

Housing Policy and Finance in Panama: The Role of the Private Finance Sector¹

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1. CENTRO BANCARIO INTERNACIONAL (CBI)

1.1 Composition

The *Centro Bancario Internacional (CBI) de Panamá* [Panamanian International Banking Centre] is composed of various banks, differentiated by the type of licence that they possess, which indicates the kind of operations that they are authorised, or not authorised, to perform. There are three types of licence: a general licence to carry out business at a local and international level; an international licence for only international business; and a representation licence which permits only the offering of client support services.

The *Sistema Bancario Nacional (SBN)* [National Banking System] is different from the *Centro Bancario Internacional*. Only those banks holding a general licence from the SBN, that is to say, those banks in conditions to conduct local banking and/or international banking business.

Currently, the *Centro Bancario Internacional* is formed by 80 banking institutions consisting of 45 banks with a general licence, 29 with an international licence and six banks with a representation licence. Of the 45 with a general licence, only 29 banks participate in the local market, of which 17 are private, Panamanian banking institutions, two are official institutions (*Caja*

de Ahorros and *Banco Hipotecario Nacional*), and 10 are private, foreign institutions, which participate significantly, in one way or another, in local business.

The *Centro Bancario* in Panama is an international centre. Of the total banks, 25 have their parent bank in Panama, and of these 19 are Panamanian and the other six are constituted or created in Panama, 18 banks originating from South America, 14 from Europe, six from North America, seven from Asia and 10 from Central America and the Caribbean.

1.2 Evolution of the CBI

Figure 1 shows the evolution of the *Centro Bancario Internacional de Panamá* since it began operating in 1970, under the auspices of Decree No. 232 in July of that year, which promoted Panama as an International Financial Centre. The CBI grew enormously, in terms of volume of assets and also in the number of participants, in the decade of the Seventies. At the beginning of the Eighties, when the first crisis associated with external debt occurred, total assets fell; and towards the end of the Eighties, with the political crisis that affected Panama, confidence was lost in the country's political institutions, producing a reduction in CBI's assets once again; nevertheless, once this problem was resolved assets increased once more. In

spite of the Asiatic crisis in the Nineties, tremendous stability was observed in total asset growth. It should be noted that both total internal deposits and internal loans in the system have maintained sustained growth throughout the years.

Table 1 shows the market share of private banking in the Panamanian financial market. In 1990, official banks represented 22% of private investors' local deposits; foreign banks accounted for 38%; and private Panamanian banks almost 40%. By March, 2003, foreign banks only held 24% of these deposits, and Panamanian banks increased by almost 40% to 65%. With respect to loans one may see that in 1990 foreign banks represented 52% of all loans, and private, Panamanian banks some 36%. Currently, foreign banks represent 34% and Panamanian banks 51%; growth in the market share of official banks may also be observed.

1.3 Characteristics of the CBI

Below, the characteristics which allow an International Financial Centre to exist in Panama are explained. Perhaps the principal characteristic is monetary stability due to the use of the dollar. Panama has been using the dollar for 100 years now and, for macroeconomic ends, this is a system which is completely integrated with the North American system – a central bank

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GRAPH 1
Evolution of the International Banking System and National Banking System of Panama

