

**Action Fiche for**  
**"Rural Microfinance: Pilot Project for Agricultural Production in Palestine"**

**1. IDENTIFICATION**

Title/Number	Rural Microfinance : Pilot Project for Agricultural Production in Palestine		
Total cost	EC contribution : €1 million The Commission is the only donor for this pilot project.		
Aid method / Method of implementation	Project approach: direct centralised management. CRIS : PP/PA/2009/215-620		
DAC-code	31161	Sector	Agricultural production

**2. RATIONALE**

**2.1. Sector context**

*2.1.1. General context*

The contribution of the agricultural sector to GDP hovers around 10% depending on the year, as compared to 36% in 1970. 16% of the labour force works in the agricultural sector. In addition, the informal agricultural sector –not counted in official statistics- plays an important role for poor rural families. The agricultural sector can be seen as a "shock absorber" for many people who lost their jobs in Israel or in the OPT. In the West Bank, nearly half of the population lives in rural areas (in villages and small municipalities under 10,000 habitants).

Due to limited natural resources (land and water), the production of the agricultural sector in Palestine is unable to cover all the needs of the population. Important food items, such as wheat for instance, will in all likelihood, always require to be imported. However, current production is far from reaching its full potential. Constraints in movement and access (specially in the West bank where 60% of the land is under the full control of the Israeli Civil Administration), the closure system and the destruction of agricultural assets in the Gaza Strip (which led to the collapse of the export oriented agriculture sector) together with the extension of the exclusion zone there, recent successive droughts and lack of investment and funding opportunities should be added to natural constraints.

A major problem explaining the absence of access to finance is that the formal banking sector does not consider the agricultural sector as a potential sector for investment. The main reason might be that the majority of holdings (responsible for the bulk of the production) are of small size (few hectares). With regard to the Micro Finance Institutions (MFIs), a very small percentage of their portfolio has been dedicated to agricultural loans. The agricultural sector is seen by these institutions as a risky area, requiring specifically designed products and qualified staff.

As a consequence, the agricultural sector in the OPT does not reach its full potential. The self-sufficiency ratio (achieved for olives, some vegetables and poultry products) could be improved in some specific sub-sectors, in particular in the small ruminant sector, red meat, fodder crops, etc. A study recently conducted by Reef Finance Company –the beneficiary of this action- concluded that the potential demand on credit in agriculture is around \$300million. The large unmet demand has also been confirmed by a market survey (December 2006) carried out by PlaNet Finance, a specialised operator in micro-finance. The real demand of credit in the agricultural sector is roughly estimated at \$47million. The annual average of credit supply to the agricultural sector from banks, Micro Finance Institutions (MFIs) and NGOs is roughly estimated at \$18.08million.

In conclusion, developing financial services for agriculture, as far as agriculture outputs are mostly oriented to local markets, could impact positively on the food security situation in the OPT<sup>1</sup>, both by increasing the income of smallholder farmers and by increasing local supply of food items.

This action, by providing €1million to Reef Finance Company as a grant for capital lending, a new MFI (operations started in January 2008), fully dedicated to agriculture, will immediately increase the capacity of Reef Finance Company to provide agricultural loans. In the mid to long-term, it is expected that this additional resource will contribute to the financial sustainability of Reef and that the organisation will then be in a position to contract commercial loans.

#### 2.1.2. *MFI's context*

##### (a) Choice of MFI :

During the identification mission, ECTAO organised a meeting with the experts and the responsible officials of MFIs operating in Palestine.

6 MFIs (UNRWA, FATEN, ASALA, ACAD, REEF and PDF (Palestinian Development Fund)) attended the meeting. After the discussions and exchange of information, these MFIs, except Reef, are not considered for funding under this pilot project as they are either not interested in taking up the proposal, or less experienced or involved in the rural and agricultural development aspects of micro-credits.

The mission concluded that Reef was the only MFI ready to receive the EC funds in the framework of the pilot project. This action, providing €1million to Reef Finance Company as **a grant for capital lending fully dedicated to agriculture**, will immediately increase the capacity of this MFI to provide micro-credits to smallholder farmers in Palestine. This action will allow Reef to double its on-lending capital for micro-credits to smallholder farmers. Furthermore, Reef is convinced that the current staff is ready to analyse new applications from smallholder farmers and perform new micro-credits without any additional staff support.

##### (b) Reef Finance Company :

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<sup>1</sup> It was estimated at the end of 2008 that 50% of the population is food insecure in the Gaza Strip compared to 25% in the West Bank.

