



A Home for Every Filipino

CHAMBER OF REAL ESTATE & BUILDERS' ASSOCIATIONS, INC.

---

## **DEFECTS OF THE HOME-LENDING PROGRAM ANALYSIS & RECOMMENDATIONS**

Prepared for the  
Chamber of Real Estate & Builders' Associations, Inc. (CREBA)

By

**MANUEL M. SERRANO**

Founder & Chairman of the Board

March 2000

### **BACKGROUND**

In tracing the root cause of the shelter finance system's failure to achieve its purposes, it is incorrect to pinpoint the NHMFC as the culprit and move for the dismantling of this institution as sought in pending legislation.

There is no structural defect in the centralized shelter finance system as it was originally conceptualized and established – with NHMFC as the core institution designed to continuously generate and recycle, through secondary market operations, private funds and make these funds continuously available for home financing assistance.

What is defective is not the system itself, but rather the programs and policies imposed upon the system – in terms of (1) an insufficient, unpredictable and unsustainable funding mechanism, and (2) an operationally flawed lending mechanism.

Under the original system, the NHMFC was tasked with administering both the primary and the secondary market for home loans. For this purpose, a fund pool (composed primarily of investible funds of the SSS, GSIS and Pag-IBIG) was established through the Unified Home Lending Program (UHLP).

Under the UHLP, a nationwide network of NHMFC-accredited "originators" composed of banks and developers granted home loans to eligible borrowers, secured by a mortgage on the house/lot packages being bought. The grant of these mortgage loans were undertaken on the strength of the NHMFC's commitment to purchase the mortgages from the originators, using UHLP funds.

When the NHMFC "buys" the mortgages, the receivables therefrom together with the real estate collateral backing them would then represent NHMFC's assets which it can utilize for "securitization" – i.e. the issuance and trading of its securities in the secondary market.

Securitization would enable the NHMFC, on its own, to generate more funds and recycle the same by purchasing more home loan mortgages.

The NHMFC has become insolvent, saddled as it is by so-called "non-performing assets" resulting from failure to collect the mortgage receivables from the home loan borrowers. The secondary market remains undeveloped; the UHLP in 13 years has served only some 300,000 out of the 4.5 million homeless families; the shelter industry is in a moribund state; and the socialized housing program is at a complete standstill.

The HUDCC sought to remedy this situation through Resolution No. 12 – by dismantling the centralized system and replacing the UHLP with a program called Multi Window Lending System (MWLS).

Where before there was only one core agency tasked to administer both primary and secondary markets, under the MWLS several institutions were designated to simultaneously assume this function.

While the system was changed, however, the operational flaws in the original program that caused NHMFC's downfall remain, as may be gleaned from the herein analysis of both the UHLP and the MLWS.

## **THE ORIGINAL UNIFIED HOME LENDING PROGRAM**

### **FAULTY FUNDING MECHANISM**

Under its charter, the NHMFC was intended to be an independent, self-sustaining financing institution – operating no differently from an investment firm, but oriented solely towards housing finance.

However, under the UHLP which was instituted under Executive Order No. 90 of President Cory Aquino, the NHMFC – operating under rules and guidelines prescribed by the HUDCC – was effectively relegated to being a mere conduit or intermediary, and collector, of the SSS, GSIS and Pag-IBIG in the grant of home loans to members of these institutions.

Essentially, the UHLP was operated such that the "Funders" do not "invest" in the NHMFC as intended. Rather, the Funders would every now and then lend funds to the NHMFC, which the latter "re-lends" to the members – under terms and conditions imposed by the former – by "buying" their home mortgages originated by banks and developers. NHMFC then liquidates its loans from the Funders by remitting the proceeds from the borrower's loan amortizations.

It should be evident from this set-up that:

- a) The NHMFC – or any other institution that may take its place under the same conditions – is not financially independent, its financial position being at the mercy of the Funders and the lending guidelines prescribed by the HUDCC; and
- b) Its continuing survival, not to mention its capability to securitize, is totally dependent upon the integrity or soundness of the mortgages it holds.

### **FLAWED LENDING MECHANISM**

Under the UHLP, the primary mode utilized in extending financing assistance to home buyers is through mortgage origination, which basically operates as follows:

1. The homebuyer applies for a loan representing the full price of the desired house/lot package.
2. Upon approval of the loan, title is transferred in the name of the buyer/borrower, and a mortgage is constituted in favor of either the developer or bank who grants the loan, with the house/lot as collateral.

