

## HIPOTECARIA SU CASITA S.A. de C.V.

## RATING DATE

October 17, 2002

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RATINGS	
<b>Primary Servicer</b>	
Low-Income Loans (First Liens)	<b>SQ2</b>
<b>OVERVIEW</b>	
<b>Servicer Ability</b>	
* Collections	Strong
* Loss Mitigation	Above Average
* Judicial Timeline	Average
<b>Servicer Stability</b>	
* Financial	Average
* Strategic	Strong
* Responding to Market Changes	Strong
<b>RELATED RATINGS</b>	
Hipotecaria Su Casita	
* Local Currency Rating	<b>Ba3 (Issuer Rating)</b>
* National Scale	<b>A3.mx</b>

## SUMMARY OPINION

**Stable, Adequate Servicer**

Moody's has assigned Hipotecaria Su Casita (HSC) a servicer quality rating of **SQ2**,<sup>1</sup> based on its ability as a primary servicer for low-income loans and on the stability of its servicing operations.

HSC's loan portfolio consists primarily of low-income loans that are funded by FOVI/SHF<sup>2</sup> (SHF). SHF is a Mexican governmental agency that promotes the expansion of low-income housing. HSC also services a few loans that target middle-income individuals, which are funded by HSC's own resources. HSC's main area of business is residential mortgage origination and servicing, and it is committed to high-quality servicing and is active in promoting servicing standards in the industry.

1 See *Moody's Approach to Rating Residential Mortgage Servicers* (January 2001) for a discussion of the factors considered in the assignment of Moody's servicer quality ratings.

2 *Sociedad Hipotecaria Federal*, which manages the funds previously held by FOVI, provides financing for qualified homebuyers with funds from the World Bank, the Mexican Government, and its own funding in the capital market. Sociedad Hipotecaria Federal provides financing for qualified homebuyers through financial intermediaries (commercial banks and Sofols), which administer sponsored mortgage loans, including the disbursement of mortgage funds and the servicing of such mortgages. Mortgage financing from Sociedad Hipotecaria Federal is available for the upper end of the affordable housing market, as well as for the lower end of the middle-income housing market.

October 22, 2002

HSC's success with its portfolio is tied to its collection process and its ability to cure delinquent loans quickly before they become costly and seriously delinquent. As of August 2002, HSC had only 1,580 loans that have ever been more than 90 days past due. That number of loans is only 2.6% of the current total of its low-income loan portfolio.

HSC's strategy includes an aggressive approach to avoid the judicial process, which is both lengthy and costly. HSC often sells the property on behalf of borrowers for accounts in which the original borrowers cannot continue making payments. A new borrower will take over the property, which will most likely be financed through SHF. The company's solid performance in its loan portfolio stems from its ability to either cure loans before they enter the extra judicial and judicial processes (See p.9-10) or sell the properties on behalf of the current borrower as a way of minimizing losses.

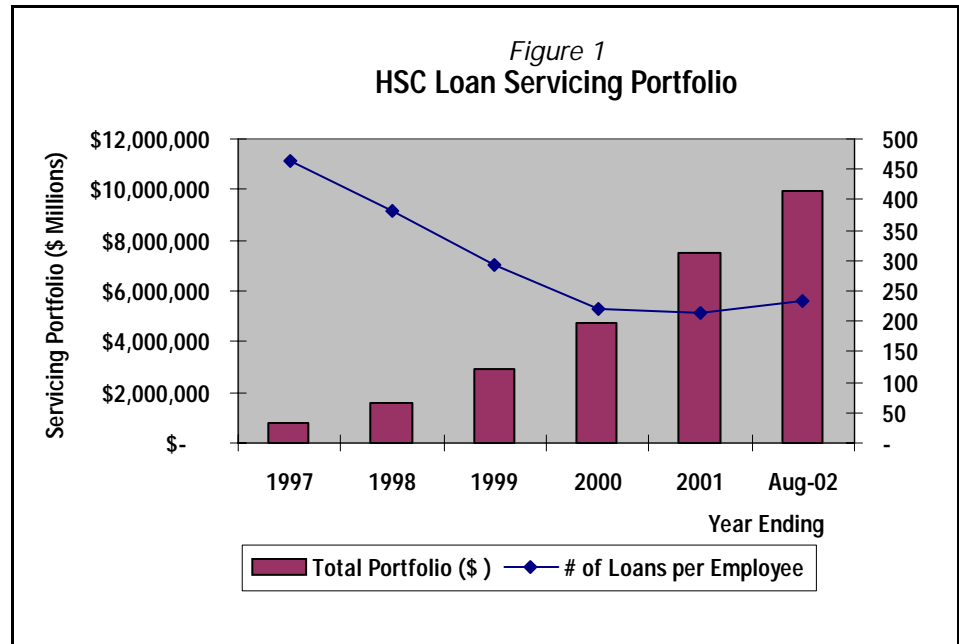
The residential mortgage loan portfolio has a high weighted average loan-to-value (LTV) ratio of 85.3% and a low-weighted average debt-to-income (DTI). HSC has a policy of only accepting loans with a maximum of 22.22% DTI (or that income be at least 4.5 times the debt service). The mortgage loans have performed similarly to Alt-A loans<sup>3</sup> in the United States.

HSC has grown rapidly in the past three years. The growth is attributable mostly to the origination of more loans and to the merger with Financiamiento Azteca (Finazte), which was completed in March 2002. Finazte was the seventh-largest SOFOL in Mexico, based on loan portfolio and capitalization.

Following the merger, HSC consolidated its position as the second-largest SOFOL in Mexico and currently has about 65,000 loans (low and middle income) in its portfolio. As a result, the company's servicing capacity increased with the addition of servicing staff and platforms (See Figure 1).

Moreover, HSC has, on average, assigned 70 delinquent accounts to each mortgage collector, which assures that accounts are managed thoroughly and effectively. HSC's compensation system rewards employees for reducing delinquencies and defaults and for minimizing losses.

HSC is committed to maintaining high-quality servicing. It has a vested interest in the loans it services, and its management has the expertise and experience required. HSC has the incentive to service its own loans effectively because its credit quality depends on its success in that role.



3 Alt-A loans refers to the credit quality of the borrower, who has obtained a level of credit score in the US, which is normally a notch below prime borrowers.

