

SUPERVISED CREDIT LENDING

1ST VALLEY DEVELOPMENT BANK, PHILIPPINES CASE

This case study was prepared by Bridge to promote new lending models that effectively address the risks associated with agricultural production.

This study focuses on the 1st Valley Bank's Supervised Credit Program for rice and corn production.

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A. HISTORY AND BACKGROUND:

1ST Valley Bank (1VB) is a rural development bank based in Cagayan de Oro City, Misamis Oriental that focuses in the provision of loan capital to entrepreneurial small-holder farmers and micro entrepreneurs in progressive communities. 1VB has received an A+ rating from the Philippine Rating Services Corporation and earned membership in the Rural Bank Association of the Philippines (RBAP). 1VB also gained recognition from the Land Bank of the Philippines as one of the Most Outstanding Rural Banks in the country as well as garnered the Eagle award by Microenterprise Access to Banking Services (MABS).

Tracing its roots from the Rural Bank of Kapatagan Valley Inc. (KVB), a stock company that began operations on November 24, 1956, the bank's clientele grew within the communities where it operates and in April 2004, KVB's stockholders entered into a consolidation agreement with the Rural Bank of Sinacaban. The bank began operations under its new name, 1st Valley Bank on September 21, 2005 after the Bangko Sentral ng Pilipinas (BSP) granted its license to operate. At present, 1VB operations span across Regions IX, X, XI, and CARAGA with thirty-one branches, seven extension offices and 1 financial solutions center.

Apart from the regular product suite consisting of savings and checking accounts, commercial loans and money transfers, 1VB offers an array of products and services that provides local small producers and businesses easy access to reliable savings and credit facilities. 1VB has 3 flagship products: (1) the Supervised Credit Program, a loan product for rice, corn and cacao production; (2) the Financial Assistance to Micro Entrepreneurs (FAME), a working capital loan for microenterprise expansion and other agricultural activities; and (3) the Gold & Gems Jewelry Loan, a multi-purpose loan collateralized with jewelry items.

This case study focuses on 1VB's Supervised Credit Program.

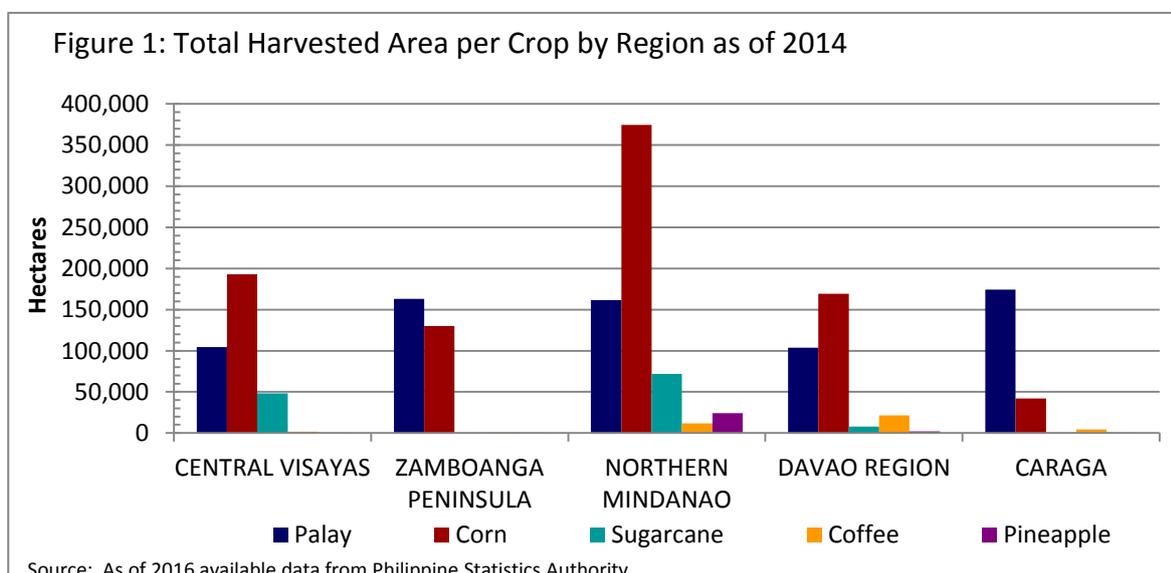
B. AGRICULTURAL LANDSCAPE AND TRENDS:

The agriculture, hunting, forestry and fishing (AHFF) industries contributed 10% to the 2013 GDP with gross value added amounting to about Php 706 billion, and 32.9% (or about Php 232 billion) of which came from the Mindanao region's agricultural output. The GVA grew 1.1% for Mindanao with regions XIII, XII and X registering 7.7%, 3.5%, and 3.2% growth rates respectively.

