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AHM

Mexican Mortgage Association

Mexico City

June 18, 2009

Impact of the Crisis Upon Housing Finance Markets in Emerging Economies

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Sub primes: from bubble to bailout

- Started in US as a “traditional” HF crisis
- Turned into a major global crisis (illiquidity, distrust, bailouts)
- Various contamination effects

- Private secondary mortgage markets closed in most developed economies, various state interventions (bailouts, guarantees)
- Remaining private issues mainly to target CB funding

- Mortgage markets in emerging economies less affected, yet funding & growth issues, credit contraction, NPLs
- Concerns to finance middle/moderate income groups



Lessons from a perfect storm...

- Excessive level of credit within the economy
- Toxic loans: low/no equity, no documented incomes, teasers & adjustable rates, non-housing consumer purposes, no recourse, etc.
- Failed system of consumer information
- Overlooked real estate bubble
- Easy money from yield-looking investors since 2001
- Myopic and speculative lenders, borrowers, investors
- Unregulated and fee-driven intermediaries (unbundled market structure)
- By-passed mortgage default insurers
- Balkanized financial regulators (vs. powerful private lobbies)
- Unsound GSE model (appetite for risks & volumes, no sunset)
- Excessive reliance on market discipline & models
- Over-complex and opaque structured finance including re-securitization (leverage of short-term debt through 2nd or 3rd level structures)
- Wrong belief that AAA = liquid
- Insufficient level of credit enhancement
- Valuation problem of mortgage securities



Leverage

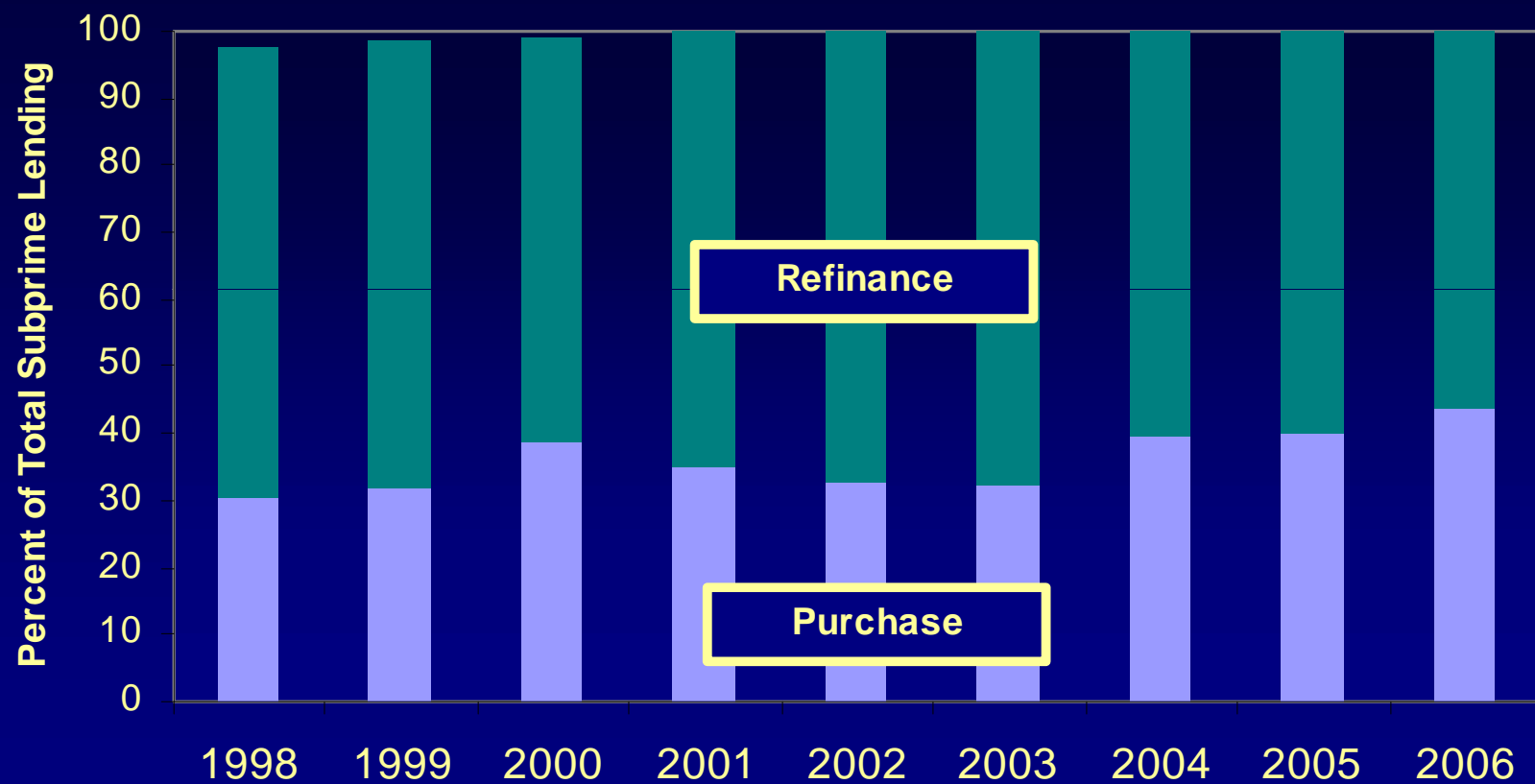
- Total U.S. Credit Market Debt Has Risen to 350% of GDP



