

The Argentinean Mortgage Market

by Dr. Luis Carlos Cerolini

ROLES OF THE PARTICIPANTS

Origination of Mortgage Loans

In the Argentine Republic, commercial banks are the normal originators of mortgage loans. The banking network in the financial system comprises a total of 117 banks (both private and public), with over 4,000 branches, geographically distributed throughout the country.

Based on the enactment of Law number 24.441 for housing financing and considering the need to supply new loans to feed the future secondary mortgage market, the National Mortgage Bank (known as the B.H.N. for its acronym in Spanish) fostered the creation of other entities or firms that can originate mortgage portfolios.

To date, the B.H.N. has a total of 45 registered originating firms distributed throughout the country, which are subject to a rigorous qualification process and periodic control. Finally, the municipalities and provinces are also mortgage originators subject to the same qualification and control process.

To date, only 400 municipalities in the interior of the country are qualified, but it is expected that a significant increase will take place in

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the next few months, given the growing interest in the B.H.N. operations.

Funding

Traditionally, lenders have financed mortgage loans with their own resources. This explains the limited development and growth of the mortgage market. The Argentine financial system, to describe it in a single figure, has total resources of 12 billion dollars.

Without a doubt, the future growth of the Argentinean housing finance system will only be possible through development of the secondary mortgage market, as lending institutions are constrained by the Basel regulations. This makes it necessary to base the growth of the mortgage market on off-balance sheet resources.

Servicing and Collection of the Portfolio

The banking network mentioned above is entrusted with servicing and collection for the mortgage portfolios. This network administers the loan portfolio it has originated, as well as the portfolio originated for the B.H.N. There are no companies providing master servicing for third parties.

The greatest experience in administering mortgage portfolios has been developed by the B.H.N. However, as a result of the origination of portfolios by the retail banks for the B.H.N., a rigorous portfolio administration procedure has been established. This includes

a complete manual and administration regulations which covers aspects such as:

- Criteria for eligibility of the administrator.
- Debtor and administrator contractual relationship.
- Registrations and files.
- Amortization system and payments records.
- Insurance.
- Monthly installments liquidation.
- Mortgage transferences.
- Prepayments.
- Controls and audits.
- Administration of overdue mortgages.
- Registration of employees (authorizations, etc.).
- Reports and remittances.

All of these aspects are developed in detail and are being disseminated among the retail banks that enter the system.

PRESENT SIZE OF THE MORTGAGE MARKET

Number of Outstanding Mortgages

As of March 1996, the total portfolio of originated and outstanding mortgage loans throughout the whole Argentinean financial

system amounts to approximately 450,000 mortgages with an outstanding balance of \$10.147 billion.

Of this total, around 60% (\$6 billion) is housing mortgages, while the balance is made up of mortgage loans granted for other purposes. Of the \$6 billion housing mortgages, approximately 45% (\$2.7 billion), has been originated in foreign currency. The loans in local currency (pesos) amount to nearly \$3.3 billion.

As of March 1996 the B.H.N. held a portfolio of housing mortgage loans in the amount of \$3.302 billion. This includes retail portfolio, wholesale portfolio and global disbursements (intermediate financing).

As of July 30, 1996, the B.H.N. retail portfolio of individual loans was equivalent to \$2.746 billion, distributed into 172,000 mortgages, issued in pesos. The wholesale portfolio on that same date (individual loans disbursed by the B.H.N. through the retail banking network) amounted to \$260 million, distributed among approximately 10,000 loans, all of them originated in foreign currency. The rest of the wholesale portfolio in foreign currency is represented by the global disbursements.

**GENERAL CHARACTERISTICS
OF THE MORTGAGE LOAN PORTFOLIO
IN ARGENTINA**

Overview

The mortgage segment has significantly increased its participation in the total loan portfolio of the financial system. As of December 1994, the mortgage segment represented 14.2% of the total portfolio of the system with a volume of \$9.3 billion; in March of 1996, this percentage increased to 17.8%, with a volume of \$ 10.147 billion. This increase is produced mainly by the housing mortgages.

Average Value of Mortgage Loans

There is insufficient information to know the average value of the mortgages for the whole financial system. However, based on in-

formation that exists at the B.H.N., which is an important reference point in the Argentinian mortgage loan market, the average value of mortgage loans held there is between \$30,000 and \$50,000 for each loan granted.

