



Kosovo Business Finance (KBF) Project

Quarterly Report

USAID Contract No.
167-C-00-01-00106-00

Submitted by:
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Submitted to:
USAID

March 1 – May 31, 2003



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1.0 EXECUTIVE SUMMARY

The Kosovo Business Finance project has been in operation for two years. Since the initial start of the project, much progress has been made to realize the project goals and objectives. This report summarizes our activities and overall progress for the quarter of March 1 – May 21, 2003. It is provided in accordance with the Section C, Benchmarks, and Section F.4, Technical Reports, of the Contract for Services No. 167-C-00-01-00106-00 (“the Contract”).

1.1 Project Background

On 10 May, 2001 Deloitte Touche Tohmatsu Emerging Markets, Ltd. (DTTEM) and the United States Agency for International Development (USAID), through its Regional Contracting Office (RCO), signed contract 167-C-00-01-00106-00 for the implementation of the Kosovo Business Finance Project (“KBF” or “the Project”). The KBF is the second component of the Kosovo Employment Generation Program (“KEG”) under implementation by the USAID/Kosovo Mission.

The purpose of the KBF is to:

1. Support the recovery and revitalization of small and medium enterprises (SMEs) in Kosovo by providing a quick response SME credit facility (“the Loan Production Unit” or “LPU”);
2. Establish a full-service bank (“the Bank”) to mobilize deposits and provide other financial services to SMEs in Kosovo; and
3. Provide technical assistance to develop the financial analysis and management capability of bank professionals locally to assure post-Project sustainability.

The KBF will support USAID/Kosovo’s Strategic Objective 1.3 - Establishment of a Market-Oriented Economic Policy and Institutional Framework. The explicit focus of the program will be on stimulating employment and increasing private investment in the SME sector, thereby supporting the rapid and sustainable recovery of living standards for the Kosovar population.

1.2 Progress Summary

The following points summarize the progress achieved during this period for the American Bank of Kosovo/ Raiffeisen Bank Kosovo in the area of operations and in the SME loan program. Activities for the Kosovo Business Finance Fund are also highlighted below.

American Bank of Kosovo Activities

Board meeting held: On May 7, 2003, the new ABK/RBKO board held their first meeting in Prishtina.

Customer satisfaction surveyed: Based on the results of an assessment designed and administered by a local survey company, it was determined that respondents rated ABK’s services to be ‘Highly Positive’.

Deposits gathered: By May 31, 2003, ABK's deposit level has remained fairly stable at approximately 58 million Euros. However, ABK/RBKO continues to hold strong with the second largest market share for deposits in Kosovo.

ABK name changed: The ceremony to change the name of the American Bank of Kosovo to Raiffeisen Bank Kosovo was held in May. Representatives from USAID, RZB, Deloitte and ABK/RBKO gathered with key clients and the local/international press to officially launch the new name.

Loans approved: During the quarter, the credit committee approved a total of 765 new loans. Since project inception, the credit committee has approved 2,175 loans for a total outstanding portfolio of 29.6 million Euros.

Loans disbursed: A total of 18.02 million Euros has been disbursed to borrowers during the quarter, for a total of 48.7 million Euros disbursed to borrowers since project inception.

Loans in arrears: According to the credit administration team, 4.12% (Euro 1,218,705) of loans were in arrears (more than 30 days past due) on all or a portion of their payments.

Jobs created: KBF project/ABK financing will result in the creation of 5,028 new jobs or one job for every 11,210 Euro of loan volume.

Kosovo Business Finance Fund Activities

KBFF Assets disposed: At the end of the quarter, the local KBFF office closed. It was determined that since the acting KBF project COP, local representative of KBFF, would not be needed in Prishtina on a full time basis, the current assets of KBFF, including furniture and basic office equipment, would be donated to the Alliance of Kosovar Businesses (AKB).

Interest in ABK/RBKO: KBFF submitted notification to RIB detailing the intent to sell the remaining 24% interest in the Bank in May. USAID, RIB, KBFF, Deloitte and ABK/RBKO will continue discussions on the logistics of the sale of shares throughout June.

Delinquent loans pursued: KBFF still maintains ownership of four delinquent loans. Actions have been taken against borrowers in all cases. 3 cases are still pending.

Kosovo Business Finance Project Activities

KBF Project Year 2 ends: In May 2003, the KBF project reached the end of its second year. The project team completed a self-assessment to compare project progress with set benchmarks and targets. It became evident that the team had exceeded performance expectations in several areas.

Long-term staff changes: During the last month of the quarter, the assignments for Arelis Gomez, Credit Administration and Alan Pieper, Chief of Party ended. They both were transitioned off the project. However, Alan will continue to work with USAID and the project team to represent KBFF in the sales negotiations with RZB. Also in May, John Fitzgerald

suffered a mild heart attack and was evacuated for medical attention in Austria. We will continue to monitor the situation and assess when the best date of return would be for John, if given medical clearance.

Short term technical assistance provided: The ABK/RBKO team is using the short-term technical assistance to assist with the Globus operating system. There are currently 48 days of short-term assistance that can be allocated for use by the team to meet the required 11-month commitment stated in the bank sales documents.

Potential change in scope of work: On May 29, project management staff had a conference call with USAID to discuss the future of the KBF project. It was proposed by USAID to change the existing scope of work under the contract. This would encompass a close out of the banking and lending component and focus on development of an Educational Endowment Fund. Further discussions on this proposed scope of work will take place over the next couple of months.

1.3 Outstanding Issues and Concerns

We will continue to work with USAID on a daily basis to inform of important issues, concerns, and/or developments that arise in the course of our work. In addition to updates during the period, there are more general issues and developments that we would like to highlight in this report that may have a bearing on performance and/or give rise to new challenges in the future. These are summarized as follows and explained further in Section 6 of this report.

Deposit Targets: Deposit mobilization is not occurring as rapidly as previously expected because the overall deposits in the banking system in Kosovo are stagnant. All deposit growth requires gaining market share at the expense of competing banks. As a result, ABK's deposit base has steadily expanded, but the result is far less than the project targets.

Demobilization of Expatriates: At the end of May, USAID/Kosovo discussed a potential change in scope for the project. This encompassed demobilizing seven expatriate consultants by July 10, 2003. Deloitte expressed several concerns in being able to complete this task in the stated timeframe.

Potential Claims by RIB: As part of the notification that was given to RIB of KBFF's intent to sell its remaining shares of ABK/RBKO, RIB was given the opportunity to make claims against the purchase price of the shares. Deloitte will work with USAID to investigate and determine the validity of these claims.

