Titularizadora Colombiana
UNA CASA PARA TODOS

REPORT OF THE PRESIDENT AND BOARD OF DIRECTORS TO THE ORDINARY GENERAL SHAREHOLDERS' MEETING

MARCH 12, 2013

1. Introduction

During 2012, the Colombian economy slowed down due to the fall of the construction sector, paralysis of the manufacture sector and fall back in the energy-mining sector growth. Notwithstanding, the economic growth rate (4%) is still favorable though still below the 4.5-5% economy potential.

The slowdown in the investment and household consumption affected the growth. Whereas the public expenditure showed a major increase, it was not sufficient for containing the slower pace in the economy. In addition, the slower growth in exports—the energy exports particularly— took toll on the economic activity in general.

Despite the slower product dynamics, labor force records continued showing favorable figures for most of the year. In average, the unemployment rate was 0.7 percentage points below 2011 monthly records. Nonetheless, the positive trend in employment growth began to disappear in September 2012. After 45 months of uninterrupted growth of working population, this figure diminished during the last trimester of the year.

As it was, labor conditions in cities like Bogotá, which had been showing a decisive progress for more than 10 years, started deteriorating as a result of government measures that affected the private sector dynamics. Specifically, building activity was adversely affected by institutional restrictions imposed on the construction in Bogotá. In this sector only, more than 60 thousand jobs were lost in this city.

The adverse performance of the construction activity in the capital city had a direct impact on the figures countrywide. All the business chain links were affected, from project launch (-17%) to house sales (-6%) to housing works beginning (-15%). Only the mortgage loan segment remains unimpacted.

In 2012, more than COP 10 trillion were disbursed for home buying loans, representing a 12% growth with respect to the previous year. This dynamism led the mortgage loan to exceed COP 33 trillion, which in real terms is the highest of the entire financial history in Colombia.

Notwithstanding, due to the natural lag between the variables related to the housing construction and those related to housing financing, the latter is forecasted as an obstacle during 2013. Whereas the forecasted scenario does not seem catastrophic, it would break 12 years in a row of growth in the mortgage loan disbursements.

Mortgage backed securitization in turn delivered acceptable results. During said fiscal period, three issues were achieved for COP 1.2 trillion backed by mortgage loans denominated in pesos (TIPS Pesos N-4, TIPS Pesos N-5, and TIPS Pesos N-6), thus allowing Titularizadora Colombiana to keep its leading position among private issuers in the country. With these issues Titularizadora reached a total of 38 issues for more than COP 16 trillion.

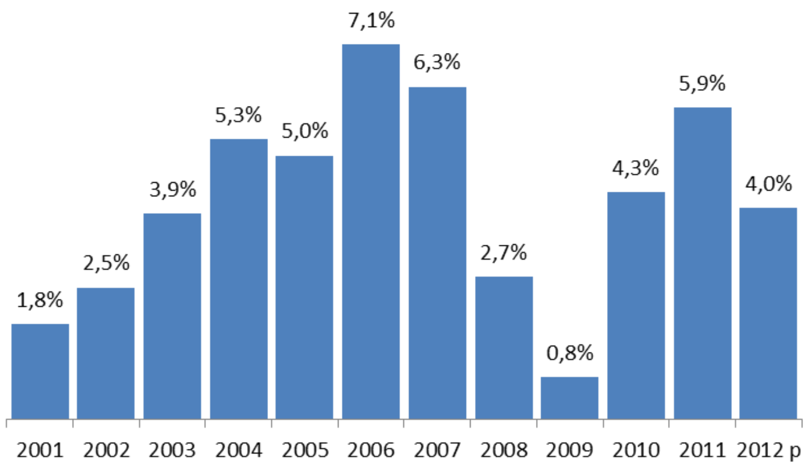
2. Macroeconomic Environment

2.1 Economic Growth

The economy dynamics slowed down in 2012. Following a 5.9% growth in the first nine months of 2011 (similar throughout the year), this rate decreased to 3.9% for the same period of 2012. The deceleration was marked by the third trimester's tumbling in sectors that had been driving the economy, such as construction and mining-energy, due to the lack of building works' execution, a weakened construction sector in Bogotá, and problems related to environmental license issuance and the growth of physical insecurity of oil pipelines.

Therefore, the total economic growth in 2012 is expected to end in 4% at most (Chart 1). Sectors such as industry and agriculture (despite the third quarter's greater than 4% growth) will adversely impact the growth of the year aggregate production due to structural competitiveness troubles in Colombia, which leave this sector greatly exposed to foreign exchange rate fluctuations.

Chart 1. Economic Growth
Source: DANE



Certain sectors of the economy still show positive results such as the finance sector (Chart 2). On the one hand, the mortgage loan portfolio kept on showing a very satisfactory behavior by reaching a 15% annual growth as of November 2012. This figure is less than in November 2011 (22%) but still higher than twice the nominal economy growth. It additionally resulted from the withdrawal of monetary incentive started by the central bank (Banco de la República) during the second semester of past year.

In general, out of the nine productive activities, seven slowed down with respect to data reported for the first three trimesters of the year. Only electric energy supply and social services showed positive variations.

Chart 2. Economic Growth per Sector

Source: DANE

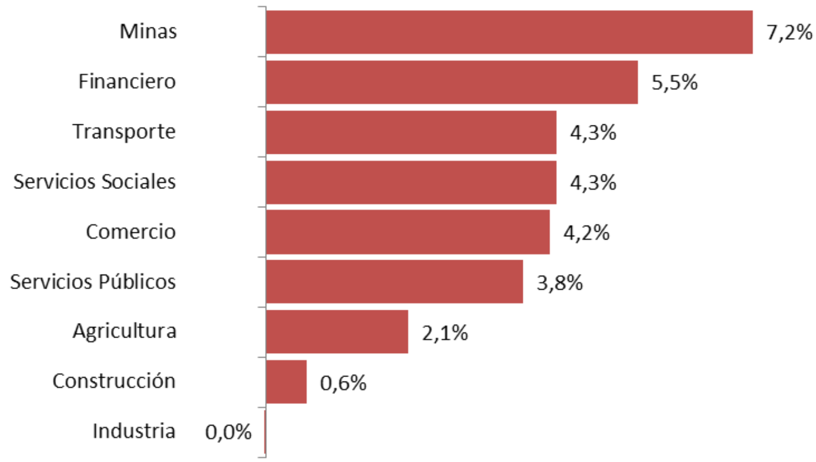
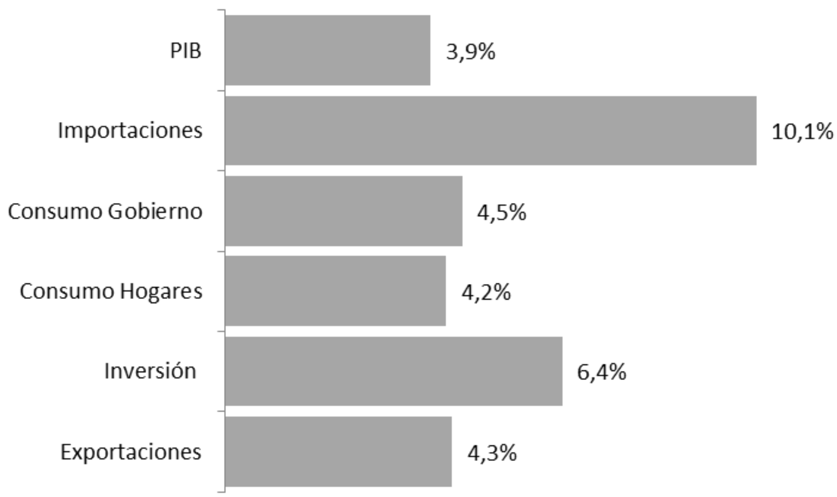


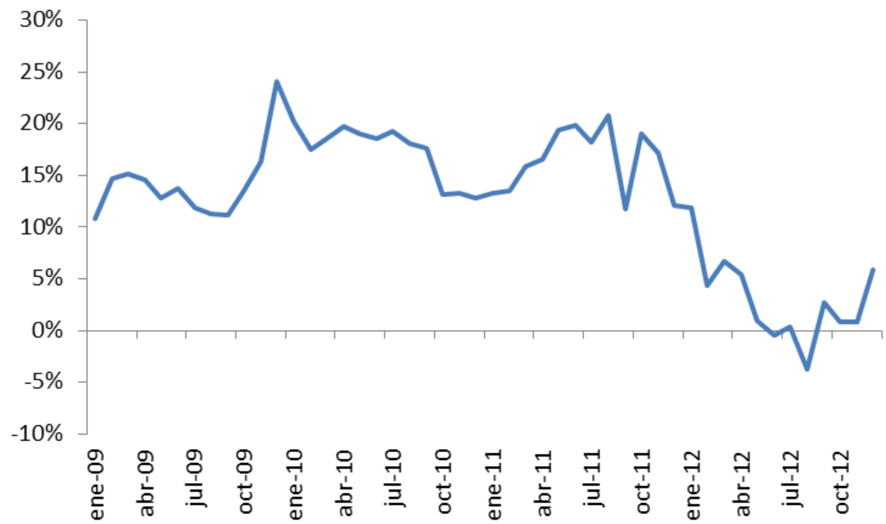
Chart 3. Economic Growth Component of Expenditure
Source: DANE



As to the demand, the fall in the construction sector and capital investment imports cut the growth of the investment component of the economy (Chart 3). While this item grew at almost 18% rates in 2011, the variation diminished to little over 6% in the first three trimesters of 2012. This fall greatly impacted the aggregate product due to the relative importance of the gross capital formation that is currently circa 30% of the GDP.

Private consumption also slowed down slightly from 6.6% between January and September 2011 to 4.5% in the same period of 2012, due to the consumer confidence reduction, the loan interest rate increase and the continuation of the rarefied international environment. The main reason of this fall is the slowdown of durable good consumption, from two-digit growth rates the previous year down to less than 3% variations this year.

Chart 4. Annual Variation of Crude Oil Price
Source: UPME



Unlike household consumption, public consumption behavior improved by growing from 2.5% in 2011 to 4.2% in 2012. These figures reflect the activation of the fiscal policy as a countercyclical tool, despite the low rate of building works execution.

In fact, exports reflected the global economy behavior. They grew by 10.1% in the first nine months of 2011 and by 4.3% in the same period of 2012. The main reason was a weak external demand particularly from the US and bottlenecks in oil crude production and export that prevented the achievement of the government goal to exceed one million barrels per day.

2.2 Labor Force

Labor market performance has shown a positive behavior along 2012 although since September the results in function of working and unemployed persons deteriorated slightly. Whereas during the first eight months of 2012 the unemployment record was 0.7 percentage points average below data reported in 2011 (Chart 5), for September there was no difference. As it is, the unemployment rate recorded for that month was 9.9%, i.e. 0.2 percentage points of the rate observed in September 2011.

The number of people in work started to show a marginal decline with respect to 2011 data. After 45 months of positive annual variation in the number of workers (4.7% average) this trend ended in October (Chart 6) when the working population decreased by 92 thousand persons. During those 45 months, the average annual job creation was close to 800 thousand; nevertheless, if we consider data since August 2010 only (Santos government beginning), this number approaches 900 thousand. In summary, the total number of jobs created in this government is circa 1.3 million.

Chart 5. Unemployment Rate
Source: DANE

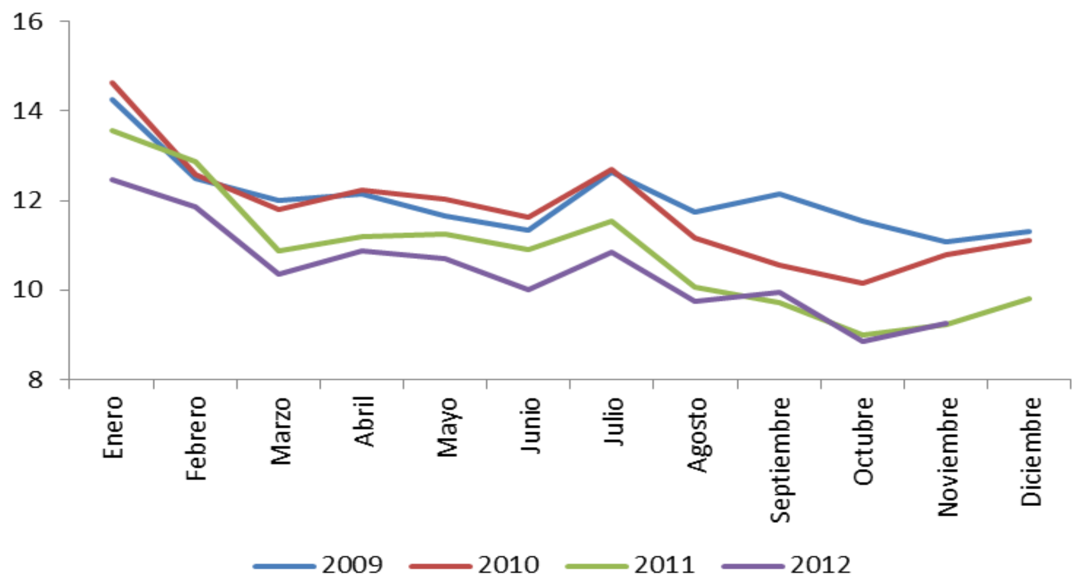
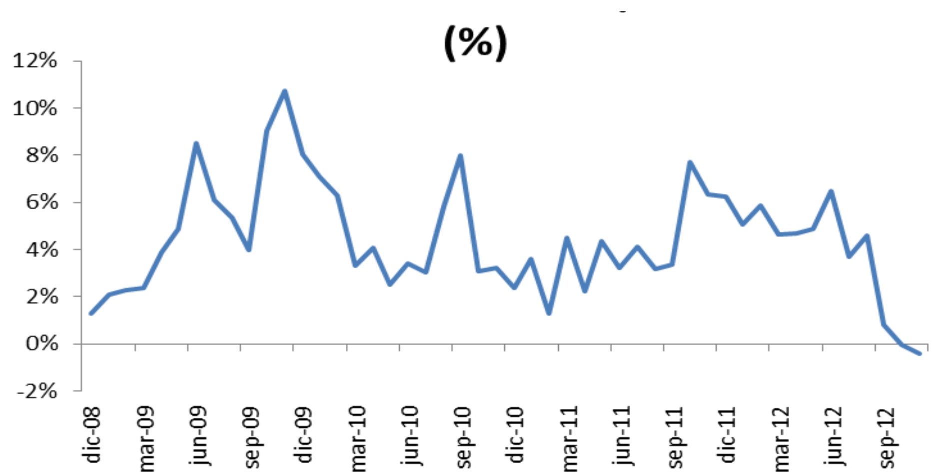
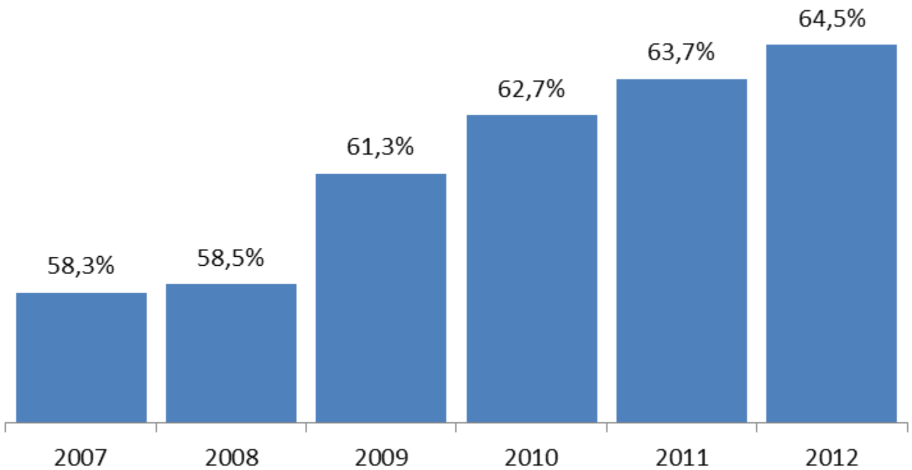


Chart 6. People in Work Annual Variation
Source: DANE



The unemployment rate drop in Colombia during the last four years was possible even with the sustained increase in job supply. The overall labor force participation rate (TGP in Spanish) has been growing since 2007 when it was 53.8% (percentage of working persons over the total working-age population), up to 64.5% in 2012 (Chart 7). This increase indicates that 3.3 million additional people joined the labor force and encountered satisfactory jobs.

