

Capital Market Development in the Caribbean: The Home Mortgage Bank of Trinidad and Tobago

by Calder Hart

BACKGROUND AND RATIONALE

The Home Mortgage Bank of Trinidad and Tobago is a secondary mortgage institution. As such, it has no direct interface with the consuming public, i.e., mortgagors and prospective mortgagors, but serves as a bank to the primary mortgage lenders, such as commercial banks, life insurance companies, trust companies, etc. It is a facilitating device for the movement of capital and savings from the investor through the primary mortgage lender to the prospective homeowner. The primary mortgage lender retains the interface with his customer and continues to administer the mortgage as if he still owned it. As a secondary mortgage institution, we expect to be invisible to the individual and specific customer, i.e. mortgagor.

One of the major objectives of a secondary mortgage institution is the transfer of capital that might not otherwise be available to the mortgage market by promoting the liquidity of the instruments used to securitize that investment. The Home Mortgage Bank acts as a self-adjusting mechanism to distribute

capital from highly liquid areas and institutions to less liquid ones. It creates an equal and level playing field for lenders, regardless of the size of the institution or its geographic area of business. The Home Mortgage Bank, as a secondary institution, is a mechanism which effectively promotes the velocity of capital. Its administrative structure must impart confidence to, not only the investing public, but also the institutions that it is expected to serve. To this end, its operations must be conducted in a timely and efficient manner.

STRUCTURE

The ownership of the Home Mortgage Bank is the result of a unique public/private shareholding comprising the Central Bank of Trinidad and Tobago, the International Finance Corporation (the private financing arm of the World Bank), the National Insurance Board (social security institution), and the commercial banks and insurance companies of Trinidad and Tobago. The ownership is 32.5% public and 67.5% private with the Central Bank being the largest shareholder at 15%.

The Home Mortgage Bank has entered into a Subscription Agreement with the International Finance Corporation which defines the standards, particularly the operating and financial standards, that the institution is

expected to maintain as well as the determination of institutions deemed eligible for designation as approved lenders. Included in the criteria for designation as an approved lender are standards of net worth as well as operational expertise and experience in loan underwriting and administration. Approved lenders are expected to execute a Deed of Sale and Administration which sets out the responsibility of the lender in administering the individual mortgage loans and provides the Home Mortgage Bank with a beneficial legal interest in the mortgage deed which is achieved through supplemental deeds. Primary lenders receive a fee ranging from 1% to 1.5% for administering the Deed of Sale and Administration with full recourse to the lender. Other products include reduced fees for partial or non recourse to the lender by the Home Mortgage Bank. In addition, the lender receives a fee of 1%-2% for operating the bridging facility for new construction loans.

As the Home Mortgage Bank is essentially a wholesale operation, it provides an effective and efficient mechanism for accessing funds which is achieved with relatively low overhead and related expenses. Those overhead charges will reduce significantly over time because of the wholesale nature and the automated operating structure that is a fundamental prerequisite for secondary institutions.

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As a result of the creation of benchmark residential mortgage interest rates, downward adjustments in our fee structure will be allocated both to lenders for their achievement of various policy initiatives (this forward looking approach was actually signaled in the International Finance Corporation Subscription Agreement), and the balance going to reduce the rate to the mortgagor and therefore enhancing affordability.

The Home Mortgage Bank has established a benchmark interest rate for new residential construction as well as the financing of existing homes. It will only purchase loans by the lenders that fulfill the policy envelope as defined in the IFC Subscription Agreement.

POLICY

The policy envelope is as follows:

1. Mortgage loans will only be purchased which are secured by a first mortgage deed or comparable type of instrument.
2. Second mortgage loans are not permissible.
3. The maximum loan-to-value/cost will be 90%.
4. The amortization term will be for a maximum of 30 years.
5. The home to be financed must be owner occupied.
6. The mortgage interest rate should be in a range not exceeding 3% over the cost of funds.
7. The price range of eligible housing in Trinidad and Tobago will be T.T. \$150,000 and up with no ceiling.
8. Residential mortgage lenders must have a minimum net worth of T.T.\$3 million, and their quantum or share of our mortgage portfolio cannot exceed 20% of the total portfolio.

9. To achieve a high level of security our mortgage portfolio is expected to show geographic diversity as well as prudent standards of risk assessment and underwriting.