2.0 AMERICAN BANK OF KOSOVO/RAIFFEISEN BANK KOSOVO

As part of the Kosovo Business Finance Project, the team was required to establish and effectively manage a full-service bank aimed at mobilizing deposits and providing other financial services throughout Kosovo. Once the bank was established, an additional goal included locating a private investor to take over majority ownership from USAID. On December 10, 2002, the Kosovo Business Finance Fund (KBFF), established by the KBF project, and Raiffeisen

International Beteiligungs AG (RIB) signed the “Sales and Purchase Agreement” whereby RIB purchased 76 percent of the American Bank of Kosovo/Raiffeisen Bank Kosovo’s (ABK/RBKO) capital stock from USAID. USAID, through the KBFF, continued as a 24 percent shareholder. As of May 2003, KBFF has notified RIB of their intent to sell their 24 percent interest, whereby USAID would no longer have involvement in the ABK/RBKO.

2.1 Bank Operations

The mission of the American Bank of Kosovo/Raiffeisen Bank Kosovo’s (ABK/RBKO) is to promote Kosovo’s long-term economic development by profitably providing a full range of needed financial services to small and medium-sized enterprises throughout Kosovo. The team continues to pursue this mission by offering high-quality banking service to all of ABK/RBKO’s business and retail customers. In line with the mission, the main goal of ABK/RBKO is to be Kosovo’s leading full-service commercial bank, managed to international standards and serving all segments of the Kosovo economy.

Including the headquarters branch in Prishtina, the ABK/RBKO now has 17 locations serving the citizens of Kosovo. ABK branches and sub-branches can be found in the following locations:

| | |
|---|---|
| <p>Branches:</p> <ul style="list-style-type: none"> • Prishtina • Ferizaj • Prizren • Mitrovica • Gjilan • Gjakova • Peja | <p>Sub-branches:</p> <ul style="list-style-type: none"> • Shtpce • Zvecan • Kaqanik • Dragash • Malisheva • Vushtri • Kamenica • Gracanica • N. Mitrovica • UNMIK Headquarters |
|---|---|

On May 7, 2003, the Board members of the ABK/RBKO traveled to Kosovo to hold the first meeting of the new members in Prishtina. The meeting coincided with the official ceremony to change the name of the bank to Raiffeisen Bank Kosovo.

This section will provide an overview of the progress made in the management and growth of this bank during the last quarter.

Operating System Improvements

The IT department continues to work to solve Globus related issues and improve communications within Prishtina and the branches. By May, Globus was balancing and was providing the majority of required information and reports. Major loan reconciliation efforts were achieved in the first quarter of this year and are continuing. The two short-term consultants continue to work with the team to make improvements to the operating system.

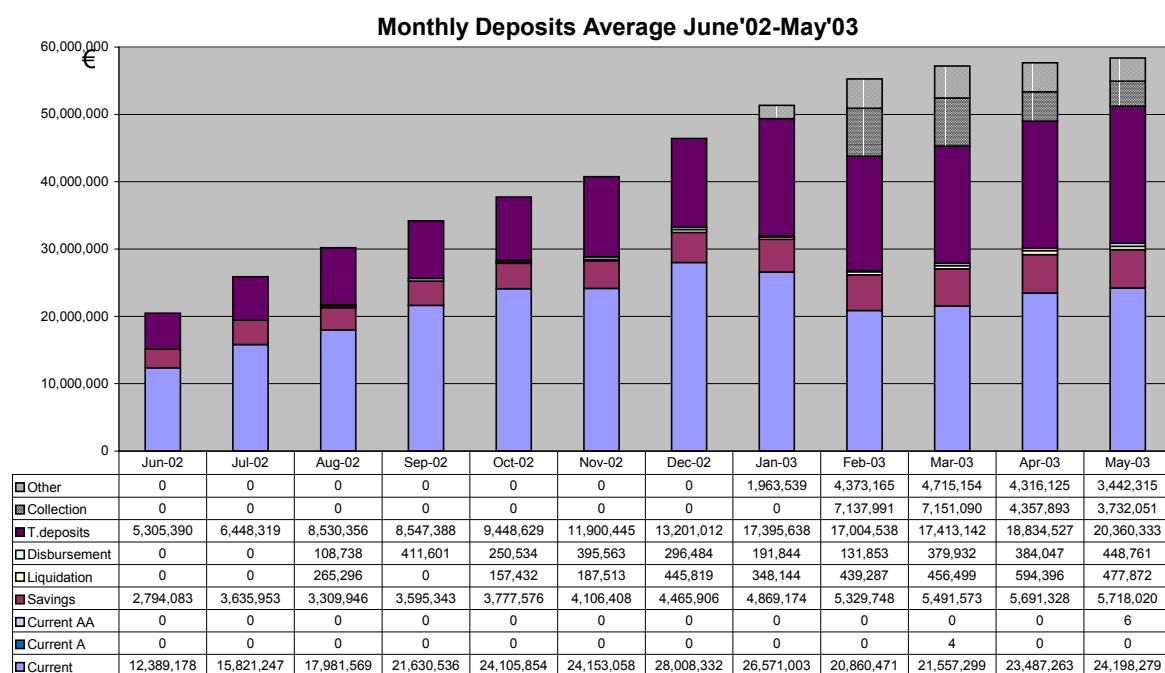
Customer Service

In order to fulfill one of the main goals of the project, the team has focused on improving the customer service levels at all ABK/RBKO branches. Detailed training on position functions and procedures is provided for all job areas in order to ensure that the staff is knowledgeable enough to answer most potential questions posed by ABK customers.

Recently, the business development team worked with a local company in Kosovo to design and administer a second customer service survey that was implemented at all branches. The customer surveys were administered during the month of April and results were tabulated for inclusion in May. Based on the assessment, it was determined that the respondents rated ABK's services to be 'Highly Positive'. In fact, all factors measured by the survey received a rating between 'Superior' and 'Good'.

Level of Deposits

In May, ABK's deposit levels remained fairly constant at approximately 58 million Euros. This could be due to several clients withdrawing funds for projects during the summer months, as deposit levels at all banks tend to decline a bit in the summer months. However, ABK/RBKO still holds its position with the second largest market share in Kosovo and is expected to maintain this position throughout the year. The chart below provides a detailed view of the deposit trends for different products from June 2002 through May 2003.



2.2 Financial Position

There has been much progress made at the ABK/RBKO in the areas of operations and controls. For the first quarter of 2003, the management team was able to reduce expenses by approximately 20%. Additional savings have been found to reduce costs by an additional 10-15%. In May, the ABK/RBKO Board formally approved the additional capital request to support operations. The team will continue its efforts in pursuit of reaching profitability before the end of the year.

PriceWaterhouseCoopers (PwC), Kiev submitted a proposal to perform the March 31 audit for the ABK/RBKO, as required by the sales agreement option for KBFF to divest of its shares to RIB. If approved, PwC can begin the audit on June 16 and will conclude the work and report by mid-to-late July, assuming that it also meets the scheduling needs of the bank.

