

Chazen International Study Tour Report

The Mexican Dream: Affordable Housing in Mexico

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**Runner-Up,
Outstanding Study Tour Report Award**

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Chazen International Study Tours

Designed to enhance the classroom curriculum, Chazen International Study Tours offer students and their faculty adviser an intense, firsthand experience of the business and culture of their chosen country or region. Study tours are initiated by students and organized with the help of the Jerome A. Chazen Institute of International Business. During the study tours, students meet with leading executives and government officials while visiting businesses, factories and cultural sites. Destinations change yearly, as study tours are student-initiated. Recent destinations include Brazil, China, Dubai, India, Japan, Mexico, Romania and South Korea.

Executive Summary

Columbia Business School's March 2008 study tour to Mexico focused on the country's housing market and examined innovative approaches by both government and industry to provide quality, affordable housing for millions of Mexicans. Organized by the School's Real Estate Association and the Chazen Institute of International Business, the trip offered students a frame of reference for the turmoil in the U.S. housing market that occurred during the time of the trip.

Students attended a housing panel, where leaders of prominent low-income-housing developers, financial institutions and government agencies shared valuable insights into Mexico's affordable-housing challenge. Students also visited two affordable-housing development projects near Mexico City and Monterrey to get a firsthand look at how affordable-housing projects are designed and built to suit the needs of working Mexican families. In the current debate in the United States about new regulations for and oversight of the housing industry, perhaps Mexico's solution to achieving the "Mexican Dream" of owning a family home can offer some insightful perspectives on how future distress might be avoided.

Overview of the Mexican Real Estate Market

Consecutive years of GDP growth, rising income levels, an emerging middle class, steady inflation levels, relatively low interest rates and a large, dynamic population of young people entering the workforce all point to a favorable economic environment for Mexico's real estate market. Perhaps the most encouraging development in recent years has been the influx into the Mexican real estate market of sophisticated institutional investors, such as private equity firms and foreign strategic investors. International powerhouse real estate players, such as Hines, Reichmann International and ProLogis, have invested aggressively in Mexico. Their involvement has also dramatically enhanced the standards of real estate development in the country, as technologically advanced and environmentally conscious building designs are now a practical requirement for all high-end development in Mexico.

Study-tour meetings with private equity firms, such as Mexico Retail Properties and O'Connor Capital Partners, also confirmed Mexico as a key strategic market in Latin America. Joel Zorrilla, MBA '85, whose hotel chain City Express Hotels recently received a sizable equity investment from Morgan Stanley's expansive Real Estate Fund, also impressed upon students the incredible real estate opportunities throughout Mexico, not just in the major markets.

The Affordable-Housing Challenge

A housing panel organized by the Columbia Business School Alumni Club of Mexico constituted one of the highlights of the trip for many students. The esteemed panelists—senior decision makers in key government agencies, developers and mortgage lenders in the affordable-housing market in Mexico—outlined the tremendous challenge of a housing shortage in Mexico.

The country currently confronts an estimated housing deficit of 6 million dwellings nationally, a staggering number given that there are only 25.7 million homes in Mexico¹ and that only roughly 750,000 units are built every year.² Experts on the housing panel suggested that a lack of available financing for home builders going back 10 years has since contributed to inadequate housing development, especially in the affordable-housing segments. Only 6 percent of homes in Mexico are financed by mortgages, compared with about 67 percent in the United States.³

The Mexican government has, however, recently taken aggressive steps to meet the affordable-housing challenge, which is particularly welcome news in a country where half the population lives in poverty.⁴ Additionally, more than 60 percent of the population in Mexico is under 30 years old, a contributing factor in the projected doubling of households in Mexico over the next 25 years.⁵ Action by the Mexican government, therefore, will facilitate faster supply-side development for the anticipated rise in housing demand.