Chart 7. Overall Labor Force Participation Rate (%)
Source: DANE

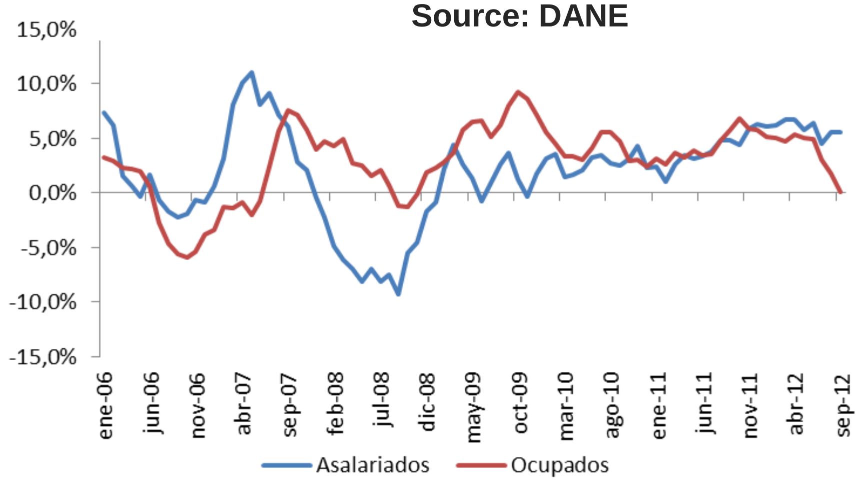


The unemployment rate drop has been heterogeneous across the country. In cities like the Atlantic coast cities, Bucaramanga, and Bogotá, the average unemployment rate diminished to one-digit figures throughout the year, whereas cities of the coffee-growing region and the Pacific coast kept high unemployment rates. For example, cities such as Popayán, Quibdó, or Pereira have not achieved any significant progress in unemployment rates, which remain 17%, 18%, and 16% respectively. On the one side, the reason is that these regions were affected by the international crisis that reduced the in-flow of remittances, and on the other side, climate disorders in the two previous years (the "el niño" phenomenon) affected strongly the agricultural sector.

In fact, the agricultural sector has destroyed around 128 thousand jobs across the country since August 2010. The agricultural and the financial sectors were the only to destroy jobs in such period. Sectors that did not show favorable results in terms of production actually did with respect to job creation e.g. the manufacture sector. In the last 27 months, around 300 thousand jobs were created.

An interesting phenomenon took place in the labor force during 2012—the creation of almost 450 thousand salary-earning jobs, well above the 360 thousand jobs created in 2011, a very positive number because the growth rate of wage-earning jobs has been greater in average than the growth rate of total working population (Chart 8). It means that the economy is enhancing in job formalization, which is favorable for the internal job demand dynamics.

Chart 8. People in Work v. Wage-Earners Annual Variation (%)
Source: DANE

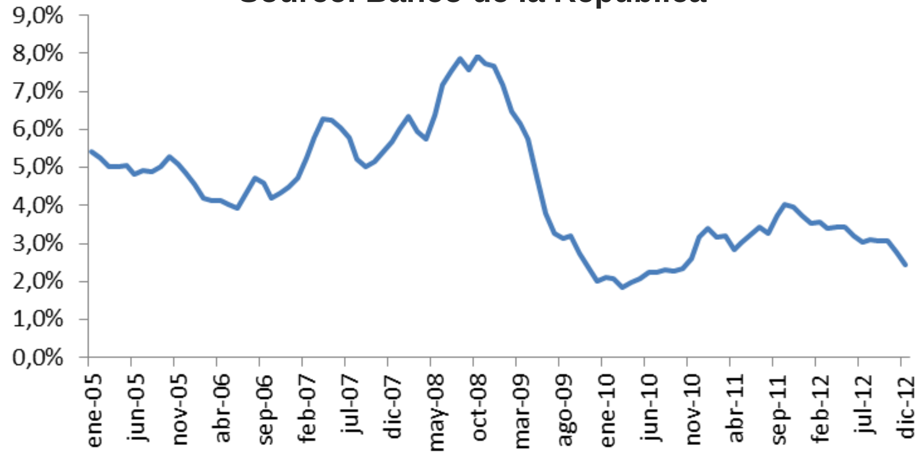


2.3 Inflation, Monetary Policy, and Credit

The central bank (*Banco de la República*) changed its monetary policy since the second semester of 2012. Following a series of increments in the intervention rate since mid-2011, this rate declined by 100 basis points and closed the year in 4.25%. This action resulted from the haste of the Board of Directors of the Banco de la Republica in applying the monetary incentive in face of the economy deceleration signs, the confidence in a favorable inflation performance and the revaluation pressure that continues hounding the economic environment.

Inflation closed in 2.44% year-end 2012 (Chart 9), lower than the rate expected by the market and the target range mid-point thus making room for monetary intervention. In general, the inflation did benefit from the tradable goods, which showed a less than 1% variation in the last 12 months, due to the foreign exchange revaluation effect. Likewise, the pressure exerted by regulated goods disappeared during the year mainly owing to the hydrocarbon price stability.

Chart 9. Inflation
Source: Banco de la Republica



Since October 2011, the food group began to reduce the uptrend in prices. After reaching the highest variation (6.63%) in that month, the datum recorded for December 2012 was 2.52%. Supply restrictions resulting from a rainy period totally disappeared. Notwithstanding, in April and May this expense group was affected by international prices of certain food items which also increased sharply upon climate troubles in large production countries.

Education and health items reported the higher growth in prices with 4.59% and 4.27% respectively in 2012. Training and teaching sub-item drove the former with a 4.14% growth and the private insurance dragged the latter with a 5.99% growth.

The foreign exchange rate showed a 9% revaluation closing in COP 1,768 per USD 1. This behavior resulted from a strong incoming of capitals, in particular DFI exceeding USD 15 billion and incoming portfolio investment of circa USD 11 billion in the third trimester.

2.4 External Sector

Despite the weakening external demand, exports continued growing at a much more moderated rate than in 2011 (42%) but is still positive (6.3%). Up to November 2012, the country had exported close to USD 55 billion due to industrial and gold exports that grew by 8% and 17% respectively. The oil export segment variation was 6.4%—much lower than 58% in 2011.

Agricultural exports fell by -4.4% due to the -23% reduction in coffee sales resulting from production losses from raining, *"broca"* (coffee bean borer) infestation outburst, crop renewal, and revaluation. Some products showed a favorable yet insufficient performance that did not offset the coffee production fall, such as the export growth of livestock and meat (67%), cereals (21%), fish and seafood (12%), and dairy products and eggs (10%), which benefited from the application of several free trade agreements and reactivation of trade with Venezuela.

During 2012, Venezuela was the destination of circa USD 2.8 billion in Colombian exports, thus generating an export share gain, a phenomenon not seen since 2007. Other markets displayed a positive dynamics, such as Spain (262%), China (58%), and Peru (12%). The two former particularly consolidated as fuel and oil buyers, whereas Peru now represents a greater than USD 1 billion market for non-oil exports.

Total imports are calculated in USD 58 billion representing a favorable trade balance around USD 1.5 billion. The trade balance has been deteriorating with some countries, in particular China, Mexico, Germany, Brazil, and Argentina, which together add up to a USD 13,454 million cumulative trade deficit.

Imports grew faster than exports with an 8.6% variation. This phenomenon arose from the 53% increase in fuel imports surpassing USD 5 billion. In like manner, food products (32%), clothes (31%) and pharmaceutical products (13%) had a favorable impact in import behavior.

2.5 Fiscal Balance

Fiscal accounts' behavior was very favorable during 2012. Tax revenues amounted to COP 96 trillion, 12% above 2011 collections. In general, the Central National Government revenues amounted to COP 106 trillion, owing to the capital resources that added up to COP 9.5 trillion. The result was a COP 16 trillion deficit equivalent to 2.4% of the GDP (Table 1).

The National Government debt balance was placed in COP 215 trillion, out of which, COP 155 trillion correspond to internal debt and the remaining COP 60 trillion to external debt. Therefore, the relative public debt to GDP ratio is 32%, a moderate value if compared to periphery Europe countries such as Italia (120%) and Greece (160%) with serious debt troubles or to Japan (223%) with the highest public debt in the world.

Table 1. Consolidated Public Sector Balance
Source: *Ministerio de Hacienda y Crédito Público* (Ministry of Finance)

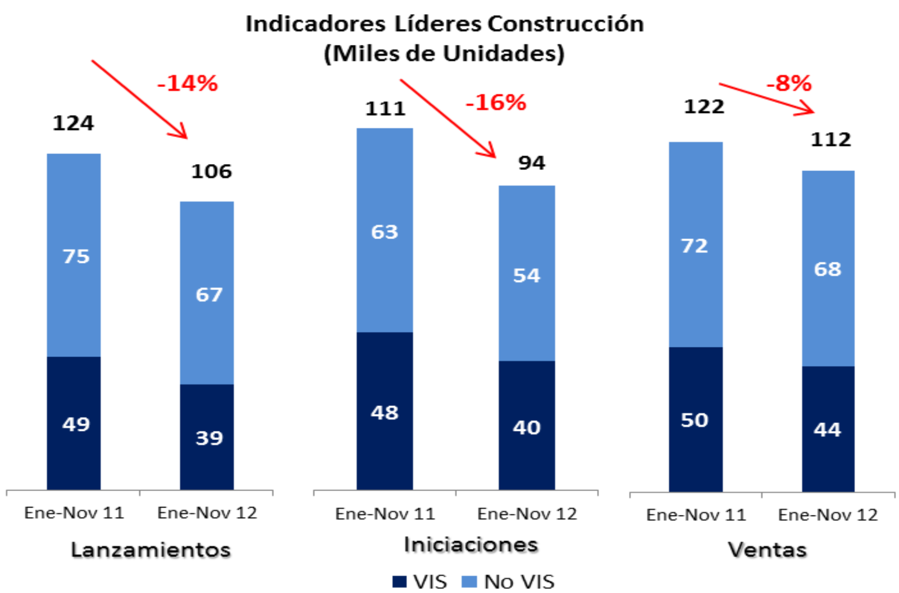
	2012	
COP Trillion	MFMP (Medium-Term Fiscal Framework)	December 28
Total Revenues	107.6	106.9
(out of which) Tax	96.3	95.0
(out of which) Capital Resources	9.3	9.3
Total Expenditure	123.6	123.0
(out of which) Operation**	85.7	86.4
(out of which) Investment**	19.5	19.3
Total Balance	-16.0	-16.1
Total Balance (GDP %)	-2.4	-2.4

2.6 Recent Evolution of Housing Market

In the April 2009 to October 2011 period, the housing sector indicators showed an exceptionally good performance, such as housing sales, construction licenses, and mortgage loan disbursements which reached historical maximum records. This extraordinary performance even set the alarms at the financial authorities about a potential destabilizing phenomenon formation such as a housing price bubble.

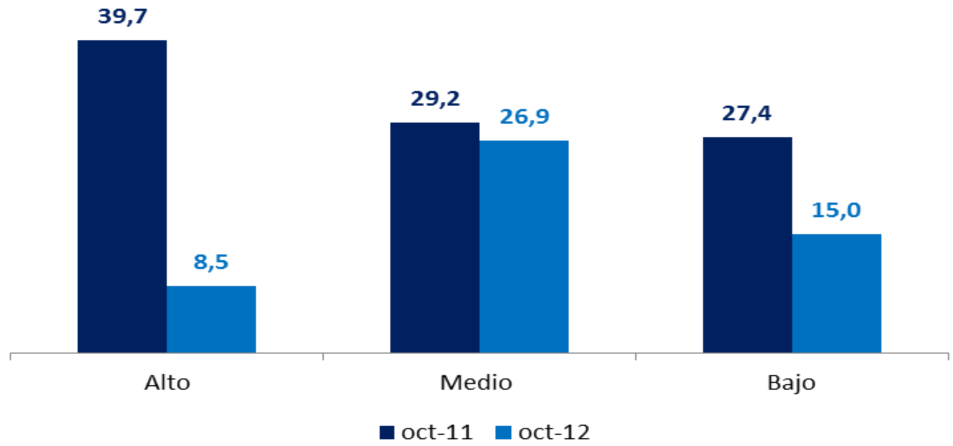
Nonetheless, this situation drastically changed since the third trimester of 2011. In the last 12 months, the dynamics of this sector decayed considerably in all its indicators (Chart 10) as a consequence of the strong slowdown for the activity in Bogotá. Whereas cities like Barranquilla, Santa Marta, and Villavicencio still show two-digit growth rates, these figures are not enough to offset the reduction in the capital city.

Chart 10. Leading Housing Sector Indicators
Source: Camacol - 13 Regional Offices



Two differently originated phenomena caused the precarious situation of the housing sector in Bogotá. The first is the frail housing demand in high social strata (Chart 11) that shows signs of fatigue in face of the fast growth of prices and the ascending cycle in mortgage interest rates.

Chart 11. Do you think this is a good time for home purchase?
Source: Fedesarrollo



The second is the administrative measures taken by the Bogotá capital district government, oriented towards the contention of horizontal growth in the city and the creation of urban soil for more vulnerable social sectors in downtown areas.1. These measures have not only worsened the land availability issue (which affects VIS & VIP housing mostly) but also created a climate of uncertainty for residential building business, since these measures directly affect the cost structure. In face of this perspective, builders' trust fell sharply (Chart 12) thus impacting new housing launch for sales, which diminished by 17% for the total market and 31% for the VIS segment (Chart 13).

[1] Measures adopted in the District Development Plan include: 1. Builders must destine 20-30% of the useful urban soil to priority social-interest housing (VIP in Spanish) through the development of projects either in the same building, or in other project, or by monetary offset. 2. This Plan decreed the priority development and construction in urban lots within less than three years and, in case of breach of this regulation, a forceful disposal of the real estate in public auction would proceed. 3. The plan provides that constructor shall contribute in cash by way of the burden-benefit system, to the financing of water supply and sewage matrix networks expansion in other than VIS/VIP urban zones. 4. The bulk sale of treated water was frozen and the investments in water supply networks for neighboring municipalities were stopped. 5. Urban expansion plans were frozen for the development of 124 thousand housing units (71 thousand of the northern zone plan and 53 thousand of the Usme –southern–zone plan)

Chart 12. Builders Expectative
Source: Fedesarrollo

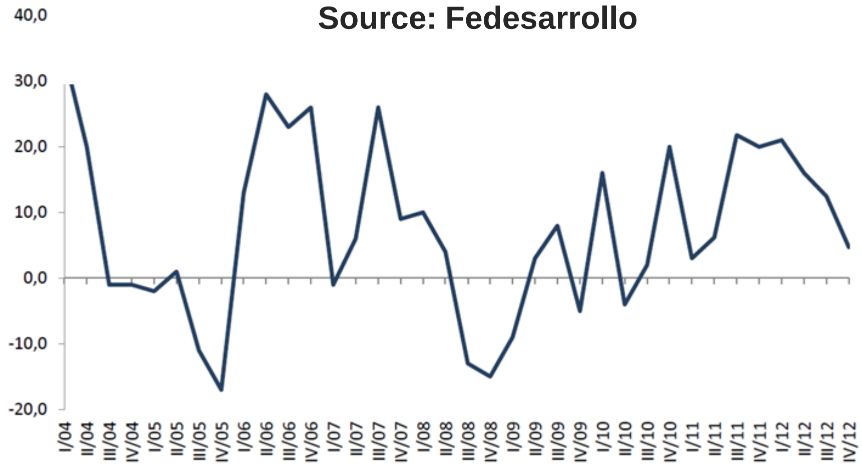
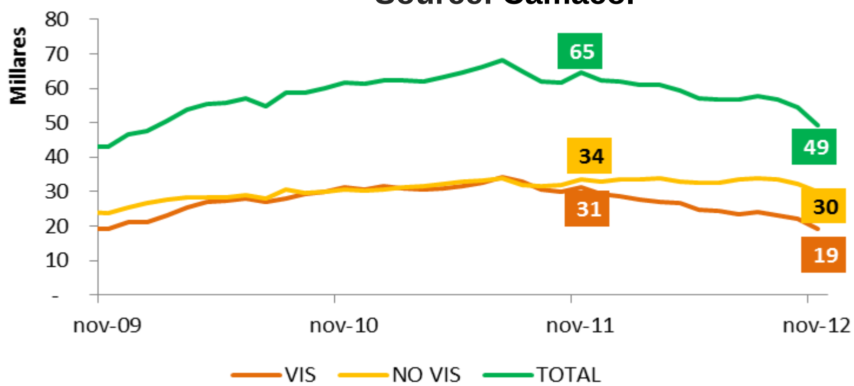
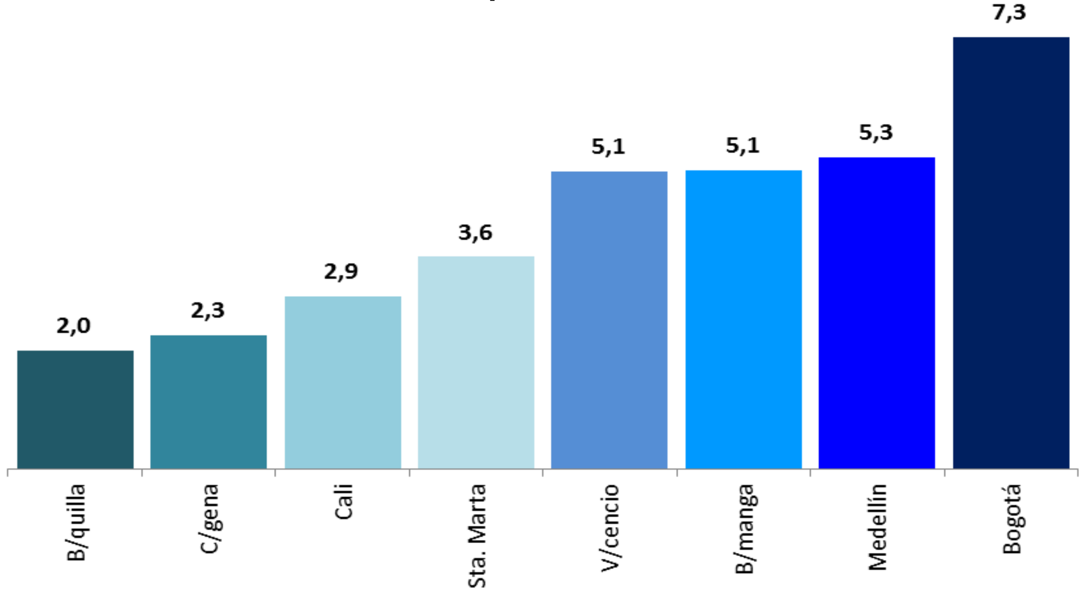


Chart 13. Housing Launches Bogotá (Annual)
Source: Camacol



The reduction in the number of house launches is a logical consequence in the current scenario, because the price increase imposed by those measures (particularly in land price) is not unlimited (there is a VIS price regulation) and thus, the margins for constructors tend to narrow. Although some builders have tried to substitute the Bogotá market with other cities', records show that this is still insufficient (Chart 14).

