

MORTGAGE LENDING IN BRAZIL

Contributed by Luiz Henrique Rocha, Director General, ABECIP, an IUHF member, is the Brazilian housing finance trade association, based in São Paulo.

I. Introduction

1. Long term lending in Brazil has traditionally been very scarce due to the very high inflation rates prevailing until not so long ago. Hence mortgage lending has been restricted to the housing finance loans granted by the Housing Finance System (SFH).
2. These loans have been made possible by monetary correction or adjustment, which was introduced in 1964 to prevent the capital base of such loans and of government-issued securities to be eroded by inflation.
3. The economic stabilization process implemented with the Plano Real, in July 1994, is enabling the development of new sources of financing for the real estate sector, as well as the implementation of a secondary mortgage market in Brazil.

II. Housing finance loans by financial institutions

4. Housing finance loans are made available by financial institutions authorized by the Banco Central do Brasil to raise savings deposits. There are 41 such institutions, including the Federal Savings Bank (Caixa Econômica Federal) and one savings and loan association. The remaining financial institutions are private or state-government owned multi-chartered banks. In addition to requiring authorization to operate in housing finance, such institutions are subject to the National Monetary Council (Conselho Monetário Nacional) and Banco Central regulations and supervision.
5. Savings deposits are their main funding source. The deposits earn interest of 0.5% per month and their balance is adjusted every month on the same day that the accrued interest is credited to the account. The interest is calculated on the adjusted balance.

There are presently about 85 million savings accounts held by the above financial institutions totaling R\$ 90.5 billion (approximately US\$ 52 billion). The National Monetary Council establishes strict rules for the use of these deposits, as follows:

- 15% have to be deposited as reserve requirement with the Central Bank.
 - 60% at least have to be used as housing finance loans, i.e. loans for the purchase or the construction of housing units. At least 80% (48% of the deposits) must be loans under so-called “Housing Finance System” conditions (*financiamentos no âmbito do SFH*) (see item 6 below). The remaining 20% (up to 12% of the deposits) may be housing finance or real estate finance loans at free market rates and conditions. No home equity loans may be made with these funds.
 - The remaining funds (about 25%) of savings deposits are used as cash reserves or invested in government securities (approximately 50%) or loans to real-estate-related activities: working capital for building companies, wholesalers and retailers of building materials; construction or purchase of offices, shopping centers, stores; and home equity loans.
6. The conditions of the loans made under the Housing Finance System (80% of 60% or 48% of the deposit base) are also established by the National Monetary Council:
- Interest rates: 12% per annum for individuals purchasing a home or 13% per annum for builders constructing flats for residential purposes
 - Monetary adjustment of principal and installment: monthly by the same index that is applied to savings deposits
 - Maximum value of the real estate unit being financed: R\$ 180,000 (approximately R\$ 104,000)
 - Maximum financing value: R\$ 90,000 (approximately US\$ 52,000)
 - Maximum Loan to Value (LTV) : 90% (market practice is 50% to 60%)
 - Maximum term: 48 months (production) 20 years (purchase) (market practice is 10 to 12 years for purchase)
 - Loans must be made to finance the construction or purchase of residential units only.
 - The collateral of the loan is the mortgage of the unit being financed.
 - Insurance policies: life and permanent disability of the borrower(s) and damages to or losses of the real property unit being financed.
7. The terms of the free market rate loans (20% of 60% or 12% of the deposit base) are freely negotiated between the creditor and the debtor(s). Interest rates are normally higher than those applicable to HFS loans (presently they are around 13%-14% per annum). The loans are also subject to monthly monetary adjustment. The insurance

policies required are the same as those required for SFH loans. Until recently, these loans could only be destined to finance residential units. Since June 1998, however, half of them can be used to finance non-residential units as well.

There are no limits on the real property value or on the financed amount as in the case of the HFS loans, however, borrowers may not use some of the advantages granted to the borrowers of the HFS loans, such as the use of their FGTS deposits to pay off the loan or part of the installments.