Industry	PHILIPPINES*	MINDANAO	Mindanao % to Phils.	Region IX	Region X	Region XI	Region XII	Region XIII	ARMM
AHFF Total	706,619	232,389	32.9	29,916	61,376	39,977	53,262	17,382	30,476
Agriculture and Forestry	575,616	193,313	33.6	19,940	53,545	37,133	44,282	15,279	23,134
Fishing	131,003	39,076	29.8	9,976	7,831	2,844	8,980	2,103	7,342

Source: As of 2016 from Mindanao Development Authority
Values in Million Pesos

While the Mindanao region's primary product is coconut, with an average yield of 9.6 million metric tons from 2010 to 2013, in 1VB's core areas of operation, corn and rice remain to be viable industries for the bank's agricultural products because they have a relatively huge market share. Corn yield in 2013 amounted to about 1.9 million metric tons largely (62.35%) coming from Northern Mindanao. In the same period, rice production reached about 2.7 million metric tons. There are about 1.3 million parcels of land in Zamboanga Peninsula, Northern Mindanao, Davao Region and Caraga used for agricultural purposes. About 909,000 hectares of which are utilized for corn production while about 706,000 hectares is used for rice. Sugarcane and Coffee farms in 1VB's area of operation take up about 128,000 and 40,000 hectares respectively.



Certain trends have emerged in the industry that point to prospective areas of growth for 1VB's market:

Decrease in average farm size while number of farms increase - In 2014, it is estimated that number of farms increased in provinces where 1VB has a footprint, except in Davao region. This could be attributed to the partitioning of farmlands as one generation of agricultural operators hand it down to their successors. Chunking lands into smaller parcels result in an increased number of smallholder farmers holding ownership of about 1.45 hectares on average. The increase could translate to a greater borrower base for financial service providers. Another contributor to diminishing farm size is the conversion of agricultural land to commercial and residential purposes. Farm conversion is driven by external factors, such as industrialization and rapid population growth, and internal factors, such as low productivity and lack of working capital. The later set of drivers point to a need for reliable credit and various savings instruments tailored to the cash flow needs of smallholder producers.

Agriculture sector lending rise but remain below the legal requirements – The BSP reported an increase of 22.6% in the amount of loans extended to the agriculture sector, jumping to Php401.2 billion in 2015 from Php327.3 billion the previous year. However, the compliance rate for agricultural credit stood at 14.4%, which is below the 15% allocation requirement of total loanable funds. The volume of loans used for alternative compliance to RA 10000, mainly loans invested in treasury securities, exceeded those of direct compliance by about Php33.5 billion. In an effort to encourage the flow of funds into agriculture lending, the BSP approved the implementation of a value chain financing scheme that is expected to reduce the credit risk of small producer lending. Some of the features of the value chain products include: trade-receivables financing, factoring and warehouse receipts.

Natural calamities remain the primary cause of crop failure – El Niño conditions continue to plague the Philippines as 42% of the country is still experiencing way below normal rainfall. Most affected areas are in Mindanao where drought is taking a toll on 20 provinces including Misamis, Bukidnon, Davao, and Zamboanga, and still 3 more provinces are under a dry-spell since March 2016 according to the International Federation of Red Cross. About 181,000 farmers nationwide are estimated to have been adversely affected, 54% and 38% of which are rice and corn farmers respectively. The insufficiency of rainfall has caused production losses of about Php32.3 million in Region IX, Php747.5 million in Region X and Php69.2 million in Region XI, devastating mostly rain-fed lands. The Department of Agriculture has been partnering with various institutions in focusing efforts to production support, water management and information dissemination to mitigate El Niño impact on farming households. Financial service providers are essential in helping the unbanked majority of small-holders to create safety nets through savings mechanisms and insurance instruments during such calamities.