Chart 14. House Sales per 1,000 inhabitants
Source: Galería Inmobiliaria, DANE, and TC Computations



The reduced number of launches affected the sales performance particularly in the VIS market. Insofar as the supply is exhausted without replacement of the units sold, sales are decaying. This has been partly the case of the entire VIS/VIP segment in Bogotá and the NO-VIS bottom-level component with respective 33% and 28% sales reductions. Notwithstanding, it is worth to mention that this segment was equally affected by the exhaustion of resources destined to subsidy in the first version of FRECH (Fund of reserve and stabilization of mortgage loans, as per the initials in Spanish)

In turn, the effect on sales in higher social strata resulting from the frail demand is smaller but not negligible. In this NO-VIS segment, of greater than COP 200 million prices, the sales were reduced by 6%. Even more, the sales of housing units of greater than COP 600 million prices have contracted by 15% (Table 2).

Table 2. Sales in Bogotá and neighboring municipalities
Source: Galería Inmobiliaria

	Bogotá			Otros Municipios		
Rango de Precios	2011	2012	Var %	2011	2012	Var %
VIP	4.530	1.032	-77%	3.567	5.076	42%
VIS	12.923	10.529	-19%	14.772	17.515	19%
Total VIS	17.453	11.561	-34%	18.339	22.591	23%
VIS - 200	8.988	6.362	-29%	1.754	1.753	0%
200 - 300	5.898	5.106	-13%	488	567	16%
300 - 400	2.993	3.018	1%	241	171	-29%
400 - 600	1.552	1.826	18%	296	365	23%
> 600	1245	1070	-14%	464	410	-12%
Total No VIS	20.676	17.382	-16%	3.243	3.266	1%
Total	38.129	28.943	-24%	21.582	25.857	20%

The fall in sales led to a correction in the issuance of construction licenses for the capital city for both the residential and nonresidential building segments (Chart 15). As it is, the amount of meters licensed during the last 12 months is quite close to historical minimums for both sectors. Nonetheless, there is a marked difference. Whereas the nonresidential sector never recovered the levels of before the 2009 crisis, the residential licenses evidenced a behavior similar to a bubble: a fast growth followed by a sharp fall. Although this behavior was influenced by the enactment of earthquake resistance regulations in 2010, a greater scope correction is applied to licenses in Bogotá than in the rest of Colombia (53% v. 15%, respectively).

The reduction in this indicator directly impacts the construction sector activity. During the first six months this year, the number of housing units started shows a 15% decrease (Chart 16). The reduced activity started to take toll on employment and reduction of the related activities dynamics. Between March and November 2012 only, the construction sector in Bogotá destroyed more than 60 thousand direct jobs without considering the adverse consequences on related activities such as cement shipping (in November 2012, shipment reductions reached 10%).

Chart 15. Construction Licenses (Annual)
Source: DANE

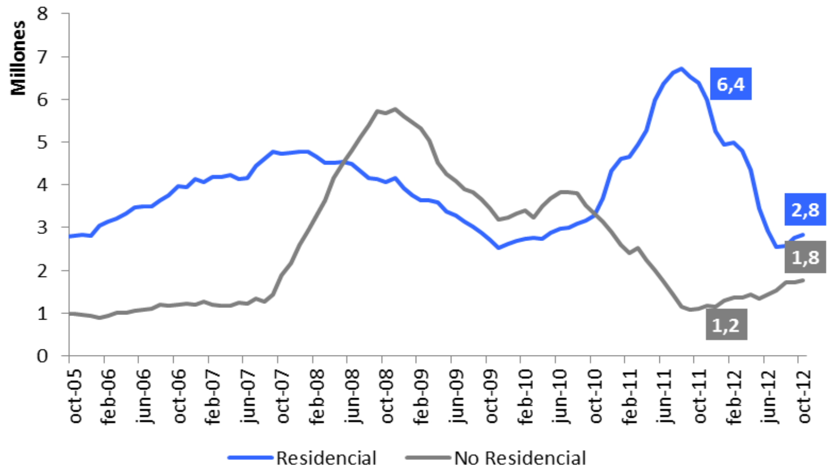
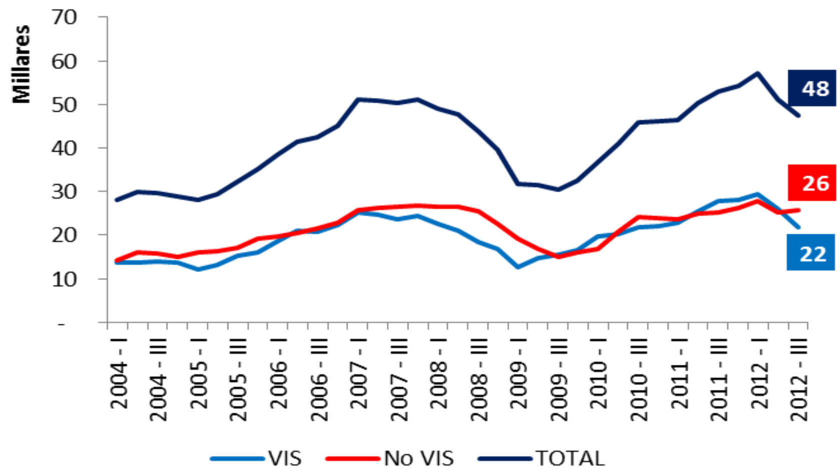


Chart 16. Housing Construction Starts Bogotá (Thousand units)
Source: DANE



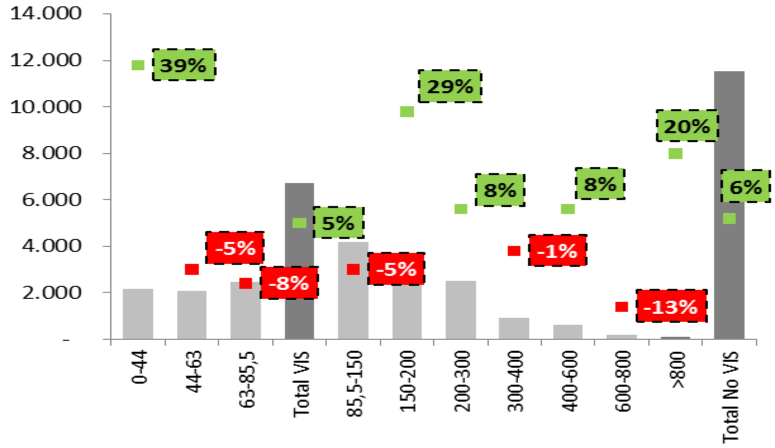
In the rest of the country, the sector behavior is combined. Whereas cities connected to mining-energy activities such as Barrancabermeja, Villavicencio, and Valledupar show an interesting rebound, bigger cities like Medellin and Cali are showing a deceleration process, less sharp than in Bogotá though.

In particular, sales in Medellin (capital of Antioquia department) started to correct the excessive supply in non-VIS segment that was growing since 2010. In that period, the number of units sold exceeded the structural demand for housing (11 thousand NO VIS housing units sold v. 9 thousand NO VIS households formed per year), which was translated into an accumulation of buildings in the investors' hands. In face of the growth in time to sell/lease these real properties, the demand

Chart 17

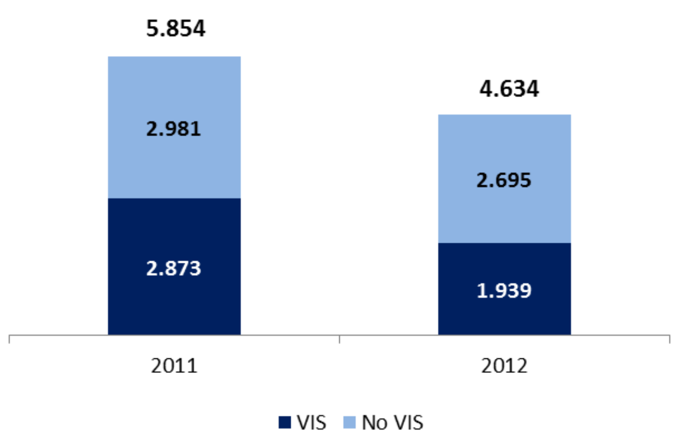
in this niche has been decelerating, especially in 5 and 6 strata (Chart 17).

Chart 17. Housing Sales Medellín
Source: Galería Inmobiliaria



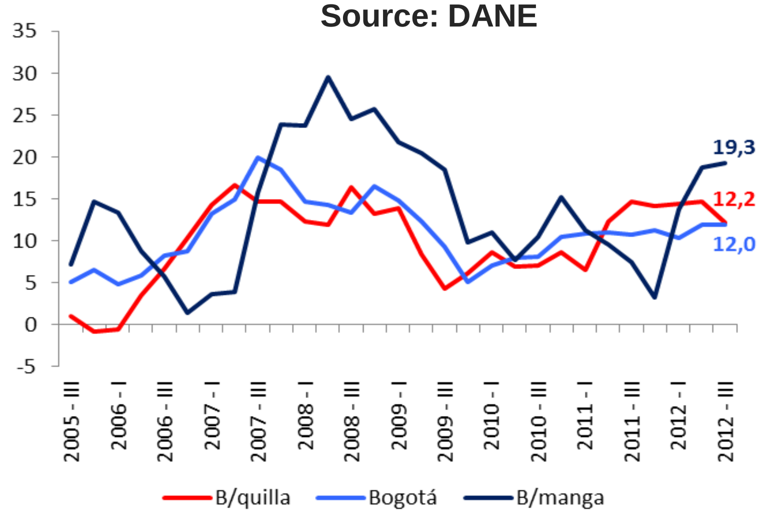
The building activity in Cali has suffered also. Sales in that city have been showing a 7% fall year to date. In this case, the basic elements behind that phenomenon seem to obey more to the supply (falling by 21% in November, Chart 18) than to the demand, particularly in VIS segment. Unlike the supply troubles arising from the soil shortfall, troubles in Cali are more related to the excessive stapes to be processed in order to perform real estate projects. In this arena, the local government made the correct decisions such as implementing a single window for this process. This encouraged the filing of projects and the launch of new housing for sale grew by 12% this year.

Chart 18. Housing Supply Cali
Source: Galería Inmobiliaria



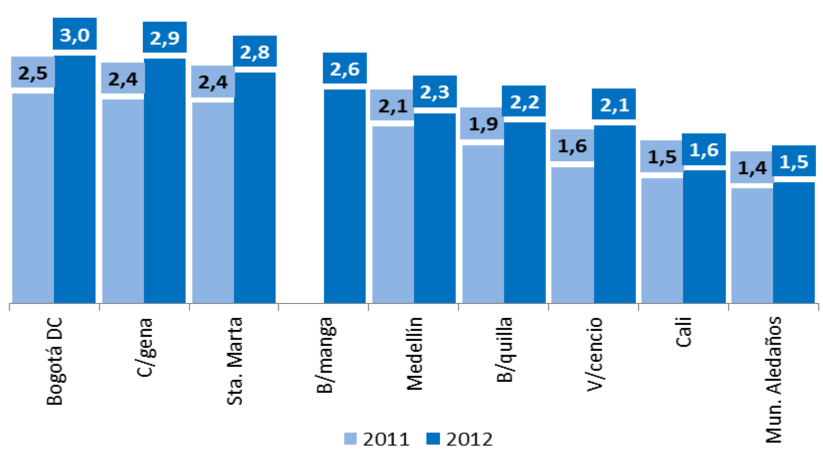
The housing market weakness has not translated in price deceleration. On the contrary, Bogotá, Medellín and Bucaramanga still show a two-digit growth (Chart 19) and reflect the limited supply that exceeded the demand adverse effect. Therefore, the probability that a mortgage bubble explodes in Colombia is smaller and smaller because the provisions aimed to freeze the city expansion represent a strong restriction to housing construction.

Chart 19. Housing Price Annual Variation
Source: DANE



Notwithstanding, the low risk of a price reversion does not imply moderation in prices. For example, the average price per square meter for housing supply in Santa Marta grew by 31% between 2011 and 2012 (Chart 20) whereas the VIS housing supply grew from 6% to 14%. Today, this amount represents 41% of GDP per capita in the region, which does not seem in line with the 17% in the rest of the country.

Chart 20. Square Meter Average Price
Source: Galería Inmobiliaria and TC Computations



2.7 Mortgage Sector Recent Evolution

The mortgage sector has not felt the housing market effects yet. Although between March and July 2012 the mortgage loan disbursements decreased by 11% average (except in May with a 46% growth), since August the originations retook an uptrend due to the implementation of the housing subsidy program second version and the fall of interest rates by more than 70 basis points since middle year (Chart 21). This enabled the sector to make disbursements for COP 10.2 trillion representing a 9% growth with respect to the COP 9.4 trillion of the previous 12 months (Chart 22).

