Guidelines for Implementation of UDLF

Rural Financial Services Component

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Part I. RFS Thrusts under UDLF

A. Objectives of Rural Financial Services (RFS) Component

The overall objective of the Rural Financial Services component is to establish a replicable model of savings-based credit delivery system in the uplands. It shall be a system that revolves around the people-owned Financial Service Centers (FSCs), which are under the nurture and supervision of rural banks and primary cooperatives participating as partner financial institutions (PFIs) under the Upland Development Programme (UDP) in Southern Mindanao. The long-term goal of FSCs is to provide sustainable financial services to upland households like safe repository of savings, affordable credit facilities, micro-insurance services and the like.

The pursuit of RFS objective in the uplands shall be done in partnership with four (4) institutional partners, namely: (a) UDP; (b) PFIs; (c); FSCs and local government units (LGUs). Together these partners will establish the Upland Development Loan Fund (UDLF) and are expected to put up counterpart investments through a 55-25-15-5 percent sharing arrangement, respectively. The UDLF shall finance the multifarious credit needs of upland communities through the financial instruments of PFIs.

B. The focus of UDLF

The UDLF shall focus on the development of sustainable agricultural activities as well as the creation of off-farm microenterprises in the targeted watershed areas. These pursuits shall be accomplished using mainly the FSC network in the watershed areas.

The UDLF shall focus on the credit needs of upland communities beyond the carrying capacity of FSCs. Theoretically, the FSC could handle loan size of up to P12,000 per borrower only. The PFIs therefore should handle loan accounts above the P12,000 level.

C. Basic Considerations

UDLF shall allow the PFIs the opportunities to generate income, befitting any profit-oriented institutions. Failure to recognize this moneymaking concern would unnecessarily endanger the PFI-UDP partnership.

Any pecuniary motives of PFIs, however, shall be consistent with the egalitarian objectives of UDP in the uplands. UDP is mandated to protect watersheds. In doing so, it has to encourage sustainable and watershed-friendly agricultural practices. The PFIs should therefore rise above their seemingly parochial interests and regard the uplands as equally important arena for advocating environment conservation measures.

UDLF shall likewise bring about the financial empowerment of upland households via people-owned and –managed FSCs. PFIs should work hand-in-hand with UDP in transforming FSCs as viable financial institutions capable of providing microfinance services to upland households. The PFIs are expected to nurture FSCs up to the highest stage of institutional development.

Part II. Definition of Terms

1. Upland Development Programme (UDP) in Southern Mindanao is a collaborative effort of the Government of the Philippines (GOP) and the European Union (EU) under the tutelage of the Department of Agriculture (DA). Its priority thrust is upland resource generation, particularly in selected watershed areas in Southern Mindanao.

2. Rural Financial Services (RFS) – refers to one of the six components of the Upland Development Program, which is supposed to support the financial requirements of upland households in the targeted watershed areas.

3. Partner Financial Institutions (PFIs) – are the seven (7) rural banks one (1) cooperative bank and seven (7) primary cooperatives that signified willingness and exhibited capability to work in the uplands as a new frontier in upland finance.

4. Savings and Loan Groups (SLGs) – composed of 15-25 members organized as mechanism for pooling small savings of upland households and venue for effecting joint and several liability schemes.

5. Financial Service Centers (FSCs) – expected replicable model of people-owned and –managed financial institution in the barangay providing savings facilities, credit services and microinsurance products to upland households. The SLGs constitute the financial base of FSCs.

6. Agriculture-based projects – those projects recommended by LGUs on technical merits that are consistent with the Community Watershed Plans (CWPs) and Farm Plans (FPs) prepared by the community. These projects have longer gestating cycles generally entail high lending costs and perceived as high-risk accounts.

7. Microfinance approach – a new approach in lending to the poor wherein borrowers start with small loans based on cash flows of the household, weekly amortization is non-negotiable, solidarity group of five members is a must, and forced savings scheme is always incorporated in the amortization schedule. This approach specifically caters to women and known to have worked well in off-farm based microenterprises in urbanized communities.

