

CENTRAL AMERICAN MICROENTERPRISE RECOVERY PROGRAM

(TC-98-11-01-9-RG)

EXECUTIVE SUMMARY

EXECUTING AGENCY: Inter-American Development Bank

BENEFICIARIES: Microentrepreneurs in the areas affected by Hurricane Mitch

OBJECTIVES: The objectives of this program are to: (i) help microenterprises in the areas affected by Hurricane Mitch to recover, and (ii) strengthen, operationally and financially, the intermediary financial institutions (IFIs) operating in the region (paragraph 2.1)

COST:

Reimbursable component (Facility IIIB)	US\$10,000,000
Nonreimbursable component (Facility IIIA)	US\$ 2,000,000
Technical assistance (Facility IIIA)	US\$ 475,000
Administration (Facility IIIA)	<u>US\$ 425,000</u>
Total	US\$12,900,000

TERMS: The program's execution period will be one year and six months, and its disbursement period two years (paragraph 2.3).

EXCEPTIONS TO BANK POLICY: The Bank will contract directly the consultants needed for the technical assistance component (paragraphs 2.7 and 2.14), while the Country Offices will contract staff directly for the temporary coordination units. The financial intermediaries will not be required to follow the established procedures for procurement of goods and services, although they will be required to show *a posteriori* that procurement was based on efficiency considerations.

SPECIAL TERMS AND CONDITIONS: The total amount loaned to an IFI is not to exceed the equivalent of US\$500,000 (paragraph 2.9).

The loans will be disbursed in two tranches. The first, for up to 50% of the loan amount, will be made at the time of the signing of the loan agreement. The second will be for 50%, and will be made once

evidence has been presented to the Bank's satisfaction showing how the first tranche was used and the progress made toward accomplishment of the goals of the project being financed (paragraph 2.25).

Inasmuch as this is an emergency operation, a bridge loan of up to US\$50,000 is suggested for those MFIs that have already done business with the Bank and were affected by the hurricane (paragraphs 2.26, 2.27 and 2.28).

Based on the findings of the demand study and the evaluations of individual applications, the Bank will be able to make adjustments in the operation that ensure that its objectives are fully achieved. It could even establish different financial terms and conditions for each MFI (paragraph 2.29).

The Donors Committee is delegating authority to approve individual operations to the Bank's Management (paragraph 5.1).

CENTRAL AMERICAN MICROENTERPRISE RECOVERY PROGRAM

I. FRAME OF REFERENCE

- 1.1 In early November of this year, Hurricane Mitch devastated large areas of Central America. As the hurricane passed, the flooding was extensive, causing loss of human life and destroying crops, the means of production and basic infrastructure.
- 1.2 The areas hardest hit were those where micro- and small enterprise is most developed. The principal source of financing for those who own these businesses are intermediary financial institutions (IFIs), which perform an essential function in Central America in generating income, jobs and production.
- 1.3 Nevertheless, the resources of these institutions and, by extension, their chances of achieving greater financial deepening, depend on the quality of and turnover in their loan portfolios. Because the hurricane destroyed the region's productive infrastructure, the IFIs are bound to see increased delinquency in their loan portfolio, which will affect their own earnings and those of their customers; because credit will be tight, IFI customers will be less able to continue to carry out income-producing projects.
- 1.4 Initial estimates indicate that within the affected area there are both well established IFIs and others in development, as well as extensive networks of credit unions. Taken together, the IFIs in the area have over US\$100 million in productive assets and around 250,000 customers, although this figure does not include all members of the extensive network of credit unions in the area.
- 1.5 Given the flexibility of the MIF's instruments for assisting the growth of micro- and small enterprise, a financial strengthening program is needed in the affected area to enable the IFIs to remain in business. This will ensure service to microentrepreneurs affected by the hurricane, and the survival of the microlending industry, which has made significant headway and become reasonably well established in Central America in the last 10 years.

