

UNCDF LOCAL FINANCE INITIATIVE (LFI)

Case Study No.6: NUCAFE Uganda

Unlocking Private Finance

INTRODUCTION

To realize inclusive growth, countries should have the capacity and resources to mobilize, allocate and account for capital flows to “last mile” pockets where poverty is entrenched, economic opportunities are limited, and development plans under-funded. Concurrently, local communities should have access to capital to fund their local development needs and respond to growing demands for better infrastructure, services, and jobs.

Yet, in many least developed countries (LDCs), local savings are not invested locally or limited investment is provided for local development because of lack of confidence from financiers and track record of successful transactions. Innovative financing mechanisms coupled with UNCDF risk mitigation instruments help reveal markets to a wider pool of investors; and thereby crowd-in non-traditional funders, public and private, into new areas.

In 2012, UNCDF launched the Local Finance Initiative (LFI), a “last mile” finance model aiming to unlock finance so that local development projects can get to “closure.” The purpose of LFI is to correct market failures and attract catalytic capital for the investments that are not being picked up by existing public or private investors. Therefore, LFI does not seek to crowd out the private sector and provide public subsidies for those investments that would be likely to attract investment without its support. This represents the foundation on which LFI investments are identified and how the selection process does not distort the market. UNCDF seeks to spark a demonstration effect where the public sector can replicate the blend, leveraging the private sector finance to take the business model to scale. The LFI approach and its risk mitigation strategies

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Unlocking Public and Private
Finance for the Poor



have proven that local development investments can access additional funds from domestic capital markets, which is in line with the call for action in the Addis Ababa Action Agenda and Sustainable Development Goal 17 (the means of implementation) to mobilize resources from multiple sources to finance development. As the LFI investment pipeline is expanding rapidly, UNCDF would like to document and capture the knowledge, information, and lessons learned in a systematic manner. This series of case studies aims to demonstrate how LFI approach contributes to unlocking domestic capital and realizing transformational local impact.

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Case study 6 covers LFI's use of blended finance to attract external investments for the National Union of Coffee Agribusinesses and Farm Enterprises (NUCAFE) project in Uganda.

PROJECT SUMMARY

Name:

National Union of Coffee Agribusinesses and Farm Enterprises (NUCAFE)

Location:

Mukono district, central Uganda

Sector:

Sustainable agriculture

Purpose:

Purchase equipment, complete construction of coffee factory, and operationalize factory and shop

Total project cost:

US\$ 3.8 million (UNCDF seed capital grant + commercial bank loan + project developer's contribution)



"NUCAFE manufactures roast and ground coffee sold on the local market. We contribute to domestic consumption of locally roast and ground coffee through our Omukago Coffee Shop franchise, where good quality coffee is served by professionally trained coffee barristers. The whole magic is basically the more coffee cups we sell, the higher the returns to the farmers."

Joseph Nkandu
Executive Director, NUCAFE

DEVELOPMENT CHALLENGE

The National Union of Coffee Agribusinesses and Farm Enterprises (NUCAFE) is a social enterprise of coffee farmers in Uganda with a membership of 195 associations and cooperatives with over 200,000 farming families having over 1,000,000 farmers. NUCAFE was set up to assist Coffee farmers to profitably own their coffee along the value chain for their sustainable livelihoods and customer satisfaction. Founded in 2003, NUCAFE has grown and evolved as a vibrant private sector led farmer owned organization formed to serve and position farmers well in the liberalized coffee value chain in Uganda.

Seeking to groom farmers to become social entrepreneurs, NUCAFE decided to establish a National Coffee Entrepreneurship and Career Service Centre. The “Centre for Agribusinesses and Farmer Entrepreneurship enhancement” (CAFÉ) will provide warehousing, processing, training, and marketing services to farmers’ associations and cooperatives. Through the CAFÉ, farmers will receive capacity building to participate in the most profitable nodes of the coffee value chain, with increased ownership enabling them to influence the price of coffee of high value. Their engagement in higher value activities will result in improved household incomes, improved livelihoods, rural development and stimulate employment creation in the local economy.