8. Corporative – this a coined word from **corpo**(ration) – (coope)**rative**. Corporative is a collection-in-kind scheme designed to ensure produce of borrowers are delivered to the corporative to pay off debt of loan obligations. This is a joint investment of PFIs and FSCs to undertake high impact socio-economic projects.

9. Watershed areas – are those watersheds in the UDP selected 120 barangays in 30 municipalities of Compostela Valley Province, Davao Oriental, Davao del Sur, Sarangani and South Cotabato.

10. Seed Capital – is the revolving fund at the community level managed by the FSCs in tandem with the PFIs. This fund caters to the small production as well as provident needs of FSC/SLG members.

Part III. Implementing Policies

A. Salient Features of UDLF

UDLF is a revolving fund at the municipality level administered by PFIs. It shall be implemented based on the agreed policy directions set by all the partner investors sitting *en banc* in the UDLF Steering Committee (SteerCom). The FSCs, PFIs, LGUs and UDP shall be represented in the SteerCom. All decisions in the SteerCom should be reached by consensus.

The PFI acts as the trustee of UDLF. It shall be given discretionary authority to address the day-to-day operational issues. For this reason, management fees shall be charged for the services rendered by the PFIs.

The partner investors shall equitably share in the benefits derived from UDLF operation. In the same vein, all costs and risks shall be shared as well.

UDLF shall continue to address the financial requirements of upland communities even after the technical life of UDP. The PFI shall remain the trustee of UDLF unless the partner investors declare otherwise.

B. Credit Framework under UDLF

PFIs shall prioritize FSCs as the main lending channel of UDLF in the barangay. The FSCs, which have shown depth of outreach, quality portfolio and demonstrated commitment to upland clients, can borrow from UDLF to beef up its Seed Capital. The Seed Capital should give preferential focus on small agriculture-based projects particularly in the watershed areas. Only when the size of projects are beyond the capacity of FSCs that PFIs shall consider direct lending to upland clients. Only projects involving credit of up to P12, 000 are deemed considered within the capability of FSCs.

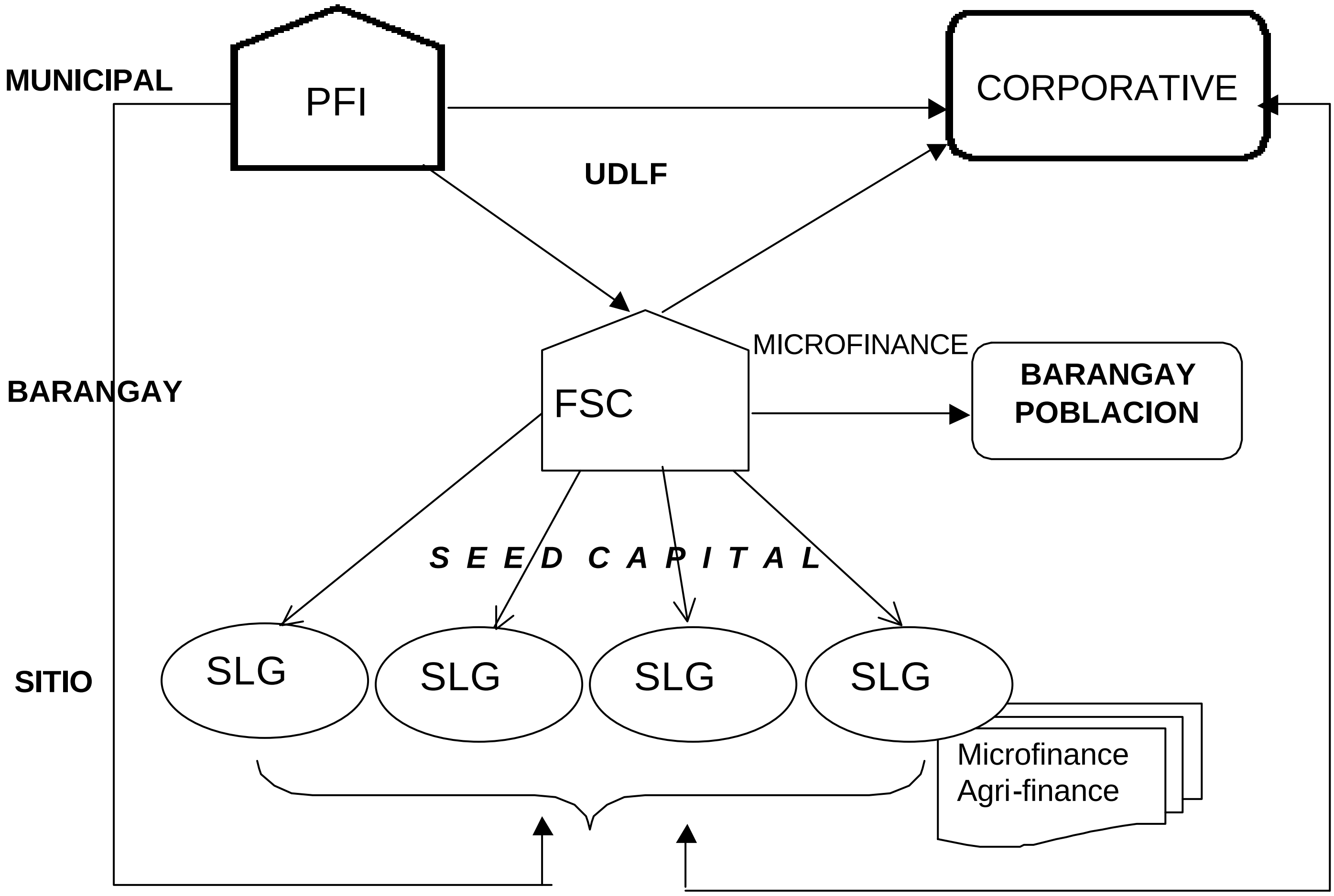
FSCs shall also engage in microfinance services in areas where microfinance approach is considered appropriate. Generally, the centers of barangays are eyed as suitable for microfinance approach. This does not exclude upland sitios as potential territories wherein microfinance could also flourish.