8. The terms and conditions of the loans made with the remaining funds of savings deposits are freely negotiated between the contracting parties. Such loans tend to be short term, since funds are scarce and financial institutions worry about maintaining a liquidity safety net in case of large withdrawals by savings depositors. As a result medium to long term financing for the building or purchase of non-residential units must be normally sought outside the Housing Finance System.
9. Until very recently originating banks were responsible for the whole servicing process of the loan, including the
 - analysis of the application, documentation and credit risk
 - preparation of the financial contract
 - credit of the loan proceeds
 - collection of installments, including insurance premium and other charges if applicable
 - foreclosure procedures if required.

Outsourcing has become increasingly used by most banks. There are today about several processing bureaus, which issue the monthly installment advice and process the payments. More recently a couple of servicing companies have been established to provide, with the help of legal offices, all the works to complete the origination of a housing finance loan. These servicing companies are being also required to help banks in the collection of payments in arrears and in foreclosure procedures.

10. Loans granted by financial institutions with savings deposits are normally intended to the upper middle class families.

III. Other data on the Housing Finance System

11. Housing finance loans are also made available by the Federal Savings Bank and by state or local-government-run housing companies and by private and public housing cooperatives with FGTS resources. The FGTS is a fund made up of monthly deposits made mandatorily by employers into accounts held in the names of their employees at the Federal Savings Bank, each deposit corresponding to 8 percent of the monthly salary of each employee. These deposits add presently to some R\$ 66 billion (approximately US\$ 38 billion).

12. Savings accounts and FGTS deposits are thus the two main sources of funding of the Housing Finance System. The System finances presently some 200,000 units per year compared with 600,000 units in the early eighties.

In 1999, financial institutions financed 35,222 residential units, totaling R\$ 1.66 billion, of which 16,845 loans (R\$ 740 million) financed the construction of new units and 18,377 (R\$ 915 million) financed the purchase of new or existing residential units. The average loan thus amounted to R\$ 47,000 (approximately US\$ 27,000).

Loans with FGTS funds financed about 176,150 residential units last year. These loans were destined to the lower income families - families with a monthly income of up to twelve minimum wages (approximately US\$ 933). Average loans amounted to approximately R\$ 20,000 (US\$11,500).

IV. Housing finance and real estate credit outside the Housing Finance System

13. Since the early nineties, new funding sources for real estate financing have been introduced in Brazil but it was only after the economic stabilization process started producing results that they became operative.

14. Real Estate Investment Funds were regulated in 1993. Today, there are about 30 such funds, most of them financing non-residential projects. The scope of each fund, though, is limited to the project for which it was set up. The fund is divided into quotas, which are sold to investors, mainly pension funds and other large institutional investors.

Real-estate-receivables-backed debentures started being issued by Special Purpose Vehicles three years ago, providing funding for a couple of real estate developers. High interest rates and the large devaluation of the Real in early 1999 slowed down new debenture issues.

15. In 1995, the setting up of mortgage companies were regulated by the National Monetary Council. They are not allowed to raise savings deposits. Their funding sources are mortgage bills (letras hipotecárias), debentures, foreign loans and other loans. However, they may freely use their funds in any type of real estate financing. Three mortgage companies have already been set up so far. Financing operations though are still on the slow side.

16. In view of the lack of financing for the middle class and the restrictions imposed on borrowers by the Housing Finance System, **real estate developers and builders** came

up with their own financial schemes to raise capital for their projects. Normally they start selling flats or offices well before construction is started. Construction begins when the flow of installments is sufficient to pay for part of the building costs. By the time the purchaser receives the keys to his home or office, normally after 48 months, most of the costs have already been paid for. The purchaser, however, continues paying installments for another 12 to 52 months, pending on the project. It is estimated that about 100,000 units were being financed and built this way and one stage.

The bankruptcy of a very large and nationwide operating builder and developer, the financial crisis suffered by other developers as well as falling purchasing power and rising unemployment amongst the middle income families have also reduced these operations substantially.

Additionally banks are reviewing their financing operations to developers and builders. A draft of a bill of law was submitted recently to the government to increase the guarantee of the purchasers of the residential units and of the financing bank that they will be receiving the purchased real property and the proceeds of the loan, respectively.

