

Mortgage Lending in Argentina and the Prospects for a Secondary Market

by Jorge Solari

INTRODUCTION

With three mortgage-backed securities (MBS) in the international market in 1996 and 1997, Argentina seemed at the gates of development of a secondary mortgage market. A legal framework allowing for securitization had been implemented; mortgage documentation was standardized; and underwriting and servicing procedures were redesigned to meet international standards.

Two years after those promising securities were issued, however, the gates are yet to be open. Several factors have halted the process and become a disincentive for the development of an Argentine secondary mortgage market. These factors include the revenue spread enjoyed by big mortgage lenders, their lack of capital needs and lenders' unwillingness to share loan information with other financial entities involved in the transaction (such as a servicer or trustee).

In the 1990s, Argentina experienced a resurgence of long-term financing for both consumers and commercial borrowers. This came after decades of short-term and ex-

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pensive lending. In this decade, mortgage lending has been the main driver and focus of private and public banks, fueled by a housing deficit and banks' desire for loans backed by good collateral.

Also, mortgage lending provided financial institutions with a secure and stable source of revenues. This surge in mortgage lending was achieved by the stabilization and growth of the economy. It was also a reflection of foreign investors' renewed interest in Argentina, which provided financial entities with longer term lending at a cheaper cost.

Until the second half of 1998, mortgage origination increased at a rapid pace. It was aimed at a middle class market having unmet housing demands, and a willingness and ability to incur indebtedness, as loan conditions more closely resembled those of developed countries.

During the second half of 1998, the global market crisis and especially the financial troubles of Argentina's biggest neighbor, Brazil, hurt Argentine financial institutions by closing financing lines and increasing the cost of those left in place. This led to deterioration in mortgage loan conditions offered to debtors.

The deterioration of economic conditions and expectations led to a decrease in con-

sumers' willingness to incur additional debt. The uncertainty created by the upcoming presidential elections in October 1999 also dampened consumers' appetites for mortgages. The resulting decrease in the growth of banks' mortgage portfolios further lessened banks' desire to securitize mortgages.

This article will review Argentina's housing and related financing conditions and why, despite strong legal and regulatory conditions, a secondary mortgage market will not develop in the short term. It will also describe the successful first mortgage-backed securities and detail how they are performing.

HOUSING DEFICIT AND MORTGAGE LENDING: TURNING MONEY INTO MORTGAGES

The growth of the Argentine real estate market has been directly influenced by the country's political and economic history. During the last two decades, there have been substantial fluctuations in housing investment due to years of high inflation, lack of government investment in infrastructure, and volatile and changing government policies.

During the two decades before Argentina's 1991 stabilization plan, mortgage loans were expensive and of short duration. They were only available to creditworthy people who financially did not need them. Moreover, dur-

ing most of the 1980s, mortgages were not available because of the high volatility of the economy. Banks, which borrowed short term, were discouraged from committing their funds to long-term lending. In addition, the costs of mortgage loans were prohibitively high because of the banks' high cost of short-term capital for long-term lending (which meant five to seven years).

The 1991 census calculated approximately 8.5 million households in Argentina. According to several public and private sources, the housing deficit was estimated at 3 million units. This deficit reflected mainly the number of owners living in substandard housing.

The supply of rental housing was not able to reduce this deficit. Historically, it has been legally very difficult to evict tenants who failed to pay their rent, which discouraged investment in rental properties. Because of this and the uncertain inflationary environment, the rental supply has been very low compared to that of other countries.

Economic Recovery Leads the Way

Argentina's economic recovery was a prerequisite for the development of a housing finance market. This is because borrower demand for mortgage finance depends on a number of factors, including job security, a stable inflationary environment that can protect real wages and promote savings, and the speed of financial reforms pursued by the government. All of these conditions were gradually met in the 1990s, which meant the end of the short-term, high-cost banking loans as the only source of financing for consumers and companies in Argentina.

After the strong contraction during the 1995 crisis, the Argentine banking system resumed its rapid asset and deposit growth in the context of improving solvency. From June 1995 through October 1998, assets and deposits climbed 95.5% and 74.4%, re-

spectively. Nonperforming loans decreased to 9.4% of total loans, as the growing economy benefited from the increased payment capacity of debtors.