3. The NHMFC, utilizing UHLP funds, "buys" the mortgage from the developer or bank, paying the latter a lump sum representing the total value of the mortgage receivables.
4. The NHMFC then collects the buyer's amortizations.

Innocuous at first glance, this mode however is inherently and fatally flawed.

Firstly, the use of the mortgage instrument necessitates transfer of title of the house/lot to the buyer not upon full payment of the account, but at the time of mortgage execution.

Simply put, in "buying" the mortgage, what the NHMFC buys is not the property itself, but merely a piece of paper entitling it to the mortgage receivables and to the property in case of loan default. It holds no "real" asset until it either receives the cash amortizations, or gains title to the property upon foreclosure in case of default.

In case the buyer defaults on the loan, NHMFC would need to institute foreclosure proceedings before it can acquire title to the property. Only after title passes on to NHMFC may it re-sell the property and recover its investment in the mortgage papers it bought. And foreclosure proceedings, including the grace period for buyers to redeem the mortgage, can take anywhere from \_\_\_ to \_\_\_ years. For this duration, NHMFC derives no cash flow from the mortgage paper that it holds.

Secondly, under the UHLP no equity or "down payment" is required of the buyer. While this may be favorable in terms of marketability of house/lot packages and affordability on the part of buyers, however, it robs the buyer of any motivation to avoid defaulting on his amortizations. Having paid no equity, the buyer has very little if any stake on the property, hence there is no fear of major loss on his part in case of default.

Lack of credit discipline is further encouraged by the foreclosure procedures that were designed in favor of buyers, as well as the perception that the NHMFC – being part of Government – will not be serious in pursuing ejection proceedings.

If equity were to be required, it would reduce the financial drain on the part of the NHMFC in case of loan defaults, even as it would avoid incidences of such defaults by increasing the borrower's proprietary stake and therefore his interest in maintaining his account up to date.

Thirdly, once the mortgage is passed on to the NHMFC, the developer or bank is paid the lump sum value of the outstanding mortgage. Thereafter, the latter is absolved of any further responsibility as far as collection or collectibility is concerned.

The combined effect of these 3 flaws in the lending mode – i.e. immediate ownership transfer to the buyer/borrower, buyer/borrower's lack of proprietary stake, and non-accountability of the originating developer or bank – is that the mortgages held by NHMFC are **unsound**. The NHMFC assumes all the risk, not to mention the financial burden and administrative difficulties associated with collection and foreclosures.

In short, the lending program as devised provides both borrowers and loan originators alike with all the ease, while heaping all the difficulties upon the NHMFC. This situation, multiplied a hundredfold (and more during economic downturns which further impair the borrowers' capacity to amortize), would bring any financing institution down to its knees.

When further combined with the manner by which the Funders' infuse funds into the NHMFC – i.e. in the form of meager loan trickles, at unpredictable time intervals, and under stringent repayment terms and schedules – illiquidity and finally bankruptcy become the inevitable fate of the institution.

## **THE MULTI WINDOW LENDING SYSTEM**

Under the MWLS, NHMFC's function was parceled out to "lending windows" composed of several government financing institutions (GFI). These lending windows were designated to originate, under guidelines prescribed by the HUDCC, housing loans either by themselves or through developers and other financing institutions that they will accredit, and to administer home mortgages in a manner that still remains unclear.

Lending funds are to be provided by participating Funders (SSS, GSIS, Pag-IBIG, PNB, DBP and LBP) via "funding commitments" – the amount and terms of which are subject to yearly negotiations among themselves.

As with the original UHLP, eligible home loan borrowers are limited to members of SSS, GSIS and Pag-IBIG.

As originally conceptualized, the MWLS basically operates as follows:

- a) At the beginning of the funding year, the Funders agree among themselves on the amount of funds that each of them will allocate for home lending purposes for the year
- b) Each Funder then allocates its funding commitment among its designated lending windows, under terms and conditions that the Funder and the window may agree upon
- c) The lending window then parcels out its fund allocation, in the form of commitment lines for the year, to either its branches or to developers that it will accredit
- d) The lending window branches and the developers utilize their respective commitment lines to service home loans of SSS, GSIS and Pag-IBIG members.

