Real Investment Opportunities in Chile

by Pedro D. García

INTRODUCTION: A SNAPSHOT OF CHILE'S ECONOMY

Chile is a mid-sized country, population 14 million, that has successfully transformed itself into a leading, stable and strong free market economy. In 1997 it achieved its 13th consecutive year of steady GDP growth at an average annual rate of 6.6%, with the GDP amounting to nearly US$71 billion. The government's macroeconomic policies have consistently fought against inflation, which has decreased from an average annual rate of 15.1% between 1988–1992, to 6.8% for 1993–1997, and is expected to achieve 4.0% between 1998–2002, very close to the inflation rates of the developed countries.[1]

Total public and private domestic savings rate grew from 9.1% of GDP in 1985 to 23.8% in 1990, and is currently around 24.5%. It is expected to decline, however, to an estimated average of 21.8% between 1998 and 2007 because of the expanding domestic consumption rates. The investment rate is approximately 25% of GDP and is expected to maintain this level for the next 10 years, being fueled mainly by the Chilean social security private pension funds and other institutional investors, such as insurance companies, mutual funds and investment company funds.

As of June 1997 all these institutional investors held investments amounting to US $47 billion, or 65% of GDP, with the pension funds alone managing roughly US$32 billion, or 45% of GDP, a figure that is expected to grow to 100% of GDP by the year 2015.[2] This increase will have profound consequences for business opportunities in Chile, given the pension funds' eagerness for attractive projects in terms of investment return. However, the pension funds are also interested in projects abroad and have been obtaining authorization from the government to invest a greater percentage of assets outside Chile.

The above performance has been very influential on the real estate industry. During the period between 1960 and 1985 Chile had an average of 2.8% annual GDP increase, but the average increase for construction activity was a mere 1.4%. However, between 1986 and 1996, GDP increases averaged 7%, while the construction activity increase was 8.9%, with a 13.3% increment in housing construction.[3]

External debt amounted to US$26.8 billion in 1997 and is not a problem for Chile. The rating agencies have rated Chile's long-term foreign currency debt as A-, the highest in Latin America.[4]

International Trade Activity

Chile's economy is mainly based on free trade. In 1997 its exports were approximately US$16.8 billion. Imports amounted to US$19.7 billion, generating a slight trade balance deficit. The United States is our main trading partner, followed by the ASEAN countries, although trade with the European Union is growing, as it is with Latin American countries, thanks to the general economic recovery of the region. Chile has a low tariff rate, averaging 8%, unilaterally lowered during the last 10 years. In a continuous trade opening process, Chile has also signed free trade agreements with some relevant partners such as Mexico, Canada and Colombia. It also recently became a member of APEC, and since 1996 has been an associate of MERCOSUR (*not ipso iure* member because this tariff union still has higher tariffs), and is first in line for a planned NAFTA extension.

Chile is also becoming a capital exporter, with large companies investing heavily in our region: nearly US$8 billion or 9% of GDP are dispersed among Argentina, Peru, Bolivia, Brazil and Colombia, from power generation facilities to financial services companies to

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real estate businesses. For example, some real estate developers are well positioned in Argentina, and others are starting to become so; a Chilean holding is now a partner of one of George Soros' Funds in making real estate investments in large extensions of lands in Buenos Aires.

Foreign investment inflows reached US$4.3 billion in 1995, exceeded US$6 billion in 1996, and became a historical record during 1997, with US$8.1 billion.[5] The main areas of foreign investment are copper mining production and the services and industry sectors. Issuance of American Depository Receipts (ADRs) of Chilean corporations traded on the New York Stock Exchange is also relevant, and amounted US$2.3 billion during 1997.

Legal, Regulatory Framework

The Chilean legal framework for foreign investment is very friendly. There is a simple and liberal Foreign Investment Act, dated 1974, that requires authorization for capital inflows involving more than US$5 million, provides foreign exchange guarantees and allows foreign investors to do business on the same basis as their Chilean peers. Repatriation of capital is permitted after one year, while investment returns can be repatriated regardless of time windows. The Central Bank also regulates foreign investment via capital inflows or credits, but in a more informal way and without foreign exchange guarantees.[6] Special investment company funds for foreign capital were created in the late 1980s in order to have a special purpose vehicle facilitating foreign capital inflows.