To date, NUCAFE has completed the first phase of the CAFE with the establishment of a coffee processing factory. The organization has invested over US\$ 2 million in infrastructure such as warehousing, a coffee green bean sorter and grader, roasting and grinding machines, and other value addition equipment. NUCAFE also developed its marketing capabilities, and the entrepreneurship skills development and training that it provides to farmers.

In order to complete the second phase of the project, NUCAFE is in need of external financing. Under this phase, involves finalizing the factory, purchasing the remaining machinery, adding warehouse and training centre, and obtaining sufficient working capital to operationalize the factory. The project is designed to return at least 90% of the sales price back to the farmers for each transaction processed and marketed kilogram of different forms of coffee including graded, roast and ground coffee (finished product). The remaining 10% will be reinvested towards continued service delivery for farmers and to maintain business viability.

MARKET CONTEXT

Uganda is Africa’s largest coffee exporter and second largest producer after Ethiopia, which consumes 10% of its coffee. Coffee, as a commodity, has continued to play a leading role in the economy of Uganda, (contributing between 20 – 30% of the foreign exchange earnings), despite



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the vigorous efforts by Government to diversify the economy. In 2015, Uganda produced 285,000 Metric Tons (MT) of coffee and total annual exports in the 2015-2016 fiscal year were valued at US \$352 million. The country hopes to increase coffee production to six-fold by 2020 in line with government targets.

The Uganda coffee value chain consists of input supply, production, regulation and development, bulking, transporting, storing, packaging, wholesaling, retailing, research and consumption. The major actors in the coffee value chain include small scale farmers/producers, large scale farmers, rural assemblers/commission agents, transporters, wholesalers, processors, and retailers. The coffee sub-sector is almost entirely dependent on about 1,740,000 smallholder farming families, 90% of whose average farm size ranges from less than 0.5 to 2.5 hectares. The coffee industry employs over 10 million people through coffee related activities.

Over 95 % of the total annual coffee production is exported as green beans. Secondary processing also known as export grading transforms the clean Fair Average Quality (FAQ) coffee into the various coffee grades that meet the international standards. Domestic consumption of roast and ground coffee is still very low at about 3 – 6 % of Uganda's total annual production.

There are few indigenous roasting companies which roast coffee beans locally many of which are informal and whose final products are sold locally. There is therefore great potential to exploit by roasting coffee in Uganda and export to international as well as local markets. There is huge untapped market of setting up coffee cafes, shops, and franchises.

PROJECT RATIONALE

UNCDF identified this project through a call for proposal. NUCAFE previously obtained a short-term line of credit to build the factory but completion of the construction to get the CAFÉ to an operational level requires longer-term financing (> two years) that the organization has not been able to obtain. UNCDF's intervention to unlock financing would have a transformational impact on the over 1 million farmers affiliated with NUCAFE, not to mention the indirect effects that the CAFÉ would have on the local economy and to increased domestic consumption of high quality coffee.

NUCAFE follows a farmer ownership model (FOM), which is designed to support coffee farmers to organize themselves to assume as many roles as possible in the coffee value chain in order to increase their market value share. The model puts particular emphasis on organizing farmers for effective advocacy, and on the systematic application of knowledge and innovative business practices into the value chain. In essence, the relationship between the association and member farmers is not transactional and based solely on production and sales, but strives to create a sustainable and mutually reinforcing network where decision-making and economic benefits are equitably distributed.

