

Asian CMBS market faces title challenges

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By Alison Cooke, CEO, First American Title Insurance Company
HONG KONG – A growing proportion of international real estate investment is being targeted at Asian markets by property developers and financiers who hope to eventually exit their investments by issuing REITs, IPOs and mortgage-backed securitisations (MBS). However, property registration systems and mortgage origination practices in Asia are very different to elsewhere.



US-style securitisations have already been successfully implemented in Europe. In 2006, European CMBS issues exceeded 65 billion euros and some commentators are predicting European issues will overtake U.S. issues in the next five to ten years.

The recent successful launch of the first US-dollar denominated commercial mortgage-backed securitization (CMBS) in China has heightened market expectations for the development of a securitisation market in Asia.

Strong global demand for real estate investment will inevitably lead to the development of a deeper MBS market in Asia.

But Asia's country-level regulations, property registration systems and mortgage origination practices are very different from the established markets of the United States and western Europe.

The emerging giants of China and India* have systems burdened by their histories, overwhelmed by the volume of transactions as their real estate markets boom; and hindered by lack of sophistication as new types of transaction & market players emerge, and by less-than-transparent business practices.

Whilst market transparency in China and India is improving over time, some of the key concerns for investors include the quality of the underlying assets, the ability of the sponsors to guarantee that the secured mortgages are registered in the correct priority and that the mortgages are both valid and enforceable.

Fraud on title and on mortgages is a rapidly growing area of concern for both banks and mortgage-backed securitization bondholders. This is where title insurance comes in.

Title insurance is a pre-requisite to a mortgage-backed securitisation issue in the United States as it provides a major link in the approval of the income pool.

Elsewhere, mortgage pools are either title-insured in the same way as in the USA or the quality of the pool has been vetted by the buyers and/or sellers lawyers at great cost and length.

Even with such vetting it is often the case that the seller will still be required to warrant good title to the mortgage properties.

Title insurance has become commonly used in Europe over the last 10 years, and in the last five years in Asia. It has even been widely adopted in Australia, where the Torrens Title system is perhaps the best in the world. Elsewhere in Asia and in the UK, known defect coverage is regularly used by both owners and banks to cover risks which would otherwise be unacceptable and prevent transactions from occurring.

First developed to provide an additional layer of protection for real estate owners and financiers to a legal opinion, the title insurance industry has developed increasingly innovative uses for its product.

For example, First American last year provided a guarantee that mortgages secured over some 164,000 properties in Germany would achieve correct priority registration (something which will take the German authorities a year to achieve), allowing the US\$6.8 billion securitisation to be given an AAA rating.

Developers of villa resorts in Thailand have discovered the marketing potential of the product and are starting to offer title insurance as part of their sales packages, reducing the time required to close transactions by removing a major concern of overseas buyers – the vagaries of the Thai registration system and business practices.

The potential applications of title insurance in Asia are broad-ranging given the title risks inherent in any transaction.

These risks can be physical, financial, legal, or plain criminal. Fraudulent transfers of land and grants outside the authority of government official are commonly void in civil law jurisdictions and will usually result in the property being returned to the rightful owner or appropriate authority.

Very few governments will compensate owners who lose their land as a result of information in government registers being inaccurate. Any ability to claim against your legal advisor in negligence is usually limited to the scope of the advice given and the level of professional indemnity insurance carried by those advisors. In many emerging markets there is no requirement for legal advisors to carry PI insurance.

The banking industry has not yet developed a set of standard, tested and accepted documentation for loan securitisations in Asia, meaning that loan validity may be challenged, impacting on enforceability. Outside Asia's major cities, local officials may not be aware of international financing methods, making appropriate registration of mortgage assignments to protect bondholders difficult to achieve.

All this has implications for prospective mortgage-based debt investors. The wide availability of title insurance across Asia goes a considerable way to addressing these concerns.

_ * First American recently added India to its list of 11 insurable jurisdictions in Asia, and 80 globally. India's property title system and market practices present considerable difficulties in establishing clean title to property. The deeds registration system is not guaranteed by the State and is inconclusive, typically leaving buyers with 30 years of title deeds to assess.

Customary rights and community property rules differ by religion and location and present a myriad of complications. Anecdotal evidence from legal advisors indicates that the level of fraud in Indian real estate transactions is very significant; and the court system is notoriously slow._