Source: Ned Davis Research, 2008.



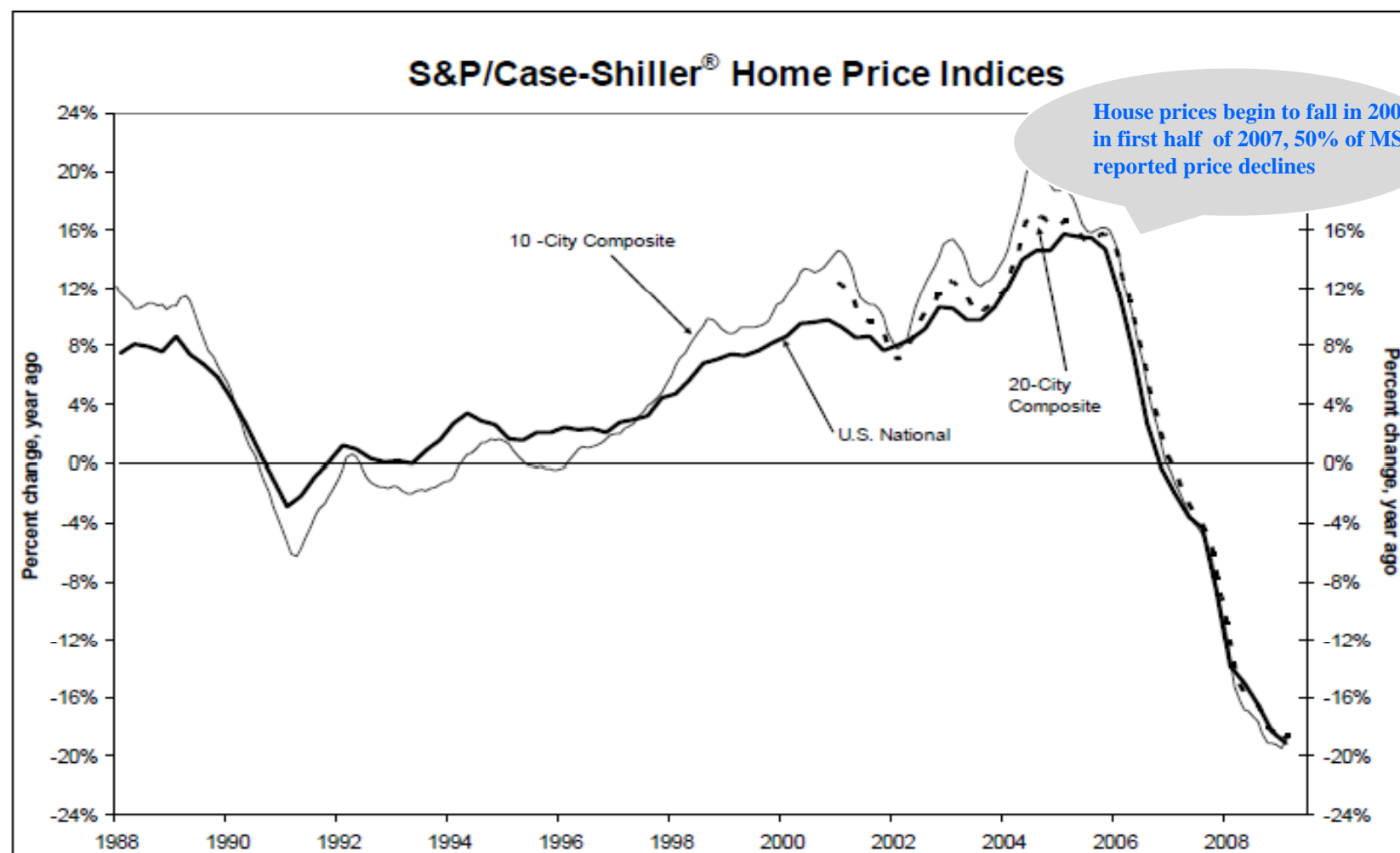
Most subprime lending for refinance, not for purchase



