

UNRWA Microfinance Department – Palestine, Jordan and Syria

Started in 1991, the UNRWA Microfinance Department (UNRWA MD) is an East Jerusalem-based autonomous department of the United Nations Relief and Works Agency (UNRWA) for Palestine Refugees in the Near East. Initially specialized in SME lending, UNRWA MD moved into microfinance lending through the launch of the solidarity group lending product targeting women in Gaza in 1994. UNRWA MD is unique for being part of the UN and being a multinational MFI having operations within three countries namely Palestine (West Bank and Gaza), Jordan and Syria. As of June 2009, UNRWA MD had an outstanding portfolio of 18.3 M USD serving 20,293 clients.

GIRAFE Rating

Rating

C++

Outlook

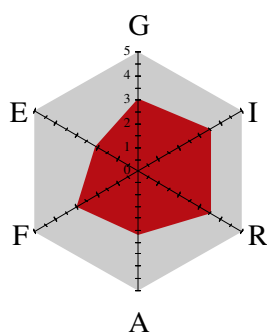
Positive

Date of the rating

August 2009

Valid until July 2010

Rating per evaluation area



Governance – Information – Risk –
Activities – Funding – Efficiency

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Rating highlights

- UNRWA MD has been able to significantly improve its profitability levels, noting a positive ROA for the first time in its history in 2008 of 1.9%, up from the previously negative levels of (11.9%) in 2006 and (2.2%) in 2007.
- The profitability is backed by increasing portfolio yield as UNRWA MD has been able to significantly reduce its yield gap through improved credit risk levels. PAR 30 reduced from over 20% to 6.2% as of December 2008, although it still stands high as per international benchmarks and is slightly up in June 2009 to 7.5%.
- Gaza and West Bank continue to pose a challenging operating environment due to political risk as well as subsidized lending by its competitors. UNRWA MD has been able to maintain its leading market position in Palestine, while further diversifying its portfolio to Jordan and Syria.
- Governance continues to prove a challenge to UNRWA MD given its status as a department within UNRWA which limits a proper balance in decision making. This risk is partially mitigated through the presence of a strong management team.
- Further challenges remain in planning – most notably in developing financial projections – as well as a continued struggle to operate within UNRWA's bureaucratic environment.

Outlook

The Positive outlook reflects Planet Rating's opinion that UNRWA MD will be able to continue its positive trend in improving profitability, lowering credit and concentration risk in its portfolio, while further solidifying operating systems.

Performance indicators

'000 USD	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Jun. 2009
Assets	10,224	16,891	16,976	18,785	25,398	25,730
Loan portfolio	6,820	9,089	7,647	10,577	16,565	18,268
Active borrowers	11,626	14,572	12,373	12,666	17,493	20,293
Av. outst. loan per client	587	624	618	835	947	900
Staff	200	217	215	250	288	282
ROE	(12.0%)	(4.5%)	(15.1%)	(2.8%)	2.8%	7.6%
ROA (without donations)	(11.3%)	(3.6%)	(11.9%)	(2.2%)	1.9%	4.9%
Liabilities / Equity	0.13x	0.30x	0.23x	0.28x	0.57x	0.53x
Portfolio yield	27.1%	29.4%	28.9%	28.1%	34.2%	36.3%
Operating expense ratio	42.0%	35.2%	38.8%	44.3%	35.4%	27.9%
Funding expense ratio	(0.1%)	(0.0%)	(0.2%)	(1.2%)	(0.3%)	0.8%
LLP expense ratio	6.3%	1.4%	17.4%	(8.0%)	(3.2%)	0.9%
PAR 31-365	25.4%	20.0%	30.1%	6.4%	6.2%	7.5%
PAR > 365	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%
Write-off ratio	5.0%	9.1%	13.1%	14.9%	1.9%	0.8%

Microfinance sector

Palestine

The demand for microfinance services is strong given that almost 50% of Palestinians in the West Bank and Gaza (1.7 million of an estimated 3.6 million) live below the poverty line and that 600,000 live below the subsistence level. Due to high unemployment caused in a large part by Israel's occupation and closure policies, and subsequent Intifada movements, many Palestinians are forced to turn to self-employment activities boosting demand for microfinance services. According to a CGAP report, it is estimated that the number of Palestinian microenterprises needing loans is around 150,000 households and that a further 200,000 households need small-balance savings accounts and money transfer services. Despite a diversity of demand, most Palestinian MFIs offer only microloans. Savings and credit cooperatives offer savings products, which are available only to their members.

There are presently 14 providers of microfinance services: one bank (Al Rafah Bank) and 13 MFIs with various legal structures (e.g. UN, NGO, cooperative, company). The 13 non-bank MFIs are members of the Palestinian Network for Small and Micro Finance (Sharakeh). As of December 2008, the 13 MFIs served an estimated 32,000 clients of which 59% are women, with an outstanding portfolio of 48 M USD. These numbers represent 20% of the estimated market demand. The top tier MFIs are well-funded, often benefit from foreign technical assistance and are the strongest operationally. Other less connected and less well-funded MFIs are often weak operationally.

Most Palestinian MFIs are not sustainable in part due to the extraordinary difficulty to operate under the Israeli occupation, which greatly hampers productivity and efficiency. A key reason however is the fact that only a few MFIs charge market or at least cost-recovery interest rates due to the lack of exposure to international best practices and/or the strong socially-oriented mindset. Only a few MFIs are truly run on self-sustaining basis and many others display high aid dependency mindset. Sharakeh is currently working on setting-up a Credit Guarantee Scheme covering political risk for clients in West Bank and Gaza, which is intended to become operational in 2010.

The Palestinian microfinance industry development is heavily influenced by donors and their agendas. Support for MFIs is coming from two main donor programs: 1) the Deprived families Economic Empowerment Program (DEEP), funded by the Islamic Development Bank and executed by the United Nations Development Program (UNDP) in partnerships with the Palestinian Authority (PA);

2) the Small and Microfinance Assistance for Recovery and Transition (SMART), funded by USAID and designed to promote growth of outreach and improved risk management. Some MFIs have felt caught in between the two differing ideological backgrounds of the two programs with the former strongly focusing on Islamic lending and the latter on commercialization.

MFI As of Dec. 2008	Portfolio in M USD	%	Active loans	%
UNRWA (Palestine)	10,857,705	16.8%	9,194	27.3%
FATEN	10,516,002	16.2%	4,954	14.7%
Ryada (CHF)	10,986,624	17.0%	4,374	13.0%
ACAD	2,529,741	3.9%	2,542	7.6%
ASALA	2,440,862	3.8%	2,219	6.6%
PARC	2,293,210	3.5%	2,200	6.5%
Al Rafah Bank	16,791,174	25.9%	1,637	4.9%
REEF	1,114,868	1.7%	254	0.8%
Others (estimate)	7,260,988	11.2%	6,263	18.6%
Total	64,791,174	100%	33,637	100%

Source: MiX, Sharakeh; Al Rafah Bank and PARC data as of Dec. 2007

Unless licensed as a bank, the MFIs are not regulated. A recent presidential decree delegated the authority to license, monitor, and supervise the MFIs to the Palestine Monetary Authority (PMA), which initiated draft regulations to be legislated and enforced, following the formalization of the new Palestinian Companies Law. In total, 9 MFIs signed up for the PMA credit bureau, which is mandatory for commercial banks. In August 2009, the PMA approved three MFIs (Asala, CHF, and UNRWA). The main bottleneck for the other 6 MFIs was the strength of their MIS or the data accuracy therein.

Jordan

Microfinance in Jordan started in the mid-to-late 1990s, and is characterized by the presence of both market-oriented and subsidized credit providers. Through the AMIR program, which has provided funding, technical assistance, and advocacy, USAID has played a leading role in supporting a sustainable microfinance environment. As of December 2008, the four MFIs funded by the USAID/AMIR program, namely Tamweelcom, MFW (WWB affiliate), MEMCO (CHF affiliate), and AMC, were serving 60% of the active clients and accounted for 39% of the industry outstanding portfolio. Other sustainability-oriented loan providers include: the National Microfinance Bank (NMB or Al Watani), a government initiative funded by the King Abdullah Foundation and AGFUND¹ and launched in March 2006; FINCA, the latest and fastest growing entrant on the market; UNRWA, which focuses on, but does not solely work with Palestinian refugees; and the private banking sector, which has been making consumer loans increasingly accessible to those with a salary.

¹ Arab Gulf program For United Nations Development Organizations.

Funded by the Jordanian government, KfW and the EU, the Development and Employment Fund (DEF) was created in 1991 and currently provides loans at substantially lower rates than other MFIs, focusing on loans over 2,000 JOD (2,807 USD). Subsidized providers include the National Assistance Fund (NAF), the Industrial Development Bank (IDB), and governmental organizations such as the Agricultural Credit Corporation. A myriad of other smaller government and quasi-government players also exist, but little information is available regarding these institutions.

The total potential market for microfinance services in Jordan was estimated at around 150,000 micro-enterprise clients² before the Iraqi war: since then, immigrants' influx could have raised the number of potential clients up to 250,000. When counting in either small enterprises and private businesses or other loans (education, housing, etc.), this figure could go up to 5-600,000³. The market coverage thus ranges from a low estimate of 30% to a high estimate of 60%, in both cases one of the highest in the MENA region.

MFI As of Dec. 2008	Portfolio in USD	%	Active loans	%
DEF	50,138,776	38.8%	17,515	12.2%
MEMCO	15,922,428	12.3%	11,552	8.1%
Al Watani	15,311,580	11.9%	20,900	14.6%
MFW	15,405,639	11.9%	34,349	23.9%
Tamweelcom	14,537,114	11.3%	39,352	27.4%
AMC	4,647,175	3.6%	2,946	2.1%
UNRWA (Jordan)	3,640,341	2.8%	3,711	2.6%
FINCA	2,394,709	1.9%	9,062	6.3%
Others	7,139,890	5.5%	4,103	2.9%
Total	129,137,652	100%	143,490	100%

Source: MiX, MFI, CGAP; MEMCO and others as of Sept. 2008.

