



**Titularizadora**  
COLOMBIANA

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**TITULARIZADORA COLOMBIANA**  
**REPORT OF THE PRESIDENT AND BOARD OF DIRECTORS TO THE ORDINARY  
GENERAL SHAREHOLDERS MEETING**

**FEBRUARY 2019**



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## INTRODUCTION

Titularizadora Colombiana kept in 2018 its leading position as private debt issuer in Colombia. In essence, five issues were offered for COP 1 trillion representing 10% of all the instruments underwritten during the period. These results place the company as the second most important issuer by volume in the market. In the previous five years, the total sum issued amounts to COP 4.7 trillion.

Out of the main milestones fulfilled this year, the launch of real estate securitization stands out, representing the development of equity securities (*titulos participativos*) backed by the cash flows of the lease and mark-up in price of real estate assets of non-residential sectors. The placement of this product was exceptionally successful as the demand exceeded almost 6 times the supply of securities. This situation materialized because of the appetite shown by the institutional investors and the high willingness to purchase shown by individuals. Overall, 350+ investors engaged in this product.

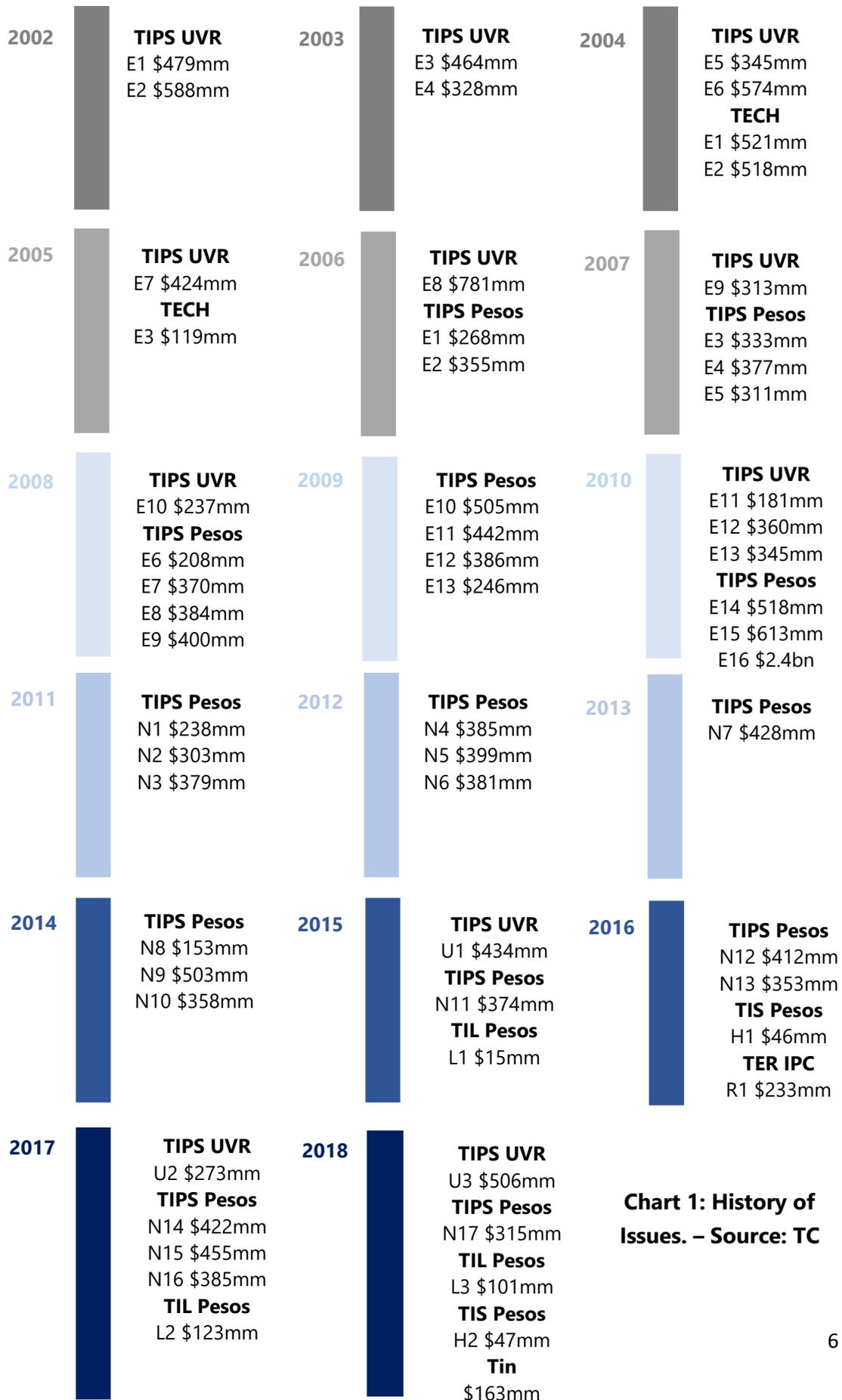
The consolidation of alternate asset securitization such as consumption loans with drafts (TIL) or mortgage loan portfolio of non-banking originators (TIS) constituted another major achievement in 2018. The recurrence of the issuance of these products has provided for the development of a *class of assets* that facilitated engaging new originators in the capital markets of Colombia. Likewise, mortgage-backed securitization showed a satisfactory performance due to, on the one hand, the introduction of innovations to the security placement mechanism (offering book building) and to the structure of various senior risk series, and on the other, due to the stability of the issues managed, which represent circa 10% of the mortgage loan portfolio in Colombia.

The Company financial results showed a substantially better performance than those of 2017. Net profit grew by circa 30%, owing to the combined effect of the income growth and the execution of an operational efficiency plan that has allowed for major achievements in the productivity.

The Company risk rating remained in the AAA range with a stable outlook, thus, reinforcing the financial and operational soundness of the Company.

Year 2019 involves important challenges related to the placement of securitizations backed by mortgage and consumption loans, the growth of assets in the real estate vehicle, and the development of new products for long term financing of urban and national infrastructure. The possibility of leveraging more capital resources for productive activities in the country makes us quite optimistic in the development of the country.

# Management Report 2018



**Chart 1: History of Issues. – Source: TC**



## 1. GENERAL

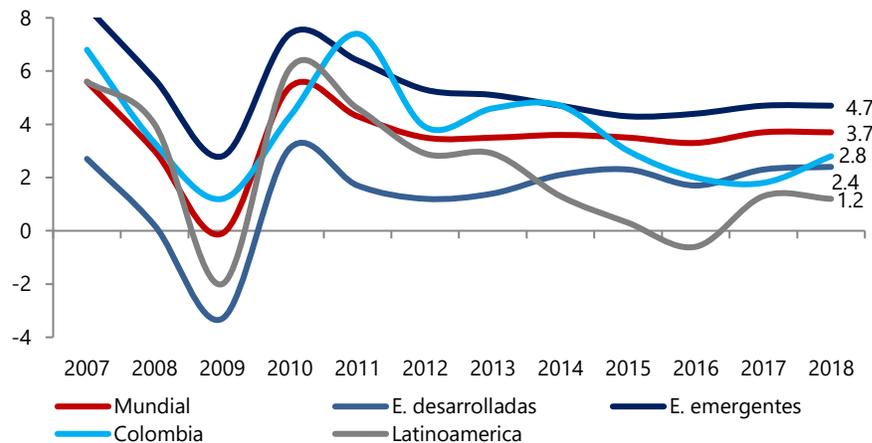
### 1.1. EVOLUTION 2018

#### 1.1.1. MACROECONOMIC ENVIRONMENT

##### 🏠 International Market

The global economic growth in 2018 was limited by the Federal Reserve interest rate increments and by the recurrent trade war between China and the US materialized in the application of custom tariffs in general for US imports of steel and aluminum.

**Chart 2: World economic growth (%) Source: IMF**



The Federal Reserve continued the monetary normalization program and increased the intervention rate on four occasions, finally falling in the 2.25%–2.50% range in December. This because, on the one hand, the strength shown by the real economy and the job market that over the year showed historic figures not seen in decades, and on the other hand, the inflation convergence toward the central bank target levels. This position seems to have slackened in the last quarter of the year due to negative effects on the economic activity caused by commercial disputes, oil price increase, and US dollar strengthening. In this regard, the interest rates increase speed is expected to moderate in 2019.

Chinese economy showed a major reduction in the growth rhythm leading to historically low levels during over two decades. This behavior obeyed to the urgent need to reduce the financial leverage of Colombia, which looked excessively high and created uncertainty about the financial sustainability. This phenomenon led to a deceleration in the gross capital formation, which added to the trade pressures created a burden to the overall economy.



Amid this situation, the central bank has attempted to contain the fall in the economic activity with extensive interventions into all the monetary arsenal.

Furthermore, the European Central Bank put an end to the asset purchase program due to a better performance of the aggregate economy of the EU, although without the expected rebound of the inflation rate. Therefore, the intervention rate is expected to remain 0% for most of the year and the extent of the monetary authority balance not to start diminishing before year 2020.

It is worth underlining that two events marked the economic and political agenda in this region during 2018. First, the lengthy and complex process of the United Kingdom exit from the European Union (Brexit), which has affected the trust of the economic operators on both sides of the English Channel entailing investment and consumption costs. Second, the disputes between the Italian government and the European Commission on determining the budget deficit for the coming years led to multiple volatility events that affected the appraisal of the Italian public debt and the deterioration of the economic activity, which resulted in a negative performance during the year.

*In Latin America, the elections constituted a core topic, mainly in Mexico, Brazil, and Colombia.*

In Mexico, the taking office of a president formerly a stranger to the establishment, has created fear in the markets, particularly due to radical measures as the suspension of the new airport in Mexico City and the fuel cut in face of the ongoing illegal leaks in oil pipelines. In Brazil, on the contrary, the presidential election has been positively valued by the financial markets, which have shown major appreciations in value since November. This optimism corresponds to the existing expectation on the execution of structural reforms required for fiscal sustainability in Brazil, such as the pension system reform.

Another particularly important event in the region occurred in Argentina with the current account crisis caused by the political difficulties the government faced to make the fiscal consolidation credible. In response to the shock, the government was forced to resort to multilateral bodies to avoid a new crisis of its debt (which in turn worsened the political environment), while the central bank was trying without success to defend the exchange rate band by applying progressive increments to the intervention rate. This situation placed Argentina on the brink of a new recession due to serious issues of institutional structure that interfere with the recovery of the macroeconomic equilibrium.



Finally, in the first 10 months of 2018, the oil crude price showed major increases reaching highs not seen since 2014, as a result of the sanctions against Iran, the production fall in Venezuela, and the expected preservation of the oil producers agreement within the framework of the OPEC (and Russia). Nevertheless, since October, the constant increments in the crude oil inventories added to the perspective of lower world demand growth and a less radical position regarding sanctions on Iran crude oil, reflected in a collapse of crude price, which wiped out the profits obtained up to that time.

## Local Market

*The economic activity expansion is expected to fall around 2.7% in 2018, which although higher than in 2017 (1.8%) is still lower than the initial market estimate.*

Although consumption was the component that showed the best performance during the third trimester of 2018, the fourth trimester forecast shows a deterioration resulting of the impact caused by the tight political environment (in particular the development of the Finance Law or tax reform) and the “surprise” that the employees income tax return (deduction limit to 35%) caused to the private sector confidence.

Likewise, the investment did not show the expected behavior due to difficulties posed by the financial closings of the fourth-generation concessions, the fall in the commercial loan portfolio (despite lower underwriting interest rates), and the uncertainty in face of the modified tax outlook. Exports had a favorable performance showing a growth higher than 10%. In particular, traditional (oil) and manufacture exports had a very positive dynamics, as opposed to the fall in the agricultural sector exports, mainly coffee and banana sales, which diminished by circa 10%.

In 2018, the job market showed a weak performance because the economic growth did not match the potential of the significant Venezuelan migration and its effect on the job supply. The unemployment rate closed the year in 9.7%, higher than the 8.6% of the previous year. This increment shows how the effect of job participation reflects on the number of unemployed people across the country (15%, a figure not seen since 2009). Nevertheless, the creation of jobs held a growing trend. In particular, the mining-energy sector increased the number of working population the most, whereas the building industry contributed the most in creating jobs.

Inflation in 2018 converged toward the target goal of the Banco de la Republica (Central bank); the Consumer price index showed an annual variance of 3.18%, lower than 4.07% of 2017 closing. Tradable and food inflation remained low and so did the non-tradable inflation in the second semester of 2018. As the oil prices showed increments for most of the year,



the regulated prices showed increments substantially higher than the overall inflation. As to the Monetary Policy, the Banco de la Republica reduced, in 2018, the intervention rate from 4.75% to 4.25% as a result of lower inflationary pressures, the inflation expectation anchor, and the negative product gap.