Initially implemented with Pag-IBIG as the lending window, loan origination basically worked as follows:

1. The buyer applies for a housing loan through the developer who processes the loan.
2. The developer then passes on the loan application and documentation requirements to the lending window (Pag-IBIG) for review and approval.
3. When Pag-IBIG approves the loan, it notifies the developer to transfer title to the buyer, on guarantee that Pag-IBIG will remit directly to the developer the loan proceeds corresponding to the full price of the H/L package.
4. Upon transfer of title, the buyer executes a mortgage in favor of Pag-IBIG.
5. Upon receipt of the mortgage papers, Pag-IBIG releases the loan proceeds to the developer.

Recently, the MWLS was revised to the effect that while the lending window continues to originate with the use of the mortgage instrument, the participating developer however originates using the Contract-to-Sell (CTS).

Under the CTS scheme, title to the H/L package remains with the developer for the first 2 years of the loan's term. The loan proceeds are released by the lending window to the developer in exchange for, among other pertinent documents.

- The assignment to the lending window of the rights over the property and the CTS and its corresponding receivables;
- An undated Deed of Absolute Sale in favor of the buyer and a Loan Mortgage Agreement in favor of the lending window; and
- A 2-year CTS buy-back warranty by the developer, or HIGC guaranty in the case of socialized housing.

On the 3<sup>rd</sup> year of the loan, a CTS on current status is to be automatically converted to the Deed of Absolute Sale with REM. In this case, the title then passes on to the buyer, subject to the mortgage in favor of the lending window.

Collection of loan amortizations is to be effected by the lending window either through salary deduction arrangements with the borrower's employer if the borrower is employed, or if self-employed, through drawdowns from the borrower's savings account which he will be required to maintain with the lending window.

In case of the borrower's default within the first 2 years of the loan, the CTS will be cancelled and the developer will be required to buy them back under the warranty. In case of failure by the developer to make good on the warranty, the lending window will call on the HIGC guaranty.

### **OPERATIONAL DEFECTS**

his MWLS lending scheme differs from the original UHLP scheme in that the mortgage is executed in favor of the lending window (initially Pag-IBIG), and not in favor of the loan originator (developer or originating bank). As such, it is not a case of "mortgage buying" or trading, but rather a form of **direct lending** where the originator is a mere conduit or loan processor.

While this may afford the lending window some measure of control over the account (since it has the opportunity to closely scrutinize the loan application prior to approving the same), however, as with the original UHLP the lender remains highly vulnerable to the risks that caused NHMFC's downfall, since the fundamental flaws remain:

- a) In the case of mortgage origination by the lending window itself (assuming that it will lend based not on sound banking practices but on the MWLS guidelines), as before, the buyer gains title to the property without any proprietary stake and prior to full payment of his account.

As such, the mortgage remains an unsound instrument since the probability of default remains high, and the lender would still face the daunting task of foreclosure before liquidity or investment recovery may be achieved.

- b) In the case of CTS origination, the instrument is similarly rendered unsound with the non-requirement of buyer equity. The requirement for a developer warranty against the borrower's default would not serve to prevent the incidence of such default. Neither would it eliminate the risk of illiquidity on the part of the lender in case of default, considering that
- Title under the CTS remains in the name of the developer, and the MWLS guidelines do not provide for automatic title transfer in favor of the lender, or any other strong deterrent against the developer's violation of warranty; and
  - Calls on the HIGC guaranty in case of default or warranty violation would serve as liquidity assurance only if the cover is in the form of cash or marketable securities.

As far as collection efficiency rate is concerned, there is no assurance that the MWLS will perform any better than the original UHLP, despite its provision for collection through (1) automatic salary deductions by the borrower's employer, or (2) automatic drawdowns from the borrower's savings account which he may be required to maintain with the lending window.

Effective implementation of these collection schemes is doubtful, considering that having no basis in law, these cannot be imposed as a precondition to the availing of loans under the government's lending program.

Furthermore, it appears unjust to impose upon employers the burden of collection, when the developer's warranty is supposed to ensure collectibility.

And while HIGC's loan guaranty may afford some measure of protection, guaranty calls however represents an undue burden for a cash-strapped government, even as it perpetuates the "bail-out" mentality where the government – and consequently the entire nation – is made to assume all the risk for program failures that can, after all, be avoided.