Average Term for the Loans

In this item, again, there are insufficient data to establish the average term of the mortgages for the financial system as a whole. The experience at the B.H.N. places the term at an average 11.6 years.

Types of Mortgages

Before the Housing Finance Law number 24.441 was enacted (in January 1995) in most of the housing mortgage loans, securitization was not foreseen. Consequently, mechanisms to encourage standardization, transferability and quick repossession in the event of default, were not included.

The enactment of the cited law completely revises the mortgage regime, providing this instrument with two attributes that it lacked in the past:

1. The possibility of choosing a quasi-administrative foreclosure procedure, limiting the intervention of justice to the establishment of default and granting the lender all capabilities to lead the foreclosure process by himself, limiting total expenses to 3% of the amount of the outstanding loan plus charges.
2. The possibility of assigning the mortgage, without the requirement of prior agreement on the part of the mortgage debtor. This is fundamental for the transferability to the Special Purpose Vehicle and its future securitization.

In addition, it should be noted that the Central Bank of the Argentine Republic designed a

standard model for mortgage loans which allows for the origination of homogeneous mortgage loans in respect to terms, currency, interest rate, amortization system, maximum loan ceilings, maximum loan-to-value ratios, installment/ income ratio, amount of expenses and fees. Then the Central Bank took care of spreading out its mandatory implementation among all lenders, in order to make feasible the future securitization process.

**Currency or Unit in Which the
Loans Are Awarded**

Historically, loans in United States dollars represented around 60% of the total portfolio of mortgage loans throughout the financial system. As of 1991, almost all of the mortgage loans had been awarded in United States dollars. In 1996, loans in pesos have started to appear in a greater proportion, although these bear higher interest rates and shorter terms.

Average Loan to Value

The loan to value at which banks operate at present is between 50% and 75% of the valuation of the property (private banks at 50% to 60%, and the B.H.N. at 75%), depending on whether the property to be financed is new or used.

Delinquency Ratios

The experience of default that has been verified by the B.H.N. on its wholesale portfolio (9,700 loans, with a volume of \$260 million) is 0.9%. The portfolio in foreclosure is but a mere 13 cases, with a percentage of just 0.24% of the total portfolio.

The few experiences collected with respect to loans that have completed the whole foreclosure procedure show a period between three and five months from the beginning of the foreclosure. The historical experience gathered from the portfolio generated by the

B.H.N. before 1991 indicates that the delinquency indexes are somewhere between 12% and 13%.

**POTENTIAL GROWTH OF THE
MORTGAGE MARKET IN ARGENTINA**

Population Growth Index

In accordance with the projections calculated by the INDEC (National Statistics and Census Institute), the average annual population growth rate for the next 15 years will be around 1.2% per year, and at present the population is approximately 35 million inhabitants.

Demand for Housing

At present, the country has 8.5 million housing units. The current deficit of housing is approximately 3 million units, which comprises 800,000 additional homes that are required and 2.2 million substandard quality houses (lack of security, lack of essential services, advanced obsolescence, overcrowding, etc.).

If one were to make up for the cumulative deficit to date, within the next 20 years, it would be necessary to build 150,000 houses per year. The growth of the population, however, would require 100,000 additional units per year, assuming an annual population growth of just 1.2%. On the other hand, obsolescence (using a 60-year depreciation) would require the construction of an additional 100,000 houses per year. This means that, in order to overcome the deficit and maintain the stock of housing in acceptable condition, around 350,000 houses would have to be built per year. Taking a value of US\$25,000 per house, this represents a total investment of US\$9 billion per year.

Currently, Argentina only invests US\$4 billion per year, which means 160,000 new housing solutions per year. Present investment only represents 1.3% of the GNP; the solution to the problem requires the investment of 3% of

the GNP. These figures provide a general idea of the Housing Market dimension, and as such, the potential performance of the mortgage market in the country.