The lack of a credit bureau, which has been waiting for official authorization since 2003, has been recently compensated by the creation of an information sharing platform hosted by Delta Informatics, which has provided the loan-tracking system for most MFIs. As a positive result, cross-indebtedness decreased down to 13% for those MFIs.

Syria

With a large part of a 20-million population living below the poverty line and at least one million unbanked micro-entrepreneurs⁴, Syria's microfinance market remains one of the largest untapped and least competitive in the MENA region. The main microfinance providers are either international NGOs or state-run initiatives through local programs or banks. Most of them focus on agriculture loans in rural areas, with the exception of UNRWA that serves urban areas of Damascus inhabited by Palestinian refugees. In such a context, informal money lenders are believed to

² 2002 AMIR estimates.

³ Source: MFIs own studies; "Access to Finance", CGAP, March 2009.

⁴ Source: "Policy and regulatory framework for microfinance in Syria", CGAP, January 2008.

serve the large majority of microcredit demand, presumably at an average effective rate of 77%⁵.

The Aga Khan network launched its microfinance activities in Syria in 2003, in agreement with the Syrian government. Since then, the First Microfinance Institution (FMFI) has grown to become the most significant player in Syria. Created in 2001 under the umbrella of the Syria Trust for Development and supported by various international organizations (EU, UNDP, IFAD), the Fund for Integrated Rural Development of Syria (FIRDOS) operates only in rural areas and comprise a microfinance program. The state-owned Agriculture Cooperative Bank (ACB) and Saving Bank (SB) provide loans to SMEs and have been considering the microfinance market, but the first is a large public organization with many short-comings and the second is too small to fulfill the demand⁶. The community-based village funds ("sanadiqs") such as the UNDP-funded Jabal al Hoss project are better organized, but they still lack financial and operational expertise to operate on a large scale.

MFI As of Dec. 2008	Portfolio in USD	%	Active loans	%
FMFI	13,870,004	69.5%	14,690	64.5%
UNRWA (Syria)	2,066,986	10.4%	4,588	20.1%
FIRDOS	2,260,103	11.3%	1,000	4.4%
UNDP - Jabal al Hoss	1,750,000	8.8%	2,500	11.0%
Total	19,947,093	100%	22,778	100%

Source: MiX, MFI; Jabal al Hoss and FIRDOS as of Jun. 2006.

By enacting the Microfinance Decree in February 2007 (law n°15), the Syrian government has shown the will to create a conducive environment for the microfinance industry growth. Under such law, the Credit and Monetary Council (CMC) that oversees the banking sector would provide licenses to for-profit deposit-taking Social Financial Banking Institutions (SFBI), which comes as a legal breakthrough in the region. Among other stakeholders, KfW and IFC are interested in supporting the set up of new MFIs but, in effect, an SFBI would need to be registered as a joint-stock company (JSC) to be entitled to collect deposits, which requires at least five founding shareholders. Furthermore, the law comes with significant constraints such as a minimum capital requirement of 250 M SYP (5 M USD), income tax of 25%, and compulsory reserves equivalent to 30% of the net income. As importantly, and though there is no interest cap as per se, the CMC regularly publishes a range of "acceptable" rates, but did not specify whether those would also apply to SFBIs. Altogether, these factors explain why no SFBI has been created to date.

⁵ Source: International Center for Agricultural Research in Dry Areas, ICARDA-33/500/Dec. 2004; CGAP 2008 report.

⁶ SB has started piloting microfinance services with the technical assistance of CGAP and QFI, an Egypt-based consulting firm historically involved in the regional microfinance industry.

Political & economic environment

Palestine

The political and security situation of the Palestinian Territories asphyxiates the economy, which remains dependent on a foreign aid lifeline. After Hamas took control of the Gaza Strip in June 2007, President Mahmoud Abbas withdrew to the West Bank, dissolved the coalition government, and formed a new government. While the Gaza Strip has remained isolated, the situation has evolved in a more favorable manner in the West Bank with the lifting of the financial blockade affording room to maneuver to revive the economy. Mobilization of the international community late 2007 resulted in promises of 7.4 billion USD in aid from donor countries to enable the territories to meet current spending needs and rebuild infrastructure. But rebuilding the economy will suffer from the renewal of military conflict between Israel and Gaza in December 2008.

The tighter restrictions imposed by the Israeli government on the circulation of goods and people limited economic activity in the West Bank in 2008 while the Gaza Strip's borders remained closed. Goods and services exports to Israel have declined, forcing companies to cease operations. The drop in loans to the private sector is indicative of the decline in private investment. An inflationary surge attributable to soaring raw material prices eroded household purchasing power and drove up production costs. Inflation was higher in Gaza (18%) and the West Bank (13%) than in East-Jerusalem (7%). Investments financed by foreign aid underpinned the – albeit very weak – economy. Unemployment remained high, especially in Gaza, where it has hovered around 30%, and in the West Bank, 19%. Nearly 80% of households live below the poverty line in Gaza and 46% in the West Bank.

Easing inflation in 2009 will doubtless increase household purchasing power and reduce production costs for companies. But GDP growth will depend on the security situation, normalization of relations between Hamas and the Palestinian Authority, and an easing of the restrictions imposed by Israel. In December 2008, the end of a six-month truce announced by Hamas resulted in a resumption of hostilities that will maintain economic and social difficulties of the Palestinian Territories.

Prudent spending policy, including a freeze on civil service wages (which represent over half of current spending), significantly reduced the deficit, exclusive of investment spending, in 2008. Larger-than-expected donations, representing as much as 28% of GDP, fostered the emergence of a public sector financial surplus. In 2009, despite a continuing policy of tight control over current

spending, increased investment spending will likely widen the deficit and increased aid will be necessary to cover it.

USD billions	2006	2007	2008(e)	2009(f)
Economic growth (%)	-4.8	-0.5	0.8	0.6
Inflation (%)	3.8	2.7	11.5	4.0
Unemployment (%)	23.6	21.3	22.1	21.7
Public sector balance (%GDP) (1,2)	-31.1	-31.7	-23.0	-23.8
Public sector balance (%GDP) (1,3)	-14.7	-11.7	4.8	-5.9
G&S exports (%GDP)	46.1	46.7	43.1	39.9
G&S imports (%GDP)	78.5	78.5	75.1	76.3
Current account balance (%GDP) (2)	-32.4	-31.8	-32.0	-36.4
Current account balance (%GDP) (3)	-9.9	-6.9	0.3	-11.5

Note: (1) current spending balance (2) excl. donations (3) incl. donations.

Jordan

Gradual growth slowdown: Discontinuation of subsidies on oil products and the rise of world prices for raw materials and staple foodstuffs compounded by inflation imported via depreciation of the dollar-pegged dinar generated strong inflation in 2008. Surging prices affected private consumption despite the steady flow of emigrant worker remittances. Slowdowns gripped the financial, insurance, and property sectors. In the manufacturing sector, clothing suffered from weakening United States demand. Tourism nonetheless remained buoyant. Investment – relatively stable – continued to drive economic growth.

An appreciable drop in raw-material and staple-foodstuff prices since the 2008 fourth quarter will likely improve household purchasing power and spur private consumption in 2009. But a drop in emigrant worker remittances, affected by the economic slowdown in Gulf countries, could limit the resulting consumption growth. Ongoing work on investment programs in progress – industrial, property, and infrastructure projects financed mainly by foreign direct investment – will likely continue to underpin the economy. The credit crunch abroad and the crisis of investor confidence could impede inflows of new foreign direct investment, particularly in the property sector. In a context of world economic crisis, tourism could also suffer and exports continue to decline. Easing tensions in Iraq could, however, generate increased import and re-export business through Jordan. Overall, a moderate slowdown is expected in 2009 and the economy could grow at a respectable clip. Jordanian banks, which focus mainly on the domestic market, have no direct exposure to the world financial crisis. But they are vulnerable to an economic slowdown, domestic and regional stock market volatility, and a possible property market downturn.

Dependence on increasingly scarce foreign capital: The country suffers from severe imbalances in public sector and

external accounts, exacerbated in 2008 by the cost of oil. In 2009, a drop in inflation is expected to facilitate reducing social spending and holding the public sector deficit to about 8.5% of GDP excluding donations. Early repayment of Paris Club rescheduled debt has significantly reduced the level of albeit still high government debt. The current account deficit moreover will likely remain near its level of 2008. The weakening of imports – attributable to the price decline for raw-materials and staple foodstuffs as well as to the GDP growth slowdown – will likely offset the deceleration of exports, tourism earnings and private transfers. A shortage of foreign capital to finance the deficit could put pressure on liquidity in the country.

Although exposed to regional instability, the Hashemite Kingdom benefits from political and financial support from friendly countries. Its political stability is not expected to be in jeopardy.

COFACE Country Rating: B – Political and economic uncertainties and an occasionally difficult business environment can affect corporate payment behaviour. Corporate default probability is appreciable.

Business Climate Rating: A4 – The business environment is acceptable. Corporate financial information is sometimes neither readily available nor sufficiently reliable. Debt collection is not always efficient and the institutional framework has shortcomings. Intercompany transactions may thus run into appreciable difficulties in the acceptable but occasionally unstable environments rated A4.

