

Secondary Mortgage Market Developments

ECHMB – Steady Progress

Amidst significant challenges, the **Eastern Caribbean Home Mortgage Bank (ECHMB)** has made steady progress in its three years of operation. Indications are that the resources of the traditional primary lenders are becoming increasingly stretched, and alternate-financing sources will be needed. It is hoped that the existing barriers will be broken down gradually, and these institutions will see the wisdom of turning to the ECHMB.

Rationale

The ECHMB was established as the premier secondary mortgage institution within the EC\$ area. A feasibility study conducted in 1992/93 which helped to inform the decision to establish ECHMB, estimated the primary residential mortgage in the EC\$ area about \$900M. That market is now estimated at about \$1.4 Billion. In addition there are indications that demand for housing is increasing through population growth, urbanization, expansion of villages and rising per capita income. The commitment by governments in the respective territories to increase homeownership substantially is also expected to influence demand.

The technical rationale for primary lenders to engage in business with the ECHMB is:

1. By selling qualified mortgages on a voluntary basis, the sellers are able to reduce the concentration and liquidity risks associated with mortgage lending.
2. By continuing to service mortgage for ECHMB, the sellers to retain the relationship with the customers for cross-selling opportunities and can secure servicing fee income.

The lending decisions of commercial banks are essentially deposit-driven.

Through the secondary mortgage market, the ECHMB acts as a mediator between the bond and housing markets, effectively assuming the funding risk and alleviating the asset-liability mismatch in the commercial banks.

Performance

In his presentation to the CASHFI-BMFC conference held in Barbados, April 29-30, 1999, ECHMB's General Manager, St. Bernard J. Sebastian provided an update on the performance of the bank. ECHMB started commercial operations in May 1996 and purchased the first pool of mortgages in March 1998. As at March 31, 1999, total outstanding balance in mortgages stood at \$11.3M. Recently the bank concluded a \$9M transaction for the construction of new housing in St.Kitts/Nevis, working jointly with a primary lender and developer.

The bank raises funds through the issuance of corporate debt. To date, the bank has raised \$46M through four successful placements of bond issues on the regional market. Institutional investors in the OECS as well as others with headquarters in Barbados have taken up these bonds.

After the first two years of operations, the bank reported a net profit of \$225,000, and for year ending March 31, 1999 recorded profit was \$784,000

Challenges

For the bank to accelerate the pace of growth and make the kind of impact envisioned there are some challenges to overcome. These are:

- Sale of mortgages with recourse*
 Some banks have registered their discomfort with the condition that “purchasing of mortgages is made with recourse to the primary lender” Given that only high quality mortgages are purchased after they are deemed to be eligible by the ECHMB, it is argued that ECHMB should therefore assume any risk thereafter. The ECHMB on the other hand argues that prudent banking practice demands the maintenance of this condition. The bank must firstly retain its role as a secondary lender, complementing (rather than competing with) the activities of the primary lenders; and secondly ensure at all times that obligations to bond holders can be met.
- Administrative and servicing fees*
 Some banks are of the view that the 1.5% fee is not sufficiently attractive to lure them into selling mortgages. The ECHMB feels this is born of a misconception by the banks that there is significant additional administrative work associated with selling mortgages. Based on the administrative structure and processes, the ECHMB insists that there is little or no additional work involved. Having regard for the cost of borrowing and required minimum spread of 2% between the return on its assets and the cost of its liabilities and administration, the ECHMB sees the present fees as being the optimum allowable.
- Sale of mortgages unattractive*
 Some banks have indicated that they have not reached their

ceiling for funding committable to mortgages. In any event, they are simply reluctant to give up their good quality income earning assets until it becomes absolutely necessary. the ECHMB hopes that in time they will see the financial wisdom in offloading some of their mortgages to the mortgage bank, thereby creating the “headroom” for new lending.

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