DUALITY OF PURPOSE

The twin focus of a secondary mortgage institution has to deal with:

- Capital markets;
- Mortgage markets.

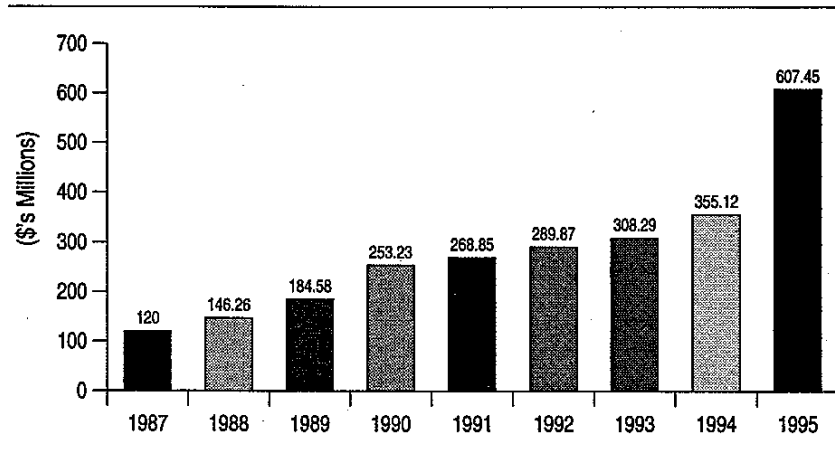
In respect to the capital markets, the role of a secondary mortgage institution is to influence the diversity and velocity of the actual money market. In Trinidad, the Home Mortgage Bank of Trinidad and Tobago has issued \$744.53 million in tax-free and non-tax-free mortgage-backed bonds which have been issued for short-, medium- and long-term periods. As a comparison, more than 50% of our bond debt is five-plus years, and this ratio compares more than favorably with the length of maturities issued by the American secondary institutions. Mortgage pass-through securities provide a shorter term cash deposit-type instrument. These instruments are attractive because:

- a. The interest is tax free on the bonds.
- b. The mortgage pass-through securities are short-term deposit-type instruments which can be redeemed monthly.
- c. The Central Bank had been the market maker for our bonds by operating as a buyer of last resort.

This window, however, was rarely utilized and at no time were any more than 1/2-of-1% of our bonds held by the Central Bank. In Trinidad and Tobago a bond market has been recently established as an adjunct to the stock exchange. Shortly, we expect to see more activity in respect to these types of instruments, as soon as the securities industry becomes as familiar with debt instruments as they are with equity ones. The recent enactment of a Securities and Exchange Commission will likely provide further impetus to this.

In respect to the mortgage market, the Home Mortgage Bank is obviously one of the financing mechanisms for the larger industry envelope which, of course, is the housing market. In Trinidad we have purchased \$605.562 million in mortgages. While our

Figure 1. Total Bonds in Issue



Initial focus was in the purchase of existing portfolios and assisting hard-pressed mortgagors, recent policy has been to encourage new construction, support public initiatives aimed at private lenders and strategic acquisition of existing portfolios. We have sought to establish a uniform mortgage policy

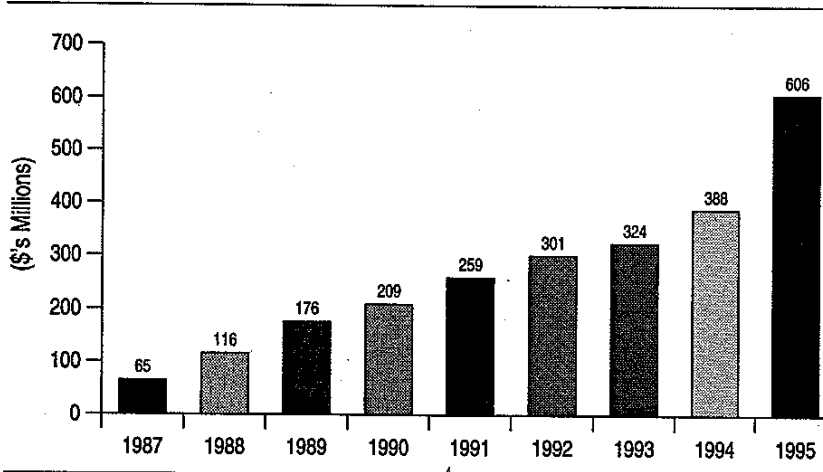
through an advocacy position on the following:

- Standardized Mortgage Deed;
- Automated and streamlined Land Registry System;
- Abolition of prepayment penalties;

- Bridging interest rate to be at the takeout or completion mortgage interest rate;
- A National Mortgage Insurance System for balancing risks and allowing higher ratio mortgage loans to be considered.