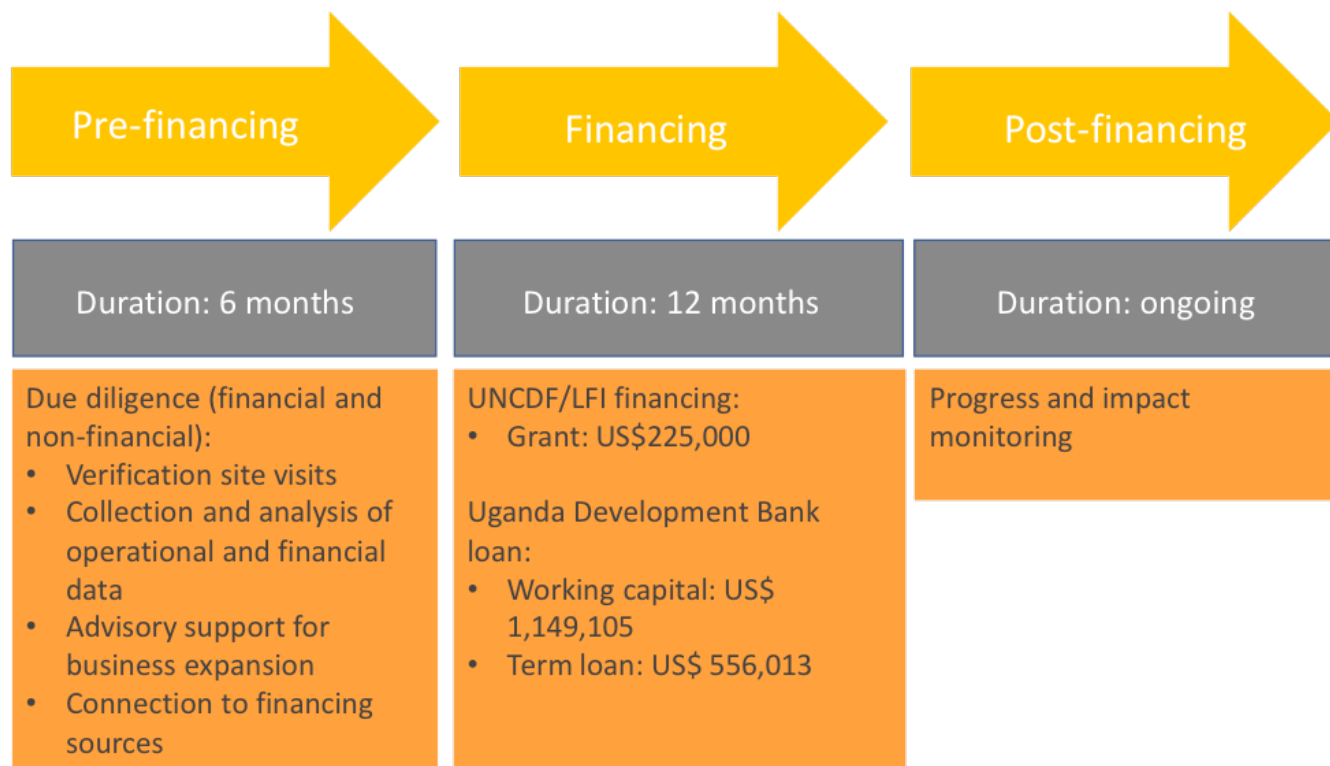
Currently, agricultural value chains deprive farmers of over 90% of the retail value of their produce, leaving most of them unable to make savings, reinvestments and improvement in their livelihoods. Moreover, the separation of agricultural production from value addition processes cuts farmers off from the potentially significant profits that are achieved in the later stages of the value chain. Enhancing and expanding farmers' roles and responsibilities along the commodity value chain can therefore play a critical role in jump-starting economic transformation.

At the project developer's level, UNCDF's support of NUCAFE also enhances the credibility and bankability of the organization, thereby paving the way for additional investments from impact investors and other development finance institutions.

PROJECT IMPLEMENTATION

LFI's key activities under this project can be broken down into three distinct phases (see Figure 1 below). Overall, the initial two phases spanned a period of 18 months and involved the participation of multiple stakeholders (project developer, local government entities, local financial institutions, UNCDF).

LFI used a mix of technical assistance and financial assistance in this project intervention, with technical assistance being provided to the promoter during the first phase for project development, and collaboration with the various external financiers on terms and conditions during the second phase.



Pre-financing

During this stage, LFI investment officers worked closely with the project developer to conduct due diligence of the project – collecting and analyzing all relevant operational, financial, operational and legal information. The key tasks included:

Project preparation:

- Site visits to verify availability of raw material, existence of contractual arrangements with farmers (out-grower scheme), processing capacity and gathering market intelligence
- Development of data collection tools for collecting operational and financial data
- Verification of commercial viability of the expansion through detailed financial analysis
- Determination of the optimal size of the project and structuring of the proposed investment

Business advisory support:

- Adjustment of business plan to a more moderate and feasible plan that fits within the developer's targeted type of debt financing.