USD billions	2006	2007	2008(e)	2009(f)
Economic growth (%)	6.3	6.0	5.4	4.4
Inflation (%)	6.3	5.3	15.8	7.6
Public sector balance (%GDP) (*)	-7.5	-8.5	-9.7	-8.4
Exports	5.2	5.7	6.6	7.1
Imports	10.3	12.0	15.7	16.0
Trade balance	-5.1	-6.3	-9.1	-8.9
Current account balance (%GDP)	-17.1	-19.9	-24.5	-20.3
Foreign debt (%GDP)	99.3	94.5	73.1	72.7
Debt service (%G&S exports)	7.7	6.9	4.1	3.7
Foreign currency reserves (in months of imports)	5.9	5.6	4.3	4.1

Note: (*) excluding donations (e) estimates (f) forecasts.

Syria

Restoring production capacity enabled Syria, in 2008, to stem the rapid decline of the oil sector that has undermined economic growth. The non-oil economy achieved good performance in recent years underpinned by foreign investment, notably petrodollars from regional countries. Transfers from the diaspora and the influx of Iraqi refugees

spurred private consumption with household spending nonetheless affected in 2008 by soaring staple commodity prices and reductions in subsidies. The essentially favorable economic trend overall benefited a range of sectors including property, construction, transports, tourism, and commerce.

A growth slowdown in 2009: The economy will not escape in 2009 the consequences of the world crisis propagated via foreign demand with the oil market the first victim at the regional level. The economic downturn and tightening credit conditions on foreign markets are expected to have a negative impact on investment from Gulf countries and on public sector investment, penalized by a necessary fiscal spending adjustment. Property development and infrastructure modernization could slow. Household consumption will continue to suffer from a still-high level of inflation with subsidy reductions offsetting the positive effects of declining prices for fuel and staple foodstuffs. Transfers from the diaspora could decline amid the virtually-worldwide tendency of incomes and stock market prices to fall as a result of the crisis. Tourism could also suffer from the fall of incomes. Agriculture, affected by drought in 2008, could, however, rebound in 2009. The government has undertaken reforms to improve a business environment that still has some shortcomings (limited corporate transparency, cumbersome bureaucracy) and can be responsible for late payments and difficulties with debt collection.

Widening twin deficits: In the absence of diversified resources, the depletion of oil reserves has resulted in twin deficits albeit kept under control in recent years thanks to soaring barrel prices. With average barrel prices in 2009 far below the levels reached in 2008, fiscal revenues will fall with oil still generating over 20% of the total collected. Implementation of a VAT system has been postponed again. The widening of the public sector deficit will likely be limited by the reduction of subsidies (with domestic prices higher and world prices for subsidized products in decline) and the slowdown of investments.

Although the fall of oil prices will also exacerbate the current account deficit, the effect will be moderate since the country's hydrocarbon imports and exports are roughly equivalent. Fuel subsidy reductions have already had a positive impact on domestic consumption, tending to reduce waste and smuggling, which will likely keep imports down. With foreign debt at moderate levels, financing needs are expected to remain limited. A substantial decline in foreign direct investment could, however, affect liquidity and undermine the exchange rate.

COFACE Country Rating: C – A very uncertain political and economic outlook and a business environment with many troublesome weaknesses can have a significant impact

on corporate payment behavior. Corporate default probability is high.

COFACE Business Climate Rating: C – The business environment is difficult. Corporate financial information is often unavailable and when available often unreliable. Debt collection is unpredictable. The institutional framework has many troublesome weaknesses. Intercompany transactions run major risks in the difficult environments rated C.

USD billions	2006	2007	2008(e)	2009(f)
Economic growth (%)	5.1	4.2	5.2	3.5
Inflation (%)	10.4	4.7	14.7	8.6
Public sector balance (%GDP)	-1.2	-3.4	-3.1	-4.0
Exports	10.0	11.3	12.5	11.0
Imports	11.3	12.6	14.3	13.4
Trade balance	-1.2	-1.3	-1.8	-2.4
Current account balance (%GDP)	-1.0	-1.3	-1.8	-2.0
Foreign debt (%GDP)	-3.1	-3.2	-4.0	-4.5
Debt service (%G&S exports)	21.6	16.9	17.1	18.1
Foreign currency reserves (in months of imports)	5.2	4.9	4.6	5.7

Source: COFACE's Country Risk Rating Guidebook 2009. (e) estimates (f) forecasts. Disclosure Statement: Data is provided with authorization from COFACE – a shareholder of Planet Rating.

Institutional presentation

UNRWA

Following the 1948 Arab-Israeli conflict, the United Nations Relief and Works Agency (UNRWA) for Palestine Refugees in the Near East was established by United Nations General Assembly resolution 302 (IV) of 8 December 1949 as a subsidiary organ of the United Nations to carry out direct relief and works programmes for Palestine refugees. Today, UNRWA is the main provider of basic services – education, health, relief and social services – to over 4.3 million registered Palestinian refugees in the Middle East. Most of UNRWA funding comes from voluntary contributions of donor states. UNRWA's largest donors are the United States, European Commission, the UK and Sweden. Other major donors include the Gulf Arab States, Scandinavian countries, Japan and Canada. UNRWA's chief officer, the Commissioner General, is appointed by the UN Secretary General after consultation with the Advisory Commission and is the only head of a UN body to report directly to the General Assembly. The Advisory Commission meets annually to review Agency activities.

Legal form, supervision and audit

As a department of UNRWA, the Microfinance Department (MD)⁷ does not have a separate legal personality. Its current activities are also not regulated.

UNRWA MD does have separate audited accounts. Until 2004 they were audited by a Palestinian auditing firm El Yousef & Co. (formerly a correspondent firm to KPMG) and since then by the UN Board of Auditors (BOA), neither of which has qualified their opinion for the period under review. UNRWA MD has contracted El Yousef & Co. for FY05, and Grant Thornton Mohamed Hilal from Cairo, Egypt from FY06 onwards to conduct an internal audit with a focus on the internal control system and staff compliance. UNRWA's financial year starts on January 1st and ends on December 31st.

Ownership

As a department UNRWA MD is 'owned' by UNRWA. UNRWA MD is part of the regular UNRWA management decision making structure. All major decisions have to be approved within UNRWA that, in turn, follows the UN system standard rules and regulations.

An Advisory Board (AB) was set up in 2000 to assist management on strategic issues. The AB provides recommendations to the UNRWA Commissioner General who has the sole decision making power. The AB is made up of 7 voting UNRWA officials, 2 independent microfinance experts (of which one position is currently vacant) and 2 UNRWA MD non-voting members (the Director and Chief Microfinance Operations). UNRWA's Deputy Commissioner-General is the AB Chairperson with the UNRWA MD Director acting as the AB Secretary. The AB is scheduled to meet on an annual basis.

Donations

UNRWA MD has received 22.8 M USD of donations since its inception. The largest contributions have come from the Netherlands, USAID, Norway, Germany, Arab Authority for Agricultural Investment and Development (AAAID), and Luxemburg.

Funding composition

UNRWA MD has not yet contracted any debt. However, it has signed an Administration Agreement with the OPEC Fund for International Development (OFID) in 2004 to administer the PalFund Trust Fund, which currently amounts to 6.9 M USD as of June 2009 and will increase to 9.9 M USD in 2009. As of June 2009 this fund represents

⁷ In this report UNRWA MD will refer to the microfinance department only, where UNRWA refers to the total UNRWA organization.

27% of UNRWA MD's assets. No repayment date has been set under this agreement.⁸

Management team

The senior Management Team is headed by the UNRWA MD Director Alex Pollock – an experienced British national – since 1998. He is involved with the Middle East affairs, particularly Palestinian ones, in various capacities since 1982. He is a board member of Sanabel and National Microfinance Bank of Jordan (NMB or Al Watani). He is seconded by Jane Giacaman as Chief Microfinance Operations. The total management team consists of a Chief of Finance, Administrative Officer (responsible for HR), Monitoring & Evaluation Officer, Marketing Officer, MIS Coordinator and a Verification Officer (Internal Audit). A Quality Assurance and Control Officer (the current Administrative Officer) will become responsible for performance monitoring and quality control of processes.

Organization

UNRWA MD is run as an autonomous department within UNRWA and it operates the credit programs with little interference from UNRWA. The management team is based in its Head Office (HO) in East Jerusalem. Each of the four regions (Gaza, West Bank, Jordan and Syria) is headed by a Chief Field Microfinance Officer (CFMO) who is supported by a Credit Operations Manager (COM). Branches are headed by a Branch Manager (BM) and consist of LOs⁹, who are supervised by Area Loan Supervisors (ALS), a cashier and clerk. Due to movement restrictions and the current closure, the Gaza Field Office has considerable autonomy (e.g. separate MIS, accounting system and management structure).

Credit decisions below 3,000 USD are taken by the BM above which they are approved by COM. The cashier receives cash repayments from clients, or from LOs who can collect repayments in the field. All cash is deposited in the bank at the end of the day. Disbursements are made by check.

UNRWA MD uses an in-house developed, Access-based MIS for loan tracking: Loan Management Information System (LMIS). Cashiers enter repayment data in a local database and send this to the HO on a weekly to bi-weekly basis, except for Gaza which has its own database. Loan application data is entered at the regional offices. For accounting UNRWA MD uses the same system as UNRWA:

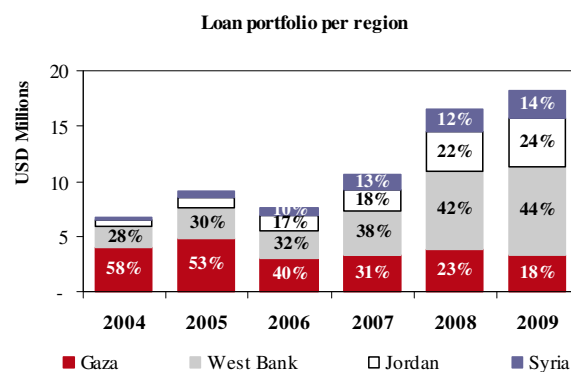
⁸ The contract stipulates that UNRWA MD will only have to repay the fund in line with the maturity of the loans UNRWA MD has disbursed under the fund.