2.3 Business Development

The ABK/RBKO continues to aggressively pursue deposit and loan growth in the Kosovar market. The team projects a growth in customer deposits to Euro 90 million and a growth in loans to Euro 56 million by the end of the year through a combination of the continued implementation of the SME loan program, initiation of a loan program for the next largest level of companies and also by offering a new range of consumer loans in the retail sector. Due to the involvement of RIB in the ownership structure of the ABK, during the month of May, the team focused on launching a new name, Raiffeisen Bank Kosovo (RBKO), for the bank. Also, during the quarter, the marketing and business development teams in Prishtina have increased to further develop the business in the Prishtina area and to focus as well on larger companies and organizations.

Rebranding ABK

With the sale of the majority of ABK shares to RIB, the name of the bank changed to Raiffeisen Bank Kosovo (RBKO). The rebranding campaign culminated in a formal ceremony held on May 8, 2003 to coincide with the Board Meetings held in Prishtina. A press conference was held along with a reception for RBKO's principal customers, senior locals and international officials and dignitaries. A six-week intensive media campaign was launched to inform the general public and businesses of the bank's new name. As part of this campaign, several new products will also be launched, as discussed in the New Products section below.

New Products

ABK offers a full range of deposit products, money transfer services, pension payments, welfare payments, payroll processing services and a basic cash management system to larger companies that have operations throughout Kosovo. The Bank also has an active SME lending program.

As part of the rebranding campaign, ABK launched several new products, including a basic cash management/payroll system for the largest entities in Kosovo, an own-brand RBKO debit card with an overdraft facility on it for qualified customer employees and several new retail loan

products, including home improvement loans. With the success of the SME loan program during the first two years of the KBF project, the lending team has also developed several new commercial loan products for release in the Kosovar market.

A Product Pricing Committee systematically reviews all ABK financial products to determine whether product prices are competitive in the marketplace and profitable for the bank to offer.

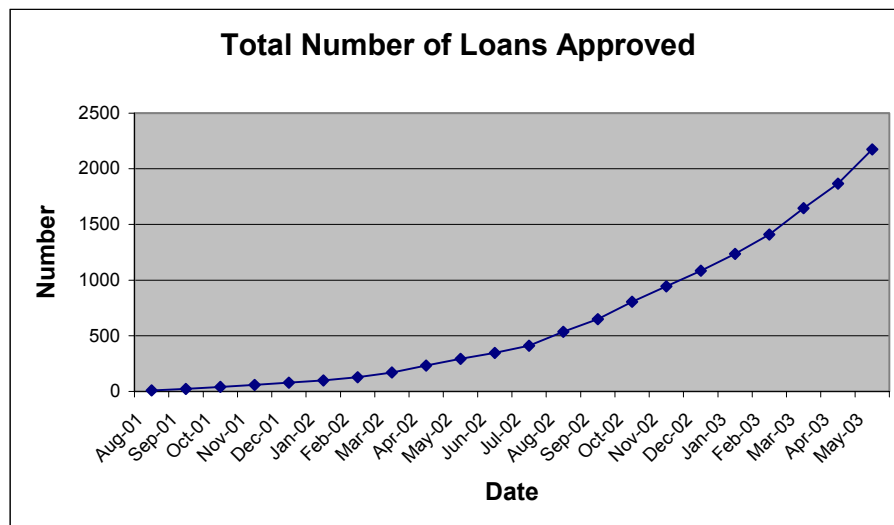
2.4 Lending Activity

During the first two years of the project, the lending team has disbursed over 1,060 loans for a value of over 27 million Euros and surpassed the targets set by USAID for this period. Approximately 46 million Euros has been disbursed to ABK borrowers and further disbursements of approved loans occurred on a daily basis throughout the quarter. According to the Credit Administration Department, as of May 10, 2003, ABK/RBKO held forty three loans that were more than 30 days past due on all or a portion of their payments. These loans represented an arrears rate of 1.38% with a principal outstanding on the loans in arrears totaled at 378,517 Euros.

The team is now focused on pursuit of the aggressive benchmarks that have been set by USAID for Year 3 of the project. This section provides an overview of these and other activities in the lending unit and credit administration department during the quarter from March 1 – May 31, 2003.

Loans

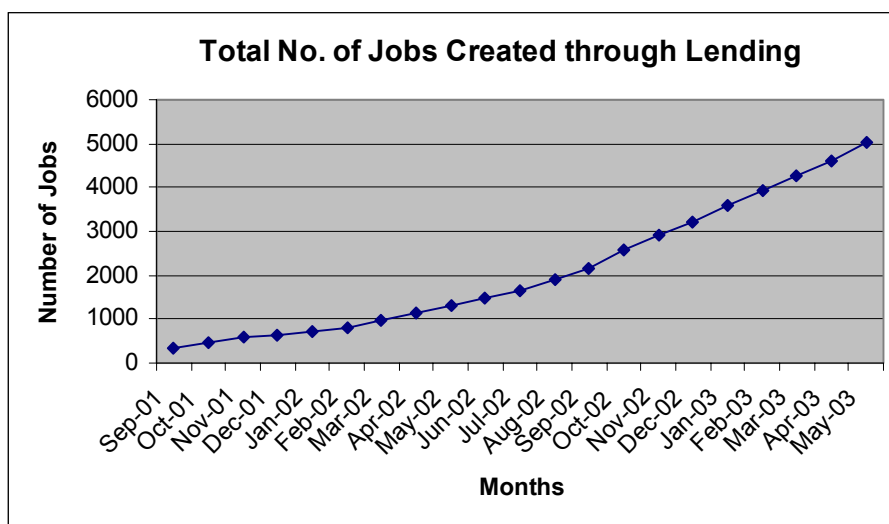
The Lending Unit approved 765 SME loans during the quarter, bringing the project-to-date loan approvals to 2,175 loans for a total outstanding portfolio of 29.6 million Euros. The chart below details the number of loans approved by the credit committee since the KBF project began lending in August 2001.



The average loan size in the KBFF/ABK portfolio is approximately 28,000 Euros for a term of approximately 15 months. The average new loan amount and term are slowly increasing as the team continues to diversify the portfolio.

Employment Generation

As of May 31, 2003, it is estimated through surveys conducted of loan applicants that KBF project/ABK financing will result in the direct creation of 5,028 new jobs or one job for approximately every 11,210 Euro of loan volume. If we use the figure of 5,000 DM (or approximately EURO 2,500), as stated in the RFP, for loans disbursed equates to one new job (as stated in the KBF RFP), then the number of jobs created is 22,456 (56.4 million EURO disbursed as of May 31 divided by 2,500). The chart below shows the number of jobs created in Kosovo through the lending program since the start of the project.