**Chart 3: Intervention rate of Banco de la Republica (%), Inflation (annual variance, %). Source: DANE, Banco de la Republica**



Three major events occurred in the fiscal sector during 2018: first, the fiscal rule amendment related to the structural deficit convergence of 1% that initially was to be reached in 2022, was put off to 2027 after the amendment. Second, the passing of the finance law (tax reform) which entailed a new balancing of tax burden from the legal entities (progressive reduction of the income tax rate, and deductions from sales tax IVA for capital assets and from the industry and commerce tax ICA for income tax) toward the individuals (increase in high salary taxes, equity tax, excise duty for housing, sales tax IVA to every phase of sodas and beer production, higher tax on dividends). Third, maintaining the risk rating for the sovereign debt of the country despite the pressures on the central government balance, the public debt high levels, and the effect of political obstacles on the implementation of structural reform of fiscal stability, such as the pension system reform.

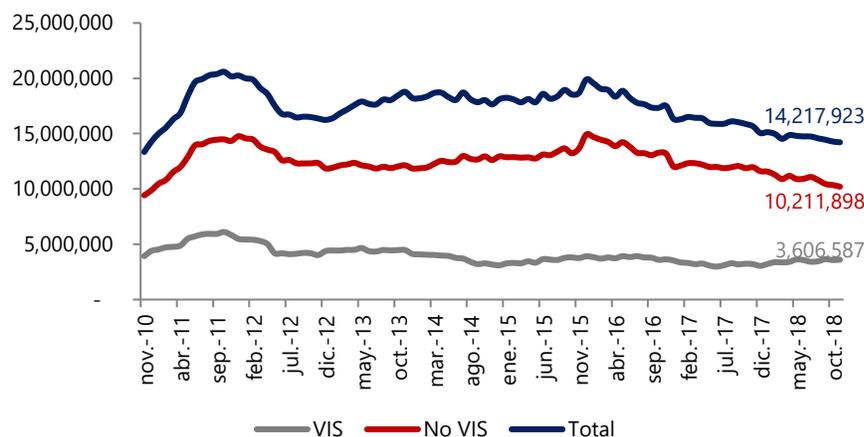
## 1.1.2. HOUSING MARKET AND MORTGAGE SECTOR

During the second semester of 2018, the construction sector trend switched. After seven consecutive trimesters of downward trend in this activity, negative numbers changed in the third trimester owing to the near 2% growth. This phenomenon obeys to the recovery in the buildings segment (both residential and non-residential) and to the smaller contraction in the construction of roads and civil engineering works. Particularly the dynamics of works census and of the area under license for social housing (VIS) favored the aggregate result of the industry. Nonetheless, as of the November cutoff, the last 12 months showed a 9.2%



contraction in the area licensed for housing, which reflects the obstacles to housing projects other than social housing (NO VIS), in particular houses priced above COP 300 million.

**Chart 4: Area licensed for housing (12 month accumulated, m<sup>2</sup>) Source: DANE**



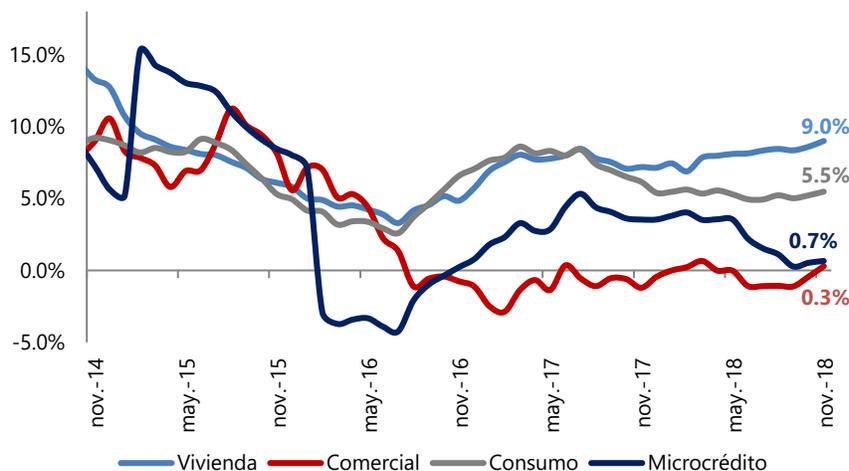
During 2018, the new housing units increased by 2.2% showing a recovery with respect to the 7.5% fall of the previous year according to Galeria Inmobiliaria. This behavior was the result of the VIS housing good performance boosted mainly by Bogota and its surroundings, and Cali whilst Medellin and the Caribbean coast showed a substantial decrease in sales. Regarding NO VIS sales, they were held behind due to the cyclic obstacles of the economy.

In November 2018, the mortgage loan portfolio accelerated and showed a 9% real increase (the highest growth of all the components of the total financial system portfolio) whereas the non-performing loan portfolio grew by 14.9% (a relevant decrease with respect to 2017, when the non-performing loan portfolio increased to levels circa 40%). Despite the non-performing loan portfolio dynamics, the quality indicator measured as from the 120-day delinquency is kept at reasonable levels (3.1%) in terms of history and in comparison to other portfolios. This indicator is equally favorable, even when including portfolio write-offs of the entities, which grew up to 3.6% of the total portfolio.

Regarding origination, disbursements for home purchase grew by 13.9% in 2018. This situation is caused by at least three phenomena: First, interest rates over the year decreased to historical lows, which jointly with interest rate subsidies promoted a higher demand for credit. Second, used homes share in loan placement reached circa 60% of the total loans. Third, parametric marginal changes increased the loan supply in the economy, particularly the LTV variance (NO VIS 48% in 2017 to 50% in 2018), the higher share of home purchase with loan, and the positive real increase in house prices. The 12-month accumulated disbursement amounted to COP 17.67 trillion in November.



**Chart 5: Loan portfolio real annual growth per modality (%)**  
**Source: Superintendencia Financiera, TC**



## 1.2 OUTLOOK

### 1.2.1 MACROECONOMIC ENVIRONMENT

In average, Colombian and international analysts estimate the 2019 growth to be around 3.2%, as a result of a boost in public expenditure, caused by the economic cycle of the *territoriales* (subnational) entities, the gross capital formation in face of the new tax regulations, the reduction in available capacity of companies, the reactivation of investment in (energy and transportation) infrastructure, and the increase in exploratory activity of the mining-energy sector. Consistently, the household consumption will hold a favorable performance due to the growth in purchasing power resulting from a major actual increase in the minimum legal wages, the job market stability, and the improvement in the trust of households.

The market is expecting an inflation of circa 3.4% by the end of 2019, based on a higher domestic demand. Nevertheless, some risks are estimated to show an upward trend, such as the materialization of the *"niño"* climate phenomenon, the inertia effects of the minimum legal wages, and a substantial increase in the exchange rate. In addition to this, a higher oil price would push the increase in fuel prices and therefore the component of regulated-price goods and services. In that regard, the Banco de la Republica intervention rate is expected to be intervened twice, at the most, in 2019, because the product gap remains to be positive.

### 1.2.2 HOUSING MARKET AND MORTGAGE SECTOR

Housing sale is expected to grow by 5% in 2019. The drive of this dynamics will continue to be the VIS segment, even though the progressive reduction of supply may affect this performance. NO VIS sales will entail a reduction of the finished stock sale, in particular for the upper social stratum segment. The demand growth added to the supply contraction will



enable a slack in the stock turnover indicator, which reached top levels in the 2017–2018 period. Under this circumstance, housing prices will hold their uptrend in this fiscal year.

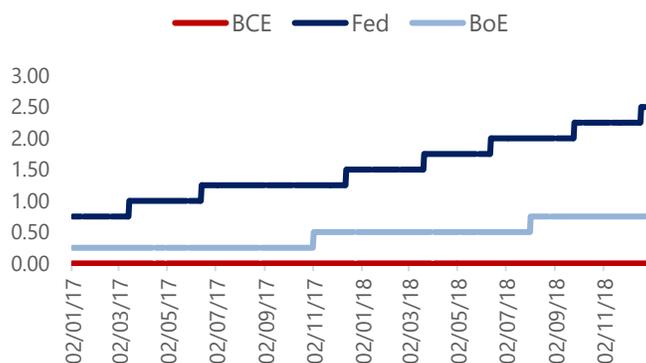
The growth estimate for the mortgage loan portfolio is 10% throughout 2018. This growth consolidates the 2018 dynamics of the sector leading to the mortgage loan value reaching an 8% with respect to the size of the economy. Although this value has grown substantially in the previous 12 years (it was 3% in 2006), it is still relatively low as compared to other economies in the region.

## 2. CAPITAL MARKETS

### 2.1 INTERNATIONAL MARKETS

The monetary policy normalization continued in 2018 in most of the developed economies, considering the economic growth recovery and the inflation increase. The Federal Reserve continued increasing rates in four occasions during the year while the Bank of England did so once. Furthermore, in December the European Central Bank formally announced the end of the monetary incentives by purchasing bonds starting the following January. It was relevant that at the end of the year the Federal Reserve changed its discourse and a more flexible language was introduced, which reduced the agents' expectations as to the rate increments in 2019, impacting both developed and emerging economies.

**Chart 6: Monetary Policy. Source: SEC**

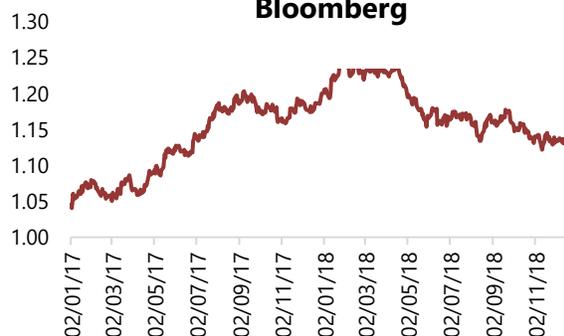


The US economic growth showed a rebound with respect to the previous year; however, the indicators were not equally favorable in Europe and in China. Two facts in particular affected the agents' expectations around the world over the year and had an impact on the financial markets. The first fact has to do with commercial tensions arising from the aggressive tone of the US regarding the trade policy and the new customs tariffs imposed on its major business partners as a way to amend commercial deficit.



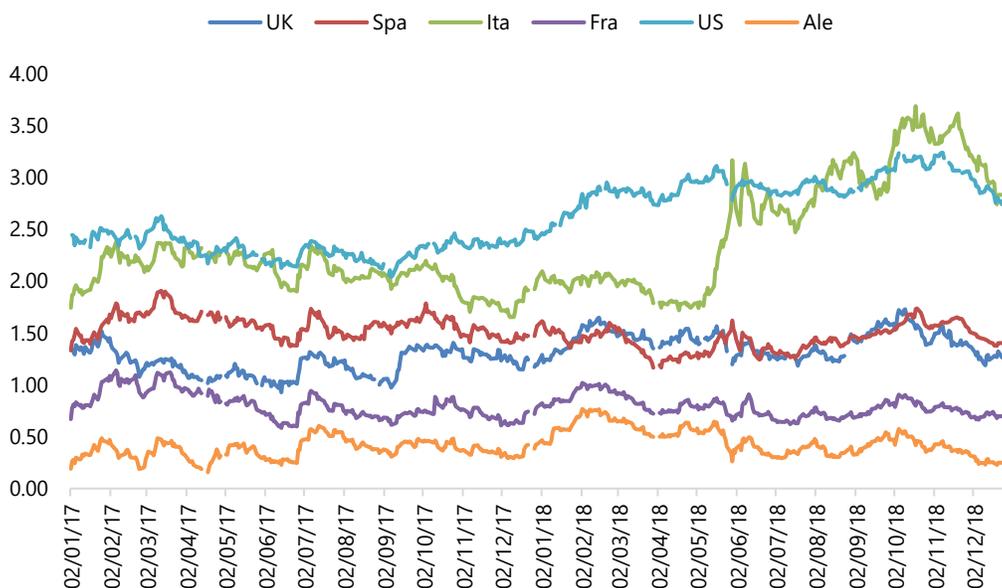
The second fact refers to *Brexit*, due not only to the obstacles to reach a deal between the United Kingdom and the European Union but also to the internal UK troubles to approve the agreement that was finally reached with the EU. This increased the expectation of an exit without agreement, considering its impact on the economies of the UK and of Europe in general. The US economic recovery and the events in Europe (Brexit deal, lower economic growth, and political tensions with Spanish and Italian governments) favored the US dollar strengthening and, consequently, a weakening euro.

**Chart 7. Euro performance. – Source: Bloomberg**



Throughout the year, the financial markets reflected the uncertainty of the aforementioned and other issues, thus substantially increasing the volatility, when compared to the previous year. Accordingly, sovereign bonds gradually reflected the economic recovery and the monetary policy normalization through the increase in rates. However, in face of isolated risk events, the uptrend was reversed as they were considered safe-haven assets.