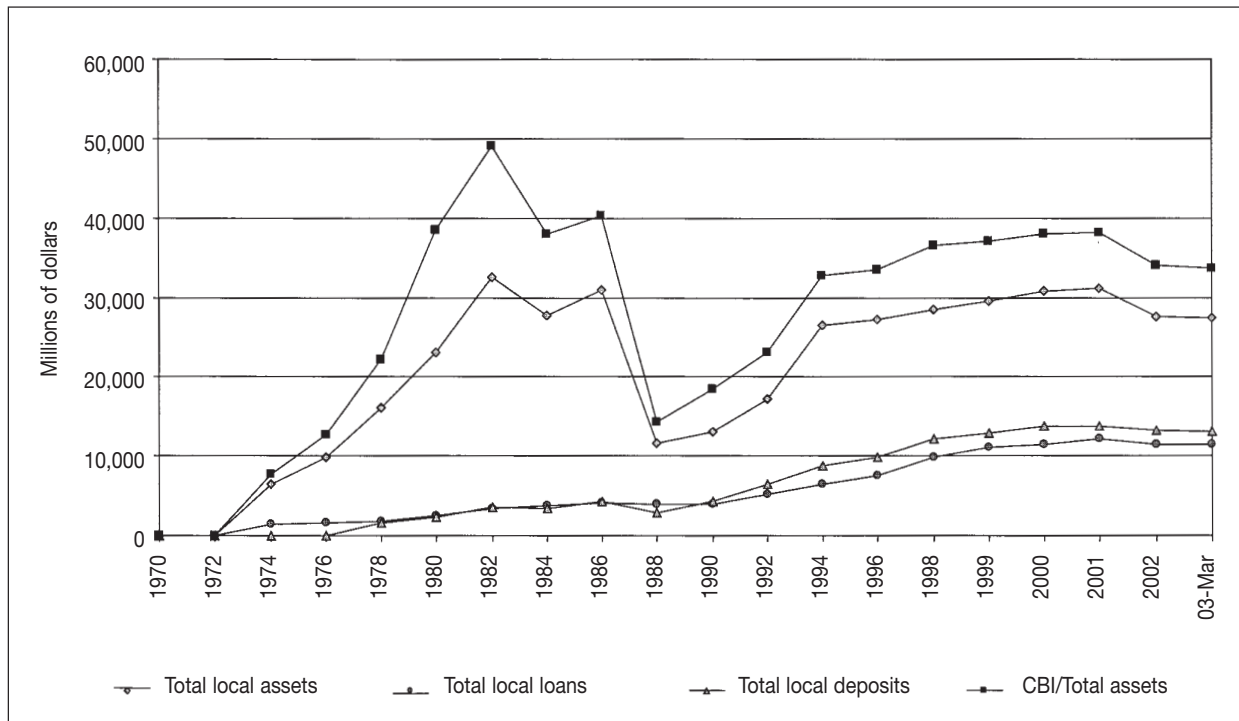
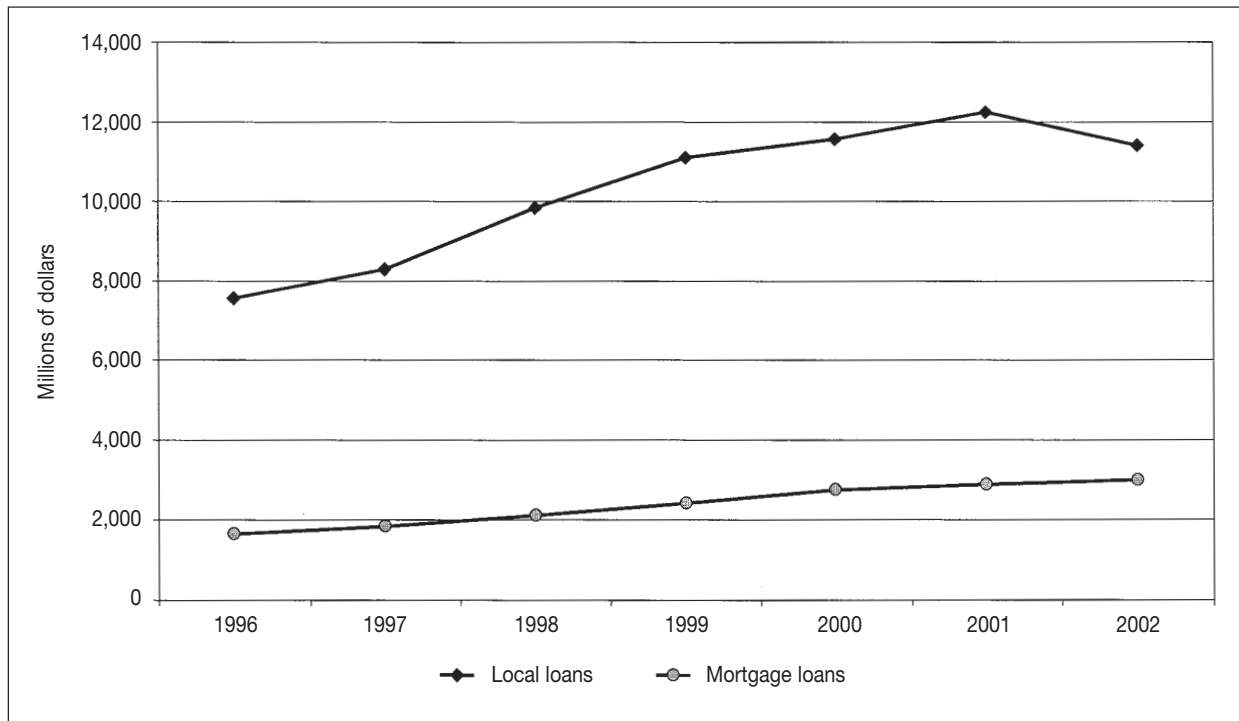