Targeted Lending

In accordance with the Project goals for employment generation and economic stimulation, the lending priority is to finance businesses engaged in labor-intensive manufacturing and production activities. Of the 2,175 loan applications that were approved by the project to date, 54.5% are in the manufacturing/production industry sector, 15.6% are in the service industry sector and 29.9% are engaged in pure trade. A detailed breakdown of the loan portfolio by industry sector is shown below.

Industry Concentration

As of May 31, 2003

| Industry Sector | Amount | | # of loans | |
|------------------------------------|----------------------|--------------|-------------|--------------|
| | | % | | % |
| 1. Manufacturing+Production | 31,894,536.68 | 56.6 | 1180 | 54.6 |
| Manufacturing/ Wood | 5,873,254.19 | 10.4 | 233 | 10.8 |
| Metal Fabrication | 1,467,093.03 | 2.6 | 56 | 2.6 |
| Glass Production | 228,600.00 | 0.4 | 15 | 0.7 |
| Textile/ Aparent | 1,390,233.41 | 2.5 | 69 | 3.2 |
| Printing/paper products | 1,147,122.54 | 2.0 | 39 | 1.8 |
| Hygienic Production | 824,680.87 | 1.5 | 18 | 0.8 |
| Plastics | 1,364,195.99 | 2.4 | 51 | 2.4 |
| Pharmaceuticals | 394,777.51 | 0.7 | 14 | 0.6 |
| Soft Drinks products | 433,867.95 | 0.8 | 17 | 0.8 |
| Food | 5,225,249.96 | 9.3 | 205 | 9.5 |
| Milling Plant | 1,317,266.41 | 2.3 | 32 | 1.5 |
| Construction | 7,648,309.39 | 13.6 | 263 | 12.2 |
| Electrical | 331,532.75 | 0.6 | 8 | 0.4 |
| Farm/Fish, Eggs | 2,369,630.00 | 4.2 | 112 | 5.2 |
| Other | 1,878,722.68 | 3.3 | 48 | 2.2 |
| 2. Trade | 18,568,009.75 | 32.9 | 646 | 29.9 |
| Fertilizer distribution | 260,884.21 | 0.5 | 5 | 0.2 |
| Food distribution | 655,666.27 | 1.2 | 28 | 1.3 |
| Retail | 17,651,459.27 | 31.3 | 613 | 28.3 |
| 3. Services | 5,695,733.58 | 10.5 | 337 | 15.6 |
| Hotel/Restaurants | 2,192,587.94 | 3.9 | 130 | 6.0 |
| Professional services | 3,703,145.64 | 6.6 | 207 | 9.6 |
| Total | 56,358,280.01 | 100.0 | 2163 | 100.0 |

The lending team focuses on visiting clients within Prishtina as well as throughout all of Kosovo, including the Serbian enclaves. Of the 2,175 loans approved, 16.9% are to borrowers within the Prishtina municipality, 13.6% in Prizren, 8.0% in Ferizaj and 4.3% in Mitrovica municipality. The following chart shows a detailed breakdown of the geographic concentration for all loan clients throughout Kosovo.

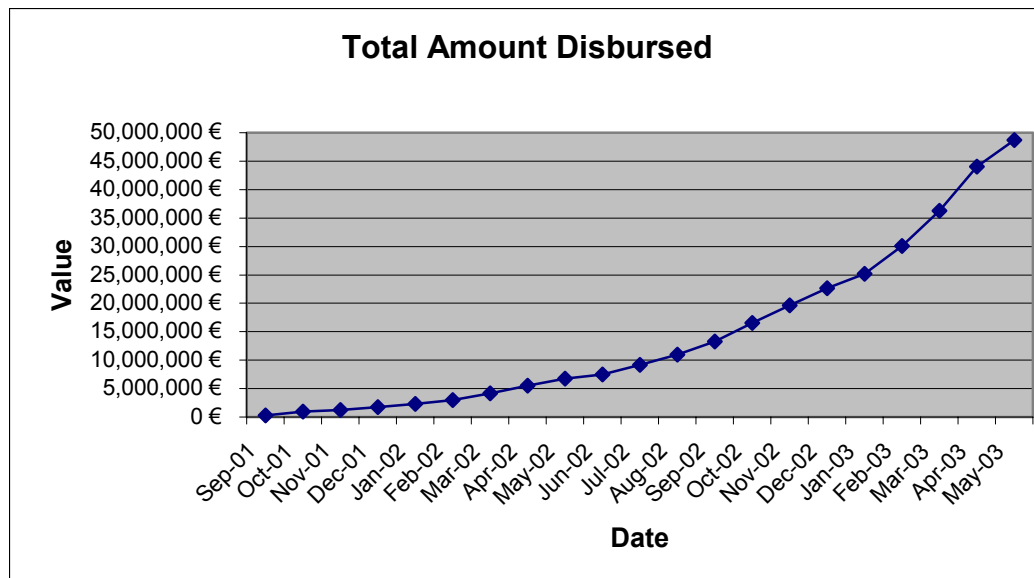
Geographic Concentration

As of May 31, 2003

| Municipality | Amount | | # of loans | |
|--------------|----------------------|--------------|--------------|--------------|
| | | % | | % |
| Decan | 498,080.99 | 0.9 | 28 | 1.3 |
| Dragash | 62,500.00 | 0.1 | 4 | 0.2 |
| Drenas | 679,364.59 | 1.2 | 36 | 1.7 |
| Ferizaj | 4,918,571.83 | 8.7 | 173 | 8.0 |
| Fushe Kosove | 600,413.79 | 1.1 | 23 | 1.1 |
| Gjakove | 3,667,048.11 | 6.5 | 207 | 9.6 |
| Gjilan | 6,174,510.05 | 11.0 | 200 | 9.2 |
| Istog | 1,085,022.53 | 1.9 | 50 | 2.3 |
| Kacanik | 493,400.00 | 0.9 | 15 | 0.7 |
| Klina | 256,550.00 | 0.5 | 16 | 0.7 |
| Kamenice | 762,400.00 | 1.4 | 39 | 1.8 |
| Leposaviq | 265,414.00 | 0.5 | 30 | 1.4 |
| Lipjan | 1,121,032.54 | 2.0 | 37 | 1.7 |
| Malisheve | 617,022.63 | 1.1 | 27 | 1.2 |
| Mitrovica | 1,406,943.55 | 2.5 | 92 | 4.3 |
| Peje | 5,041,626.95 | 8.9 | 224 | 10.4 |
| Podujeve | 802,462.88 | 1.4 | 36 | 1.7 |
| Prishtine | 15,700,187.63 | 27.9 | 366 | 16.9 |
| Prizren | 7,781,034.70 | 13.8 | 295 | 13.6 |
| Rahovec | 602,625.84 | 1.1 | 31 | 1.4 |
| Shtime | 427,784.21 | 0.8 | 9 | 0.4 |
| Skenderaj | 193,448.13 | 0.3 | 15 | 0.7 |
| Strpce | 268,610.00 | 0.5 | 26 | 1.2 |
| Suhareke | 813,450.84 | 1.4 | 33 | 1.5 |
| Viti | 702,495.00 | 1.2 | 32 | 1.5 |
| Vushtri | 461,195.22 | 0.8 | 28 | 1.3 |
| Zvecan | 790,504.00 | 1.4 | 74 | 3.4 |
| Zubin Potok | 164,580.00 | 0.3 | 17 | 0.8 |
| Total | 56,358,280.01 | 100.0 | 2,163 | 100.0 |

2.5 Disbursements

As noted in the following chart, a total of 48.7 million Euros has been disbursed to ABK/RBKO borrowers since the beginning of the KBF project, with further disbursements of approved loans occurring on a daily basis. During the quarter, the team disbursed a total of 18.02 million Euros.