II. THE PROGRAM

A. Objectives

- 2.1 The objectives of this program are to: (i) help microenterprises in the areas affected by Hurricane Mitch to recover, and (ii) strengthen, financially and operationally, IFIs operating in the region.

B. Description of the program

- 2.2 Under this microenterprise recovery program, loans will be granted to microenterprises through financial intermediaries, and the IFIs' infrastructure will be restored. The program, for a total of US\$12.9 million, comprises the following components: (i) a reimbursable component for the equivalent of US\$10 million in local currency (Facility IIIB); (ii) a nonreimbursable component in local currency for US\$2 million (Facility IIIA); (iii) a technical assistance component for US\$475,000 (Facility IIIA) and (iv) administration for US\$425,000 (Facility IIIA).
- 2.3 The program's execution period will be one year and six months from the date of its approval; its disbursement period will be two years. If at the end of the execution period there are resources that have not been committed, that balance will be cancelled.
- 2.4 At least 80% of the program resources that the IFIs onlend will be within the affected area; the remaining 20% may be used to give loans to microentrepreneurs outside the emergency area whose businesses were affected by Hurricane Mitch.
- 2.5 The **reimbursable component** will finance new loans needed to reactivate productive activity by microentrepreneurs in the affected area.
- 2.6 The resources from the **non-reimbursable component** will be used to rebuild the IFIs' basic infrastructure destroyed by the hurricane, such as physical premises, data systems and operations-related vehicles.
- 2.7 The resources provided for the **technical assistance component** will finance the Bank's contracting of specialized personnel to perform, among other activities, the following: (i) a study of demand and survey of credit needs within the affected area; (ii) preparation of IFI selection criteria; (iii) preparation of applications to request support; (iv) support to the IFIs with preparation and justification of their proposals; (v) technical support to the program's executing agency; (vi) random supervision of the IFIs' selection and approval process; and (vii) evaluation of the program's performance. The itemized budget appears in Annex I.
- 2.8 The cost of the **administration of the program** is estimated at US\$425,000. These resources will finance the cost of creating and operating, for 18 months, the temporary coordination units, one in each country affected, based in the Bank's Country Offices. Each unit, depending on the country's needs, will have up to two professionals specialized in credit analysis and knowledgeable in microfinance. Each unit will also have the administrative staff needed for the secretarial and logistical work, who will be hired by the Country Offices with assistance from SDS/MIC.

C. Terms governing loans and subloans

- 2.9 The IFIs that qualify based on the eligibility criteria mentioned in paragraphs 2.31 and 2.32 will have access to program resources in two forms: (i) a loan of up to US\$500,000, coupled with nonreimbursable resources for up to 20% of the loan amount; or (ii) loans without the nonreimbursable component for those IFIs that did not sustain any infrastructure losses. In no event shall resources be approved solely on a non-reimbursable basis. The lending will be governed by the credit regulations that appear in Annex II.
- 2.10 The loans to IFIs will be for up to 10 years, with a grace period of up to 5 years. The interest rate will be equivalent to the rate of inflation, as determined by the Central Bank, for the 12 months prior to signing of the loan agreement. This rate will remain fixed for the life of the loan, although it may be reviewed should the inflation rate change significantly.
- 2.11 For their part, the IFIs that receive program resources are to onlend to microentrepreneurs on the terms prevailing on the local market for commercial lending.
- 2.12 The profits and earnings that the IFIs show as a result of the program's support are to be reinvested into the microenterprise sector's loan portfolio and used to capitalize the IFIs.