TABLE 1
Participation of Private Banks in Panama's Banking Market
(in millions of dollars)

	December 1990		December 2001		March 2003	
	\$	%	\$	%	\$	%
DEPOSITS						
Official Banks	562	22.07	1,046	10.58	1,072	11.02
Foreign Banks	987	38.77	2,335	23.62	2,341	24.06
Private Banks of Panama	997	39.06	5,505	68.80	6,318	64.93
National Banking System	2,546	100.00	9,887	100.00	9,731	100.00
LOANS						
Official Banks	324	12.26	1,331	11.48	1,759	14.58
Foreign Banks	1,365	51.65	4,437	38.27	3,660	33.80
Private Banks of Panama	954	36.10	5,827	50.25	5,589	51.62
National Banking System	2,643	100.00	11,595	100.00	10,824	100.00

GRAPH 2
Growth of Mortgage Loans in the National Bank System of Panama



never having existed – which has brought about low levels of inflation as a direct consequence and important stability in the price of assets; even in moments of crisis towards the end of the Eighties, the price of banking assets did not lose as much value as in other countries.

Another characteristic is the free movement of capital, which constitutes a competitive advantage. Moreover, the *CBI* is a centre that counts on the physical presence of banks: unlike any other centre, in Panama there are more than US \$400 million invested by the banks in physical assets, which generates more than 12,000 jobs, with wages accounting for more than US \$165 million, and banking activities contributing to about 10% of the gross internal product of the country.

Another important characteristic is that the *CBI* is a very well regulated financial system. The new banking law of 1997 incorporated

the complete supervision of operations; the *CBI* thus adheres to the international standards of the *Comité de Basilea* [Basel Committee], covering the regulation of related parties, corporative government, risk classification and reserves. This means that the functional transparency of the *CBI* has improved with time.

The presence of international banking in Panama has been a key factor in allowing this country to currently count upon a first class international banking centre, and sound, competitive, private, Panamanian banking. The presence of foreign banking in Panama has resulted in the following advantages: (a) complete financial integration, that is, Panama is directly connected to the capital market through the banking institutions; (b) sharing of knowledge, products, technology and, above all, professional training; and (c) open and competitive banking from the outset.

2. MORTGAGE FINANCING IN PANAMA

2.1 Evolution of mortgage credit and participating agents

Figure 2 shows the growing evolution of internal credit until 2001, when a slight fall occurred. As for mortgage credit, this experienced sustained growth throughout all these years. Even more significantly, the fall in the level of internal credit that occurred in the years 2001 and 2002, did not occur in mortgage credit; on the contrary, it continued to increase with relative health and stability.