⁹ Internally UNRWA MD uses the term Credit Extension Assistant instead of LO.

RAMCO. Within this system UNRWA MD has its own separate ledgers. At present, expenses are made by UNRWA and UNRWA MD has to wait until the 15th of each month to receive the accounting data from UNRWA. As of Oct. 2009, UNRWA MD will become responsible for its own accounting within RAMCO. UNRWA MD is in the final stages of purchasing a new, integrated MIS: OMNIenterprise, by InfracoreTech of India.

Market penetration

UNRWA MD started its operations in Gaza in 1991 and expanded to West Bank in 1998 and to Jordan and Syria in 2003. Due to political and economic factors (cf. Political & economic environment) the percentage of the outstanding portfolio in Gaza has reduced from 53% in Dec. 2005 to 18% as of Jun. 2009. Jordan and Syria have significantly increased their share in the portfolio from 10.5% and 6.5% in Dec. 2005 to 24% and 14% in Jun 2009 respectively.



The competitive environment greatly differs per region with strong competition in Jordan, moderate but increasing competition in West Bank and Gaza and low competition and a virtually untapped market in Syria.

Products and services

UNRWA MD currently offers six loan products for micro and small enterprises, consumption and housing purposes. Loans in Gaza are offered in USD, in West Bank and Jordan in Jordanian Dinar (JOD) and in Syria in Syrian Pounds (SYP). All loans have interest on a flat basis, monthly repayments and no disbursement fees. The compounded effective interest rate (EIR) is estimated at 36% in 2009, slightly up from 35% in 2007 due to changes in the composition of the portfolio.

- Micro Enterprise Credit (MEC) offered in all regions ranges from 200 to 11,000 USD, with a term between 4 to 11 months. Interest is flat 2% per month with an average EIR of 40%.
- MEC+ is offered in West Bank, Gaza and Jordan and ranges from 6,000-15,000 JOD (8,616-21,186 USD), with a term between 4 to 18 months (24 months in Jordan). The interest rate is 1.65% flat per month below 9,000

JOD and 1.5% for higher loan amounts, with an average EIR of 33%. The MEC+ product replaces the first loan of UNRWA, the Small Scale Enterprise (SSE) loan that was started in 1991 in Gaza which has been discontinued in 2009. The SSE loan could go up to 70,000 USD and had an estimated average EIR of 16.5%.

- The Consumer Loan Product (CLP) is offered in all regions with a maximum amount of 3,000 USD and otherwise similar loan terms to the MEC.
- A Housing Loan Product (HLP) was developed in Gaza and was introduced in the West Bank in 2009. The loan has a maximum loan amount of 15,000 USD and a term between 12 to 36 months. The loan attracts a 9% annual flat interest rate (10% in West Bank) with an estimated average EIR of 16.5%.
- A Solidarity Group Loan (SGL) was introduced in Gaza in 1994 and is focused solely on women. The loan amount ranges between 200 and 4,000 USD and has otherwise similar loan terms to the MEC. Group size can be from 3 to 8 women.
- For Syria, the SGL was redesigned to an individual loan for women named: Women Household Credit (WHC). The loan terms are similar except for the collateral requirements.

Collateral requirements are post-dated checks and a guarantor for all loans except the SGL loan which only requires a notarial deed to establish the group guarantee. In Syria also promissory notes are required. For the HLP and MEC+ loan in Gaza (and previously for the SSE loan) the client requires an UNRWA staff member as guarantor. The HLP loan is also available to UNRWA staff members themselves.¹⁰ For the HLP and MEC+ loan in West Bank and Jordan also post-dated checks are required from the guarantor, who do not need to be an UNRWA staff member. UNRWA MD does not allow rescheduling of loans.

UNRWA MD is discussing the possibility of attracting savings in West Bank and Gaza with the PMA, although likely deposits could not be intermediated.

In Gaza UNRWA MD offers training services to its clients in subjects such as book keeping, taxation, computing and e-commerce. Training is provided on a cost-covering basis.

Networks

UNRWA MD is a member of Sharakeh, the Palestinian Network for Small and Microfinance and Sanabel, the Microfinance Network of Arab Countries.

¹⁰ In Gaza UNRWA has 10,335 employees.

Governance

Governance and decision making is rated “b”

Support

In the event of financial difficulties, UNRWA MD would turn to UNRWA for support. UNRWA exerts a strong, but generally appropriate influence on UNRWA MD’s decision-making process. UNRWA’s capacity and propensity to support UNRAW MD financially is considered high as UNRWA MD is an integral and highly visible part of UNRWA’s activities and it represents a big credit provider, notably in Palestine, for the target clientele.

Decision making

As a department within UNRWA the Microfinance Department (MD) does not have an ideal institutional set-up for its microfinance operations. However, UNRWA MD has been able to do almost all things necessary to ensure that it can function as an autonomous MFI within UNRWA, and UNRWA MD is supported by UNRWA in its vision and mission to operate as an autonomous, self-sufficient microfinance unit. A spin-off from UNRWA remains on the agenda with a transformation plan to be developed in the coming months after an initial scoping study was conducted in 2007. However, the spin-off is not likely to become effective within the coming two years.

At present, UNRWA has not been able to create a governing system to ensure a balance in decision making between the management (UNRWA MD) and the owners (UNRWA). The Advisory Board does not provide sufficient balance in decision making due to infrequent meetings¹¹, limited technical expertise present on the AB, as well as changing members.¹² However, UNRWA MD has taken good action to invite two external microfinance experts to the AB to strengthen its technical capacity. It should be noted though that UNRWA MD, being part of UNRWA, is as such also accountable within the UNRWA management structure. The UNRWA MD Director participates in regular management meetings of UNRWA.

A statutory limitation is that the AB can only advise the UNRWA Commissioner General, who has the sole decision making power. However, this has not proven a limitation in practice as all recommendations have been approved to date. UNRWA MD would benefit from a documentation of the main discussion points to create a stronger continuation of on-going discussions between consecutive meetings, as for

¹¹ The last two AB meetings were in December 2005 and March 2008.

¹² The UNRWA directors on the AB are elected based on their position within UNRWA. Staff changes within UNRWA creates similar changes in the AB. Furthermore, UNRWA directors may send a representative if they cannot attend in person.

the past AB meeting only the final recommendations to the Commissioner General were written-up.

Planning

UNRWA MD has an appropriate strategy in place focusing on further improving its profitability and lending activities, further expansion in the four operating regions, and transformation. An extensive 2009-2011 business plan has been drafted, which at the time of the rating was pending final approval by the UNRWA MD Director. The planning process was changed to a participatory nature with the aim to create stronger commitment among staff for the objectives.

The business plan however only contains targets in terms of number and amount of loans to be disbursed, but does not include a projection of a full income statement (only expenses are budgeted per year), nor balance sheet or cash-flow projections for the three years. This highly limits the prediction of future profitability, financial position or funding needs. Furthermore, the projections are mostly based on standard growth targets per LO, but are not sufficiently underpinned by an analysis of internal capacity or outside competition, which undermines their relevance. A basic SWOT analysis was conducted by staff for each region during the planning process, but UNRWA MD would benefit from a more strategic analysis for the department as a whole. Scenario planning is essential for UNRWA, especially for an area such as Gaza where a projected increase of 177% in loans disbursed in 2010 depends on a lifting of the embargo, which is difficult to predict.

There is a good annual budget preparation by branch, region and HO, with good follow-up of the budgets on a monthly basis, and more thoroughly on a quarterly basis. The budgets however only consist of a cash-flow planning, rather than an income statement.

Management team

UNRWA MD has a good Management Team (MT) in place, which is committed, motivated and with adequate capacity for all positions given the current size of the institution. There is a good focus on training for MT members and the team brings in long standing experience in microfinance as many have grown through the ranks of UNRWA MD. Key-person risk is limited within UNRWA MD with two strong top-managers in place, and a wider team of experienced managers. The succession plan for the Director is contingent upon the transformation of UNRWA MD.

The management team shows a good execution capacity with strong focus on implementing key projects on a timely basis. Even if delays are experienced due to UNRWA bureaucracy, the team is well capable to maneuver within

this system to make things go as fast as the system allows. However, MT meetings are ad-hoc and the team relies more on frequent informal meetings which is possible with the open working culture at the HO. The MT could benefit from more structured meetings with documented minutes which would allow for a stronger follow-up on key issues.

There is good support from middle management, although capacity is more variable at this level. Stronger middle management would be instrumental in the efforts made toward profitability and reduction of PAR.

Human resource management

For UNRWA MD there is a professional administration of human resources guided by UNRWA policies and processes. Recruitment has to be done through UNRWA and is well designed combining interviews with job-related tests. However, the process is lengthy (3-6 months) which creates significant delays in filling vacancies and recruiting new staff. In all regions, except for Jordan, this is compensated by the use of temporary, daily-paid staff.

The induction process for new staff is adequate with on the job training of LOs. This process could use strengthening, given that, especially in the case of faster growth, this system will have to become more formalized with stronger training and coaching. Furthermore, there is a good focus on continued staff training with both internal and external training (local and international) made available to staff. However, the current vacancy of a Training Officer since January 2009 has resulted in less internal trainings (especially in Jordan and Syria). A new Training Officer is expected to come on board by year end based in the Head Office.