However, foreign credit is more expensive than domestic sources of money, because the Central Bank, which is independent from the government, imposes a mandatory non-interest-bearing 30% reserve on long-term loans for the first year of the loan duration. In 1996, the Bank extended this provision to capital increases. The reasons advanced by the Central Bank in favor of this policy are the fight against inflation and the avoidance of speculative inflows of money (so-called "bird capital"). Given the recent experiences in the Asian currency markets and the similar experience with the Czech currency earlier this year, the concerns of the Central Bank cannot be considered to be without foundation, although we hope this will be a temporary protective regulation.

Foreign investment in the real estate sector in Chile is still thin and timid, although it has grown from US$36.3 million in 1995 to US$203.3 million in 1996,[7] an enormous increase. Average real estate investment return was 8.2% in 1994 and 9.4% in 1995;[8] however, for future years this rate will likely decrease for the reasons that we will see below.

Interest Rate Trends

Interest rates are still higher than rates in the developed countries (OECD). Currently, the short- term rate is around 8.5%. This rate was raised in February 1998 by the Chilean Central Bank as a cautionary policy because of the recent Asian financial turmoil. The average short-term rate during the period 1993-1997 is estimated to be 8.5%. Not considering the recent Asian crisis, the main reason for the difference has been that the Central Bank does not want to overheat the economy—i.e., generating an inflation increase—by an immoderate growth of domestic consumption due to less expensive access to money. However, assuming that inflation decreases and the Central Bank relaxes the reserve for foreign loans and capital increases, short-term interest rates in Chile should gradually go down to an average of 5.5% during 1998-2002, compared with an estimated 3.5% short term LIBOR for the same period.[9]

This total economic performance has permitted rising living standards for the Chilean population and promising prospects for real estate development. Wages grew in real terms at an average pace of 4.7% during 1990–1996.[10] Adjusted annual per capita income at purchasing power parity was US$8,890 in 1994 and is expected to be US$11,600 by the end of the millennium, and US$16,500 in 10 more years.[11] Many Chileans are overcoming poverty, a sad scourge that some years ago affected 20% of our population. Recent studies show that the private sector has contributed 70% of the improvement in living standards in comparison with the public sector.

Financial Sector Composition

The Chilean financial sector is very sophisticated. There is a continuous updating and upgrading process. Disintermediation is a key word: Banks (a concentrated industry; only 30 operate in Chile) have been lowering their spreads and are becoming more short-term lenders, as the powerful pension funds and the insurance companies have been investing more in long-term debt instruments. There are also investment company funds, a vehicle created to act as a specialized conduit for debt and equity investments by institutional investors. One kind of investment company fund is the real estate investment company fund, that collectively manage today US$513 million in real estate investment—still far from the legal limit of US$3 billion that they are allowed to invest.[12]

Thanks to legal reforms, the newest development in the market is the securitization of assets and the introduction of mortgage-backed securities. Banks and other financial institutions are trying to win positions to capture this market. New regulations will allow banks to finance trade operations between third countries, and raise the percentage of their assets that the pension funds can invest abroad. Congress is about to discuss legislation authorizing offshore investment and trading in foreign securities in the Chilean stockmarket. To date, the Chilean stockmarket is one of the largest in South America: it has 323 corporations registered, with total assets of US$84.7 billion and total trading volume of US$4 billion during the first half of 1997.[13]

HOUSING REAL ESTATE BUSINESS IN CHILE

Regarding housing business opportunities in Chile, some data will be of interest:

1. Investment in real estate housing was US$3.126 billion in 1995 and US$3.416 billion in 1996, representing a 9.3% increase from 1995 to 1996. Public sector housing investment is included in this amount and represented US$489 million during 1995 and US$499 million in 1996, a 2.1% increase from 1995 to 1996. Private sector housing investment was US$2.637 billion in 1995 and US$2.916 billion in 1996, a 10.6% increase.[14] The estimates for 1997 were for a slight decrease, amounting to -0.5%, due to the increase in interest rates experienced in 1996.[15]

   Housing investment in Chile is mainly private, but nearly 15% of this investment is done by the public sector via subsidies. The basic subsidy method is that the government builds the houses using private contractors chosen in a bidding process and pays a percentage of the price of the new house, while the acquirer pays the difference. The applicants for subsidies need to meet certain requirements: no current home-ownership, earnings below a certain level and an amount of money previously saved. Subsidized houses constitute about 58% of the total number of houses built annually in Chile. In addition, the government provides a generous subsidy for housing acquisition in officially declared urban renewal areas, like Santiago's downtown.