Most banks and financial service providers are reluctant to cater to farmers' needs because of the high credit risk it entails. In order to address technological gap and low productivity, the government continues to roll out projects for the development of the sector, investing in improvement of irrigation systems and farm to market roads, setting-up trading centers, and increasing adoption of good agricultural practices through technical assistance. Strengthening the linkages between value chain actors is crucial not only in minimizing the lending risk for banks but also in creating more opportunities for the industry's growth.

C. 1st Valley Bank’s Supervised Credit Program

1st Valley Bank has been in the business of lending to farmers since 1970, offering the Agri-Agra loan, which is secured by real estate property. In 2010, 1VB introduced the Supervised Credit Program for clients in the rice farming industry. It was also during this time that then bank president, Atty. Sonny Lim, established a department to focus on the continued development and implementation of the program. After a successful pilot, the bank has rolled out the product for corn production in 2011 and has piloted it for cacao in 2015.

Product Features - Supervised Credit is an unsecured loan program provided to rice, corn and cacao farmers. The credit is bundled with the provision of technical and marketing assistance to help improve farmer’s productivity and income. The loan is 85% guaranteed by the Agriculture Guarantee Fund Pool (AGFP) and is complemented with a multi-risk insurance coverage from the Philippine Crop Insurance Corporation (PCIC). The bank is charging an interest rate of 1.6% per month, based on diminishing balance. About half of the clients make a lump sum payment upon harvest through partner traders, while the others opt to pay in installment at 1VB branches (20%) or through their Account Officers (30%).

Crop	Maximum Loan per Hectare (up to 5 ha)	Term	Interest Rate	Other Charges	Repayment Method
Rice: Irrigated Farm	Php25,000	180 days to match a typical cropping cycle	20% per annum, diminishing	2.8% service charge	Option 1: Full payment upon harvest Option 2: Installment payment during loan period
Rice: Rain-fed Farm	Php15,000				
Hybrid Corn	Php30,000				
Cacao(for farm establishment)	Php75,000				

Source: As of 2016 from 1st Valley Bank

Marketing and Sales Force - Clients of the Supervised Credit program are assigned to agricultural specialists who act as both trainer and account officer (AO). The AO’s primary task is to provide technical assistance and advice concerning agricultural practices and new technologies that would help improve production. Records of the borrower’s operations are made by the AOs to ensure that the funds are allocated well and are used for their intended purpose. Farm supervision requires the AO four visits within a season:

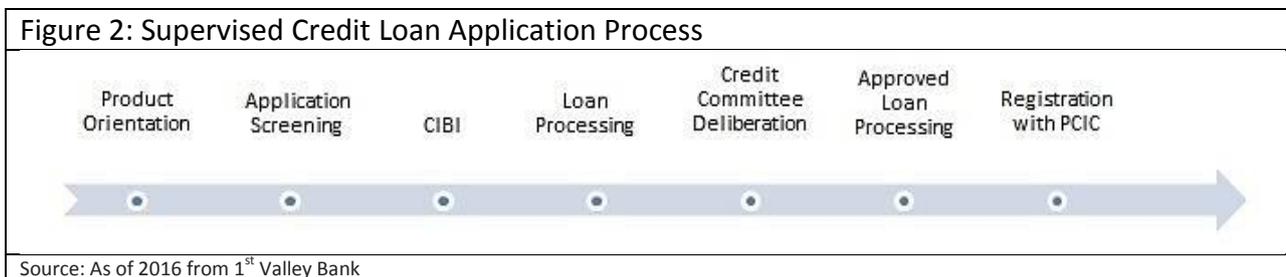
- 1st Visit – During land preparation
 - 2nd Visit – After planting/transplanting process
 - 3rd Visit – During fertilizer application period
 - 4th Visit – 20 days before harvest
- } First three visits should be completed within 30 to 45 days of the planting season.

The program currently employs 54 AOs, with highly agricultural areas such as Bukidnon, Marandang, Buug, and Balingasag deploying more than one per branch. All AOs are equipped with a motorcycle and are required to conduct farm visits twice a week. The technical assistants

network creates an efficient data-collection mechanism that captures farm-level information that not only helps provide timely and relevant advice to different farmers' situations but also provides the useful insight on the product's development.

