13. Mid-Term Review Report on ADCP, December 2003;
14. Financial Sector Assessment of Azerbaijan, Joint IMF-World Bank FSAP, Report Number 29608, June 2004;
15. National Bank of Azerbaijan, Information Database, August 2005;
16. Progress Monitoring Reports 2000 - 2005;
17. Exit Strategy for Implementing Agency, 2005.

Additional Annex 8. Financial Ratios and Portfolio Quality of CUs

I. Consolidated Balance Sheets and Income Statements for CUs as of December 31, 2004

Below are the consolidated financial statements for 19 out of 30 CUs that have been established in Azerbaijan under the Project. The rest of the CUs have been established so recently that have not yet produced any financial statements. These statements reflect true consolidated financial standings and are reported to the Supervisory Body, National Bank of Azerbaijan. The statements shall be viewed without prejudice however, as only 2 CUs have been in operation more than one year by the end of 2004. None of the CUs are allowed to collect deposits, and the lending capital is formed solely on member contributions and loans from the Project. The statements have not yet been audited, as the CUs are very young, but are planned to be audited in the next fiscal year.

Consolidated Balance Sheet for 19 CUs
December 31, 2004

AZM 4,900

\$1

ASSETS	Amount in Azeri Manat	Amount in USD
1. Cash and balances with banks and other FIs	273,229,000	\$55,761
1.1 – Cash	167,514,000	\$34,187
1.2 – Accounts with Banks and other FIs	105,715,000	\$21,574
2. Investments and Long-term receivable	0	\$0
3. Loans to Members	6,226,799,000	\$1,270,775
3.1 – Total loans outstanding – short term	6,226,799,000	\$1,270,775
3.2 - Total loans outstanding – long term		
3.3 – Less : Reserves for possible losses		
4. Interest and fees receivable – net	64,089,000	\$13,079
5. Furniture and Equipment	346,624,000	\$70,740
6. Accumulated Depreciation-Furniture and	-22,167,000	-\$4,524
7. Other Receivables	0	\$0
8. Prepaid Expenses	0	\$0
9. Other assets	8,663,000	\$1,768
10. Suspense and / or clearing accounts	22,167,000	\$4,524
TOTAL ASSET	6,919,404,000	\$1,412,123
LIABILITIES AND EQUITY	Amount in Azeri Manat	
10. Members Deposits	0	\$0
11. External credits / borrowings	4,119,437,000	\$840,701
11.1 Implementing Agency	4,119,437,000	\$840,701
11.2 Bank – loans	0	\$0
11.3 Other borrowings	0	\$0
12. Interest payable	8,051,000	\$1,643
13. Accounts payable	0	\$0
13.1 Wages Payable	0	\$0
13.2 Dividends Payable	0	\$0
14. Accrued expenses and provisions	0	\$0
15. Taxes payable	0	\$0
16. Suspense and / or clearing accounts	0	\$0
17. Other liability accounts	93,820,000	\$19,147
TOTAL LIABILITIES	4,221,308,000	\$861,491
18. Equity Accounts	2,698,096,000	\$550,632
18.1 – Members' share	2,126,888,000	\$434,059
18.2 – Reserves (previous earnings)	-11,958,000	-\$2,440
18.3 – Donated Capital	465,500,000	\$95,000
18.4 – Net income (loss) for the current year	117,666,000	\$24,013
TOTAL EQUITY	2,698,096,000	\$550,632
TOTAL LIABILITIES AND EQUITY	6,919,404,000	\$1,412,123