## SERVICING PORTFOLIO

HSC's servicing portfolio consists of 89.9% of loans in which it has a direct ownership interest; thus it has a strong financial interest in servicing performance. The servicing portfolio was \$9.9 billion pesos at the end of July 2002. Most of the loans are part of a Mexican government initiative to provide affordable housing for low-income citizens. In the U.S. market, the loans would be considered subprime in terms of type of borrower.

*Figure 2*  
**HSC Loan Portfolio (As of 08/2002)**

WA LTV (origination)	85.30%
WA LTV loans over 80% (origination)	89.00%
Seasoned 3 to 5 years	28.30%
Average time serviced by Servicer (months)	30.7
Loans Serviced by Servicer for 1+ years	79.30%
Percentage of Loans 90+ Days Delinquent (including judicial process)	1.52%

This portfolio has a very high average LTV, which could result in delinquencies and ultimately defaults during economic downturns due to the low equity position of the borrowers on these homes. On average HSC's portfolio of loans have been seasoned for about 2.5 years, and almost 80% has been serviced by HSC for at least one year (See *Figure 2*).

The growth of HSC's mortgage portfolio is controlled and steady (see *Figure 5*) through their own originations, by product type. All the mortgage loans HSC services are floating- or fixed-rate, first-lien mortgages, denominated in pesos (44.2%) or UDIs (55.8%). The UDI is a non-

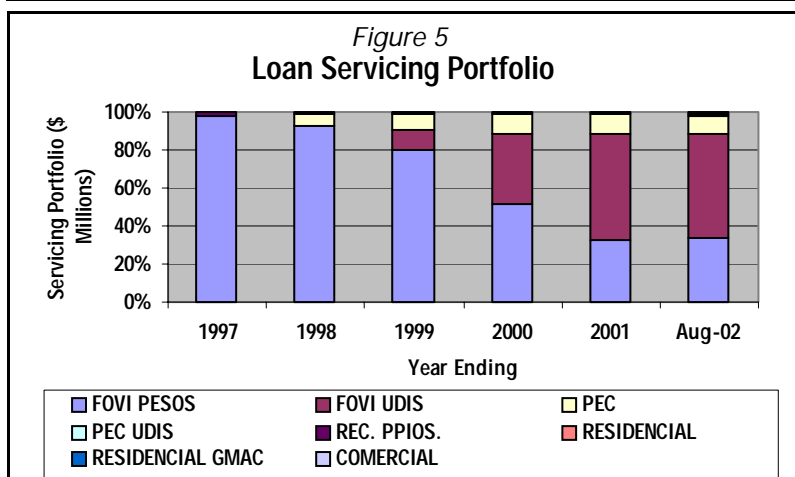
traded currency that is indexed to the Mexican inflation. Moody's believes the loan characteristics contribute to the weakness of the portfolio and to the difficulty to collect, especially in an economic downturn. Nevertheless, HSC has been able to maintain a low rate of delinquencies, as shown in *Figure 3*. Even on a static pool basis, HSC's loan portfolio from 1999 has less than 3.5% of loans with more that 90 days delinquency and under 1% in the judicial process as of August 2002 (see *Figure 4*).

*Figure 3*

All Loans	1997	1998	1999	2000	2001	2002
Current	94.08%	94.33%	96.35%	94.25%	90.41%	90.32%
1-30 Days Delinquent	3.04%	3.19%	1.49%	3.35%	5.17%	5.59%
31-60 Days Delinquent	1.05%	0.74%	0.69%	1.15%	2.10%	1.96%
61-90 Days Delinquent	0.72%	0.44%	0.27%	0.44%	0.95%	0.62%
90+ Days Delinquent	0.97%	0.67%	0.84%	0.69%	1.15%	1.14%
Judicial Process	0.15%	0.63%	0.36%	0.12%	0.19%	0.35%

*Figure 4*

Static Pool Basis	1999	2000	2001	2002
Current	96.35%	95.90%	90.11%	86.43%
1-30 Days Delinquent	1.49%	1.69%	4.05%	5.89%
31-60 Days Delinquent	0.69%	0.89%	2.53%	2.67%
61-90 Days Delinquent	0.27%	0.42%	0.86%	1.55%
90+ Days Delinquent	0.84%	0.91%	2.00%	2.82%
Judicial Process	0.36%	0.19%	0.44%	0.64%
Total	100.00%	100.00%	100.00%	100.00%



Furthermore, the type of product could have an impact on collection difficulty. More than 50% of HSC's portfolio of loans is denominated in UDIs, which during inflationary periods could cause a payment shock to the borrower due to the lag time for salaries to catch up to inflation. Nevertheless, during 1997 and 1998 when inflation was 15.7% and 18.6% per year respectively, HSC's collection performance held steady. However, only a small percentage of HSC's portfolio was denominated in UDIs at the time. Today over 50% of the portfolio is denominated in UDIs, thus increasing their exposure to inflationary risks.

## SERVICER ABILITY

### Healthy Cure Rates: Evidence of Servicer's Ability

HSC has demonstrated its ability (as a mortgage loan servicer) to cure delinquent loans before they migrate to higher delinquency levels. Only 1.5% of HSC's loan portfolio is delinquent more than 90 days including accounts in the judicial process and only 0.35% is currently in the judicial process (usually about 180 days delinquent or more).

Figures 6, 7 and 8 show the cure rates on about 50% of the low-income loans serviced by HSC. Of the previously delinquent accounts, 58.7% has had some level of recovery, including 51.5%, which have experienced a total cure; 20% remained at the same level of delinquency, and 21.2% migrated to a higher delinquency level.