### **UNSUSTAINABILITY**

As with the UHLP, the shelter finance system under the MWLS is rendered unstable, non-viable and unsustainable not only by the operational flaws in the lending scheme, but also by the unpredictability and limited availability of funds.

Fund infusions into the program are mere "commitments" and are totally dependent upon the good graces of the Funders, and their participation may be withdrawn at any time.

In the absence of a clear securitization program that will allow the shelter finance system to become self-sustaining, withdrawal from the program by the Funders would spell doom for the lending program.

Furthermore, the fact that these funding commitments – including the terms and conditions for the release thereof – are subject to yearly negotiations, proper programming of housing production by developers is therefore impossible to achieve. The prospect of projects being stuck in the pipeline due to untimely release of loan take-outs on which project continuity largely depends, is a major deterrent to more active private sector participation in housing production.

As it is currently, the total funding commitment of P40 Billion – of which only Pag-IBIG's share has so far been made operational – assuming it is all lent out, would translate to only some 200,000 housing units,

far short of the 350,000 annual production target. Beyond this volume, the shelter industry cannot be expected to produce without any firm assurance of available financing assistance for their target market.

### **BIAS AGAINST THE INFORMAL SECTOR**

The bias in favor of lending only to the formal sector (i.e. members of SSS, GSIS and Pag-IBIG) represents a denial of equal opportunity for the informal sector – an opportunity that Government is mandated under the Constitution and the law to provide without any such distinction.

If such bias is predicated on the assumption that the formal sector is less of a credit risk than the informal sector, the proper move should have been to devise a relatively risk-free lending program that will benefit both sectors at the same time.

## **CREBA RECOMMENDATION**

### **ON THE LENDING ASPECT**

Whether lending is to be undertaken through a single window or multi-windows, there is need for a risk-free lending program that will:

- c) Ensure the collectibility of housing loans;
- d) Eliminate the need for calls on government guarantees; and
- e) Ensure the secondary soundness of loans as a precondition to viable and operations.

Essential to such a program is a risk-free instrument – the Contract-to-Sell (CTS). The CTS is inherently superior to the mortgage in terms of the protection afforded to the lender. For, with the mortgage instrument, title transfer in the name of the buyer is indispensable in constituting the mortgage. In contrast, with the use of the CTS, for as long as the account is not yet fully paid, the time for effecting title transfer in the name of the buyer/borrower remains entirely the option of the lender/CTS assignee.

When endowed with certain other features, the CTS mechanism would allow the lender/CTS assignee to gain almost full control over the subject property – such that in the event of loan default, the lender can easily effect cancellation of the CTS and forthwith re-sell the property, hence avoiding the incidence of "non-performing assets".

Thus, CREBA recommends that:

- a) The major portion of the home lending funds should be allocated to CTS origination rather than mortgage origination; and
- b) The CTS origination scheme should be revised as follows:
  - The buyer/borrower should be required to pay front-end equity of 5% for socialized packages and 10% for non-socialized. In addition, the origination fee and other fees and loan charges should also be paid front-end and not capitalized as is currently the practice.

These front-end payments, which will be forfeited in case of default and thus represent substantial loss for the borrower, will serve to instill credit discipline.

- There should be no automatic conversion of the CTS into a REM after 2 years. Instead, in addition to the pre-accomplished Deed of Absolute Sale in favor of the buyer/borrower, a separate Deed of Absolute Sale in favor of the lender should also be required.

This would ensure that in case of default at any time, title transfer in favor of the lender/CTS assignee can be easily effected.

- A collection agreement should be entered into between the lending window and the developer, to the effect that for a fee of 1.5% of the receivables, the developer will be responsible for collecting the amortizations and remitting the same to the lending window.

This arrangement will relieve the lending window/CTS assignee of the burden of maintaining an administrative machinery solely for the purpose of collection.

- The developer's warranty should be to the effect that he guarantees 100% collection of all the accounts passed on to the lender, and should be backed by a 10% retention of the total proceeds of all the accounts subject of the collection agreement. So as not to unduly burden the developer, the retention should be entitled to interest of 10% p.a.

Should the developer fail to remit collections for 3 consecutive months on any of the accounts, the lender/assignee will require the developer, on pain of forfeiture of the entire 10% of all the accounts he passed on (delinquent or not), to either (1) update the delinquent account at his own expense, (2) replace the account with another current CTS, or (3) buy-back the account.

