Economic Analysis

Recent increase in Infonavit delinquency owing to good accounting practices

However, formal job losses will result in further impairment over the coming months

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June 25, 2020

- **The Institute's reclassification of 116,000 loans to the past-due portfolio, as they were considered to be outstanding, increased delinquency to 14%. This is an accounting change rather than a growing impairment of credit**
- **However, if the extended portfolio is considered, the impaired portfolio reaches almost 18%**
- **Moving forward, there is concern over a scenario wherein formal job losses could affect 1.5 million workers. This could translate into an impairment of the portfolio, which would complicate Infonavit's financial situation and could put the health of other players' mortgage portfolios at risk**
- **The concept of the extension should be eliminated, since it has negative externalities on the mortgage loan market. Instead, a better mechanism to protect workers who lose formal employment would be unemployment insurance**

At the end of November last year, Infonavit (the *Instituto Nacional para la Vivienda de los Trabajadores* — Mexican National Institute for Workers' Housing) announced a reclassification in the past-due portfolio forming part of its overall portfolio. This was done in order to meet the implementation requirements of the IFRS (International Financial Reporting Standards).

As part of this reclassification, the Institute announced that it had discovered that between 2010 and the first half of 2019, a little over 116,000 mortgage loans that had fallen into arrears were automatically reclassified as current loans after the three-month period granted as part of the *Borrón y Cuenta Nueva* (Clean Slate) program. As such, the interest accrued was capitalized, but without informing the borrowers in order for them to give consent, which is a necessary requirement.

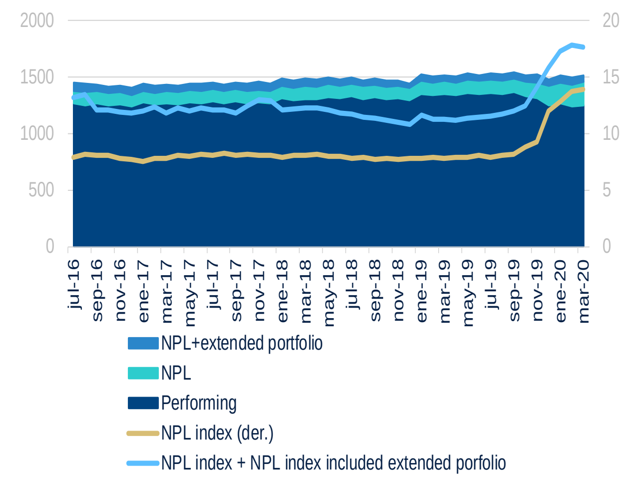
The result of this adjustment was that the past-due portfolio increased at the end of 2019 to 171 billion constant pesos, representing a delinquency rate of 12%. The reclassification of these 116,000 loans as overdue is consistent with good accounting practices and greater transparency.

However, as we have already stated in several editions of the Mexico Real Estate Outlook, when studying the quality of the Institute's portfolio, not only the past-due portfolio component should be considered, but also the extended portfolio.

In accordance with Annex 38 of the *Circular Única de los Organismos de Fomento y Entidades de Fomento* (Single Circular of the Development Agencies and Entities), the extended portfolio consists of all those loans granted by Infonavit that, under the terms of the law pertaining to Infonavit, have some extension in force for the payment of the corresponding amortization for ordinary capital and interest, and that therefore, at the end of said extension period, may be reallocated to the ROA (*Régimen Ordinario de Amortización* — Ordinary Amortization Scheme) or REA (*Régimen Especial de Amortización* — Special Amortization Scheme).

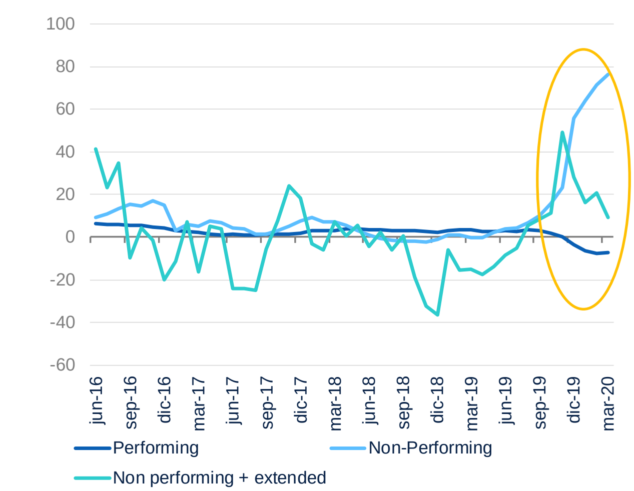
The extension period to which Infonavit borrowers are entitled is the grace period that exempts them from the obligation to make payments and is limited to 12 consecutive months or 24 months over the entire life of the loan. The request must be made within one month of the date on which the borrower ceases to receive salary payments, and the interest generated as a result of this process will be capitalized to the unpaid balance of the loan. These loans cannot be legally considered to be overdue, since this is a contractual right of creditors. However, we believe that this right should be replaced as it can lead to problems in the portfolios of banking institutions. A better scheme to protect workers who lose their jobs would be unemployment insurance. However, for the purposes of analysis, the impaired portfolio can be defined as the overdue portfolio plus the extended portfolio.

