



Hipotecaria

Su Casita

Finance

Construction



Facility



IFC



Background

In May 2004, IFC signed the first ever Construction Finance Facility (CFF) for Hipotecaria Su Casita (HSC), to be utilized for the construction of residential low-income homes in Mexico.

This is an important step in the IFC's mission to support increased access to housing in emerging economies, which underlies its Housing Finance Practice. In light of the nature of the risks inherent in construction finance, the IFC, though recognizing the strong developmental impact of these types of investments, has been wary of venturing in this segment of the housing value chain. The CFF provides an innovative structure to deal with some of the key risks inherent to construction finance.

Further, while the IFC has an extended portfolio of housing finance projects, the CFF is the first IFC project that directly addresses the supply side of the housing sector. This new product expands the array of support the IFC can provide, especially as many emerging countries while having some access to mortgage finance (through primary and secondary mortgage markets) have limited access to construction finance. The CFF will increase the number of homes created per year in Mexico and over the life of the facility finance a total of 5,500 homes.

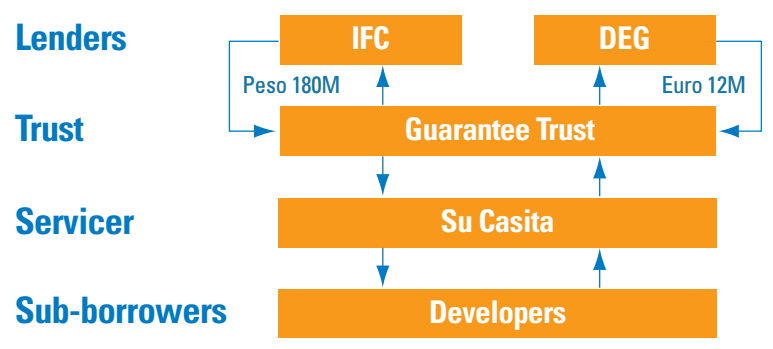
Facility Description

WHAT ARE THE KEY ELEMENTS OF THE STRUCTURE?

As Figure 1 presents, there are three main elements in the transaction. First, the IFC and Deutsche Investitions Entwicklungsgesellschaft mbH (DEG), collaborate to provide peso-denominated parallel loans which are disbursed directly to a guarantee trust. Second, A trustee is appointed to monitor the assets held in the trust. HSC originates construction bridge loans with eligible developers, with both the loans that are funded by the CFF and the developers meeting pre-established criteria pertaining to loan-to-value, level of financing, distribution of loans per region (for the sub-loans) and financial conditions and ownership structure (for sub-borrower criteria). Third, HSC, acting as a Servicer, monitors the performance of the developers, and ensures that the rights to all security for the sub-loan are in the name of the trustee and on behalf of the IFC/DEG.

The CFF is structured as a 7 year loan with a three year grace period, thereafter payable in four equal installments. With a typical construction loan in Mexico having a tenor of 20 months, this allows the CFF to be repaid to the trust and then re-borrowed for at least three times to maximize the number of houses that could be financed by the CFF. The main security for the CFF is the underlying construction sub-loans that are originated and held in a guarantee trust. HSC also provides a corporate guarantee to repay the loan in case there is insufficient funds in the trust to repay the IFC/DEG obligation.

FIGURE 1—THE TRANSACTION STRUCTURE



The Key Risk and Mitigants?

Table 1 below provides a matrix that describes the key risks inherent in the CFF and the mitigants that are imbedded in the structure.



