This brief is one in a series of five MBP Technical Briefs focused on MFI response to rapid-onset natural disasters. These briefs discuss the potential interventions and actions that MFIs could undertake in the aftermath of a disaster, based on the experiences of MFIs from Hurricane Mitch and the Bangladesh flood of 1998.

New Loans after a Natural Disaster[1]

WHY DO MICROFINANCE INSTITUTIONS MAKE NEW LOANS AFTER A NATURAL DISASTER?

Immediately after natural disasters, many microfinance institutions (MFIs) make emergency loans to help clients buy food, clean water, or medicine. Later, in the reconstruction phase, MFIs may provide housing or asset replacement loans to put clients back on their pre-disaster footing.

TO WHOM SHOULD AN MFI MAKE NEW LOANS?

After a natural disaster, the best policy for an MFI to follow is to make new loans only to clients in good standing. In the case of small emergency loans, this policy may be stretched to include the MFI's entire clientele. For larger reconstruction loans, MFIs may limit loans not only to those in good standing but also to those carrying less than a certain threshold of debt.

In deciding whether to extend emergency loans, MFIs also should consider whether clients will be better served by new loans (which will place them further in debt), by rescheduling their current loan payments, by gaining access to compulsory savings accounts, or some combination thereof. (For more information, see Brief No. 1: "Loan Rescheduling after a Natural Disaster," and Brief No. 3: "Using Compulsory Savings for Natural Disaster Response"). For those households hit hardest, non-financial emergency services may be a better choice than an emergency loan (see Brief No. 4: "Non-Financial Emergency Services to MFI Clients").

WHAT ARE POST-DISASTER LOANS INTENDED TO DO AND WHAT ARE THEIR TERMS?

Emergency loans provide small sums of money sufficient to buy food, clean water, and medicine. In some cases, they are large enough to replace basic household assets, make modest home repairs, or repay debts incurred during the emergency (to buy food or medicine). These loans are most useful if available immediately after a disaster strikes. Emergency loans have a short repayment duration, often one month or shorter. Most MFIs provide these loans without interest or at a subsidized rate. These loans are offered by both large and small MFIs. Across the board, MFIs report near 100 percent repayment rates for emergency loans.

Asset replacement and housing loans are medium-term loans made for the purpose of replacing or repairing physical assets of the household and business. Intended uses include replacing lost equipment needed for income-generation activities, ranging from cooking utensils to sewing machines, and rebuilding damaged homes and business premises. The objective of these loans is to help the household reconstruct livelihoods and businesses to return to their pre-disaster state. These loans generally bear terms of at least one year and have standard interest rates.

As with emergency loans, timing of asset replacement loans is critical. First, they are more effective if given after the emergency stage is over and reconstruction has commenced. Indeed, housing and asset replacement loans given immediately after a disaster appear to have lower repayment rates than those made six months after the disaster. In any case, these loans should not be made available until MFI staff can make assessments of the damages and the credit standing of the clients.

Protecting Against Default: Grameen Bank's Housing and Asset Replacement Loans

For asset replacement loans, Grameen Bank's policy is to extend loans only to members who have a few installments left in their current loan. Members who have paid more than half of their loans are eligible to borrow up to the amount repaid at regular terms and conditions. Housing loan terms are similar. But for long-term clients who have not taken a housing loan before, loan size is only half of that made to long-term clients who have previously acquired a housing loan.

(Source: Barua, Dipal C., "The Grameen Strategy to Combat the Flood of 1998," prepared for the 1998 SEEP Network Annual Meeting, Washington, D.C.)

Because asset replacement and housing loans require significant liquidity on the part of the MFI, they are typically provided only by larger MFIs.[2] Not only do the terms and conditions of these loans require that the MFI have cash on hand, but poor repayment rates create a new drain on MFI resources.[3] MFIs should expect that three or four consecutive new loans would be required in order to generate enough income to completely service asset replacement and housing loans. At least one large MFI in Bangladesh has stopped offering these loans because of their high maintenance and delinquency costs. These loans create an administrative burden on MFIs as well: those MFIs specializing in group-based, short-term loans must update their financial technology and skills to manage these medium-term, individual loan products.

MFI COMMENTS ON POST-DISASTER LOANS

Some MFIs in Bangladesh argue that the best loan product for disaster recovery is the standard microfinance short-term working capital loan. Their rationale is that since many of the individuals hardest hit by a disaster have lost their former livelihoods, they would need working capital to begin a new business rather than an asset replacement loan. Other MFIs argue that there is a need for asset replacement loans, but that if the scale of the need is insufficient, it is not in the MFI's interest to develop a special product. For example, a stronger case can be made for a new product if 10,000 clients need housing reconstruction loans than if only 30 clients are affected.

ENDNOTES

[1] This document draws on information presented in two MBP papers, "Microfinance in the Wake of Natural Disasters: Challenges and Opportunities," by Geetha Nagarajan, 1998, and "Bangladeshi Experience in Adapting Financial Services to Cope with Floods: Implications for the Microfinance Industry," by Warren Brown and Geetha Nagarajan, 2000 (both available at www.mip.org/pubs/mbp-def.htm, under "Managing Risk").

[2] Only 15 percent of small MFIs in Bangladesh offered these products after the 1998 flood.

[3] For example, in response to the floods from 1991 through 1994, the Bangladesh Rural Advancement Committee (BRAC) made housing loans to flood victims amounting to US$650,000. It recorded 59 percent repayment within 30 days past due; 14 percent of the loans were eventually considered unrecoverable. (Source: "Post-Cyclone Rehabilitation and Development Program: August 1991 to December 1994," BRAC, May 1995.)