"THE CREDIT FUND LOMBARDY EASES SUSTAINABLE INVESTMENTS IN THE AGRI-FOOD SECTOR"

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The EAFRD Credit Fund Lombardy is the first combined financial instrument in a Rural Development Plan in Italy. Implemented in 2017, it made access to finance easier for agri-food companies while improving primary producers' integration in the agri-food chain.

A conversation with Giovanni Rallo, Managing Director of Finlombarda, Credit Fund Lombardy's managing entity, and Rita Cristina De Ponti, Head of the EAFRD Managing Authority at the Directorate General for Agriculture, Food Sovereignty and Forests in the Lombardy region.

1. Ms. Rita Cristina De Ponti, can you give us a short introduction to the Credit Fund model as financial instrument? What is its purpose and who are the main actors?

The "Credit Fund" financial instrument was activated to bring financial institutions closer to agri-food companies. According to an analysis conducted at the beginning of the 2014-2020 programming period agri-food companies found it extremely difficult to access the banking system, and this difficulty jeopardised their capacity to make investments of a certain size (>1 M€). Through the Credit Fund, we wanted to support more actively supply chain projects, which have an important impact on primary agricultural production in Lombardy, thus favouring and strengthening territorial and local development.

Furthermore, the financial instrument has, for the first time, triggered a revolving mechanism of approximately EUR 35 million, thanks to repayments, generating additional flows of money in favour of the Lombardy region with the objective of further reutilisation. At the same time, the lead company in the supply chain project benefitted from a reduction of the debt towards the bank, providing a mutual advantage for further future bankability. Leveraging the creditworthiness of the large company made it possible, on consequent, to act in favour of the SME which supplies primary agricultural products for three years at least.

The main players involved were the professional organisations representing the different Lombardy supply chains (milk, meat, wine, fruit and vegetables, cereals and rice), banks affiliated with Finlombarda as well as Lombardy food companies which, in quality of leaders of of each supply chain, have in turn involved the SMEs supplying primary agricultural products.

Upstream the credit process, we also find actors such as:

- The EAFRD Managing Authority at the Directorate General for Agriculture, Food Sovereignty and Forests in the Lombardy region;
- Finlombarda acting as the Credit Fund Manager;
- The Regional Paying Body (OPR) disbursing both the loan to Finlombarda and the grant component;
- Finlombarda affiliated financial intermediaries (which are about a dozen and which include local banks, mutual banks as well as some major banks in the country).

2. How long did it take to structure and implement the Fund, Ms. De Ponti?

Structuring the Credit Fund took approximately six months. It started in October 2015 with the ex-ante evaluation and ended in April 2016 when the Fund was established. As to the implementation, it took almost a year, with the publication of the first call for tenders taking place in March 2017.

In this regard I must also say that the "Credit Fund" as the first combined financial instrument, not only in Italy but also in Europe, has initiated "a cultural revolution" in the use of European funds, in particular in the agricultural sector, introducing innovative logics in an environment traditionally dominated by grants. It thus contributed to an enhanced collaboration between this sector and banks.

Anyway, the overall set-up timing needed to meet regulatory requirements, allowed a greater awareness of the innovative choices made for a more effective use of European funds among all the actors involved (public administration, private sector, and their representatives).

3. **Now Mr. Giovanni Rallo how do you think the new economic situation characterised by inflation and rising interest rate did impact the implementation of the fund? What consequences do you expect for the future?**

During the implementation of the financial instrument, we observed a partial mismatch between the product and the evolution of the economic and financial context.

The set-up of the instrument required a significant amount of time, due, namely, to complex phases and timing dictated by the programming cycle. As a result, once operational, the product was no longer fully aligned with market conditions which in the meantime had significantly changed.

However, now, in a situation of high interest rates, I can say that the beneficiaries are surely more than happy with the possibility of benefitting from a fixed rate of 0.5% for the entire duration of the loan (10 years plus a 3-year grace period). Furthermore, the investment has enabled them to improve the production processes in terms of energy efficiency, further reducing their production costs. Therefore, Credit Fund is proving to be an excellent instrument.

Looking at the new programming period, it will be important to include elements of flexibility while setting up such an instrument to be able to adapt on an ongoing basis to rapidly changing market conditions (interest rate increase, etc.).

4. **Fine, we take your point on adaptation, now, Mr. Rallo, the financial structure of the Credit Fund combines investment loans with grants. Earlier on, has been mentioned "a cultural revolution" in the use of European funds in the agri-food sector traditionally dominated by grants. In your view, how important was combination for the uptake of the instrument?**

The "Credit Fund" provides investments loans for a maximum duration of 10 years as well as a grace period of up to 3 years and an annual nominal interest rate of 0.5%.

This loan component covers 32% of the investment made by the agro-industrial company and is part of a broader financial intervention, which also includes:

- A capital grant which covers 20% of the investment, again from Rural Development Plan resources.
- a co-financing loan with bank at market conditions to cover the remaining 48%.

Given the above, it is easy to understand how, in specific "market failure" situations, a combined financial instrument can be effective to overcome the level of uncertainty linked to decision about the bankability of a given beneficiary for a given project of significant size.

Finally, I think that to be financially attractive, the facilitation resulting from the combination of loan and grant must always consider the right trade-off between the economic benefit for the company and its supply chain and the complexity of the underlying bureaucratic requirements.

5. **Thanks Mr. Rallo for this view on combination. Now, Ms. De Ponti, one of the main objectives of this model financial instrument is to support projects that have a positive impact on the overall supply**

chain, while ensuring that the benefits reach smaller agricultural producers. Could you please elaborate further on this important aspect?

