"IMPORTANCE OF FINANCING in MEXICO INCREASES FOR U.S. BUYERS"

By Mitch Creekmore, Stewart International

Our U.S. mortgage market debacle has many Americans asking questions about and searching for answers to the financial crisis we're experiencing. It's clearly impacting Wall Street, financial institutions, banks and securities companies. Some of the biggest mortgage originators in our country are on the brink of extinction. Others have already gone out of business. Home values are depreciating in some markets, principally those on the east and west coasts, Florida and California (55% of Sub-prime loans were made in these 2 states). These markets, coupled with Arizona and Nevada, had experienced over 100% appreciation in annualized home value during the period from 2000-2005. Today they're flat or trending downward. Residential foreclosures are on the rise, and each day we receive notifications about lenders that are no longer accepting mortgage applications and are ceasing their lender operations. Why? Because lending practices had become very lax in the last three years and financial institutions had strayed away from sound, fundamental lending guidelines creating "time bomb mortgages. 0% down adjustable rate mortgages ("ARM's") and "stated income" loans had become the order of the day and made housing speculation all the more attractive in the big four markets with big appreciation on the investment horizon. Many had not considered that an affordable house must be tied to one's income and repayment ability and not to the financing mechanism employed (affordable being total housing expenses must not exceed 28% of income). Median income and price per square foot do have a correlation to affordability. Just consider Los Angeles at a $530,000 median home price with a median income per year of $61,700. Nine out of the ten least affordable housing markets are in California. New York slipped in at number seven. This should certainly come as no surprise to Americans given the history of homes price appreciation on the West Coast!

For the past 25 years, securitization-based finance has been replacing the portfolio-lending model as the dominant means of financing in the United States. The U.S. mortgage system has become the benchmark model for other mortgage programs in the world. In the United States, the mortgage system can be explained as a "360°" process. First, financial institutions that originate loans must qualify prospective borrowers relative to their income, assets and debts. Subject to this assessment they then determine the loan to value ratio and the required down payment. In essence, lenders arrive at a profile of the borrower's overall credit worthiness and determine the acceptable parameters for a given mortgage. Once the mortgage has been originated, the loan will be pooled with other mortgages and the loan portfolio will be rated according to the borrower, financing terms, the asset itself, and the "risk" of the mortgage. The rating placed on the loan pool (from Standard & Poor's, Moody's, etc.) will determine the "discount rate" for selling the portfolio. Selling the loan portfolio in the secondary mortgage market and the offering of mortgage backed securities, primarily in the form of rated bonds to investors on Wall Street (from big companies like Lehman Brothers, Goldman Sachs, Citigroup, Bank of America and Wachovia), completes the cycle of liquidity in order to recapitalize primary mortgage lenders across the country. Though this explanation is extremely simplistic, it's the basis for how the U.S. mortgage system thrives. In recent years it has been a multi-trillion dollar industry. Today there is uncertainty and some question whether securitized debt will survive and whether bond buyers will return to the market given the severity of the current mortgage "hiccup." In short, the market is paralyzed with panic due to a lack of faith and trust in our basic securitization model.

For those of us that work in the residential sector in Mexico and Mexican real estate in general, how will the U.S. mortgage crisis impact our market to the south? Will Americans still be interested, still be attracted to the opportunity that Mexico presents as a second home investment or as a retiree destination? Without question, the largest group of residential buyer's in Mexico have been Californians, and they are the very ones that have been hardest hit. So what do we do now, where do we turn for the means to buy that residence south of the border? Unless one is a cash buyer and not seeking 3rd party financing, regardless of where you reside, the days of home equity loans to finance that "Mexican dream house" are gone. Lines of credit for taking equity out of your primary residence have all but dried up and gone south. But not to Mexico! There is an alternative to all cash and that's a U.S. mortgage on Mexican residential property.