Chart 21. Mortgage Interest Rate (%)
Source: Superintendencia Financiera

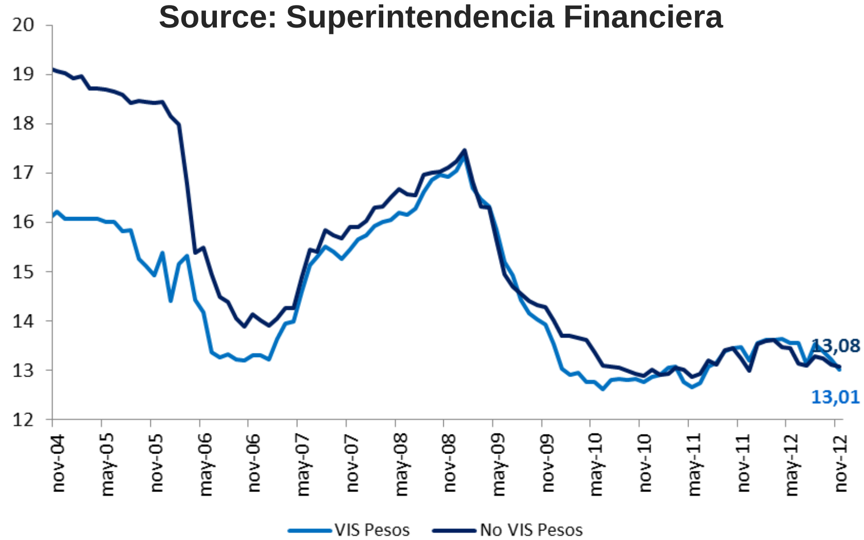
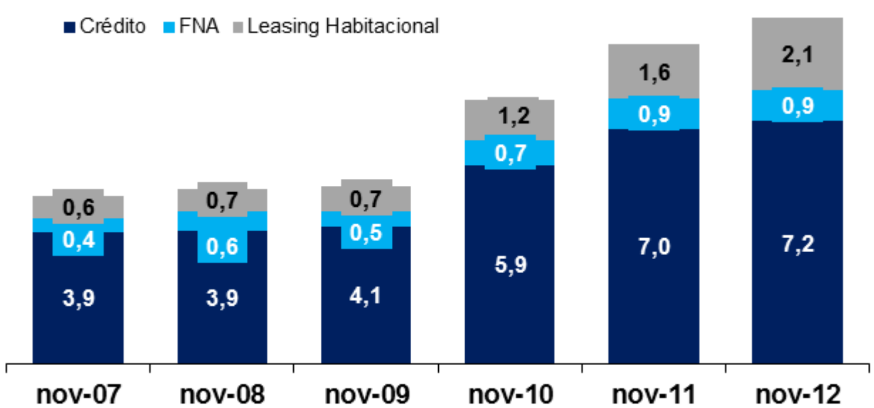


Chart 22: Mortgage Loan Disbursements (COP trillion)
Source: Superintendencia Financiera



This favorable behavior resulted from three elements: First, a lag of one year approximately between the leading variables in the housing sector and in the mortgage activity; second, the positive dynamics of some of the essential components of a mortgage loan such as housing prices and LTV; and third, the expiration of the tax benefit for housing leasing which boosted a massive underwriting during the year.

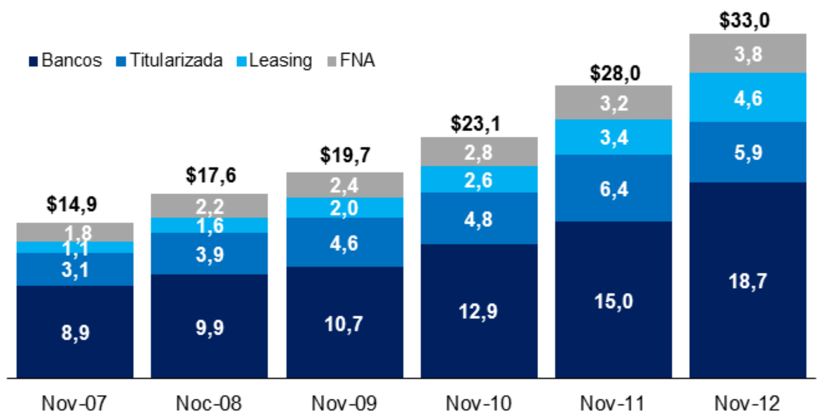
A notorious change in the mortgage loan origination dynamics throughout 2012 was a greater origination of UVR mortgage loans. While in October 2011, the share in total disbursements was 6.3% it grew to today's 8.1%. Despite the still relatively low volume of UVR mortgage loans, this year the 67-month downtrend was broken. This phenomenon is related to the growth of VIS mortgage loan demand, which requires loans with lower monthly installments during the first months of the loan life in order to be able to reach the financial closing.

In the first trimester of 2012, the number of mortgage loans disbursed reached a historical maximum. A total of 129 thousand mortgages were originated, out of which 53% corresponded to new home purchases (47% used) and 50% to social interest housing (50% NO VIS). Even though this figure improved the last years, it still shows the failures in access that the most vulnerable households have in the country. Nonetheless, in the last two trimesters there was a decrease in the figures for this indicator, thereby reflecting partly the fatigue in the demand.

Furthermore, the origination number increase does not necessarily reflect a greater number of borrowers. Although since 2009 the financial sector disbursed 350 thousand mortgages, the mortgage loan borrowers grew by 80 thousand only (from 758 to 834 thousand). These figures show a dislike for mortgage loans inherited from the late 1990s crisis, when more than 200 thousand families lost their homes. In addition to using any excess liquidity for early amortization of loans, households seek to finance their mortgage obligations using consumption loans with the purpose of releasing the collateral security (posing a risk to the system's financial stability).

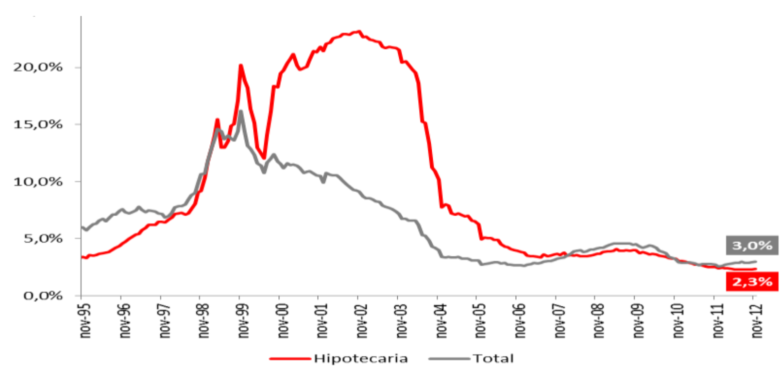
Notwithstanding, the borrower number deadlock is not in line with the mortgage loan balance because it has changed by 73%, i.e. from COP 19 trillion to COP 33 trillion (Chart 23). This implies that the average balance of each borrower jumped from COP 25 million to COP 27 million. This figure equals 2.8 times the Colombian GDP per capita, which compared to the United States (3.2 times) or Chile (2.4 times) seems relatively high.

Chart 23. Mortgage Loan Balance (COP trillion)
Source: DANE



Notwithstanding, the mortgage debt growth in Colombia has not reflected in the increase in households' financial load. These obligations hold only 2% of the families' income (13% the consumption) and represent only 7% of the total wealth, thus favoring the behavior of the mortgage loan delinquency indicator (Chart 24).

Chart 24. Mortgage Loan Portfolio Quality
Source: Superintendencia Financiera



3. Capital Markets

Volatility and uncertainty in the capital markets continued during 2012, with a greater turmoil in the first than in the second semester. The Eurozone crisis remained as the main factor for international uncertainty, driven by the unexpected change in the Greek government and fears of Eurozone break-up, and spreading to larger economies such as Spain and Italy. European leaders had to increment efforts to contain the crisis by promoting a greater fiscal and regulatory commitment and making major concessions to Greece, thus showing their own commitment to prevent the exit of members.

The weak economic growth in several regions added to the Eurozone crisis as a factor for market instability. To compound the concerns on the weak growth in core Europe and recession in the periphery countries are the frail recovery of the US economy and the fears for a smaller economic growth in China. Furthermore, there are consequences of a lesser global demand upon emerging economies, which until past year had managed to stay aside from the global economic deceleration and the European financial crisis.

Correspondingly, the capital markets were not unaffected by the political changes arising from the elections year in several regions (USA, France, China, Japan, Russia, and Greece) that promoted an even greater uncertainty and delayed the adoption of pending actions in some cases. Accordingly, the geopolitical tensions in Middle East (Syria, Israel, and Egypt) contributed to the instability and affected the commodities market.

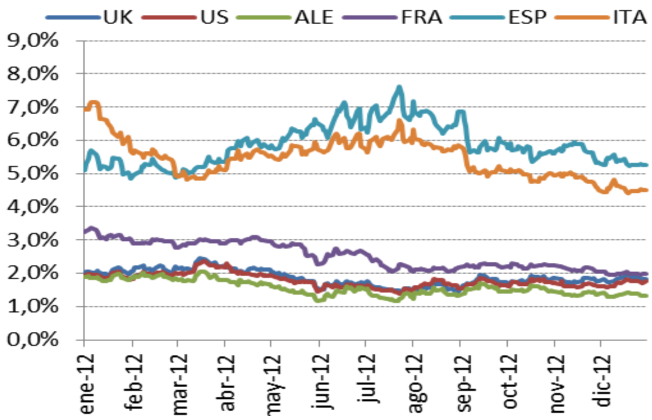
3.1 International Markets

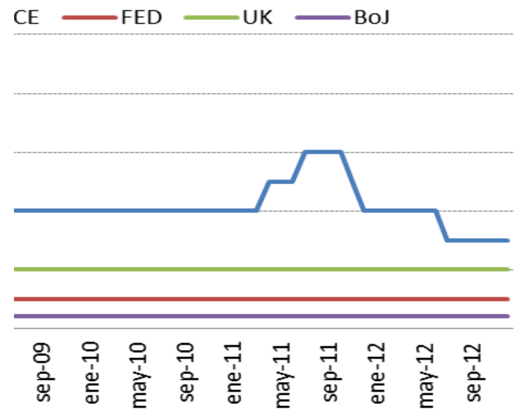
International markets were influenced by the tax policy development and the intended economic boost of central banks of the core countries through monetary policies. Adjustment and stabilization continued in Europe through fiscal austerity plans in periphery countries that did not help the economic recovery but rather promoted a strong civil unrest. US in turn retook the investors' doubts regarding the tax sustainability and had to face the so-called "fiscal cliff" late in the year, placing the debt ceiling increase debate on hold. The evolution of the Eurozone crisis and first world fiscal policy promoted the preference for safe haven assets and took the sovereign bond interest rates to historically low levels, except in some Eurozone periphery countries that had to face the increase in their underwriting rates to record levels (Chart 25).

Central banks recovered their major influence on markets' behavior by playing a determinant role through their accommodating monetary policy and non-conventional measures adopted (such as quantitative easing, liquidity injections, increase of balance by purchasing securities in the primary and secondary markets, etc.). The Federal Reserve supports the US economy recovery by its quantitative easing (QE3-4) and the near-zero rates through mid-2015, showing thereby the FR's discourse orientation of its near-future actions. The European Central Bank (ECB) not only cut its intervention interest rate by 25 basis points, but also contributed to appease the markets in the second semester through its program of bond purchase in the secondary market and its commitment to do whatever was required to preserve the euro. Likewise, the Bank of England and Bank of Japan used aggressive quantitative easing policy and increased their balance significantly (Chart 26).

Chart 25. 10-year Sovereign Bonds
Source: Bloomberg

Chart 26. Monetary Policy
Source: Bloomberg





A decisive monetary policy was material to the risk premium reduction in European countries (Chart 27) and to the stock market index recovery, which were unequal by regions but in any case performed better with respect to the previous year taking indexes to positive yields (Chart 28).

Chart 27. 5-year CDS USD
Source: Bloomberg

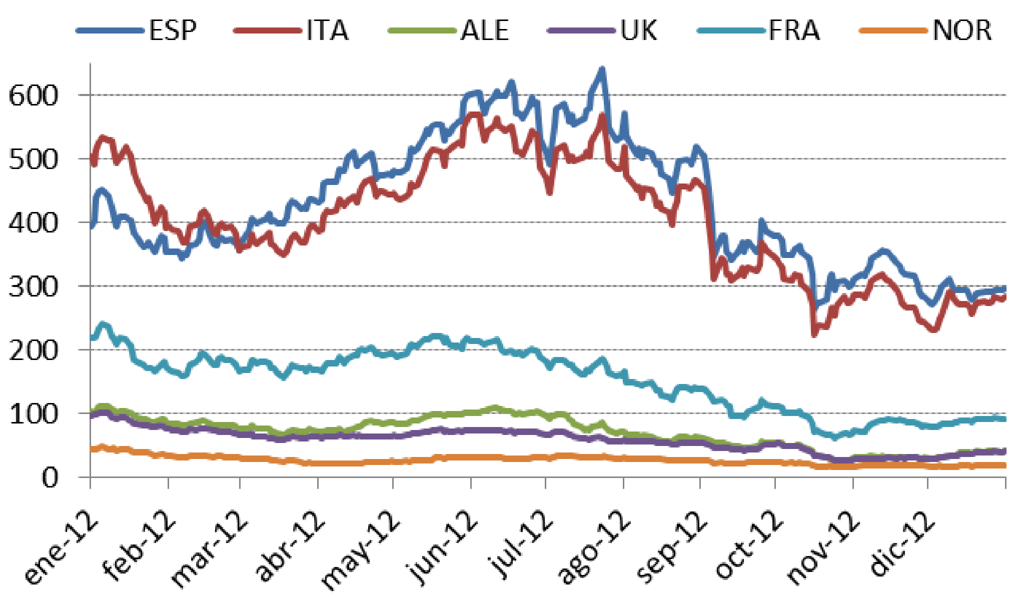
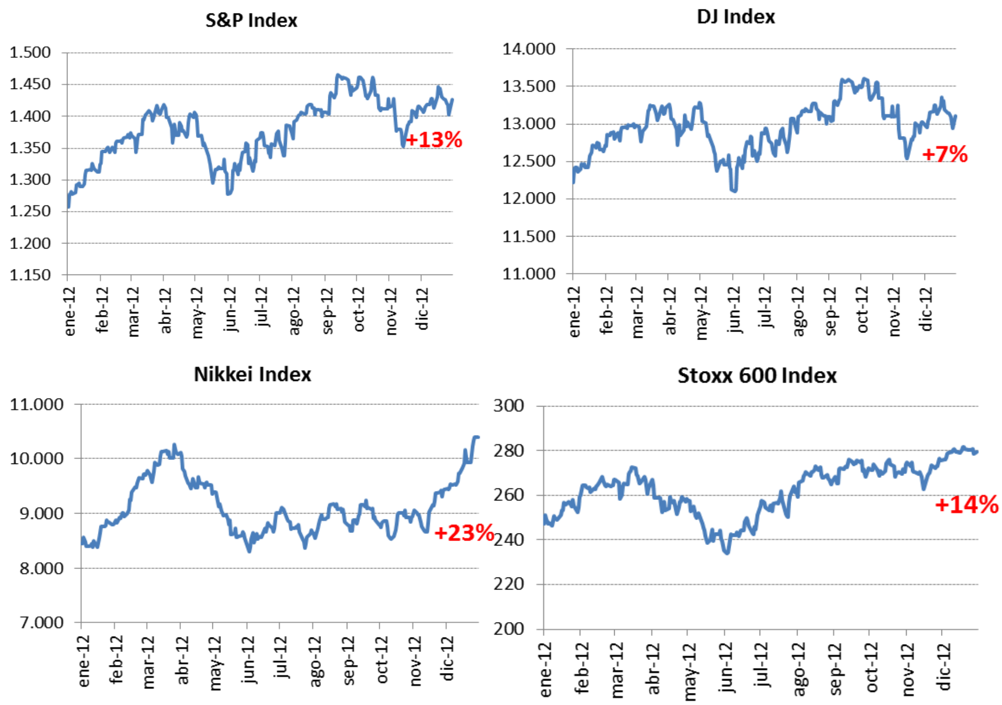


Chart 28. Stock market Indices
Source: Bloomberg



Latin America has not been unrelated to the international markets behavior. Risk premium in Latin American countries evidenced volatility similar to the rest of the world (Chart 29) and the frail economy spread from First World countries was felt harder in its economies. The economic growth was quite different by countries: Chile and Peru kept a good outlook throughout the year; Colombia lost dynamism in the second semester thus forcing the central bank (Banco de la República) to change its monetary policy approach; Mexico improved its outlooks as the US economy recovered; Brazil tolerated the economic deceleration to a greater degree due to a decrease in the demand for commodities, thus forcing the central bank to reduce its intervention rate by 325 basis points and the government to design economy boosting policies (Chart 30).