TABLE 1—KEY PROJECT AND MITIGANS

KEY RISKS	DESCRIPTION	MITIGANTS
Macroeconomic	Impact of political, economic and social factors on pool performance	<ul style="list-style-type: none"> Partial payments required due to changing macroeconomic conditions
Construction	Losses incurred due to developers inability to complete projects, or do low quality work, or sell the houses on completion	<ul style="list-style-type: none"> Ensure pre-selling of home Require performance bonds and insurances Extensive monitoring by HSC and other government agencies. Loan disbursements tied to completion rates
Credit	Potential for default or bad performance of the underlying sub-loans	<ul style="list-style-type: none"> Trustee will ensure that all loans funded by CFF follow the IFC/DEG eligibility criteria for sub-loans and sub-borrowers, which ensure high credit underwriting HSC required to replace all loans that are 90 days overdue Credit enhancement via reserve account
Servicer	Potential loss due to the actions of HSC	<ul style="list-style-type: none"> Required to maintain specific financial ratios pertaining to total exposure, loan losses and losses in relation to reserves Required to maintain minimum servicer rating provided by at least two of the international rating agencies (Moody's Investor Services and Standard and Poor's) Lenders have right to appoint back-up servicer

Application to Other Markets

WHAT FACTORS ENSURE THAT THE CFF WORKS?

While the CFF can be applied to other markets, there are specific factors that make this facility workable in the context of Mexico. These include:

Strong Sponsor: This project is being launched with a sponsor, Hipotecaria Su Casita, which is well known by the IFC based on prior financial transactions. This gives some comfort to the IFC as HSC, as a Servicer, is a key element of the structure.

Construction in Mexico: Residential construction in Mexico is very competitive and there is a fair amount of standardization in the operations of the developers in terms of site preparation, labor usage, required machinery and house designs. This makes the projects very distinct from the actual developer and thus allows for ease of transition in a project, in case a developer fails. Also, the industry is well established with good governance and monitoring practices and laws to prevent child labor, environmental hazards, ensure equity (particularly to indigenous peoples) and reduce corruption.



IFC's exposure to these risks and simultaneously builds the IFC internal expertise and capacity in construction finance, both in new projects and portfolio management.

Tested Trust Structure: The use of a guarantee trust mechanism to isolate the underlying assets (land and in progress construction) from HSC is also well tested in Mexico and gives confidence for the security arrangements of the CFF.

Stable Macroeconomic Conditions: The current stable macroeconomic conditions in Mexico also creates a good environment for a product like this. First, it facilitates a facility that is denominated in local currency and thus preventing an asset liability FX mismatch at the level of the Trust; also it gives confidence in the fact that the level of demand for housing would be sustained and thus reduce the potential takeout risk to the developer.

Limiting Land and Infrastructure Finance: By limiting the use of proceeds to the operational construction cost and requiring approvals after the developer has secured the land and provided basic infrastructure, the project ensures that the developer has sufficient equity invested in the project prior to receiving finance from the CFF and also avoids operating in two aspects of construction finance which are highly susceptible to speculative activity.

HOW CAN THE STRUCTURE BE MODIFIED TO SUIT OTHER MARKET CONDITIONS?

In spite of the above drivers which make the transaction work and which are somewhat idiosyncratic to Mexico, the CFF can be applied to other market conditions. Some of the possible modifications that could be considered include:

Partial Credit Guarantee: Instead of a direct loan, a partial credit guarantee could be utilized to secure funding from local financial intermediaries that are directed toward construction finance. This is applicable in markets where the IFC cannot provide local currency funding and this mechanism avoids FX risk and takes advantage of locally mobilized investments.

Utilizing Local Intermediaries: While the history of the IFC's relationship with HSC plays an important role in determining the sponsor to work with in Mexico, HSC could easily be replaced with other strong financial intermediaries that have established relationship with local developers. If a financial intermediary which does not have an extended history in this sector has an interest in participating, then it could be possible to outsource some elements of the servicing function (for example, performance monitoring) to a specialized independent entity (such as an engineering or consulting firm).

Enhancing Developer Operations: In countries where there might not be suitable local developers who will be eligible to work in this market, it could be possible to entice international players through joint ventures or other collaborative arrangement to work with local developers and thus secure access to the facility.

The above adjustments to the CFF can extend the application of this product to many countries. However, it is important to note that the expansion of the CFF will be done within the context of an overall strategy which sets guidelines and targets for the IFC's exposure to these risks and simultaneously builds the IFC internal expertise and capacity in construction finance, both in new projects and portfolio management.

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