Figure 1. **Infonavit Portfolio Balance**
(Millions of pesos and %)



Source: BBVA Research based on Banxico data

Figure 2. **Infonavit Portfolio Balance**
(Annual % change)



Source: BBVA Research based on Banxico data

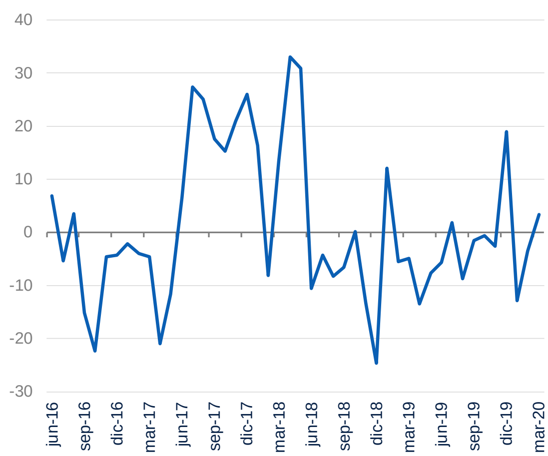
The Institute's delinquency rate deteriorated due to this reclassification. However, the balance of the extended portfolio also increased significantly during 2019, prior to the outbreak of the COVID-19 pandemic. Between August and December last year it increased by an average of 20.5% in real terms, and as of the end of the first quarter of 2020 it has grown by an average of 15.3%.[1]

1: Constant prices calculated based on INPC data

While the impaired portfolio (taking into account the extended portfolio) has accounted for a percentage around four points above the delinquency rate (which takes into account only the past-due portfolio) in recent years, both had been contained owing to the increase in the Institute's mortgage loan origination. However, for most months in 2018, funding placement remained in negative territory and barely grew by 1.5% in real terms, while for all of 2019 it contracted by the same rate. In the first quarter of 2020 the amount financed by the Institute decreased by 4.3% on average, also in real terms.[2]

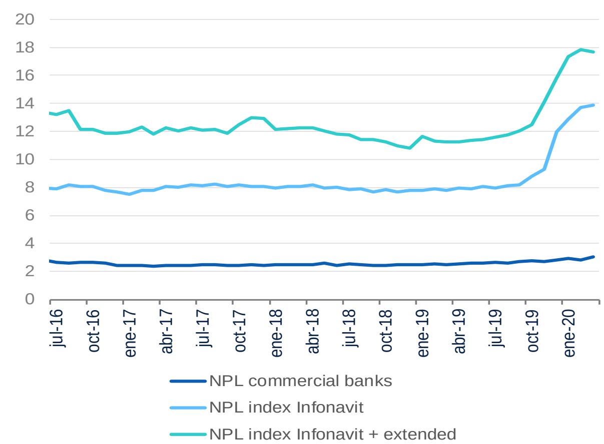
The fact that the Institute's impaired portfolio, taking into account the extended portfolio, has been exceeding 12% for several years is undoubtedly a cause for concern, because this has reflected the fact that, despite the institution's efforts to increase the denominator via the current balance through greater financing origination, this has not been successful in recent years, even though it increased the maximum credit limits in order to achieve stronger penetration of the medium-income residential market, a practice that was rightly abandoned under the current administration. Moreover, the marked slowdown in the generation of formal employment, as recorded by the IMSS (*Instituto Mexicano del Seguro Social* — Mexican Social Security Institute), which had only increased by 1.4% at the end of 2019, and the potential loss of 1.5 million jobs this year could cause the Institute's financial situation to worsen.

Figure 3. **Infonavit: mortgage origination**
(Real annual % change)



Source: BBVA Research based on Infonavit data

Figure 4. **Delinquency rates**
(%)



Source: BBVA Research based on CNBV and Banxico data

In Figure 3, we can even observe that, despite the double-digit increases in financing origination recorded by Infonavit between the second half of 2017 and the first quarter of 2018, the past-due portfolio increased by 5.1% in real terms, meaning that this positive temporary performance did not necessarily translate into an improvement in the portfolio. In fact, we can also observe in Figure 4 that, compared to the banking sector, which has kept delinquency below 3%, Infonavit's delinquency has remained at 8% and is virtually above 12% if the extended portfolio is included.

2: Constant prices calculated based on SHF house price index data.

Assessment

The reclassification of loans that did not meet the conditions to remain part of the current balance of the Infonavit portfolio is a positive and assertive decision in the interest of transparency. Although this has been reflected in a short-term increase in the Institute's delinquency, it is important to analyze this long-term indicator and also consider the extended portfolio. The extended portfolio as such has not only generated unfair competition in the mortgage market, since the private sector lacks such a concept, but could also reflect a systemic risk that could be transferred to the entire system, given that Infonavit holds almost 50% of the mortgage portfolio.

We certainly consider it to be positive that Infonavit seeks to favor lower-paid workers in the fulfillment of the various housing solutions. The Institute's financial situation is more thoroughly explained by a series of policy decisions from previous years, making it a cumulative effect, whereby penetration in the segments traditionally served by the banking sector could have caused a problem of moral hazard, since by granting credit to higher-risk workers in more expensive segments, the extended portfolio could be encouraging a lower commitment to housing recovery since it is covered by the Institute.

We believe it is right that the Institute has withdrawn from the middle-income and residential segments. It did not make sense to have a public institution competing with the private sector in a context where there is no market failure. It should also be considered that, given the current scenario in which job losses could affect as many as 1.5 million people, the impact could be significantly adverse in that it will not only be more complicated to recover the lost jobs, but there will also be a risk of increasing the number of abandoned homes, thereby damaging the value of securities. We support the Institute's policy of focusing on cleaning up the portfolio through various support measures, mainly for lower-income workers; however, in view of the job losses we are witnessing, more efforts will be needed to maintain the financial health of its portfolio as well as that of the system.