Delinquency	Current	30 days	60 days	90+ days	Forbearance	Foreclosure	Totals
July 01 No. of Loans	35643	972	312	403	14	44	37,388
Paid In Full	590	6	0	1	0	1	598
Current	31556	576	160	146	9	0	32,447
30 Days	2071	187	67	44	0	0	2,369
60 Days	777	75	22	14	0	0	888
90+ Days	627	110	59	96	0	1	893
Forbearance	3	4	1	10	3	0	21
FC	19	14	3	92	2	42	172
<b>Total</b>	<b>35,643</b>	<b>972</b>	<b>312</b>	<b>403</b>	<b>14</b>	<b>44</b>	<b>37,388</b>

Recoveries	1,025	58.74%
No Change	350	20.06%
Migration	370	21.20%
<b>Total</b>	<b>1,745</b>	<b>100.00%</b>
<b>Total Cure</b>	<b>899</b>	<b>51.52%</b>
<b>90+ days Total Cure</b>	<b>157</b>	<b>34.06%</b>

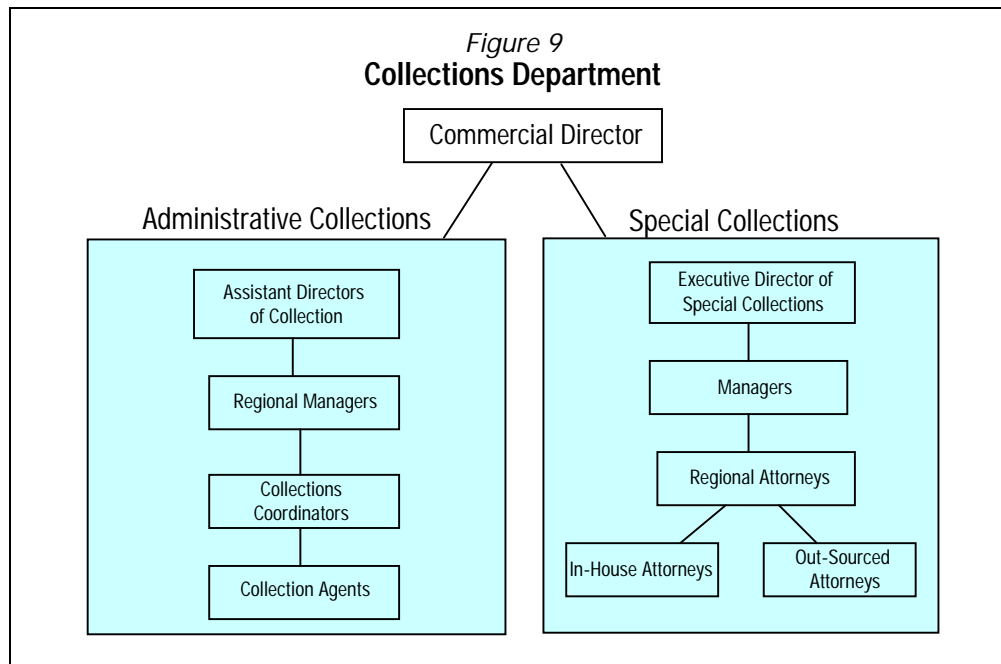
## COLLECTIONS DEPARTMENT

### Collection Management

HSC's collections division is the responsibility of the commercial director, who is supported by assistant directors, who are in charge of the southern and northern collection divisions. He is also supported by the executive director of extra-judicial and judicial collections.

Delinquency	July 01 No. of Loans	%	July 02 No. of Loans	%
Paid in Full	0	0%	598	1.6%
Current	35643	95.3%	32,447	86.8%
30 days	972	2.6%	2,369	6.3%
61-90 days	312	0.8%	888	2.4%
90+ days	403	1.1%	893	2.4%
Forb	14	0.0%	21	0.1%
FC	44	0.1%	172	0.5%
<b>Total</b>	<b>37,388</b>	<b>100.0%</b>	<b>37,388</b>	<b>100.0%</b>

Figure 9 presents the organizational chart of HSC's collections department:



### Collection Procedures

HSC tries to minimize losses and the migration from one delinquency bucket to the next by establishing early and extensive contact with delinquent borrowers. The company makes many attempts to contact each delinquent borrower, by telephone, by mail and through on-site collectors to ensure that all borrowers receive their statements.

Borrowers will receive a mortgage statement between the fifth and tenth day of the month. It is hand-delivered by a collection agent every month and informs the borrower of the outstanding balance and of the next scheduled payment date, in addition to the amount. Hand-delivering notices and statements is an important part of the procedure, because some borrowers might have forgotten about payment and the personal contact reinforces the obligation of the borrower to pay his/her debt as scheduled. On a quarterly basis borrowers receive three preprinted deposit slips, along with their account statements, to facilitate payments. These deposit slips allow borrowers to make payments with minimal effort, as some borrowers may not know how to fill out payment slips.

Borrowers can make monthly payments to the servicer through any of the following three methods:

1. At any HSC branch, at which 34% of all mortgage payments are made. Branches are located close to the housing developments and are open on Saturdays to facilitate borrowers.
2. Payment booths, at which 12% of the mortgage collections are made. Payment booths are generally built in housing complexes where HSC holds a sufficient number of loans so that it is cost feasible. Booths are also open on Saturday to facilitate payments.
3. At any Banamex or Bital bank branch, at which 54% of all mortgage collections are made. Banamex will only accept payments accompanied by the borrower's account statements. Payments at Bital, on the other hand, can be submitted using the bank's Automatic Reception of Payments Form, and are deposited into an account created exclusively for receiving these payments. Borrowers are not required to have an account at these banks, as payments are made to an HSC account with an attached reference number. This reference number is HSC's internal reference to the loan. When HSC does the reconciliation of deposits, the staff is provided with the reference numbers in order to match them with the loans. This is the same method used by utility companies (light, telephone, cable, gas, and credit cards) so that an individual can pay utility bills at any bank.

Banamex is Mexico's second-largest bank, with 1,491 branches located throughout the country in all states. Bital is Mexico's fourth-largest bank, with 1,379 branches in the country located in all states. Both Banamex and Bital are currently rated **Baa2** for long-term deposits with stable outlooks. The **Baa2** rating is the highest for any bank in Mexico, which are constrained by the sovereign ceiling. The branches tend to be in urban areas where as the housing developments are in more isolated areas. Nevertheless, many borrowers work near or in the cities and some can more easily make payments at bank branches.

## Collection Stages

HSC has a call center located in the corporate offices in Mexico City. The call center employs six phone operators who work an average of 40 hours per week (8 hours a day) in three shifts to provide 24-hour coverage for borrowers.

HSC uses various methods to collect on a past-due loan that cannot be resolved by the call center. HSC has a network of 100 branches and collection booths to facilitate the collection process. Currently, it employs 185 collectors. In addition, HSC staffs 10 in-house attorneys and also uses 21 outsourced attorneys for extra-judicial and court proceedings when in-house resources are not available.

Typically, delinquencies are allocated as follows:

1. Call center: delinquencies of 1-30 days are handled by the HSC call center.
2. Administrative: delinquencies of 31-120 days are assigned to HSC on-site collectors.
3. Extra-judicial: delinquencies of 121-180 days are assigned to in-house or outsourced attorneys who specialize in extra-judicial collections.
4. Judicial: delinquencies of more than 180 days go into court proceedings.