Chart 28. 5-year CDS USD
Source: Bloomberg

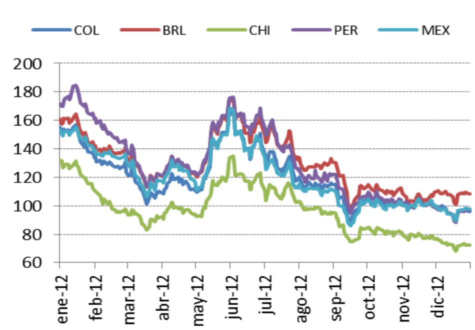
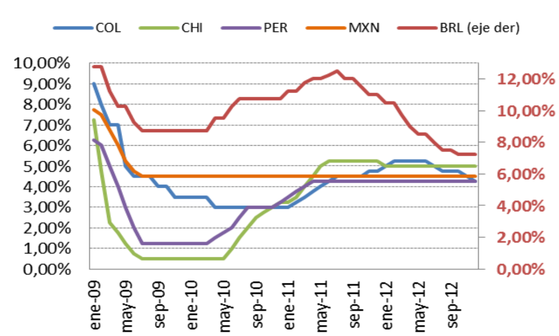


Chart 29. Monetary Policy
Source: Bloomberg

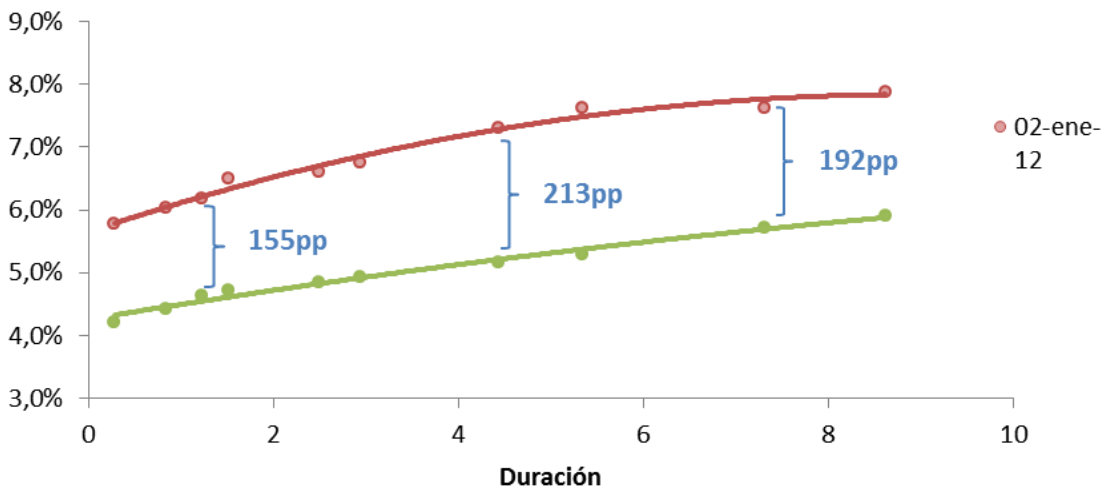


3.2 Domestic Market

3.2.1 Fixed Income

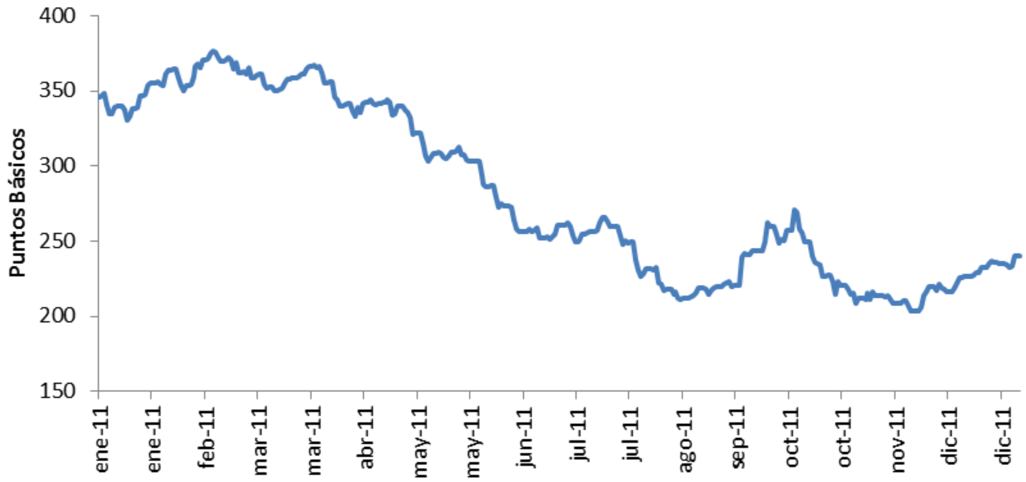
Inflation in 2011 fell within the target range (2%-4%) closing the year in 2.44%, below the index expected by analysts, the lowest since 2009 and 1.29 percentage points below the December 2011 inflation (3.73%). This datum gave the central bank room to pursue its expansionary monetary policy that restarted in July 2012 as a result of the economy deceleration evidenced by data below the expected indicators of industrial production, retail sales, exports, and general behavior in most sectors. The repo rate closed the year with a 75-percentage points reduction down to 4.25%.

Chart 31. TES Yield Curve
Sources: BVC (Colombian Stock Exchange) and TC computations



The reduction in the central bank reference rate and the favorable behavior of inflation boosted important increases in price in both public and private debt fixed-income instruments throughout the year. Despite the expansionary monetary policy of the second semester, the yields curve for Fixed-Rate TES bonds continued flattening also caused by the good fiscal performance resulting of the tax collection that surpassed the initial target (COP 93.8) and could make the public sector consolidated deficit smaller than the initial estimate (-1.2%). The difference between the short and long sections of the curve (TES Jul-24 v. TES Abr-13) which early 2012 was around 185 basis points, was 149 in December with a lowest point of 98 basis points in November (Charts 31 and 32).-

Chart 32 Short and Long-Term Rate Difference
Sources: BVC (Colombian Stock Exchange) and TC computations



3.2.2 Variable Income

The local stock market indexes evidenced a volatile behavior along 2012 and in general terms, stock prices did not reflect the good results showed by Colombian companies as a result of the international markets turmoil. Nevertheless, foreign investors evidenced a strong demand as the larger stock buyers throughout the year (COP 3.4 trillion) followed by the local pension fund administrators (AFP) (COP 1.4 trillion). To the first trimester appreciation in value followed months of volatility that reflected the uncertainty arising from the Eurozone crisis and weak global economic growth and from local events such as the intervention to and further liquidation of the stock broker firm Interbolsa S.A. Recovery started in the last month of the year and the Colcap index behavior sufficed to close the year above the first trimester level (Chart 33).

Chart 33. Stock Indices
Source: BVC (Colombian Stock Exchange) and Bolsa y Renta

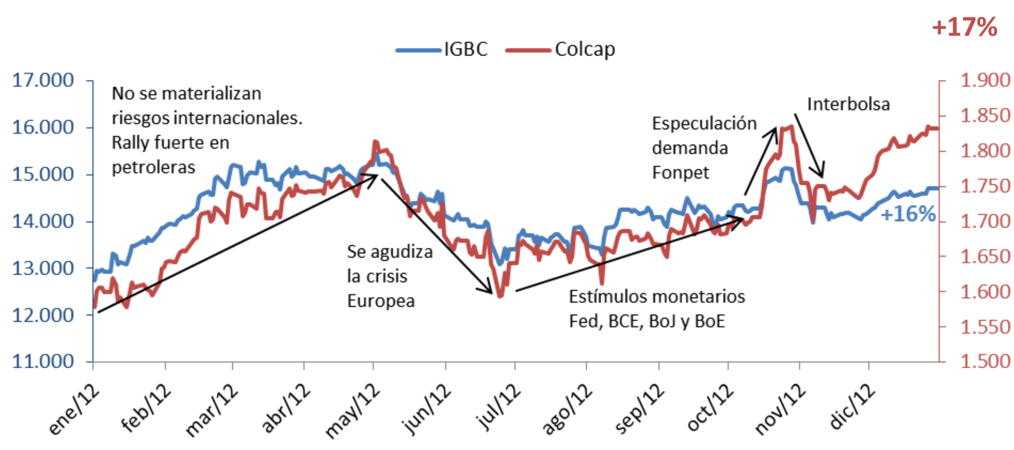


Chart 34. Peso/US Dollar
Source: Banco de la Republica

US Dollar

The foreign exchange rate suffered a strong appreciation in value that worsened during the last months of the year and took the Colombian peso to close with a 9% revaluation as against the previous year closing. The strong appreciation in value during the first four months reversed in face of the worsened European crisis and a more aggressive position of the Banco de la Republica in defense of the exchange rate by announcing additional dollar purchase and by reducing the intervention interest rate in the second semester. Notwithstanding, in face of the abundant global liquidity produced by the central banks' quantitative easing and the no materialization of international risks, the Colombian peso closed the year under a strong revaluation pressure like the other regional currencies (Chart 34).

3.2.3 Variable Income

Fixed income investment instruments' issues to the market in 2012 were COP 10.2 trillion, i.e. 15% over those of 2011 (COP 8.8 trillion). Titularizadora auctioned a total COP 898 billion representing 9.7% of the total underwriting. The total amount issued in securities was COP 1.17 trillion (Charts 34 and 35).

Chart 34. Evolution of TC share in Fixed-Income Issues
Source: BVC (Colombian Stock Exchange) and TC computations

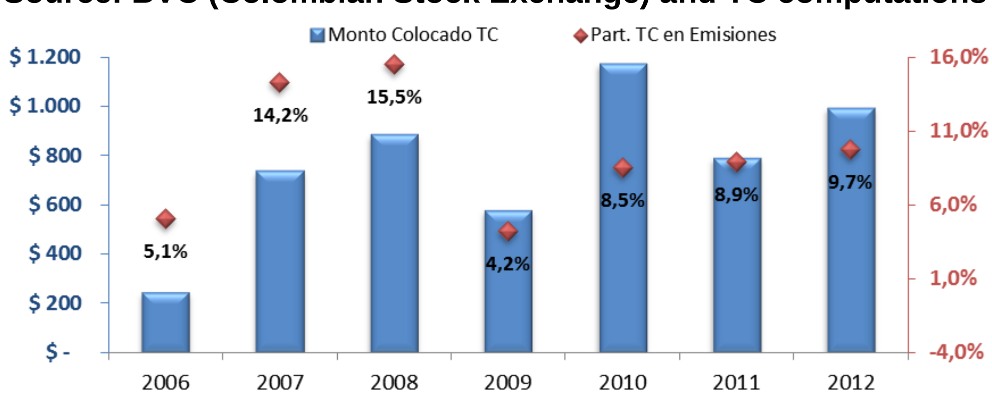
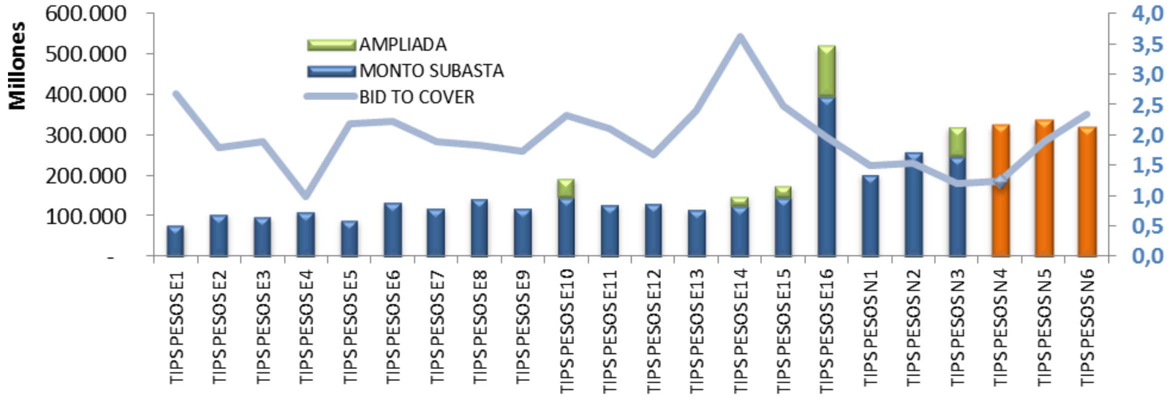
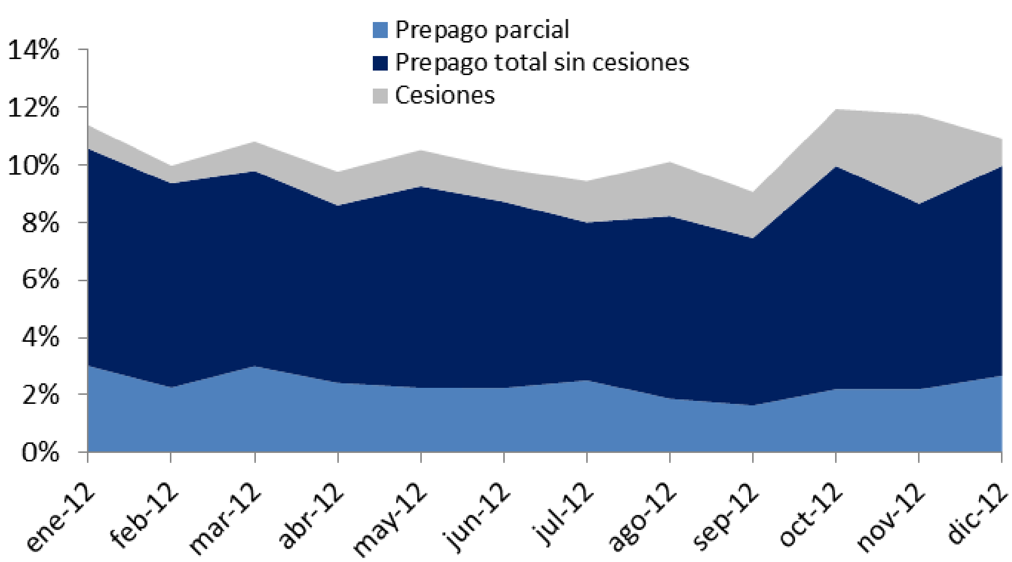


Chart 35. TIPS-Pesos Issues and Auctions
Source: BVC and TC



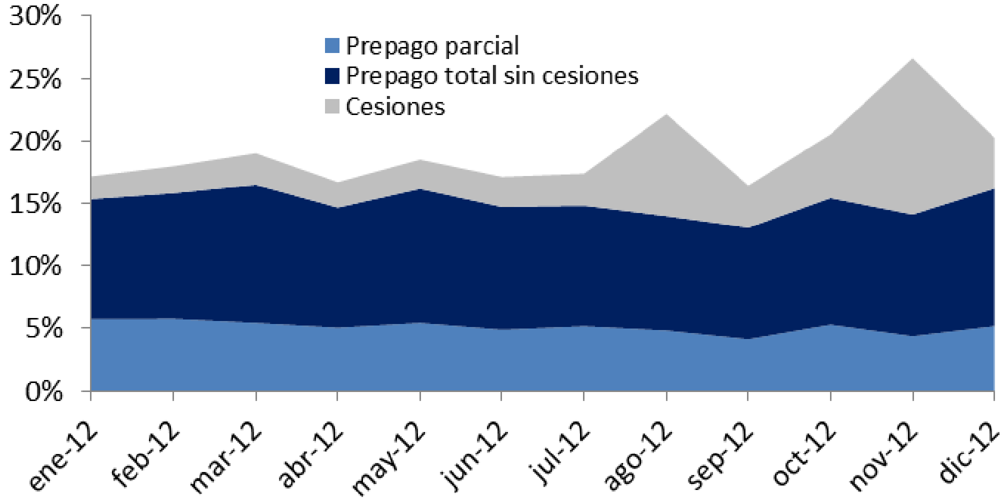
The variables with the highest relevance to the mortgage-backed securities issues' performance (prepayment index and delinquency index) showed a relatively stable behavior along the year although in the last months the prepayment index of both Pesos and UVR securities had a rebound. The average prepayment index for UVR issues was 10.5% and for Pesos issues was 19.15% in 2012 (Charts 36 and 37).

Chart 36. Prepayment Index –UVR
Source: TC



Prepayment simple average -UVR issues-

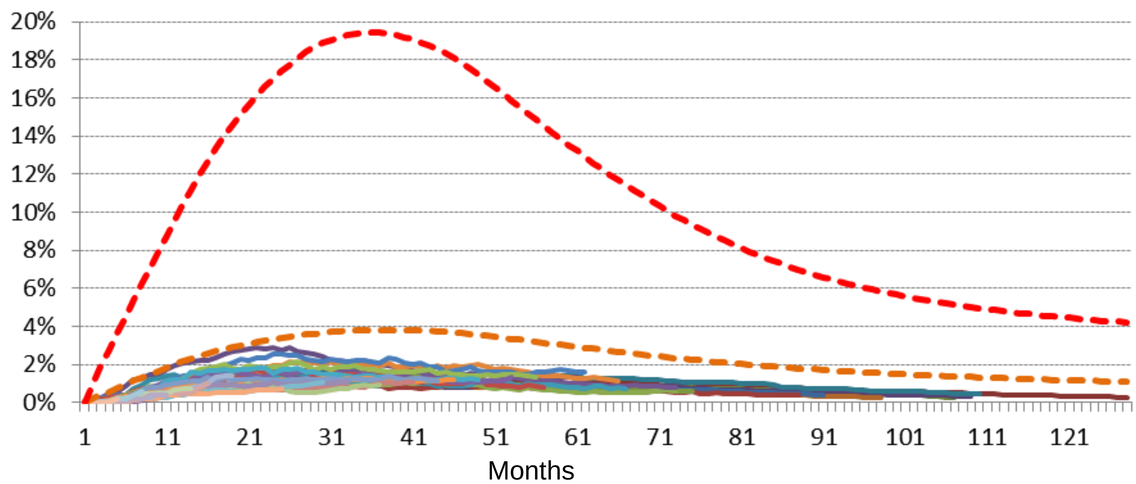
Chart 37. Prepayment Index –Pesos
Source: TC



Prepayment simple average -Pesos issues-

As to the credit risk, the issues' mortgage loan pool analysis evidences that the current levels are quite far from the stress scenarios levels of same pools. For this reason, all (UVR and Pesos) TIPS issues have retained the highest credit rating AAA for their senior (class A) securities (Chart 38).