SECONDARY MARKET

Securitization Development

There are three important aspects that are to be kept in mind in objectively evaluating the potential development of this tool in Argentina:

1. The legal context in which securitization is to be developed.

The enactment of Law 24.441 for the financing of housing introduces legal certainty regarding some aspects that were important to establish in the Argentine market, so that instruments such as securitization could be developed. These are:

- The foreclosure regime was restated, thus allowing an effective and quick repossession of the property.
- The possibility of assigning mortgages without requiring acceptance by the debtor was established as a way to generate liquidity for the mortgages.
- The costs generated by the mortgage assignments and the execution of the mortgage contracts with a notary public were reduced.
- The trust mechanism was regulated so as to be the most adequate instrument for securitizing mortgages.
- A homogeneous model for mortgage loans to serve the whole financial market was drafted by the Central Bank of the Argentine Republic. This has transformed the mortgage loan into a type of commodity which, in addition to fulfilling the legal requirements in order to be assigned, would have the minimum conditions for standardization at a low cost.

- Tax contribution aspects were regulated to provide fiscal certainty for the new instruments.

2. Feasibility of a secondary mortgage in Argentina and its potential.

The most important argument for believing that a strong secondary market will develop in the future is the low stock of mortgages that our financial system has at present in comparison with other countries. The \$10.147 billion in mortgage loans that the financial system has at present represents just 3% of the GNP, as compared to 17% in Chile, 50% in Spain and over 100% in United States.

On the other hand, there is an increasing supply of funds stemming from retirement and pension funds, and more are expected from mutual funds, which still have not entered the capital market and are eager for new and better instruments to channel their savings.

To date, the retirement and pension funds administrators possess \$4 billion, of which \$800 million is invested in term instruments in the financial system; a good portion of that money could be channeled to the capital market through instruments that offer high security levels and great stability in the flow of funds.

3. The B.H.N. role as the main actor in this market.

As established in its corporate by-laws, the B.H.N. participates in this market as a wholesale entity performing a role similar to the one the United States secondary market agencies carry out.

The B.H.N. operates in the secondary mortgage market, purchasing mortgages from the originators (basically the banks and other private entrepreneurs) in order to put them in Special Purpose Vehicles, administered by a trust, which converts them into bonds issued by the trusts and places them in the capital market.

At present the B.H.N. is working on two mortgage-backed securities issues:

- The first issue is based on the peso portfolio originated by the Bank with its own resources before 1991, in the total amount of \$330 million and represented by somewhat more than 19,500 loans, with a weighted average maturity of 16 years and a 48% average loan-to-value ratio.

This \$330 million represents a preselected portion of the total portfolio (\$650 million composed of 42,000 loans) and is part of the retail loan portfolio originated by the Bank, prior to 1991 (\$2.7 billion in 17,000 loans). The servicing and collection are performed through the 1,700 authorized branches of the private retail banks.

The legal structure is that of a pay-through, that is to say, the Bank issues guaranteed negotiable obligations for the future stream of funds, separated from the mortgage loans.

The portfolio is administered by a third party, the Fiduciary Trust, but the ownership of the loans is not transferred. Deutsche Morgan Grenfell was the Institution that designed the structure for the securities.

A senior bond in the amount of approximately 80% of the portfolio will be issued, with an annual put option in favor of its bearers; a subordinate bond will be issued for the remaining 20% balance. The potential purchasers are the institutional investors (pension funds, insurance companies, Work Risk administrators) and also some individual investors, with a significant geographical dispersion throughout the country.

The guarantee to the investors will be provided by the cash flow of the portfolio, the loan-to-value ratio, the 20% subordination and the over-collateralization (the difference between the total amount of the loans and the total amount of the senior and subordinate bonds), as well as by the net worth of the B.H.N.

- The second issue is based on the dollar portfolio, originated as of 1994, the great majority of which is financed with collections of yields and amortizations, and to a lesser degree, with Eurobond investment programs.

This is a US\$300 million deal, backed by almost 12,000 loans, with an average term of 11 years and a 58% loan-to-value ratio. The portfolio was originated by a network of 40 retail banks. The administration of the portfolio

is performed by the banks themselves, based on the Mortgage Loan Administration Manual and the Mortgage Loan Administration Rules. The B.H.N. acts as General Administrator, playing the Master Servicer role.