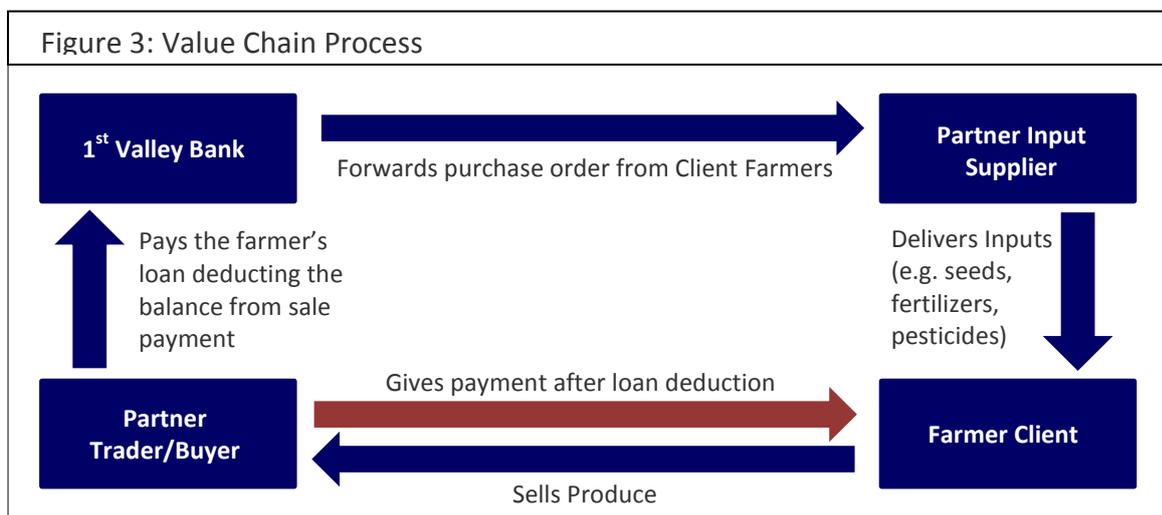
Loan Process – A new loan application is typically processed within four working days, while loan renewals for existing clients can be processed and approved in one day. New applications begin with a product orientation to introduce the product features to potential clients as well as present the application requirements. After screening the application and conducting a credit and background investigation, the bank will begin to process the loan. If all documentary requirements are sufficiently fulfilled, loan approvals will be processed along with PCIC registration for crop insurance. Fund disbursements will be delivered at a given schedule throughout the crop cycle.

Figure 2: Supervised Credit Loan Application Process



Value Chain Implementation - The attractiveness of this program lies in 1VB's partnership with various players in the value chain that gives the farmers access to lower input prices and better market opportunities. On one end of the value chain, the loan is partially disbursed to the clients through the provision of inputs at discounted prices, delivered by partner input supplier at the beginning of the season. On the other end, the farmers have the option to sell their produce to the bank's partner traders at a relatively higher price come harvest season. Moreover, the partner traders also serve as a collection channel of the bank since the farmers' loan payments are automatically deducted from the sale proceeds. The integration of value chain actors and the assistance provided by the technical specialists are essential in producing output that meets quality standards and maximizing margins by channeling supply to demand. This mechanism improves the viability of farming as an income-generating activity and encourages more small-holders to participate in the program.

Figure 3: Value Chain Process



Market Performance and Growth Potential – The supervised credit portfolio for rice and corn grew 30.79% to Php312.6 million in December 2015 from Php239M in 2014, as clientele base increased for both products. The number of accounts has been increasing for the past 3 periods since 2013 with an average growth rate of 25.94% attributed mainly to the increase in loans extended to new farmers, and to the expansion of coverage to untapped barangays and municipalities.