The PFIs shall support the microfinance facilities of FSCs through UDLF. It is expected that UDLF shall make up the main source of funds for the FSC microfinance services.

The UDLF shall similarly support upland high-impact economic projects through corporative scheme. UDLF should invest in corporative projects in the name of FSCs. The FSCs are enjoined to embark on a capital build-up scheme to retire the UDLF investments. Only the UDP equity investment in the UDLF shall be used for the purpose of enabling FSCs to engage in corporative partnership with PFIs.

Figure 1 shows the schematic diagram of UDLF credit framework.

Figure 1. UDLF CREDIT FRAMEWORK



C. UDLF Facilities

UDLF shall have three (3) main credit windows. First is the window for agriculture-based projects. This facility shall prioritize projects requiring more than P12,000 credit support. Lending through this window shall necessitate the following features:

1. Preferably, projects shall have maximum maturity of one year.

2. Borrowers should have successfully undergone at least three (3) loan cycles under the Seed Capital facility of FSCs. Entry level under UDLF should be P13,000 per borrower.

3. Borrowers should have more than one source of income to allow him/her to service loan obligations on a weekly basis. It shall be noted that weekly amortization, regardless of loan purpose and amount, is non-negotiable.

4. Borrowers shall be members of joint and several liability groups.

The second UDLF window is the microfinance facility for FSCs with capabilities to do microfinance approach in barangay centers or in other areas considered appropriate. To achieve economies of scale and to take advantage of other potential markets with abundant microfinance clients, the FSCs shall be allowed to expand to areas other than UDP domain. However, expansion to other non-UDP areas shall be allowed starting 2004 and after satisfying the following prerequisites:

1. No new FSC shall be organized in other areas. The same FSC (operating in UDP areas) shall provide microfinance services to clients in non-UDP areas.

2. Microfinance clients in non-UDP areas should be members of their own SLGs.

3. Expansion to non-UDP areas shall be permitted only after FSCs have shown beyond doubt that it has saturated the UDP areas. The FSCs should also indicate that expansion to non-UDP areas is a necessary strategy towards achieving financial self-sustainability.