The creation of Reef Finance Company was an initiative of the Palestinian Agricultural Development Association (PARC), the biggest agricultural NGO in the OPT. This was financially supported by the Dutch Cooperation (2007-2009). Before the creation of Reef, PARC provided micro-credits combined with other activities such as training and social assistance in rural areas. In 2007, PARC decided to transfer the micro-credit activities to a specialised MFI : Reef Finance Company. Reef's set-up and procedures are in accordance with the Palestinian Monetary Authority (PMA) regulations.

- Reef is financing the following products: (i) Purchase of feeds, birds, poultry and cattle; (ii) Purchase inputs for agricultural production (seeds, seedlings, fertilizers); (iii) Purchase equipment, tools, transport vehicles, tractors; (iv) Agricultural processing and manufacturing.
- Reef's main clients are cooperatives, associations and their members as well as small entrepreneurs and businesses. 90% of the loans proposed are in kind with cash and Islamic credit making up the difference. (Islamic credit is a financial system operating without interest rates; each loan is a shared responsibility of risk and loss between the lender and the borrower).
- The loan period varies between 12 and 24 months (sometimes with 3 months grace period) with the maximum of individual loan being between \$7,000 and \$15,000. Reef estimates an average micro-credit per client will amount to \$4,000. The loans to cooperatives and associations are estimated to have a maximum value between \$50,000 and \$100,000.
- The net loan portfolio till 31/05/2009 is \$1,999,412 (balance sheet total \$3.3million)
- The operating revenue until 31/05/2009 is \$61,278 whereas the operating expenses until 31/05/2009 are \$206,902. This is normal for a young MFI and can be explained by the following aspects: interest and commission are low; the key success of Reef is monitoring which has a high operational cost; the volume of the outstanding portfolio is low. Reef has its audited statements for the year 2007 and 2008 and provides monthly financial statements.
- External lending: In October 2008, Reef received a first loan of \$75,000 form Banca Etica. Reef has approached also the EIB (via PARC) without success because the latter considers it as still too young. Reef hopes to be able to approach private financial institutions after its consolidation.
- Number of loans (during 2008): 233 (22 for cooperatives and associations and 211 for individuals). Number of loans per staff member: 12.26.
- Number of loans (during 2009 by 31/05/2009): 207 (12 for cooperatives and 195 for individuals).
- The average outstanding micro-credit per beneficiary is \$4,975. The average credit amount outstanding for cooperatives is \$44,400 and for individuals \$7,500.
- By 31/05/2009 Reef reached 597 micro-credit beneficiaries (402 of them having outstanding micro-credits).

– Repayment rate is 97.2% (at 31/05/2009).

### 2.1.3. *Coherence with government policy*

This project is coherent with the government policy which favours import substitution in the interest of food security for the smallholder sector as well as moving away from highly perishable agricultural production for export (foods, vegetables and flowers). Even if the bulk of the farm inputs (especially animal feed) has to transit through Israel it is less sensitive to temporary closure of the corridor (in comparison to the perishable foods, vegetables and flowers for export). "Micro-finance and Micro-Credit Services for Rural and Urban Entrepreneurs" is part of the Palestinian Reform and Development Plan.

## 2.2. **Lessons learned**

In the agricultural sector, lessons learned are: i) the important role played by small-holding farmers in the total output. They are the economic actors to be considered to boost agricultural production; ii) the importance of mainstreaming natural resources protection in agriculture policy. The production during many years in the Gaza Strip of high water consuming export crops has led to the salinity of the aquifer; iii) the potential of sustainable alternatives. For instance, the olive production, well adapted to climate and soil conditions, has recently demonstrated its potential for exports.

In the micro-finance sector, lessons learned are: i) the need for specialised and efficient MFIs to provide financial services as opposed to NGOs; ii) the need for adoption of and commitment to recognized "best practices" in the sector, especially regarding transparency in terms of performances indicators (financial and social), effective interest rate charged; iii) the need for innovative forms of collateral iv) the need for regulating the sector and for a better donor coordination in the sector; vi) the need for MFIs -already operating for many years- to build a link between the formal banking sector and the MFIs as a way of increasing the operations of the MFIs.

It is worth noting that the EC funded in the past projects with the "Arab Centre for Agricultural Development – ACAD", an NGO specialised in agricultural micro-credit. These projects were positively evaluated and contributed to the sustainability of this MFI.

## 2.3. **Complementary actions**

The creation of Reef Finance Company was an initiative of the Palestinian Agricultural Development Association (PARC), the biggest agricultural NGO in the OPT. This creation was financially supported by the Dutch Co-operation (2007-2009). Dutch Co-operation is currently designing a second phase of the project which will consist again in capacity building and operational support components for the coming years.