Chart 38. >120-day delinquency indicator with recovery on balance as of the issue date —Source: TC

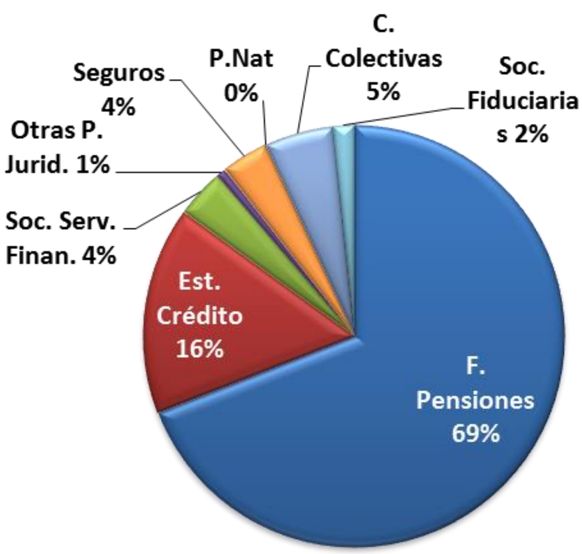


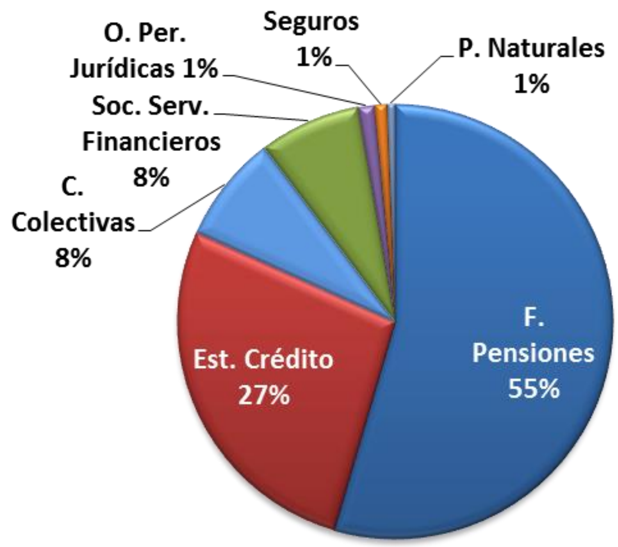
Note: this chart shows the >120-day delinquency indicator on the issue balance. Dotted lines correspond to the 97.5% percentile of the TIPS Pesos-A-E-9 issue and to the maximum stress of TIPS A in same issue.

4. Issues

Titularizadora Colombiana placed three issues of mortgage backed securities in Pesos during 2012: TIPS Pesos N-4, TIPS Pesos N-5 and TIPS Pesos N-6 in February, May, and August, respectively, for a total of 38 issues for COP 16.07 trillion with a COP 5.62 trillion balance as of December 31, 2012. Allocations by sectors did not vary substantially and pension funds had the greater participation. In like manner, a greater participation of credit institutions, collective portfolios, and finance service companies was important with respect to the previous year allocations (Chart 39).

Chart 39. Allocation Distribution 2011-2012
Source: TC





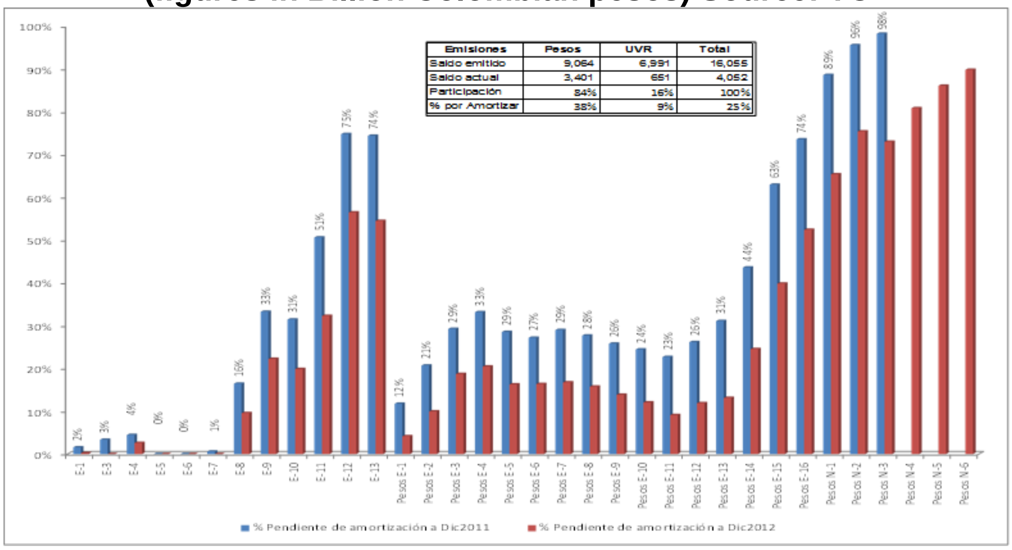
5. Assets Behavior

5.1 TIPS Issues Performance

Ending 2012 the company reached a COP 16.6 trillion total in issues of Class A Mortgage-Backed Securities, out of which 56% was denominated in pesos and 44% in UVR currency. As of December 31st, the balance of these outstanding Class A TIPS amounts to COP 4.05 trillion with total amortizations of 75% of the principal issued (Chart 40).

In July, an early liquidation event occurred and was formalized for the TIPS E-3 and TIPS E-6 issues backed by UVR mortgage loans, as provided in the respective prospectus and rules of issue. The criteria determined for each issue were met in July 19 and 21 respectively, the liquidation of those issues was carried out, and their cancellation with the Colombian Registry of Securities and Intermediaries started.

Chart 40. Class A TIPS Balance and Outstanding Percentage (figures in Billion Colombian pesos) Source: TC



5.1.1 Securitized Portfolio

Mortgage loan balance of Titularizadora Colombiana's TIPS issues closed in COP 5.68 trillion ending December 2012 for 143,378 mortgage loans. The non VIS mortgage loans value share corresponds to 87.9%. The composition of issues by mortgage loan type is as follows:

Table 3. Portfolio Composition by Asset Type
Source: TC
Principal Balance as of December 31, 2012 (COP Million)

Issue	VIS Mortgage Loans	Share	NO VIS Mortgage Loans	Share	Total
E-1	2,631	36.6%	4,562	63.4%	7,193
E-4	10,368	71.0%	4,243	29.0%	14,611
E-5	15,361	69.6%	6,721	30.4%	22,082
E-7	3,064	15.3%	16,934	84.7%	19,998
E-8	48,960	29.7%	115,893	70.3%	164,853
E-9	57,338	47.3%	63,868	52.7%	121,207
E-10	24,646	31.8%	52,972	68.2%	77,618
E-11	42,798	47.3%	47,632	52.7%	90,431
E-12	175,877	70.4%	73,932	29.6%	249,809
E-13	109,357	46.4%	126,291	53.6%	235,647
PESOS E-1	-	0.0%	37,372	100.0%	37,372
PESOS E-2	-	0.0%	67,859	100.0%	67,859
PESOS E-3	-	0.0%	85,005	100.0%	85,005

Issue	VIS Mortgage Loans	Share	NO VIS Mortgage Loans	Share	Total
PESOS E-4	-	0.0%	104,017	100.0%	104,017
PESOS E-5	45	0.0%	77,580	99.9%	77,625
PESOS E-6	-	0.0%	53,261	100.0%	53,261
PESOS E-7	-	0.0%	94,908	100.0%	94,908
PESOS E-8	-	0.0%	98,789	100.0%	98,789
PESOS E-9	-	0.0%	94,203	100.0%	94,203
PESOS E-10	-	0.0%	120,627	100.0%	120,627
PESOS E-11	48	0.0%	98,597	100.0%	98,645
PESOS E-12	879	0.0%	90,273	99.0%	91,152
PESOS E-13	705	0.0%	62,415	98.9%	63,120
PESOS E-14	-	0.0%	186,440	100.0%	186,440
PESOS E-15	-	0.0%	311,961	100.0%	311,961
PESOS E-16	195,945	0.0%	1,235,451	86.3%	1,431,396
PESOS N-2	-	0.0%	235,438	100.0%	235,438
PESOS N-1	-	0.0%	165,643	100.0%	165,643
PESOS N-3	-	0.0%	281,209	100.0%	281,209
PESOS N-4	-	0.0%	311,917	100.0%	311,917
PESOS N-5	-	0.0%	334,979	100.0%	334,979
PESOS N-6	-	0.0%	334,283	100.0%	334,283
Total	688,023	12.1%	4,995,277	87.9%	5,683,300

The mortgage loans securitized until 2012 evidenced good performance as to collection, thus allowing to honor the scheduled principal and interest payments of each issue as set out in the respective issue prospectuses.

The securitized portfolio includes FRECH mortgage loans, where FRECH (Fund of reserve and stabilization of mortgage loans) is a benefit offered by the National Government to cover a percentage of the remuneratory interest rate agreed for the mortgage loans. For 2012, FRECH mortgage loans kept 15% share, quite similar to 2011.

In the risk profile identification for securitized mortgage loans, the loan to value ratio LTV allows to identify the potential creditor margin in case of an eventual deterioration of the real estate price or a default situation. This margin remains in very favorable levels as shown below in the LTV table. Year end, 78.28% of the portfolio has a less than 50% LTV, 21.47% keeps a 50%-70% LTV and only 0.26% keeps a 70%-80% LTV.

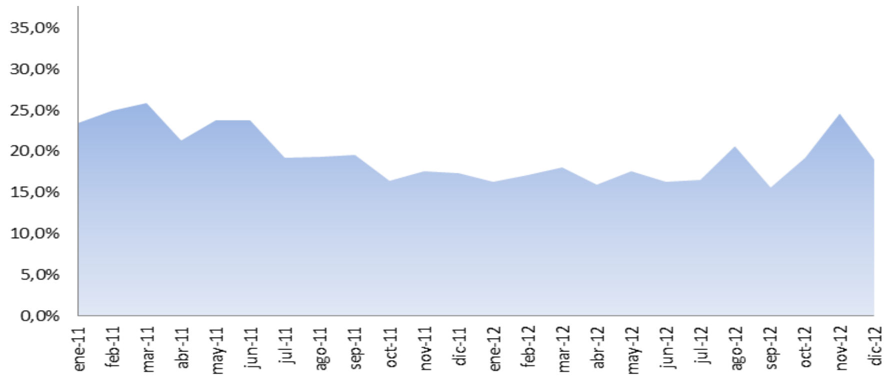
Table 4. Portfolio Balance by LTV
Source: TC

LTV Range	Balance	%
70%-80%	14,497	0.26%
50%-70%	1,220,193	21.47%
0-50%	4,448,610	78.28%
TOTAL PORTFOLIO	5,683,300	100.00%

5.1.2 Mortgage Loan Payments

Mortgage loans grant the borrower the opportunity to prepay the mortgage loan in full or in part without penalty. A reason for a borrower to prepay a mortgage loan in full concerns the strong competition in the financial sector which offers very attractive interest rates to its clients and therefore mortgage loans are transferred between financial entities, which is known as mortgage loan assignment under the Housing Law, which entails the prepayment of securitized mortgage loans.

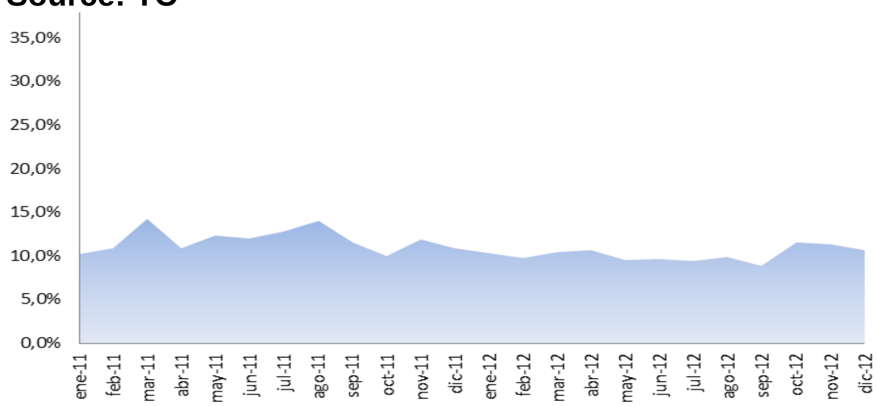
Chart 41. Annualized prepayment index for PESOS Issues
Source: TC



Prepayment index for 2012 reached 18.1% for pesos mortgage loans, less than the index for 2011 that was 21.1% (Chart 41).

As to the mortgage loans denominated in UVRs, the simple average of annualized prepayment was 10.3% remaining stable with respect to 2011 figures (Chart 42).

Chart 42. Annualized prepayment index for UVR Issues
Source: TC



5.1.3 Mortgage Loan Payments

Good payment habits of the borrowers of securitized mortgage loans in 2012 year to date, kept delinquency within the expected levels as reflected in the good levels of non-performing index in the different issues. In like manner, the excellent mortgage loan performance in face of the delinquency levels of the projected maximum deterioration scenarios allowed the TIPS to hold the highest credit rating.

The following charts reflect the >120-day delinquency level and the REO (assets received as payment) levels in the different issues, as against the projected maximum deterioration scenarios for each month of the effective term of both UVR and Pesos issues, where the excellent performance of securitized mortgage loans stands out.

Chart 43. Maximum Delinquency Scenario–PESOS Issues
Source: TC

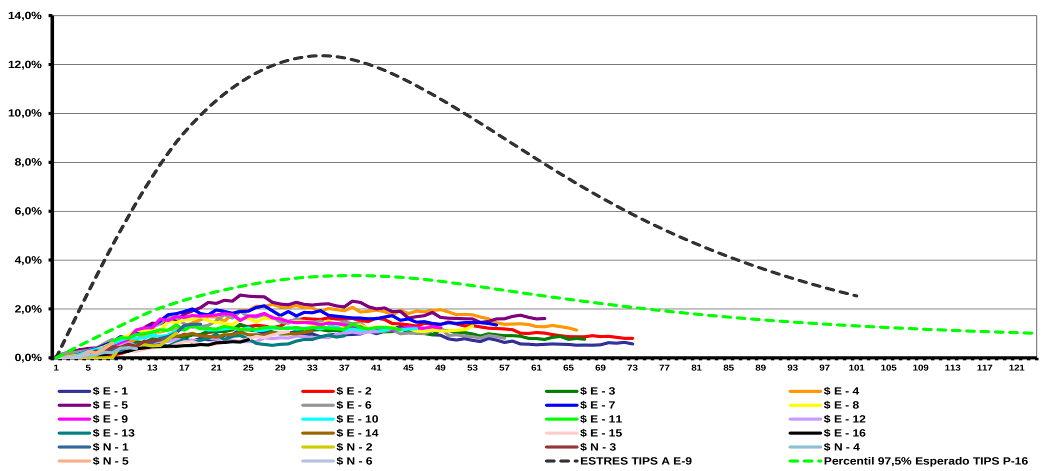
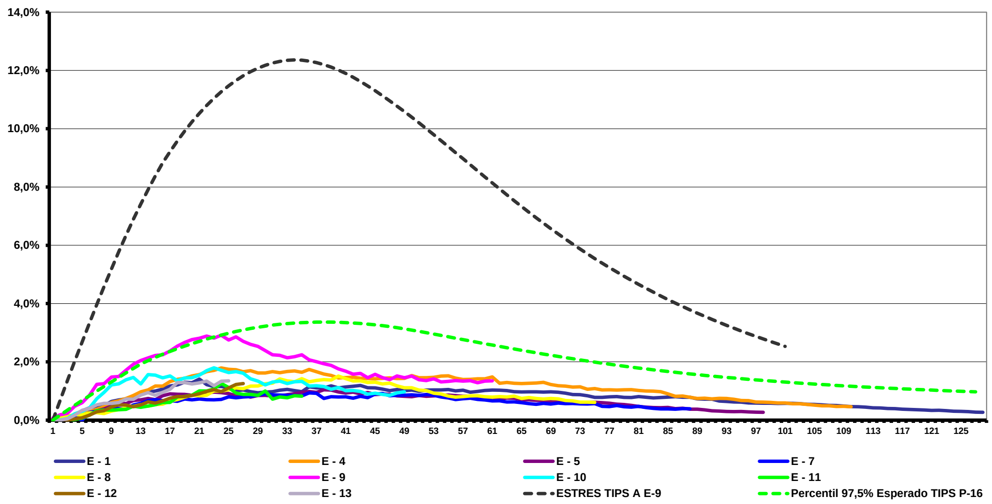


Chart 44. Maximum Delinquency Scenario–UVR Issues
Source: TC



5.2 Assets Received as Payment (REO)

Assets received as payment (REO: Real estate owned) result either when a borrower requests to repay a mortgage loan in full or in part (deed in lieu) or by award of an executory proceedings (foreclosure sales).

