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OPPORTUNITIES FOR REAL ESTATE SECURITIZATION

Real estate acquisition is one of the most profitable investment opportunities in Bulgaria. The increase of purchasing power and the more favourable borrowing conditions have enabled many individual investors to acquire apartments, houses, villas, and shops. Real estate investment is one of the most lucrative type of investment for it provides returns that significantly exceed the return on alternative investments with a comparable risk exposure. However, direct investment is not the only way to invest in real estates, especially in terms of real estate portfolio diversification. The ***aim*** of this paper is to interpret the term "securitization" in terms of opportunities for its application to real estates.

Generally, the emergence and development of securitization is associated with the capital and financial asset markets in the USA (Kohn, 1999). However, according to some studies the first securitization schemes originated in the 12th century in France for settlement of lease payments while the first Special Purpose Vehicles (SPV) were established in Italy in 1432. In the United States, securitization is associated with mortgage loans and the active involvement of the government. For the first time mortgages were securitized in 1970 by a government agency (GNMA) and in 1975 Sperry Corporation for the first time securitized another type of receivables - on leased computers.

Securitization is associated mainly with residential mortgages and the related mortgage bonds are known worldwide as RMBS (Residential Mortgage-backed Securities) or MBS (Mortgage-backed Securities). In Bulgaria they are known as "covered bonds" issued pursuant to the Mortgage Bonds Law, which does not explicitly stipulate that they imply securitization.

The actual definition of securitization is still subject of heated debates. For example, a paper on securitization published by the International Finance Corporation points out that there are different ways to define it, but in essence, it is the financing or re-financing of income yielding assets by packaging them into a tradeable form through an issue of bonds or other securities (Securitization, Key Legal and Regulatory Issues, 2004, pp. 1-2). This definition does not specify the nature of the assets (real or financial), but the practice shows that it refers most often to financial assets. In this respect, the following definitions and basic concepts of the term "securitization" can be considered[1]:

a) the process of transformation of financial assets into securities[2];

b) substitution of bank loans with securities. Banks buy discounted securities against promissory notes, bills of exchange, or other securities[3];

c) the process of financing a pool of similar but unrelated financial assets (usually loans or other debt instruments) by issuing to investors security interests representing claims against the cash flow or other economic benefits generated by the pool of assets[4].

There are various types of assets that can be securitized: residential mortgage receivables, commercial mortgage receivables, credit card receivables, loan purchase receivables and leasing installments, consumer loans, trade receivables, future receivables. In general, any asset that could bring income can be securitized[5].

The main benefits for the sellers of receivables (e.g. companies, banks, etc.) in the securitization process are:

- they receive liquid assets equal to the selling price for transferring the securitized assets to SPVs and thus improve their liquidity and financial position;
- they are able to diversify their sources of financing and thus reduce the cost of borrowed capital.

It is worth noting that in the broader sense of the term, securitization is perceived mainly as a means of transferring (collecting) receivables. For example, the UN document that initiated the international efforts to harmonize receivables collection practices, pointed out that this could be done through factoring, forfeiting, refinancing and securitization, and project funding.

Securitization and REITs are seldom considered together although there is no doubt that they are related. In most countries securitization and REITs are subject to separate regulatory provisions. However, according to some studies, securitization is a process of turning equity interest in real estate, which is illiquid and lumpy, into tradable securities such as bonds and shares (Sing, 2001). In order to achieve effective real estate securitization, we need a special purpose vehicle that bridges the real estate and the capital markets.

Considering the specifics discussed so far, we have to define the nature of securitization in terms of Bulgaria's legislation and practice in terms of the provisions of the Special Purpose Investment Companies Act (SPICA) and their justification:

a) The Act settles the dealings related to the securitization of real estates and receivables through companies having obtained licence for conducting activity as special purpose investment companies, as well as their incorporation, activity and dissolution.

b) The Act has three main objectives: 1. to create conditions for development of investment through securitization of real estates and receivables; 2. to create conditions for development of the capital market; and 3. to provide protection of the interests of the investors in the special purpose investment companies.

c) It defines SPVs (or SPICs - special purpose investment company) as "… a joint-stock company which, under the

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[1] Without prejudice to the legal definition of securitization of LSPV.
[2] see AS 32 – Financial Instruments and IAS 39 – Financial Instruments: Disclosure and Presentation
[3] http://www.banker.winbg.net/index.php
[4] http://www.investinreits.com/larn/glossary.cfm
[5] In the United States, subject to securitization are assets such as intellectual property, healthcare, and even the wind.

conditions and by the order of this Act, invests the funds raised by issuance of securities in real estates or receivables (securitization of real estates and receivables).

d) “Securitization” is defined as “activity by which real rights (right of ownership and right of construction) on real estates or rights on pecuniary receivables, including future receivables, are materialized in securities publicly offered.”

e) The definitions included in the justification of the SPICA clarify the perception of the Bulgarian legislative authorities regarding securitization. Some of the more important points are:

- The act shall settle dealings related to joint investments for securitization of real estates or receivables;
- The joint stock effect is achieved by means of collective investment vehicles. In essence, they are not regular companies for manufacturing, commercial, or mediation activities but a pool of assets invested for a specific purpose;
- Investments in real estates and construction have a certain disadvantage. Regardless of the attractiveness of real estates, the high risk-return ratio and the formalities associated with the transfer of the title on real estates, make these assets rather illiquid. This problem can be solved in terms of securitization – an activity by which the equity interest in lumpy and illiquid assets is turned into publicly tradable securities.

It is a well-known fact that investments real estate can be direct and indirect. Since real estates are highly illiquid and quite lumpy assets, SPICs are schemes for indirect investment. They can invest in both real and financial assets by securitizing the (materializing) real rights (right of ownership and right of construction) on real estates or rights on pecuniary receivables in securities.