Source: Inside Mortgage Finance, Center for Responsible Lending



Evolution of home prices



Source: Standard & Poor's and Fiserv

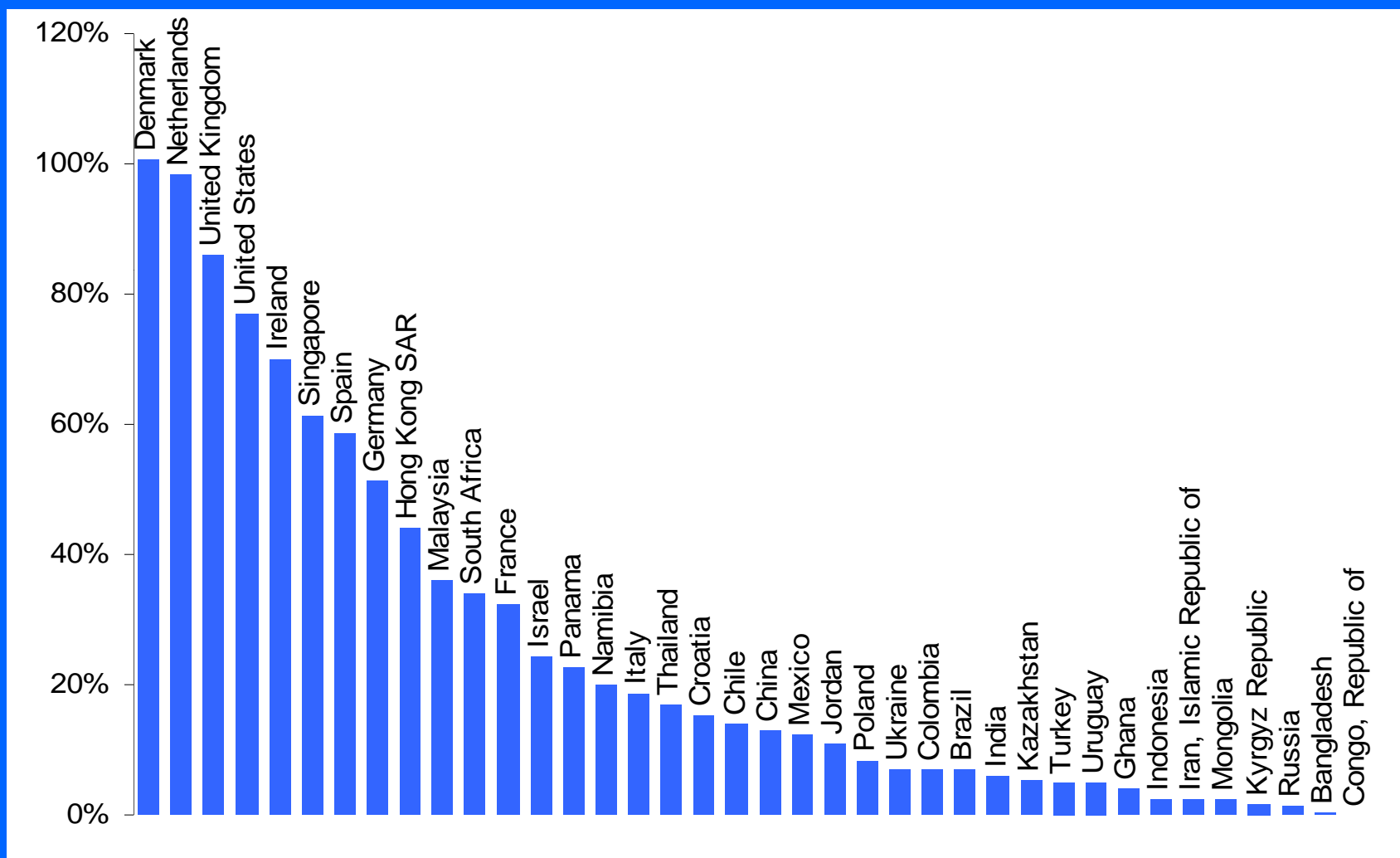


A more adverse environment

- Crisis in developed economies
 - ✓ US: multiple public bailout plans (TARP, FED, FDIC, GSE), 1/5 all mortgages (10 M.) with negative equity, already 6 M. foreclosure filings in 2 years, etc -> how to revert spiral of foreclosure, price collapse, illiquid & insolvent institutions
 - ✓ Expanding crisis in Spain, UK, Hungary, other EU countries



