Real Estate Watch

Mexico

The program for non-affiliates: entry into a market with great potential

Economic Analysis

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- **This is an initial effort to offer housing solutions to a population that has received little attention in this regard, with the public housing institutions themselves being overwhelmed**
- **Considering only families without a home that meet the participation requirements, the potential of the program could be of 1.4 million people receiving credit, a figure comparable to that estimated by the federal government of 1.2 million**
- **Available figures on the distribution of mortgage credit by banks, by income level and type of beneficiary, provides a reference framework for the federal government to assess the evolution of the program**
- **All things considered, we can expect implementation of the program to be gradual given that it is new and concerns a segment little known by the banking institution**

The federal government launches a program to facilitate access to mortgage credit to workers needing housing and whose employment condition does not allow them to obtain a credit through public housing institutions. This is a promising initiative because the market that it seeks to attend is almost the same size as that covered by Infonavit and Fovissste jointly. Although implementation of the program will be challenging due to its newness and the characteristics of the segment to which it is directed, it has the advantage of building upon the successful experience of development banking with support scheme for SMEs. We describe herein the main characteristics of the program and the reasons that could motivate participation on the part of financial intermediaries and construction companies themselves. As an initial experience this is of tremendous importance. Although it will be necessary to closely follow the program to see if adjustments are needed, it already represents a step forward in the bancarization of a population segment that has been scarcely attended up to this time.

Non-affiliates in context

Housing assistance programs have received a considerable boost over the last decade, although not in a generalized manner. Efforts by the federal government up to now have been concentrated mainly in workers affiliated to some public housing institution and who do not have the necessary income to meet the monthly repayment of a mortgage, including under lower property prices.[1] These efforts have also been aimed at those living in rural areas or who are heavily marginalized, where housing supports are combined with those of urban services provision.[2]

[1] Which is the population with income under four minimum salaries and which is assisted by subsidy, by the federal government for the principal and by public housing institutes for the interest.

[2] The January 2011 issue of *Real Estate Watch Mexico* describes the programs through which the federal government has tried to address the housing needs of the population living in marginalized conditions. It is available on the Internet at: http://www.bbvaresearch.com/KETD/fbin/mult/1101_SituacionInmobiliariaMexico_19_tcm346-243477.pdf?ts=27102011Essentially, these programs attend to people living in rural communities or towns with high level of marginalization. Assistance programs consist in paving or basic infrastructure works (potable water, sewage, lighting) as well as assistance for local initiatives.

However, for the segment of the population that is not affiliated to social security, but could have income to cover payments for a home, efforts have been scarce. As for the private sector, financing to the non-salaried population was mainly the remit of Dedicated Purpose Credit Institutions ("Sofoles") and Multiple Purpose Credit Institutions ("Sofomes") but with the financial problems seen over recent years, this group has been under-attended.

To quantify the potential size of the program we start with homes where none of the members working qualify for housing assistance.[3] Of the total census of 112.7 million, the Economically Active Population (PEA)[4] amounts to 44.7 million, of which, according to the ENIGH 2010 study, 24 million are without social security. In terms of family units, the figure is 11.5 million[5]. However, if we consider workers who, in spite of having social security[6] do not receive housing assistance, the figure rises to 17 million families.

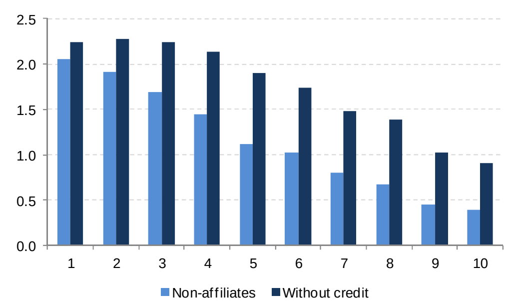
With this in mind, considering that the program offers the opportunity to those receiving income above three minimum wages, the potential is 11.3 million families. In fact, the program separates the universe of beneficiaries between those with incomes from three to five minimum salaries and those over five.[7] In the first group there are five million families and in the second 6.3 million.