17. Some states and municipalities run their own housing programs for the lower income families. These programs differ from state to state and from county to county.

V. The secondary mortgage market in Brazil

18. As of 1995 ABECIP - the Brazilian savings and loan trade association started studying a new system aimed at providing financing for the real estate sector. The result of these studies was the implementation of a secondary mortgage market in Brazil and the creation of a securitization company, named Cia. Brasileira de Securitização – CIBRASEC, both in 1997.

CIBRASEC has been designed to play the role of Fannie Mae / Freddie Mac in Brazil, purchasing real estate credits and receivables from mortgage companies, banks, real estate credit companies, savings banks and savings and loan associations and, on the other hand, issuing securities guaranteed by such credits and receivables. These securities, called CRI (for *Certificados de Recebíveis Imobiliários*) will be placed primarily with pension funds, insurance companies and foreign investors.

The company already started operating albeit on a modest scale. Three economic shocks, namely the Southeast Asian crisis (1995), the Russian crisis (1997) and the

devaluation of the Real in January 1999, have prompted the Brazilian authorities to skyrocket the domestic interest rates to prevent a major capital flight.

As a result, the development of the secondary mortgage market, which we understand will be an important player in the real estate financing in Brazil, has been on the slow side. Nonetheless, annual inflation rates have plummeted from 2,000 to one-digit figures and the economy is showing the first signs of a recovery. We thus believe that the legal framework and the economic conditions are already in place to enable this important market to grow.

ABECIP

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Table 1. INFLATION RATES IN BRAZIL

Year	GPI-DS	NCPI
1974-78	40.0	-
1979	77.2	-
1980	110.2	110.66
1981	95.2	91.19
1982	99.7	97.87
1983	211.0	172.90
1984	223.8	203.27
1985	235.1	228.65
1986	65.0	57.85
1987	415.8	394.90
1988	1,037.6	993.29
1989	1,782.9	1,863.56
1990	1,476.6	1,585.18
1991	480.2	475.11
1992	1,158.0	1,149.06
1993	2,708.6	2,489.11
1994	1,093.8	929.32
1995	14.78	21.98
1996	9.34	9.12
1997	7.48	4.34
1998	1.70	2.50
1999	20.0	8.40

GPI - DS : General Price Index - Domestic Supply
of the Fundação Getulio Vargas

NCPI : National Consumer Price Index of the
Fundação IBGE

Table 2. FINANCIAL INSTITUTIONS OF THE BRAZILIAN HOUSING FINANCE SYSTEM

Institution	Capital Ownership	Type of financial institution
1. Federal Savings Bank	Public	savings bank
2. Bradesco	Private	multi-chartered bank
3. Itaú	Private	multi-chartered bank
4. Nossa Caixa Nosso Banco	Public	multi-chartered bank
5. Real	Private	multi-chartered bank
6. HSBC	Private	multi-chartered bank
7. Unibanco	Private	multi-chartered bank
8. Banespa	Public	multi-chartered bank
9. Banestado	Public	multi-chartered bank
10. Banrisul	Public	multi-chartered bank
11. Banerj	Private	multi-chartered bank
12. Bandeirantes	Private	multi-chartered bank
13. BESC	Public	multi-chartered bank
14. BCN	Private	multi-chartered bank
15. Meridional	Private	multi-chartered bank
16. América do Sul	Private	multi-chartered bank
17. Poupex	Private	S&L
18. BankBoston	Private	multi-chartered bank
19. Finasa	Private	multi-chartered bank
20. Safra	Private	multi-chartered bank
21. Bilbao Vizcaya	Private	multi-chartered bank
22. Sudameris	Private	multi-chartered bank
23. BEMGE	Private	multi-chartered bank
24. Banestes	Public	multi-chartered bank
25. BMB	Private	multi-chartered bank
26. Baneb	Private	multi-chartered bank
27. Santander	Private	multi-chartered bank
28. BRB	Public	multi-chartered bank
29. Citibank	Private	multi-chartered bank
30. Bandepe	Public	multi-chartered bank
31. BEC	Public	multi-chartered bank
32. BEG	Public	multi-chartered bank
33. BANESE	Public	multi-chartered bank
34. Boavista	Private	multi-chartered bank
35. BEA	Public	multi-chartered bank
36. BIC	Private	multi-chartered bank
37. Banpará	Public	multi-chartered bank
38. BEM	Public	multi-chartered bank
39. Rural	Private	multi-chartered bank
40. BR	Private	multi-chartered bank
41. BEPI	Public	multi-chartered bank