2. The 1992 official Chilean census showed an approximate deficit of 600,000 houses, with a total supply of 3.1 million houses as contrasted to 3.7 million needed at that time. Some 83.5% of Chileans live in urban areas, according to the 1992 census. The total number of houses built during 1995 was 135,600 and 141,000 during 1996. Santiago, the Chilean capital, represents roughly 50% of the total market for private housing without public subsidies. However, from 1992 to date, as a result of economic growth, Santiago has been decreasing its relative real estate development size compared with other main Chilean cities.

3. Apartment buildings are an important component of total available housing, particularly in the biggest Chilean cities. Although we do not have statistics for the entire country, the average sales time for the stock of apartments in Santiago is now bordering on 16 months. This long period is expected to increase due to the interest-rate increase that the Central Bank ordered in February 1998. Prospective buyers were affected by a general mortgage loan interest-rate increase as of January 1998.[16]

Optimistic Prospects

Prospects for the economy and real estate market are moderately optimistic for the next years:

1. Chile is close to full employment rates, with only 6.1% of its workforce unemployed as of the third quarter of 1998. The wage increases referred to above will probably keep pace during the next few years, triggering demand for better houses in all respects: size, quality, location, green areas, infrastructure, etc. Domestic consumption rates have been expanding, with an adjusted average of 5.7% between 1993 and 1997.

   We can expect that some of the poorer social groups will leave public subsidies and become "bankable," thereby providing more clients for private mortgage banks. Those who will continue depending on welfare will now have access to bigger houses and will be able to trade their current houses freely, which they cannot now do until some years after having acquired their houses. Middle- and upper-Chilean social groups will also look for improvements, updating their existing homes, moving to other areas or acquiring second homes for vacation purposes.

2. Chile will have lower interest rates so long as the Asian turmoil is stopped and inflation is defeated; this will stimulate housing acquisition and remodeling. In this regard, all mortgage debt in Chile is now contracted for on indexed terms, i.e., the amount of interest paid is linked to an index that reflects the average inflation rate over a period of six months (the "Unidad de Fomento" or "UF"). This index is adjusted daily and is determined by the Central Bank. The Chilean internal debt market is starting a slow path to deindexed or nominal financial instruments. These instruments would not have the problem of being burdened with the inflation concerns that currently hammer Chilean mortgage debtors.

3. Over a 25-year horizon, a total demand of at least 1.8 million new houses is expected. Population growth alone will require 470,000 houses, a number that could be bigger, given the decreasing number of persons living in the same

house (from an average of 4.39 inhabitants in 1982 to 3.95 in 1992). The mere replacement of existing houses could require 360,000 new houses for a 25-year horizon, and the difference from the total estimate of 1.8 million houses may well be filled by the economic growth alone.[17] In addition, changing lifestyles will contribute to a surge of new residential market opportunities: single parents, young married couples, separated wives or husbands, and university graduates no longer living in their parents' houses are becoming a fast growing market niche.

4. The scarcity of land in some important Chilean cities, due to zoning and planning constraints, and the advantages that recreational areas have when some property is held in common are two factors driving many real estate developers to promote more condominiums: the first factor is particularly relevant regarding the urban areas of cities like Santiago, Concepcion or Vina del Mar, where apartment buildings have been flourishing during recent years.

   The second factor is starting to be relevant in big recreational complexes, where houses and apartments are intertwined with club houses, golf courses and access to the beach. For example, a French consortium is now finishing a US$100 million luxury condominium complex in a beach location that is 100 kilometers from Santiago; and Chilean investors have been very successful in a condominium with recreational apartments having an average value of US$250,000. This appears to present an attractive business opportunity for foreign investors, such as management companies for large portfolios of residential real estate, since these projects would contain major maintenance responsibilities and cash flows.