Alongside strengths such as a strong inclination of regional agro-industrial companies for exportation and the resilience of the cooperative system, the SWOT analysis identified significant weaknesses in the sector such as the unequal distribution of supply chains added value, at the cost of the primary sector. Another traced weakness was the high price volatility which jeopardises the sustainability of agricultural businesses.

On the basis of the SWOT analysis results, agro-industrial companies operating in integrated supply chain projects (with positive impacts on primary producers) were therefore identified as the primary target of the financial instrument. To prove their belonging to supply chain projects, agro-industrial companies must sign supply chain agreements with primary producers to guarantee certain price and quantity conditions.

Beyond the more "transversal" advantages of financial instruments, the main benefits are as follow:

- For agro-industrial companies, which are the "direct" recipient of the subsidy:
  - An easier access to bank credit, thanks to the risk sharing with the Credit Fund, together with a combined non-repayable grant.
  - The reduced cost of the Credit Fund loan thanks to the application of a subsidised rate.
- For supplier farms, which are the "indirect" recipients of the subsidy:
  - A greater stability in terms of income, given that, to benefit from the financial instrument, agro-industrial companies must provide supply contracts for at least 3 years after the closure of the project signed with supplier farms.

The abovementioned benefits bring to a higher positive impact to the entire local regional ecosystem that is hardly achievable by other types of financial support.

6. **Thank you, Ms. de Ponti, for this explanation. Now that we understand the advantages for agri-food companies and smaller primary producers to take part, Mr. Rallo, can you explain the benefit that private financial institutions may find to co-invest in investment projects supported under this instrument?**

First, financial intermediaries affiliated with Finlombarda share the financial risk with the Credit Fund and potentially, being co-investors, may also widen their customer base. Indeed, also having a grant component, they can deal with more solid customers to whom offer additional financial solutions as they can borrow a higher amount of money (as their margin debt is higher).

Finlombarda itself, after the financial intermediary economic assessment, carries out a further assessment on the creditworthiness of the applicant company, in relation to the loan requested from the Credit fund.

Furthermore, investments loans have an impact on supply chain projects and the involvement of medium or small primary producers can have positive effects at local level, even in terms of improved publicity of the private financial institution.

7. **Now, in terms of concrete results achieved so far (such as for instance the number of projects approved, the number of beneficiaries supported, the type and size of companies supported, the number of individual producers having benefitted indirectly from the instrument, the loan amounts allocated and disbursed, etc.), can you share any with us Mr. Rallo?**

The adopted scheme has allowed to indirectly reach small agricultural businesses, which are the main target of public policy and the weak link in the supply chain, due to their difficulties in accessing bank credit. At the same time, it has allowed to enhance the functioning of the financial instrument which focuses on the strongest processing company, the latter being the central point in the supply chain and the one which has the best financial rating.

Now, to give you some concrete data, the Credit Fund with a budget of approximately 57 million euros, (EUR 35M million in financing and EUR 22 million in grants) generated EUR 53 million of additional financing through affiliated banks.

Considering the overall result of the three calls launched, s, 23 projects and 20 beneficiaries (some of them applied for separate projects over several editions) were supported for a total amount of ca EUR 110 million of eligible investments.

Out of the EUR 35 million loans granted on EAFRD resources, 25 have been disbursed to date.

Indeed, through the signature of the supply chain agreements, the 23 projects have involved several hundred of primary producers in the Lombardy region.

8. An impressive result indeed. Now Ms. De Ponti, with some hindsight, would you say that this instrument was a success story in terms of efficient use of public resources, leverage effect and easier access to credit for small enterprises? And do you plan to replicate the model in other Italian regions?

Yes, the Credit Fund can be considered as a success story. The financial instrument can be replicated in other rather lively economic territories in the country, capable of favouring a driving and lasting effect.

The Fund is in fact inspired by reverse factoring logics; it represents a suitable model for contexts where we have a large financially reliable buyer (the agro-industrial company), and upstream, a series of smaller suppliers with lower credit ratings (SMEs from the primary agro-industrial sector).

Therefore, its positive impact is not limited to the loan applicant but is extended to other smaller players in the supply chain. Furthermore, it allows to monitor the added value generated by its financial flow, creating co-responsibility between the various actors in favour of the development of the entire territory.

In order to support this strategy, any legislative and regulatory intervention that contribute to streamlining procedures for structuring and launching financial instruments are obviously welcome, so as to reduce the "time- to-market" period, as well as to simplify the revision procedures of financial instruments, in case of need to adapt it to any changing economic situation.

9. Finally, Ms. De Ponti, can you say a few words on the impact of the soaring cost of energy on agricultural businesses? How do agri-food companies, which are heavy users of energy, cope with this difficulty in your region and how can a financial instrument like the Credit Fund play its part to relieve the burden on them?

Within the framework of the 2014-2022 RDP, measure 22 'Exceptional temporary support for farmers and SMEs particularly affected by the consequences of Russia's invasion of Ukraine' was activated at the end of 2022, making EUR 17.4 million available for farmers operating in the pig and mountain dairy sectors.

The aim was to provide timely help to these sectors, which have suffered more than others from the crisis generated by the international geopolitical situation and the increase in energy, fertiliser and feed prices.

As far as the credit measure is concerned, the required flexibility should be consistent not only with changes in the market rate, but also with a sudden change in the external environment, such as a high energy price.

By financing investments for the improvement of company production processes, the credit fund can lead to greater efficiency in the consumption of raw materials (e.g. water) accompanied by energy savings and, in general, make the company more independent of external factors.