Banks improved their credit allocation process with better systems and procedures to assess the quality of debtors. Nevertheless, certain institutions have seen their liquidity tested, as the global credit crunch almost blocked Argentine banks' access to foreign funding sources. (Table 1 shows mortgage lending growth in the last six years. Table 2 details the 10 biggest private mortgage lenders.)

With the 1991 convertibility plan, real estate prices started to rise considerably and borrowers' income level stabilized or grew in real terms. These factors enabled medium- and low-income people to afford mortgage loans.

Moreover, economic stability attracted capital inflows and new investments. The major national mortgage bank, Banco Hipotecario S.A. (BHSA), was restructured (from 1990-1991), streamlined (from 1991-1993) and then partially privatized (in 1999). The economic stability also brought about a rise in the supply of rental property.

Mortgage Debt Preferred to Rental Payments

As mortgage loan terms have edged closer to developed market standards, however, consumers have shown a preference for taking on mortgage debt instead of paying rent on someone else's investment. The key in attracting borrowers has been the installment value offered through mortgage financing. Faced with monetary obligations for rent and mortgage financing that are similar, consumers now opt for homeownership.

As mortgage maturities have lengthened, monthly mortgage payments have declined, making homeownership even more favor-

able. Extensions in mortgage terms were made possible because banks were able to resort to the capital markets to get funding at longer durations.

Before the 1998 global market crisis which resulted in the Latin American region liquid-

Table 1. Argentine Financial Entities Mortgage Lending (in millions)

Date	Mortgages	Total Loans	Mortgage Loans Share
Dec 93	6,679	47,707	14%
Dec 94	8,970	56,062	16%
Dec 95	9,940	54,179	18%
Dec 96	11,004	61,347	18%
Dec 97	12,818	69,495	18%
Dec 98	15,387	76,955	20%
98/95 Growth	130%	61%	

(The chart includes non-housing mortgage loans. It is estimated that 60% of the loans are home mortgage loans.)

Table 2. Biggest Argentine Private Mortgage Lenders

Bank	Dec 1998	Share
Banco Hipot	3,629	23.59%
Banco Galic	1,277	8.30%
Bank Boston	843	5.48%
Banco Rio	781	5.08%
Banco Fran	572	3.72%
Citibank N.A.	499	3.24%
Banca Nazio	444	2.89%
HSBC S.A.	318	2.07%
Banco Quiln	282	1.83%
Banco Bans	207	1.34%
Remaining	7,786	50.60%
Total	15,387	100%

ity crunch, mortgage loan conditions were similar among competing banks, since most of them get their funding from the same sources. During the crisis, the Argentine banking system was one of the most affected by the Brazilian devaluation, with banks suffering from reduced liquidity and an unfavorable economic environment.

Foreign funding sources disappeared, forcing the banks to change their financial plans and repay maturing debt issues. These actions caused a slowdown in lending. They also led to deterioration in mortgage lending conditions from the consumer's perspective. As can be seen in Table 3, conditions have deteriorated, and the needs of the supply and demand of mortgage funds have taken separate roads.

**SECURITIZATION:
LEGAL FRAMEWORK IS READY,
INVESTORS ARE WILLING,
ORIGINATORS ARE NOT**

In Argentina, where only 5 to 10% of homeowners have mortgages, the lack of mortgage funding creates a great incentive for securitization. The government was the major force behind securitization in Argentina and passed a law in January 1995 that permits the securitization of mortgages and other assets.

Table 3. Global Financial Crisis Effect on Mortgage Condition

<i>Loan Conditions</i>	<i>Market Trend Before Crisis</i>	<i>Post Crisis</i>
Loan to Value	60-90%	50-60%
Rate	9-15%	11-18%
Loan Term	10-25 years	5-15 years
Currency	peso/dollar	dollar

The intent was that BHSA (100% state-owned at the time) would purchase, securitize, and sell loans in the domestic and international capital markets, thereby ultimately lowering housing costs. Furthermore, securitization could ensure the ready supply of investment funds from the capital market to fund mortgage lending; the development of a secondary mortgage market would allow banks and lenders to transfer interest-rate, credit and liquidity risks to the capital markets.

