



Background

Mexico's Federal Mortgage Corporation, Sociedad Hipotecaria Federal (SHF), is a Mexican development bank responsible for developing financial markets for private housing and expanding access to housing finance to lower income borrowers. SHF plays a crucial role as a market maker, providing liquidity to the market by standing ready to buy and sell mortgage securities.

The scarcity of credit brought on by the 2008 financial crisis forced SHF to increasingly rely on short-term borrowing to fund its longer term lending operations. The resulting rollover risk and mismatch of financial terms jeopardized SHF's continuing support of existing markets as well as its role in developing lower income housing finance markets. SHF was looking for ways to reduce balance sheet vulnerability.

Challenge

SHF needed access to flexible, long-term financing in local currency to extend the maturity structure of its portfolio and avoid the foreign currency exposure usually related to external financing. It also needed tools to manage interest rate risk over time as onlending to financial intermediaries materialized.

SHF's challenge was to find ways to strengthen its balance sheet in order to continue leading the development of the domestic housing finance market.

Structure and Description

An IBRD Flexible Loan for USD 1 billion (roughly 13% of SHF's total balance sheet) with a 30-year maturity including a 5-year grace period allowed SHF to extend the maturity of its debt portfolio to attain a more stable risk profile. Using the risk management options embedded in the loan, SHF accessed currency and interest rate risk management tools to mitigate its exposure to foreign exchange and interest rate volatility.

Highlights

- Mexico's federal mortgage corporation manages balance sheet risk through a 30-year USD 1 billion IBRD loan with embedded risk management tools
- Subnational entity accesses local currency financing and interest rate management tools at more favorable rates and in larger volumes than it would have been able to achieve on its own

Figure 1: Financial Terms

Amount	USD 1 billion
Maturity	30-yr final maturity; 5-yr grace period
USD Interest Rate	Floating rate (6-month LIBOR ¹ + fixed spread)
Currency Conversion	MXN
MXN Interest Rate	Floating rate (28-day TIIE ² + spread) and fixed rate
Risk Management	Currency and interest rate hedging

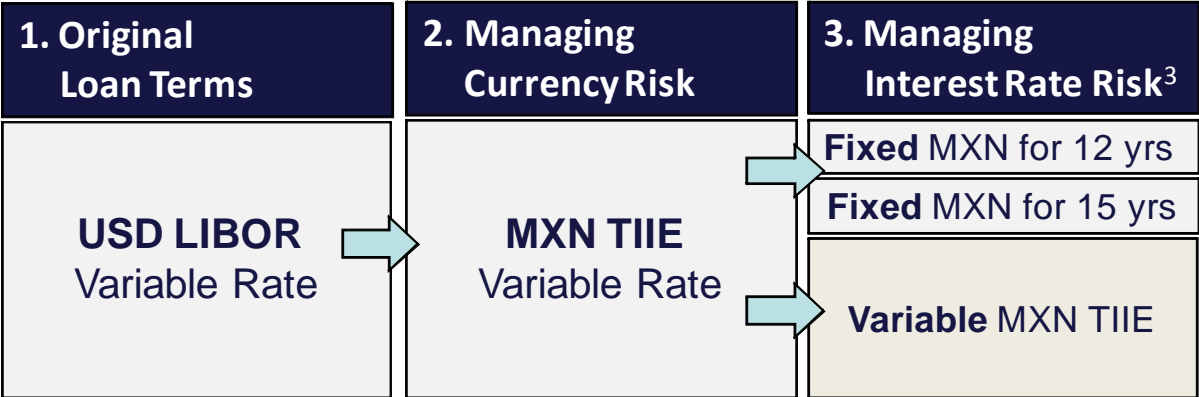
IBRD partnered with SHF to customize the loan with a mix of fixed and floating interest rates in Mexican pesos. SHF has the option to change the mix of fixed to variable interest rates in the future for the full or partial maturity of the loan, in order to match the interest rate risk on its balance sheet. See Figure 2.

Outcome

World Bank market specialists and SHF partnered to custom build a package of financing and risk management tools that allowed SHF to strengthen its balance sheet and attain a more stable risk profile in terms of maturity and interest rate basis and currency mix. IBRD acted as a market intermediary, accessing long-term cross-currency and interest rate swaps in the market at more favorable rates than SHF would have been able to attain had it accessed the market directly.

1. LIBOR (London Interbank Offered Rate) is a floating reference rate based on the interest rates at which banks borrow unsecured funds from other banks in the London wholesale money market.
2. TIIE (Tasa de Interés Interbancaria de Equilibrio) is a benchmark Mexican peso floating rate index.

Figure 2: Illustration of Currency and Interest Rate Risk Management Transactions



3. SHF executed partial maturity fixings of a portion of the Mexican peso floating rate financing for periods of 12 and 15 years, respectively.

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