Consolidated Profit and Loss Statement
December 31, 2004

AZM 4,900 \$1		
	Total in Azeri Manat	Amount in USD Equivalent
1. Interest Income	644,134,000	\$131,456
1.1 Loans to members	644,134,000	\$131,456
1.2 Accounts with banks and other FIs	0	\$0
1.3 Investments and long term receivables	0	\$0
1.4 Others	0	\$0
2. Non Interest Income	62,357,000	\$12,726
2.1 CU Fees and charges	1,032,000	\$211
2.2 Others	61,325,000	\$12,515
3. Gross Income (3 = 1+2)	706,491,000	\$144,182
4. Financial Costs-External Credit	145,442,000	\$29,682
4.1 External credit/borrowings	145,442,000	\$29,682
4.2 Dividend Expense on Shares	0	\$0
4.3 Savings expense		
5. Gross Margin (5=3-4)	561,049,000	\$114,500
6. General and Administrative Expenses	430,736,000	\$87,905
6.1 Personnel expenses	174,038,000	\$35,518
6.2 Office expenses	181,022,000	\$36,943
6.3 Occupancy expenses	24,950,000	\$5,092
6.4 Travel expenses	0	\$0
6.5 Depreciation and amortization	22,167,000	\$4,524
6.6 Taxes and licenses	0	\$0
6.7 Loans servicing expenses	0	\$0
6.8 Marketing expenses	0	\$0
6.9 Cashier shortage (overage)	0	\$0
6.10 Other	28,559,000	\$5,828
7. Loan Loss Reserve Expense		
8. Net Income from Operations (8=5-6-7)	130,313,000	\$26,594
9. Other Income	0	\$0
10.1 Previous Period Adjustments (Net)	0	\$0
10. Net Income (Loss) before Income Tax (10 = 8+9)	130,313,000	\$26,594
11. Tax on Profit (or Loss) on Ordinary Activities	12,647,000	\$2,581
12. Net Income (Loss) after Taxes (12 = 10-11)	117,666,000	\$24,013

II. Prudential Norms of NBA

In order to ensure sound and stable development of the Credit Union system in Azerbaijan Republic, control its financial position and regulate its functioning, the National Bank of Azerbaijan (NBA) has set forth the following prudential norms, developed with assistance of the Project to fit the requirements for CU monitoring. It shall be noted that these norms apply to all CU in the country, and license from a number of CUs (established outside the Project) have been revoked for failing to meet the norms. The CUs established under the Project are already in compliance with all prudential norms, except for credit classification norm that they are expected to comply with, as described below.

Status of Compliance with Prudential Norms of NBA

	Norm	Current
1. Minimum amount of share capital	20,000,000 Manat	Yes
2. Minimum capital adequacy	0.25 (1 Year of Operation); 0.20 More than 1 Year of Operation)	Yes
3. Balance of maturities	> or = 1	Yes
4. Maximum loan exposure with respect to one borrower: Total Loans to Member / Share of Member in CU; Total Loans to Member with Largest Loan / Mutual Credit Fund	< or =10% 0.1	Yes
5. Maximum unsecured credit risks	< or = 0.2	0
6. Capital reserves maintained by the credit unions	> or = 1	1
7. Classification of credits; Allowances for Loan Losses / Delinquency for special reserve fund: Unsatisfactory Loans (0-59 Days Overdue); Insecure Loans (60-179 Days Overdue); Bad Loans (> 180 Overdue)	30% 60% 100%	Expected*

There were no loan provisions reported in this time period, as CUs had not yet been trained to define their delinquencies properly. According to component reporting data, while there were no loans delinquent for more than 60 or 180 days, the portfolio at risk at 30 days (PAR 30) amounted to 6.3% of total loans outstanding, which would have amounted to roughly US \$24,500 in loan-loss provisions (Item 3.3 of the Consolidated Balance Sheet above), about 2% of total loan portfolio. These short-term delinquencies are now strictly monitored, training on compilation of adequate financial statements have been provided, and the CUs are expected to fully provision the loan portfolio at risk, as per requirements of the NBA: PAR 60 at 30%; PAR 180 at 60%; and PAR above 180 at 100%. For project monitoring purposes, the data for PAR 30 is also collected.

III. Key Financial Ratios

In addition to the above, below is information on key financial performance and loan quality ratios consolidated for these 19 CUs. Only selected ratios are included, as these institutions are small, and engage only in limited number of operations. It should be noted that:

1. As CUs were not allowed to collect deposits, the ratios exclude indicators that involve deposit / savings;
2. Most of the indicators were monitored during supervision.