Housing debt to GDP ratios (2007) smaller mortgage markets in EE





A more adverse environment

- Limited direct effects in most emerging economies
 - Low or no exposure to subprime assets
 - More limited & careful use of structured finance
 - Primary HF markets still prime (small, conservative) although degrading
 - In few cases, factor to destabilize financial sector (Ukr, Latvia, Hungary, EUA)
 - Variable impact over domestic mortgage securities (frozen/active)

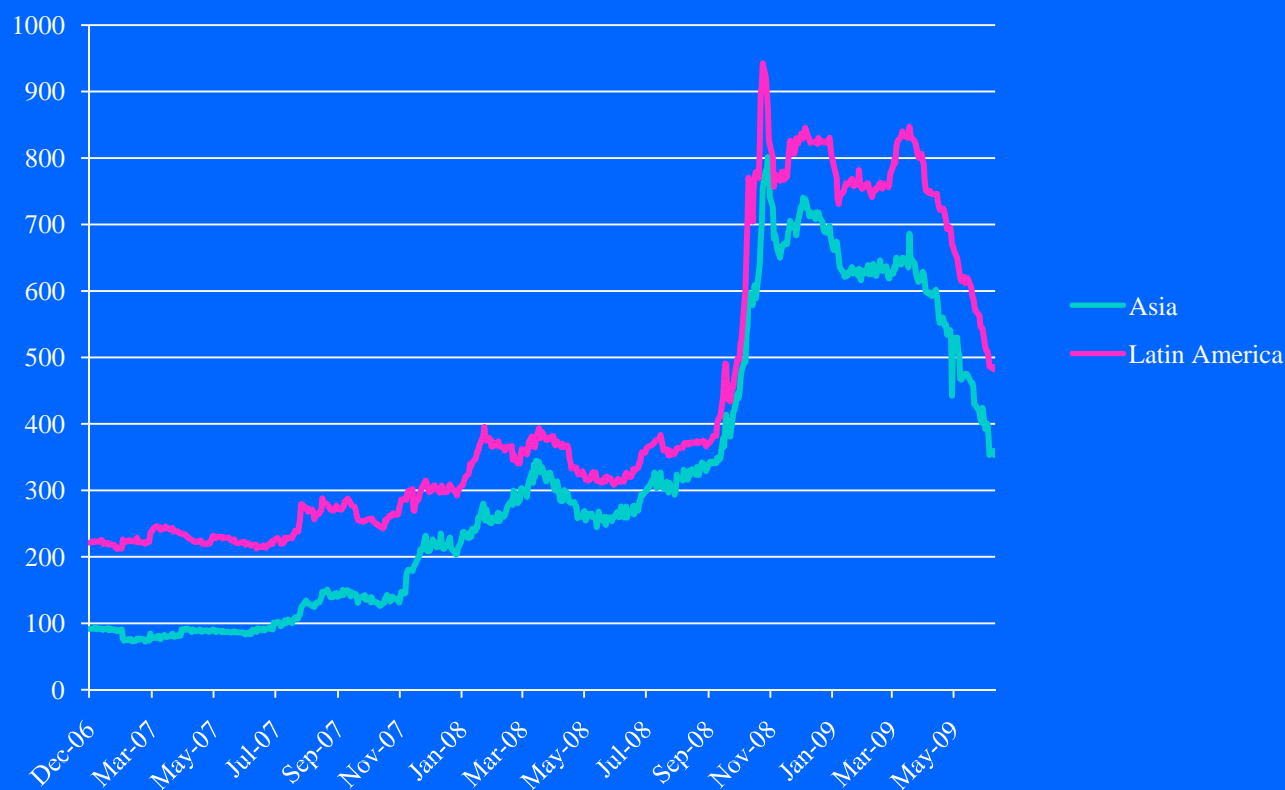
- Indirect effects
 - Recession, affected disposable incomes (unemployment, remittances)
 - Higher credit rates: higher risk exposure, constrained access
 - Concerns about the quality of mortgage portfolios
 - Liquidity squeeze, notably for specialized lenders
 - Credit contraction (lower income households first affected)
 - Depressed capital markets -> affected institutional investors



Corporate bond spreads

Emerging-market corporate bond (CEMBI) spreads Dec 2006 – May 2009

Basis points



Source: Bloomberg.