Staff evaluation is carried out annually for all staff using a standard UNRWA form which limits job related evaluation and is mostly a checklist of performance with little room to provide additional comments. For LOs, a monthly evaluation is conducted based on quantitative targets to continuously monitor and manage their performance. UNRWA MD has developed an incentive system for BMs, which after a long period of discussion was approved in principle by UNRWA in August 2009 and is pending final approval in September 2009.¹³

Staff turnover has been moderate to high, coming down from a high 20% in 2007 to 12% in 2008. The high turnover in 2007, and to a lesser extent in 2008, was caused by the reduction of staff in Gaza due to the slowdown of the

¹³ UNRWA MD chose as a strategy to first get it approved for BMs, and UNRWA MD will seek further approval from UNRWA for an incentive system for LOs.

activities there. However, for 2009 the staff turnover is on an increasing trend.

■ Information

Information is rated “b”

The current information system at UNRWA MD is not fully efficient, nor secure, but provides all relevant data. The lack of on-line access between branches and the HO, as well as the stand-alone database for Gaza hinders the easy and timely availability of consolidated data, as consolidation of portfolio and financial information needs to be done manually in excel. Furthermore, depending on UNRWA for accounting data delays the preparation of financial statements which are only ready more than one month after the end of the month. UNRWA MD is aware of these shortcomings and is working on improvements. As of October 2009, UNRWA MD will get the responsibility of UNRWA to manage its own accounting, which will speed up the preparation of financial statements, and recently automated reporting of the IS and BS have been implemented in RAMCO.

The in-house developed Access-based LMIS is not fully secure, nor scalable, although given its limitations functions well within UNRWA MD. Security of the LMIS is basic with low password complexity, although centralized data entry minimizes risk for data manipulation. Furthermore, there is key person risk on the LMIS officer as he is the only person to know the source code of the current MIS. A new, integrated MIS is in the final stages of purchase. When implemented well, this will provide UNRWA MD with an efficient system that is on-line accessible by staff.

Otherwise, the risk of data loss is well mitigated through a good back-up system through UNWRA as well as anti-virus software. Paper data is securely stored, although the second original copy of the loan contract that is kept, is more-useful stored in a separate location.

With the current system good financial information is available globally, as well as per branch and region as branches and regions are managed as profit centers.¹⁴ Additionally basic product costing has been done to set desired interest rates. For portfolio information, LOs have all needed data daily for managing their portfolio. Numerous detailed reports are available allowing UNRWA MD to analyze its portfolio according to all desired cross-sections. Global reports require consolidation in excel and are less frequent available.

¹⁴ HO costs are attributed according to outstanding portfolio. Fully informed financial statements are only available quarterly as depreciation and the loan loss provision costs is only posted quarterly.

■ Risk management

Risk management is rated “b”

Procedures and internal controls

UNRWA MD has good internal controls embedded in its procedures that are well document in relevant manuals, of which some originate from UNRWA (e.g. the HR manual). The procedures are generally well known by staff and staff compliance to procedures is adequate. Minor incompliance is continuously found by Internal Audit (IA) of which most could be prevented by stronger hierarchical supervision of staff: HO to CFMO to BM to ALS to LO. Procedures for cash management are adequate, both for cashiers and LOs collecting cash directly from clients, including proper controls on use of receipts at the branch as well as in the field. UNRWA MD is currently investigating possibilities for cash insurance at branches and in transit to the bank. There are sufficient procedures to ensure data reliability with monthly reconciliation between the MIS and accounting data, and bank reconciliations.

In terms of risk management UNRWA MD could benefit from a more proactive identification of risks, as compared to the current predominant mode of updating procedures reactively. Furthermore, financial risks are not all identified and/or managed (cf. Funding & liquidity).

Internal audit

UNRWA MD has a moderate to good Internal Audit (IA) function. The IA function of UNRWA MD consists of three components: the Verification Officer (VO) within the department, the IA department of UNRWA as well as the outsourced annual financial and portfolio audit by Grant Thornton Mohamed Hilal (GTMH). The IA process would gain in efficiency with better coordination between the three components and building on each others work rather than duplicating it. Although GTMH uses the reports of the Verification Officer, the VO is otherwise not involved in the audit by GTMH. Neither the overall IA process, nor the audit process for the Verification Officer is documented in an audit manual for UNRWA MD.

The scope of all three audits combined covers most areas of risk with the exception of financial risks, reputation risk and strategic risk. The Verification Officer only has a focus on operational and credit risk in the branches, but does not audit HO processes, which is the same scope of work as GTMH who however also focuses on the accounting process. The HO processes fall under the responsibility of the UNRWA IA department. Their audits are however weak and infrequent due to understaffing in this department and the low priority of the microfinance department in their work.

Branches are audited at least once yearly by the Verification Officer, although sometimes for only one loan product per audit. At present staff capacity is not sufficient to carry out a sufficient number of audits for West Bank, Syria and Jordan.¹⁵ Only a small percentage of branch visits are surprise visits, with the majority of visits planned ahead. Branch audits have a good coverage of branch procedures including visits of clients. The present Verification Officer has sufficient skills for branch audits, but would need strengthening of skills to have a full overview of all risks of UNRWA MD.

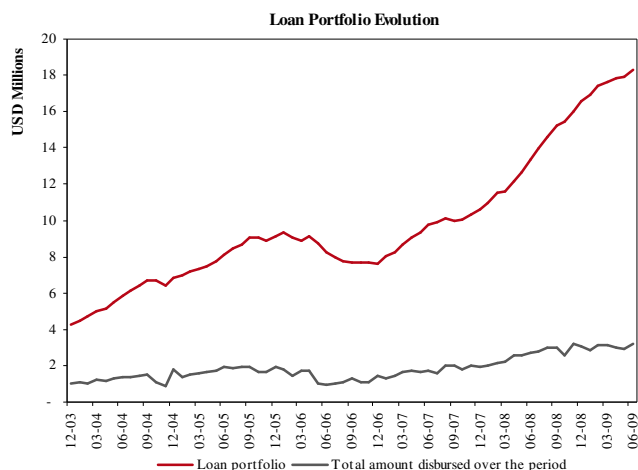
The current institutional set-up does not guarantee sufficient independence of the IA function. However, given the lack of a proper governance body this is understandable, as well as given the fact that the management team is officially under the audit control of UNWRA.

■ Activities

Activities: products and services is rated “c”

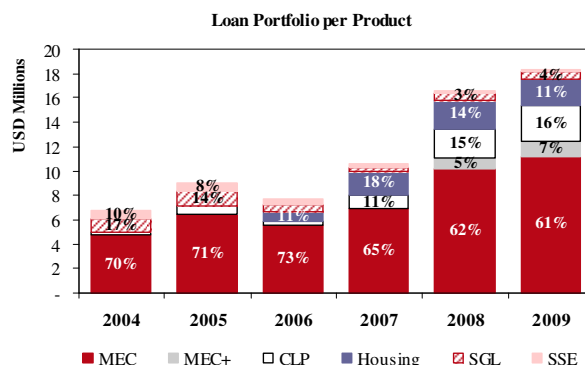
Financial services evolution

UNRWA MD has shown strong portfolio growth since the beginning of 2007 when relative peace returned to West Bank. In FY07 and FY08 UNRWA MD has grown by 38% and 57% respectively, after a decline of 16% in FY06. During the first six months the portfolio growth slowed down to 20% (annualized), which is mostly due to the economic recession but also due to internal reasons in Syria (finding appropriate branch locations) and Jordan (staff capacity).



The portfolio composition has also changed in the past years. The MEC loan continues to dominate the portfolio, although slightly reducing from 70% of the portfolio to 61% as of June 2009. As a result of Gaza’s economic isolation the

housing loan has increased whereas the SSE and SGL loans decreased.¹⁶ The Consumer Loan Product (CLP) has also increased since it is being offered in West Bank in 2007 and Syria and Jordan in 2008.



Financial services management

The credit methodologies for the different products are well designed, although certain weaknesses limit adequate credit decisions and low collateral requirements limit delinquency management.

For the MEC loan there is only a limited documentation of the business analysis and the maximum loan size is based on the net business income¹⁷ rather than the more conservative net household income. For the MEC+ loan an appropriate more detailed business analysis is available. For the CLP, the monthly installment can be as high as 33% of the monthly salary, which is relatively risky. LOs could benefit from stronger business analysis skills, but otherwise in general have sufficient skills to properly implement the credit methodologies.

On the one hand, in Palestine, UNRWA MD will now (as of August 2009) use the credit bureau to strengthen its credit decision, although a specific policy is still to be developed how the credit bureau information will be taken into account.¹⁸ On the other hand, UNRWA MD does not participate in the credit bureau set-up by the most prominent MFIs in Jordan that became operational in the end of 2008.

The loan products do not require very strong collaterals (mostly post-dated checks, promissory notes and notarial deeds), except for the Housing Loan Product in Gaza which requires a salary guarantee from an UNRWA staff member. This limits the strict enforcement of delinquency management for UNRWA MD. Besides this, the

¹⁶ These three loans are predominantly offered in Gaza.

¹⁷ A monthly installment cannot exceed 33% of net monthly business income

¹⁸ At present the total loan repayments of the client have to be below the limit that UNRWA MD has set. However, UNRWA MD has not yet established guidelines on how to account for a previous poor repayment record.

delinquency management procedure has been well developed and is well known by staff, although it could be implemented more diligently by LOs, who should avoid unofficial rescheduling of loans by verbal agreement.

Within branches, in general, priority is given to productivity and profitability rather than PAR – even though there is clear awareness among staff about PAR and the need to reduce it. As such, UNRWA MD would benefit from a better balance in the priority of productivity and PAR targets. There is good monitoring of LOs and their performance, with frequent discussions based on quantitative indicators with ALS and BM. However, the ALS and BMs share the above priority of productivity and profitability. The incentive system as planned for BMs does include a focus on PAR indirectly¹⁹, but is not expected to sufficiently balance productivity and credit risk within UNRWA MD.