By providing lower mortgage costs and increased availability of mortgages, securitization would ultimately facilitate housing development. Although securitization has been successfully achieved and major advances in key areas such as legal framework and investor demand have been made, however, factors slowing the process, such as originators' strong incentives not to sell their portfolios, make a developed secondary mortgage market unlikely in the short run.

Legal Framework in Place

In January 1995, Argentina enacted Law 24,441 on housing financing. The main objective of the law was to provide a legal framework to encourage the securitization of mortgage portfolios. This, in turn, would lead to a growth in mortgage loans at terms and rates affordable for the less privileged classes. This goal ultimately implied that securitization would fuel the housing construction industry and help reduce unemployment.

Additionally, this act was also designed to favor the issuance of asset-backed securities. The law, and successive regulations of the Argentine securities and exchange commission, was successful in providing legal comfort to investors in terms of the true sale nature of assets sold to a trust, their isolation from a seller's estate, tax exemptions and other aspects that are required in a typical MBS in other countries.

Law 24,441 also created the necessary procedures to shorten the terms of foreclosure procedures. Historically, the process of foreclosure has been a lengthy one. Foreclosures averaged 15 months in length and often exceeded two years. The new legislation shortens the terms under which a creditor may commence a public sale of a foreclosed property. It also limited the terms of a debtor in presenting any defenses.

It is too early to discuss any real efficiencies resulting from the new legislation. However, it is expected that, in time, benefits of the new law will be realized.

The Central Bank of Argentina also has contributed to the goal of a secondary mortgage market by encouraging banks to meet specific criteria in terms of standardized loan documentation, origination procedures and appraisals. If a bank fails to meet these criteria, it is required to put up additional capital against its mortgage assets.

**Foreign Investment Helps
Originator Preparedness**

Most financial institutions have professionalized their staffs, and gained technological and procedural expertise after being absorbed by foreign institutions. While in December 1994 assets of foreign-controlled institutions were Arg\$12.9 billion (or 15% of total assets held by financial institutions), by October 1998 they had climbed to Arg\$83.5 billion (or 60%). Among the 10 largest institutions ranked by deposits in 1994, there were only two foreign-owned banks; by October 1998, after many mergers and acquisitions, this number had climbed to six.

This will help Argentine financial institutions prove that they are capable of consistently originating and servicing mortgage loans that have international standardized credit procedures and underwriting practices, and that they can show the historical performance data necessary for securitization.

Strong Local and Foreign Investor Interest

The growth of managed savings institutions, such as pension and insurance funds, could help spur the development of a secondary mortgage market in Argentina. This, along with international investors who have shown in recent years an interest in the Argentine market, can supply the demand to support the growth of MBS.

Both mutual and managed funds are excellent matches for MBS because these investors' funds have a relatively long investment horizon that coincides with the long maturities of most mortgage loans. In Argentina, a growing workforce is expected to add Arg\$400 million per month to the sizable \$13.5 billion under management in May 1999 by the private pension fund companies. In addition, the total amount of mutual funds has grown consistently to Arg\$7.7 billion of funds managed in June 1999 from Arg\$389.5 million in December 1994.

Originator Disincentives Outweigh All Other Factors

Argentine financial institutions are aware of the many advantages that can be achieved through securitization. This type of financing can provide an alternative funding source, access to long-term and lower cost funding, and allow for the growth of lenders' businesses. Another important benefit, although not always obvious to lenders, is that the process of securitization will enable them to fully and clearly understand their strengths and weaknesses in underwriting and servicing procedures, asset characteristics and performance; this could enhance the profits of their day-to-day business.

But those same financial institutions consider that, despite these advantages, there are also a number of factors that outweigh these benefits: The costs and resources imbedded in a transaction can make it un-

economical for issues below Arg\$50 million (which eliminates the incentives for small financial institutions).

- Banks with the biggest portfolios of mortgages still have excess capital requirements (as shown in Table 4).
- Currently, there is no market for independent trustees, so banks will likely have to share their portfolio data with a competitor which will perform the role of trustee.
- There are no present intentions in the market to allow the growth of financial entities dedicated to the servicing and custody of assets.
- The financial crisis has slowed the growth of mortgage assets, discouraging the need for securitization.

Smaller institutions have had a more proactive approach towards securitization, as they have been hit the hardest by the liquidity crisis. However, they are more likely to have small loan pools which make securitization less economical. Also, these lenders are less likely to have the servicing and underwriting systems needed for MBS.