However, certain delinquencies can be moved to the more severe categories before the normal time has elapsed if the collector in charge determines that collection is not probable through the current method. That may occur, for example, if a borrower cannot be located or is deemed unwilling and unable to pay the debt.

HSC has set collection target recovery rates for each of these categories, as shown in *Figure 10*:

Category	Percentage Collected
1-30 days delinquent	95%
31-90 days delinquent	90%
91-120 days delinquent	85%
120-180 day delinquent/ Extra judicial process	80%
More than 180 days delinquent	75%

## 1. Administrative Collection

### A. Call Center Process

The HSC Call Center contacts borrowers via phone in three stages. *The first stage* is the welcome call to all new borrowers who have signed mortgages to explain procedures and verify data. Therefore, shortly after signing a mortgage loan, all borrowers will receive a call from HSC's call center to explain payment procedures, including specific locations where payments can be received, clarify any doubts, and verify data about the borrower.

The first call is placed to all newly originated mortgagees, which account for 80 to 100 new borrowers per telephone operator per month. The caller also warns the borrower of the problems associated with being delinquent on payments. For example, the caller will explain that delinquencies can lead to bad credit and also to penalty fees. The information obtained from the borrower is stored in a database to be used by HSC collectors.

*The second stage* involves a reminder call to borrowers that have been delinquent more than three times in the past 12 months. HSC has a policy of calling 10% of delinquent borrowers at random every month to anticipate future collection problems. The call is to remind them of their upcoming payment, as well as to determine as soon as possible if there is any serious problem with the account, thus demonstrating that HSC is taking proactive steps to prevent further delinquency.

*The third stage* involves calls to borrowers who are currently delinquent. Delinquent borrowers will receive a call

from a phone operator about five days following a missed payment date. HSC needs at least five days to reconcile the accounts, as payments are coming in from different locations.

For example, checks paid through Banco Bital or through Banamex take at least two days to clear and the information is usually not sent to HSC until one day after the deposit has been made. Payments made at booths take one full day to process because the information is sent to HSC headquarters at the end of each day. Payments made at HSC branches are processed faster than at any other location. However, HSC is unable to determine if a particular account is delinquent until it has received all information from the banks.

The phone operator will follow the manual's instructions for these calls, including the following:

- Informing the borrower of being delinquent on the mortgage, stating the total amount due.
- Verifying data on the borrower and on the account.
- Inquiring about the reason for non-payment.
- Requesting the borrower to promise payment by a specific date.
- Informing the borrower of the potential consequences for non-payment (i.e., bad credit and delay penalties)
- Reminding the borrower of the many places where payment can be made.

If the borrower is unwilling or is unable to promise payment, the account is returned to the collections coordinator, who will determine whether the account will go to a collection agent or to the extra-judicial or judicial process.

If the borrower does promise to pay the overdue amount by a certain date and the probability of the borrower making the payment is reasonably high, then the account stays within the call center. The client's promise is recorded and if payment is not made by the date agreed upon then the account is given to the coordinator, who reassigns it to a collection agent.

All information derived from these calls and in any encounters with the borrower is recorded and maintained in a database, which is used to take a pro-active position regarding collection.

Compared with U.S. servicers, Mexican low-income mortgage servicers make more personal visits to collect. That has proven to be far more efficient than phone efforts. Accordingly, the HSC Call Center has a policy of calling a borrower a maximum of four times. The calls will be made to the different numbers available and at different times. If the phone operator is ultimately unable to locate the borrower the information is recorded and the account is turned over to the collections coordinator.

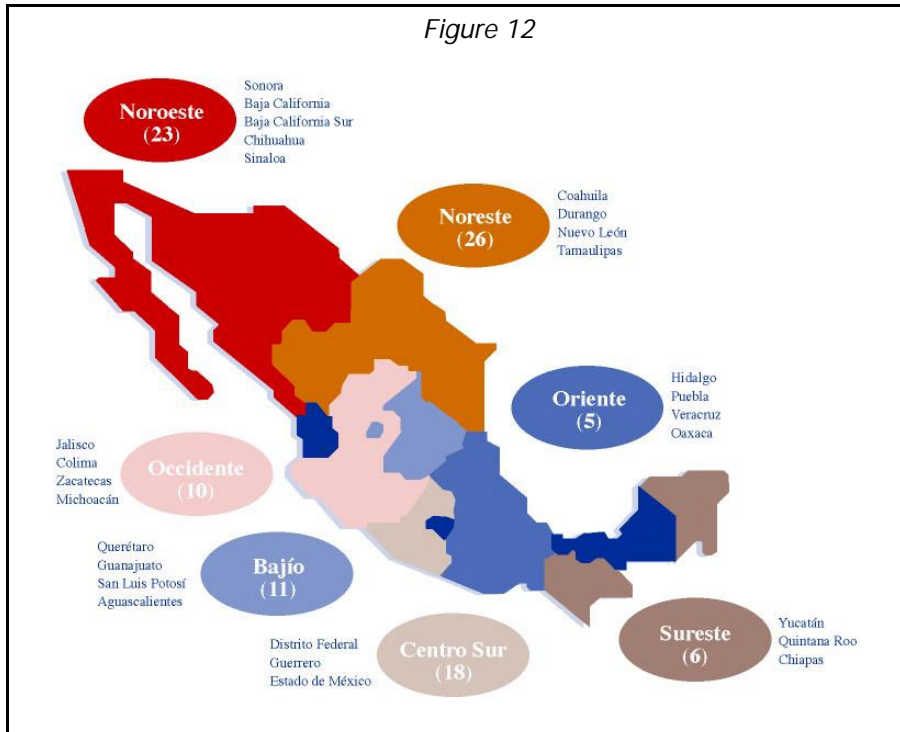
In the past 12 months, outgoing telephone contacts for the mortgage portfolio reached the appropriate party 65% of the time, and the call center was able to resume a payment schedule. Of those borrowers who had promised to make payments 20% did not honor their promise. If the promise is broken, the loan automatically goes to the collection coordinator, who continues the collection process. A promise to pay does not constitute an automatic shift from delinquent to current. If the payment was delinquent and the borrower made a promise to pay and broke it, the account stays within the delinquency bucket determined by the severity of the delinquency (monthly payments past due).

