

Real Estate and Housing Financing in Brazil

by Luiz Eduardo Pinto Lima

HISTORICAL OVERVIEW

The Housing Finance System (SFH) was created in 1964 to provide long-term finance to families for the purchase of their homes, thereby reducing the housing deficit and social tension in large urban centers. The system was predicated on the introduction of monetary correction in Brazil, which enabled the granting of long-term loans and became the pillar of the System.

Construction of commercial real estate, shopping centers and other non-residential real estate has been financed with a small part of savings deposits, bank loans and companies' own resources. In recent years they were also financed with funds raised by the placement of real estate debentures and investment fund quotas with institutional investors.

However, the surge in inflation in the '80s and early '90s compromised the financing capacity of the System. In view of this, studies have been carried out in recent years to find new sources of funds for housing and real estate financing.

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THE PRESENT HOUSING FINANCE SYSTEM

As regards the Housing Finance System, the main financial agents are:

- multiple-charter banks with a real estate credit department,
- savings banks,
- real estate credit societies and
- savings and loan associations.

There are 51 such institutions, of which 27 are private and 24 public. The multiple-charter banks appeared in the late '80s as a result of the merger of the commercial and/or investment bank with the finance companies and real estate credit societies of a same financial conglomerate. As a result, there are only a few real estate credit societies and savings and loan associations still operating in Brazil.

In addition to these institutions, which fund their operations with savings deposits, housing finance is also provided by state and local governments through their housing companies or cooperatives and also by some state-run pension institutes.

Servicing and collection of the loans are the responsibility of the originator. The largest banks have their own systems for servicing their loans. The remaining banks use the data

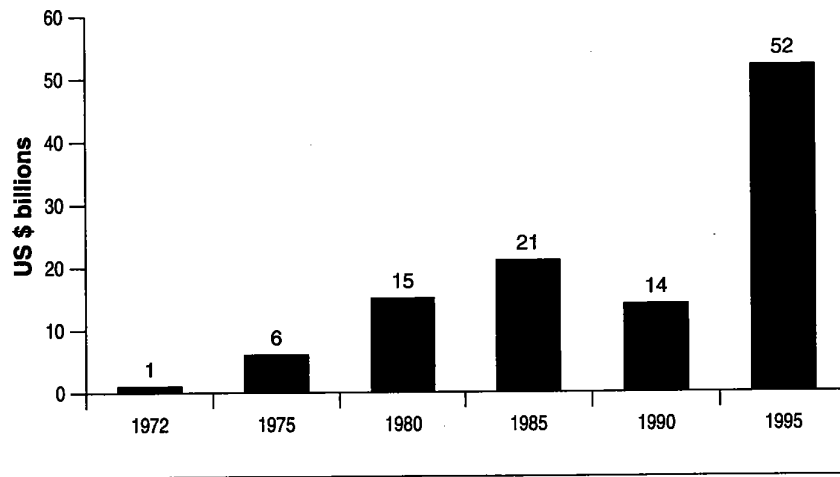
processing systems of specialized companies. The main source of funds of the Housing Finance System is by far savings deposits. The Central Bank establishes strict rules for the use of these funds, including compulsory reserve requirements (15%), minimum volume destined to housing finance (70%), minimum volume of funds destined to loans at 12% per annum interest and borrower requirements to be eligible for such loans.

The second largest source of funding of the System comes from mandatory deposits made by employers on behalf of their employees at the Federal Savings Bank, named FGTS (Fundo de Garantia do Tempo de Serviço). These deposits are mainly used by Housing Companies and Cooperatives. In the past, financial institutions also borrowed resources from the Fund to finance the construction of residential units, but this has since been discontinued for new operations.

Savings accounts and FGTS deposits increased exponentially during the first 15 years. Growth was more moderate in the last two decades, as can be seen by the following chart. Savings deposits currently amount to US\$52 billion and FGTS deposits US\$50 billion.