Furthermore, Reef Finance Company is currently benefiting from capacity building activities provided by Sharakeh (the local network of MFIs) and PlaNet Finance through a project funded by the EC (this project will end in 2009). The capacities of the MFIs are being strengthened in marketing, crisis risk management, rating in micro-finance, communication and sales, operational and financial analyses, project

design and budgeting, middle manager and human resources, accounting, product development, training delivery, costing and pricing.

Finally two additional programmes (ESAF funded by USAID and DEEP funded by Islamic Development Bank) propose capacity building activities to MFIs.

#### **2.4. Donor coordination**

A donor task force for small and micro-finance was created in 2009. The task force is co-chaired by the Palestinian Monetary Authority (PMA) and USAID. This task force aims at sharing information in the sector and enhancing the coordination between donors. The task force works for the adoption of "best practices" within the sector (e.g. enhance transparency in the sector regarding social and financial performances indicators).

One of the objectives of enhanced donor coordination is also to come out with a common funding policy. The regulations recently issued by the EC stating that grants for capital lending should only be given to start-up MFIs or to MFIs targeting remote rural areas represent a good basis for discussion.

The PMA issued draft regulations for the sector. After signature by the President of the PA, these regulations will have to be translated into more detailed and concrete rules. The task force represents an appropriate forum to discuss these issues.

During the process of the donor co-ordination, ECTAO will continue to respect the Commission's commitments under the Paris Declaration, the European Consensus on Development and the EU Code of Conduct.

### **3. DESCRIPTION**

#### **3.1. Objectives**

The overall objective of this pilot project is to increase food security in the OPT both through an increase in agricultural production and an increase in the incomes of smallholder farmers.

The specific objective is to increase financial services (micro-loans) in rural areas for agricultural purposes.

By providing a grant for capital lending to Reef Finance Company, Reef MFI will be able to provide more micro-loans to smallholder farmers. The increase of the portfolio of Reef will also impact on its financial sustainability and its capacity to deliver on mid and long-term basis financial services in rural areas.

#### **3.2. Expected results and main activities**

The main activity will consist in providing micro-credits to smallholder farmers for agricultural activities. Surveyed micro-entrepreneurs indicate credit needs mainly for expanding their businesses, financing assets, working capital and for starting up new businesses.

The expected result is the distribution of an additional 250 loans per year. This calculation is made using an average loan amount of €4,000 and a payback period of 12 months.

Because Reef Finance Company has aspirations to become a rural bank, their strategy is currently based on both Palestinian banking law and micro-finance best practices. This represents a guarantee that Reef will continue working towards becoming a professionalised MFI. Supporting Reef Finance Company is fully in line with the 2008 EC guidelines to support for micro-finance.

### **3.3. Risks and assumptions**

It is clear that the escalation of the Israeli-Palestinian conflict could impact on movement and access conditions and therefore on the economy. In such a situation (which happened in 2006) borrowers might face difficulties to pay back their loans. The commitment of Reef to provide loans mainly for the needs of the local market will mitigate the risk (production for exports are more sensitive to movement and access conditions). Also well designed collateral policy could be helpful for mitigating this risk.

Climate change and successive droughts in the OPT also represent a major risk for agricultural production. Different mitigating measures will be implemented to decrease the risk of failure of agricultural projects (drought resistant varieties, collection of rain water, performing irrigation techniques, etc.)

### **3.4. Crosscutting Issues**

Environmental preservation is the first cross-cutting issue concerning agriculture. Scarce water resources limit the availability of water for agricultural production. The commitment of Reef to sustainable agriculture, mainly dedicated for the needs of the local market, avoiding sponsoring high water consuming crops for exports, provides the necessary assurance that the environment will be mainstreamed in this pilot project. In addition some agricultural micro-projects currently in the portfolio of Reef have a positive impact on the environment, such as livestock projects which provide a source of organic fertiliser to enrich soils.

On gender issues, it is worth noting that female employment in the agricultural sector represents 34.3% of the total work force. The main role of women in the agricultural sector is in farming, processing and marketing of household agricultural products. Women play a major role for the food security at household level by providing agricultural products (e.g. through home gardens) and additional incomes.

Good governance and human rights are fundamental aspects of the Reef Finance Company's mission. In fact, this MFI is a non-profit company which aims at providing micro-credits in order to improve the food security but also to efficiently contribute to poverty alleviation. The founders of the MFI have then indirectly contributed to the good governance (by deciding to dedicate the provision of micro-credits by a specialised MFI) and human rights (by assigning the provision of rural micro-credits to smallholders in rural areas where other MFIs are reluctant to operate).