4. FSCs should likewise reveal readiness and competencies in expanding to other areas.

5. Non-UDP areas of FSCs are no longer covered by UDP subsidies.

6. As a safety net, UDLF funds used in non-UDP areas should be pegged at half the exposure in UDP areas.

The third UDLF window shall be for the corporative projects that will evolve when other UDP components (e.g., infrastructure component) shall have achieved significant headways. The use of UDLF for corporative projects shall be in accordance with the following conditions:

1. Corporative projects shall involve the formation of marketing/processing facilities that will service primarily the requirements of all UDP areas.

2. All corporative projects shall be based on in-depth studies conducted for the purpose of determining technical feasibility and economic viability.

3. Corporative schemes shall prioritize projects of producer/trader associations organized by UDP.

4. Corporative projects shall be multi-commodity oriented.

5. No corporative project shall be implemented without the basic infrastructures in place e.g., access road.

6. UDLF shall support working capital requirements, fixed assets and land development costs of corporative projects.

7. UDLF shall similarly support the production credit requirements of farmer-investors in corporative projects.

D. Mechanics for Setting up UDLF

There shall be at least one UDLF per PFI. The UDP, PFI, FSC and LGU will contribute to UDLF based on the following distribution:

Partner	% Share
UDP	55
PFI	25
FSC	15
LGU	5

The investment contributions of UDP and PFI shall not be lower than P2.3 million and P750,000 per municipality, respectively. In order to set up UDLF immediately, PFIs should put up investment amounting to a minimum of P100,000 or a maximum of P170,000 per municipality. UDP shall match PFI investment to the tune of P300,000 (minimum) or P510,000 (maximum). The balances of respective fund commitments shall be expedited upon completion of PFI business plans for UDLF.

The FSCs shall contribute to the UDLF a minimum of P10,000 per FSC. This will allow them representation in the UDLF Steering Committee. FSC investment in UDLF shall come from repayments to Seed Capital they borrowed from UDP. The FSCs are strongly urged to make significant investments to bolster their voting rights in the UDLF. The FSCs should have adequately revolved the Seed Capital and satisfy the various needs of members before they make investments in UDLF.

PFI shall treat UDLF in their books as a liability account. Earnings of UDLF shall accrue to all investors after deducting the following cost items:

1. Operating costs (e.g., transaction costs of UDLF Field Officers)

2. Loan-loss provisions

3. Cost of inflation

4. PFI management fees

In principle, interest rates for the use of UDLF shall be pegged at cost-plus rate. No wide variances should be allowed in the rates charged by the different PFIs.

E. Terms and Conditions

1. The UDLF (Agricultural Finance) Facility

(a) The UDLF loans are for (a) additional funds required by FSCs for their own lending operation, (b) short-term individual production loans above P12,000, and (c) medium-term (3 years) loans for post-harvest facilities, farm transport equipments and small irrigation facilities, livestock, perennial crops, etc.

(b) Interest rates for loans to FSCs shall be at least at 1.5% month.

(c) Loans to special interest groups like the producer-trader organizations can be used for purchase of capital equipment, recurrent operating costs, acquisition and supply of inputs and for purchase of members' produce.

(d) Special loans to assist FSCs in the construction of building including office furniture and equipments could also be accommodated. Concessionary rate of 10%per annum is pegged for this type of loan.

2. UDLF Microfinance Facility

(a) Special fund to jumpstart microfinance operation of PFIs (via FSCs) in barangay centers.

(b) Use of UDLF funds for microfinance purposes shall bear interest rates approximating LANDBANK/PCFC rediscount rate offered to microfinance institutions.

(c) The use of UDLF for microfinance operation of PFIs shall under no case more than the total exposure to agricultural finance in the targeted sitios.

3. Equity Sharing (Corporative) Facility

(a) This facility is to encourage and attract UDP, FSCs and LGUs to become partners of PFIs by undertaking equity investment in upland high-impact economic projects.