Table 2 presents the relation between banks that participate in mortgage financing in Panama. These institutions control 99% of all residential mortgage credits in Panama – more than US \$2,400 million; however, the first seven banks alone represent 87% of the market, amongst which figure the two

TABLE 2
Mortgage Loans in the National Banking System of Panama: Banks
(in millions of dollars)

	31st of December, 2002		31st of March, 2003	
	US\$	%	US\$	%
Banco General, S.A,	532,825	21.9	544,911	21.6
Primer Banco del Istmo, S.A.	389,963	16.1	426,094	16.9
Caja de Ahorros	334,565	13.8	338,013	13.4
HSBC Bank, Plc.	297,260	12.2	324,905	12.9
Banco Nacional de Panamá	282,454	11.6	304,270	12.1
Banco Continental de Panamá, S.A.	170,959	7.0	177,895	7.0
Citibank, N.A.	79,910	3.3	77,127	3.1
Banco Panameño de la Vivienda, S.A.	65,899	2.7	69,380	2.7
Banco Bilbao Vizcaya Argentaria	95,724	3.9	64,189	2.5
BankBoston, N.A.	58,122	2.4	57,975	2.3
The Bank of Nova Scotia	48,259	2.0	52,427	2.9
Banco Atlántico, S.A.	32,053	1.3	32,515	1.3
Credicorp Bank, S.A.	11,631	0.5	12,467	0.5
Global Bank Corporation	11,541	0.5	7,827	0.3
Total	2,411,165	99.2	2,490,085	99.2
National Banking System	2,429	100.0	2,524,006	100.0

official Panamanian banks – the *Caja de Ahorros* and the *Banco Nacional de Panamá*, two foreign banks - *HSBC Bank Plc.* and *Citibank, N.A.*, and three Panamanian banks - *Banco General S.A.*, *Primer Banco del Istmo*, and *Banco Continental de Panamá, S.A.* A significant number of foreign banks participate in one way or another in diverse mortgage credit financing areas. Therefore, there exist an important number of financial institutions that participate in housing finance in Panama.

2.2 Key factors for the development of the mortgage market

The key factors for development in the residential mortgage market are as follows: (a) active participation by the international banks and the development of strong, local banking; (b) relatively stable macroeconomic conditions; (c) competitive finance conditions; (d) a reliable judicial system; (e) a direct debit system for monthly payments – which consists of the following: that the

moment a person receives a bank loan, they sign an authorization note so that their monthly loan fee may be directly deducted from their salary, thus allowing the bank to collect from the company payroll, this being a relatively simple operation and permitting the banks to collect on the loans with great ease; (f) an extensive client base and price sustainability; (g) acceptable non-performing loan levels; and (h) the existence of special product support programs.

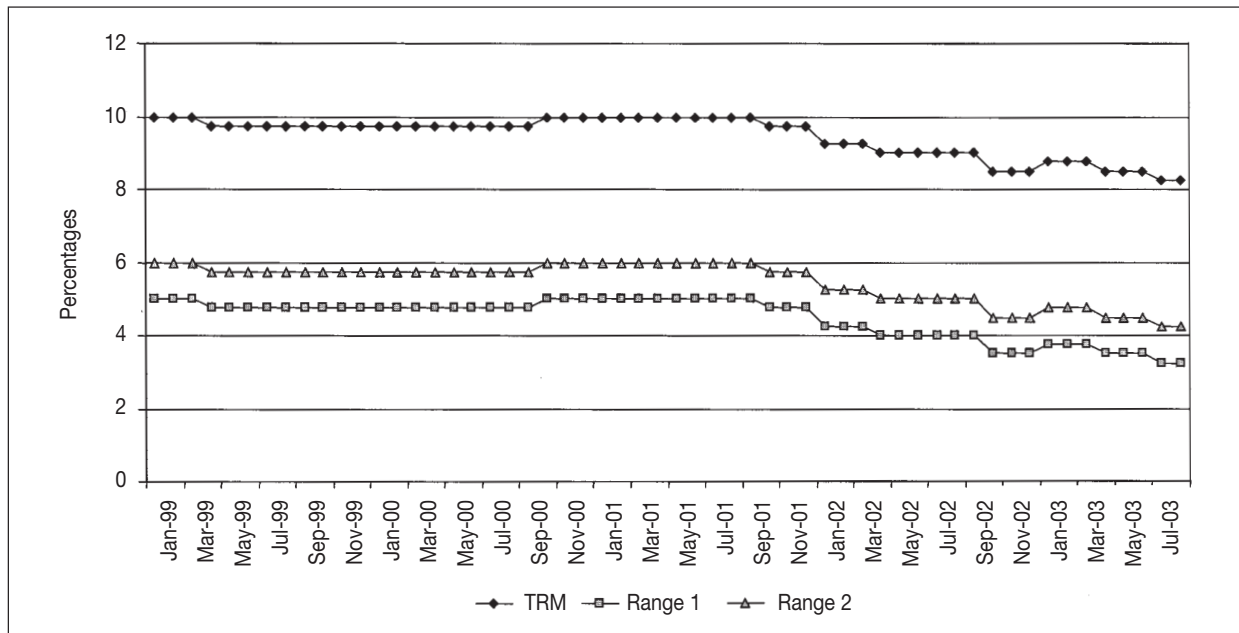
2.3 General policies for the granting of mortgages