Of the outbound calls, 10% were successful only in leaving messages. From those, 15% returned the calls, and the collection process continued. In 35% of the cases, the call center was not successful in reaching anyone. In addition, only 10% of the incoming calls were dropped (see *Figure 11*).

<i>Figure 11</i> <b>Key Collection Management Statistics</b> <b>From Dec. 2001 to June 2002</b>	
Average Contacts per month	4 per delinquent borrower
7242 outbound calls	
1810 inbound calls	
Right Party Contact	65%
Kept Promises	80% (last 12 months)
Dropped Calls	20%

## B. Handling of Accounts 30-120 Days Delinquent

Once an account is more than 30 day's delinquent, it is initially assigned to an HSC administrative collections branch, according to the location of the property. HSC has 46 branches throughout Mexico.



The typical staffing structure for an administrative collections branch includes one collection coordinator, three to six collectors, one to three phone operators, and one cashier in each branch and payment booth within the branch's jurisdiction. All the administrative collection branches report to their regional coordinators of administrative collections, who are located at the HSC regional offices (See *Figure 12*). There are currently 36 regional administrative coordinators. The regional coordinator must ensure that target collections are met and that collections procedures are being followed. The regional coordinator in turn reports to the national manager of administrative collections, who is ultimately responsible for the administrative collections.

The collector has some discretion in determining the possible resolution of the delinquency. For example, he can enter into a payment agreement with the borrower if he determines that the likelihood of payment is reasonable. However, the branch coordinator must first determine that the borrower has not entered into a payment plan previously, as borrowers cannot be given special payment plans more than once. The total time frame for payment plans cannot exceed the total months outstanding. For example, a borrower who is three payments behind can only be given up to three months to bring payments up to date.

If the borrower does not meet this new agreed-to payment plan, then the branch coordinator (only the coordinator) has the discretion of adjusting the payment plan. For security purposes, the collectors cannot accept payments personally, all payments must be made via a payment booth or an HSC branch or a participating bank.

The specific strategy for collection may differ according to the circumstances. For example, if borrowers say they did not pay because they were upgrading the property (which would need to be proved), then they will be more likely to pay as they are investing in the property. Therefore, such a borrower will be given an opportunity of signing a payment plan to pay for the overdue amount. If on the contrary, the borrower is not living at the property and does not seem willing to pay, then the account may be directed to extra-judicial process immediately. If the borrower has lost a job and does not expect to renew employment in the next 90 days, then the account is referred to the collection's coordinator where they may pursue alternate solutions.

*Figure 13*  
**Manual Procedures**

- Visit the home, employment of the borrower or other places
- Give letter personally to borrower and obtain a receipt of delivery
- Inquire the reason for non-payment plus written evidence.
- Solicit promise to pay or sign a payment plan for the delinquent amount
- Sell the property on behalf of the borrower.
- Negotiate the borrower turning over the property (if applicable).
- Open a file for this borrower indicating new resolution plan.
- Record information into database.
- Prepare a letter to borrower indicating time of delinquency and amount owed (a second letter would be sent if the borrower becomes 60 days delinquent, then a third after 90 days).

If a collection agent determines that a borrower is unlikely to be able to make the payments, the collection agent can suggest selling the property on behalf of the borrower or negotiating the turning over of the property. HSC will sell the property on behalf of the borrower if the borrower signs a power of attorney. Possible purchasers are listed in a database, generated by the collection's coordinator at the housing developments. Another way of finding a substitute borrower is via the developers' possible borrowers list. That way is less costly than a foreclosure because the property is only transferred once, thus saving the legal fees associated with transferring the property to HSC and then transferring it again to the new purchaser.

If the client cannot or does not enter into a payment plan, does not agree to giving HSC the power to sell the property on his or her behalf, nor relinquishes the property, or if the account has four missed payments, then the account is passed on to the extra-judicial procedure. In special situations, the account can be taken directly to court at the discretion of the collection's coordinator. All information regarding the collection effort is well-documented and later used by the extra-judicial and judicial collection agents.

## **2. Extra-Judicial Collections**

When an account is more than 120 days overdue or when it has not been adequately resolved by the collection agent, it is referred to either an in-house attorney or an outsourced attorney specializing in extra-judicial collections. The extra-judicial procedure is necessary because Mexico's judicial system is time-consuming and favors the borrower. Depending on the availability of resources, the account is assigned to an attorney for extra-judicial collection. If the account is assigned to an out-of-house attorney, he or she must first sign a contract accepting the task and present credentials for approval of the special collections department management. HSC currently has 10 in-house attorneys and 13 regional law offices, which they regularly use for outsourced attorneys.

The attorney assigned to the account will try to resolve the delinquency outside of the court in order to keep costs low. The attorney will determine the strategy for resolving the delinquent account with information from the administrative collection effort. The attorney may use the threat of legal action to persuade the borrower to resolve his delinquency. The delinquency can be resolved by the borrower paying all delinquent debt, by HSC selling the property on behalf of the borrower, or by a negotiated settlement for turning over the property to the lender. If none of the proposed solutions are accepted, then the account goes into the legal foreclosure process.

As of August 2002, HSC had 154 loans in the extra-judicial stage.

An account will automatically go into legal proceedings, if not resolved within a normal certain timeframe, as follows:

- 60 days if the borrower is planning to make overdue payments;
- 90-120 days if the borrower has entered into any payment arrangements (available only if the borrower owes six payments or less);
- Up to 150 days if the borrower is overdue on one to three payments.

## **3. Judicial Proceedings**

Judicial proceedings in property foreclosures in Mexico are lengthy and costly, thus HSC makes every effort to avoid this procedure. However, when the administrative and extra-judicial processes fail, HSC resorts to the legal process to foreclose on a property, which will be handled by either in-house or outsourced attorneys in HSC's network of associated legal firms.