SIGNALS OF SUCCESS

Figure 2. Accumulated Value of Mortgages Purchased



The major key to analyzing whether the Home Mortgage Bank has been a success is to evaluate how the various component players have benefited in its nine years of operation.

Shareholders

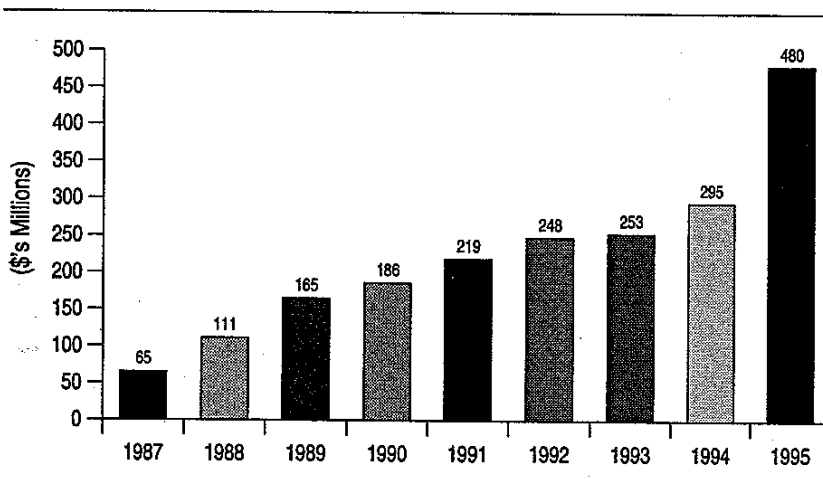
1. Since the Home Mortgage Bank was established, it has produced a profit each year, and the shareholders have received a yield comparable to the long-term government bond yield, or better, as dividend, with last year's dividend being 16%.
2. The earnings per share on shareholders' equity has been in the 20%-25% range, with last year's figure at 34.26%.
3. The institution in nine years has generated net profit after tax of \$31 million.
4. The capitalized value of each \$100.00 original share in the Home Mortgage Bank is now considered to be in the range of \$250.00-\$300.00.

Bondholders

Investors traditionally value security and liquidity as the two major elements for holding long-term instruments, and in support of those two major features:

1. Less than 1/2-of-1% of our bonds had been held by the Central Bank, and currently there is an active market for our bonds.
2. The Home Mortgage Bank is, after the government of Trinidad and Tobago, the

Figure 3. Mortgage Portfolio Serviced



largest issuer of bonds. To date, 24 bond series have been issued. At the time of the Home Mortgage Bank's creation, no more than \$200 million a year had been raised in the local bond market by all issuers. By 1992 that figure in Trinidad had climbed to \$1.4 billion and has remained in excess of a billion dollars each year since.

3. More than 50% of our debt has over five years to maturity.
4. The interest on our bonds is tax free.
5. Our bonds are eligible for inclusion in the statutory fund and reserve of insurance companies as well as collateral security for lending by commercial banks.

Mortgagors and Lenders

Initially, with the downturn in the oil-based Trinidad and Tobago economy, the major focus of the Home Mortgage Bank was relief of hard-pressed homeowners through a

reduction in their gross debt service. Recently, however, as the asset growth of the Home Mortgage Bank allowed it to increase its influence over the overall residential mortgage market place, it has created a competitive and market-driven mortgage environment.

1. The Home Mortgage Bank's benchmark interest rates in Trinidad are 11% for new and existing homes, a rate comparable to or less than the government borrowing rate of the past several years.
2. This rate has allowed the smaller institutions to access the most prime mortgage market financing for their customers and in fact, has given all prospective homeowners in Trinidad and Tobago the opportunity to use their own financial institution, as opposed to using the major lenders, for the best deal.
3. It has allowed the institutions to provide bridging finance at the takeout or completion mortgage interest rate.