Design financing options:

- Preparation of LFI's internal investment documents to support a recommendation of financing investment.
- Preparation of investment package (e.g. financial model, info memo) for submission to third parties including potential lenders and equity investors.



"My dream at NUCAFE is to see growth in entrepreneurial ideas among farmers. At NUCAFE, we like to promote coffee with traceability of the farming region because it carries different tastes and aroma. We are selling coffee with a story. Each bean is unique by the taste, farmer, and culture. We want to tell these stories on our packaging and on our website. My favorite story is 'bunjako' coffee (Robusta) and it tastes almost like an Arabica because of the history of where it comes from, Lake Victoria. This coffee was found growing naturally around Lake Victoria. It brings a big story for Uganda because Robusta Coffee originated here."

Joseph Nkandu

Executive Director, NUCAFE

Financing

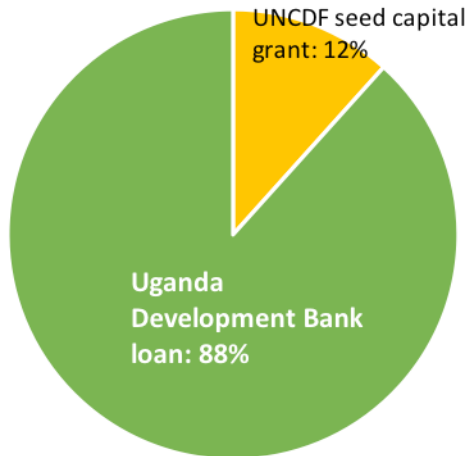
To date, NUCAFE has invested over US\$2 million in the project but has a financing gap of approximately US\$ 2 million in order to make the CAFÉ fully operational. Because of the large financing gap, NUCAFE still needed UNCDF support to de-risk the transaction in order to attract external financing for scale up. Ultimately, the financing structure for the project consisted of the following elements.

UNCDF instruments: Technical assistance and a catalytic seed capital grant of \$225,000 to enable the developer to meet the equity contribution requirement of the lender. The grant also helps to meet last mile transaction costs incurred by the developer in the process of meeting loan conditions from UDB.

Uganda Development Bank (UDB): TUNCDF succeeded in facilitating a loan totaling US\$

1,705,118 from UDB, of which US\$ 556,013 will go towards the purchase of remaining equipment for the factory (generator, coffee huller) as well as civil works such as construction of warehouse and factory fence, paving the compound, etc. The balance of the loan facility comprises working capital for operating the factory, shops, and café.

Percentage of financing unlocked by LFI



UDB was the lender of choice for several reasons. First, the bulk of the NUCAFE project entails significant capital expenditures and construction, which require a term loan of at least five years. Only two banks were willing to offer this term—the commercial Bank Ecobank was willing to offer a 4-year term loan but also needed a UNCDF partial guarantee whereas UDB agreed to a 5-year loan without a guarantee. Secondly, because UDB is a government-owned bank with a development objective, UNCDF was able to support the project developer to negotiate a lower interest rate at 9% p.a. instead of 12%, thus reducing the overall debt burden for the developer.

Pre-financing

LFI’s assistance does not end with the funding approval. Upon the issuance of the financing agreements, UNCDF worked with the project developer to clear all remaining conditions precedent for disbursement including UNCDF’s financing of seed capital. UNCDF will continue to provide monitoring of loan utilization, business advice to the developer on his operations to ensure repayment, and technical support to ensure that the project is achieving the intended socio-economic development impact.