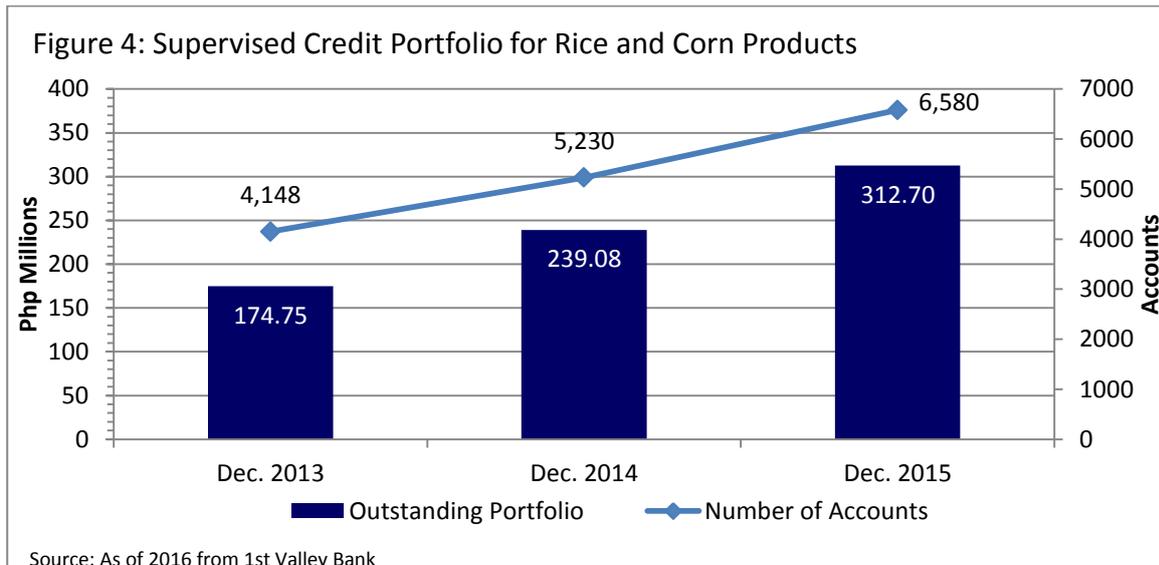
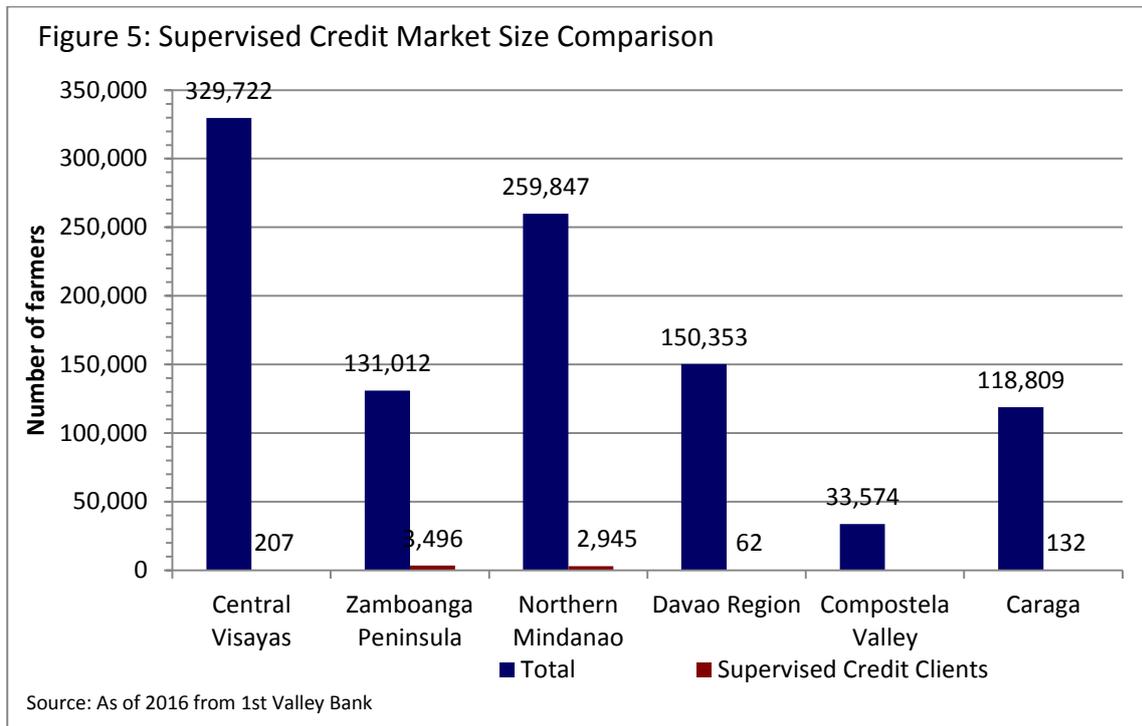


Table 3: Supervised Credit Portfolio as of January 30, 2016

Past due days	Number of active clients	Portfolio outstanding (Php 000)	Portfolio at risk
>0 days	1,304	40,571.42	17%
>30 days	1,217	37,514.65	16%
>90 days	1,098	32,199.47	13%
>180 days	958	25,031.22	10%
>360 days	807	19,100.95	8%

Source: As of 2016 from 1st Valley Bank

With 5,384 active clients in the supervised credit program, 1VB’s current outstanding portfolio stands at Php154.4 million. There is an opportunity for growth both in regions where 1VB currently operates and in those markets yet to be penetrated. Across all regions in Mindanao, Supervised Credit clients comprise only less than 1% of the total farmer population. In Bukidnon and Negros Oriental, sugarcane production is an attractive growth area where there are 26,000 and 9,000 farms respectively. Coffee is another product that could potentially expand 1VB’s market especially in Davao and Northern Mindanao.