Source: ABECIP / Central Bank of Brazil

**Table 3. SAVINGS DEPOSITS
HELD BY FINANCIAL INSTITUTIONS OF THE
BRAZILIAN SAVINGS AND LOAN SYSTEM
(Balance at the end of period - US\$ billion)**

YEAR	BALANCE
1981	15.0
1982	19.4
1983	22.6
1984	18.4
1985	20.7
1986	22.1
1987	30.6
1988	34.0
1989	28.4
1990	13.9
1991	12.7
1992	17.0
1993	21.8
1994	51.6
1995	52.9
1996	59.4
1997	80.2
1998	73.4
1999	50.6

Table 4

USE OF SAVINGS DEPOSITS BY THE BRAZILIAN HOUSING FINANCE SYSTEM

100%	100%	SAVINGS DEPOSITS	
15%	15%	reserve requirement	deposited at the Banco Central
60% of which:		real estate financing loans , of which	loans to finance the purchase, remodeling or building of residential and non-residential units as follows.
80%	48%	- minimum 80% to SFH loans (construction and purchase)	- loans subject to fixed interest rates and some conditions established by the National Monetary Council
20%	12%	- 20% to free interest rates loans, of which 50% may be housing finance (construction and purchase) and 50% non-residential real estate units	- loans freely negotiated between the contracting parties. There are no limits as to real property value or amount of financing.
Approx 25%	12,5 %	Remaining funds	
	12,5 %	- free reserves	- cash or government securities
		- loans to real-estate-related activities and home equity loans	- short term loans at market rates

**Table 6. HOUSING FINANCE SYSTEM LOANS
(Number of financed units)**

YEAR	NHB/FSB*	BS&L SYSTEM**	TOTAL
Up to 1979	1,572,569	913,343	2,485,912
1980	366,808	260,534	627,342
1981	198,514	266,884	465,398
1982	282,384	258,745	541,129
1983	32,685	44,562	77,247
1984	43,551	42,807	86,358
1985	25,005	34,652	59,657
1986	44,350	62,312	106,662
1987	99,227	132,005	231,232
1988	98,249	181,834	280,083
1989	31,617	68,089	99,706
1990	165,617	74,993	240,610
1991	359,719	41,050	400,769
1992	43,801	64,869	108,688
1993	4,256	53,708	57,964
1994	-	61,384	61,384
1995	16,550	46,594	60,827
1996	30,019	38,286	125,547
1997	172,490	35,487	207,977
1998	125,093	39,368	164,461
1999	176,150	35,222	211,372
TOTAL	3,888,954	2,756,728	6,645,382

* National Housing Bank + Federal Savings Bank - loans granted with FGTS and other public fund resources

** Brazilian Savings and Loan System (includes Federal Savings Bank) - loans granted with savings deposit funds

Source: ABECIP / NHB and Central Bank of Brazil

Table 7. HOUSING FINANCE LOANS BY THE BRAZILIAN S&L SYSTEM

YEAR	Number of residential units			US\$ Million		
	Building	Purchase	Total	Building	Purchase	Total
1993	41,901	11,807	53,708	477	102	579
1994	39,177	21,617	60,794	1,253	678	1,931
1995	22,128	24,466	46,594	850	1,081	1,931
1996	21,439	16,847	38,286	673	735	1,408
1997	19,556	15,931	35,487	856	868	1,724
1998	21,287	18,081	39,368	1,111	984	2,095
1999.	16,845	18,377	35,222	740	915	1,655

Source: Central Bank of Brazil