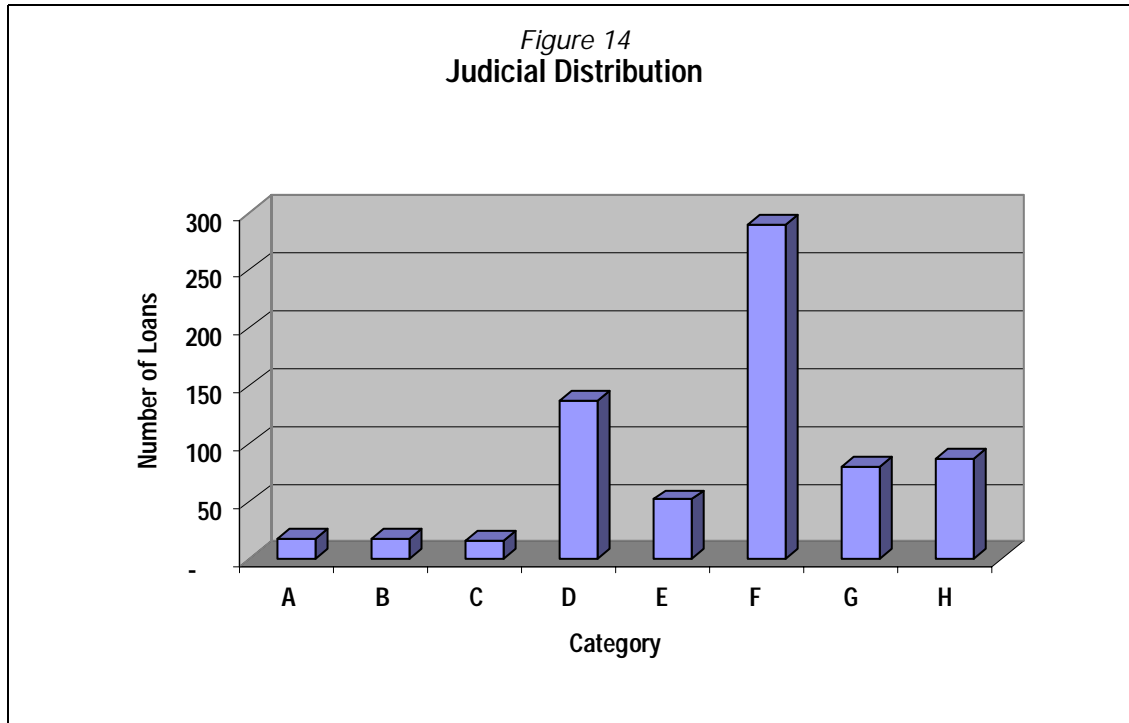
The HSC legal representative in legal foreclosures will file a suit with the court system for the payments due and accrued interest. The courts will then issue a letter to the borrower, stating the obligation to respond to the suit within 30 days. The judge will issue the "demand" letter, usually excluding any accrued interest.

If the borrower does not adequately challenge the charges within 30 days, he/she will have 120 days to pay off the amount due. If the borrower does not pay the amount due by that time, HSC can request the court to issue the order for eviction, which takes about 90 days. If the court orders the eviction, the borrower has at least another 120 days before he/she must vacate the property. In total, the foreclosure takes at least one year, from the initiation of the proceedings. Only then can HSC attempt to sell the property.

Overall, the foreclosure, eviction, and liquidation process takes 30 to 36 months (including the usual administrative and extra-judicial process), which results in significant losses due to the missed payments and high likelihood of damage to the property. Please note that this process could take longer depending on the outcome in the extra-judicial process.

HSC currently has 694 accounts still in the judicial process, which has many stages and which can be resolved in many different ways. The initiation of a judicial claim normally frightens some borrowers, thus encouraging them to find alternative solutions. Some borrowers decide to turn over their property as a form of payment (deed-in-lieu) before court proceedings are concluded. Others will sign a power of attorney to HSC to sell the property on their behalf in order to liquidate the debt. On rare occasions, some borrowers will pay off their remaining debt. In addition, the judicial process can be concluded by (i) the foreclosure and the sale of the property, or (ii) by a court order of repayment of the overdue debt.

A breakdown of the various accounts currently in the judicial process is illustrated in *Figure 14*:



CODE	Concept	Definition
A	REO Judicial	Properties adjudicated during the judicial process.
B	Legal Settlement/ Stipulated pay plan	The borrowers in these accounts have signed judicial agreements to repay their debt and to then comply with the terms of the mortgage going forward.
C	Deed-In-Lieu	When the borrower turns over the property as a form to pay for the outstanding debt.
D	Litigation/ Suit Filed	Accounts for which law suits have been filed and Su Casita is awaiting the admission of delinquency.
E	Litigation/ Borrower Notified	Accounts where the lawsuit has been registered in the Superior Tribunal of Justice and the borrower has been duly notified.
F	To Sell on behalf of borrower	Where the borrower has signed the property over to HSC to sell it.
G	Litigation/ Preparing to Initiate Process	Accounts where it has been determined to initiate the judicial process.
H	Litigation/ Decision issued	When the Judge had issued his decision, in favor or against HSC.

## HSC DEFAULT MANAGEMENT: LOAN LOSSES MINIMIZED

HSC's strength as a servicer lies in its ability to prevent accounts from defaulting. Only 2% of the accounts are more than 60 days past due. However, HSC has various techniques and mechanisms to protect against losses from defaulted loans. To date, HSC has had only 1,580 accounts more than 120 days delinquent, which is 2.6% of the current loan portfolio. Forty six percent (46%) of the 1,580 loans have already been completely resolved through various loss mitigation techniques.

The most frequently used method that HSC uses to protect against losses is to sell the property on behalf of the borrower, without repossessing the property. As a result, HSC saves on legal fees because the property is transferred only once, in contrast to twice in a typical foreclosure/REO process. Forty seven percent (47%) of all the severely delinquent accounts have been resolved through this method. On average, with this method, HSC has a severity of loss of 41%. Another frequently used method involves the court's ordering the borrower to pay overdue debt to HSC. If the borrower pays off the amount as ordered, the account is considered current again. However, the court usually does not recognize accrued interest, resulting in some loss to HSC. This method accounts for 21% of the accounts being resolved, which were previously in default.