Congress has recently enacted legislation that modernizes the old regulations on common property, dating from 60 years ago, and mostly leaves to the common proprietors decision-making authority over the crucial issues of a condominium, such as the distribution of common areas, and the decision to liquidate the condominium or rehabilitate it. This latter decision is very important with respect to older buildings. An Achilles' heel for the improvement of the market for recreational and vacation properties could be the lack of adequate infrastructure. In this respect, however, the Chilean authorities are working on awarding concessions of tollroads in a Build Operate Transfer context and on improving the archaic Chilean airports.

Housing Finance Trends

We will now focus our attention on real estate finance from the standpoint of prospective house acquirers. Interest rates are now pegged to an 8.5% annual interest rate on indexed mortgage loans. Two years ago, the largest foreign Bank in Chile, Banco Santander, revolutionized the market by launching what it called "Super Hipoteca" ("Super Mortgage Loan"), cutting the interest then charged on mortgage loans to 7.8% and providing up to 90% of housing acquisition finance, while the previous amount was restricted to no more than a 75% loan-to-value ratio. Santander's competitors reacted promptly in offering similar products, triggering an important reduction in interest rates, and also lowering the spread from 3% to 1.3%, thereby benefiting the consumer.

To date, the main players in housing finance are the state-owned Banco del Estado de Chile, with a 36% market share, followed by Banco Santiago (its principal shareholders being the Chilean Luksic family, the British Hong Kong and Shanghai Banking Corporation, and the Spanish Central-Hispano Bank) with a 28% market share.[18] Interest rates are now stable and mortgage lenders are not willing to commit suicide by lowering the spread beyond the current point. Hence, they are competing for consumers by providing other services, such as shortening the time period for credit approval, providing lawyers to make the analysis of clear and marketable title, and registering the acquired property in the local records office.

Regarding financial instruments for house financing, the leading security is the "mortgage letter" ("Letra de Credito Hipotecaria").[19] This is a kind of long-term letter of credit that has roughly a 66% share of the market but is decreasing in volume of transactions. The mortgage letter of credit is issued by a bank, which sells this security to investors. Upon issuance, if the market value is less than the par value, the mortgagor must pay the difference to the bank. No prepayments are allowed, at least on convenient terms for borrowers. The main advantage of the mortgage letter is the fast legal foreclosure procedure, which makes it almost impossible for the borrower to oppose the foreclosure.[20]

Another instrument, the "mortgage loan" ("Mutuo Hipotecario"), has been getting greater consumer approval during recent years. Banks and special purpose corporations (the so-called "Hipotecarias" or "mortgage corporations," a sort of mortgage bank) are able to make mortgage transactions, but the mortgage corporations are limited to house acquisition by individuals and within city limits, while the banks can lend for other purposes and without restrictions regarding corporations or urban limitations. The mortgage loan has varieties similar to those employed in the mortgage market of the United States; these are intended to capture market segments by the mortgagees. The main kinds of products are:

- The Adjustable Payment Mortgage Loan, developed by Hipotecaria "La Construcción," where the debtor can opt for two kinds of monthly payments, either a 15- or 20-year payment schedule, without liquidated penalties. This loan is directed to persons with variable earnings, especially young professionals, who are expected to increase their wages over a period of time.[21] This product resembles the Graduated Payment Mortgage (GPM) or Flexible Payment Mortgage (FPM), that permits a changing payment schedule.[22]
- Some banks have instituted a limited kind of Open-End Mortgage, by allowing prepayments (repayment before maturity) with no penalties.
- Some mortgage loans allow the borrower to make their first payment six or seven months after credit approval and to suspend payment one month per year.
- Finally, the scheduling for payment (that is, the loan maturity) varies from 15 to 25 years, depending on the lender.

Interestingly, Chilean mortgagees do not provide Variable Rate Mortgages (VRM) or Adjustable Rate Mortgages (ARM), as they are known in the American market, where the loan is tied to a market-interest-rate index or to a government bond rate, thereby benefiting the borrower when the interest rates decrease. The reason probably lies in the Chilean mortgage loans being tied to the Consumer Price Index, and the borrower paying an interest above the inflation rate as expressed in an inflation unit (the UF, stated above). Thus, Chilean mortgage lenders prefer the Price Level Adjusted Mortgage (PLAM). Chilean mortgagees are not as liberal as their Canadian peers, who offer the Rollover Mortgage, allowing both lender and borrower to renegotiate the interest rate each certain period of time.[23]