(b) This facility facilitates the pooling of resources of the partners based on capital requirements, viability, and socio-economic impact of economic projects identified in the uplands.

(c) Through the PFIs, this facility will develop and reinforce the competence of FSCs in handling big economic projects.

(d) Through UDP, this facility shall promote the transfer of appropriate technology and marketing assistance to the syndicated project to ensure its success.

(e) The extent of UDP equity investment in economic projects in the uplands shall not exceed P1.5 million per municipality.

(f) Corporative projects should be implemented through a corporate business entity duly governed in accordance with Corporation Code of the Philippines. UDP should at least have one seat in the governing board.

(g) UDP shall allocate funds to support activities such as conduct of studies, workshops, conferences related to planning, packaging, implementation and monitoring of projects for which equity investment was made possible.

F. UDLF Procedural Matters

UDP and PFI shall convene the UDLF Steering Committee. It shall be composed of the following members:

Chairperson - UDP-PPO Manager

Members - PFI representative/decision-maker
` FSC Chief Executive Officer
LGU representative/decision-maker

The functions of UDLF Steering Committee are:

1. Provide regular forum for discussions of project proposals or financial schemes that will require syndication of funds to be drawn from the individual contributions in UDLF.

2. Provide venue for discussion of the allocative uses of UDLF to priority projects and activities deemed important by the UDLF investors.

3. Provide mechanism for harmonization or rationalization of seemingly incompatible thrusts as well as arbitration of conflicts that may arise in the course of implementing the business partnership in the uplands.

The UDLF Steering Committee prepares Annual Plan and Budget (APB) that will show list of possible projects and corresponding funding requirements. It should be based on technical inputs from PPO and partner investors.

The partner investors decides which of the projects or activities in the APB they will finance and how much. All the investors shall agree on the specific policies and procedures and most especially the legal framework that will govern their collaboration especially in syndicated financing schemes.

Technical Working Group (TWG)

1. TWG assists UDLF Steering Committee in identification, screening and packaging of projects for UDLF funding.

2. TOU Chief of PPO heads TWG; members include relevant specialists of PPO and representatives of PFIs, LGUs and FSCs.

UDLF Process Flow

Activity	Timeframe	Remarks
A. UDLF Credit (Microfinance/Agricultural finance) Facility		
1. Project Identification and Planning	3 months after release of Seed Capital	
1.1 Conduct of area-focus, resource-based project identification		PPO shall take the lead based on the results of CWP, FP, marketing studies, AEZ, etc.
1.2 Packaging of project feasibility studies and preparation of investment presentation materials		UDLF Steering Committee to agree on allocation of funds based on presentation materials
2. Pooling of Financial Resources	6 months after release of Seed Capital	
2.1 Conduct of meetings within UDLF Steering Committee to review proposals		c/o UDLF Steering Committee
2.2 Collection of fund contributions from different partners		
2.3 Execution of Memorandum of Understanding (MOU) between and among parties involved.		- The MOA of UDP-PFI earlier signed is for generating fund pledges - This MOU serves as legal basis specifically to govern joint effort in financing upland projects. It is also a mitigating measure to spread the risks to those directly involved.

B. UDLF (Corporative) Equity Sharing		
1. Project Identification and Planning	3 months after release of Seed Capital	PPO and PFI shall take charge
1.1 Conduct of area-focus, resource-based project identification		
1.2 Packaging of project feasibility studies and preparation of investment presentation materials		
2. Pooling of Financial Resources	6 months after release of Seed Capital	c/o UDLF Steering Committee
2.1 Conduct of meetings within UDLF Steering Committee to review proposals		
2.2 Collection of fund contributions from different partners		
2.3 Execution of Memorandum of Understanding (MOU) between by and between parties involved.		This is pledging to be part of syndicated project pending incorporation.
3. Formation of Corporate Entity	8 months after release of Seed Capital	
3.1 Processing of incorporation papers		
3.2 Formation of professional team		
4. Implementation Proper	One year after release of Seed Capital	
5. Periodic Performance Review		
6. Expansion/diversification		
7. Capital build up of FSCs/UDP Divestment		

UDLF Flow Chart