RESULTS AND IMPACT

The NUCAFE project provides evidence that UNCDF grant funding and tailored technical support can facilitate the entrance of private financing for increased production and processing of a key agricultural crop in Uganda. In this case, UNCDF funding and technical assistance successfully **unlocked 88% of the total financing gap, with a leverage ratio of over 1:7, and enabled the implementation of a US\$ 3.8 million local development project in rural Uganda.**

More importantly, the project will generate significant socio-economic impact for the household and smallholder farmer, and have a multiplier effect on the local economy. Through the CAFÉ, the project will enhance farmers' capacity to participate in the most profitable nodes of the coffee value chain, and consequently, resulting into improved entrepreneurship, household incomes, improved livelihoods, rural development and innovators for employment creation. Specific impacts are as follows:



Income Generation and Poverty Reduction

Under the FOM, the buyers will pay a fair-trade Minimum Price and/or a fair-trade Premium to the farmers. Premium money is meant to improve the situation of workers, farmers and local communities in health, education, environment, economy etc. The farmers will decide the most important priorities and use for the premium. It is expected that farmers will earn at minimum an additional 30% per kilogram of cherries sold, potentially doubling the farmer's current earnings.



Job Creation

The project is slated to create 500 new jobs at the CAFÉ and the farmers' associations/cooperatives. NUCAFE plans to work with 195 cooperatives with a potential outreach of over 200,000 farming households and 1 million individuals.



Enhanced Capacity to Access External Financing

As a result of this transaction, NUCAFE has started to attract other development partners. With the factory up and running again, the organization has received an **additional US\$ 1.9 million in new funding**—US\$ 1,391,798 from a BiTrust and US\$ 537,377 from Nordic Contribution. The leveraged funds are to be used to: (i) increase the volume of marketed specialty eco-friendly coffees, (ii) increase processing and storage capacity at the hubs by 30% through the adoption of productivity and quality-enhancing best practices (irrigation, fertilizers, and GAPs) (iii) reduce utilization of diesel and other fossil fuels by 80% by the end of the project, and (iv) increase by 50% the proportion of women and youth realizing a financial benefit. In addition, NUCAFE received a contract from an Italian buyer to provide 30,000MT of beans annually starting in October 2018. The government also considers NUCAFE as a key player in the coffee sector, thus increasing the organization's profile and credibility among potential funders and investors, domestically and internationally.



Eco-friendly Agriculture and Improved Resilience

The NUCAFE business model includes requirements from the coffee producers for environmentally sound agricultural practices that leads to sustainable crop planning and harvesting practices. NUCAFE seeks to promote agro-forestry by planting trees as major activity within coffee nursery project. NUCAFE encourages to minimize the use of mineral fertilizers and safe use of agrochemicals, proper and safe management of waste after processing, maintenance of soil fertility and water resources. Sustainable agricultural and land management practices will also lead to improved resilience to climate change and natural disasters among small-scale coffee farmers.



Economic Empowerment of Women

The project and the use of the FOM will result in empowerment of women and youth by allowing them to take leadership roles and positions in the coffee value chain at the respective co-operative organizations, and promoting their active participation in decision making.



Improved Governance and Strengthening of Civil Society

The NUCAFE project will engender improved governance, accountability and transparency in co-operative societies and farmers' organizations, thereby increasing their influence in civil society. The systematic integration of knowledge and training into membership services will increase member loyalty and retention, help to attract new membership, further strengthening the Union and ensuring long-term viability of the business.



Contributing to Global Development Agendas and Government of Uganda National Development Strategies

The NUCAFE project contributes to SDG #2, "promoting sustainable agriculture" by aiming to double the agricultural productivity and the incomes of small-scale coffee growers, particularly women, through knowledge, training, markets, and opportunities for value addition. Likewise, the project will contribute to the objectives of the Addis Ababa Action Agenda (AAAA) to support private sector investments in agriculture. Within Uganda, NUCAFE will be one of the key Government Private Partners enabling the successful implementation of the National Coffee Policy, which espouses long-term competitiveness of the sector through a socially, environmentally and economically sustainable approach.