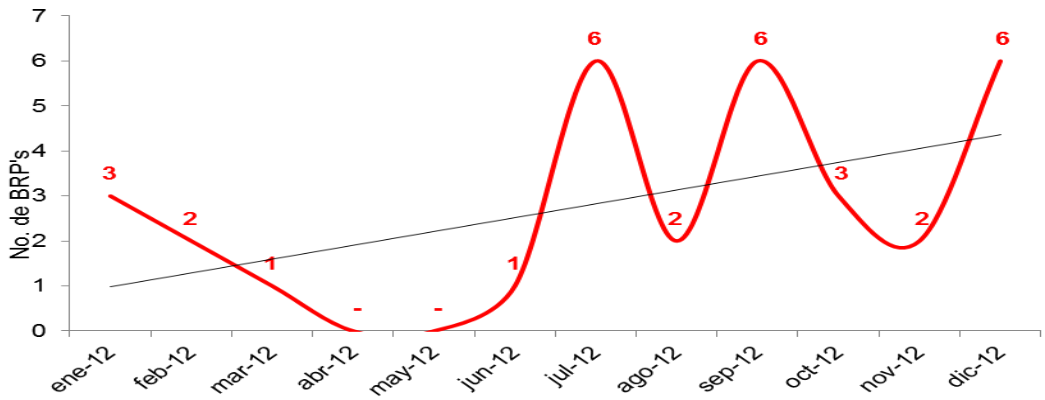
At 2012 closing Titularizadora's inventory is forty-three (43) real properties with a market value of COP 4,869 million, distributed by Issue as follows:

Table 4. REO by Issue
Source: TC

ISSUE	REO Qty	Real Property Market Value
E-1	4	170
E-4	3	122
E-7	4	306
E-8	2	189
E-9	5	402
E-10	1	95
E-12	1	438
PESOS E-2	1	229
PESOS E-3	3	444
PESOS E-4	2	221
PESOS E-6	1	50
PESOS E-7	6	966
PESOS E-9	4	440
PESOS E-10	1	194
PESOS E-11	1	65
PESOS E-12	3	443
PESOS E-16	1	87
TOTAL	**43**	**4,869**

Sales of these real properties showed good performance with the sale of 31 properties, as shown in the chart below:

Chart 45. REO Sales Performance
Source: TC



Real estate inventory by mortgage loan servicer shows the following composition:

Table 6. REO Inventory
Source: TC

SERVICER	QTY	MARKET VALUE
BANCOLOMBIA	21	3,108
BBVA	1	53
BCS	6	515
COLPATRIA	3	107
DAVIVIENDA	12	1,087
Total	**43**	**4,869**

5.3 Securitized Mortgage Loan Servicers

Below is the mortgage loan distribution per Servicer for TIPS and TECH issues as of December 2012:

Table 7. Mortgage Loan by Servicer
Source: TC

Entidad	Emisiones Tips			Emisiones Tech			Total		
	Cantidad	Saldo($MM)	%	Cantidad	Saldo($MM)	%	Cantidad	Saldo($MM)	%
BANCOLOMBIA	61.779	2.411.512	42%	1.491	57.579	100%	63.270	2.469.091	43%
BANCO DAVIVIENDA S.A	47.100	2.039.647	36%				47.100	2.039.647	36%
BBVA COLOMBIA	5.041	269.108	5%			0%	5.041	269.108	5%
BANCO BCSC	20.443	601.140	11%				20.443	601.140	10%
BANCO COLPATRIA S.A.	4.225	190.116	3%			0%	4.225	190.116	3%
BANCO AV VILLAS S.A.	3.721	106.608	2%			0%	3.721	106.608	2%
BANCO CORPBANCA COLOMBIA S.A	1.069	65.169	1%			0%	1.069	65.169	1%
Total	143.378	5.683.300	100%	1.491	57.579	100%	144.869	5.740.879	100%

During 2012, the activities of the servicers held good levels with respect to the results of the indicators defined for mortgage loan portfolio servicing processes and recertification processes.

5.4 Master Servicing Internal Processes

This past year the company kept its purpose of improving and integrating applications, thereby it improved security, management, control and production of reports of the underlying assets and structured liabilities. In this context, several alternatives are under study for the purpose of enhancing the basic application for our business (HITOS) for the servicing of new securitization products.

In terms of operational efficiency, the company made progress in documentation and tuning of the operational business model by updating procedures, manuals, and control activities.

In terms of operational efficiency, the company continued improving the operational business model procedures by updating procedures, manuals, and control activities during the year. This activity reflected in the award of ISO 9001:2008 Recertification for the "Issue Master Servicing" processes, an activity oriented to controlling the mitigation of credit and operating risks in the underlying assets, managing cash flow of the *universalidades* and divulging information to investors about issues status in a timely and reliable manner, among other activities.

This rating was achieved for the implementation of the continued improvement required by the Quality Management System that helps permanently keep in control the fulfillment measurement of improvement plans identified in each of the procedures that comprise it. The system remains focused on the development of processes in pursue of the excellence.

5.5 Support to Mortgage Sector

In 2012 Titularizadora Colombiana kept the strategy to create add value for the mortgage sector in topics related to process standardization and best practice identification in the following topics:

The company finished the project that defines the standards for insurance industry and action protocol in the case of catastrophic losses, assisted by insurance companies, servicing banks, banks association (Asobancaria) and insurers association (Fasecolda).

Legal Processes: The company jointly with the servicers analyzed the implications of the Law on insolvency for securitized mortgage loans and identified good practices.

Administrative Collection Process: The company held workshops about the Negotiation model in the operation and the alignment of that model to the strategy for management and operative groups of the Servicers. Workshops were held on monitoring of the macroeconomic variables, a determinant factor of the mortgage loan portfolio performance.

Custody processes: Regarding the custody processes and the archive and preservation conditions, this year the company conducted a technical and specialized audit on the sites where securitized mortgage loans are kept in custody, evaluating structural aspects, environmental conditions, shelf distribution, and disaster prevention equipment. Amongst others, the audit qualified the temperature, humidity, and lighting specific standards and obtained appropriate results that favor the general-industry best practices in these processes.

Financial training: In 2012, Titularizadora Colombiana started a new initiative in support of Asobancaria's project "Education of home owners and debtors." After successfully completing the phase of digital tool divulgation, TC began a campaign to present the program in construction companies since they are the principal marketing channel for housing and the preliminary approaches to these companies will help structure the strategy for the major cities. The website—main education channel— had 197,395 visits during 2012.

5.6 Divulgation and Marketing

Titularizadora's plan of communication to the market and general public was based on two guiding principles. First, positioning the mortgage securitization as an essential tool for housing sector development in Colombia through specialized events' sponsorship and participation. Second, addressing the investor seeks to position TIPS mortgage-backed securities as an alternative source of portfolio diversification safely and with profit, which has been divulged in countrywide circulation media and specialized congresses.

6. Management and Human Resources

The outcomes obtained are the result of the work performed by our 60 highly qualified employees. During 2012 under our human resource strengthening strategy, we carried on technical training, skill strengthening and formal refresh at top class universities and in all the organization levels.

Up to December 31, 2012, appropriate insurance coverage was maintained. Prudent standards relating to industry practices in similar companies were followed with respect to protection of assets, premises, and technology infrastructure; liability of directors and officers; and loss of securities due to dishonest or fraudulent acts by employees.

7. Legal and Regulatory Issues

Regulatory Developments

During 2012, the regulatory developments that affect securitization bore great relevance in the company operation. The first semester of 2012 continued the processing of Bill 178/2011 (whereby financial consumers are allowed to prepay loan operations and other provisions are issued) at the Congress of the Republic. The congress finally passed this legislative initiative enacted as Law 1555 of July 9, 2012. The importance of this law lies in the particular way its article 3 defined a special regime of guarantees for the execution of mortgage backed securitization processes. This topic of the essence to the mortgage-backed securitization in Colombia aims at allowing the mortgage loans' originator to automatically hold the preemptive right to the mortgage (on the assigned mortgage guarantee) subsequent to the mortgage on that guarantee at the time that both the mortgage loan and the mortgage guarantee were assigned for securitization, without affecting in any case Titularizadora's preemptive right in and to the mortgage loan guarantees involved in securitizations. Thereby, this law allows originators to maintain the coverage on other debts—different from said mortgage loans—owed by borrowers of the securitized mortgage loans, and it guarantees that borrowers will not be affected by the securitization in case they require further credit backed by the securitized mortgage guarantee. The National Government in furtherance of its regulatory powers conferred by Law 1555/2012 is working on the implementation decree for the procedure to apply the subsequent mortgage guarantee in mortgage-backed securitization, which is expected to be enacted in the first semester of 2013.

Another initiative of the essence to the mortgage sector processed in the first semester of 2012 was the Law of Housing (Law 1537/2012). This law amended Law 546/1999 §24 whereby the procedure for long-term mortgage loan assignment is regulated, in the case that as per the will of the loan borrower, such loan is assigned to other financial entity that becomes the creditor. In terms of the applicable regulations, the mortgage loan assignment is executed by endorsing the promissory note and delivering the mortgage guarantee/security that covers said loan. The power conferred to borrowers to assign their mortgage loans to other financial entities without limitation resulted in a competition among financial institutions to acquire mortgage loans originated by other entities by offering lower interest rates, and thereby caused massive loan assignments at present. This scenario allowed to identify the need to specify certain aspects of Law 546/199 §24, which may give rise to a discussion in lack of a regulation about the legal proceeding applicable to its implementation. In particular, this law provides that the loan disbursed by the new creditor to pay for the loan assignment is covered by the collateral guarantee of the loan assigned, thereby preventing any potential discussion on the actual existence of the mortgage security if the payment of the assigned obligation is made prior to the formalization of the mortgage loan assignment (by promissory note and security endorsement and delivery). Given the important volume of loans being assigned, this clarification is of the essence to the mortgage loan securitization because of the required mitigation of any eventual discussion during these processes about legal risks that might affect the underlying asset enforceability for payment of the mortgage-backed securities purchased by the investors.

Finally, we should comment upon the legislative initiative that regulated the Regime on insolvency of non-merchant individuals contained in Law 1546/2012 (General procedural code). This regulation defines a scheme for the borrower to seek a payment agreement with its creditors for its outstanding obligations. The impact of this law in mortgage-backed securitization is explained because this process entails the termination of any executory mortgage collection proceedings, thereby tying the payment of the obligation to the borrower's payment agreement with its creditors. In addition, the Regime of insolvency for non-merchant individuals includes an equity liquidation regime in the case of default in the payment agreement set out in the course of an insolvency process. With the purpose of specifying the scope of this liquidation regime with respect to the mortgage obligations covered by guarantees tied to family equity or with effect on family home, Decree 2677 of December 21, 2012 implemented the Regime of insolvency for non-merchant individuals by providing—for the Equity liquidation regime in particular—that mortgage loans with effect on family home/equity be subject to a special procedure within the liquidation process in such a way that the mortgage guarantees/collaterals that back the mortgage loans granted for homeownership financing are left out of the liquidation estate of a non-merchant individual. Doubtlessly, this specification settles any concerns on the impact of the individual liquidation regime in mortgage-backed securitizations and mortgage loans in general, making it clear that in these proceedings the preemptive collateral is not included in the borrower's liquidation estate, thus allowing to directly obtain the collateral by way of a direct award for mortgage loan payment.

Legal Issues

Legal Contingencies

On October 23, 2012, National Tax and Customs Administration (DIAN) terminated the government process resulting from its Official Revision Assessment No. 312412011000035 of September 23, 2011. DIAN resolved against the recourse of request for reconsideration submitted by Titularizadora, and thereby confirmed the official revision assessment of the income tax for year 2009. The administrative decision submits an increase in the income tax greater than the tax initially paid for COP 719,288,000 and a penalty for inaccuracy for COP 1,150,861,000. The corresponding contingency is fully provisioned in the financial statements ending December 31, 2012 for COP 1,870,149,000. Titularizadora will bring an action for annulment and restoration before the Cundinamarca Contentious-Administrative Court within the four-month term provided for that purpose, i.e. by February 23, 2013.

Compliance with specific regulations

On the matter of the corporate governance rules applicable to the company, Titularizadora continued complying with the provisions of External Circulars 028 and 056 of 2007 and 007/2011 issued by the *Superintendencia Financiera*

(Finance Superintendent's Office), which govern the Colombian Code of best corporate practices (*Codigo Pais*) (which elaborates on best practice disclosure under the principle of "fulfill or explain"). With regard to the Investors Committee, we point out that meetings were held as per schedule during 2012. Thereby, the Committee was ratified as a privileged instance for properly and timely informing the investors of the company situation and the development, performance, and perspectives of its securitization processes.

8. Other

8.1 Management Report of Asset Laundering and Terrorism Financing Prevention and Control (SARLAFT) Activities

8.1.1 Activities and Compliance with Regulation

In compliance with the provisions of Chapter 11, Title I of the Basic Legal Circular (External Circular 007/1996) of the *Superintendencia Financiera* (Finance Superintendent's Office) and according to the work plan outlined for SARLAFT implementation, the Titularizadora carried out the following activities in 2012:

Periodic reviews of the proper operation of SARLAFT phases and elements, and monitoring of the company risk level based on the self-assessment of processes that have an impact in respect of the risk of asset laundering and terrorism financing.

Validation of procedures and mechanisms implemented for gathering effective, efficient, and timely knowledge of all existing and potential customers and particularly the third-party engagement process as per SARLAFT policies and procedures.

Training program that targeted all the company officers and addressed the basic concepts of laundering risk, the applicable regulations and SARLAFT elements, and by means of tests this training revealed to which level each officer has adopted the notion of accountability to SARLAFT management and operation.

Submission of trimester reports to the Board of Directors and company Management about the behavior of the risk profile and the effectiveness of the internal control mechanisms and tools.

Strengthening of mechanisms and tools set for SARLAFT, which have prevented that the company be used for asset laundering and/or terrorism financing and periodically were evaluated by the internal control function and the statutory auditor, thus providing room for improvements that were evaluated and implemented by the Company.

Strengthening of mechanisms and tools set for SARLAFT that have prevented that the company be used for asset laundering and/or terrorism financing, and which periodically were assessed by the internal control function and the statutory auditor, who thus proposed improvements to be evaluated and implemented by the Company.

8.1.2 Policy Continuity

The policies and procedures regarding AL/TF risk are up to date and duly formalized on the SARLAFT manual of procedures and the Code of Conduct, both documents of mandatory compliance by company officers. All the same, internal procedures continue including the policy of not carrying out transactions in cash with its customers.

Moreover, due to the nature of the business, the operations related to primary underwriting of mortgage-backed securities under the securitization processes are carried out only through entities subject to the supervision of the *Superintendencia Financiera* and directly responsible for the prevention and control of asset laundering given their knowledge of their own clients.

In addition, the performance of mortgage loan portfolio servicing by credit institutions supervised by the *Superintendencia Financiera* includes keeping contractual provisions agreed with the servicers for the purpose of managing the prevention and control of asset laundering activities over clients of the securitized loans.

8.1.3 SARLAFT Results

Titularizadora includes in its institutional culture and through periodic training and reviews, the continued strengthening of its asset laundering and terrorism financing risk management system. Likewise, during 2012 the legally mandatory reports were submitted and presented to the Information and Financial Analysis Unit (UIAF). No suspicious operations were evidenced in the company.

8.2 Internal Control System

Titularizadora Colombiana's Internal Control System is designed under the requirements and elements provided by External Circular 038/2009 of the *Superintendencia Financiera* including without limitation, guidelines; responsibilities with respect to its performance, its elements and special areas; and the methodology specified for its appropriate and sustainable performance.