D. Program execution

1. The Bank's responsibility

- 2.13 As this is an emergency program, it is suggested that execution be decentralized to ensure a rapid approval and disbursement. To that end, authorization is being requested to allow the Country Offices to approve the individual operations. At headquarters, the unit with basic responsibility will be SDS/MIC, and technical support will be provided so that the program is carried out properly.
- 2.14 Under the technical assistance component (paragraph 2.7), SDS/MIC will be in charge of (i) hiring the consultants to survey the situation of the IFIs and of the microentrepreneurs in the disaster area and from there estimate the magnitude of the demand; (ii) developing the selection criteria for IFIs to receive the credit; (iii) preparing the model of the credit and infrastructure support application; and (iv) supporting the Country Offices during the contracting of the consultants that will provide technical support to the temporary coordination units.
- 2.15 Those consultants will assist the IFIs with preparation of plans of action for rebuilding the productive activities and with preparation of the credit application. As the monitoring of the IFIs' portfolios will continue for 18 months, it will not only help

the IFIs with execution of the plans of action they are to submit as a condition precedent to disbursement (paragraph 2.23), but will also support the Bank's Country Offices as well.

- 2.16 The Bank will contract directly the consultants needed to perform the technical assistance component (paragraphs 2.7 and 2.15). The Country Offices will directly hire the staff of the temporary coordination units. The financial intermediaries will not be required to adhere to the procedures for procurement of goods and services, although they will have to show, *a posteriori*, that procurement was based on considerations of efficiency.

2. Temporary coordination units

- 2.17 For execution purposes, two temporary coordination units will be formed in Central America: one in Nicaragua and the other in Honduras. In addition to fulfilling the general terms of the program's operation, they will: (i) evaluate the IFIs' applications; (ii) evaluate an IFI's chances of recovery; (iii) monitor to make certain that the loans approved are for those IFIs that were truly affected by the hurricane; (iv) after examining the applications, submit them to the Bank's Country Office for approval; (v) supervise the disbursement process, and (vi) coordinate with other donors that are providing resources to help these areas recover.
- 2.18 The staff of the temporary coordination units will travel to the interior of the countries affected to assist the IFIs and verify program execution in the field.

3. The Bank's Country Offices

- 2.19 The Country Offices will be assisted by the temporary coordination units, which will be in charge of (i) evaluating credit applications; (ii) issuing opinions thereon, and (iii) controlling the disbursements process.
- 2.20 The Bank's Representative in each country will either approve or deny the applications, making certain that they meet the program's eligibility criteria and objectives.
- 2.21 The Country Office will be in charge of loan portfolio recovery.

4. Formalization of a lending operation and disbursements

- 2.22 The IFIs will submit the credit application, properly filled out and accompanied by the following documents: (i) each institution's

plan of action, describing its financial and institutional circumstances and the mechanisms planned to maintain a healthy flow of resources to the microenterprises and appropriate recoveries; (ii) an audited portfolio report demonstrating the portfolio affected by the hurricane, and (iii) price quotations on the infrastructure works and equipment needed to rescue the institution.

- 2.23 If, after examining the application, the Bank's opinion is a favorable one, its Legal Department will draw up the loan agreement and the disbursement process will commence.
- 2.24 The loans will be disbursed in two tranches: the first, representing 50% of the loan, will be made when the loan contract is signed; the second will be made once the IFI has remitted to the Bank a report describing how the funds from the first tranche were used and the progress made toward accomplishment of the goals of the project submitted.
- 2.25 As this is an emergency operation, however, and IFIs need liquid resources to serve their clients, the possibility of a three-month bridge loan is being considered for those institutions affected by the hurricane and that were or are presently executing Bank programs and have met all the goals and requirements of those operations and meet the eligibility criteria indicated in paragraph 2.30 and sections (a) and (c) of paragraph 2.31. This bridge loan, which may not exceed US\$50,000, will be given when a tentative agreement is signed. That agreement will then be subsumed into the definitive loan contract under the credit application submitted.
- 2.26 If by the end of those three months the IFI has not submitted a formal credit application, it shall immediately repay the bridge loan in full, plus any interest owed since the time of its disbursement.
- 2.27 When an IFI has received a bridge loan of the type described in paragraph 2.26, the amount advanced under the bridge loan is to be deducted from the initial 50% disbursement and the bridge- loan contract is to be rescinded.
- 2.28 Based on the findings of the demand study and the evaluation of individual applications, the Bank may make adjustments to the individual operations to ensure that the objectives are fully accomplished. Different terms and conditions may even be set for a given IFI, depending on its financial position and, in particular, that of its customers.
- 2.29 Targets for program execution are summarized below: (i) during the month of December, the Bank will convene a program planning meeting, to be held in one of the affected countries and attended by members of the MIF and each of the Bank's Country Offices;