The general policies that govern housing finance granted by private banking in Panama, that is, the existing policies across the banks, are as follows:

(a) The minimum amount financed is US \$14 thousand, though it should be noted that the great majority of banks participate in the highest earnings sections of the market;

- (b) The typical time period is up to a maximum of 25 years – although there are banks that grant mortgages of over 30 years, in 5 year renewable periods, although repayments are made on the basis of the full 25 years of the contract;
- (c) The interest rates are all variable, and may be preferential rates which vary according to the market reference rate, or market rates;
- (d) The level of finance can typically reach up to 95% of the sale price of the house, although there are institutions that, for reasons of competitiveness, grant 100% finance and others 90%, depending on the policy of each banking institution;
- (e) The monthly repayment fee represents up to 30-35% of the family's income.
- (f) The mortgages have disencumbrance and fire insurance, the latter covering 80% of the value of the house.

GRAPH 3
Evolution of Interest Rates in the Preferential Interest Rate Legal Framework of Panama



- (g) The mortgages include closure fees and legal costs;
- (h) The method of payment is direct debit or voluntary payment;
- (i) The required guarantee is that the first mortgage be registered in the Registro Público de Panamá [Panamanian Public Register] which is a very sound legal structure; and
- (j) The employment stability required in order for financing to be given is generally of a minimum of two years.

3. LEY DE INTERESES PREFERENCIALES

In Panama any person that pays a mortgage debt in a bank has the right to deduct up to US \$15 thousand from their tax declaration for the interest paid on this loan over one year. In practice, people belonging to low income groups have not made use of this right; if they had done so, the tax collection

authority would have had to reimburse them at the end of each year for an amount of money corresponding to the retained tax.

Essentially what the implementation of the *Ley de Intereses Preferenciales* [Law of Preferential Interest] sought to achieve was a reduction in mortgage interest rates. Currently, people may opt for one of two alternatives: the system of presenting an income tax declaration and deducting the paid interest, or taking advantage of the *Ley de Intereses Preferenciales* and using it to obtain a mortgage loan at a reduced rate of interest.

Discounts in interest rates are determined in such a way that the amount of interest that the State returns to the banking institution at the end of the year equals the amount that it would have returned to the taxpayer if he or she had chosen to present his/her sworn tax declaration. The principal advantage of the *Ley de Intereses Preferenciales* is that it increases the ability of families to obtain a property, because by reducing interest rates, the monthly

repayments are reduced and, as such, the ability to acquire a mortgage increases. If one considers, in addition, the economic activity generated by the construction sector, in reality what the Government concedes to the banks in preferential interest is much less than it would have had to pay to taxpaying individuals, plus one must consider the greater contributions that are derived from the increased economic activity favoured by the *Ley de Intereses Preferenciales*. This is the basic principle behind the legislation.

There are some conditions applicable to loans granted under this system. The loan must be destined for the purchase or construction of the borrower's principal residence. Furthermore, this residence must be new. The loan may not exceed US \$62,500 and there are two conditions. The minimum repayment period has to be 15 years. The performance of the lending banks' loans is the market's reference rate, which is calculated as being the average of the interest rates of the four largest private banks in the system; currently this rate is

around 8.25% per annum, and is updated every three months by the *Superintendencia de Bancos*.