The internal control system includes essential elements such as the application of self-control, self-management, and self-regulation principles and policies which govern the performance of each activity of each process and allow to strengthen the effectiveness and efficiency of the operations, to prevent and mitigate frauds, to optimize risk management and to guarantee the reasonableness of financial data generated by the company.

The company continued performing activities aimed at strengthening the internal control system during 2012. Regarding its components, the following activities stand out:

Control Environment: Holding of training and education programs defined by the company to strengthen knowledge, skills, and conducts required for performing the different jobs. Formalization and divulgation of the fraud and wrongful conduct prevention program approved by the Audit Committee and Board of Directors. Periodic monitoring of the "transparency channel" as an essential element for officers to inform of potential wrongful acts.

Risk Management: Execution of plans and programs in 2012, as determined for each risk management system applicable to the company. Update and divulgation of the policies and procedures that support the company's risk management.

Control Activities: Continuation of review and update of process manuals during 2012 as scheduled. Monitoring of the implementation of key controls. Consideration of relevant improvement opportunities submitted by the statutory auditor, external auditor, and internal control function.

Information and Communication: During 2012, the information systems supported the company's process performance and enabled the data generated and published to comply with the security, quality, and reliability criteria. Execution of data vulnerability and security tests on the company's applications and technological infrastructure.

Monitoring: Directors, process owners, and vice presidents supervised the proper application of existing controls within their daily responsibility for internal control, thus enabling the activity performance assessment, reporting of potential internal control weaknesses, and taking the relevant improvement actions in a timely manner.

The statutory auditor, the external auditor and the internal control function assessed the internal control system effectiveness. In 2012, the internal control function checked the system component performance focusing on topics deemed relevant to the business processes and those support processes that require special attention due to their nature. In that framework, it checked for compliance the obligations arising from the responsibilities for issue structuring and servicing as well as for generation, quality and timely release of information on the company and the securitizations.

Evaluation results were satisfactory and no material or significant weakness was identified which could affect the company's Internal Control System application. Those results reflected the appropriateness of the control environment; the risk identification, measurement, and management process performance; the effectiveness and degree of execution of control measures; the policies and procedures defined and applied for data generation and supply; the documentation and formalization of communication channels; and the monitoring and periodic assessment by VPs and executives on their own process performance.

The Audit Committee examined and assessed the internal control related comments that the statutory auditor, the external auditor and the internal auditor submitted, and company Management considered and implemented them within the terms agreed upon in the respective action plans.

According to the foregoing, we may assert that the company has an adequate internal control system and a process of financial reporting that complies with the applicable laws and regulations.

The Audit Committee fulfilled its responsibility as to obtaining information of and supervising the company internal control system and then issued its opinion on the important aspects with the aim to strengthen the existing control measures, so that the designed procedures reasonably protect the assets both of the company and of the issues managed, and there are controls which allow the transactions to be checked for appropriate authorization and recording.

8.2.1 Evaluation of Disclosure and Control Systems

The required checks were run on the disclosure and control procedures used during the preparation and divulgation of the company financial statements. These tests evidenced the comprehensiveness, reasonableness, and validity of the accounting data, thus concluding that the financial information and financial statements as of the 2012 closing are in line with the applicable regulations and the company's accounting policy.

According to the results from periodic reviews of the company's control measures in place, the conclusion is that such measures were correctly applied and provide a reasonable assurance that Titularizadora's financial information has been properly recorded, processed, and presented, and the financial statements and other reports disclosed to the public do not contain any defects, inconsistencies, or material errors that might prevent the knowledge about the actual situation of the equity or the operations transacted during 2012.

8.3 Operating Risk Management

Pursuant to the work plan outlined for operational risk management, during 2012 the company performed the activities and procedures necessary for periodically assessing and monitoring current and potential operational risks, identifying and qualifying any associated controls, recording of risk events and timely setting the appropriate corrective and improvement actions that have strengthened the company's business and support processes.

With the Operational Risk Official accompaniment and the commitment of each process leader and each officer, the company implemented the Riskit technological tool for operational risk management, thus enabling the risk management culture consolidation across the organization and the optimization of the risk matrix update, action plan generation and risk event recording.

In 2012, the periodic reviews by the Operational Risk Official and SARO Committee included monitoring and assessment of any risks identified in the processes, verification of the control measures and follow up of the action plans outlined for risk events materialized.

As of the 2012 closing, the risks identified in company's processes are duly qualified and categorized according to the methodology set and the associated control measures allow keeping them in low and middle risk levels.

In 2012, any risk events were duly recorded according to the applicable laws and regulations and the corresponding internal procedures. Likewise, the SARO Committee assessed those risk events and the company took the actions necessary for improving the control measures existing in the company. Any events occurred in 2012 did not result in any losses that affected the company's P/L statement.

Under the activities aimed to strengthen the operational risk management, the company executed the training plan that addressed topics related to the applicable laws and regulations, methodology and procedures set by the company for SARO management and use of the SARO support tool.

Under the Business Continuity Plan, tests were conducted in 2012, which allowed to probe the infrastructure set for contingencies and of the operation execution for business critical processes.
With the purpose of preserving the current standard improvement, the company implemented the work plan produced by the internal audit of the Project and Process Director's office in application of the BS25999 standard.

The statutory auditor and the internal control function gave recommendations that were adequately processed and allowed to strengthen risk analysis, control design, event recording timeliness, and procedure documentation.

8.4 Risk Disclosure

Note 22 to the Financial Statements includes the disclosure of criteria, policies, and procedures used in the evaluation, management, measurement, and control of the risks associated with Titularizadora Colombiana's business.

8.5 Compliance Status of Intellectual Property Laws and Regulations

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

8.6 Information Security

Considering the business context, during 2012 Titularizadora's management of technological infrastructure, information, and IT assets complied with the requirements set in Chapter 12 of Title I of the Basic Legal Circular of the *Superintendencia Financiera* regarding the minimum security and quality requirements for doing business.
Moreover, we highlight the performance of projects for security and quality procedures improvement, mainly the segmentation of users and servers network thereby enhancing the security in the access to servers, and the improvements to the Hitos and Porfin applications that enhanced data encryption and strengthened access.

8.7 Report of Operations with Shareholders and Management

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

8.8 Gratuitous Transfer of Property and Assets Owned Abroad

During this year, no gratuitous transfer of property was effected.

8.9 Assets in Other Countries

As of the 2012 closing, the company does not have any investments or liabilities in foreign currency.

8.10 Investment in Other National or Foreign Companies

As of the 2012 closing, the company does not have any investments in other companies.

8.11 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 the advertisement and PR expenses incurred by Titularizadora Colombiana is set forth in detail as an attachment to the financial statements.

8.12 Status Report of Compliance with Intellectual Property Laws and Regulations

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

8.13 External Circular 052 of 2009

As of December 31, 2012 Titularizadora Colombiana, considering its business context, technological infrastructure, and IT assets, finished the implementation of the requirements and elements set out in External Circular 052/2009 and submitted the corresponding reports to *Superintendencia Financiera* by the established deadlines.

9. Financial Statements as of the 2012 Closing

9.1 Balance Sheet

9.1.1 Assets

Ending December 2012, Titularizadora Colombiana's total assets amounted to COP 172,294 million with a 3% decrease with respect to the 2011 closing. The main variation in assets accounts lies on the 41% reduction in deferred charges and the 33% expenses paid in advance resulting from their amortization. Cash account shows a 25% decrease and real estate appreciations in value show a 14% increase.

9.1.2 Liabilities

As of the fiscal year closing, the level of company's leverage is 16% corresponding to COP 26,856 million including a COP 13,548 million income and complementary tax provision, the liability recognition for wealth tax and provisions for income tax claim.

9.1.3 Shareholders' equity

Shareholders' equity of Titularizadora Colombiana grew by 1% with respect to the preceding year, as a result of the growth of profits generated. The company closed 2012 with a COP 145,438 million worth equity.

9.2 Profit and Loss Statement

Operational income corresponds to 97% of total income and result from structuring, servicing, guarantee, and underwriting fees of the issues placed for COP 48,639 million and from financial income represented in investment yields for COP 13,125. Other income for COP 1,855 corresponds to income from lease and expense provision recovery.

Operational income shows that fees decreased by 18% with respect to 2011 while financial yields grew by 26%.

The company's expenses amounted to COP 33,982 million. The items with the higher variations are financial and personnel expenses. Non operational expenses with the greater reductions correspond to the item of provision for income tax claims.

Net profits were COP 29,651 million in 2011 *[sic]* i.e. COP 4,541 million less than 2011.

9.3 Financial and Operational Indicators

ROE before taxes correspond to 42% as of December 2012. In turn, ROE after taxes [2] diminished from 29.5% in 2011 to 27.8% in December 2012.

Operational efficiency grew from 25.2% in 2011 to 32.7% in 2012. At another level, the operational expenses/servicing fees increased from 46.9% in 2011 to 56.5% in 2012.

9.4 Certification of Financial Statements as of December 31, 2012

Pursuant to Law 964/2005 §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 may prevent the knowledge of the actual position of the equity or operations of the company.

In like manner, pursuant to Decree 2649/1993 §57 and Law 222/1995 §37, any financial statements-related information and representations were verified and obtained from the mandatory accounting records and reports carried under the Colombian generally accepted accounting principles and standards, and the economic events were correctly classified, described, and disclosed.

10. Outlook

10.1 Mortgage Sector 2013

A sharp fall in launches, sales, and construction licenses in 2012 prevents us from being too optimistic about the 2013 outlook for the mortgage sector, as mortgage loan activity is the last link in the home-purchase process chain. Notwithstanding, specific elements of mortgage loan demand/supply may partly contain the adverse impact of the leading indicators.

[2] Not including market price valuation adjustments

The total amount of mortgage loan originations is expected to be COP 9.6 trillion in 2013, a 4% fall back with respect to the COP 10.1 trillion estimated for disbursements in 2012. Even though the mortgage loan flow is contracting, the figures are different by far from those evidenced by launches (-17%) and sales (-24%) in the city of Bogotá that represents 46% of the mortgage market.

There are different reasons for this disparity. In the first place, access to mortgage loan will be strengthened in face of the favorable performance of macroeconomic variables related to household income (employment and wages) as well as the consolidation of the downtrend of mortgage loan interest rates due to the decay in national government debt placement and the incoming of foreign capital flows.

Furthermore, mortgage loan placement competition will be stimulated by the entrance of different bank and non-bank actors that will promote a war of interest rates for a quick capture of the market.

At another level, VIS mortgage loan demand will benefit from the performance of the interest rate subsidy program in its second version. Although part of these resources will reach households that already purchased their homes without the support of this mechanism, the program will be a determining factor in driving the mortgage loan origination from the second semester.

The price growth of new and used housing will also increase households' financing needs. In face of the weakened housing supply, the market will continue witnessing increments due to the strength of the demand. New housing shortage will probably influence the growth in used housing market share. This already happened in 2007 when the mortgage loans disbursed for used housing grew from 45% to 55% of the total.

Moreover, the mortgage loans balance will increase by 10%, from COP 33.9 trillion in December 2012 to COP 37.4 trillion in December 2013. This denotes a slowdown with respect to the three previous years when the average growth was 16%. These estimates are based on a 15% prepayment rate that might vary if the interest rate war escalates. Nevertheless, the effect on the mortgage loan volume would depend only on the volume of new demand resulting from these rate reductions.

10.2 Mortgage Sector in the Long Term

The mortgage sector will show a favorable yet not extraordinary behavior in the next 10 years. This statement is supported by at least three elements: first, the country demographic conditions will strengthen the structural demand for housing; second, the economic growth will allow improving household socioeconomic conditions and third, mortgage interest rates will decay in face of the growth of national savings and external liquidity, thus facilitating the access to mortgage loans.

Between 2013 and 2023, more than 4 million households will be created in Colombia, not only because of the population dynamics (Colombia will have 52 million inhabitants in 2023) but also due to structural changes such as reduction in the average household size from 3.7 to 3.2 people arising from the single-person households increase (12% of the total households in 2012, 18% in 2023).[3].

90% of the 4 million new households will demand for urban homes. Adding the internal displacements arising from the country's urban deepening (urban rate will grow from 77% to 85%) the result will be the need to build more than 4.5 million housing units in the cities. This entails a necessary quantitative leap in the production levels due to the annual shift of 180 thousand to 450 thousand unit constructions.

Besides, the modernization of the Colombian productive structure will support the country's economic growth in the next decade and thus will drive the middle class development in Colombia. Today, just 28% of the households belong in this segment, a number that seems small compared to those of countries such as Chile and Mexico, where the middle class is 55% and 41%, respectively.

Middle class consolidation will result both from the strengthening of macro variables related to household socioeconomic conditions including employment and income, and from the labor/economy formalization process. Higher education levels and the quality of public policy oriented towards narrowing the social divide will influence this phenomenon.

Thereby, if Colombia replicates the figures observed in Mexico, about 3.5 million more households would join the middle class by 2023. In this scenario, the savings capacity and access to the financial system would improve the accessibility to home ownership. For example, whereas in Colombia the current number of mortgage loans annually originated correspond to just 40% of existing households, this proportion is 98% in Mexico and 133% in Chile.

The enhancement in families' access to mortgage loans is also conditioned to improved mortgage loan financial conditions arising from the interest rate reduction. This phenomenon will happen because of the growth in public and private savings and the liquidity excess in international markets.

A conservative estimation of the institutional investor portfolio value shows it multiplying by 2.2 in the next 10 years to reach close to COP 700 trillion. The increase in resource supply will press the interest rates.

This statement bears more weight if we consider the fiscal consolidation process in Colombia. According to medium-term fiscal framework figures, Colombia will have

[3] In countries like USA, Canada, and Australia, the respective percentages of single-person households is 26%, 25%, and 24%.

a fiscal surplus starting in 2014, thus the debt requirements will decay more and more. Calculations show that the central government debt will decrease from 35% of GDP in 2012 down to 25% of GDP in 2022. The reduction in the public debt relative size entails a fall in the demand for savings-resources. Whereas public debt takes 50% of the current total investments in the institutional portfolio, the forecast is only 35% in 10 years.

In face of the government debt stock decay, the economy yield curve is expected to flatten and shift downwards. Evidence shows that this phenomenon emerges with the economic development.

Moreover, capital flows will continue incoming as a result of the excess liquidity in international markets and the favorable perspective of the Colombian economy. Given the monetary policy slackness in developed countries (expected to remain until 2015 at least) and the yield requirements for pension savings in face of the population aging in the developed world, the rates offered by emerging economies including Colombia look very appealing. The estimated value of the world investment portfolio amounts to USD 60 quintillion, the third part of which is in developing economies. This percentage is expected to stabilize around 50% in the next decade. More incoming foreign resources will put more pressure on interest rates in all the economy, including mortgage interest rates.

Interest rate reduction has a positive effect on the mortgage sector, as it directly stimulates mortgage loan demand (for every 100 basis point of reduction, the number of disbursements grows by 17%). Nonetheless, most of these originations are actually portfolio repurchase that although they do not affect the total system balance, they do have a perverse effect on the securitized mortgage loans.

Despite the expected deployment of the mortgage activity in the next decade, the figures are not extraordinary. For example, mortgage loans will increase from 5.1% of GDP in 2012 to 7.5% of GDP in 2023, a number that is rather small even for the current regional standards (Chart 18). This is the result of three features of the sector that prevent further dynamics in the activity.

First, despite the forecasted major reductions in mortgage loan interest rates, these falls are restricted by implicit risks arising from the regulatory framework in Colombia. In this regard, the mortgage loan originators should charge in the rate such elements as the existence of interest rate ceilings and the legal insecurity arising from retroactive changes.

Additionally, the interest rate is affected by the prolonged duration of legal proceedings to recover collaterals, the relatively high credit risk (past-due mortgage loan portfolio is 2.5% of the total portfolio in Colombia, whereas it is only 1.6% in Chile and 1.3% in Panama) and the lack of prepayment penalties.

Second, other provisions such as limitations to LTV, maturity terms and amortization systems in mortgage loans, create a barrier to the indebtedness. For a household with a 4-minimum legal wage income wanting to purchase a real property priced 80 minimum legal wages, it takes 125 months to accumulate the required savings. Therefore, these restrictions should be released to streamline the home purchase decisions in families.

Third, households' dislike for mortgage indebtedness that resulted from the mortgage crisis in the 1990s brings about the accelerated amortization, which consumes a considerable part of the mortgage loan portfolio growth.

Original signed
Alberto Gutierrez Bernal
President

The preceding report was adopted unanimously by the Board of Directors of the Company at their meeting of January 24, 2013, to be presented at the General Ordinary Shareholders Meeting of March 12, 2013.

Original signed
Efrain Forego Fonseca
Chair of the Board of Directors