In May, it was realized that the ABK had made a loan to Reshati Impex, which was outside of ABK's lending policy and in violation of USAID lending policies and ADS 3.12.5.4e. The loan was approved in mid February and disbursed March 17, 2003. Of the loan amount of Euro 153 000, only 40% was to be used for the purchase of alcohol products. This amount represents less than 0.24% of our outstanding portfolio as of March 31, 2003.

The CEO of ABK/RBKO confirmed that he and all members of the credit committee – loan officers, Senior Credit Manager, and Credit Administration Specialist -- were aware of the bank's and USAID's lending policies. The approval and disbursement of the Reshati Impex loan appeared to be a result of miscommunication and misunderstanding that loans outside of USAID goals and policies could be approved. As a result, the following actions were taken to rectify the situation:

- Raiffeisenzentral Bank transferred funds to purchase the Reshati Impex loan on May 16, 2003, which effectively took it off the books of Raiffeisen Bank Kosovo.
- All members of the credit committee and credit administration read the ABK (now RBKO) credit policy manual and sign that they know and understand the policy.

- An internal audit of all files approved since January 1, 2003 was issued to ensure that they meet ABK/USAID lending criteria in terms of their activities and the uses of the funds. As there are around 1000 files, this was not complete until the end of May 2003.

The CEO has committed to reviewing the current management and structure of lending and credit administration in order to ensure that files are complete and properly kept and maintained. Bank internal audits did reveal deficiencies, and as of March 2003 the Credit Administration department had not remedied all of these deficiencies. This task has been re-delegated and is under the direct supervision of the CEO. Significant improvements are expected by June. Already additional care is being taken to ensure that all file cabinets are locked and keys are kept secure.

2.6 Portfolio Performance

As of May 31, 2003, the total principal in arrears, over 30 days past due, for the ABK/RBKO portfolio was at 4.12% of the outstanding portfolio (Euro 29.6 million), for an estimated value of Euro 1.2 million.

The estimated value of collateral that was pledged and filed on the loans in arrears is 4-to-18 times greater than the loan amount. Therefore, the loans appear to be adequately secured. However, the security position is only valuable to the extent that the Municipal Courts recognize contractual rights to acquire the property through foreclosure actions. The attitude of the courts differs by municipality, with some courts being very understanding of the KBF project/ABK contractual rights and others appearing to be obstructionary.

2.7 Staff Development and Training

It is the goal of the project to develop Kosovar citizens into credit and banking professionals that can assume the roles of Loan Officers, Credit Managers and Branch Supervisors within the organization. Job training occurs each workday in all departments since the employees continue to work directly with senior management in the activities related to their specific tasks. In the lending unit, lending associates work with their respective Loan Officer/Senior Manager on originating, disbursing, and monitoring SME loans. The following trainings took place during the quarter.

KOSOVO BUSINESS FINANCE FUND

Training Schedule Report
As of May 31, 2003

| TITLE | DESCRIPTION |
|--|--|
| Small and Micro Lending Techniques | Short course to ABK management on how small and micro lending techniques could be utilized in the ABK lending process; |
| Lending Processes | Approach and format for completing the Loan Recommendation form and other loan file documents. |
| Trade Finance Products For Lending Associate | Deposit Accounts; Transfers; Other financial services; ABK marketing; Comparative advantages of ABK products and services over those of competitors. |

3.0 KOSOVO BUSINESS FINANCE FUND

The Kosovo Business Finance Fund (KBFF) was established under USAID funding as a non-profit organization to aide in the reconstruction and economic development in Kosovo by encouraging lending activities, particularly to borrowers that are small or medium size business. In November 2001, the KBFF, along with RIAS, established the American Bank of Kosovo to further its lending objectives. By December 2002, the KBFF, and Raiffeisen International Beteiligungs AG (RIB) signed the “Sales and Purchase Agreement” whereby RIB purchased 76 percent of the American Bank of Kosovo’s (ABK/RBKO) capital stock. USAID, through the KBFF, is currently a 24 percent shareholder of ABK/RBKO.

3.1 Interest in ABK/RBKO

In its current role, KBFF serves as the representative of USAID to ensure that the goals of the KBF project are met through the lending activities conducted at the American Bank of Kosovo. As the structure and demands of the ABK/RBKO have changed since the closing of the sale of shares to RIB, USAID determined that it might be best for KBFF to become involved in other initiatives. Therefore, in May, KBFF submitted notification to RIB detailing the intent to sell its 24% interest in the ABK/RBKO. A draft term sheet was prepared by RIB to initiate discussions. USAID, RIB, KBFF, Deloitte and ABK/RBKO will continue discussions on the logistics of the sale of shares throughout June.

3.2 Indemnity Account

As part of the efforts to integrate the KBFF lending activities into the ABK to create a fully functioning bank, most of the loans initially granted through the KBFF were transferred over to the ABK. After the sale of shares to RIB, an indemnity fund of USD 1 million was created to cover the existing ABK loan portfolio for any loan losses over 0.75% per annum.

3.3 Portfolio

KBFF continues to own and manage four of the five seriously delinquent loan accounts. During the month of March, KBFF liquidated the real estate property acquired in the Dardan Commerce settlement for a price of 62,000 euros. The sales proceeds from the property sale exceed the outstanding debt owed by Dardan Commerce by 14,500 euro. KBFF has won court rulings to liquidate pledged real estate in two of these cases (Gryka e Llapushnikut and Egzoni) and is aggressively pursuing collection actions on the other two (Bibi Commerce and Dafina).

On April 30th, in the District Court of Prishtina, the Judge convicted Mr. Berisha (BiBi Commerce borrower) of presenting fraudulent documents to KBFF and sentenced Mr. Berisha to 4 years in prison and that he repay the original loan amount of 51,000 euro to KBFF. Obviously, the 51,000 will not be repaid anytime soon since Mr. Berisha is in prison. However, winning this case is worth a lot more than the direct monetary results because of the message that it sends to all other borrowers. This one case will produce immeasurable beneficial results in maintaining the quality of the loan portfolio.

