The report on the *ex ante* assessment of the financial instruments of Lithuania's Common Agricultural Policy Strategic Plan for 2023–2027

Summary

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SUMMARY

The *ex-ante* assessment report on the financial instruments of Lithuania's Common Agricultural Policy Strategic Plan (hereinafter referred to as the CAP SP) was prepared in the framework of the implementation of the service contract signed between the Ministry of Agriculture and UAB ESTEP Vilnius for the *ex-ante* evaluation of the CAP SP and *ex-ante* assessment of financial instruments.

The aim of *ex-ante* assessment of the financial instruments of Lithuania's CAP is to evaluate the rational to use financial instruments in achieving the CAP objectives in the fields of agriculture, forestry and rural development. Based on the Article 58 of Regulation (EC) No 2021/1060 an *ex-ante* assessment shall be completed before managing authorities make programme contributions to financial instruments. The *ex-ante* assessment shall include at least the following elements:

(a) the proposed amount of programme contribution to a financial instrument and the estimated leverage effect accompanied by a short justification;
(b) the proposed financial products to be offered, including the possible need for differentiated treatment of investors;
(c) the proposed target group of final recipients;
(d) the expected contribution of the financial instrument to the achievement of specific objectives.

In assessing the rational to use financial instruments in achieving the objectives of the interventions set out in the Lithuania's CAP SP, an analysis on the demand-for-credit market and financing gap in the fields of agriculture, forestry and rural development was carried out. The report states that Lithuanian economy is characterized by a low level of development of the capital market, as well as the strict funding requirements imposed by credit institutions on SME entities, the lack of collateral sought and the high cost of obtaining funding (including administrative costs, costs of providing guarantees, interest rates). According to the Bank of Lithuania, due to the negative effects of COVID-19 on the economy, loans to businesses decreased by 15.2 % in 2020 compared to 2019, and although the flow of new loans increased again in 2021, it did not reach the pre-pandemic level. The main reason for the decline in the Lithuanian business credit market is reduced bank risk appetite and lack of competition in the Lithuanian banking sector. This encourages banks to focus on large business customers while limiting financing to SMEs. In 2019, Lithuania ranked second in the euro area as a whole in terms of the rate of cost of new business loans. Due to the seasonality of activities, price fluctuations, adverse climatic risks, credit institutions in the agricultural, forestry and food sectors consider them to be at higher risk and therefore face even greater external financing difficulties for natural and legal persons operating there.

Access of agricultural actors to external financing can be improved by creating financial instruments to address market failures, partly financed by national or EAFRD funds. Currently, financial instruments in Lithuania to reduce the funding gap in the agricultural sector are implemented by the national development institution "Agricultural Credit Guarantee Fund" from national funds and from the funds returned from the 2007-2013 RDP financial engineering instruments and from the 2014-2020 RDP financial instruments. However, the measures taken are of limited financial scope and do not fully meet the needs of market participants. The lack of financing under market conditions was identified as one of the main weaknesses in the assessment of the Lithuanian agricultural and rural economic, social and environmental situation (*Source: Assessment of the Lithuanian agricultural and rural economic, social and environmental situation, 2021*). In the SWOT analysis, the scarcity of resources for land acquisition and the lack of capital for business start-ups were identified as key weaknesses in achieving SO2 andSO7 targets. The need to expand the use of financial instruments to promote the competitiveness of the agri-food sector and the smooth generational renewal in rural areas has been confirmed by the FI-compass study (*Source: Financial need in agriculture and agri-food sector in Lithuania, 2020)* and current *ex-ante* assessment. Both studies highlight a greater need for external financing in the agricultural sector in

Lithuania compared to the situation in the EU. For example, in 2017, 45 % of all farmers applied for external financing in Lithuania, while the EU average was 30 %. The need to borrow funds for both investment and working capital has increased further in recent years. A survey of farmers carried out during the *ex-ante* assessment of financial instruments shows that over the last 3 years (2019-2021), 54 % of respondents applied for external financing. The average share of non-approved farmers' applications for loans was 25 % compared to 37 % for young farmers. The *ex-ante* evaluation report on financial instruments notes that the impossibility to borrow funds on the market restricted the participation of some target groups in the investment measures of the Lithuanian Rural Development Programme 2014-2020.