LESSONS LEARNED

UNCDF LFI's support to develop an implementable business plan was pivotal in NUCAFE's ability to obtain financing. NUCAFE's board and management team had a clear vision for the CAFÉ and what they would like the centre to achieve. Putting that vision and concept into an operational plan proved more challenging as the project developer had limited in house experience in this regard. As a case in point, in the initial phase of constructing the coffee processing factory, NUCAFE underestimated the scale of their financing needs and had to dip into a line of credit that they held with a local financial institution to finish the construction, leaving them short on the working capital necessary to get the factory up and running. With the factory non-operational, the organization was unable to generate sufficient revenue to obtain additional financing from its current bank. In short, the developer underestimated the length of the runway to get to where they want to be.

With UNCDF technical support, NUCAFE was able to develop comprehensive investment documents that detail the type of capital investments that are needed, the cost of these investments, and the timing of these investments. The LFI investment officer coached the developer on how to prioritize and sequence the purchase of equipment to get the factory operating as soon as possible. For example, instead of purchasing a huller for arabica beans right at the onset, the CAFÉ can begin by processing robusta beans since this does not require any additional equipment. This would then generate the cash flow to enable the purchase of the huller at a later date. LFI also gave advice on a production model that would generate higher return, for instance the minimum percentage of beans that should be sold as higher value ground and roasted as opposed to graded green beans. By helping the developer identify its needs and building scenarios for their project, UNCDF can run a financial model that captures more accurately the financing gap, and can assess whether the level of capital requested is within an acceptable range for a financial institution.

UNCDF LFI's interventions help to make a business case for financing membership/cooperative organizations. NUCAFE is incorporated as an organization limited by guarantees (rather than by shares). In that sense, members are considered to be guarantors so the main driver is to increase farmers' earning rather than maximize profit. NUCAFE exports coffee at world market rate but the organization mandates that at least 90% of sales price is distributed to farmers, with the remaining 10% to be re-invested into the company's operations and finance any debt. It is not a typical business model, and given the low margin, it is certainly not a model that financial institutions are familiar or willing to work with. Likewise, equity investors were not willing to engage with NUCAFE because of its farm ownership model. One of the important contributions that LFI made in the course of this transaction was to develop documentation and financial projections for the farmers' ownership model to make the case that even with a modest 10% margin, NUCAFE has the capacity to take on more debt and has sufficient liquidity to service the loan.



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It is important to work with and nurture relationship with select financial institutions.

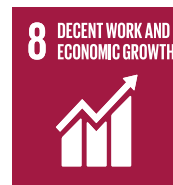
UNCDF plays an important intermediary role in brokering a relationship between NUCAFE and the lender. UDB was an appropriate partner for NUCAFE for several reasons. As a development bank, UDB was in a position to take on more risk, providing a longer-term loan and a larger amount than would be palatable for traditional private banks. Having UNCDF as a funding partner also increased the bank's willingness to lower its interest rate, which helped to reduce the overall debt burden for the developer. The importance that UNCDF gave to relationship building with the bank—through constructive engagement and continuous monitoring of the loan application—helped to expedite the process towards final approval of the loan.

Financing serves as an important enabler of organizational development and capacity building for membership organizations. Working with a membership organization like NUCAFE can create impactful change at multiple levels of a value chain. The financing for the second phase not only goes toward building the physical infrastructure for the factory and the processing activities, NUCAFE will introduce more integrated training services to increase the knowledge and capability of farmers, processors, marketers, and other players along the value chain. Hence, the economic gains and developmental benefits of the project are manifested all along the value chain.

UNCDF & SUSTAINABLE DEVELOPMENT GOALS



LFI with impact on



ABOUT UNCDF

The UN Capital Development Fund makes public and private finance work for the poor in the world's 47 least developed countries (LDCs).

With its capital mandate and instruments, UNCDF offers “last mile” finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development.

UNCDF's financing models work through two channels: financial inclusion that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and by showing how localized investments—through fiscal decentralization, innovative municipal finance, and structured project finance—can drive public and private funding that underpins local economic expansion and sustainable development.

By strengthening how finance works for poor people at the household, small enterprise, and local infrastructure levels, UNCDF contributes to SDG 1 on eradicating poverty and SDG 17 on the means of implementation. By identifying those market segments where innovative financing models can have transformational impact in helping to reach the last mile and address exclusion and inequalities of access, UNCDF contributes to a number of different SDGs.



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