Credit risk

Credit risk has seen a significant improvement over the past two and a half years, but remains moderate to high. PAR 30 stood as high as 30% in December 2006, but came down to 6.4% and 6.2% in December 2007 and December 2008 respectively. In 2009 PAR 30 slightly increased to 7.5% as of June 2009.

The main credit risk is concentrated in the MEC and CLP with PAR 30 at 9.0% and 8.7%, respectively.²⁰ The Housing Loan Product has a low PAR 30 of 0.9%, most notably due to its strong salary guarantee of UNRWA staff. Geographically, Gaza and Syria perform better (5.1% and 4.7%) as compared to West Bank and Jordan (8.6% and 9.0%). For Gaza this is due to the large percentage of the well performing housing loans. The overall increase in PAR for UNRWA MD since December 2008 is most notably due to Jordan which saw an increase in PAR 30 from 5.1% in December 2008 to 9.0% in June 2009 mostly as a result of the economic recession. Gaza and Syria show minor increases only (around 1%) and West Bank shows more or less a stable performance.

UNRWA has a good write-off policy in place with all loans over 360 days written off monthly. The write-off ratio has significantly reduced as well to a reasonable 1.9% for 2008, down from 13.1% in 2006 and 14.9% in 2007. There is good follow-up of written-off loans as indicated by the recovery of late loans.²¹

¹⁹ The incentive system includes branch profitability which includes Loan Loss Provision Expenses related to PAR.

²⁰ Mostly due to its discontinuation the SSE loan had a high PAR 30 of 35.7% as of June 2009.

²¹ On average around 20% of the outstanding balance of written-off loans under collection was collected annually.

UNRWA has chosen a good diversification policy to expand to Jordan and Syria to reduce its exposure to potential renewed violence and/or disorder in Palestine. At present this diversification does not improve the credit risk profile as Jordan and Syria have a similar performance to Gaza and West Bank. Furthermore, no specific limitations or targets are set for portfolio distribution per region or business sector. Portfolio concentration is monitored by branches, but without sufficient guidelines for branch staff. Staff loans are kept to a minimum and are well managed.

Planned fast growth rates (cf. Planning) are not yet sufficiently well planned in terms of staff recruitment and training, which could lead to an increase in credit risk.

Credit risk coverage

UNRWA MD has a moderate credit risk coverage. PAR is adequately covered by loan loss provision with a credit risk coverage of 65.7% of PAR 30 and 134% of PAR 90. Several guarantees are in place for the different loans, but these are mostly used as a deterrent and are less effective for recovering late loans.

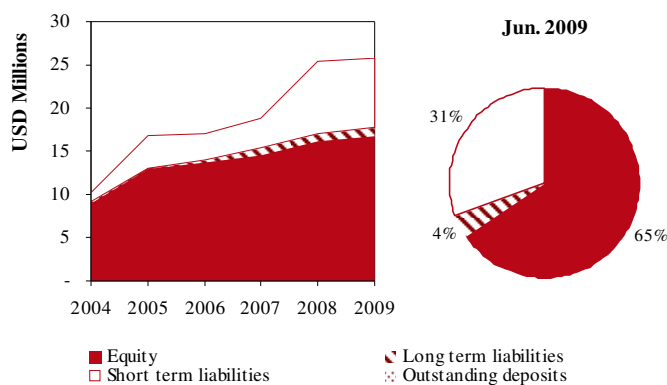
Funding and liquidity

Funding and liquidity is rated “b”

Capitalization and funding strategy

UNRWA MD remains well capitalized with a Capital Adequacy Ratio (CAR) of 90% as of June 2009. The strong capitalization is the result of a high inflow of donated equity and the fact that the institution has not financed its portfolio through debt. UNRWA MD slightly leveraged its donated equity through the PalFund Trust Fund, with the leverage increasing from 0.13x at FYE04 to 0.57x at FYE08.

Funding Structure



Future funding needs are not precisely known and requires stronger financial projections (cf. Planning). Limited initiative has been taken by UNRWA MD so far to secure the 2009-2011 funding needs. However, UNRWA MD has

sufficient liquidity to cover projected growth until the end of 2009. Furthermore, an increase of the PalFund Trust Fund by 3 M USD is already contracted.

For fundraising, UNRWA MD is assisted by the External Relations department of UNRWA, from which on the one hand it benefits in terms of contacts, but on the other hand it limits direct involvement from UNRWA MD on its own fundraising. Another potential bottleneck is that grant funding for Syria and Jordan is not as easily available and is yet to be tested by UNRWA MD. To date UNRWA MD has chosen not to attract debt – although contractually possible through UNRWA – but to meet its funding needs outside of Palestine this might become necessary. Negotiation skills for debt contracts will need to be proven in practice.

Liquidity risk

The finance department is well organized and staff is sufficiently skilled, although details of Asset and Liability Management are not known as UNRWA MD has not yet had a need for its detailed management. Liquidity risk remains low as UNRWA MD has held significant liquidity positions to date with a Liquidity to Asset Ratio well above 10%. Detailed liquidity planning using cash-flow forecasts will become necessary when UNRWA MD further optimizes its asset deployment. On the other hand internal liquidity management is well organized and excess funds are only invested with one month terms.

Maturity risk is absent as the main liability (the PalFund Trust Fund) is payable with the same maturity as the loans that were disbursed under this fund. However, maturity risk is not monitored at present.

Market risk

UNRWA MD is not exposed to interest rate risk, but is exposed to foreign exchange risk. As of June 2009, 14% of its loan portfolio is denominated in SYP and 68% in JOD. This – together with cash held in SYP and JOD – leads to an open position on Tier 1 capital of 17.5% on SYP and a significantly larger open position of 88.6% on JOD.

- The open position on the SYP remains manageable at this level. Even if it has led to FX gains in recent years, in the first six months of 2009 it led to a drop in ROA of 0.5 percentage point (annualized).
- UNRWA MD would be able to withstand a potential devaluation of the JOD against the USD and remain sufficiently capitalized, although it would significantly lower its capitalization. This risk is partly mitigated by the USD/JOD peg that has been fixed for the past sixteen years.

For both, UNRWA MD would benefit from investigating options to reduce its open position.

Efficiency and profitability

Efficiency and profitability is rated “c”

Profitability analysis

UNRWA MD has made great strides over the past two years to become profitable raising its ROA to (2.2%) in 2007 and to 1.9% in 2008, establishing its first profitable year. The increase in profitability is most notably due to significant improvements in its portfolio quality and gains in efficiency. With the improvements in portfolio quality UNRWA MD was able to close its yield gap and raise its portfolio yield to 34% in 2008 – up from 27-29% in the four years prior – which matches its theoretical yield of 36% relatively well.

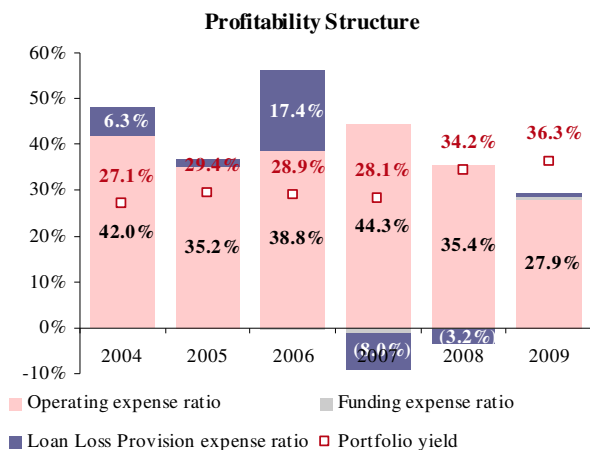
Overall UNRWA MD has a moderate revenue quality and is likely to be able to sustain its revenues. In all regions a constant struggle remains to differentiate itself from the other UNRWA donor programs, in which UNRWA MD succeeds as good as can reasonably be expected. Otherwise, notable geographic differences exist in revenue quality:

- Palestine: Good revenue quality with a leading position in the market; although increasing competition will require continuous product improvement to remain competitive.
- Jordan: Low revenue as UNRWA MD is a small player and a late entrant to an almost saturated market. In this market its products are not competitive with low loan terms and initial loan size, and slightly higher interest rates.
- Syria: Good revenue quality as it operates in a largely untapped market with very limited competition.

Good initiative has been taken by UNRWA to establish Social Performance Management and Marketing Departments to focus on product development and refinement based on customer feedback, as well as stronger branding of UNRWA MD in the market.

The other reason for the increase in its profitability has been gains in efficiency. This is mostly due to an increase in its average loan size from 618 to 947 USD between 2006 and 2008 and partially through a modest increase in staff productivity between 2006 and 2008. For 2009, a further reduction of the operating expense ratio is expected, which for the first six months has dropped below 30% to 27.9%, on the back of further improvements in LO and staff productivity. Further improvements are possible, especially in more efficient back-office functions as the percentage of LOs to total staff remains low between 45-50%. Profitability has also been assisted in the past two years by loan loss provision reversals. The current year shows however that without this added income, UNRWA remains profitable. It can further be assisted by improved asset optimization which to date has remained low, although it has slightly improved from 53.5% in Dec. 2007 to 67.5% in Jun. 2009.

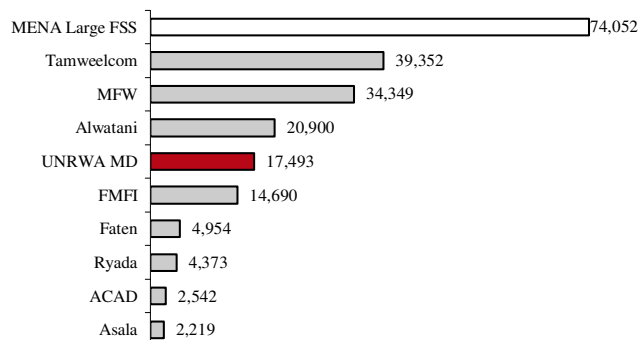
The profitability outlook for UNRWA MD is positive as indicated by a ROA of 4.9% for the first six months of 2009. UNRWA can further benefit from increased efficiencies in staff and LO productivity and increasing economies of scale, but will carry the initial higher costs of implementing a new MIS.