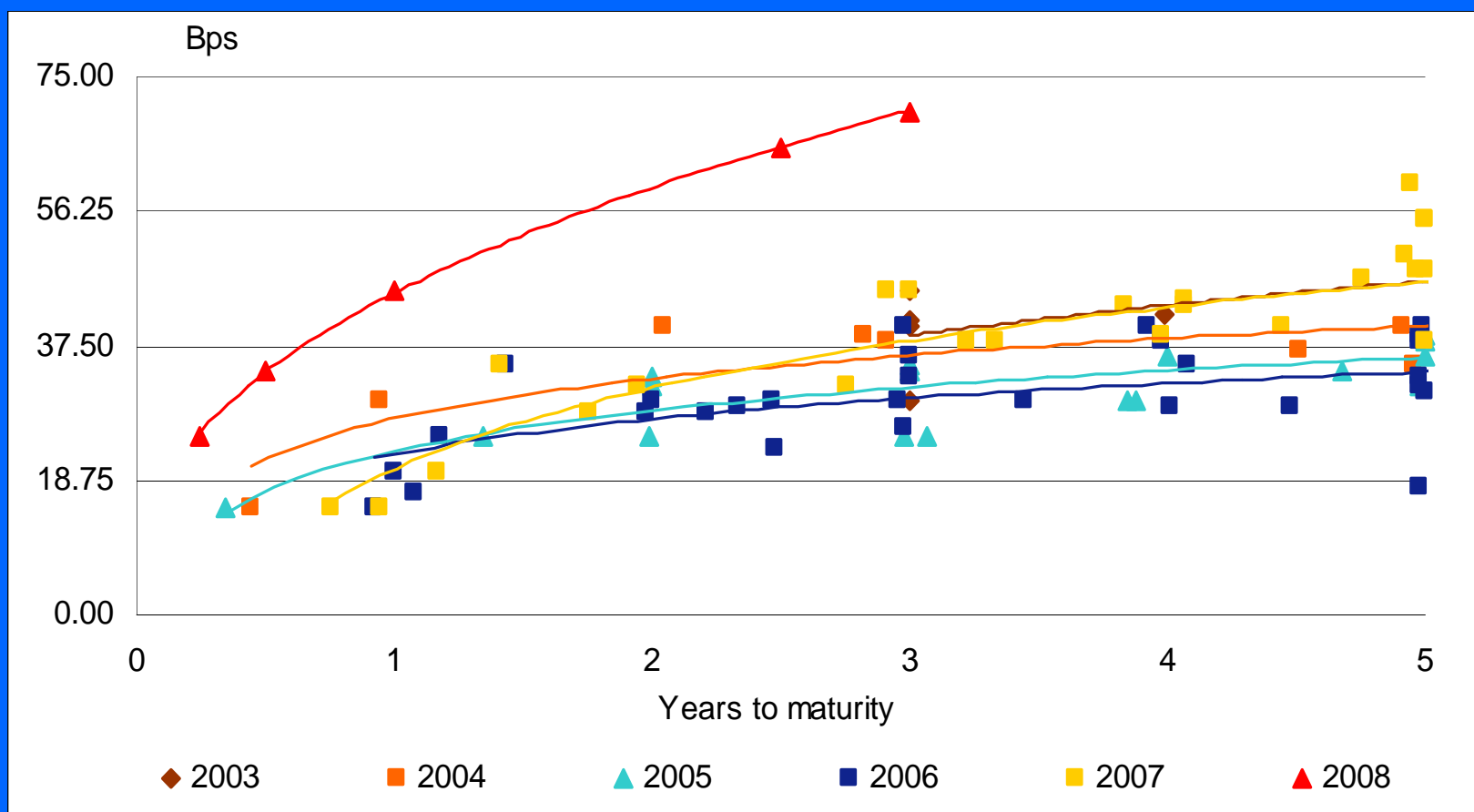
Mortgage funding from capital markets

	Housing Loans outstanding (US\$ Billion equivalent)	% funded through capital markets
Argentina (2005)	3	7% (MBS)
India (2008)	72	6% (MBS + NHB) est.
Korea (2008)	255	5.1% (MBS)
South Africa (2007)	102	7% (RMBS)
Mexico (2007)	81	5% (RMBS)
Chile (2008)	24	27% (18% CB, 9% MBS)
EU 25 (2006)		27% (16% CB, 11% MBS)
US (2006)	10,900	54% (MBS, GSE, etc.)