In the last three years, financial institutions financed an average of 55.000 residential units per year with savings deposit funds. The loans

Figure 1. Savings Deposits

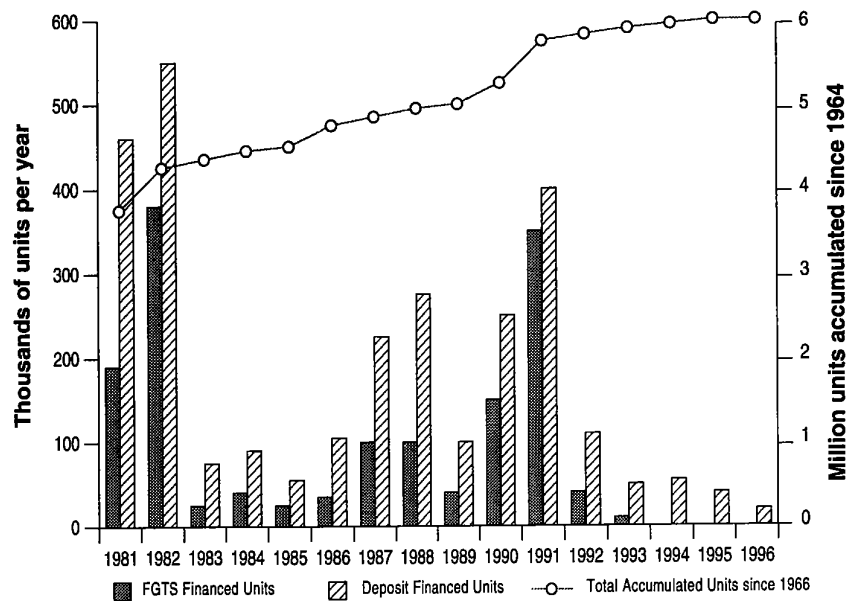


averaged US\$1.5 billion per year, of which some 50% were destined to the production of housing units and the remainder to families to finance the purchase of flats or houses.

Throughout its existence, the System financed 6 million units, 2.6 million with savings deposit funds and 3.4 million with FGTS and other resources of the government, as shown by the next chart. Today, there are approximately 1.2 million housing finance loans granted to individuals and families outstanding in the banking industry and another 2 million with nonfinancial agents of the Housing Finance System.

Loans for the purchase of a residential unit average between US \$30,000 and US \$40,000, covering between 50% and 60% of its value. In the past they were made for 15 to 25 years. At present, terms average 10 to 12 years.

Figure 2. Real Estate Finance in Brazil



Housing finance loans by the banking industry are granted at the government-determined 12% per annum rate or at market rates, which vary between 14% and 18% per annum. Various requirements have to be fulfilled by the borrower and the residential unit to qualify for the 12% rate. Loans granted by state-run housing companies and cooperatives are made available at lower interest rates and longer terms.

All loans are made in the local currency, the real, but they are adjusted monetarily every month or quarter, pending their origination date. Since 1991, adjustment is made according to the Reference Rate (TR) published by the Central Bank, which is also applied to savings and FGTS deposits. The rate is calculated by the Central Bank every day based on CD rates of the 30 largest banks.

Delinquency rates—at 12%—are very high at present as a result of a very tight monetary policy. As domestic interest rates are coming down with the consolidation of economic

stabilization, delinquency will fall to the historical levels of up to 5%.

NEW SOURCES OF FUNDS FOR REAL ESTATE FINANCING

Since 1991, ABECIP has been working very hard, together with the Ministry of Finance, the Ministry of Planning, the Central Bank, the Federal Savings Bank—which is the largest financial agent of the Housing Finance System—and other entities to provide new sources of funds to finance the production and purchase of real estate.

As a result, Real Estate Investment Funds were introduced by Law 8,668 in 1993. Over 30 funds have already been registered with CVM (Comissão de Valores Mobiliários), Brazil's Securities Exchange Commission, 17 of which have been or are being subscribed by investors. At the same time, real estate debentures were placed in the market to finance mainly non-residential units.

More recently the Central Bank adopted several measures to foster real estate financing:

- Authorization for mortgage companies to be installed in Brazil. Four groups have already filed application with the Central Bank to set up their companies;
- Authorization for banks to raise funds abroad for this purpose;
- New regulation for special savings deposits, whereby the depositor is guaranteed housing financing by the bank in which the deposits are made after a given period of time, established in the contract subscribed by the two parties.