**Chart 8: 10-year Sovereign Bonds. Source: Bloomberg**





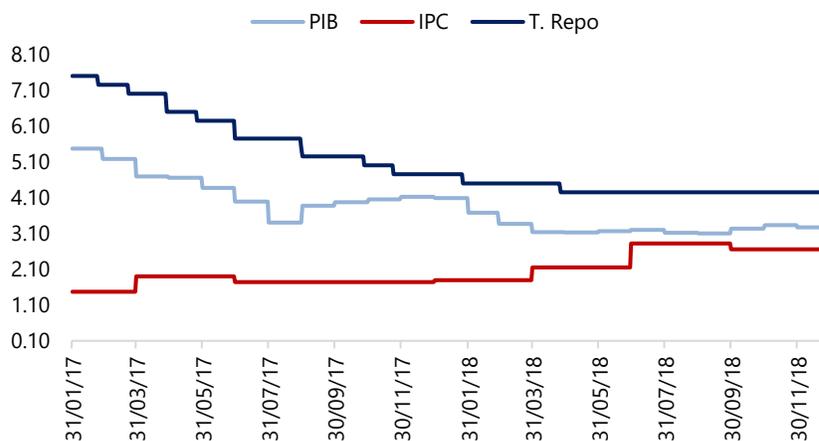
The market of commodities also experienced a fair amount of volatility throughout the year. Regarding oil, both Brent reference prices and WTI increased in general until October, as a result of the expected higher demand in face of the economic recovery and particularly because of the agreement on production reduction of the countries members of OPEC and Russia, aimed to reduce the global inventories and recover the price. Nevertheless, the end of the year saw a strong price reversion in face of the production growth in the US and Russia, and in face of the signs of a weaker demand resulting of the expected deceleration of the international economic growth in 2019.

In this environment, emerging countries were mainly affected by the capital flows reversion to the developed economies. Countries as Argentina and Turkey where the currencies showed a strong volatility, pushed the measures taken by the monetary authorities and the rate increase. In Latin America, the international investors continued looking sympathetically at countries such as Chile, Peru, and Colombia. Strong volatility episodes occurred in Mexico and Brazil, affected by presidential elections with different outcomes as left- and right-wing governments respectively won.

## 2.2 NATIONAL MARKETS

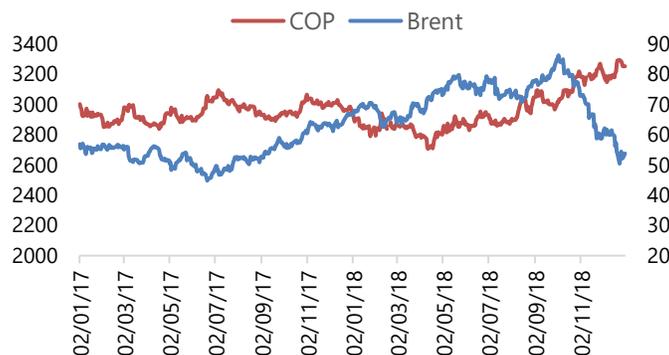
The domestic outlook showed the stability of inflation that allowed the central bank to continue reducing the intervention rate. Total inflation ended 2018 in 3.18% (as compared to 4.09% in 2017), slightly above the middle part of the range and showed a downward trend throughout 2018. Inflation downtrend and lack of dynamics in the economy enabled the Banco de la Republica to reduce the repo rate twice, at the beginning of the year down to 4.25% to incentive the economic growth. The growth performed better throughout the year reflecting in indicators such as those of retail sales, industrial production, and current account deficit, especially in the second semester once the uncertainty associated with the elections calmed down.

**Chart 9: Inflation and Repo Rate – Economic Growth. Source: Banrep**





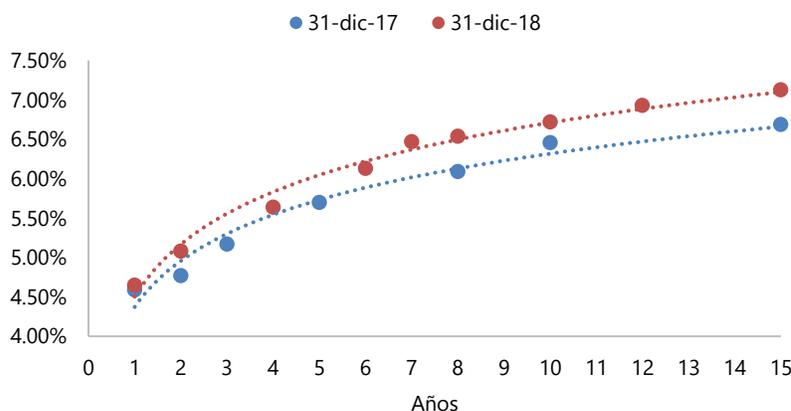
The trend of the Colombian peso showed appreciation in the first trimester but then, as from the second trimester it showed a devaluation resulting from a worldwide lesser appetite for emerging, the local political uncertainty, and the less favorable fiscal indicators. High correlation with oil prices remained, mainly at the end of the year.



**Chart 10. Colombian Peso – Brent. Source: Bloomberg**

TES curve showed an upward trend throughout the year. The appetite for fixed rate assets was relevant in the first semester; nevertheless, the increment expectation for repo rate in 2019 and inflation resulting of the impact of the initial contents of the finance law bill (where the sales tax IVA to the “family shopping basket” was proposed), in addition to the “niño” phenomenon in the first trimester of 2019, led the market stakeholders toward a clear preference for indexed rate instruments.

**Chart 11: Fixed Rate TES yield curve. Source: Bloomberg**



Fixed interest rate issues placed an amount of COP 38.8 trillion in TES bonds: COP 30.9 trillion corresponding to Auctions (COP 17.9 trillion for pesos issues and COP 13 trillion for UVR) as well as COP 7.8 trillion in Public Entities. Additionally, COP 12.5 trillion were issued in short-term TES bonds. Through the Stock Exchange, fixed rate issues amounted to COP 9.5 trillion in 2018, 22% below 2017 (COP 12.2 trillion).



## 3. MORTGAGE-BACKED SECURITIES ISSUES

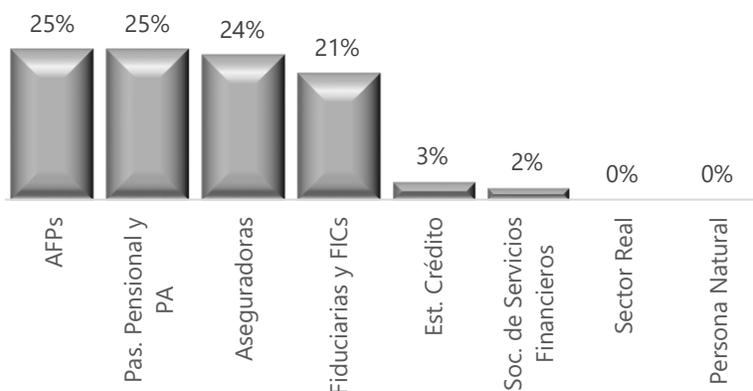
Two (2) issues were carried out in 2018 backed by mortgage loans originated by bank entities: one (1) fixed rate issue corresponding to the TIPS Pesos N-17 in March and the other, TIPS UVR U-3 in July. The total value of the loans and securities issued are shown in the following table:

**Table 1: Issues 2018**

	Loans	Series A Securities	Subordinated Securities
TIPS Pesos N-17	\$ 307,884	\$ 277,096	\$ 38,331
TIPS UVR U-3	\$ 488,733	\$ 439,859	\$ 66,197
<b>Total</b>	<b>\$ 796,617</b>	<b>\$ 716,955</b>	<b>\$ 104,528</b>

Figures in million  
COPs

The originators for the **TIPS Pesos N-17** issue were Banco Davivienda and Banco Caja Social, which respectively contributed 51.3% and 49.7% of the loans. The amount offered in auction was COP 240,149 million and included an extended auction for COP 36,946 million fully underwritten. The investors' demand amounted to COP 520,490 million for a 2.17 bid-to-cover ratio. Cutoff rate was 6.57% AE.



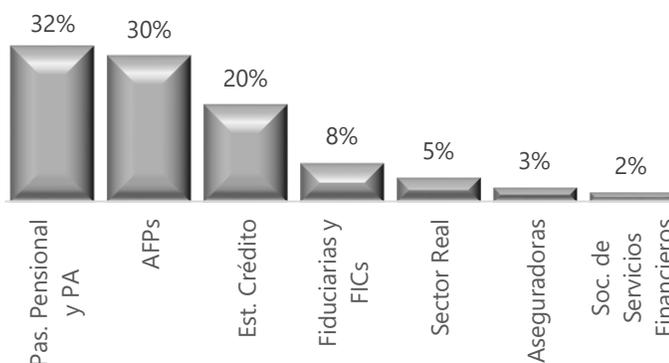
**Chart 12. TIPS Pesos N-17 Awards. Source: TC**

The originators for the **TIPS UVR U-3** issue were Banco Caja Social, Banco Davivienda, and Bancolombia which, respectively, contributed 51.2%, 30.4% and 18.5%. The issue was placed through the new mechanism for fixed rate, *id est* offering book building, which stated a minimum equivalent to COP 351,433 million and a maximum amount of COP 454,916 million. The final amount of Series A securities was equivalent to COP 439,858 million corresponding to 100% of the amount available, according to the loan portfolio. The demand amounted to COP 688,564 million for a 1.96 bid-to-cover ratio. Cutoff rate was 3.18% AE.



A remarkable participation of pension liabilities, pension fund management entities, credit establishments, and insurance companies continued. In the TIPS UVR U-3, the participation of Trust funds, Collective investment funds (FICs), and the real sector increased.

**Chart 13. TIPS UVR U-2 awards. Source: TC**



## 4. ISSUES OF SECURITIES BACKED BY NON-MORTGAGE ASSETS

### 4.1. FAMILY SUBSIDY FUND “COMPENSAR”

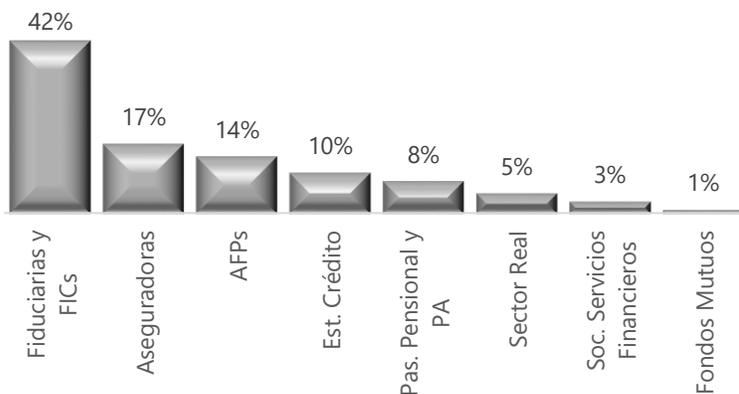
In August, the **TIL PESOS L-3** issue took place in the Second Market backed by consumption loans with drafts originated by COMPENSAR, the third issue Titularizadora launched backed by this type of assets and the second tranche of the Program of issue and underwriting of loans originated by COMPENSAR. Below is the issue summary:

**Table 2. TIL L-3 Issue**

	<b>Total Portfolio</b>	<b>Serie A Securities</b>	<b>Subordinated Securities</b>
TIL L-3	\$100.022	\$83.518	\$18.354

Figures in millions COPs

The issue mechanism was the offering book through the Colombian stock exchange. Series A lowest amount was COP 70 billion and the highest amount was COP 83,518.5 million. The final amount offered in auction of Series A securities was COP 83,518.5 million. Investors' demand amounted to COP 131.3 billion for a 1.88 bid-to-cover ratio. Cutoff rate equaled 7.09% AE. The investors' sectors that were awarded the securities are shown below:



**Chart 14. TIL L-3 issue awards. Source: TC**

## 4.2. CONFIAR COOPERATIVA FINANCIERA

**TIS Pesos H-2** issue took place in May backed by mortgage loans originated by Confiar Cooperativa Financiera, constituting the second tranche of the Program of issue and underwriting of loans originated by CONFIAR. The issue conditions are listed below:

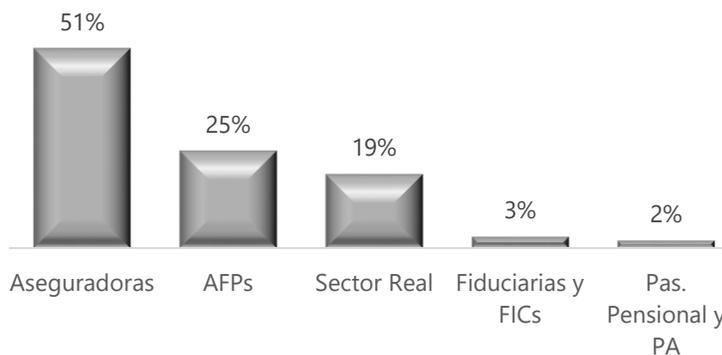
**Table 3. TIS H-2 Issue**

	<b>Total Portfolio</b>	<b>Serie A Securities</b>	<b>Subordinated Securities</b>
TIS Pesos-H2	\$47.604	\$39.750	\$7.854

Cifras en millones de pesos

The issue was also conducted by offering book through the Colombian stock exchange. Investors' demand amounted to COP 41,79 billion for a 1.19 bid-to-cover ratio. Cutoff rate equaled 7.29% AE. The investors' sectors that were awarded the securities are shown below:

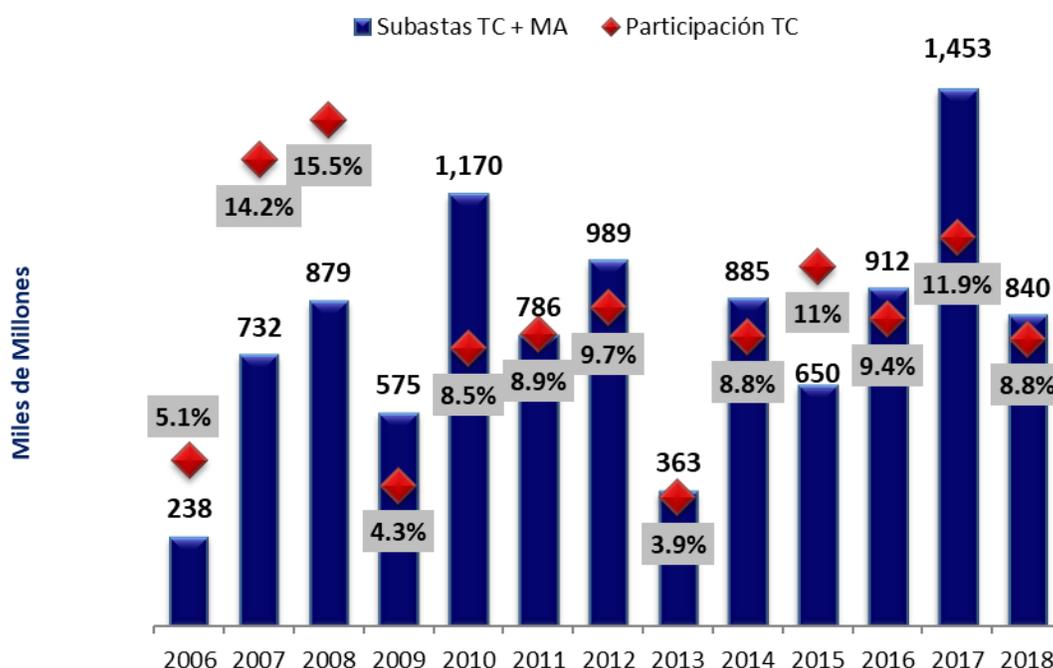
**Chart 15. TIS H-2 issue awards. Source: TC**



Considering the four issues of credit-backed securities accomplished over the year, the amount issued by Titularizadora in 2018 was COP 970,062,000. At another level, the value of the Series A securities placed by auctions and offering book was COP 840,223 million representing 8.8% of the Colombian stock exchange fixed rate issues in 2018.



**Chart 16: Issues at the Bolsa de Valores (Colombian stock exchange)**  
**Source: BVC. TC Calculations**



Including 2018, Titularizadora completed 59 issues for a total COP 22.48 trillion loan portfolio and a COP 4.48 trillion balance of serviced loans as of December 2018.

## 5. ISSUES AND LOANS PERFORMANCE

### 5.1. ISSUE PERFORMANCE

Ending 2018, the company reached COP 22.29 trillion in issues out of which 64.90% was backed by mortgage loans in COPs, 30.4% in UVR currency, 1.8% corresponds to non-performing loans in UVRs, 1.08% corresponds to securities backed by consumption loans with drafts, 1.05% to commercial loan backed securities, and 0.73% to real property backed securities. At the end of 2018, the balance of securities amounts to COP 4.0 trillion with total amortizations of 81.1% of the principal issued (Table 3).

The early liquidation event was formalized for the TIPS Pesos E-5 issue in 2018 and the cancellation of the following issues started: TIPS: E-8, E-9, E-10, E-11, Pesos E-6, Pesos E-7, Pesos E-8, Pesos E-9, Pesos E-10, Pesos E-11, Pesos E-12, Pesos E-13, Pesos E-14, and Pesos E-15 according to the respective rules and prospects.

On another note, in 2018, Titularizadora conducted a new issue of securities backed by consumption loans with drafts, an issue backed by real estate, in addition to two issues of

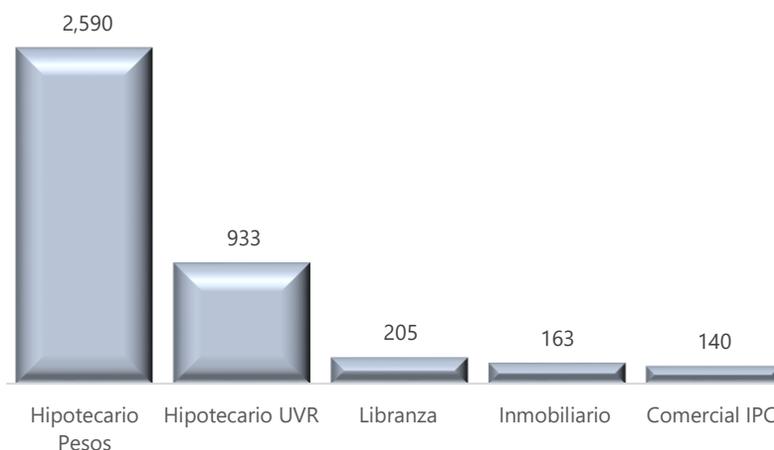


mortgage-backed securities in COPs and one in UVRs.

**Table 4. Balance and Outstanding Percentage of Securities  
(Figures in Billion Colombian pesos)**

Source: TC

Product Line	Balance Issued	Current Balance	Share	% to be amortized
Mortgage-backed in Pesos	14,468	2,590	64.90%	17.90%
Mortgage-backed in UVR	6,781	933	30.42%	6.15%
Non-performing Mortgage-backed UVR	405	0	1.82%	0.00%
With Drafts	240	205	1.08%	85.38%
Commercial consumer price index	234	140	1.05%	60.02%
Real estate	163	163	0.73%	100.00%
<b>Total</b>	<b>22,292</b>	<b>4,031</b>	<b>100.00%</b>	<b>18.08%</b>

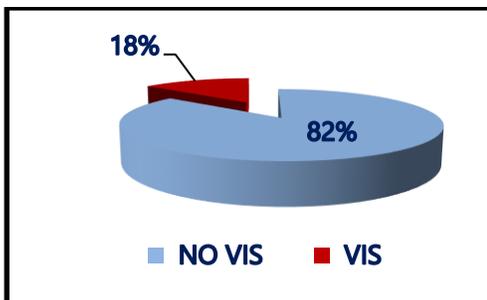


## 5.1.1. SECURITIZED LOAN PORTFOLIO

As of 2018 closing, the securitized loan assets comprise mortgage loans, consumption loans with drafts, and commercial loans. Below are the loans balance and general features and characteristics.

### MORTGAGE LOANS

The loan balance of the issues amounted to COP 4.19 trillion as of the December 2018 closing. The balance is represented by 103,793 individual mortgage loans with 82% in NO-VIS mortgage loans and 18% in VIS mortgage loans.



**Chart 17. Loan portfolio distribution by type of loan**  
**Source: TC calculations**

In 2018, 23 issues contained FRECH subsidized mortgage loans, with securitized mortgage loans representing 16% share on the total balance. FRECH (Fund of reserve and stabilization of mortgage loans) is a benefit offered by the national government to cover a percentage of the remunerative interest rate agreed for the mortgage loans, in abidance by the law. The performance of FRECH mortgage loans shows a sustained good performance.

Below is the breakdown of the mortgage loans per issue:



**Table 5. Loan portfolio breakdown by type**  
**Source: TC**  
**Principal Balance as of 31 December 2018 (COP Million)**

Saldo de capital en \$ cartera titularizada por emisiones						
EMISION	UVR	%	PESOS	%	TOTAL	%
E-1	730	0%			730	0%
E-8	13,281	1%			13,281	0%
E-9	12,597	1%			12,597	0%
E-10	11,056	1%			11,056	0%
E-11	10,866	1%			10,866	0%
E-12	57,816	5%			57,816	1%
E-13	64,870	6%			64,870	2%
UVR U-1	230,149	21%			230,149	5%
UVR U-2	215,956	19%			215,956	5%
UVR U-3	444,799	40%			444,799	11%
TECH E-1	46,256	4%			46,256	1%
TECH E-3	6,303	1%			6,303	0%
PESOS E-6			5,119	0%	5,119	0%
PESOS E-7			11,132	0%	11,132	0%
PESOS E-8			8,922	0%	8,922	0%
PESOS E-9			9,524	0%	9,524	0%
PESOS E-10			13,649	0%	13,649	0%
PESOS E-11			11,533	0%	11,533	0%
PESOS E-12			9,898	0%	9,898	0%
PESOS E-13			5,514	0%	5,514	0%
PESOS E-14			30,735	1%	30,735	1%
PESOS E-15			55,373	2%	55,373	1%
PESOS E-16			257,309	8%	257,309	6%
PESOS N-1			34,707	1%	34,707	1%
PESOS N-2			51,079	2%	51,079	1%
PESOS N-3			51,790	2%	51,790	1%
PESOS N-4			67,650	2%	67,650	2%
PESOS N-5			68,078	2%	68,078	2%
PESOS N-6			42,168	1%	42,168	1%
PESOS N-7			100,800	3%	100,800	2%
PESOS N-8			57,192	2%	57,192	1%
PESOS N-9			215,037	7%	215,037	5%
PESOS N-10			137,865	4%	137,865	3%
PESOS N-11			168,698	5%	168,698	4%
PESOS N-12			230,791	7%	230,791	6%
PESOS N-13			237,977	8%	237,977	6%
PESOS N-14			271,326	9%	271,326	6%
PESOS N-15			306,091	10%	306,091	7%
PESOS N-16			288,516	9%	288,516	7%
PESOS N-17			252,047	8%	252,047	6%
PESOS H-1			34,241	1%	34,241	1%
PESOS H-2			44,299	1%	44,299	1%
Total general	1,114,680	100%	3,079,058	100%	4,193,738	100%



Regarding the risk profile for these issues, the loan to value ratio remains favorable. Ending the year, LTV <50% for 79.9% of the loan portfolio, 50%-70% LTV for 18.1%, and 70%-80% LTV for only 2.0%.

**Table 6. Loan Balance per LTV for TIPS Issues. Source: TC Principal balance as of 31 December 2018 (COP million)**

LTV Range	Balance	%
>70%	83,901	2.0%
50%-70%	758,056	18.1%
0%-50%	3,351,781	79.9%
<b>Total Portfolio</b>	<b>4,193,738</b>	<b>100%</b>

The performance of the collection of securitized mortgage loans in 2018 allowed to honor the scheduled principal and interest payments of each issue, as set out in the respective expected scenarios and issue prospectuses.

## **PORTFOLIO OF CONSUMPTION LOANS WITH DRAFTS**

As of 2018 closing, the balance of TIL Pesos L-1 issue backed by consumption loans with drafts originated by COLSUBSIDIO and of the TIL Pesos L-2 and TIL Pesos L-3 issues backed by consumption loans with drafts originated by COMPENSAR was COP 196 billion represented in 23,386 loans with a distribution of operational agreements of 86.33% with private companies, 6.73% with public entities, and only 0.39% with mixed companies.

The revolving purchase mechanism defined for TIL Pesos L-2 issue is in effect until June 2019 and for TIL Pesos L-3 issue until August 2020 as defined in the prospectus and rules of issue.

## **COMMERCIAL LOANS**

The TER IPC R-1 issue closes 2018 with COP 93 billion commercial loan balance represented by 10 rediscount loans serviced by FINDETER.

## **5.1.2 LOAN PREPAYMENTS**

Partial or full payment in advance to the principal balance of the loans that back an issue is named "*Prepayment*" and for a securitized portfolio it is measured by an annualized index (value of principal prepayment as against principal value of loans at the start of the period).

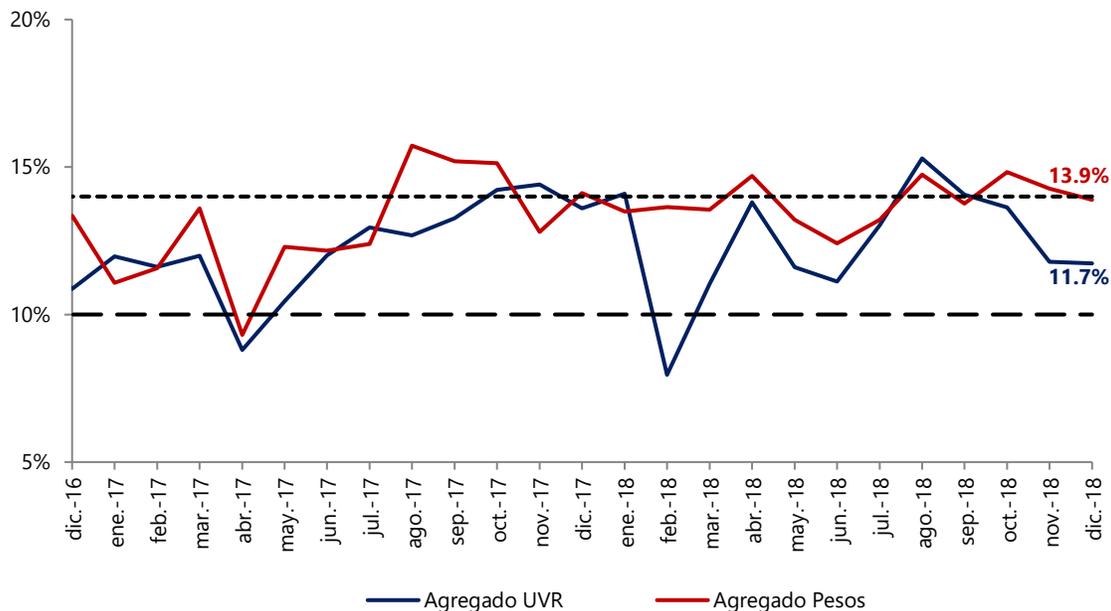
## **MORTGAGE LOAN PORTFOLIO**

The average prepayment over the last 12 months was 13.9% for pesos issues, which was quite close to the 12.9% average of the immediately preceding year. Nevertheless, for most of the year it showed an increase resulting from the competition for clients through the rates.