Tensions on South Africa securitization markets

AAA spreads, source: Standard Bank, 2008





The evolution of housing finance in EE

- In average smaller “prime” markets (conservative lending, bundled markets, wealthier urban borrowers, credit culture)
- Past period of easy & rapid expansion is over (example of an excessive growth: from 12% to 41% of GDP in 4 years in Latvia)
- But still large demand for housing (urbanization, middle income, etc): Ex: HF 0.7% GDP Pakistan, 7% GDP India
- Dominant bank depository funding model still to be better balanced with bond markets despite current difficulties (deposits can also be volatile, limited, and short term)



The evolution of housing finance in EE

The most affected or vulnerable countries combine:

- Large foreign funding dependency (rollover from banks or bonds markets)
- Specialized lenders without proper balanced funding structure
- Local variations of toxic loan products (ex: high LTV forex loans)
- Macro uncertainty, destabilized financial sector
- Under-developed institutional investors (pension funds)
- Constraints affecting the supply of affordable housing
- Declining real estate prices (no reliable information system)
- Poorly managed and priced risks
- Weakened lending standards
- Unregulated intermediaries (brokers, appraisers)
- Weak or absent financial regulatory and supervisory system

Challenges ahead in emerging economies (I)



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- Expand HF access without disrupting financial sector : tighten regulations vs. implement housing growth stimulus package
- More strictly regulate riskier credits (teaser ARMs, forex loans, etc)
- Better inform and protect mortgage consumers
- Introduce counter-cyclical LTVs regulations (buffer effect in Spain?)
- Tightening of capital adequacy for credit risk (not only banks, more detailed than 35% RW), also for market and liquidity risks
- Tools to manage credit risk (future of MI industry? monoline rules?)
- Identify bubbles (reliable data on housing markets & prices)
- State support to cover for catastrophic system risks, target subsidies (avoid substituting for private funding?)

Challenges ahead (II)



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- Diversify domestic funding sources
- Revive mortgage securities despite the global confidence crisis
- Growing interest for liquidity facilities (counter-cyclical) & covered bonds
- Securitization to be revised: keep incentives by originators and servicers to manage risks, provide more data, keep structuring simple, enhance standards, independent reviewers, master servicers, larger credit enhancement, regulatory and accounting framework (mark to model?)
- Improve HF markets infrastructure (titling, mortgages, appraisal, etc) and housing policy (supply) as still insignificant HF markets in most countries
- Support residential rental markets (not only owner-occupied solutions)
- Finance moderate/informal income groups: risk-sharing funds, flexible loans, lease to own loans, microfinance, contractual savings, Islamic HF, smarter subsidies



Chile: an evolving pattern

- A declining role of traditional capital market based instruments

CHILE: Residential Mortgage Loans Outstanding			
	1999	2003	Dec 2008
Letras de Credito	69%	67%	18.5%
Mutuos Hipot. Endosables	20%	14%	9.5%
Mutuos Non Endosables	11%	19%	72%
	100%	100%	100%
Source: Superintendencia de Bancos/Camera de la Construccion			

Total Residential Mortgages (without leasing): US\$ 24 Billion

- Securitization remains of limited use : about 7% mortgage lending



Colombia

- 1998 crisis → deteriorated mortgage portfolios, collapse of some lenders
- 1999 law to rebuild the foundations
 - ✓ Portfolio converted to fixed real rates, S&Ls into banks
 - ✓ Adjusted regulatory framework , incl. strict lending norms
- Vital access to bond market funding
 - ✓ Tax exemptions for all mortgage securities (until 2010)
 - ✓ Govt. guarantee sold for bonds backed by social loans
 - ✓ High portfolio yields and pre-crisis familiarity to RMBS
- Securitization = 30% of mortgage loans by TC, private conduit
- RMBS market slowed down but not closed
 - ✓ Good mortgage lending standardization
 - ✓ Simple & replicable issues (pass through bonds)
 - ✓ Diversified domestic investors base, transparent information