### **3.5. Stakeholders**

The main stakeholders are the following:

- Several MFIs (and the local network), potentially interested by this pilot project, were consulted. An in-depth analyse of Reef Finance Company was performed as this MFI was found to be the only institution fulfilling the main selection criteria (clear commitment to the agricultural sector, "start up" MFI). Reef shows a real interest for this project.
- The NGO "Palestinian Agricultural Development Association" (PARC) which created Reef (55% of its equity) was also consulted. PARC welcomed this possibility of support.
- The Dutch Co-operation Services. This Cooperation Agency provided financial support for the creation of Reef (capacity building and operational cost). At the time of the mission, a consultant was preparing the revision of the business plan of Reef. It was clearly stated that the Netherlands intends to continue its support to Reef Finance Company notably in capacity building and operational cost. The Dutch Cooperation office welcomed the complementary EC support.
- Contacts with the Palestinian Monetary Authority and the Ministry of Agriculture offered the assurance to the identification mission that this pilot project is in accordance with national priorities - Main micro-finance programmes were consulted and the identification mission got the assurance that Reef benefited and will continue to benefit from these programmes in terms of capacity building activities.

## **4. IMPLEMENTATION ISSUES**

### **4.1. Method of implementation**

The project will be implemented under centralised management through the signature of a grant contract between the Commission and Reef Finance Company (a non-profit organisation) following a direct award based on article 168(f) of the Implementation Rules taking into account the specific characteristics of this action and the technical competence and expertise of Reef Finance Company.

### **4.2. Procurement and grant award procedures**

This pilot project is designed in respect of the procedures and standard documents laid down by the Commission, in force at the time of the adoption of the programme estimates in question.

### **4.3. Budget and calendar**

The total EC financing is €1million. There is no contribution of the beneficiary; the exception made to the co financing rule is in accordance with art. 253 (b) given the crisis situation currently applies to Palestine.

The duration of the project is 24 months.

#### **4.4. Performance monitoring**

Additional conditions will be applied in order to ensure more professional and sustainable delivery of micro-credits. Details of these conditions are contained in the 2008 EC guidelines to support microfinance which will be attached to the grant contract of this pilot project.

They aim at achieving professionalism and sustainability through the introduction of minimum requirements in regards to the beneficiary's expertise (i.e. the capacity to provide financial services according to agreed international standards of good practice) and experience (track record in the microfinance field). Furthermore, the EC guidelines to support microfinance serve as a basic format for inclusion of performance measuring and monitoring system concerning the microfinance action.

As such, the results of the financial analysis of the identification mission will be used for the follow up and any other monitoring missions for this project.

By the end of the project's life Reef Finance Company shall:

- Ensure (by providing reasonable guarantee) that the assets created by the EC grant contribution and used by Reef for its lending operations for the duration of the project will continue to be used for the same (or similar) objective as originally foreseen by the project (i.e., providing micro-loans to smallholder farmers for agricultural activities – add description of the targeted clients, loan sizes, lending criteria, etc).
- Have demonstrated (in an independent evaluation/performance assessment or rating done by a specialized microfinance rating agency) a sufficient level of performance as a micro-lending institution over time as measured by indicators of outreach, portfolio quality, efficiency, and sustainability against pre-defined targets.
- Have demonstrated (by providing financial projections, organization's business plan etc.) its commitment to further improving long-term sustainability with the aim to reach operational self-sufficiency (i.e., operational costs fully covered by revenue from loans) and financial self-sufficiency (i.e., revenue from loans fully covers all costs, including operational costs, inflation, cost of funds, and provisioning costs).

Upon fulfilling these conditions Reef Finance Company shall become the legal owner of the assets created by the EC grant contribution.

All funds from the EC grant contribution that have been disbursed to Reef and effectively used for on-lending will be subject to the transfer of legal ownership.

#### **4.5. Evaluation and audit**

The beneficiary will be asked to plan annual evaluations. Furthermore, monitoring and follow up missions by the EC services (mainly ECTAO) or external consultants of the Commission will be conducted regularly. Other support measures such as audits and evaluations of the project will be performed by the Reef Finance Company respecting the requirements of the EC procedures in the domain. Original copies of these audits will be provided to the EC services indicated in the grant contract.



At the end of the project an external audit of Reef's operations shall be conducted to determine the real value of the assets, created by the EC grant contribution, subject to the transfer of legal ownership.

All support measures must be implemented in accordance with the European Commission's standard procedures for the implementation of external actions.

#### **4.6. Communication and visibility**

The EC guidelines on communication and visibility will apply.