For loans in UVRs, prepayment showed a remarkable reduction with respect to the previous year from 14.0% to 11.7% in 2018, mainly resulting from the inflation impact and a recomposition toward the pesos type.

**Chart 18. Annualized prepayment index for PESOS and UVR Issues**Source: TC

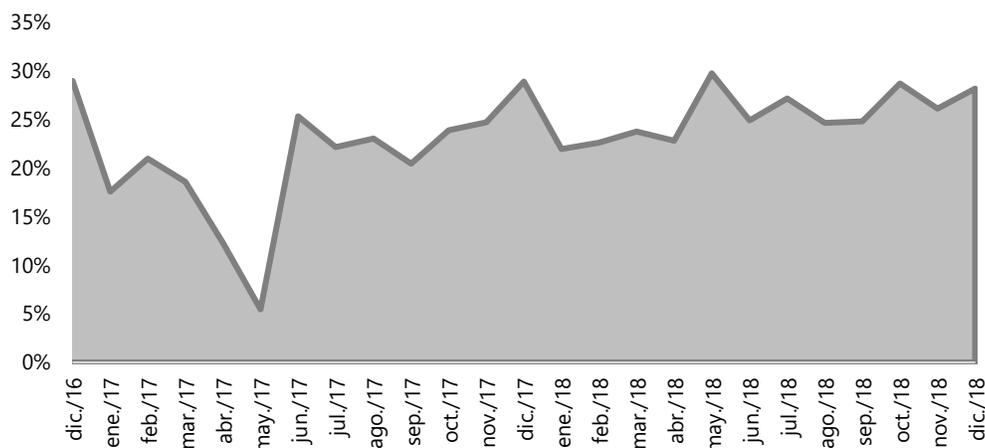


## PORTFOLIO OF CONSUMPTION LOANS WITH DRAFTS

Consumption loans with drafts show an annualized average prepayment of 28.2% in the previous 12 months, falling within the expected range in stable market conditions.



**Chart 19: Annualized prepayment index for Loans with Drafts Source: TC**



## **COMMERCIAL LOANS**

Commercial loans show an annualized prepayment of 35% rolling average throughout 2018, which is within the expected range for securitized loans. In 2018, prepayment partial credit enhancement was used for this issue and loan purchases were made for COP 69,582 million.

### **5.1.3 RATING THE ISSUES**

#### **MORTGAGE LOAN PORTFOLIO**

Mortgage-backed securities issued were rated better in 2018 as the senior securities consistently obtained AAA rating for all the issues. Ending 2018, 27 issues are in effect, 26 of which kept or obtained improved ratings for subordinated securities, whereas a case occurred with rating reduction for subordinated securities of TIPS Pesos N-6 issue, which showed high prepayment levels. Overall, in 2018 the issues showed a better prepayment and delinquency performance, thus increasing the coverage levels. These results have been given recognition in the risk ratings assigned.

#### **PORTFOLIO OF CONSUMPTION LOANS WITH DRAFTS**

The rating of senior securities remained AAA. In the TIL Pesos L-1 issue, subordinated securities ratings were enhanced and for TIL Pesos L-2 and TIL L-3 issues, ratings remained the same. The issues of securities backed by consumption loans with drafts showed an improved performance that increased the coverage levels. The credit enhancement mechanism of successive purchased was executed successfully for all the TIL issues.



## **COMMERCIAL LOANS**

Ratings of TER IPC R-1 issue remained unchanged, series A securities in AAA and of series B in BBB+.

### **5.2 PAYMENTS TO LOAN PORTFOLIOS**

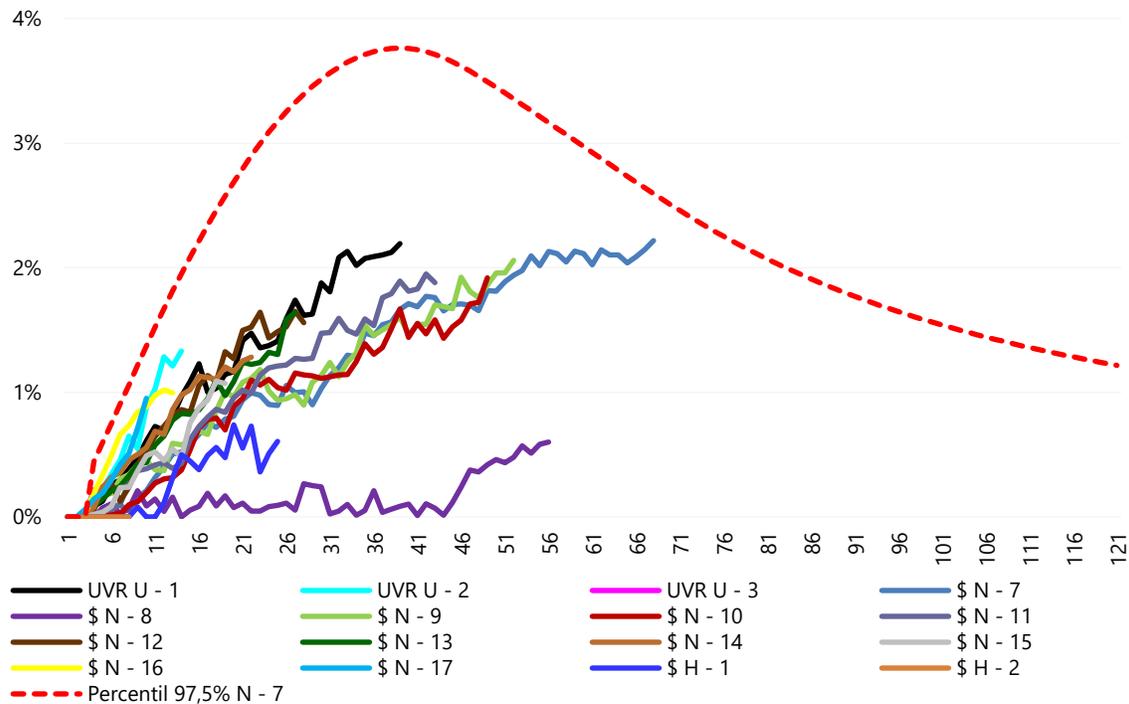
#### **5.2.1 MORTGAGE LOAN PORTFOLIO**

Facing an adverse economic environment for loan portfolios, the strategy in 2018 relied on a stringent follow-up of the loan performance as to hold optimal levels of recovery, contention, and effective contact, as well as pursuing quality improvement and increasing volumes in the normalization proposals presented by borrowers. Hence, the delinquency levels of each issue showed a performance that fell in the expected levels, thus allowing to keep the highest credit rating of TIPS issues.

The following chart reflects the more than 120-day delinquency loans with respect to the projected levels in the top deterioration scenario for each effective month of both Pesos and UVR issues, standing out the excellent performance of securitized loans during 2018.



**Chart 20: Reference Scenario for Loan Pools with >120 days delinquency – PESOS and UVR Issues. Source: TC**

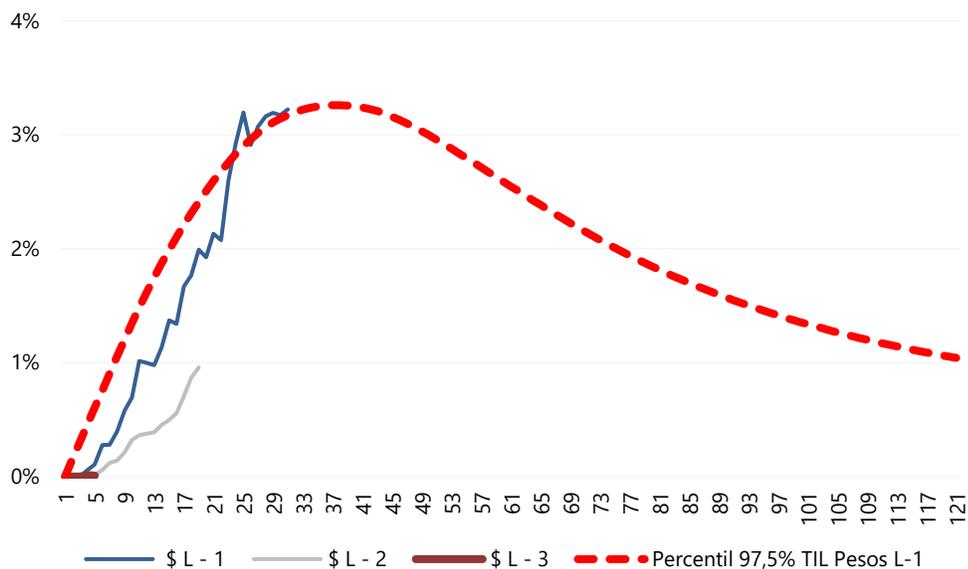


## 5.2.2 CONSUMPTION LOANS WITH DRAFTS

The portfolio of securitized consumption loans with drafts as of 2018 closing evidenced good payment behavior, thus allowing deterioration levels to remain similar to the expected delinquency levels far from affecting the payment to principal for associated securities.



**Chart 21: Evolution of >90-day delinquency for TIL Pesos on balance as of the issue date – with recovery. Source: TC**



## 5.2.3 COMMERCIAL LOANS

Securitized commercial loans showed optimum performance levels for TER R-1, ending 2018.

**Table 7. TER R-1 Issue Delinquency. (COP million)**  
Source: TC

Delinquency Range TER R-1		
Delinquency Rates	Loans Qty	Balance
Performing	10	193.278
31 to 60	-	-
61 to 90	-	-
91 to 120	-	-
Greater than 120	-	-
<b>Total</b>	<b>10</b>	<b>193.278</b>



## 5.3 ASSETS RECEIVED AS PAYMENT (REO)

Assets received as payment (REO: Real estate owned) result from the repayment of a loan in full or in part, either upon the borrower's request (deed in lieu) or by right of action (foreclosure sale or award, or insolvency agreement).

As of the year closing, Titularizadora's inventory comprised of twenty-one (21) real properties with a book value of COP 736 million, broken down by issue.

**Table 8. REO by Issue (COP million)**

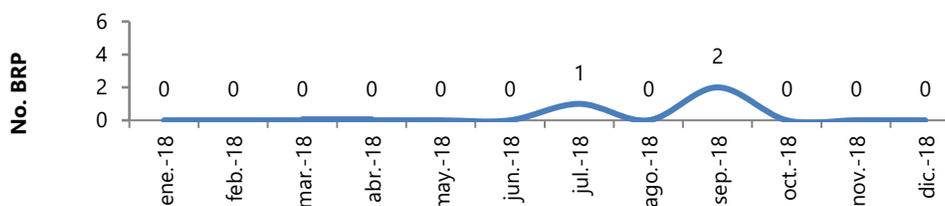
Source: TC

ISSUE	REO Qty	MARKET VALUE
PESOS E-9	1	210
PESOS E-16	5	522
PESOS N-1	1	582
PESOS N-2	1	65
PESOS N-3	1	35
PESOS N-4	6	723
PESOS N-6	2	599
PESOS N-7	3	300
PESOS N-5	1	221
<b>Total</b>	<b>21</b>	<b>3.258</b>

REO (Real Estate Owned) portfolio marketing was slow due to the elections period during the first semester of 2018; and in the second, 3 properties were sold.

**Chart 22: REO Sales Performance 2018**

Source: TC





## 5.4 SECURITIZED LOAN SERVICERS

### 5.4.1 SECURITIZED MORTGAGE LOAN SERVICERS

Below is the mortgage loan distribution per Servicer for mortgage-backed securities issues as of December 2018:

**Table 9. Securitized Mortgage Loan Servicers**

SERVICER	PRINCIPAL *	LOAN QTY	% PRINCIPAL
BANCO DAVIVIENDA S.A	1,817,694	40,889	43%
BANCO BCSC	1,250,567	33,173	30%
BANCOLOMBIA	759,698	21,016	18%
BBVA COLOMBIA	152,639	3,009	4%
FONDO NACIONAL DEL AHORRO	57,192	1,983	1%
ITAÚ CORPBANCA COLOMBIA S.A	54,998	561	1%
CONFIAR - Cooperativa Financiera	78,540	2,396	2%
BANCO COLPATRIA S.A.	15,046	387	0%
BANCO AV VILLAS S.A.	7,364	379	0%
<b>Total Loan Portfolio</b>	<b>4,193,738</b>	<b>103,793</b>	<b>100%</b>

Figures in millions COPs

The results of management indicators during the year and of the recertification process for each entity ensure that the asset servicing remains within the standards and levels established in the initial certification.