Table 1
Millions of social security affiliates who do not qualify for housing credit assistance

Decile	Population	Workers	Non-affiliates	Without housing assistance
1	9.1	2.8	2.6	2.8
2	9.7	3.1	2.7	3.0
3	10.2	3.4	2.6	3.1
4	10.9	3.8	2.6	3.3
5	11.4	4.2	2.5	3.4
6	11.6	4.7	2.6	3.5
7	12.4	5.2	2.6	3.7
8	12.3	5.5	2.4	3.7
9	12.8	6.0	2.1	3.6
10	12.3	5.9	1.7	3.1
Total	112.7	44.6	24.4	33.2

Note: millions of people by decile of current income
Source: BBVA Research with data from INEGI's ENIGH 2010 study

Chart 1
Non-affiliate worker families and those who do not qualify for housing credit assistance



Note: millions of families by decile of current income
Source: BBVA Research with data from INEGI's ENIGH 2010 study

Therefore, the first to be said is that the non-affiliated workers' market is different from that of workers who do not qualify for a housing subsidy, with the latter being larger.[8]

Second, isolating the population that can participate in the program from those who have a housing need (families without homes) the participation potential is 1.4 million homes. This figure is consistent with that estimated by the Low Income Mortgage Program for non-affiliated families needing a house, of 1.2 million.

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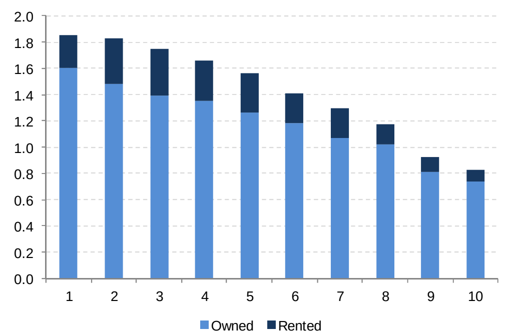
[3] The specific point that "no member" has a right to housing is important. If the head (male or female) of the family does not receive assistance but his spouse does, this family will have access to a financed residence; but families without any member receiving such help will find it difficult to have a access to a home.
[4] The Economically Active Population (PEA) category includes people over 14, but for the program only the population from 18 to 65 is taken into account. Although the high limit could be extended to a greater age, the criteria is adopted that, on average, credits are given for 20 years and the combination between the age of the beneficiary and the term is maintained at 85 years.
[5] To put the size of the program in context and compare it with those of public institutes, it is worth noting that in the Infonavit there are about 9 million people with rights to housing that the institute has yet to attend, who are the people who have a right to a housing subsidy but do not exercise it.
[6] From the IMSS, ISSSTE, ISSFAM, or Pemex, but not from the Seguro Popular
[7] Segmentation is based in that the required income for payment of a mortgage is around 4 minimum salaries and therefore those of the first group receive a state aid to cover the monthly installment.
[8] In the original Federal Mortgage Society (SHF) estimates for this program, measuring potential based on the housing deficiency, the number of potential beneficiaries of the program was 5.9 million homes.

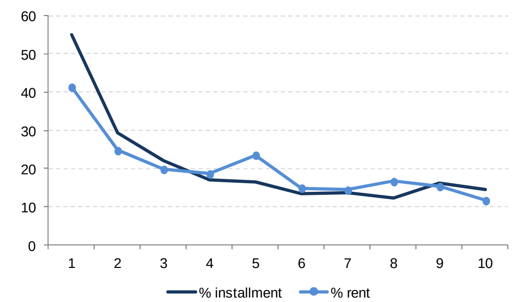
Furthermore, it is very interesting to note that for this group of families, the proportion of current income paid in rent is comparable and in some cases greater than that paid for mortgages by families with similar incomes.

Chart 2
Ownership of home by workers not qualifying for housing credit assistance (millions of families)



Note: millions of homes by decile of current income
Source: BBVA Research with data from the ENIGH 2010 study

Chart 3
Income paid in mortgage or rent by families who do not qualify for a housing subsidy (% of current income)



Note: percentage with respect to average income by decile of current income
Source: BBVA Research with data from the ENIGH 2010 study

Characteristics of the program

Similarly to the guarantees program used by development banking in the SMEs financing program, the "Non-affiliates" program is supported by, firstly, a guarantees fund that attracts interest by banks to provide financing for this population and, secondly, the improvement of the profile of beneficiaries through a take-up subsidy (equivalent to 10% of the value of the home), a home credit insurance, and more favorable credit conditions[9].

Home builders are also involved in the program, covering either partially or totally (depending on the beneficiary's income) the initial losses guarantee premium.