*Figure 15*

<b>Defaulted Loan Resolution Frequency Distribution</b>		
	<b># Loans</b>	<b>%</b>
Sold on Behalf of Borrower	501	47%
Paid in Full	8	1%
Legal Settlement Satisfied	223	21%
Power to Sell on behalf of Borrower		
REO	323	31%
<b>Total</b>	<b>1,055</b>	<b>100%</b>

*Figure 16*

<b>CODE</b>	<b>No. of Accounts</b>	<b>Concept</b>	<b>Definition</b>
Judicial Back to Current	223	Accounts returned to regular Payment	The borrowers in these accounts have previously signed judicial agreements to repay their debt and debt has been repaid and the account is being paid in a normal manner. If the account becomes delinquent again, the sentence would be executed automatically, without re-ntering the judicial process.
Paid in Full	8	Liquidation of Debt	The accounts where the remaining debt, including past due interest has been paid in full.
Sold on Behalf of Borrower	501	Sold on Behalf of Borrower	When the borrower has signed an agreement for HSC to sell the property
<b>TOTAL</b>	<b>732</b>		

## TIMELINE MANAGEMENT-FORECLOSURES AND REPOSSESSION

HSC spends a significant amount of time in resolving defaulted loans. The delay is caused, primarily, by the slow foreclosure and eviction process in Mexico. In addition, HSC does not usually initiate legal proceedings until an account is already at least 180 days overdue because it focuses on resolving the default before it reaches that stage. However, accounts that do become more than 180 days delinquent have taken almost two years to resolve. Sales on behalf of the borrower have also taken a long time to resolve - on average 21 months. In addition, about 21 months are needed to resolve defaults when the court orders repayment of overdue amounts. On average, it takes 17 months for a property to become real-estated-owned (REO), but the property must still be vacated and sold before the loan may be considered resolved.

*Figure 17*  
**Timeline Based on Category of Loans**  
Average Months in Each Stage

	<b># Months</b>
<b>1) Sold on Behalf of the Borrower</b>	<b>21</b>
- Time until borrower signs the property to HSC to sell it	9
- Time to sell	12
<b>2) Judicial Back to Current</b>	<b>21</b>
- Time until judicial process starts	6
- Time to resolve during judicial	15
<b>3) REO</b>	<b>17</b>
- Time until judicial process starts	6
- Time until REO	11

## COLLECTION SYSTEM REPORTS AND TECHNOLOGY

HSC maintains a digital record of all mortgages it services, which is updated each time a borrower makes a payment. This data is backed up daily and kept in a fireproof safe. The information is also sent to the mortgage lenders and to Grupo Computacional Hipotecario S.A. de C.V. (GCH) weekly for back up.

GCH, founded in 1997, is owned by HSC and by General Hipotecaria, Financiamiento Hipotecario, and by the consultant developer. GCH was created to develop the Just-In-Time (JIT) system that HSC currently uses. The JIT system interfaces directly with HSC's "Sistema Experto Hipotecario," which is its origination database when a mortgage is signed. The JIT system provides daily reports that can integrate 110 mortgage parameters, such as LTV, DTI, location, etc. JIT can be run on PCs or on servers and the servicing data are centralized. The front end of the JIT database is Visual FoxPro and a SQL server is on the back end, which allows for faster data manipulation and report generation.

## INFRASTRUCTURE AND OPERATIONS

Overall, HSC maintains a well-trained and experienced staff, which has sufficient resources to manage its workload at current staffing levels. HSC invests substantially in training its staff and places equal importance on the incentive of its collection agents with that of the company.

New hires are entered into a training program, in which they learn the basic roles of their positions and company policies. The amount of training depends on the position. Human Resources is in charge of all HSC on-going training and plans courses according to company needs.

In 2001, HSC increased its workforce by 44.5% and had a 12.8% rate of employee turnover. The rapid growth rate is attributable, in part, to the Finazte merger, while the turnover rate stems from HSC's policy of letting collection agents go if they do not meet collection goals.

## MANAGEABLE WORKLOAD FACILITATES LOAN HANDLING

HSC employs a total of 629 people, 40% of which belong to the collections department. Among those working in collections, 185 are collection agents. The typical staffing structure for an administrative collections branch includes one collections coordinator, three to six collection agents, one to three phone operators and one cashier in each branch and payment post within the respective branch's jurisdiction.

*Figure 18*

<b>Position</b>	<b>No. of people</b>	<b>Experience in Collection</b>	<b>Experience in HSC</b>
Call Center	8	3.6 years	2.6 years
Collection Coordinators	38	3.6 years	2.6 years
Collection Agents	84	2 years	1.6 years
Cashiers (also work as collection agents)	98	3 years	2.5 years

HSC also employs 12 in-house attorneys, of which three are the regional attorneys. In addition HSC uses 13 external regional law offices to fulfill the need for outside attorneys.

HSC has sufficient resources to manage its workload at current staffing levels and allocates relatively few accounts to its collection agents. Currently, collection agents work on an average of 70 accounts. The 13 external regional law offices receive, on average, 75 accounts each. Moody's notes that the low number of loans to collectors allows them to devote significant attention to each loan, enabling them to resolve loan problems more efficiently.

HSC maintains a well-trained and experienced staff. On average, administrative collection agents have two years' experience with HSC; and the majority has prior experience in commercial and financial collections. Collection agents have on average two years of collection experience. Branch coordinators average 3.6 years of experience. The external attorneys average about five years of experience in collections within the financial center and in-house attorneys average 3 years of experience. HSC's senior staff has extensive experience in collections, averaging more than six years in collections.

## **TRAINING AND COMPENSATION**

HSC invests substantially in training staff. It has budgeted \$3.7 million pesos in training for 2002--a major increase from \$577,000 pesos in 2001. Each new collector takes a training course that emphasizes their basic roles and explains company policies. In addition, HSC provides specialized external training courses for telephone operators and administrative collection agents. Employees of the collection department are also equipped with training manuals for their particular specialization within the department. In addition, the internal audit department performs an annual audit to determine the need for additional training.

The collection workforce's compensation is based on performance-with incentives in line with that of the company. Administrative collection agents earn on average a salary of \$4,500 pesos per month, plus a quarterly bonus based on the amount of money recovered by the agent in that quarter. Collections coordinators receive an average salary of \$8,459 and a quarterly bonus based on the total money collected in their branch.

The out-of-court and judicial collection workforce is also compensated for its efficiency. In fact, the external law offices are paid solely on a success-fee basis and can receive a maximum of 15% of the money they collect. HSC in-house attorneys earn an average of \$8,500 pesos and are paid a bi-annual bonus, which is subject to a maximum of 45 days' salary for the entire year of work. The bonus varies depending on the performance of HSC. However, HSC is planning on changing the compensation structure of the attorneys to match those of the collection coordinators.

## **QUALITY CONTROL**

Quality control is the responsibility of the Internal Audit Department. As part of the quality control task the Internal Audit Department performs a thorough annual internal audit of HSC's entire business, including an evaluation of the mortgage origination and collection processes.