Experiments With Leasing

A recent innovation in housing acquisition finance is housing real estate leasing, thanks to legislation enacted in 1993 and reformed in 1995.[24] We do not have time to explain this innovation fully, which is intended to be an alternative to mortgage loans. Succinctly, a person without enough savings to purchase a house with the help of a mortgage loan can acquire a property from a special purpose corporation, the real estate corporation, by leasing the house and making installment payments to the real estate corporation, directly or through a special purpose thrift corporation, that invests the money in the same way that the Chilean pension funds are allowed to. The final payment makes the lessee proprietor of the house. The real estate corporations can sell the leasing contracts—with a mortgage security interest attached—to special purpose vehicles, the securitization corporations, who in turn will issue bonds and sell them into the secondary market.

Notwithstanding the creativity of the Act, housing real estate leasing has not developed as expected, and to date, only a few of lease transactions have been closed, even when the government provided funds for 5,000 of these transactions during 1997 in the public subsidy context that we have already referred to.

The main reason for this cold reception is high transaction costs. These are the result of two factors: excess regulation in the law itself and excessive requirements that the administrative agencies have imposed upon the agents of the leasing system. These high transaction costs have made these leasing transactions more expensive than the new types of mortgage loans that have been introduced in the market, where the lenders provide up to 90% of the acquisition cost of a house.

From the securities market standpoint, the private pension funds are responsible for 80% of the total purchases of mortgage instruments, amounting to US$5.5 billion to date. Life insurance companies are also active participants in this market, with US$2.2 billion invested, given the long-term obligation nature of their life policies. In this context, mortgage securitization holds promise, and recent legal changes have paved the way for nearly 10 new bankruptcy remote special purpose securitization vehicles, the securitization companies, that are actively trying to buy mortgage loans and to issue bonds for institutional investors.[25]

The market is reasonably interested, and the first mortgage securitization was projected by Hipotecaria La Construccion in 1997, amounting to a modest US$5 million, although the numbers have been increasing since then to intended securitizations of US$50 million or US$100 million per issue. Financial needs of institutional investors are the principal determinants for the kind of bonds issued in securitization transactions. For example, it is possible to issue "balloon" bonds, with interest and principal payments correlated with life insurance companies' requirements. It is also possible to issue Adjustable Rate Bonds, tied to interest rate changes in another significant financial instrument.

Another method of securitization could be a Deferred Payment Bond, where a bond series has preferred payment to others that are paid after the preferred.[26] As we mentioned above, investment companies are expected to boost their participation from the modest US$0.5 billion that they manage in real estate investment, to the legal limit of US$3 billion, thereby providing pension funds and other institutional investors an alternate way to invest in mortgage-related securities.

Legal and Regulatory Requirements

In order for a security to be part of a securitization process, it is necessary to obtain a legal or a regulatory approval. To date, the instruments related to real estate finance that can be required in secured transactions are: the mortgage letter of credit; the mortgage loan; the housing real estate lease contract under the Housing Real Estate Leasing Act; and real estate leasing contract not submitted to this latter Act (for example, for commercial or corporate purposes).

From the standpoint of potential secured bond buyers, the mortgage loan is more attractive than the mortgage letter of credit, given that the lower interest rate of the latter does not generate an attractive spread for the securitization company. Transaction costs are also greater for mortgage letters of credit. Chilean regulations also require securitization instruments to be rated by two independent rating agencies. There is also another way of being involved in the securitization market, by buying shares of securitization investment company funds.[27]

The risk of the securitization process lies mainly in the adequacy of the Chilean legal framework for the sophisticated techniques that such a process requires and in the willingness of the Chilean regulators to let the markets work without harming consumers.[28] This development process is very similar to the first steps of securitization in the United States, where judicial decisions overshadowed the development of what is now a trillion dollar industry.[29] However, as we have shown, the enormous potential of securitization for real estate finance is both beneficial for the housing and commercial aspects of this industry.

Another development expected in the Chilean financial market for housing acquisition is the appearance of the government as second-tier banker, in a form adapted from the United States housing government-sponsored entities (GSEs), such as Fannie Mae, Freddie Mac, and Ginnie Mae. The Housing and Urban Development Ministry, with the advice of the American Administration and the MBAA, is trying to move itself from the position of direct subsidizer to one of guarantor of commercial banking loans to persons that are expected to get involved in public aid as subsidy beneficiaries. The Ministry also sees opportunities for foreign investors in the development of insurance and other financial products to cover interest-rate risk and legal habitability warranties that the real estate developer is responsible for.