### 5.4.2 SERVICERS OF SECURITIZED CONSUMPTION LOANS WITH DRAFTS

The authorized servicer of TIL L-1 Issue is Caja Colombiana de Subsidio Familiar COLSUBSIDIO which closed the year servicing a loan principal balance of COP 2,462 million. The authorized servicer of TIL Pesos L-2 and TIL Pesos L-3 Issue is Caja de Compensación Familiar COMPENSAR and the year is closed servicing a loan principal balance of COP 193,741 million.

As to these Servicers' performance and servicing, they remain within the established standards and levels upon examination of the resulting indicators defined for the loan portfolio servicing processes and the servicer recertification process conducted in COLSUBSIDIO and COMPENSAR.

### 5.4.3 SECURITIZED COMMERCIAL LOAN SERVICERS

The performance and activities of FINDETER (Financiera de Desarrollo Territorial S.A.), the servicer of commercial loans, fall within the standards and levels established in the initial



certification in 2017 according to the resulting indicators defined for portfolio servicing processes and the recertification process conducted in 2018.

## **5.5 MASTER SERVICING INTERNAL PROCESSES**

Servicing standards were examined to determine potential improvements arising from new processes and updating, none of which essentially affects the operation nor the external and internal indicators. In this context, the master servicing of issues is strengthened in general for Colombia as well as for its use in other countries.

Continuous adjustments are being applied to the business base application (HITOS) for the management of other products and countries, thus ensuring improvements to the current mortgage functionality and safe integration with other applications.

### **5.5.1 SUPPORT TO MORTGAGE SECTOR**

In 2018, Titularizadora Colombiana held the strategy of creating added value for the mortgage sector in matters related to the standardization of processes and the identification of best practices with respect to:

- Administrative and Judicial Collection: Event of recognition to the collection activities, granting a distinction to securitized loan servicers that stood out for their activity results in the previous year. A forum where they shared experiences and best practices for recovery in administrative and judicial collection, that allowed for standing out in the results of securitized loans collection.
- Custody Processes: During the year, the company worked with servicers in outreaching and implementing better practices in the preservation, monitoring and reporting of the documentary guarantees.

### **5.5.2 QUALITY MANAGEMENT SYSTEM – MASTER SERVICING OF ISSUES**

Titularizadora Colombiana completed the transition to the new ISO 9001 Standard Version 2015 employing its quality management system. This implementation reviewed and updated the documented information as required to ensure the system efficiency, activities, auditor competency, and processes.

The main activities and achievements of 2018 were:

- Strengthening of continuous improvement to each process of the organization, helping thereby the dynamic and constant management of initiatives created for correcting and improving weaknesses found by the improvement sources.
- The indicator obtained in the satisfaction survey for servicers was 91%, higher than the indicator for 2014 and a significant improvement in its components.



- Certification renewal under the new ISO 9001:2015 Standard granted by ICONTEC —the certifying body— proved the requirements compliance and the system evolution.

## 5.6 OUTREACH AND MARKETING

Titularizadora's plan of outreaching the market and the general public focused on positioning the mortgage loan securitization as a tool essential to the development of the housing sector in Colombia, housing finance, fund raising for non-banking originators, innovation in financial structures to back securities, as well as highlighting the benefits of the securities in terms of diversification, security, and return for investment portfolios.

The strategy for the issue of real estate securities (TIN) was essential in 2018, focused on social networks and participation in print media of wide circulation and magazines, with a high participation of the target segments of investors.

## 6 REAL ESTATE SECURITIZATION

### 6.1 GENERAL INTRODUCTION TO THE PRODUCT

The program for the issue and underwriting of TIN equity securities (*titulos participativos*) is the result of a real estate securitization in which the properties are isolated in a Universalidad (a special purpose vehicle) and the equity securities are issued to be charged to said vehicle. The securities' yields result from the real property lease and mark-up in price. This program was approved by the *Superintendencia Financiera de Colombia* on 7 September 2018. Among the product's main features stand out their equity and fungible nature, that the vehicle's useful life is 100 years with a 2 trillion COPs global quota and an offer targeting the main market. In addition, the program risk profile is moderate-conservative and proposes the distribution of profits on a monthly basis.



**Chart 23. Main program features.**  
Source: TC

Tranche 1 was issued on 25 October 2018 for an authorized value of COP 162,750.

Fitch Ratings ratified the Program rating in iAAA on 31 October 2018, the top possible rating for this type of products.

## 6.2 UNDERWRITING RESULTS

Tranche 1 was issued on 25 October 2018 for an authorized amount of COP 162,750 million. Tranche 1 was placed in firm demand with pro rata allocation through the Stock Exchange under a two round format carried out in two different days. First Round targeted customers investors who were offered 20% of the securities equivalent to COP 32.55 billion and had a demand for COP 133,465 million meaning a 4.1 bid-to-cover ratio. Second Round addressed investing customers and professional investors, offered 80% of the securities for an amount of COP 130.2 billion, where the demand was COP 713,645 million, meaning a 5.48 bid-to-cover ratio.

On the 25th of October, 32,500 securities were allocated for COP 162.75 billion. The number of investors who were allocated securities was 350, out of which 65% corresponded to individuals, 63% of the allocated amount corresponded to pension funds, insurers, and savings capitalization banks, whereas individuals were allocated 12% of the total amount issued. The entry of individuals to the market means a major milestone to Titularizadora Colombiana, which finds huge opportunities in this segment.

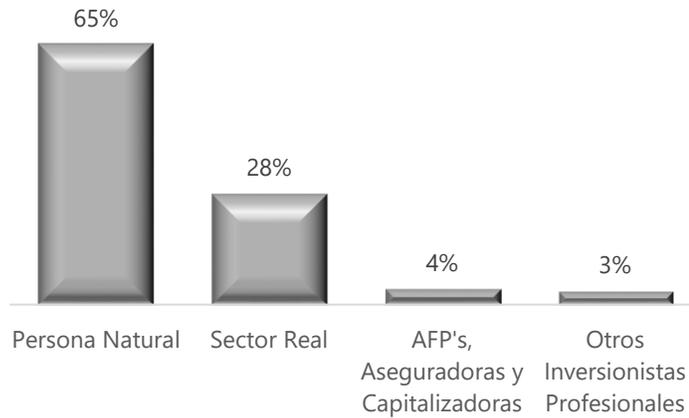
The features and characteristics of the offer and the placement results are shown in the table below:

**Table 10. TIN underwriting outcomes**

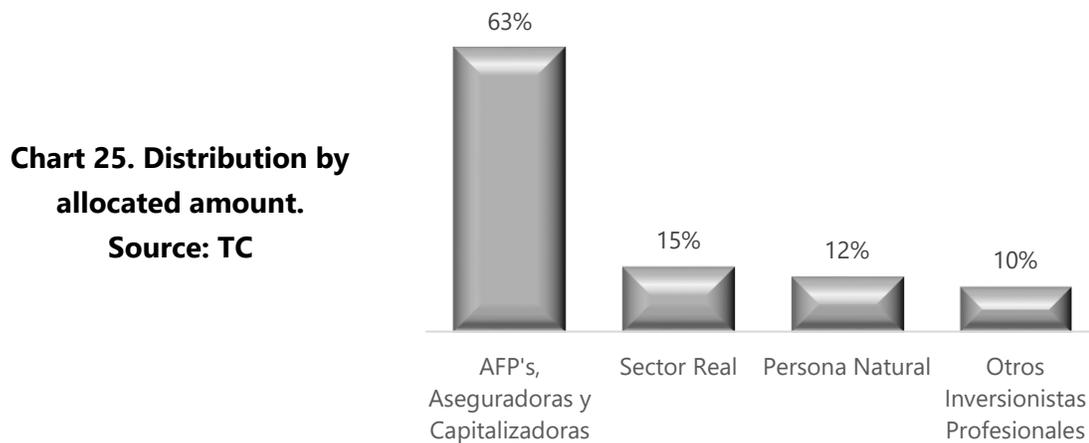
	First Round	Second Round
<b>Amount Offered</b>	COP 32,550	COP 130,200
<b>Amount Demanded</b>	COP 133,465	COP 713,645
<b>Amount Allocated</b>	COP 32,550	COP 130,200



<b>Number of Demands</b>	408	320
<b>Number of Allocations</b>	320	246
<b>Bid-to-cover</b>	4.10	5.48



**Chart 24. Distribution by number of investors. Source: TC**



**Chart 25. Distribution by allocated amount. Source: TC**

## 6.3 PRODUCT STRUCTURE AND PARTICIPANTS

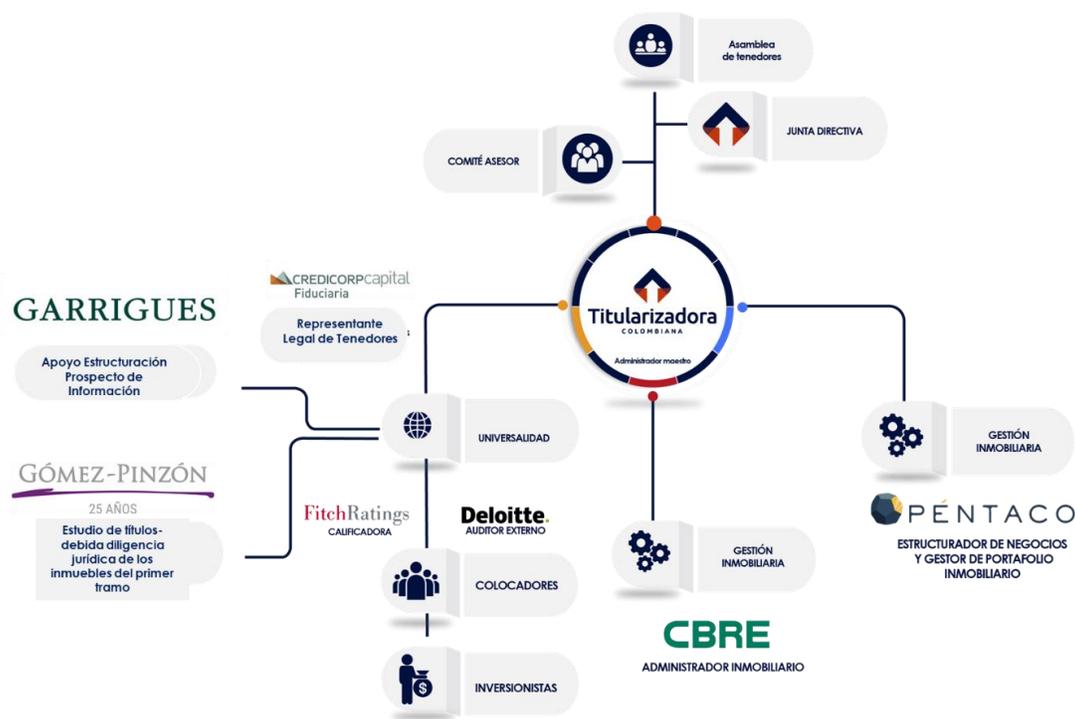
The Program of issue and underwriting of TIN equity securities is a real estate investment alternative aimed to create monthly and long-term returns arising from the economic exploitation of the real properties purchased by the vehicle.

This Program promotes an investment alternative allowing for the diversification of portfolios for the investor.



The Product's differentiating factors include the moderate/conservative risk profile, the solid corporate governance, the expert and independent real estate team, and the monthly distribution of returns.

For the Product administration and management, the following participant structure was established.



Titularizadora Colombiana stands out among the main participants in the product administration, as the Master Servicer responsible for the financial, legal, and operational structure of the Program by managing and coordinating the parties thereto. Pentaco also stands out as the real estate agent, responsible for structuring new real estate businesses and portfolio profitability. And CBRE is also noticeable as the real estate manager of the vehicle, whose main purpose is the physical administration of real properties and their economic exploitation contracts.

In addition, the Program includes a corporate governance structure where an Advisory Board comprised of three independent members who make recommendations to Titularizadora Colombiana's Board of Directors for the most important decisions of an administrative and strategic nature regarding the Product.

## 6.4 REAL ESTATE PORTFOLIO

The current portfolio of real properties was transferred to the real estate Universalidad on 25 October 2018 for an amount of COP 156,999,600,000. It includes 44 properties, a total



leasable area of 19,513 m<sup>2</sup>, fully leased to Banco Davivienda under 10 and 12 year-term contracts.

The portfolio is comprised of 25% offices and 75% commercial establishments. In addition, it is distributed in the cities of Bogota, Barranquilla, Cartagena, Medellin, and other municipalities in respective percentages of 63.10%, 12.65%, 7.49%, 7.20%, and 9.56%.

## **6.5 LEASE PROFITABILITY**

The real estate Universalidad has been operating since 25 October 2018. Thereafter until 31 December 2018 the profitability obtained through leases was equivalent to 5.91% per annum.

## **7 OTHER PROJECTS**

### **7.1 NEW ORIGINATORS**

#### **7.1.1 VEHICLES**

Titularizadora Colombiana's diversification strategy in 2018 showed progress in structuring a securitization process backed by vehicle loans originated by Finanzauto S.A., a company with more than 45 years of experience in automobile purchase financing.