BHSA MBS PROVE IT CAN BE DONE

During 1996 and 1997, Argentine MBS accounted for more than US\$550 million.

Table 4. Financial Institutions Capital Requirements

<i>Excess on Capital Requirement (%)</i>	<i>Dec 96</i>	<i>Dec 97</i>	<i>Dec 98</i>
Private Entities	36%	28%	29%
Top 10 Private Entities	37%	22%	21%

Three of these transactions, issued by BHSA, comply with the requirements and ratings established by the international markets. From October 1996 until October 1997, the bank issued dollar- and peso-denominated MBS worth more than US\$305 million and A\$199 million, respectively.

For the dollar issuances, BHSA acted as a wholesale lender by purchasing dollar-denominated mortgages from lenders and securitizing these loans. These MBS were then sold in the global and capital markets. All the rights, title and interest in the mortgages were assigned to a trustee. Also, the mortgages were registered in the name of the trustee.

The originating lenders have continued to service the mortgages, while BHSA is the master servicer and is the primary servicer for servicers that have become unable to perform and were not replaced by another servicer.

The notable feature of the bank's dollar-denominated securities is the decreasing level of subordination supporting the senior debt of each transaction. The levels have decreased for each issuance, while the ratings have remained constant; the loan characteristics have remained broadly the same, and interest rates on the debt have not wavered much.

This reflects the acceptance of Argentine MBS by local and international investors and their willingness to accept lower credit enhancement. Additionally, the senior debt issues have offered yields similar to those of equally rated U.S. MBS transactions (as shown in Table 5).

Peso-denominated Issues Differ

The securitization of BHN's peso loans was significantly different from its dollar loan-backed issues. The peso transactions are

Table 5. BHN MBS Issuance Conditions

Series	Date	Total Amount	Senior Class Fixed Rate	Senior Class Variable Rate	Senior Class Subordination	Senior Class International Rating
1	Oct 96	93,024,099	7.36%	LIBOR+1.85%	15%	—
2	May 97	106,574,337	7.91%	LIBOR+1.45%	10%	BBB-
3	Oct 97	105,420,027	7.54%	LIBOR+1.28%	8%	BBB-

secured by the future cash flow of a pool of mortgages. However, because of the high expense of assigning more than 19,000 loans, the loans were not assigned to the trustee of the securities.

While the transfer of the loans may occur upon the occurrence of certain events, it does not provide the necessary legal comfort to enable the rating to ignore the credit quality of the bank. Therefore, the peso transactions are limited to the 'raA+' rating of BHSA on the national scale.

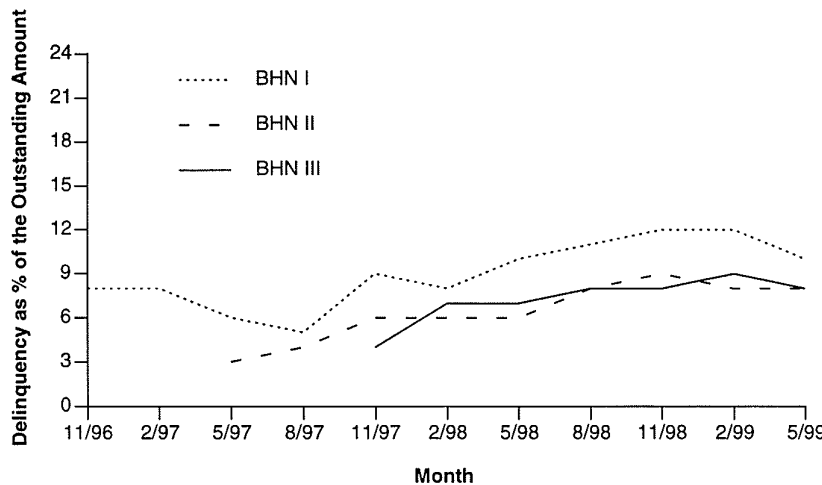
Performance of the dollar-denominated MBS has been satisfactory. Almost two-and-a-half years after the first MBS was issued in Argentina, Standard & Poor's has concluded that, although the securitized mortgage portfolios show an increase in delinquency levels, they still remain at levels that correspond to the assigned ratings.