In case of failure by the developer to undertake any of the above, the lender will (1) terminate the collection agreement, (2) take-over collection upon due notice to the borrower, (3) forfeit the developer's entire 10% retention, (4) effect actual title transfer in his name by registering the pre-accomplished DAS, and (5) cancel the CTS for the delinquent account.

After 2 years when the soundness of the loan will have been established, the 10% retention plus interest may be remitted to the developer.

- In view of the developer's warranty backed by the 10% retention, the buyer/borrower should no longer be required to secure a HIGC guaranty on the loan, as this becomes an unnecessary expense on the borrower's part. The developer's warranty should provide the loan with more than sufficient cover.
- The requirements to establish loan eligibility on the part of borrowers (i.e. certificate of membership in good standing from the SSS/GSIS/Pag-IBIG) should be dispensed with. It suffices that these borrowers are income-earners, underprivileged, Filipino citizens and are eligible for home financing assistance under the provisions of RA 7279.

This would allow the informal sector to similarly avail of housing loans as is their privilege under the law. However, in order to allow for their integration into the formal sector, as a

precondition for loan availment said non-members should be required to enroll with Pag-IBIG and pay as part of the front-end charges at least one year of membership dues.

- The tacking provisions and the maximum loan ceiling of 30x the net disposable income, as well as other documentary requirements evidencing capacity to pay, should be similarly dispensed with as they render loan availment extremely difficult.

If the intention is to protect the lender's interest by ensuring that borrowers have the capacity to amortize the loan, these provisions would no longer be necessary or relevant in view of the developer's warranty, as well as the requirement of payment of front-end charges,

The borrower's awareness that in case of default he will not only forfeit the front-end charges and any amortization he has already paid, but also be subject to ejection, should sufficiently deter a borrower from securing a loan when he is uncertain of his capacity to amortize. And if indeed default is unavoidable, the lender can always fall back on the developer's warranty.

### **ON THE FUNDING ASPECT**

The NHMFC must be imbued with the unhampered ability to continually tap the secondary market for a large volume of private funds. To our mind, this is the only way of attaining the goal of unimpeded production of at least 350,000 housing units per year for at least 20 years, and continually providing home financing assistance to both member and non-members of the Funders at affordable interest rates without need of government budgetary support.

Through executive fiat, a permanent seed fund should be infused to the NHMFC in one lump sum, in exchange for NHMFC's promissory notes/bonds or other similar instruments with fixed yields and repayment schedules.

Said seed fund should be comprised of

- a) Investment by the Funders to the extent of 30% of the investible funds of the SSS and GSIS and 70% of the Pag-IBIG fund, in the form of their outstanding mortgages or in cash or a combination of both; and
- b) The total unused Agri-Agra loan allocation of banks for the current year.

As investments rather than loans from the Funders, the fund infusions will no longer be subject to yearly renegotiations and conditionalities, and will thus lend predictability, stability and continuity to the shelter finance system.

Viability will be ensured through the revision of the lending program, and sustainability will be achieved through secondary market operations.

In addition, legislation should be enacted to institute support measures that will (1) ensure the marketability and competitiveness of housing bonds in the secondary market, and (2) reduce the mortgage redemption period to facilitate foreclosure proceedings in case of loan defaults from mortgage origination.

## **CONCLUSION**

In its backgrounder on the MWLS, the HUDCC has identified the flaws of the lending program thus: (a) no single institution can effectively service the huge volume of mortgages being generated; (b) the quality of the mortgage portfolio has to be improved; (c) limited fund sources; (d) the huge cost of subsidies has affected the system's sustainability.

From the foregoing analysis it should be evident that these flaws remain under the MWLS as presently devised.

In contrast, CREBA's proposal adequately addresses these concerns. A single institution – networked through developer origination and with the developer as collecting arm under warranty – can service any loan volume. The soundness of the loan portfolio to the point of being totally risk-free can be assured with the use of an improved CTS mechanism as recommended. The proposal for a permanent seed fund and full securitization addresses not only funding volume but also its predictability, stability and continuity. And with centralized lending, subsidy will not cost the Funders or Government anything, since centralization would allow for the proper and efficient allocation and programming of funds to the different sectors, thereby enabling the cross-subsidy mechanism to function viably.