The application of the subsidies will equal, in terms of amount, the scheme used by Conavi for the program known as "This is Your House", applicable to workers with incomes of up to 5 times the minimum wage and whose maximum amount is 33 minimum wages, or some 60,000 pesos. This amount will be that applied to the new program, and it will be distributed between take-up incentives, first loss guarantee, housing credit insurance, and payment of the monthly mortgage installment. Implementation of this last point will be interesting given that it is expected that the subsidy to the monthly payment will apply only if the beneficiaries are up-to-date with their payment to the financial entity.

According to Federal Mortgage Society estimates, in its first year the program could attend some 23,000 potential beneficiaries, with an amount of 8.8 billion pesos contributed by the government.

9 In essence, the guarantee of initial losses covers a percentage of the portfolio value, and extends to the first 24 months of credit. In turn, the home credit insurance covers the 30% of the unpaid balance of the credit and is claimable upon recovery of the building. The operational characteristics of the program, including the initial losses guarantee and the home credit insurance can be consulted in the Federal Mortgage Society (SHF) page, at www.shf.gob.mx

Table 2:

Scope of the program, actions by income level

	Income	Total
Actions	Under 5 minimum wages	9,805
	Over 5 minimum wages	12,954
Total		**22,759**

Source: BBVA Research with Federal Mortgage Society (SHF) data

Table 3

Scope of the program, amounts by income level

	Income	Total
Amounts (Millions)	Under 5 minimum wages	1,465
	Over 5 minimum wages	7,324
Total		**8,789**

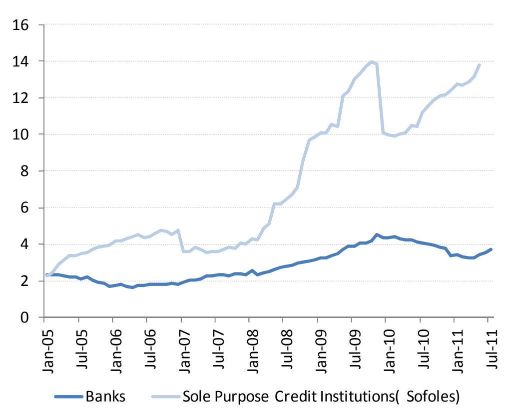
Source: BBVA Research with Federal Mortgage Society (SHF) data

Intermediaries will participate, weighing risks

Guarantee funds and the home credit insurance are without doubt favorable elements in the development of the mortgage product for non-salaried people. However, it must be kept in mind that these clients have more volatile incomes than workers in the formal sector and therefore one should expect different repayment behavior between the two groups[10].

Chart 4

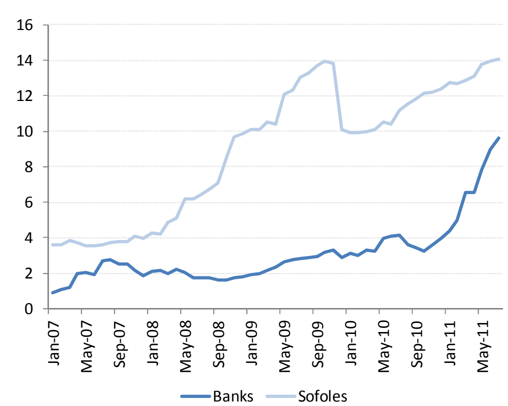
Overdue Mortgage Portfolio, %



Source: BBVA Research with data from the National Banking and Securities Commission (CNBV)

Chart 5

Overdue Bridge Loan Portfolio, %



Source: BBVA Research with data from the National Banking and Securities Commission (CNBV)

A point of reference for this is the non-performing loan rate of the Dedicated Purpose Credit Institutions ("Sofoles"), which would typically attend to population segments not attended to by banks and that, including before starting to experience a mass deterioration in their portfolios showed higher NPL rates than those of commercial banks. This leads to a situation whereby, in order to attend non-salaried people effectively, there must be a specific product design covering not only the credit characteristics (term, rate, principal), but also risk models and adequate collection mechanisms for the segment being attended to.

Therefore, we can expect that the participation of financial intermediaries will be gradual, both in terms of the number of institutions as in the credit investments made by those who participate.