(ii) in December, a consultant will be contracted to compile information on the extent of the damage to the IFIs and their customers; (iii) the staff of the temporary coordination units will be hired in February at the latest; and (iv) using the three-month bridge-loan mechanism, expectations are that disbursements will begin in the month of January.

E. Eligibility requirements for IFIs

- 2.30 For purposes of this program, IFIs are considered to be private institutions, regulated or unregulated, that have at least 50% of their active portfolio in the microenterprise sector.
- 2.31 The only eligible IFIs will be those with a demonstrated portfolio of active loans within the areas affected by Hurricane Mitch that: (a) had a portfolio delinquency rate of less than 7.5% prior to the disaster, calculated as principal balances with installments in arrears as a percentage of the total portfolio; (b) have a substantiated proposal; (c) have a portfolio of active loans in the affected areas; (d) submit financial statements with a clear breakdown of their lending portfolio so as to determine the impact of the loans granted in the affected areas on their financial statements; and (e) submit a client recovery plan while sustaining a financial and institutional presence in the area.

III. RISKS

- 3.1 The chief risk involved in this operation is that the IFIs may not have sufficient administrative and financial capacity to handle the larger sums and that they may not have the response capability to properly address demand in the affected area. To mitigate this risk, there will be temporary coordination units and technical support financed with resources from the administration and technical assistance components.
- 3.2 Another potential risk is that IFIs will use the funds for purposes other than those intended, thereby taking advantage of the relatively low interest rate. This risk will be minimized through the plans of action, the random evaluations and tight supervision of the program.

IV. EVALUATION AND MONITORING

- 4.1 The program's operation will be monitored according to the terms and conditions established for each IFI. At headquarters, program execution will be the responsibility of the SDS/MIC; in the

eligible countries, that responsibility will rest with the Country Offices.

- 4.2 Every six months, Management will prepare progress reports on the program, measuring the extent to which the objectives have been accomplished and the funds invested, to keep the Donors Committee informed.
- 4.3 Six months into the program, a midterm evaluation will be done to evaluate the scope of the program as of that date. Based on the findings, the Bank may make any adjustments needed to ensure that the program's objectives are achieved.
- 4.4 A final evaluation will be done of the program at the end of the execution period, in other words, one year and six months after the program's start.

V. SPECIAL CONDITIONS

- 5.1 The Donors Committee will delegate authority to Management for approval of individual applications.
- 5.2 Based on the evaluations' findings, Management may introduce changes needed in the operation to ensure that the program's objectives are accomplished.
- 5.3 The Bank's Representatives in the eligible countries will be authorized to approve the credit applications.

Technical Assistance Budget

Item	Estimated time	Value
Demand study and evaluation of losses	1.5 months	US\$15,000
Preparation of IFI selection criteria	1.0 months	US\$10,000
Preparation of loan application forms	1.0 months	US\$10,000
Support to IFIs in presentation of proposals	12 months	US\$125,000
Technical support to the Bank's Country Offices	12 months	US\$100,000
Monitoring and random evaluations, and midterm and final evaluations	18 months	US\$200,000
Contingencies		<u>US\$15,000</u>
Total		US\$475,000