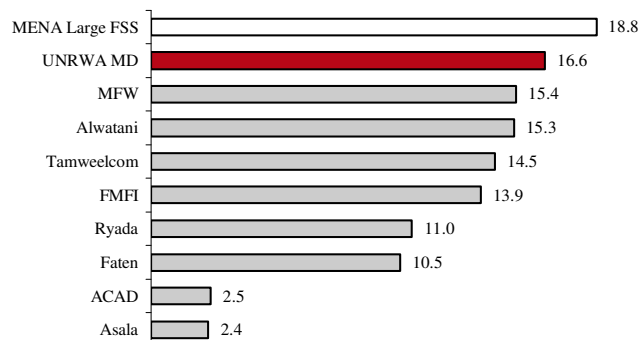
The opinions expressed within this report are valid for one year after the rating mission. Beyond one year, or in case of a major change during this period affecting the institution's performance, that change due to the institution itself or its operating environment, Planet Rating does not guarantee the validity of the opinions contained herein, and recommends that a new rating evaluation be undertaken. Planet Rating cannot be held responsible for investments/financings that are made based on this report.

Benchmarking

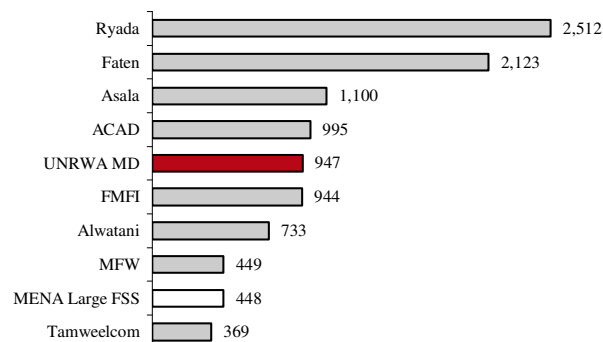
Active borrowers



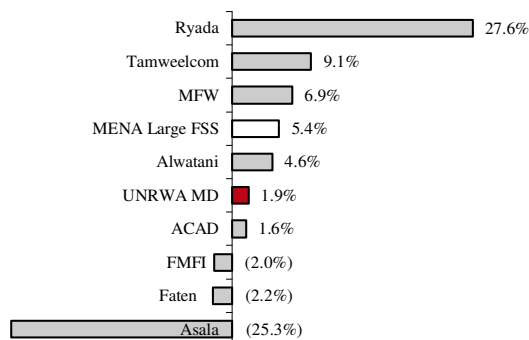
Loan portfolio (M USD)



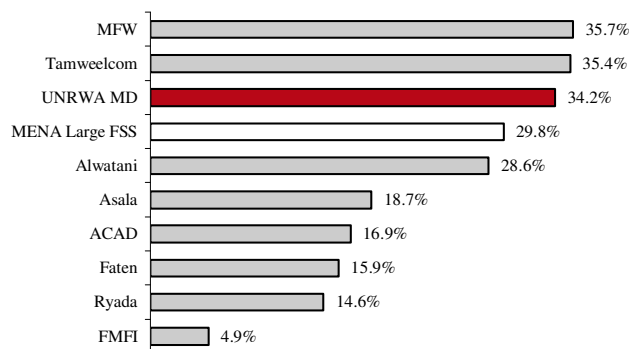
Average outstanding loan per client (USD)



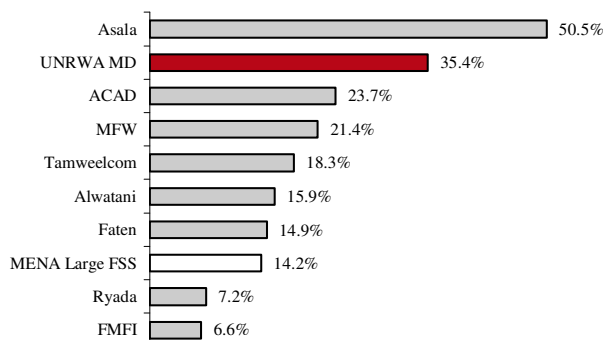
ROA



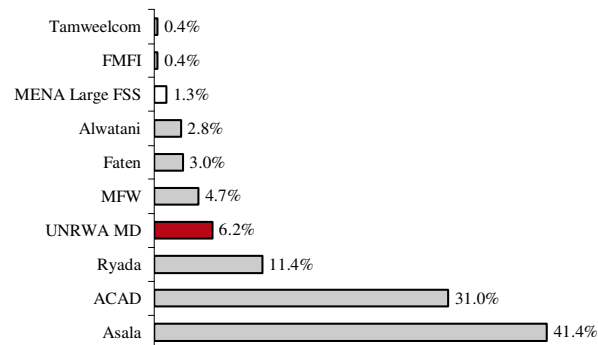
Portfolio yield



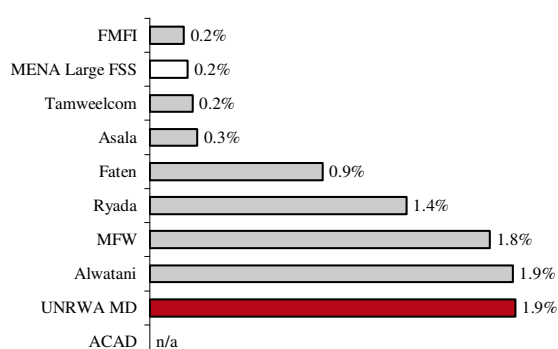
Operating expense ratio



PAR 31-365



Write-off ratio



Source: UNRWA MD and Tamweelcom, Planet Rating own data. Other MFIs: www.mixmarket.org. All data as of 2008 except MENA Large FSS benchmark which is 2007.

Data in USD, unless otherwise stated

■ Performance indicators

Loan Portfolio	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Jun. 2009
Loan portfolio evolution						
Loan portfolio	6,820,420	9,089,219	7,647,170	10,576,959	16,565,033	18,268,492
<i>Growth</i>	58.8%	33.3%	(15.9%)	38.3%	56.6%	10.3%
Active borrowers	11,626	14,572	12,373	12,666	17,493	20,293
<i>Growth</i>	41.7%	25.3%	(15.1%)	2.4%	38.1%	16.0%
Average outstanding loan per client	587	624	618	835	947	900
Average amount disbursed per loan	846	932	1,093	1,129	1,296	1,295
Portfolio quality						
Rescheduled loans	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
PAR 31-365	25.4%	20.0%	30.1%	6.4%	6.2%	7.5%
PAR > 365	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%
Write-off ratio	5.0%	9.1%	13.1%	14.9%	1.9%	0.8%
Credit risk coverage						
Risk coverage ratio (PAR 30)	58.9%	58.8%	82.8%	77.6%	67.2%	65.7%
PAR 30 net of loan loss provision / Equity	8.0%	5.8%	2.9%	1.0%	2.1%	2.8%
Staff						
Total number of staff	200	217	215	250	288	282
% Credit officers	45.5%	45.2%	42.8%	42.8%	45.5%	51.1%
Turnover	4.3%	2.9%	7.4%	20.2%	12.3%	11.6%
Profitability analysis						
ROE	(12.0%)	(4.5%)	(15.1%)	(2.8%)	2.8%	7.6%
Liabilities / Equity	0.13x	0.30x	0.23x	0.28x	0.57x	0.53x
Core capital adequacy ratio	150.7%	139.7%	208.9%	128.3%	94.1%	90.2%
Total capital adequacy ratio	151.4%	140.2%	209.4%	128.5%	94.2%	90.3%
ROA	(11.3%)	(3.6%)	(11.5%)	(0.2%)	2.6%	5.4%
ROA (without donations)	(11.3%)	(3.6%)	(11.9%)	(2.2%)	1.9%	4.9%
ROA (microfinance operations)	n/a	(3.5%)	(12.2%)	(2.4%)	2.0%	4.7%
Profitability structure						
Total revenue ratio	27.8%	29.9%	31.3%	30.5%	35.2%	36.4%
Portfolio yield	27.1%	29.4%	28.9%	28.1%	34.2%	36.3%
Operating expense ratio	42.0%	34.3%	38.8%	44.3%	35.4%	27.9%
Cost per borrower	206	190	262	328	272	241
Staff productivity	58	67	58	51	61	72
Loan officer productivity	128	149	134	118	134	141
Average outstanding loan per client (USD)	587	624	618	835	947	900
Funding expense ratio	(0.1%)	(0.0%)	(0.2%)	(1.2%)	(0.3%)	0.8%
Cost of savings	n/a	n/a	n/a	n/a	n/a	n/a
Cost of borrowings	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Loan Loss Provision expense ratio	6.3%	1.4%	17.4%	(8.0%)	(3.2%)	0.9%
PAR 31-365	25.4%	20.0%	30.1%	6.4%	6.2%	7.5%
Write-off ratio	5.0%	9.1%	13.1%	14.9%	1.9%	0.8%
Resource optimization						
Outstanding Loan Portfolio / Assets	56.6%	47.5%	33.8%	53.5%	62.5%	67.5%
Revenue from investment as a % of financial revenues	2.4%	1.9%	7.2%	7.7%	2.4%	0.2%
Liquidity						
Cash to demand deposits	n/a	n/a	n/a	n/a	n/a	n/a
Liquidity / Total assets (LAR)	22.9%	13.7%	19.4%	15.4%	23.1%	16.3%
Current ratio (1 year)	918.6%	397.2%	509.8%	480.4%	278.5%	298.1%