CONCLUSIONS

Chile has been a successful economy during recent years. It began the free market reforms that paved the way for a sustained growth earlier than many other Latin American countries, and changes in the political orientation of the executive and legislative powers have not substantially altered the free and friendly economic environment that we Chileans enjoy. Real estate business opportunities are open for nationals as well as for foreign investors, while both the legal regime and the business community do not discriminate on the grounds of nationality or country origin of financial resources. The prospects are moderately optimistic even in the long term, both in the housing and in the commercial areas. Mortgage operations represent a good portion of the financial necessities, and Chile's sophisticated market is fertile ground for potential investment.

APPENDIX: CHILEAN FINANCIAL INSTRUMENTS FOR HOUSING ACQUISITION

Mortgage Letter ("Letra de Credito Hipotecaria")

The transactions underlying this instrument are the following:

1. A bank takes a mortgage for housing acquisition in a given amount and term. This mortgage is granted by a potential housing purchaser.

2. The bank issues certificates (securities) for the same amount of the acquisition value of the property. It offers the certificates to investors. The bank can also give the certificates to the borrower. Investors buy the certificates at a discount. The certificates are redeemable by paying coupons. These coupons include amortization and interest.

3. If the bank sells the securities, it gives the product to the borrower. If sold under face value, the borrower must pay the difference between the face value and the market price of the security. Thus, the bank does not lend the money directly to the borrower; it gives him "credit letters" or mortgage-backed securities ("letras"). These securities are sold in the capital markets. Since these are bearer instruments, they have great liquidity in the secondary market.

The mortgage transaction between the bank and the "borrower" requires a mortgage, contained in a public deed given before a Notary. This mortgage is registered in the Public Records Office. The mortgage is an asset of the bank, while the mortgage letter belongs to the investor who bought it. The mortgage letter constitutes a bank´s liability and an investor's asset.

Therefore, the bank is a creditor of the borrower and a debtor to the investor. The borrower must make anticipated monthly installment payments that include amortization, interest and fees. Fees are the only amount of money that the bank perceives for these transactions.

The only risk assumed by the bank is the default by some debtors. The investor who has purchased the notes bears the risk of the originator's solvency, the debtor's default and the quality of the guarantees that the debtor has given. If a debtor is allowed to prepay and indeed does so, for purposes of keeping the parity correlation between letters of credit and loans granted, the bank must retire from the market letters of credit with the same series and amount.

The mortgage letter of credit constitutes a sort of securitization. A pool or series of letters is sold to institutional investors, especially Chilean private social security pension funds or life insurance companies. The sale price is expressed as percentage of the unpaid amount of the letter of credit plus accrued interests. The investor can sell the letter, given the fact that it is issued to the bearer.

Mortgage Loan ("Mutuo Hipotecario")

Banks and special purpose corporations (the so-called "Hipotecarias" or "Mortgage Corporations," a sort of mortgage bank) are able to make mortgage transactions by extending loans backed with mortgage guarantees. However, mortgage corporations are limited to house acquisition by individuals and within city limits, while banks can lend for other purposes and without restrictions regarding corporations or urban limitations.

The mortgage loan is a mortgage-backed security. The loan is transferable by endorsement of the document on which it is expressed. It consists of money, not certificates. The borrower gets the money he needs for housing acquisition directly from the lender, without selling any certificate to investors.

It is the lender who sells mortgage-backed securities to life insurance companies and other legally allowed investors. The sale price includes a discount on the payments that the debtor must make periodically. Payments are made according to the rate of return agreed upon with the purchaser of the contract, plus a risk premium. The agreed rate is less than the rate at which the mortgage loan was entered into. Therefore, the fee for the originator is not expressed in the rate.

The principal risks for the mortgage loan are the solvency of the debtor and the nature of the underlying guarantee. Mortgage loans can be used in mortgage-backed securitizations; they can be pooled and converted into assets with great liquidity and low risk. Mortgage letters of credit are also legally permitted to be securitized; but, as mentioned above, they are in fact a kind of securitization.