Unlike the United States, the depth of the Mexican mortgage market with U.S. lenders is shallow and young. There is, however, an ever-growing awareness among American purchasers that financing is available on Mexican properties. Several lenders such as Collateral International in Birmingham, GMAC International Mortgage in Dallas, M&I Bank and the IMI Group, both in Phoenix, ConfiCasa International in Houston, GE Money, a subsidiary of GE Capital based in Mexico City, have all expanded their Mexico lending programs for U.S. buyers. New players to Mexico's mortgage arena are MSA-Mexico, Laredo National Bank and Jordny International Real Estate. The various loan products have improved over time as well. Origination is generally two to four points with LTV's from 50-90 percent financed on 20-30 year amortization schedules. Interest rates vary from a 4 year fixed loan rate at 8.25 percent for GE Money loans to fixed rate loans of 20-30 years ranging from 7.25-10.0 percent interest depending on which lender, an individual's FICO score and the loan-to-value ratio. There are even adjustable rate mortgages (ARM's) that some lenders offer. A product that is gaining greater interest for U.S. buyers that really makes sense it the CTP loan program (construction to permanent loan) that Collateral and GMAC offer. If the borrower has a free and clear lot to construct the house on, these lenders will finance the construction over nine, 12 or 18 months at an additional 1/4 - 3/8 % of the stated interest rate and then convert it to an amortized permanent mortgage. Make no mistake, in all cases, these loan products are based on a "full loan doc" underwriting criteria common with U.S. lending practices. It should also be noted that all of these lenders look to the Mexican real estate as the collateral to the debt created and not to additional security or pledges in the United States.

There is a distinct economic and protective benefit that purchasers receive in third party financed operations instead of opting for developer financing. In order to finance Mexican residential properties, first and foremost, there must be a transfer and conveyance to a Mexican bank acting as trustee in a deed protocolized by the notario publico that establishes a publicly recorded and renewable beneficiary interest for 50 years for the non-Mexican foreign buyer. It is called a fideicomiso and must be utilized for residences in Mexico's restricted zone. The lender will be the first beneficiary of the bank trust with the borrower/owner being the second beneficiary until the debt is extinguished. Generally speaking, if you decide to developer finance, there is no conveyance of the title nor is there establishment of one's beneficiary trust rights. Secondly, the interest rates that developers charge are normally 11-12% based on a short amortization schedule.

U.S. financial institutions, like those mentioned above, require a more detailed process to originate loans in Mexico. Possession of the property is not tantamount to ownership. Lenders must be assured, through a competent title search of the property and issuance of a Commitment for Title Insurance, that there is a complete chain of title for the respective residence. They want to know how the title is vested and that it is valid and that it's "of record". Lenders want a higher standard of assurance that the loans they originate are secure and the public deeds vesting the banks' lien interest are enforceable. This ultimately works to the benefit of the borrower. Lenders are going to rely on the title company investigating the property that a subdivision has been approved and published or that a condominium development has a condominium regime filed of record. Escrow considerations and escrow agreements are mandatory for U.S. lenders on Mexican transactions as well.

Lastly and possibly most importantly, financing from a U.S. lender allows you to fully deduct the interest you pay on the second home mortgage. Not only do you have the protection of having your title established and recorded in Mexico, you get the benefit of "underwriting" the interest expense against your personal income tax in the U.S. You don't get this same benefit with seller or developer financing. AND, you can also get title insurance enforceable in the United States that guarantees your bank trust! A second home in Mexico is attainable whether for vacation or retirement purposes. With Mexico's low cost of living and property taxes, many more Americans may be forced to consider retiring there. Financing will have an even greater importance in the years to come. With difficulties in the U.S mortgage arena, which may not rebound until mid 2009, developers in Mexico will be forced to establish "best practices" procedures so their real estate can qualify for financing in order to be sold. Home equity loans are gone and Americans aren't going to rob their 401's or retirement accounts to finance their property in Mexico. Our neighbor to the south still presents a great opportunity for enjoyment, comfort, security and investment appreciation. We'll just have to approach the acquisition differently and US financing should become the best alternative without "all cash"!

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