Additionally, as demand for financing outpaced by far the volume of funds available, building companies designed products to finance their projects. In general terms, they sell residential

units before construction is started. Payment terms for the buyer exceed the construction period but contractors normally ensure that a large part of their cost is covered by the time the flat or house is made available to the buyer.

One of the products designed by a company in the state of São Paulo aims at obtaining 100% of the funds required for their projects from the buyers. Each project comprises 100 flats. The buyers each pay 100 installments of 1% of the cost of the flat they purchased, which is delivered as the building is completed. The company already sold close to 3,000 flats at an average cost of US \$84,000 per unit. Of these, 1,120 have already been delivered to their respective buyers. Another company operating the same way is building 12,000 flats over a three-year period.

Other companies operate real estate consortia, which are regulated by the Central Bank. There are at present some 204 groups registered with the Central Bank with a total of 33,000 participants; these are administered by 39 companies. Some 8,000 residential units have already been delivered to these participants and another 500 are under construction. The values of the housing units are concentrated between US \$10,000 and US \$50,000.

As a result of these products, there is now an estimated volume of US \$6 billion in real estate receivables still outstanding with builders and contractors. Part of this volume is being refinanced by banks and part is available for securitization.

At present, ABECIP is endeavoring to introduce a secondary mortgage market in Brazil. Studies are well advanced and have been submitted to the government for setting up a company which will be responsible for selling real estate or mortgage-backed securities to investors and for the introduction of guarantees in the Brazilian legislation for a speedy

recovery of credits in case of default. The Ministry of Finance, the Ministry of Planning and the Federal Savings Bank have already shown their approval for the bills proposed by ABECIP.

The creation of a secondary mortgage/real estate receivables market in Brazil is part of a much larger project. The Real Estate Financing System project (SFI) prepared by ABECIP comprises the following main aspects:

- The financing of housing as well as commercial units, shopping centers, hospitals, schools, parks, and other;
- Separation of housing finance into two segments:
 1. the social segment, where loans are granted at low interest rates and borrowers may be granted subsidies funded by the government and
 2. the market segment, which is financed at market rates with the resources of the SFI;
- Multiple sources of funds—real estate debentures, real estate investment funds, certificates of real estate receivables and mortgages, foreign loans, etc;
- Free market environment as regards the SFI;
- Guaranteed speedy recovery of credits in case of default;
- Special safeguards to investors with the introduction of trustees in the Brazilian legislation as well as the transfer of property only upon total payment of the debt.

This proposed system is the opposite of what we have today. The Housing Finance System is a highly regulated system with only two sources of funds, which are destined primarily for housing finance, where the lending

institution bears all risks of the operation: the origination, the servicing, the credit and the gap risks.

CONCLUSION

Brazil's population is presently 158 million people, of which 70% live in urban centers. The growth rate of the population has come down in the last three decades, but it is still running at 1.4% per annum. By the year 2,000 Brazil should have a population of about 167 million people.

Estimates of the housing deficit, made at the request of the Ministry of Planning, are around 5.5 million units. This does not take into account the quality of dwellings, that is to say, if they have sewerage and water or electricity supplies, or if they are multifamily units or not.

Adjusting for these aspects, the housing deficit numbers may double.

The demand for new housing is being forecast at 1 million units per year. The number of units financed by the National Housing System does not exceed 100,000, evidencing the need for new financing sources. These numbers show the enormous potential of the real estate market in Brazil.

The secondary real estate receivables and mortgage market designed by ABECIP is estimated to provide additional financing facilities for up to 1.2 million real estate units over the next five years.

Economic growth rates averaged 4.7% in the last three years, with the investments-to-GDP ratio running at 20%. As the economic stabilization process implemented with the

"Plano Real" is consolidated in Brazil, domestic interest rates, which are already declining, will come to more reasonable levels. This will foster investments in general, which are presently running at 20% of GDP.

Real estate investment will be particularly stimulated as lower interest rates will enable the placement of large volumes of real estate-backed securities with domestic institutional investors. Nonetheless rates and spreads will continue to be attractive by international standards, attracting foreign investors to this market.

From the foreign perspective, there are many business opportunities available, for building companies, financial institutions and institutional investors alike, be they in the form of joint ventures, investments in real estate, financing facilities or purchase of the aforementioned securities.