In the *ex-ante* assessment of financial instruments, an analysis of the financial products currently offered on the financial market and by national development institutions, their scope and accessibility to CAP SP target groups was carried out. This analysis estimated that the funding gap not covered by the market and national financial instruments during the implementation period of the CAP SP will consist of:

- *investments in agricultural holdings, including sustainable investments*: EUR 546 million; the largest funding gap is attributed to farms of less than 20 ha, which account for more than 80 % of the total farmers' farms in Lithuania;
- *investments in the processing of agricultural products*: EUR 20 million; almost 60 % of the total funding gap is attributed to small businesses, and *start-ups* face particular difficulties;
- *setting-up and investment of young farmers*: EUR 316 million;
- *working capital*: annual financial gap is from EUR 63 million to EUR 115 million.

Following recommendations are provided in the *ex-ante* assessment of financial instruments:

- For the period 2023-2027, support in the form of financial instruments might be provided in accordance with Articles 73 and 75 of the CAP SP Regulation for the following interventions to address the identified funding gap and in line with Article 80 of the CPR: "*Investments in agricultural holdings*", *"Sustainable Investments in agricultural holdings",* "*Investments in processing of agricultural products*" and *"Initial establishment of young farmers*".
- The proposed amount of CAP SP funding through financial instruments is EUR 65 million, which, taking into account the assessed funding gap, is allocated as recommends the following: Measure "KP12vld - Investments in agricultural holdings" – EUR 30 million; Measure "KP31tvi – Sustainable investments in agricultural holdings" – EUR 5 million Measure "KP17jūs - Setting up of young farmers" – EUR 20 million; and Measure "KP30pfi - Investments in processing of agricultural products (financial instruments)" – EUR 10 million.
- Under the interventions "Investments in agricultural holdings", "Sustainable Investments in agricultural holdings" and "Initial establishment of young farmers", the proposed financial product is a risk shared loan, which may be combined with a subsidy at project level, as provided for in Article 58 (4) of Regulation (EU) No 1060/2021. Under the measure "Investments in processing of agricultural products", which will be programmed under the Article 73 of Regulation No 2021/2115, for typical projects for agricultural processing activities, a soft loan for start-ups and small and medium enterprises, which may be combined with a grant in the form of a partial write-off of a loan (capital rebate) once the final beneficiary has reached the targets set out in the business plan; as provided for in Article 58 (5) of Regulation (EU) No 1060/2021. In all cases, the combination of a preferential loan with the grant element results in a gross grant equivalent and the amounts of support must not exceed the maximum amounts of support applicable to individual interventions.
- Financial measures may be implemented throughout the territory of Lithuania.

- In line with the provisions on eligibility of expenditure laid down in Article 86 of the CAP SP Regulation, the lending period for financial instruments will expire by 31 December 2029. Financial instruments can finance tangible and intangible investments, biological assets, working capital and, where permitted by EU regulations, land acquisition costs. In all cases, the total amount of working capital support provided to the final beneficiary shall not exceed EUR 200 000 gross grant equivalent over a period of 3 fiscal years.
- Final beneficiaries eligible for support from financial instruments may be natural and/or legal persons meeting the eligibility criteria set out in the description of interventions for the final beneficiaries and project.
- The model of implementation of financial instruments should be continued as in 2014-2020. In accordance with the provisions of Article 59 (3) of Regulation (EU) No 1060/2021, it is recommended to assign the functions of Holding Fund manager the national development institution entrusted with the task of carrying out promotional activities in the fields of agricultural production and processing in accordance with the Law on National Development Institutions of the Republic of Lithuania. The Holding Fund manager may implement financial instruments directly or select financial intermediaries to lend funds to final recipients in accordance with the terms and conditions laid down in the contract with the holding fund. In line with the provisions on eligibility of expenditure laid down in Article 86 of the CAP SP Regulation, the lending period for financial instruments will expire by 31 December 2029. Management costs and fees paid to the Holding Fund manager and financial intermediaries for the implementation of financial instruments will be considered as eligible expenditure within the meaning of Article 80 of the CAP SP Regulation and within the limits set out therein.