■ Financial statements – USD

Income Statement (USD)	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Jun. 2009
Interest and fee income on loan portfolio	1,542,704	2,372,630	2,417,437	2,637,077	4,591,908	3,184,823
Interest and fee income on investments	38,571	46,172	187,690	219,303	111,107	7,845
Interest and other financial expenses	-	-	-	-	-	-
Net inflation adjustment expense	-	-	-	-	-	-
Net foreign exchange income (expense)	6,072	130	20,917	109,333	38,352	(67,622)
Net financial income	1,587,347	2,418,932	2,626,044	2,965,713	4,741,367	3,125,046
Fees and commissions on other financial services	-	-	-	-	-	-
Other operating income	962	(1,643)	17,267	6,218	24,778	1,952
Operating expenses	2,391,842	2,774,604	3,244,312	4,155,573	4,752,301	2,443,000
<i>Personnel expenses</i>	<i>1,800,672</i>	<i>2,102,123</i>	<i>2,413,381</i>	<i>2,799,614</i>	<i>3,290,739</i>	<i>1,625,401</i>
<i>Administrative and other expenses</i>	<i>531,624</i>	<i>578,492</i>	<i>712,430</i>	<i>1,204,447</i>	<i>1,241,970</i>	<i>695,519</i>
<i>Depreciation</i>	<i>59,546</i>	<i>93,989</i>	<i>118,501</i>	<i>151,512</i>	<i>219,592</i>	<i>122,081</i>
Non operating income (net)	-	(23,690)	42,956	31,093	(18,522)	22,682
Gross operating income	(803,533)	(381,005)	(558,045)	(1,152,549)	(4,678)	706,680
Net loan loss provision expense	359,543	110,609	1,457,496	(751,280)	(433,839)	79,446
Net operating income	(1,163,076)	(491,614)	(2,015,541)	(401,269)	429,161	627,234
Extraordinary income (net)	-	-	-	-	-	-
Net income before tax	(1,163,076)	(491,614)	(2,015,541)	(401,269)	429,161	627,234
Income Tax	-	-	-	-	-	-
Net income before donations	(1,163,076)	(491,614)	(2,015,541)	(401,269)	429,161	627,234
Donations	-	-	66,585	364,265	155,028	62,417
Net Income	(1,163,076)	(491,614)	(1,948,956)	(37,004)	584,189	689,651

Balance Sheet (USD)	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Jun. 2009
ASSETS	10,223,723	16,891,113	16,975,853	18,785,392	25,398,011	25,730,060
Liquid assets	2,338,598	2,311,913	3,292,414	2,892,534	5,872,899	4,182,395
Net loan portfolio	5,784,347	8,019,321	5,742,923	10,051,358	15,880,581	17,365,937
<i>Gross loan portfolio</i>	<i>6,820,420</i>	<i>9,089,219</i>	<i>7,647,170</i>	<i>10,576,959</i>	<i>16,565,033</i>	<i>18,268,492</i>
<i>(Loan loss reserve)</i>	<i>(1,036,073)</i>	<i>(1,069,898)</i>	<i>(1,904,247)</i>	<i>(525,601)</i>	<i>(684,452)</i>	<i>(902,555)</i>
Interest receivable	-	-	48,096	36,204	71,316	104,664
Financial investments	1,897,468	5,182,699	7,080,517	4,492,657	2,353,908	2,875,820
Net fixed assets	202,608	429,868	479,952	802,087	966,544	911,375
Intangible assets	-	-	-	-	-	-
Other assets	702	947,312	331,951	510,552	252,763	289,869
LIABILITIES AND EQUITY	10,223,723	16,891,113	16,975,853	18,785,392	25,398,011	25,730,060
Liabilities	1,156,154	3,939,784	3,147,664	4,132,114	9,216,860	8,862,475
Demand deposits	-	-	-	-	-	-
Time deposits	-	-	-	-	-	-
Cash collateral	-	-	-	-	-	-
Borrowings	475,000	2,375,000	2,375,000	2,375,000	6,875,000	6,875,000
Subordinated debt	-	-	-	-	-	-
Other liabilities	681,154	1,564,784	772,664	1,757,114	2,341,860	1,987,475
Equity	9,067,569	12,951,329	13,828,189	14,653,278	16,181,151	16,867,585
Core capital	9,022,569	12,906,329	13,791,213	14,623,076	16,157,723	16,847,376
<i>Paid-in capital</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Donated equity</i>	<i>13,138,028</i>	<i>17,547,227</i>	<i>20,366,195</i>	<i>21,786,818</i>	<i>22,815,665</i>	<i>22,815,665</i>
<i>Retained earnings</i>	<i>(4,115,459)</i>	<i>(4,640,898)</i>	<i>(6,574,982)</i>	<i>(7,163,742)</i>	<i>(6,657,942)</i>	<i>(5,968,289)</i>
Other equity accounts	45,000	45,000	36,976	30,202	23,428	20,209

Off Balance Sheet Accounts	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Jun. 2009
Portfolio under management	-	-	-	-	-	-
Written-off loans under collection	2,439,037	2,589,475	3,287,420	3,984,023	3,370,251	3,260,740
Guarantees	-	-	-	-	-	-

Balance Sheet Averages	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Jun. 2009
Gross loan portfolio	5,696,571	8,077,644	8,368,195	9,378,720	13,431,735	17,530,299
Assets	10,310,724	13,557,418	16,933,483	17,880,623	22,091,702	25,564,035
Deposits	-	-	-	-	-	-
Borrowings and subordinated debt	237,500	1,425,000	2,375,000	2,375,000	4,625,000	6,875,000
Equity	9,697,408	11,009,449	13,389,759	14,240,734	15,417,215	16,524,368

■ Formulas

Return on assets (ROA):	$\text{Net operating income} / \text{Average assets}$
ROA (without donations):	$\text{Net operating income before donations} / \text{Average assets}$
Return on equity (ROE):	$\text{Net operating income before donations} / \text{Average equity}$
Leverage:	$\text{Liabilities} / \text{Equity (end of period)}$
Capital adequacy ratio:	$\text{Capital} / \text{Risk weighted assets (end of period)}$
Total revenue ratio:	$\text{Total revenue} / \text{Average gross outstanding portfolio}$
Portfolio yield:	$\text{Portfolio revenue} / \text{Average gross outstanding portfolio}$
Operating expense ratio:	$\text{Operating expense} / \text{Average gross outstanding portfolio}$
Cost per borrower:	$\text{Operating expense} / \text{Active borrowers (end of period)}$
Staff productivity:	$\text{Active borrowers} / \text{Total personnel (end of period)}$
Funding expense ratio:	$\text{Interest and fees paid on funding liabilities} / \text{Average gross outstanding portfolio}$
Cost of savings:	$\text{Interest and fees paid on deposits} / \text{Average deposits}$
Cost of borrowings:	$\text{Interest and fees paid on borrowings} / \text{Average borrowings}$
Loan loss provision expense ratio:	$\text{Net loan loss provision expense} / \text{Average gross outstanding portfolio}$
Write-off ratio:	$\text{Loans written off} / \text{Average gross outstanding portfolio}$
Risk coverage ratio:	$\text{Loan loss reserve} / \text{Portfolio at risk} > 30 \text{ days}$
Cash to demand deposits:	$\text{Instantly available liquid assets} / \text{Demand deposits (end of period)}$
Current ratio (1 year):	$\text{Short term assets} / \text{Short term liabilities (end of period)}$

■ Rating scale

Rating	Rating summary	
A++	Current institutional, operational and financial performances are optimal. There is no downside risk in the short-term. Medium and long-term plans are well-designed, execution capacity is excellent and goals are very likely to be achieved. Short and medium term risks are minimal and/or well-managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should only minimally affect the institution's financial condition given its high resilience.	INVESTMENT GRADE
A+	Current institutional, operational and financial performances are excellent when compared to industry standards.	
A	Medium and long-term plans are well-designed, execution capacity is very good, and goals are very likely to be achieved. Short and medium term risks are minimal and/or well managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should have a limited impact on the institution's financial condition given its ability to quickly adjust its strategies and/or take corrective actions.	
A-	Short and medium term risks are minimal and/or well managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should have a limited impact on the institution's financial condition given its ability to quickly adjust its strategies and/or take corrective actions.	
B++	Current institutional, operational and financial performances are satisfactory when compared to industry standards.	INVESTMENT
B+	Medium and/or long-term plans are adequately designed, execution capacity is good and goals are likely to be achieved. Short and medium term risks are low and/or well managed. Areas for improvements have been identified and are being addressed. Changes in the economic, political or social environment might have an impact on the institution's financial condition that should however remain moderate.	
B	Short and medium term risks are low and/or well managed. Areas for improvements have been identified and are being addressed. Changes in the economic, political or social environment might have an impact on the institution's financial condition that should however remain moderate.	
B-	Current institutional, operational and financial performances are close to industry standards. Short and medium term risks are moderate but are not fully addressed. Most areas for improvements have been identified, but medium and long term plans miss one or several critical elements, execution capacity is uneven and some goals are unlikely to be achieved. The institution is vulnerable to major changes in the economic, political or social environment.	SPECULATIVE INVESTMENT
C++	Current institutional, operational and financial performances are below comparable industry standards. Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
C+	Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
C	Medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	TECHNICAL ASSISTANCE REQUIRED
C-	Medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
D	High risk: Important weaknesses in operational and financial areas result in high institutional vulnerability and potential risk of default. Performance is very poor in several important evaluation areas.	
E	Immediate risk of default: Existing operational and/or financial and/or strategic weaknesses create an outstanding risk of default. Performance is very poor in most evaluation areas.	