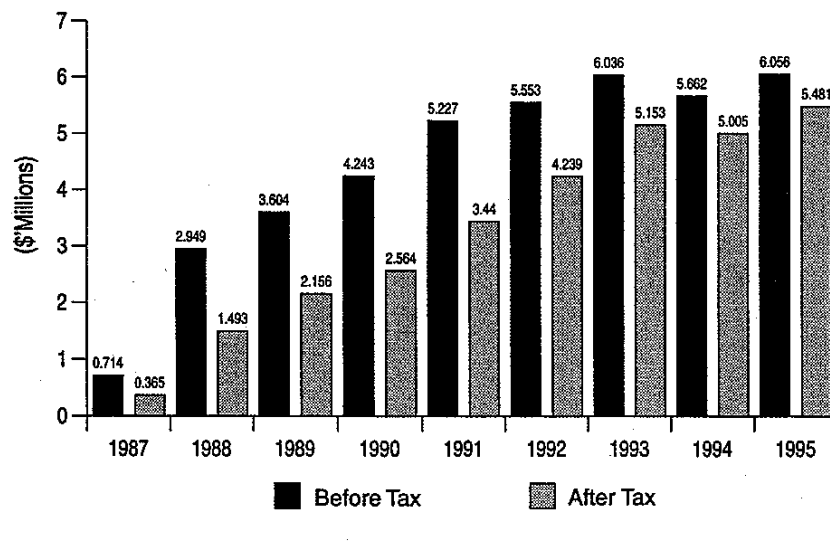
4. It has brought a fully automated environment to support the primary institutions; and when the primary institutions become fully automated, this will enable all transactions to be carried out electronically, as is the case in the United States of America and Canada.

Government of Trinidad and Tobago

In looking at the public goals and objectives which cause the creation of a secondary mortgage institution, the following are pertinent:

1. Its creation has allowed the government to delegate to the private sector more of the responsibilities for the provision of mortgage financing.
2. By directing more emphasis to the private sector as well as enhancing the availability of mortgage financing through the private sector, the government has sought to shrink the size of the public safety net, both to ensure a more dedicated and targeted approach with the limited public resources available and to enhance a greater level of mortgage availability and affordability in the wider market place.
3. It has ensured that all prospective homeowners in the country have access to the most competitive mortgage terms possible.
4. It has allowed the Home Mortgage Bank to support the total market place with market driven policies and practices as opposed to segmented targeting by public institutions with diminished public resources to draw upon.
5. It also prefers to see market advocacy support through a secondary institution by putting private resources at work to achieve such elements as:
 - Standardized mortgage deeds;
 - Abolition of prepayment penalties;
 - Bridging interest rate to be takeout rate;

Figure 4. Comparative Net Income



- National Mortgage Insurance; and
 - A more streamlined land registry.
6. The Home Mortgage Bank has contributed approximately \$15 million of corporation tax revenue through the end of 1995.

IMPLICATIONS FOR THE EASTERN CARIBBEAN STATES

In looking at the characteristics of the Eastern Caribbean States, it is quite apparent that a number of conditions exist which make the creation of a Home Mortgage Bank a timely response to not only the economic and financial conditions but to wider market needs as well.¹

1. The region has a diversified financial market place as well as eight member states.
2. There have been times of variable liquidity patterns between states and lenders in the Eastern Caribbean region.

3. With a substantial number of lenders, there is a competitive financial market in virtually all states in the region.
4. Some states, e.g., St. Lucia, have an advanced and simplified means of land conveyancing which will greatly enhance the effectiveness of the financing instruments that are issued.

SUMMARY

The characteristics which mainly contributed to the success of the Home Mortgage Bank of Trinidad and Tobago include the following:

- Targeted marketing thrust;
- Technological strength, with support from Canadian and American institutions;
- Problem-solving and cost effectiveness due to a precise focus;
- High quality board composition and management;

- Private sector confidence and support; and
- Timely and efficient response to needs of primary market institutions.

NOTES

¹ Editor's Note: The Home Mortgage Bank is a shareholder in and advisor to the newly created Eastern Caribbean Mortgage Bank (ECMB). This institution will operate across the eight member countries of the Organization of Eastern Caribbean States (OECS). The structure is modeled after those of the HMB. Its authorized capital is \$40 million, contributed by the Eastern Caribbean Central Bank and various commercial banks and insurance companies in the OECS, and its initial authorized bond issuance is \$250 million. It is exempt from corporate tax and stamp duty, and interest on its debt securities will be tax exempt.