Realizing the Mexican Dream

Central to Mexico's solution to the affordable-housing challenge are two government agencies: the National Housing Fund for Private Sector Workers (Instituto del Fondo Nacional de la Vivienda para los Trabajadores, or INFONAVIT) and Sociedad Hipotecaria Federal (SHF). INFONAVIT, which issued more than 50 percent of all domestic mortgages in 2006⁶, is entirely funded by the country's Retirement Savings System (Sistema de Ahorro para el Retiro, or SAR). Twice a month, private-sector workers in Mexico⁷, in conjunction with their employers and the federal government, make compulsory deposits in their own retirement accounts, similar to the

¹ Theresa Bradley, "Mexican Housing Booms Despite US Crisis," Associated Press, January 20, 2008.

² Fitch Ratings Special Report, *Credit Availability Underpins Mexican Homebuilder Growth—Challenges and Risks Remain*, October 26, 2007.

³ Bradley, "Mexican Housing Booms."

⁴ Ibid.

⁵ Homex S.A. (corporate presentation, March 2008).

⁶ Fitch Ratings, *Credit Availability*.

⁷ Public employees in Mexico enjoy similar benefits through FOVISSSTE, a government agency that oversees public-employee pension programs.

Social Security System in the United States.⁸ Workers then have the option to direct the balance in their SAR housing subaccounts toward down payments on houses.⁹

INFONAVIT grants loans at below market interest rates to low-income workers without intermediation by other banks and financial institutions, ensuring equal access to mortgage financing. Moreover, because INFONAVIT is an agency of SAR, it has full, accurate and up-to-date information on a worker's income and is therefore able to make prudent lending decisions. To further reduce the likelihood of default, mortgage payments are automatically deducted from the borrower's paycheck.

For its part, SHF works to ensure the proper functioning of the mortgage market in Mexico. Approximately 10 percent of the mortgages originated in Mexico are securitized and resold to investors in various tranches.¹⁰ SHF provides a guarantee of the first 25 percent of loan loss, cost of repossession and legal costs in the primary mortgage market. In the secondary market, SHF provides a guarantee of timely payment of principal and interest.¹¹ SHF also has a mandate to participate actively in the mortgage-backed securities (MBS) market by purchasing securities to ensure liquidity. Unlike Fannie Mae and Freddie Mac in the United States, SHF is backed by the full faith and credit of the Mexican government and enjoys AAA credit ratings.

The existence of SHF and INFONAVIT helps ensure that low-income earners will have expanded access to mortgage financing, while giving investors full confidence in the MBS issuances based on these mortgages, the latter illustrated by the dramatic growth of the MBS market in Mexico, from \$1.7 billion in 2006 to \$3.2 billion in 2007.¹² Impressively, Standard & Poor's credited improvements in Mexico's governmental regulations and sound servicing practices in concluding that the global housing market has had no significant effect on the country's residential MBS market.¹³

Building the Mexican Dream

To see affordable-housing development in action, study-tour students visited two large-scale development projects, one near Mexico City and the other in Monterrey. A representative from Prudential Real Estate Investor provided a tour of the Mexico City-area development project,

⁸ Javier Gurria Laviada, "INFONAVIT and the Development of Housing for Low-Income Workers in Mexico," *Housing Finance Journal*, June 1, 2000.

⁹ Alternatively, they can elect to receive a lump sum, plus yield, when they reach retirement.

¹⁰ Asociación Hipotecaria Mexicana (AHM), *The Mexican Mortgage Market: A Sustainable Growth Industry*, 2008.

¹¹ David Dale-Johnson and Gene Towle, "Mexico's Ambitious Plans," *Mortgage Banking*, June 1, 2003.

¹² AHM, *The Mexican Mortgage Market*.