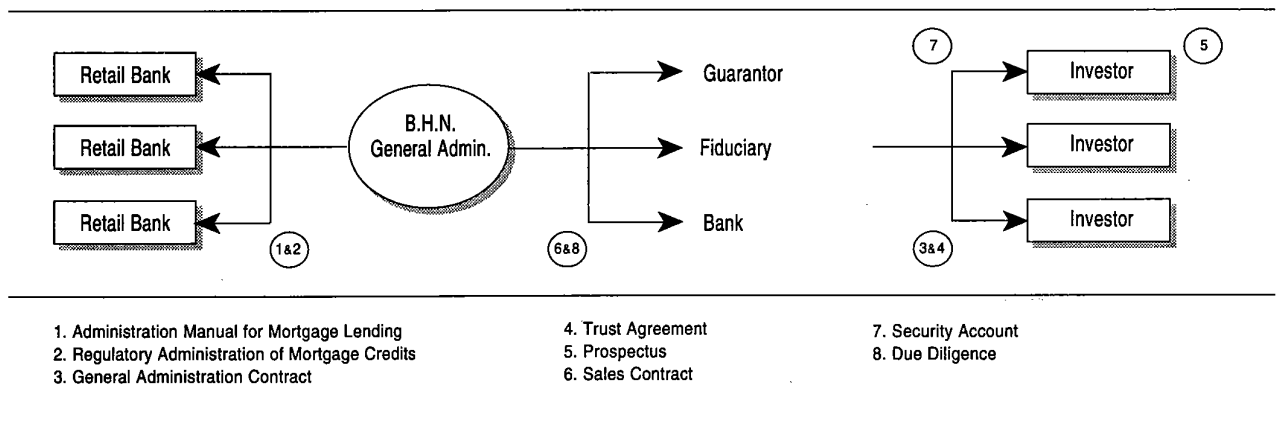
A pass-through legal structure is used in this case. That is to say, the issuer is a Special Vehicle (trust), which has the mortgage loans and some guarantee accounts on the assets side of its balance sheet and the debt issued through the securities on the liabilities side. The portfolio is administered by a third party, the Fiduciary (trust) and there is a transference of the mortgage loans ownership.

With respect to the securities, the concept of issuing different types of senior bonds was developed in order to attract international investors with different investment profiles (e.g., fixed- or variable-rate). The bonds will have both a national and international rating.

The investor will have, first, the guarantee of the portfolio flow of funds; and, second, the excess on the loan-to-value ratio, the subordination and the over-collateralization.

In summary, the players who contribute in this first attempt at real securitization carried out by the B.H.N. are the following:

Figure 1. Securitization Process



ARGENTINA

Originators of the loans: The Retail Banking Network, duly qualified by the B.H.N.

Administration and collection: The Retail Banking Network, duly qualified by the B.H.N. (Mortgage Loan Administration Manual and Mortgage Loan Administration Rules).

Master service: Banco Hipotecario Nacional (National Mortgage Bank) under a General Administration Contract.

Guarantee Account: Collateral deposit in a AAA bank, to be defined. This will cover the risk of the country balance of payments, in an amount equivalent to one year of the cash flow that the portfolio generates (for the senior securities) until it reaches a maximum of two years.

Custodian: Banco Roberts S.A. holds the titles on deposit, in a special account for this purpose.

Fiduciary Trust: First Trust New York.

Investment Bank: C.S. First Boston. This bank advised the B.H.N. in the structuring and will participate in placing the securities.

Rating Agencies: Standard & Poors and Duff & Phelps.

Investors: Institutional Investors.

OPPORTUNITIES FOR FOREIGN INVESTORS

There are a number of opportunities for foreign investors in the Argentinean mortgage market:

Investment Opportunities

- Origination of loans for housing projects. The loans can be sold to the B.H.N.
- Direct participation in the secondary mortgage market
- Financing for other real estate investments (offices, hotels, etc.)

Business Opportunities

- Marketing of software for the management, administration and collection of universal mortgages.
- Know-how transference for the management of large volumes of mortgages.
- Construction of housing through non-traditional building techniques that may enable both a reduction in the sales prices and in construction risks.
- Marketing of insurance that allows financing over 75% of the valuation.
- Infrastructure provision (water, sewerage).
- Organization and operation of the Registry of Real Estate Property.