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NOTES

[1] Sources: Chilean Census Bureau Office (INE); Fontaine and Paul Associated Consultants; Economic Research Department, Chilean Chamber of Construction.

[2] Insurance Companies manage US$8.5 billion, Mutual Funds US$3.7 billion and Investment Company Funds US$2.9 billion. Source: Daniel Yarur, Securities Superintendent (Chilean Securities Regulatory Agency), "The Chilean Securities Market: Regulations on Mortgage Securitization and Housing Real Estate Leasing Contracts," Conference at the business meeting between the U.S. Banking System and the Chilean Housing Financial System, August 21, 1997.

[3] *El Mercurio,* (Chilean Newspaper), "Positive Real Estate Trends," August 31, 1997.

[4] The Economist Intelligence Unit, "Investing, Licensing and Trading Conditions Abroad," February 1997 (EIU, Chile).

[5] *El Diario,* Chilean financial newspaper, February 10, 1998, page 25.

[6] Chilean Foreign Investment Act, Law Decree No. 600 of 1974; Central Bank of Chile, Chapter XIV of the International Exchange Regulations. The Central Bank's regulations are more flexible: a change requires only agreement of the Bank's Board, while the Foreign Investment Act needs a legislative act of the Congress.

[7] Source: Central Bank of Chile. This amount only includes direct inflows to real estate corporations and does not consider the contributions made to investment companies that may have been funneled to real estate investment.

[8] EIU, Chile.

[9] Fontaine and Paul; Economic Research Department, Chilean Chamber of Construction.

[10] Economic Research Department, Chilean Chamber of Construction.

[11] Fontaine and Paul.

[12] Chilean Investment Company Funds Act, No. 18815 of 1989, updated in 1994, 1995 and 1996.

[13] Source: Chilean Securities Agency, June 1997.

[14] Source: Economic Research Department, Chilean Chamber of Construction, Analysis of the Construction Activity in Chile During 1996 and Prospects for 1997, Mr. Pablo Araya, Chief Economist, April 25, 1997.

[15] Id.

[16] *El Diario,* January 28, 1998. Average annual real interest rates were updated from an 8% to a 10–11% range.

[17] Pix Investment, "Ins and Outs in the Real Estate Business," in *Capital, Negocios y Mundo,* (Chilean business magazine), August 1997.

[18] *Capital, Negocios y Mundo,* (Chilean business magazine), August 1997.

[19] Financial instruments are explained with more detail in an appendix of this document.

[20] The defenses for the borrower are surrealistic: payment of the debt; statute of limitations or lack of enforceable title against the mortgagee. The regulations for this security are contained in the Chilean Banking Law of 1960, in its Title XII, added in 1978.

[21] See "Diversification," article in *Capital, Negocios y Mundo,* August 1997, and Chilean Insurance Companies Act of 1931, that established the mortgage loan for Mortgage Corporations in 1989.

[22] Charles H. Wurtzebach and Mike E. Miles, *Modern Real Estate,* (5th ed. 1994).

[23] Id.

[24] Pedro D. Garcia, "Housing Real Estate Leasing Act Explanation," in *Housing Real Estate Leasing,* (Santiago, 1996).

[25] Chilean securities Market Act of 1991, Title XVIII, regarding securitization companies, added in 1994, that structure these entities as corporations rather than commercial trusts.

[26] Securitization, Hipotecaria La Construcción (Chilean Mortgage Lender Corporation), 1996. In addition, the mortgage letter of credit is in fact a kind of securitization, because it is actively traded in the secondary market and mainly bought by the Pension Funds.

[27] Id.

[28] Among the weaknesses, we could mention the following: more regulations than other countries regarding securitization; undeveloped market for interest-rate-risk hedging; and legal requirements that are not strictly related with financial aspects, such as minimum equity level per securitization company, debt-equity ratio for the total amount of secured instruments issued by one securitization company and diversification of credit originators. Daniel Yarur, Securities Superintendent (Chilean Securities Regulatory Agency), "The Chilean Securities Market: Regulations on Mortgage Securitization and Housing Real Estate Leasing Contracts," supra Note 2, and *Securitization, Hipotecaria La Construcción,* supra Note 26.

[29] Octagon Gas v. Trimmer, 1993 WL 180727.