The annual internal audit includes an audit of each of the collection branches and of HSC's headquarters. Branch evaluations are staggered throughout the year so that each branch is audited every year. The branch audit includes taking a sampling of the branch's accounts to determine whether the account procedures and documentation are performed according to company policy.

The evaluation also includes a confirmation that sufficient collection efforts are being made and that account activity is documented and backed up. Each branch is graded on its performance of complying with company standards and procedures. HSC headquarters are also audited to determine the effectiveness of central procedures and to ensure that communication between headquarters and the collection branches is strong. These results are studied at the end of the year and analyzed in comparison with those of previous years and with those of other branches.

The Internal Audit Department also assists operations by performing other tasks, including identifying the need for revising procedures, investigating specific areas of operation and procedures, and assessing the operational merger of HSC and Financiamiento Azteca.

These quality control tasks are performed by a highly trained group of accountants with substantial auditing experience. The team currently consists of seven certified accountants having an average of more than six years of auditing experience. All HSC internal auditors have previously worked in large international accounting firms or multi-national corporations.

## **SERVICER STABILITY**

### **Financial Resources and Stability**

The primary financial concern when rating a mortgage loan servicer is the servicer's ability to remain in business and to maintain its servicing quality under economic stress. HSC's financial strength is stable, and reflects its strong market position and a strong financial profile, such as low operating costs, solid profitability, and experienced and conservative management.

Similar to many of the other Sofols, HSC receives most of its funding for the origination of low-income housing mortgages and bridge loans for developers from SHF. Ninety percent of Su Casita's funding comes from SHF.

Despite these dependencies, a substantial market for low-income housing exists in Mexico, which Moody's believes will sustain HSC's core business in the near to medium term.

HSC has a growing construction loan business, which we expect will continue to grow. Furthermore, HSC has implemented a diversification strategy that will reduce its reliance on SHF funding and will increase its income from new businesses apart from social income housing. The company's diversification strategy is to provide its traditional housing business with complementary products and services. HSC is the first Sofol to introduce home improvement loans, which do not require SHF funding. It plans also to raise funds in the capital markets through the securitization market.

The company has several strategic alliances and is expecting new partner support from other non-mortgage non-bank entities, and from a mutual fund company called Interesa. Through these alliances and partnerships HSC will provide a wider array of financing and investment instruments, keeping a focus on low-income individuals and companies that cater to the low-income population.

HSC has also been successful in issuing commercial paper and bonds in the capital markets, creating a track record for the company to increase its access to the capital markets.

HSC has a \$180 million program planned financing middle-income housing. SHF is looking into piloting a co-financing program with HSC and is getting closer to engaging in a pure securitization structure. In addition, HSC has a presence in the portfolios of prominent institutional investors in Mexico. Furthermore, it currently has more than \$300 million available to draw on its bank lines and has approximately \$500 million in cash to fund activities (excluding available bank lines).

### **Commitment To High-Quality Servicing**

The supply and demand in the Mexican low-income housing market bodes well for HSC as demand for low-income housing far exceeds the supply of affordable homes. HSC plays a key role in the low-income housing market in Mexico, it covers economic segments and geographic areas of the market that are not serviced by traditional Mexican banks.

The company's goal is to be the financial agent for the Mexican family, to offer diverse savings and loan products, to achieve a competitive infrastructure for both collections and origination, and to obtain/retain qualified personnel for its expanded business by 2006.

HSC has more flexible and efficient processes for originating and servicing low-income housing mortgages than banks, and thus is able to maintain healthy operating margins and cash flows. These operating efficiencies enable HSC to maintain a very low portfolio of delinquencies.

### **Ability To Adapt To the Market**

HSC's senior management is solid and tenured, with extensive industry experience. Management is sensitive to industry trends and is aware of the way that market changes can affect the company. As an example, HSC is committed to reduce SHF funding dependency by obtaining third-party funding in the form of credit lines and strategic alliances, to improve its short- and long-term debt, and to attain capital relief by securitizing its loan portfolio.

In addition, it is aggressively pursuing new products and services, which it expects will constitute 15% of revenues. The new products and services include expanding to middle and upper-income housing; funding home improvements; financing commercial infrastructures for housing developers; using HSC's savings and loan for savings programs; distributing mutual funds; conducting collection services for third-parties; servicing third-

party loan portfolios; and creating an investment fund to purchase loan portfolios.

The company plans to also improve its growth and position in the Mexican housing market through acquisitions and joint ventures. The funding for its new business growth is expected to come from the capital markets and third-party funding. If successful, HSC will become a formidable player in housing finance and will compete with the banking sector, as well as with its competitors in the Sofol market.

### Company History

- 1993** • Secretaría de Hacienda y Crédito Público ("SHCP") authorized the creation of the SOFOL
- 1994** • Hipotecaria Su Casita, S.A. de C.V., SOFOL. (HSC) is founded
  - HSC underwrites its first housing construction loan
- 1995** • HSC raises capital and incorporates Pulte Mortgage Corp. as a stockholder
  - HSC underwrites middle income sector mortgages with its own capital
  - First SOFOL to underwrite mortgages for social interest housing under the Fondo de Operación para la Vivienda ("FOVI") program
- 1997** • First SOFOL to establish a domestic branch
  - HSC inaugurates its 20th point-of-sale; underwrites its loan no. 8,000 and is the first SOFOL to operate the PROSAVI program destined the low-income sector
- 2000** • HSC becomes the second largest SOFOL in the market
  - Capital market funding through structured debt issue (CASITA 00U)
  - First SOFOL to operate a joint program with INFONAVIT, Mexico's largest public sector mortgage provider
  - Inauguration of HSC's main offices in Mexico City
- 2001** • HSC raises capital and incorporates International Finance Corporation as a stockholder
  - HSC merges with FINAZTE, the 7th largest SOFOL
  - \$200 MM Commercial Paper issue
  - Funding source diversification, obtaining more than \$600 MM in lines of credit from both private sector and development banking institutions
- 2002** • The Sociedad Hipotecaria Federal ("SHF") begins operations with a mission to promote de Mexican Housing Market
  - HSC begins its program to finance home improvements, first of its kind in Mexico

*Figure 19*

### Financial Ownership Structure

Private Family	19.3%
Founding Partners	9.4%
Pulte Mortgage Corporation	18.5%
Other Individuals	15.4%
Construction Companies	.8%
Bank Subsidiaries	14.9%
IFC (International Finance Corporation)	14.4%
Corporacion GEO	7.3%

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