As noted, cases have been settled in court on two of the loans clients and action is continued on the remaining three in attempts to reach a settlement. Discussions have begun to take place to determine who would be the best person to represent KBFF in pursuit of legal closure on these cases. It was proposed by Alan Pieper to have Lirije Osaj, currently acting legal council at ABK/RBKO, continue to manage these loans, as she is intimately familiar with the files, has the required Albanian and English language skills, and knows the relevant banking and legal terminology. Further discussions will take place in June.

4.0 PROJECT MANAGEMENT

Project management staff continued to support the Kosovo Business Finance project from Washington DC and in Kosovo, as needed. Veronica Gilbert traveled to Kosovo for the week of May 5th in order to provide assistance and project management support to the team. Her specific focus on this trip was to attend the re-branding ceremonies of the ABK, attend the first meeting of the new ABK shareholders, meet with the KBF team and USAID to review goals and targets for Year 3, and assist with the transition of the COP to a short term advisory role.

The following is a summary of some of the major project management issues that were addressed during the quarter. In the upcoming periods, the project management team will continue to work with USAID, RZB and the project team to address issues and provide the short-term technical assistance needs for the project.

4.1 Progress Against Project Benchmarks

The evaluation period for Year 2 of the KBF project ended on May 10, 2003. An evaluation report highlighting project performance against set targets and objectives was assembled and submitted to USAID by May 30. The chart below provides a brief overview of the report on the team's progress in relation to the targets and benchmarks as stated in Modification 10 in December 2002.

| Criteria | Summary Self-Assessment |
|---|---|
| A. Cost Management Cost management, use of funds, quality of reporting, problems and trends identified, responsiveness to cost control measures | A. Cost Management Project spending has been maintained below projections for the second year of the project, signifying that total costs have remained within budget. |
| B. Organization and Management Proactive management to identify and anticipate problems; organized and detailed analysis of issues; solutions implemented with no impact to estimated cost and schedule. Organizational structure provides for personnel to achieve program goals ahead of schedule and within estimated cost. Lines of communication are well defined, clearly understood, and always facilitate rapid exchanges of information. | B. Organization and Management The team attempts to proactively address and anticipated issues and problems. The organizations under the KBF project have maintained a relatively flexible structure in order to adapt to evolving needs and goals. Innovative solutions are explored and applied in order to best address issues. The project management staff has been willing to perform beyond expectations in order to guarantee the success of the project. |
| C. Loan Disbursements and Deposits <ul style="list-style-type: none"> • Volume of Loans Disbursed – 500 Loans disbursed • Value of Loans Disbursed – Euro 24,480,000 or ABK to have 2nd largest market share in Kosovo in loans outstanding, whichever is higher • Delinquent Loan Rate – 3% of loans 60 days or more past due and/or classified by examiners as substandard | C. Loan Disbursements and Deposits <ul style="list-style-type: none"> • Volume of Loans Disbursed – Over 1060 Loans disbursed during the period • Value of Loans Disbursed – Euro 27 million disbursed to ABK/RBKO borrowers • Delinquent Loan Rate – Of the outstanding portfolio, 1.4% of loans, by value, are 30 days or more past due |

| | |
|--|--|
| <ul style="list-style-type: none"> • Value of Deposit Mobilized – Euro 150,000,000 or ABK to have 2nd largest market share in Kosovo in deposits, whichever is higher | <ul style="list-style-type: none"> • Value of Deposit Mobilized –ABK has the 2nd largest market share in Kosovo, with approximately 60 million Euro held in deposits |
| <p>D. Expansion, Service Quality and Risk Management of the Bank</p> <ul style="list-style-type: none"> • Branch and Service Expansion – A minimum of one additional branch established (7 total); Diversified lending services commenced • Customer Service – Independent customer survey rates ABK customer service ‘superior’ • Internal Efficiency – 75% of viable loan applications taken to credit committee within 3 weeks; 25% of viable loan applications taken to credit committee within 10 days • Risk Management and Sustainability – Independent assessment rates ABK risk management and other banking systems as ‘superior’ | <p>D. Expansion, Service Quality and Risk Management of the Bank</p> <ul style="list-style-type: none"> • Branch and Service Expansion – Currently ABK has 7 branches and 10 sub-branches, including locations in the Serb enclaves. ABK is the second largest bank in Kosovo, by level of deposits. • Customer Service – An independent survey rated the customer service level at the bank as ‘Highly Positive’. • Internal Efficiency – 75% of all viable loan applications are taken to credit committee within 3 weeks; 25% of all viable loan applications are taken to credit committee within 10 days. • Risk Management and Sustainability – A qualified audit statement from the BPK for the Period ending December 31, 2002 rated the condition of the bank as “satisfactory”, demonstrating adequate internal controls. There were no major issues highlighted in the report. |

The following chart provides a comparison of the team’s progress on the benchmarks and targets as stated in the project contract. As is evident, the team has greatly surpassed the initial agreed upon objectives.

| Within 720 Days | | |
|------------------------|--|--|
| 1 | <i>620 loans booked</i> | <ul style="list-style-type: none"> • Over 2,000 loans approved by the credit committee |
| 2 | <i>46,500,000 DM disbursed (includes reflows – estimated loan life is one year)</i> | <ul style="list-style-type: none"> • 27,000,000 Euros disbursed |
| 3 | <i>9,300 jobs created</i> | <ul style="list-style-type: none"> • Approximately 20,000 new jobs created (as measured by the method stated in the RFP) |
| 4 | <i>49,000,000 DM in deposits gathered</i> | <ul style="list-style-type: none"> • Over 60,000,000 Euros in deposits gathered |
| 5 | <i>Loan window operation fully integrated into the operation of the commercial banking partner institution</i> | <ul style="list-style-type: none"> • Loan window fully integrated into the operations of the commercial bank in March, 2002 |

4.2 Staffing

During the month of May, the assignments for two long-term consultants, Arelis Gomez, Credit Administration and Alan Pieper, Chief of Party, ended. They both were transitioned off of the project and their responsibilities were passed on to others who had worked closely with them. One of the local Credit Administrators was promoted to take over for Ms. Gomez as the head of the credit administration department at the bank.

The Chief of Party responsibilities for the KBF project were transferred to Veronica Gilbert, who also became the acting representative of KBFF for administrative matters. Mr. Pieper will continue to work with USAID and the project team to represent KBFF, and USAID's interests, through the negotiations with RZB for the sale of the remaining shares in the ABK/RBKO.