¹³ Standard & Poor's RatingsDirect, *Mexican RMBS Performs Well Despite Global Housing Volatility*, September 11, 2007.

which consists of identical two- and three-story homes that range anywhere from US\$50,000 to US\$200,000. Most housing units consist of two bedrooms, a kitchen, a living room and a small backyard. Buyers can apply for further financing through the development company to purchase appliances and furniture, so that the families can move in immediately after the unit is delivered. When completed, the development will include an elementary school, public spaces and recreational facilities, such as basketball courts and playgrounds. Students were generally impressed with the quality and functional layout of both the individual housing units and the development as a whole.

Students also visited on the outskirts of Monterrey a development project by Homex S.A., whose shareholders include legendary real estate investor Sam Zell. Homex has built a strong reputation as a technologically advanced and highly efficient home builder in the Mexican market. Housing units are constructed using state-of-the-art molding techniques that permit Homex to construct units quickly without sacrificing quality.

Astute management has contributed to healthy margins and strong financial returns for the home builder. On Homex's construction site in Monterrey, unionized workers are paid, not by the number of hours worked, but by the number of tasks completed. Moreover, students were amazed at the lean warehouse operation on the construction site: a sophisticated inventory-management system allows Homex to keep only three to four days' worth of building materials in inventory, resulting in cost savings that enable the company to keep unit costs attractively affordable. Since its IPO on the New York Stock Exchange in 2004, Homex's share price has increased more than 350 percent.

Future Challenges to the Mexican Dream

Many of the speakers during the trip identified some common challenges facing the Mexican housing market in the years ahead, the first being the maintenance of public infrastructure. Developers themselves are responsible for providing adequate roads, electricity, clean-water supplies and waste-management services for their development projects. However, once the development has been completed, maintenance responsibility falls to the local municipal government or community-governance body. Numerous industry participants told study-tour students that they very much doubt whether such bodies will always have the capabilities to manage the infrastructure needs of expansive projects post completion. The scale of affordable-housing projects in Mexico introduces significant demand for public infrastructure. Deterioration in the maintenance of such infrastructure could lead to significant social unrest in these communities.

Additionally, land prices are escalating in an increasingly competitive affordable-housing industry. Unsurprisingly, the ultimate result of this is often increasingly less affordable housing. Bidding wars over land are not uncommon, especially considering that there are now more than 3,000 affordable-housing developers in the country, according to estimates by the housing panelists. The risk of a land-pricing bubble could make the Mexican Dream of home ownership more out of reach for the average Mexican.

Representatives from Homex commented that, for a wide variety of reasons, homes in affordable-housing communities generally do not appreciate in price. Owners of such units tend to renovate their homes (e.g., adding a floor or adding an extension) in ways that stunt the aesthetic appeal—and, consequently, the market value—of the homes. Additionally, it is common in Mexico to pass down the family home to future generations, rather than to resell it in the market. While it is arguable whether primary residences should be relied upon as a vehicle for building wealth, owning a depreciating asset does little to alleviate financial pressure on low-income families.

While most panelists agreed that the current U.S. housing crisis and economic slowdown should have only a nominal effect on the Mexican housing market, they unanimously agreed that increasingly protectionist sentiment in the United States is of considerable concern for the long-term stability and health of the Mexican economy overall. A downturn in Mexico's economy would spell lost jobs, which would in turn make it harder for many Mexicans to achieve the dream of home ownership.

Final Thoughts

Study-tour participants learned many useful real estate lessons from Mexico's experience in developing innovative measures to address the affordable-housing challenge. The informative housing panel highlighted how the Mexican government has stepped in and provided a significant amount of liquidity in the mortgage market, while playing an active role in ensuring the quality and stability of mortgage loans. It can also be argued that the Mexican government's involvement has allowed the Mexican mortgage market to weather a stormy global credit crunch. The home-building industry in Mexico has also played a pivotal role by supplying the market with affordable yet quality dwellings that low-income families can call home. In a rewarding weeklong tour of Mexico, students saw a perfect example of how government agencies and corporations can work together to provide a valuable public good—the Mexican Dream of owning a family home.