1.2 Agricultural Credit Facility (ACF)

Section 1: Introduction

The Agricultural Credit Facility (ACF) was operationalised in October 2009 and disbursements commenced in March 2010. The ACF was set up by the Government in partnership with commercial banks, the Uganda Development Bank, microfinance deposit-taking institutions (MDIs) and credit institutions; the financial institutions involved are referred to as participating financial institutions (PFIs).

The main objective of the ACF is to promote the commercialization of agriculture through the provision of medium and long term financing of capital investments in agriculture and agro-processing. The ACF enables loans to be extended to farmers and agro-processors on more favourable terms (e.g. lower interest rates) than are available through normal market channels, because the Government subsidises the scheme through the provision of interest free loans to the participating financial institutions and through its bearing of some of the credit risk. The Bank of Uganda plays a purely administrative role in the ACF.

1 Author: ACF Section, Accounts Dept., Bank of Uganda
Section 2: Loan terms and conditions

Projects which are eligible for ACF loans include acquisition of agricultural machinery, post-harvest handling equipment, storage facilities, agro-processing and any other machinery and equipment used for agriculture and agro-processing. A maximum of 20 percent of each loan can be used to finance the purchase of material inputs used in production.

The ACF has been implemented in three phases: ACF I from October 2009 to June 2010, ACF II from July 2010 to June 2011 and ACF III from July 2011 to date. Each phase was partially funded by the Government. In ACF I and III, Government contributed 50 percent of the total funds to the ACF and bears 50 percent of the credit risk, whereas in ACF II the Government contribution and share of the credit risk is one third. Government’s contribution to the ACF is interest free to the participating financial institutions. The interest rate charged to the final borrower in ACF I and III was fixed at 10 percent per annum whereas in ACF II it was fixed at 12 percent per annum. The loans funded from the ACF have a maximum maturity of 8 years and minimum of 6 months, with a grace period of up to a maximum of 3 years.

Section 3: Disbursements under the ACF

In each of the three phases of the ACF, Government made available UShs 30 billion as its contribution to the financing of the scheme, which would have allowed total lending to the eligible borrowers of Shs 60 billion in each of ACF I and III and Shs 90 billion in ACF II.

Under ACF I, almost all of the funds available were fully utilized, enabling loans of UShs 58.6 billion to be made to final borrowers. In contrast only a small fraction of the funds available under ACF II were utilized, with loans to final borrowers falling to UShs 8 billion (less than 10 percent of the maximum). Disbursements have picked up slightly under ACF III, with loans to final borrowers amounting to UShs 15 billion, but only a quarter of the available funds have been utilized.

ACF I was popular with PFIs because the level of Government subsidy was high (50 percent of both the cost of funds and the credit risk) and the effective interest rate earned by the PFIs on their 50 percent contribution to the scheme was 20 percent per annum, which was in line with prevailing market rates at the time (the average lending rate for agricultural loans in the second half of 2009/10 was 21 percent per annum).

ACF II was much less attractive to the banks because the level of Government subsidy was cut to 33.3 percent and the increase in the interest rate which PFIs were allowed to charge the final lenders was not sufficient to offset the higher effective cost of funds and the increase in risk borne by the PFIs. In effect, under ACF II, the PFIs could earn an interest rate of only 18 percent on their own contribution to the scheme yet at the same time they bore a larger share of the credit risk than was the case under ACF I. This explains why the utilization rate of funds available under ACF II was so poor.

Although the terms of ACF III reverted to those of ACF I in terms of the level of Government subsidy, ACF III has become less attractive to the PFIs because of the sharp rise in market interest rates in 2011. Under ACF III the effective interest rate earned by the PFIs is 20 percent, the same as under ACF 1, but

Editors’ Note: This was the utilization at the time the article was written, with some five months left to the end of ACF III.
the average lending rate for agricultural loans rose from 22 percent in June 2011 to nearly 29 percent in February 2012. Consequently, ACF III is potentially very attractive for borrowers, because the lending rate is barely a third of the prevailing market rate, but it is not very attractive for the PFIs who are facing much higher costs of mobilising funds than they were in 2010. 

Section 4: Investments funded under ACF I, II & III

The bulk of the ACF funds have gone to acquisition of machinery and equipment for agro-processing, tractors and heavy machinery for land opening and commercialisation of agriculture. The chart below gives the details of the various areas funded.

Section 5: Evaluation of the performance of the ACF

The ACF appears to have contributed to an expansion of bank lending to the agricultural sector. Between September 2009 (the month immediately preceding the inception of the ACF) and March 2012, total Shilling denominated lending by the commercial banks to the agricultural sector has increased by 118 percent. This is a faster rate of increase than Shilling denominated bank lending to all sectors of the economy, which increased by 59 percent in this period. All of the ACF lending was denominated in Shillings. Bank loans to agriculture denominated in foreign currency increased by 177 percent in this period, but this was a slightly slower increase than that of all foreign currency denominated bank lending which was 211 percent. Of course it is possible that agricultural lending would still have grown as fast even without the ACF, but that seems unlikely because there are no obvious reasons, other than the subsidy afforded by Government through the ACF, why Shilling denominated bank lending to agriculture should have been much more buoyant than lending to the rest of the economy.

The loans extended under the ACF have mainly been extended to larger commercial farmers and agro-processors, many of which are well established companies that already have access to bank finance. Nevertheless, the ACF was designed to try and ensure that the funds available were not monopolised by large borrowers. Accordingly a ceiling of Shs 2.1 billion was imposed on the amount that could be extended to any single borrower or group of related borrowers. However, to date 13

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3 Editors’ Note: One reason could be the more widespread use of Warehouse Receipt modalities in lending (see Articles 1.1 and 4.2 in this Yearbook).
borrowers, which include companies involved in grain milling, sugar processing, poultry, tea growing and dairy farming, obtained loans which exceeded this ceiling; these loans in total amounted to UShs 45 billion, which is 56 percent of the entire amount of credit disbursed under the ACF to date. Another 5 borrowers have obtained loans which are either equal to the ceiling of UShs 2.1 billion or slightly less than it; these loans amount to UShs 10.4 billion.

Hence almost 70 percent of the credit disbursed under the ACF to date has gone to large borrowers with loans of UShs 2 billion or above. Many of these borrowers, who have benefitted from the low market interest rates available under the ACF, could probably have afforded to pay market interest rates for the investments, though admittedly this is not known for certain in each case. Hence whether there is a strong public policy rationale for subsidising their borrowing is debatable.

In contrast, there is a much stronger case for supporting the commercialisation of smallholder farmers, by improving their access to credit. Smallholder farmers comprise 96 percent of all farmers in Uganda, but the level of commercialisation among this sector is very low. Very few if any of the loans extended under the ACF have been made to smallholder farmers. This is because the modalities of accessing loans under the ACF are not suitable for this group. For example, the PFIs require borrowers to provide land titles as loan security, but many smallholder farmers lack these titles.

The MDIs are better suited to lending to smallholder farmers than commercial banks and development banks, because they can use innovative lending technologies such as group lending, which obviate the need for physical loan securities.

However, the MDIs have not participated in the ACF, because the cost structure of the scheme is not suited to them. Because they incur much higher transactions costs of administering loans than banks, the fixed interest rate which can be charged to borrowers is a much more serious constraint for MDIs than it is for banks.

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4 This is one of the conclusions of the World Bank report: *Uganda Promoting Inclusive Growth*, released in February 2012.