CREDIT REGULATIONS

A. Conditions for second-tier lending (from the MIF to the IFI)

1. **Objectives:** The objectives of this program shall be: (i) to help microenterprises in the areas affected by Hurricane Mitch recover, and (ii) to financially and operationally strengthen the IFIs operating in the region.
2. **Credit recipients:** The credit recipients of this program shall be private institutions, regulated or unregulated, that have at least 50% of their portfolio of active loans within the microenterprise sector and that were affected by Hurricane Mitch.
3. **Amount:** The total amount loaned to an IFI shall not exceed the equivalent of US\$500,000. The IFI is to onlend these funds to microentrepreneurs affected by Hurricane Mitch. Nonreimbursable resources may also be provided, but only to those institutions that have requested a loan for onlending to microentrepreneurs. The nonreimbursable funding shall not exceed 20% of the amount of the loan.
4. **Terms:** The amortization period shall be up to ten years, plus a grace period of up to five years.
5. **Cost:** The interest rate on the loans shall be the local inflation rate determined by the Central Bank for the 12-month period prior to the signing of the loan contract.
6. **Installments:** The loans shall be repaid in equal installments payable every six months.
7. **Eligibility:** IFIs (a) must have had under 7.5% delinquency in their portfolios prior to the disaster, figured as principal balances with installments in arrears as a percentage of the total portfolio; (b) must submit a substantiated proposal within the established time period; (c) must have a discounted portfolio in the affected areas; (d) must submit financial statements with a clear breakdown of the loans in their portfolio, such that a determination can be made of the impact the discounted portfolio in the affected areas will have on their financial statements; and (e) must submit a plan to help their customers recover, while at the same time remaining a financial and institutional presence in the region.
8. **Credit analysis and approval:** All credit applications shall be analyzed by the temporary coordination units and approved by the Country Office.

B. Conditions for first-tier lending (from the MIF to the microentrepreneur)

1. **Objectives:** The objective of this program is to provide loans and thus keep up the flow of funds that microentrepreneurs affected by Hurricane Mitch require.
2. **Credit recipients:** The credit recipients of this program shall be mainly microentrepreneurs in the disaster area, although credits may also be awarded to microentrepreneurs outside the area whose businesses were affected by the hurricane.
3. **Amount:** The IFIs shall determine the amount of the loan, based on their own rules and lending technology.
4. **Terms:** The IFIs will determine the repayment and grace periods, based on their own rules and lending technology.
5. **Cost:** The interest rate and terms of the loans shall be those in effect on the local market for commercial lending.
6. **Installments:** The IFIs will determine how frequently the repayment installments are to be made based on their own rules.
7. **Analysis and approval of the credits:** The IFIs shall review all credit applications.

PROPOSED RESOLUTION

REGIONAL PROGRAM FOR THE RECOVERY OF MICROENTERPRISES
IN CENTRAL AMERICA

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. To approve the Donors Memorandum, Document MIF-_____, for the establishment of a Program for the Recovery of Microenterprises in Central America, hereinafter “the Program”, with the purpose of contributing to the recovery of microenterprises in the areas affected by Hurricane Mitch, and to financially and operationally strengthen the financial intermediary entities that operate in the region.
2. To authorize upper limits of the equivalent of five hundred thousand United States of America dollars (US\$500,000) for loans under the Program, and technical cooperation grants in conjunction with such loans of up to twenty (20) percent of the amount of each loan.
3. To authorize the President of the Inter-American Development Bank, or whoever he designates, to approve loan and related technical cooperation grants under the Program, up to the limits established for such operations pursuant to paragraph 2 above, and to sign all contracts necessary to carry out such operations.
4. To authorize the President of the Bank, or whoever he designates, to establish limits in amortization periods for loan operations under the Program of up to ten (10) years, with grace periods of up to five (5) years. Interest on the loans under the Program shall be determined by the Management of the Bank in accordance with Document MIF-_____, paragraph 2.10.
5. That up to the amount of twelve million nine hundred thousand dollars (US\$12,900,000), or the equivalent in other convertible currencies, shall be authorized for the Program, as follows: up to the amount of ten million dollars (US\$10,000,000) for loans, chargeable to the Small Enterprise Investment Fund; and up to the amount of two million nine hundred thousand dollars (US\$2,900,000) for technical cooperation grants, chargeable to the technical cooperation resources of the Small Enterprise Development Facility.