Also in May, John Fitzgerald suffered a mild heart attack and was evacuated to Austria for medical attention. Once his condition has stabilized, he will return to the United States for a follow up visit with his own doctors. Since it was a mild attack, it is expected that John should be able to return to Prishtina at some point. We will continue to monitor the situation and assess when the best date of return would be for John, if given medical clearance.

In March, Greg Olson was appointed Mitrovica Area Branch Manager, with responsibility for North and South Mitrovica, Vustri, and Zvecan. Primarily responsibilities are to build a proper and appropriate organizational structure, develop the business, and identify and train a local successor.

Short term Assistance

As part of the Sales documents for the transfer of shares to RZB, USAID, through the KBF project, had included the long-term expatriate time for key management positions in the bank plus an additional 11 months (238 days) of short-term technical assistance. This short-term assistance included under the project is to be utilized by ABK in the most appropriate means necessary, as determined by the management staff, RZB and USAID. During the month of May, Roy Landon and Moses Ssebuliba continued to assist the team with the Globus operating system. There are approximately 48 days of short-term technical assistance remaining to be allocated in the contract.

4.3 Budget

A budgeting system has been developed that will track the budget across various cost categories for the project. In the table below, the actual expenses incurred to date are outlined. According to the chart detailing a comparison of actual costs to the budget for Year 3 of the project, it appears that, for the first month of Year 3, through May 31, 2003, the burn rate is at approximately 4.5% of budgeted costs.

| | <i>Est. Actuals</i> | | <i>Estimated</i> | | |
|-------------------------------------|---------------------------------|---------------------------|------------------------|--|------------------|
| | <i>YEAR 2 (5/05/02-5/03/03)</i> | <i>May (through 5/31)</i> | <i>Cumulative</i> | | <i>Burn Rate</i> |
| | | | <i>Amount - Year 3</i> | | |
| Salaries | \$ 987,014.73 | \$ 66,220.00 | \$ 66,220.00 | | 5.5% |
| Fringe | \$ 111,536.28 | \$ 8,097.86 | \$ 8,097.86 | | 6.5% |
| Overhead | \$ 832,375.75 | \$ 56,295.32 | \$ 56,295.32 | | 5.6% |
| Travel | \$ 112,302.16 | \$ 2,773.53 | \$ 2,773.53 | | 1.4% |
| Allowances | \$ 567,137.35 | \$ 44,574.18 | \$ 44,574.18 | | 6.5% |
| Other Direct Costs | \$ 675,007.45 | \$ 3,484.94 | \$ 3,484.94 | | 0.5% |
| Subcontractors | \$ 990,519.95 | \$ 70,235.33 | \$ 70,235.33 | | 6.0% |
| General & Administration | \$ 342,065.38 | \$ 20,134.49 | \$ 20,134.49 | | 5.0% |
| Base Fee | \$ 92,357.64 | \$ 5,436.31 | \$ 5,436.31 | | 2.9% |
| Totals | \$ 4,710,316.69 | \$ 277,251.97 | \$ 277,251.97 | | 4.9% |
| Award Fee | \$ 166,390.00 | | | | 0.0% |
| Total Value for Clin 1 | \$ 4,876,706.69 | | \$ 277,251.97 | | 4.5% |

The following chart presents a projection of project costs as compared to the Year 3 budget for the project. As is noted, through June 28, 2003, the burn rate is at approximately 14% of budgeted costs for Year 3, which is slightly below original projections, indicating a cost savings.

Estimated Kosovo Business Finance TA (CLIN 1)

| | <i>Year 3</i> | | | <i>Estimated</i> | |
|-------------------------------------|-------------------------------------|---------------------------|----------------------------|------------------------|--|
| | <i>Budget (5/10/2003-5/10/2004)</i> | <i>May (through 5/31)</i> | <i>June (through 6/28)</i> | <i>Cumulative</i> | |
| | | | | <i>Amount - Year 3</i> | |
| Salaries | \$ 1,052,657.03 | \$ 66,220.00 | \$ 80,000.00 | \$ 146,220.00 12.1% | |
| Fringe | \$ 95,673.98 | \$ 8,097.86 | \$ 10,000.00 | \$ 18,097.86 14.6% | |
| Overhead | \$ 871,290.12 | \$ 56,295.32 | \$ 67,500.00 | \$ 123,795.32 12.3% | |
| Travel | \$ 290,411.03 | \$ 2,773.53 | \$ 2,000.00 | \$ 4,773.53 2.5% | |
| Allowances | \$ 636,464.67 | \$ 44,574.18 | \$ 35,000.00 | \$ 79,574.18 11.6% | |
| Other Direct Costs | \$ 369,854.82 | \$ 3,484.94 | \$ 5,000.00 | \$ 8,484.94 1.3% | |
| Subcontractors | \$ (383,326.32) | \$ 70,235.33 | \$ - | \$ 70,235.33 6.0% | |
| General & Administration | \$ 230,509.14 | \$ 20,134.49 | \$ 15,960.00 | \$ 36,094.49 8.9% | |
| Base Fee | \$ 62,238.50 | \$ 5,436.31 | \$ 4,309.20 | \$ 9,745.51 5.3% | |
| Totals | \$ 3,225,772.97 | \$ 277,251.97 | \$ 219,769.20 | \$ 497,021.17 8.8% | |
| Award Fee | \$ 500,616.00 | | \$ 357,846.00 | \$ 357,846.00 | |
| Total Value for Clin 1 | \$ 3,726,388.97 | | | \$ 854,867.17 14.0% | |

Short term Technical Assistance

The team has allocated 190 of the 238 days of short-term technical assistance agreed to in the sales documents for RZB. For the remaining of the contract, the team has a total of 48 days of short-term technical assistance, which can be used throughout the contract. The following chart shows the burn rate to date of short-term technical assistance. Any budgeted STTA forecasted and not used during Year 2 of the project was carried over to Year 3.