D. Lessons Learned, Challenges, and Action Plans

Lessons Learned – While the Supervised Credit is a relatively new product, 1st valley bank’s over 50 years of experience operating in rural and agricultural markets brings a variety of lessons learned:

- Agricultural lending requires rigorous monitoring of and data collection from farm operations and frequent visits to clients in order to help improve production outcomes. In managing inherent risks in lending to small-holders, it essential to take a step further from conventional credit lending and to a more proactive role in supporting the success of the production and marketing process of the goods.
- Providing accessible services and low-cost methods of transaction, such as putting in place agent networks or mobile banking, can expand the outreach to untapped communities and encourage more farmers to participate in lending programs.
- Connecting farmers to various value chain actors not only creates more opportunities to maximize profit but also integrates certain processes thus making transactions more efficient and improving the industry’s viability.
- The Account Officers are key drivers in the growth of the product, having the technical expertise as well as employing a systematic approach from marketing to funds disbursement that clients appreciate.
- Testimonials from current clients are a strong marketing tool that can help spread information about 1VBs products to other unbanked farmers.

Challenges

- Climate change and natural disasters as well as pests and diseases infestation are the primary causes of low production and income. This is prevalent in corn, which is susceptible to numerous types of pests and weather changes. Farming households are not as resilient amid climate change effects and putting in place a financial safety net is crucial in mitigating losses in times of calamity.
- Collecting guarantee payments from AGFP has been a challenge for the bank as fund releases do not have a definite turnaround schedule and often take a long time. Currently, about 1VB has about Php30 million uncollected from the agency. Moreover, the AGFP line may become a constraint to growth since the limit given to 1VB is Php300 million, which will not sufficiently cover expected releases in the coming months.
- Expanding geographical footprint is limited by political instability and security situation in several provinces in Mindanao.

Action Plans

- The bank is currently practicing a ladderized lending scheme that limits new borrower loans to a maximum of 3 hectares only. Farmers are qualified to avail of the 5-hectare maximum after three crop cycles. The decision to include the size limit in the policy is based on the observation that 20% of new farmer loans become delinquent.
- 1VB intends to conduct a full roll-out of the Supervised Credit for Cacao. It is also exploring ideas to introduce new crops, such as coffee, into the program.
- New financing instruments are also being designed to offer irrigation and storage facility financing by 2016. The loan for irrigation will be collateralized by the machinery/water pump itself.
- Explore BAAC methodology to introduce more products outside of AGFP loan. This methodology simplifies the lending model by looking at the repayment history for small loans and requires joint liability for higher loan amount up to 400k.

As 1st Valley Bank continues to fulfill its mission of providing excellent banking service, the Supervised Credit Program creates broader opportunities to promote agricultural development both at the farm and value chain level. The bank's leadership alongside external support has played a key role in the development and implementation of the supervised credit program. The successful launch of this new product could not have been achieved without the significant contribution of the account officers and the cooperation of partner value chain players.

E. Annexes

I.1. Vision

To be the preferred countrywide partner for excellent, relevant and reliable banking services

I.2. Mission

To offer excellent banking services to promote development in the areas that we operate in and instill loyalty from our customers

To ensure the delivery of high returns for our stakeholders and well-being of our employees

I.3. Products & Services

Loans	Deposits	Services
Agricultural Loans Commercial/SME Loans Salary/Bonus Loans DBM Loans Pension Loans ALF/CLF Loans Gold and Gems Jewelry Loans Microfinance	Savings Deposit Time Deposit Checking Account Micro Deposits Gihandom Deposits SBR(Save, Build and Read)	ATM - In partnership with PLDT and ENCASH Savant, it interconnects with Bancnet, Megalink and EXPRESSNET Remittance - Money transfers through Western Union, Petnet, GCash; Remit Uniteller Philhealth and SSS Pension remittances

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