Upon the development of the financial, legal, commercial, and operational infrastructure and the execution of certification and rating of the originator and the underlying asset, Titularizadora plans to carry out the first issue of the product in the first semester of 2019.

#### **7.1.2 MICROCREDIT**

During 2018, with the support of the World Bank Group and the participation of the main banks that originate microcredit loans in Colombia (Bancamia, Banco Mundo Mujer, Banco W, and Bancompartir), Titularizadora started an ambitious project for structuring an issue backed by microcredit loans.

A preliminary feasibility analysis from the financial, legal, and operational perspectives and the study of different success cases of international experiences rendered positive results for the project development. Thus, Titularizadora can expect the consolidation of the structure of a microcredit loan securitization process to carry out the first issue in the second semester of 2019.



## 7.2 TITULARIZADORA DOMINICANA



In 2018 the Company completed all the requirements for the formal registration of the first issue of mortgage-backed securities in the Dominican Republic, with the participation of two local financial institutions, namely Banco Hipotecario Dominicano –BHD and Asociacion Nacional de Ahorros y Prestamos –ALNAP, which are ready to be certified as securitized portfolio originators and servicers and ready to enter into the contracts. Nevertheless, the Dominican Republic is implementing the new law of securities enacted at the end of 2017 and is making major regulatory changes in the fiscal arena which are holding back the final regulation required to complete said first securitization. As of the closing of December 2018, Titularizadora Colombiana S.A. remains a shareholder of this company in the Dominican Republic.

## 7.3 CENTRAL AMERICA

In Costa Rica, the securitization project with an entity specialized in mortgages is ongoing. General objectives of this initiative have been set at three levels: financial, legal, and operational. However, for this year we have focused specifically on tackling the financial component and have achieved the update of loan data, the interest rate analysis, and the parties to the preliminary business cases, which allow the validation of the business feasibility.

In Panama, the Company and an active entity renowned in the local market are reviewing business models aimed to identify the depth and diversity of the exchange market and the potential mortgage loan originators that would render the mortgage backed securitization feasible in that country.

## 8 MANAGEMENT AND HUMAN RESOURCES

### 8.1 HUMAN RESOURCES

A strategic factor in the achievement of our Mission is the human resource, whose development we have promoted through process innovation and quality, building an organizational culture that allows adapting to the market and environment needs. The results obtained in 2018 are the outcome of the work of our 60 employees, high-level professionals committed to the organization strategic vision and the fulfillment of their personal and job goals.

Our strategy for the Human Resource area in 2018 aimed to guarantee the company's growth and competitiveness through human talent selection, guidance, and coordination, pursuing to hold a uniform vision, share knowledge, improve skills, and create an organizational atmosphere supported by leadership, motivation, innovation, technology, and personal and professional development for each person. With this aim, processes are



executed to ensure the strengthening of the organizational culture and overall wellbeing of the human resource.

Recruiting, screening, and hiring have focused on ensuring a timely and appropriate selection of personnel. Consistently, emphasis was placed on the update and innovation of the inducement and training process for new employees as demanded by the current world.

An annual training plan was developed for all the management, professional, and operational employees, with the purpose of promoting personal, professional, and technical development with tools that enabled the officers to enhance their knowledge, skills, and abilities according to the corporate and leadership objectives.

Our Performance Management system allows the strengthening of our pursuance of results aligned with the strategic organizational goals, mission, and vision.

Such an objective is the overall wellbeing and the organizational atmosphere, for which we implemented measures, and personal and family activities that guarantee a nice, balanced working environment with job recognition. It is important to highlight the compliance of the occupational health and safety management system as defined in Law 1562 of 2012, Decree 1443 of 2014, and Decree 1072 of 2015, for the Occupational safety prevention, with emphasis on the Company preventive actions, appropriate management of the System, an annual plan and schedule, and highly committed officers satisfied with their jobs, safety, and occupational health.

During 2019 we will continue to implement strategies to strengthen the above-mentioned processes and will focus on a plan for training and technological innovation to keep up with the global trends.

## **8.2 INSURANCE**

Up to 31 December 2018, appropriate insurance coverage was maintained. Protection of the company's assets, premises, and technology infrastructure; liability of directors and officers; and loss of securities due to dishonest or fraudulent acts by employees were managed under prudent standards relating to industry practices in similar companies.

## **9 TECHNOLOGY**

By definition, our mission is to design and develop strategies, guidelines, plans, and actions that technologically support and create value to Titarizadora Colombiana's business, for the innovation and digital transformation to secure its competitive position and guarantee the functionality of applications and infrastructure, and ensure the information availability, integrity, and confidentiality. In March 2018, further to our mission the Company updated the security system for email protection, thus reducing the spam volume and stabilizing Titarizadora's email service.



In May, with the purpose of supporting the new real estate product, a new website was designed and implemented for the product marketing launch, and later a new development of the HITOS core application was released for operation support.

The newly designed website of Titularizadora Colombiana was launched on the software platform as a service for Microsoft data centers of the US mid-south followed by the implementation of the contingency at Microsoft data centers at the East of the US.

In July 2018 the analog phone system was changed to an IP phone system connected to an ETB dedicated SIP trunk, on an Asterisk virtual appliance; all the collaborators' phones were replaced, and two teleconference machines were purchased for the meeting rooms.

In August 2018, the new perimetral firewall purchase was closed for Titularizadora's data center to provide up to date security standards, protection to users' surfing, and a barrier against external cyber-attacks; the setting up of such device started in September and ended in December, with the deployment planned for 23 January 2019.

In October 2018, the electronic billing process was implemented on Apoteosys, thereby complying with the applicable laws and regulations; this service was also implemented for the real estate product mentioned previously and it was later replicated on the contingency environment.

In December 2018, the control system for physical access to Titularizadora's premises was brought to a more modern and robust version.

In the second semester, support was provided to the implementation of Superintendencia Financiera's criteria set forth in their Circular 007 of 2018, whereby instructions were issued as to the minimum requirements of cybersecurity risk management. Finally, over 2018 the technology area indicators were satisfactory in the agreed upon levels of service.

## **10 LEGAL AND REGULATORY ISSUES**

### **10.1 REGULATORY ISSUES**

First, Law 1943 of 2018 (Finance Law —or tax reform—) is worth mentioning, whereby financing standards were issued for restoring the general budget equilibrium. Article 10 of this law is important for amending article 476 of the Tax Statute, mainly item number 22 which maintains the exemption from sales tax for the fees paid for services provided in asset securitizations based on *universalidades* or autonomous capitals, the payment of which is exclusively made from resources of those *universalidades* or autonomous capitals.

Maintaining this exemption provides an integral solution to the potential disadvantage of the loan securitization as a funding source because of higher costs arising from the sales tax



(IVA) imposed on services provided for the execution of such securitizations. Actually, from the perspective of the *universalidades*, collecting said tax would create a higher cost fully attributable to the securitization structure given the impossibility to reallocate or deduct it otherwise, and thus the cash flow defined by Titularizadora would be affected substantially.

Article 71 is also worth looking, whereby item letter "f" was added to article 18-1 of the Tax Statute. Thereby, whenever a foreign investor obtains a profit from public or private fixed rate instrument trade, the withholding tax applicable to such operation corresponds to 5% instead of the 14% previously applicable. This new withholding tax becomes an incentive for foreign investors to participate in the purchase of fixed rate instruments issued in the local market.

Finally, the impact of this finance law on the financial sector must be taken into consideration because of the 5% surtax to the income tax established thereby.

Second, two decrees stand out whereby Decree 2555 of 2010 was amended:

- a) Decree 1477 of 6 August 2018, whereby Decree 2555 of 2010 is amended with respect to the equity adequacy requirements of credit institutions. Matters about securities issued in securitization processes are relevant because if such securities are rated BBB, their weight lowers from 100% to 50% and in the case of BB ratings, from 150% to 100%, which considered the standardization and good practices of securitization in our country.
- b) Decree 1486 of 6 August 2018, whereby Decree 2555 of 2010 was amended as to the criteria to determine the competence as related companies, the exposure limits, the risk concentration, and the conflicts of interest of the financial conglomerates. Hence, as per this decree, neither Titularizadora nor Titularizadora's *universalidades* are deemed related entities of financial conglomerates. It also establishes that investments made by mandatory pension funds and severance funds in securities issued in securitization processes where an originator is a related entity of such funds will not be included in computations within the limits imposed upon financial conglomerates provided they fulfill all the parameters set forth in article 2.6.12.1.15 of Decree 2555, which is consistent with the provisions of same Decree 2555 when considering investment limits for pension funds.

On another note, Decree 1913 of 2018 made changes to the investment regime applicable to autonomous capitals of the Territorial entities pension fund (FONPET) and other public capitals intended for pension guarantee and payment. Note that said decree sets limits of concentration per issuer and per issue. For the concentration limit per issuer, the decree established that in securitization processes each *universalidad* is to be studied individually and the concentration limit per issuer corresponds up to ten percent (10%) of the whole FONPET resources in that *universalidad*. For the concentration limit per issue, it indicates that FONPET resources may be used for purchasing up to thirty percent



(30%) of the value of the respective issue. Likewise, Decree 1913 restricted the possibility to invest FONPET resources in real estate equity securities.

Third, it is worth mentioning the External Circulars of the Superintendencia Financiera de Colombia listed below, which apply to the Company's activities:

- a) External Circular 007 of 2018, whereby the Superintendencia Financiera delivered new instructions for the risk management of the cybersecurity risk aimed at strengthening the protection of financial consumers information.
- b) External Circular 018 of 2018, whereby the Superintendencia Financiera changed the directives included in Forms 529 and 211 for shareholding structure reporting by the entities under surveillance and/or control; shareholders of the first, second, third levels as well as persons that exercise an effective final control.
- c) External Circular 019 of 2018, whereby the Superintendencia Financiera established the e-applications for online preparation and processing of some standardized information prospects. Although this circular may be deemed great progress in the capital markets' deepening in Colombia, the measures established thereby do not apply to Titularizadora, which will continue with the standards and parameters it has adopted up to this date in its processes of issues and of information for the market.

Fourth, three rules were issued about mandatory pension funds and severance fund portfolios, which translate into changes that will encourage the management of said funds to invest in higher risk assets, and into greater dynamics of these investors in the capital markets. Decree 959 of 5 June 2018, whereby the rules are amended for the default assignation of affiliates in the multi-fund scheme managed by the managers of the individual savings regime with solidarity; Decree 2392 of 24 December 2018, whereby the methodology for calculating accumulated profitability was updated for mandatory pension funds and severance fund portfolios; and External Circular 035 of the Superintendencia Financiera de Colombia, whereby the methodology to calculate the minimum mandatory return was amended amongst other aspects.

Finally, although the Capital markets mission started in 2018 is not a change to regulations materialized as of this date, Titularizadora deems it of the utmost importance, and expects it will result in regulatory framework amendments to foster the capital markets development, for which purpose, the Company has taken active part in the discussions held with the market.

## **10.2 LEGAL CONTINGENCIES**

With respect to the legal contingencies of the company throughout 2018, none occurred.



## 10.3 LEGAL ISSUES

### 10.3.1 "CODIGO PAIS" SURVEY

Titularizadora complied with the reporting of the implementation of the best corporate governance practices, and implemented the applicable corporate governance standards as per the recommendations of the new "Codigo Pais" and to the 2015 amendments to the Articles of Association and Corporate Governance Code of the Company.

### 10.3.2 KNOWN AND RECURRENT ISSUER

In September 2015, the *Superintendencia Financiera de Colombia* granted Titularizadora the capacity as a renowned and recurrent issuer for its compliance with requirements indicated in item 6 of the External Circular 029 of 2014 Part II Title I Chapter II and other applicable laws and regulations. This situation was held throughout 2018 by timely complying with the requirements set forth in items 6.1.1 to 6.1.6 of the regulation cited above, according to the official letter number 2018018134-004-000 dated 5 March 2018 of the Superintendencia Financiera de Colombia.

### 10.3.3 RELATIONSHIP WITH INVESTORS

Upon adoption of the best practices in the matter of information disclosure to and the relationship with investors, Titularizadora was certified by the Bolsa de Valores de Colombia (Colombian Stock Exchange) by granting the IR Issuer Recognition to the Company. This recognition was sustained throughout year 2018 for the compliance with the requirements established in the Only Circular of the Bolsa de Valores de Colombia (Colombian Stock Exchange).

## 11 OTHER ASPECTS

### 11.1 MANAGEMENT REPORT OF ASSET LAUNDERING AND TERRORISM FINANCING PREVENTION AND CONTROL (SARLAFT) ACTIVITIES

Titularizadora Colombiana consistently applied the policies and procedures defined in its Asset Laundering Risk Management System (SARLAFT) thus preventing its being used directly or through its operations as an instrument for asset laundering and/or for channeling resources toward perpetrating terrorist activities.

The most relevant actions taken in 2018 comprise the review and update of the risk matrix for the asset laundering and terrorism financing risk, which included the association of risks with the real estate securitization, the profiling of controls required for mitigation of such risks, and the assessment of level criticality as per the directives of the Board of Directors.



Periodic reviews of AL/TF risk prevention policies and procedures allowed keeping them up to date and duly formalized in the SARLAFT manual and the Code of Conduct.