Short-term Technical Assistance Use
(As of May 31, 2003)
Time Used (Days)

| Name | Allocated | Feb-03 | Mar-03 | Apr-03 | May-03 | Total | Remaining | Burn rate |
|-----------------------------------|------------|-----------|-------------|-------------|-----------|-----------|------------|------------|
| Amtec Consulting (R. Landon) | 124 | 15 | 21 | 19 | 16 | 71 | 53 | 57% |
| Bishop & Cavanaugh (M. Ssebuliba) | 66 | 0 | 4.5 | 25.5 | 20 | 50 | 16 | 76% |
| TBD | 48 | 0 | 0 | 0 | 0 | 0 | 48 | 0% |
| Total | 238 | 15 | 25.5 | 44.5 | 36 | 85 | 153 | 36% |

Obligated Funding

With regards to obligated funds for the KBF project, as discussed with USAID during the budget modification period, Deloitte expended the initial total amount obligated for CLIN 1 by December 2002. In coordination with USAID, Deloitte set up a system to have the proceeds from the sale of ABK shares cover any project related costs, until more funds are obligated by USAID. The burn rate for this period in relation to the total contract budget is highlighted below.

| | RE-ALIGNED Total Contract Value (Yr 1 - Yr 3) As per Mod #9 8/15/02* | EXPENDITURES Total Expended Year 1, 2 and 3 (thru 5/31/03) | Burn Rate | OBLIGATED** Total Obligated (thru 5/31/03) | Burn Rate | CONTRACT Total Remaining (thru 5/10/04) |
|---------------|---|---|-----------|--|-----------|---|
| CLIN 1 | \$ 12,859,173.00 | \$ 9,097,657.99 | 71% | \$ 7,269,310.00 | 104% | \$ 3,761,515.01 |
| CLIN 2 | \$ 12,060,887.00 | \$ 5,000,000.00 | 41% | \$ 5,000,000.00 | 100% | \$ 7,060,887.00 |
| CLIN 3 | \$ 4,098,690.00 | \$ 4,098,690.00 | 100% | \$ 4,098,690.00 | 100% | \$ - |
| | \$ 29,018,750.00 | \$ 18,196,347.99 | 63% | \$ 16,368,000.00 | 111% | \$ 10,822,402.01 |

*Listed CLIN 1 total does NOT include award fee not obtained in prior award fee periods

**This amount includes only funds obligated from USAID and does not include any funds from the proceeds of the sale of ABK shares. Per agreement with USAID Budapest, approved project costs after all obligated funds are expended will be paid using the sales proceeds, until additional project funds are obligated to CLIN 1.

Total Estimated Costs Paid through Bank Sales Proceeds (11/17/02 - 3/8/03) \$ 1,551,096.02

The amount charged to the bank sales proceeds for the periods from November 17 through March 8, 2003 is also listed above. As is noted in the chart, costs incurred under the project have slightly exceeded the currently obligated amount. Therefore, we would need USAID to obligate more funds to the project before the next invoice is issued in June 2003.

4.4 Contract Administration

During the month of March, contact modification number 11 was issued to name the key personnel on the KBF project. Included in this list were:

- Chief of Party, Alan Pieper (through May 2003)
- Phil Jones, Senior Credit Manager
- Gary Moinette, Loan Officer
- Greg Olson, Loan Officer
- Steve Grunerud, Chief Executive Officer
- Adriaan Van Zyl, Chief Financial Officer
- John Fitzgerald, Branch/Business Development
- Ilse Schuster, MIS Specialist
- Arelis Gomez, Chief Credit Administration Officer (this project is funded as part of the contract through May 2003; thereafter it reverts to the bank)

During the month of April, Contact Modification Number 12 was issued to obligate additional funds to the project. It increased the total obligated amount by \$600,000 to \$16,368,000. No contract modifications were issued in May.

4.5 Proposed Revision to Scope of Work

On May 29, 2003, project management staff had a conference call with USAID to discuss the future of the KBF project. It was proposed by USAID to change the scope of work under the contract to encompass an Educational Endowment Fund to send Kosovars to the US to study. This would involve closing out the banking and lending component and focusing on the development of this Fund. The reasons given for changing the scope were so that USAID could try to mitigate risk, maintain value under the contract, and minimize the management requirements for the project, as it was intensive for the amount of shares owned by KBFF.

With this change in scope, USAID would no longer fund the salaries of the 7 expatriate staff currently working at the ABK. These individuals would need to be transferred off the project and onto the RZB payroll. It was mentioned by USAID that July 10th would be an ideal date for the demobilization of all staff. However, project management expressed concerns that this might be too quick and would not allow time to work through all of the issues properly. Further discussions on the timing of demobilization and implementation of this proposed scope of work will take place over the next couple of months.

5.0 OUTSTANDING ISSUES AND CONCERNS

We will continue to work with USAID on a daily basis to inform of important issues, concerns, and/or developments that arise in the course of our work. In addition to updates during the period, there are more general issues and developments that we would like to highlight in this report that may have a bearing on performance and/or give rise to new challenges in the future. Below is a short discussion of some of the major issues and concerns during the quarter.

Deposit Targets: Deposit mobilization is not occurring as rapidly as previously expected because the overall deposits in the banking system in Kosovo are stagnant. All deposit growth requires gaining market share at the expense of competing banks. This is a difficult task but one that the ABK has confronted with incentive programs for new accounts, waiver of in-coming transfer fees, reimbursement to customers of other banks' transfer charges to an ABK account, a fast track program for large business customers and offering individualized product and services for very-large high potential clients. As a result, ABK's deposit base has steadily expanded and market share has grown faster than any other bank in Kosovo. However, the result is far less than the project targets.

Demobilization of Expatriates: At the end of May, USAID/Kosovo discussed a potential change in scope for the project. This encompassed demobilizing seven expatriate consultants to close out the banking and lending function of the project. USAID had discussed a target date of July 10, 2003. However, Deloitte has expressed several concerns in being able to complete this task in the stated timeframe since there are many logistics and uncertainties that must be addressed/clarified before final discussions can take place with the consultants on demobilization. Deloitte and USAID will continue to work together through June to arrive at an acceptable resolution on this issue.

Potential Claims by RIB: As part of the notification that was given to RIB of KBFF's intent to sell its remaining shares of ABK/RBKO, RIB was given the opportunity to make claims against the purchase price of the shares. Therefore, it may be possible that this will happen. Deloitte will work with USAID to investigate and determine the validity of these claims.

6.0 WORK PLAN FOR NEXT QUARTER

The following section provides a brief overview of the areas of focus for the KBF project team during the following quarter (June 1 – August 31, 2003).

Manage the ABK branches: The ABK management team will continue to oversee the branch network to ensure smooth operations. .

Continue emphasis on the ABK/RBKO marketing program: The New Business Development manager and all bank employees will continue to work towards increasing the level of deposits at ABK.

Continue internal improvements: Efforts for this month will be placed on providing additional training to expand knowledge of products and expected teller and customer services.

Continue Globus modifications: Short-term experts continue to work towards fixing any outstanding problems or issues with the system.

Participation in PwC audit: The Bank staff will host the PwC auditors and will be available to answer any questions or issues that arise.

Negotiations with RIB on the sale: A draft terms sheet was issued at the end of May. USAID, KBFF and RIB will work to solidify the terms.

Investigation of any claims made by RIB: If any claims are made against KBFF by RIB, the team will investigate and try to resolve these issues.

Continued management of the KBFF loans: KBFF will continue to pursue closure of the three remaining outstanding loans still under their ownership.

Demobilization of expatriate staff: Deloitte will work closely with USAID to ensure that this is done in the best way possible.

Evaluation and comment on the new scope of work proposed under the project: The home office project team will review and comment on the new scope of work being proposed under the project.