Financial Ratios

		International Benchmarks	Consolidated Ratios for 19 CUs
	Key Ratios		
1	Repayment Rate	95%	94%
2	PAR > 30 Days	3%	6.3%
3	Write-Off Ratio		0
4	Restructured Loans		0
5	ROE	> inflation	245%
6	Capital Adequacy	> or = 8%	8.3%
	Protection		
7	Annual Loan Charge-Offs/Average Loan Portfolio	0	0
8	Accumulated Charge-Offs Recovered/Accumulated Charge-Offs	100%	N/A
9	Solvency	100%	125%
	Effective Financial Structure		
10	Net Loans/Total Assets	Between 70-80%	90%
11	Liquid Assets/Total Assets	Maximum 20%	4%
12	Membership Share Capital/Total Assets	Maximum 20%	31%
	Asset Quality		
13	Total Delinquency/Total Loan Portfolio	Less than 5%	2%
14	Non-Earning Assets/Total Assets	Less than 5%	10%
	Rates Of Return And Costs		
15	Net Loan Income/Average Net Loan Portfolio	Entrepreneurial Rate	21%
16	Financial Costs: External Credits/Average External Debt	Market Rate	6.71%
17	Operating Expenses/Average Assets	Between 3-10%	11%
18	ROA		9%
	Liquidity		
19	Liquidity Reserve/Total Savings Deposits	>10%	4%
20	Non-Earning Liquid Assets/Total Assets	Less than 1%	4%
21	Yield on gross portfolio		19%
22	Current Ratio		156%
23	Funding expense ratio		4.31%
	Signs Of Growth (Annual Growth Rates)		
24	Total Assets	> Inflation	773%
25	Membership	Minimum 5%	1,500%
26	Retained Earnings	Sufficient to reach solvency	818%
27	Net loans		1,100%
	Profitability Ratios		
28	Operational Self-Sufficiency		123%
29	Financial Self Sufficiency		84%

It is important to mention that CUs are at early stages of development and they have still limited resources available. They have not yet been allowed to attract deposits from their members, which was the practice in early stages of development of financial cooperative systems almost in all CIS countries. The regulator (National Bank) has developed adequate prudential standards, and has monitored its mandatory requirements. It is understandable that CUs have not yet been able to reach the optimal financial structure. There is a definite reliance on external borrowing and financing and a tremendous growth rate in membership of the past year. While reliance of external credits undermines the overall self-sustainability, at this stage of development where there are only few incentives and low confidence in the industry, the external credit is the main source of the growth. In time, appearance of savings and deposits will provide a better balance between financing options. In general, due to a very simple financial structure of CUs at this point, some of the ratios above are not fully applicable but are still presented to mainly demonstrate the quality of the loan portfolio and growth indicators. Specifically commenting on the ratios:

- **Quality:** In general the asset quality is good with low delinquency rates and with repayment rates maintained at the satisfactory level. Though the PAR 30 exceeds the international benchmark of 3%, it shall be noted that as of June 30, 2005 it was 0.83%, with repayment rate at 96.7%. The high ratio for non-earning assets does not represent a problem for the time-being as CUs were donated fixed assets (furniture and equipment at no cost) and as their assets will further grow and diversify this ratio will diminish.
- **Financial Structure:** The allocation of 90% of resources into loans and low ratio of liquid assets, may seem to risky, however it underlines that CUs are trying to maximize their efficiency and avoid keeping idle resources as they are at this stage indebted.
- **Rates of return and costs:** Although CUs are able to attract external borrowing at the rates equal to rates paid on deposits in other financial institutions and maintain interest income from loans at high entrepreneurial level, they are not able to generate enough profits to show adequate returns. It is due to the high operating expenses, which are quite normal at the start of operations. The margin is satisfactory and allows for further growth and income generation. The return on assets is still low, however the return on institutional capital represents almost 250% (should only be higher than inflation rate) but it is mainly due to the above mentioned ineffective financial structure.
- **Liquidity:** In terms of liquidity, CUs in general have matched their short-term assets and short term liabilities, and their asset liability management is solid. Yet, there is still high ratio of liquid non-earning assets but it is not a problem at this point, as CUs have maintained cash for specific operational reason and as a cushion for the immediate demands of members or liquidity shortages. Yield and funding ratios look promising and suggest that there is adequate enough margin for CUs to sustain their operations.
- **Growth:** It is promising that in the first years of operation CUs have managed to achieve such growth results. Especially, it is worthwhile to mention that although there is an aggressive increase in lending, CUs have managed to keep repayments rates high and delinquency low. However such growth rates of course are not sustainable after certain start-up period, moreover CUs with sound lending and borrowing practices will not be able to grow that fast in the long-run. The regulator is well aware of the rapid growth, and taking necessary supervisory measures to prevent unhealthy and adverse