Regarding operations related to primary underwriting of securities performed solely through stock brokers, validation procedures were applied to the issues of 2018 and an annual confirmation with said entities was made about the compliance with agreements set for the prevention and control of asset laundering and terrorism financing.

As to the measures of control of the loans securitized and serviced by the various entities, the annual certification and recertification of loan servicers conducted also included the compliance with applicable SARLAFT requirements.

SARLAFT control and monitoring activities conducted with the process owners and officers in charge of the Company providers reinforced the proper completion of the engagement form and the data update frequency.

Finally, the company complied with its legal duty of reporting under the applicable laws and regulations, and timely addressed the requirements from control bodies.

## **11.2 INTERNAL CONTROL SYSTEM**

The Company Internal Control System has been defined and implemented as per the applicable laws and regulations and in accord with the policies and rules established by the Board of Directors, thus allowing its proper and sustainable operation.

Activities in 2018 included:

- (I) Control Setting: General governance policies, including the code of ethics and conduct, have been duly updated and released to all the company officers.

The organizational chart, the description and responsibilities of each job, have been determined, formalized, and reviewed and updated. Personnel training and education were conducted as per the annual plans. On the other hand, management indicators were applied in line with the Quality System Policies

As to the policy on prevention of the fraud and misconduct risk, the Board of Directors' Audit Committee followed up the main matters related to fraud risk as well as those related to proper and timely addressing requests submitted through the "Transparency channel."

- (II) Risk Management: Risk management systems for market, operational, and asset laundering and terrorism financing risks were kept under a stringent application of their respective policies, stages, and elements, including monitoring activities performed by the various departments of the Company and of the relevant control bodies.



Working sessions were conducted under the real estate securitization process for identifying risks of such operations and incorporating them into the risk management systems for asset laundering risk and operational risk, including the mitigation control points required to keep the new risks at the levels set by the Company.

- (III) Control Activities: The Company has appropriate controls in place for the processes and various activities performed aiming to reasonably ensure the fulfillment of the operational goals set by each area in the Company.

As per the manuals' update schedule and comments from internal quality audits, internal control, and statutory audit about the control procedures, changes were made to the manuals of business and support processes, including the required changes to control activities comprised by the operational risk of each such process.

- (IV) Information and Communication: Processes are in place for information generation, distribution, storage, and recovery according to the applicable policies and rules, and at all times subject to the information classification per type established by Titularizadora.

Communication channels enabling the internal and external publication of information are subject to review and approval protocols to ensure the integrity and reliability of the information released to interest groups.

In 2018, relevant procedures for document transfer and destruction were adapted, monitoring activities were defined for the custodian designated by the Company to store the archive and to determine the responsibilities in the documentary management.

Regarding communication channels, information screens were developed as internal information release tools and the online meeting channels were formalized to be used by the Company.

- (V) Monitoring: Ongoing supervision by process owners and the periodic follow up by the offices of the president and the vice presidents has allowed verifying the performance quality of the internal control and the achievement of the control goals.

The evaluation of the internal control system's efficiency was conducted by the statutory auditor, the external auditor and the internal control role as well as supplemented by the internal and external quality assessments performed in the framework of the company's Quality Management System in place.

The results of the reviews carried out by the internal control area, the external audit, and the statutory audit have been informed periodically to the Audit Committee



which has given its opinion on the action plans defined by Management and has been kept informed of the implementation progress.

## **11.3 EVALUATION OF DISCLOSURE AND CONTROL SYSTEMS**

The Company applied this year the disclosure and control procedures defined for preparing and releasing the company financial statements, including validation by the Financial Control area and the President's office, as well as the evaluations by the statutory auditor and the internal control role. They all jointly confirmed that the preparation, presentation, and disclosure of the financial information as of the fiscal period closing abide by the law and reasonably present the financial position of the company.

The results of periodic reviews of the company's control measures specified in the accounting, financial, and operational procedures led to conclude that such procedures were correctly applied and provided a reasonable assurance that Titularizadora's financial information has been properly recorded, processed, and presented. They also show that the financial statements and other reports disclosed to the public do not contain any defects, inconsistencies, or material errors that might prevent understanding the actual position of the equity or the operations transacted during 2018.

## **11.4 OPERATING RISK MANAGEMENT**

In 2018 the Company conducted the identification and valuation of the risks that may arise in real estate securitization; the definition and documentation of control actions established in the procedures for purchase, management, and alienation of real property; as well as the update of risk matrices including those related to issue underwriting and management.

The Company performed periodic reviews of the risk levels, as well as addressed and assessed fraud and operational risks, which showed a middle level of criticality in their residuals.

In 2018 every risk event that occurred was duly recorded as per the applicable laws and regulations; the SARO Committee assessed such risk events and preventive actions were taken as required. Four events occurred resulting in losses for operational risk for COP 109,400,075 mainly originated by penalties for delays in tax reporting.

The Company executed the training plan for the officers addressing topics related to applicable laws and regulations, and to methodology and procedures of operational risk management.

With respect to the Business Continuity Plan, the Company performed contingency tests on the applications that support the servicing to securitized assets and to investment portfolio. Functional technical visits were conducted to the facilities of the alternate operation center, which rendered successful connection tests.



On another subject, high availability tests were applied to the physical servers' infrastructure and to the virtualization platform, backup restore tests rendered satisfactory results, including a recovery activation plan in case of an ISP crash.

## **11.5 RISK DISCLOSURE**

Note 2 to the Financial Statements reports the disclosure of criteria, policies, and procedures used in the evaluation, management, measurement, and control of the risks associated with Títularizadora Colombiana's business.

## **11.6 REPORT OF OPERATIONS WITH SHAREHOLDERS AND MANAGEMENT**

In accordance with Law 603 of 2000 §1, Note 19 to the financial statements lists the operations transacted between Títularizadora and its shareholders and managers.

## **11.7 GRATUITOUS TRANSFER OF OWNERSHIP**

During this year, gratuitous transfers of assets took place for COP 29.6 million. They include a donation to Fundacion Catalina Munoz, an entity that provides housing solutions to single parents heads of households.

## **11.8 ASSETS IN OTHER COUNTRIES**

As of the 2017 closing, the company records foreign investments for COP 1.541 billion corresponding to shares in Títularizadora Dominicana.

## **11.9 COMPLIANCE STATUS OF INTELLECTUAL PROPERTY LAWS AND REGULATIONS**

Pursuant to Law 603 of 2000 §1, let it be expressly set for the record that the company has complied with the regulations on intellectual property and copyright set in the Colombian laws.

## **11.10 PAYMENTS TO DIRECTORS, CONSULTANTS, ADVERTISEMENT, AND PUBLIC RELATIONS**

The expenditure for salaries, fees, travel and lodge expenses, and any other remuneration received by company's executives and consultants, as well as advertisement and PR expenses incurred by Títularizadora Colombiana are set forth in detail in an attachment to the financial statements.



## **11.11 INFORMATION SECURITY**

The Company started a project in 2018 aimed to implement the new requirements established by the Superintendencia Financiera for risk management of the information and cybersecurity risks with the purpose of strengthening the current controls and minimizing the risks connected with information security.

## **11.12 FREE CIRCULATION OF INVOICES**

To the effect of the compliance with the Code of Commerce §788 paragraph 2 (as added by Law 1676 of 2013 §87), it is expressly set for the record that the free circulation of invoices submitted by vendors or providers was not hindered.

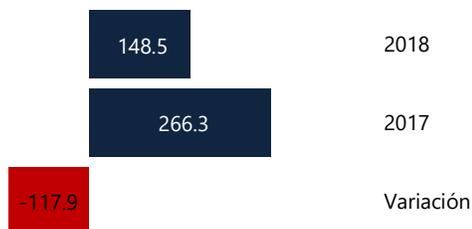
## **12 FINANCIAL STATEMENTS**

The company financial statements as of 31 December 2018 were presented in accordance with the International Financial Information Standards. The financial statements reflect the following information:



## 12.1 BALANCE SHEET MAIN FIGURES

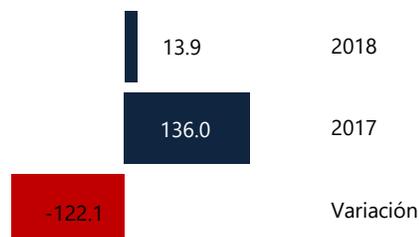
### ASSETS



Ending December 2018, Titularizadora Colombiana's total assets amounted to COP 148.47 billion, a 55% reduction with respect to 2017 closing. Assets mainly comprise Financial investment assets (50%), cash equivalent (19%), investment properties (16%), trade creditors (9%), and assets kept for sale (5%).

The main variation of the accounts as to the previous year is found in Real Estate Assets kept for sale by transfer for carrying out the real estate securitization in 2018 intended for the TIN Universalidad.

### LIABILITIES

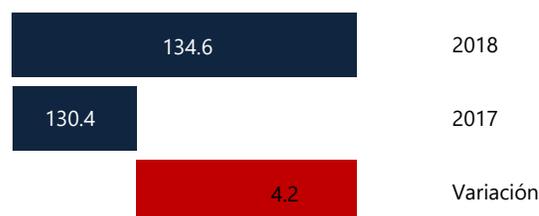


The company leverage at the fiscal period closing is 9%.

Liabilities correspond mainly to the current and deferred taxes to be paid by the Company.

The main variation with respect to the previous year is the cancellation of loans obtained for real estate purchase, which were securitized in 2018.

### EQUITY



Titularizadora Colombiana Shareholders' equity grew by 3% with respect to the preceding year, resulting from the fiscal year earnings. The company closed 2018 with a COP 134,593 million worth equity.



## 12.2 INCOME STATEMENT

Operational income corresponds to 75% of the total income, and results from the fees for issue structuring, servicing, guarantee and underwriting for COP 20,866 million, from sale profit of non-current assets kept for sale for COP 9,737 million, and from financial income represented in the yields of investments and loans for COP 8,164 millions.

Operational income shows that fees increased by 1% with respect to 2017 and financial yields decreased by 40% associated with the investment portfolio reduction.

Other income for COP 12,940 indicates mainly the income for lease and the adjustments to the Actual value unit (*Unidad de Valor Real*) Reference Rate or UVR (id est, UVR loans currently under securitization).

Company's expenses amounted to COP 26,966 million. Operating expenses show an 8% increase and non-operating expenses show a 31% increase in financial expenses mainly.

Net profits amounted to COP 15,011 million in the fiscal year of 2018 i.e. COP 3,383 million higher than in 2017.

## 12.3 FINANCIAL AND OPERATIONAL INDICATORS

ROE before taxes corresponds to 20% in December 2018. In turn, ROE after taxes changed from 11.6% in 2017 to 12.4% in December 2018.

The operational efficiency changed from 73% in 2017 to 47% in 2018.

## 12.4 FINANCIAL STATEMENTS CERTIFICATION AS OF 31 DECEMBER 2018

Pursuant to Law 964 of 2005 §46, for the preparation of financial statements and any other reports for the general public, Titularizadora Colombiana established, implemented, and evaluated disclosure and monitoring procedures and systems that ensure an adequate presentation of the financial information. The financial statements collectively do not contain any defects, inconsistencies, or errors that could preclude the understanding of the actual position of the equity or operations of the company.

## 12.5 INFORMATION ON CONSOLIDATION OF FINANCIAL STATEMENTS WITH UNIVERSALIDAD TIPS E-1

Titularizadora performed the analysis and implementation of the International Financial Information Standards (IFIS) taking into account the consolidation of the Company's and the TIPS E-1 issue's financial data, which was the first of Titularizadora's issues ever and the only issue assigning residual rights to Titularizadora. In this context, the Company carried out an



initial consolidation with the TIPS E-1 issue and reported the consolidated information including 31 December 2017.

At the beginning of 2018, the Company conducted a review of the IFIS, the IFIS' principles, and the applicable assumptions, as well as an interpretation process that allowed to advance in the understanding of IFIS contents and scope, thus concluding that the consolidation process was not relevant because: (i) The International Financial Information Standards (IFIS) and principles are based on a fundamental hypothesis of an ongoing business, which is not the case for the TIPS E-1 issue insofar as payment was already made to securities issued and registered with the RNVE (Colombian Registry of securities and intermediaries), furthermore, all that is left regarding residual rights is to wrap up the process of liquidation. (ii) The financial data on the TIPS E-1 residual rights is not relevant, material, or relatively important considering that the residual right in and to the TIPS E-1 Universalidad as of 31 December 2017 represented COP 76,853,548.35 equivalent to 0.02886% of the total value of Titularizadora's assets therein. Finally, (iii) the guarantee or credit enhancement facilities related to TIPS E-1 Universalidad were not undertaken by Titularizadora at any time, thus reinforcing the notion that the consolidation did not, nor does it have any foundation under the currently applicable laws and regulations.

In view of the above, the Company did not submit the consolidation results to the Shareholders Meeting in 2018 and made the decision to stop submitting the consolidated information to the Superintendencia Financiera de Colombia. Additionally, the no consolidation decision of Management was reported to the Board of Directors of the Company, which expressed its agreement to the criteria presented by Management and the decision to cease consolidating the Company financial statements with those of the TIPS E-1 Universalidad.