With the performance of the dollar series depicted in Figure 1, showing loans with payments overdue by at least 60 days, the following can be deduced:

Since the start of each transaction, and except for the case of the first series' portfolio, the 60 or more days delinquency never reached 10%. In the case of Series 1, the 10% ceiling is surpassed by less than 5%. Delinquency performance, considering seasoning cycles, had a similar development in all of the three cases (which is also coincidental with BHSA's total mortgage portfolio performance).

- During the last four months of 1998, and matching the downturn in the economic and financial environments, the delinquency levels increased in all of the three series. Nevertheless, the percentage of delinquent loans that was reached in each case still remains at levels that were considered in the rating analysis (1999 numbers show delinquency is recovering 1997 and first half of 1998 delinquency levels).
- Not only are these figures consistent with the ratings assigned, but the over-90-days delinquency category shows a sharp decrease where overall delinquencies have been increasing (as shown in Figure 2). This demonstrates that most of the delinquencies are short term.
- This can also be confirmed by the analysis of the foreclosure procedures. In any of the analyzed series, the percentage of cases that went to foreclosure is not higher than 1.6% of the issued principal amount.

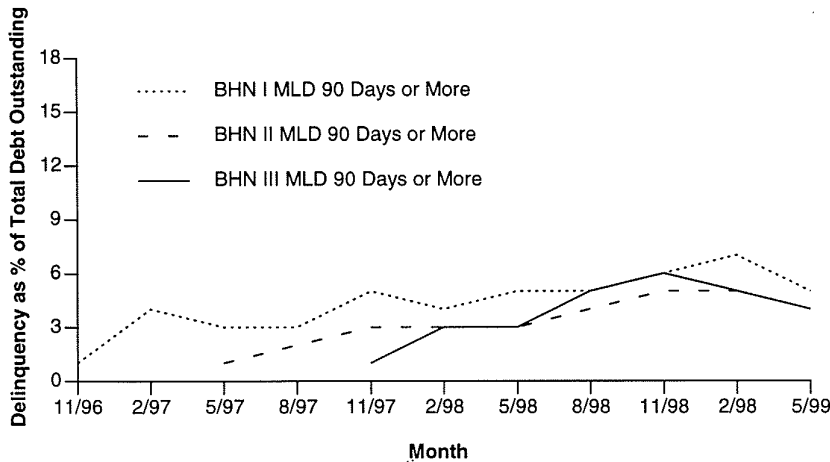
Figure 1. BHN Mortgage Trusts: 60 or More Days Delinquency



These transactions have demonstrated that all of the enhancements and guarantees contemplated in the rating analysis have been appropriate for the Argentine market.

BHSA is the first Argentine financial entity that has standardized its underwriting and servicing procedures, and this have proven to be fundamental when dealing with a portfolio that is facing worsening economic con-

Figure 2. BHN Trusts: 90 or More Days Delinquency



ditions. This, once again, reminds market participants not only of the need for a credit track record, but of fundamentally sound operation in terms of origination and underwriting procedures.

FUTURE PROSPECTS

The financial and liquidity crises have turned 1999 into an economic recessive year for Argentina. However, once prosperity is restored, banks will resume their lending, and mortgage growth and loan conditions will recover pre-crisis levels.

This will likely begin to happen in the first half of 2000, as political uncertainty is elimi-

nated, and investors' confidence in the country grows again as the country proves it is committed, regardless of the political party in power, to the economic reforms that initially attracted international investors.

Regarding securitization, and beyond the political intention to encourage it, it will take some time before the advantages of securitization, coupled with the need for a stable financing alternative in times of a financial crisis, will end up contributing to the growth of the MBS market.

A MBS surge will probably be ignited by foreign entities which, in recent years, bought local entities. These foreign institutions have

already experienced the tremendous benefits of securitization in their own developed markets.

Before that happens, however, they will have to complete their knowledge of the Argentine market, professionalize their staff according to headquarters' standards, and improve the products they offer to match their international expertise with local market needs.

Then these institutions will be ready for a second stage which will include developing a mature secondary mortgage market, perhaps the first in Latin America.

SOURCES

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"Securitization in Latin America 1998": General discussion on Latin American MBS, Argentine MBS market, rating criteria for Argentine MBS.

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