The preferential interest rate may be a maximum of 4 or 5 percentile points below this referential rate. For mortgage loans for house prices that vary between US \$25,000 and US \$ 62,500 there is a corresponding preferential interest rate of 4.35% (that is some 4 percentile points below the reference rate), while for housing with prices up to US \$25,000 the preferential rate is 3.25% (that is, 5 percentile points below the reference rate). The banks may waive up to 4 or 5 percentile points, depending on the purchase price of the property, and this percentage varies depending on market competitiveness.

The benefits of the *Ley de Intereses Preferenciales* is for a period of ten years; when this time period ends, one no longer enjoys preferential interest and the mortgage becomes a typical mortgage, the same as any other mortgage that the bank may offer. The credit derived by the financial institution from these benefits is applicable to the payment of taxes; that is, the loan may be sold for the payment of national taxes, under the condition that the loan is up to date.

Graph 3 shows the evolution of interest rates in the framework of the *Ley de Intereses Preferenciales* over the last four and a half years, which clearly demonstrate a tendency to fall. We may see the impact of this Law based on a couple of examples. For a mortgage loan of US \$60,000 the current market interest rate is 8.25% per annum; upon applying this rate, monthly repayments would be, over a twenty year period, US \$511, and the necessary family income would be US \$1,704. However, if the person were to buy the house under the *Ley de Intereses Preferenciales* system, the

interest rate would be reduced to 4.25% per annum, monthly repayments would be reduced to US \$371, and the required family income would be reduced to US \$1,238. On the other hand, if the loan were US \$25,000, applying the reference rate, the family income required to meet the monthly repayments of US \$213 would be US \$710; however, if the *Ley de Intereses Preferenciales* is applied, an annual interest rate of 3.25% would be applicable, resulting in monthly repayments of US \$142. It is clear that as the interest rate diminishes, which is possible with the *Ley de Intereses Preferenciales*, the number of people who may access the private mortgage market increases.

4. PROGRAMA DE FINANCIAMIENTO CONJUNTO (PROFINCO)

The *Programa de Financiamiento Conjunto (PROFINCO)* [Joint Financing Project] is aimed at the acquisition of new housing of social interest, and the projects which qualify for this program must be approved by the *Ministerio de Vivienda* [Ministry of Housing]. Under this program up to 98% of the value of the house is financed. The State, through the *Banco Nacional de Panamá*, creates a guarantee fund to reimburse participating banks for up to 30% of any losses incurred by the loans granted in the framework of this program. The client pays a surcharge of 0.5% on the rate applicable under the *Ley de Intereses Preferenciales* project, and the resources generated from the payment of this surcharge are deposited in the guarantee fund. The maximum default allowed is 150 days. It is of importance to note that losses and the auction of houses due to non-performing loans do not even reach 30%.

5. CONCLUSIONS

The development of a *Centro Bancario Internacional* in Panama has been fundamental to promote the finance of housing. The growth in the residential mortgage portfolio has been stable and sustained over the years. The mortgage loan offer is varied and beneficial for clients. The financing system is sustained on the basis of high liquidity, financial integration and sustained levels of saving. For these reasons, an extremely dynamic property development and construction sector has developed. The levels of non-performing loans are acceptable. Judicial security exists along with an easily executable system of guarantees. Special programs, such as the *Ley de Intereses Preferenciales*, have made access to credit easier for determined sections of the population and, as a result, have increased the mortgage market. An active secondary housing market exists, as housing originating from the execution of guarantees has a relatively fast turnover in the market, due to a housing deficit of more than 207,000 houses.

Although it is certain that in the Panamanian housing financial system, some mortgage securitising operations have taken place, especially by private banks and other institutions, in reality there has been no widespread need to opt for this alternative, and the great majority of the banks have preferred to maintain their mortgage portfolios, given that these are high performing. In any case, as the *Comisión Nacional de Valores* [National Share Value Committee] continues to perfect the securitising regulations, this, in turn, may develop a more active mortgage securitising market, this becoming another advantage that may be offered by the CBI.