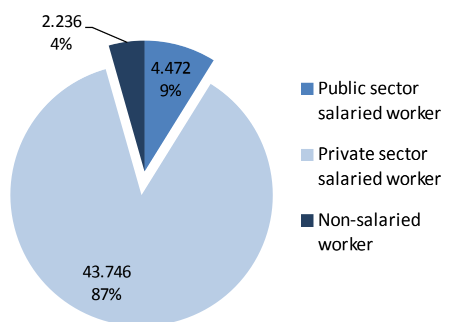
10 It is important to take into account that a central element of the business model of the Dedicated Purpose Credit Institutions ("Sofoles") had to do with repayment issues. Faced with dire liquidity problems the capacity to cover repayments was reduced as required, and this goes a long way to explain the increase in default rates of the portfolio, both in terms of mortgage and bridge loans. Unlike the credits conceded by Infonavit or Fovissste, with automatic salary deductions, or by banks, which offer direct debit from the checking account into which the salary is automatically paid, those not linked to salaries, especially if income is low, have less access to banking products.

Furthermore, intermediaries more likely to participate in the program will be those who can adapt their investment model to credits for this segment of the population[11]. It is also foreseeable that, at least at first, there will be greater interest in participation with the segment whose income is over 5 minimum wages (who are those with sufficient income to pay a mortgage) and with conservative credit practices (such as loans of relatively low value). Last but not least, participation must not imply an additional cost for participating entities in terms of regulatory compliance and reporting to regulatory authorities (for example, reporting differently to the Federal Mortgage Society [SHF] and the National Banking and Securities Commission [CNBV]).

A reference point to evaluate the success of the program is participation in the mortgage banking portfolio that non-salaried people currently possess. During 2011 (August figures) the proportion of credits granted to this segment was 3% and in terms of the amount of 4%, although the greater part is concentrated in higher income beneficiaries (93% of the total amount of credit given to non-salaried people was granted to beneficiaries with incomes higher than 15 minimum wages).

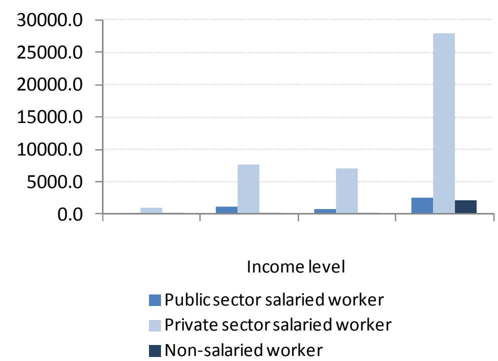
With the new program we should begin to see take-up from the non-affiliated segment of banking credit, first in the 6 to 15 minimum wage range, and eventually reaching those with less than 5. However, if the increase is in credit to non-salaried people with incomes over 15 minimum wages, this will be an indication that the program requires greater checks so as not to deviate from its original purpose.

Chart 6
Bank Mortgage Credit* 2011: credit amount and %



*Includes Banamex, BBVA Bancomer, Banorte, HSBC, Santander, and Scotibank
Source: BBVA Research with Infosel data

Chart 7
Bank Mortgage Credit* 2011: amount invested by salary tier and beneficiary



*Includes Banamex, BBVA Bancomer, Banorte, HSBC, Santander, and Scotibank
Source: BBVA Research with Infosel data

Conclusions, a promising program that will need to prove its worth

The development of a program for non-salaried people was key given the importance of this group within the economically active population and scarce coverage of it, especially with the reduction in operative capacity of the Dedicated Purpose Credit Institutions ("Sofoles") and Multiple Purpose Credit Institutions ("Sofomes") that had specialized in this group. In addition, the experience already had with guarantees funds to attract bank financing of SMEs is a good precedent. However, it is a new product for an intrinsically riskier segment requiring specialized knowledge to be served efficiently.

11 From the credit granting process, which implies the creation of a file and an evaluation of repayment capacity, to the establishment of scenarios for the mitigation of expected losses.

Therefore, although we estimate that the program has the potential to reach some 1.4 million beneficiaries, its advance will be gradual. In addition, the program will have to demonstrate its virtues, first with the higher-income segments. Quality in the process of the credit investments, from the opening of the files to the practices used in terms of conditions (term, rate, loan-to-value), etc., will be essential elements in the evolution of the program.

With all this in mind, it is necessary to note that the program for non-affiliates will constitute an important experience for which new strategies will have to be developed because it is clear that a good part of the growth of mortgage credit will take place in this segment over the next decade.

References

Federal Mortgage Society, 2011. Presentation "Non-affiliates Housing Credit Scheme". September. http://www.shf.gob.mx/prensa/Documents/Presentaci%C3%B3n%20de%20SHF%20Programa%20No%20Afiliados.pdf