developments in the system. Generally, it is definitely a good sign that CUs with their growth indicators proving of a potential unmet demand in their services and provide some confidence in the sustainability of the system.

- The profitability indicators which were presented above were selected to support confidence in the industries financial and operational sustainability. These ratios again provide a good basis to conclude that industry has potential and could be self-sustainable. Other profitability ratios seemed irrelevant as CUs have not yet operated for the enough time period to judge their performance by these merits.

It is vital at this stage that CUs maintain a sound portfolio with repayments rates high and that the delinquency should be strictly controlled and enforced by the Supervisor. It is a good sign that all profits are maintained in the reserves to fund expansion and cushion any unfavorable movements in the loan portfolio. In this regard it is sensible from the Supervisor's point of view to start enforcing loan classification and provisions. There are no major concerns in regards to financial standings of the CUs at this stage.

IV. Additional Information on the Project's Credit Line

A. Interest Rate & Sustainability

It was established at Project appraisal that the interest rate to the CUs will be market determined, equal to and set semi-annually at the six month auction rate of the NBA. For the borrower groups, sub-loans would be on-lent at the NBA six month auction rate, which was 14% at the appraisal, plus 15 percent. On-lending rates for ultimate beneficiaries were to be set by CUs and BGs based on market conditions. The on-lending rates were expected to be approximately 30% per annum, based on business plans generated from data collected for a range of agricultural, livestock, and non-farm micro-enterprise activities in rural areas in Azerbaijan. Below is information on interest rates in the country for 2004 relevant to the credit line:

2004 Interest Rates

Six Months NBA Auction Rate	7.08%
Interest Rate for Sub-Loans from Credit Line to CUs	10%
Average On-Lending Interest Rates from CUs and BGs to Beneficiaries	25%
Average Interest Rates of MFIs	18% - 40%
Average Interest Rates of Banks	21%-23%

The market interest rate and good quality of the loan portfolio allowed for CUs to generate notable revenues, sufficient to achieve operational self- sustainability of 123% and financial self-sustainability of 84% already in the second year of operation. The Subsidy Dependence Index is described in sections below.

BGs were not meant to become sustainable institutions, thus financial sustainability indicator in this case is irrelevant. The main purpose of the BGs was cultivating credit culture amongst poorest rural borrowers, and allow for the target beneficiaries to become able to join the more formal financial sector, CUs specifically. The operational sustainability though is relevant only to demonstrate that the interest rates charged by BGs were market based, and covered the costs of establishing, providing and monitoring the

BG sub-loans. As mentioned in earlier sections, the BGs are non-formal financial institutions providing loans to group members based on social collateral. The IA was in charge of assisting in creation of BGs, their monitoring, loan disbursement and collection. Thus, it is not possible to calculate the Operational Self-Sufficiency (OSS) Rate for BGs using traditional approach: first, the BGs do not have balance sheet or any other financial reporting, thus indicators such as “Loan-Loss Provision Expense” do not exist; second, all BGs were managed centrally, and thus the operating costs cannot be disintegrated into specific amounts attributable for each BG. Thus, the OSS Rate calculation was adapted to these circumstances, and was based on following assumptions:

1. The costs of the international TA within the IA were not taken into account, as the objective of the IA stretches far beyond than disbursements to BGs and such costs were not implied to be recovered at appraisal. The IA was in charge of developing overall lending manuals, methodologies, and procedures for expanding lending in rural areas and develop model of group lending that will be used in future nation-wide (and used at the moment actually – Para Bank in Beylagan and Khachmaz and Debut Bank in Ganja raions) and will have a much broader impact that what can be accounted for the subject BGs.
2. Yet, as the IA was also managing the credit line, the staff salary costs for all local consultants who worked with BG formation and monitoring, and support staff has been included in the Operational Costs, along with traveling costs, and also costs of training (which is a conservative assumption, as training can be considered an investment as well).
3. As the same staff and operating costs also worked on CU related activities, the local operating and staff costs have been separated between BGs and CUs as following. Thus, the total costs including the above components was prorated as following: 100% of these costs was attributed to BGs in Year 2002 as no CU related activity taken place that year; 80% of these costs was attributed to BGs in Year 2003, as 11 CUs were created in that year; and only 70% of these costs were attributed to BGs during January 2004-June 2005 as 19 new CUs were created and, overall, CU training and lending activities have accelerated in that period.

Operational Sustainability of BGs

	2002	2003	2004	2005 (Jan-June)
Operating Revenue (Interest Rate Charged)	0	\$146,490	\$456,582	\$387,735
Financial Expense (Interest Rate Paid)	0	\$67,824	\$209,866	\$197,913
Loan Loss Provision Expense				
Operating Expense	\$64,650	\$151,504	\$166,076	\$54,023
Total Expenses	\$64,650	\$219,328	\$375,942	\$251,936
Operational Sustainability	N/A	66%	121%	154%

As demonstrated in the Table above, by the end of Year 2004, the overall direct costs of lending through BGs, including operational and financial costs, are recovered by the revenues collected by BGs.

B. Foreign Exchange Risk

The foreign exchange risks of sub-loan repayment was to be borne by the Government. The credit line was in Manat with the Government bearing the foreign exchange risk. The exchange risk to the Government is to be compensated by the interest rate differential between IDA's standard rate and the rates paid on project

funds by LFIs.

C. Subsidy Dependence Index (SDI)

One of the Triggers for moving to the Phase II of the APL I was for reaching less than 50% SDI by CUs (implying more than three years of operation), while the monitoring indicators in the Supplemental Letter of the Credit Agreement (outcome impact indicators) expected the SDI to be less than 75% after two years of operations of the CUs. Due to delays, the disbursements to first two CUs took place in November 2003, and the next two on April 2004. As the CUs were not allowed to accept deposits either so far, some of the assumptions made at the appraisal do not apply. Thus, as CUs are mainly young, and have been in operation less than 1 year, the estimates made at appraisal are of little relevance. Yet, by the end of 2004, 13 CUs showed the SDI of less than 75%, out of which 5 had less than 50% SDI.

SDI of Established CUs

SDI ratio	< 50%	< 75%	< 100%	100- 200%	> 200%
Number of CUs as of December 31, 2004	5	13	17	2	-
Number of CUs as of June 30, 2005	7	19	25	2	-

D. Credit Targeting.

Although targeting can introduce or worsen distortions in the credit allocation process, relatively untargeted lending can also have unexpected results, such as lending to otherwise highly creditworthy clients, who would have been likely to obtain credit anyway. OED review of projects with lines of credit in 2003 indicated that ADCP credit line is fairly widely targeted with a broad potential audience, to include rural enterprises and farmers.

E. Environmental Review of Credits

Although the project Operational Manual (OM) did not cover environmental aspects, borrowers received training on integrated pest management (IPM) techniques and improved use and handling of fertilizers and agro-chemicals. Some 800 two-day training sessions on different environmental aspects (such as rules on application of pesticides, biological control measures, proper use of fertilizers, etc) have been provided to about 8,000 farmers by the Regional Advisory Centers in all five project regions. A number of information materials on different environmental topics have also been developed and distributed to beneficiaries. In general, small sizes of credits and low concentration of credits in any specific project area assures that no major environmental impact from sub-projects financed under the Rural Finance Component.

