

The influence of special characteristics of transitional countries on housing finance development

(Russia as an example)

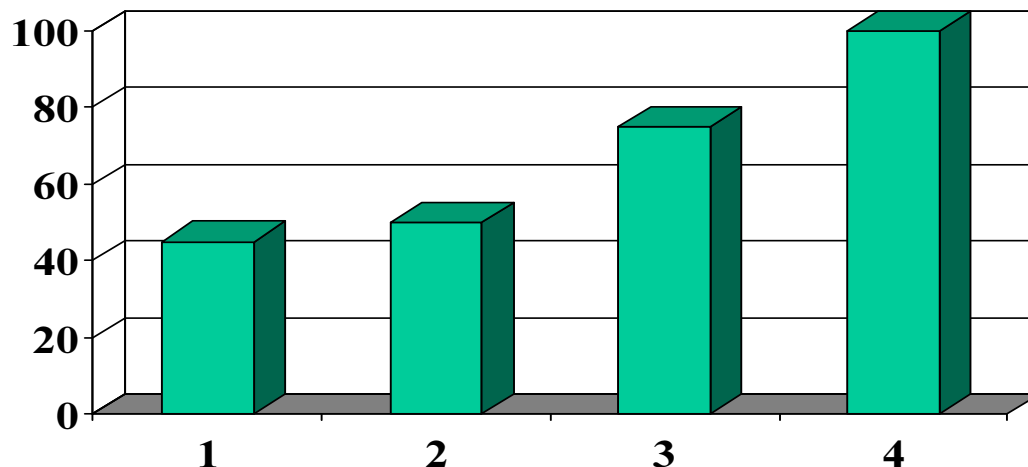
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Sources of funds

Acquisition of dwellings - savings, proceeds from sales of property.

Construction - payments of prospective owners.

Relation between stage of construction and dwelling prices



- 1. Beginning of construction**
- 2. Underground faze**
- 3. Erection of the building**
- 4. Finishing works**

Dwelling stock in Russia

- Average dwelling surface per inhabitant – 15.5 m². (average in Europe – 35 m²).
- Quality of dwellings in Russia :
 - 61.6% are amortized by more than 30%,
 - 20% do not have connection to sewerage system,
 - 35 % do not have heat water,
 - more then 50% do not have telephone connection.
- 27% of Russians consider quality of the houses they live in as poor and dangerous for life
- 61% of Russian citizens are looking for an opportunity to improve living conditions

Source: Research Center of RMA (Russian marketing association) The Report from V International scientific conference "Competitiveness and modernization of economy" (on April 6-8, 2004) "[Formation of accessible habitation market in Russia](#)"

Barriers preventing banks from housing lending

Barriers	Rating of importance	% of the banks mentioning
Lack of effective system of foreclosure and eviction	1	89%
Lack of long-term financial resources	2	85%
Unreported income of most of potential mortgagors	3	85%
High transaction taxes and fees	4	64%
Complicated registration procedure	5	55%
High operational expenses	6	55%
Absence of credit bureau	7	49%

Source: Research Center of RMA (Russian marketing association) The Report from V International scientific conference "Competitiveness and modernization of economy" (on April 6-8, 2004) "Formation of accessible habitation market in Russia"

Barriers preventing banks from construction lending

Barriers	Rating of importance	% of the banks mentioning
Lack of assets that can be used as a collateral	1	82%
High credit risks associated with the industry	2	79%
Inadequate financial reporting of borrowers	3	62%
Inadequate land rights	4	54%
Poor quality of business plans	5	46%
Long time taken for preparing design documentation	6	36%
Lack of financial resources	7	49%
No demand for construction loans	8	26%

Source: Research Center of RMA (Russian marketing association) The Report from V International scientific conference "Competitiveness and modernization of economy" (on April 6-8, 2004) "Formation of accessible habitation market in Russia"

Major risks associated with housing and construction finance in Russia.

Risks	Factors
Credit risk (risk of default)	Complications in assessment of borrower's financial capacity
Credit risk (collateral risk)	Lack of effective system of foreclosure and eviction
Interest rate (mismatch) risk	Absence of long-term resources
Collateral risk (construction finance)	Impossibility to use the building under construction as a collateral.

Solutions

- Make housing finance feasible for banks by means of changing legal, administrative and macro economic environment
- Establish specialized non-banking financial institutions able to make housing loans in the current environment

Mitigation of commercial banks' risks.

Risks	Mitigation
Credit risk (collateral risk)	Change legislation on foreclosure and eviction.
Credit risk (risk of default)	Create incentives to report real income.
Interest rate (mismatch) risk	Provide banks with long-term resources (deposit guarantees, liquidity and secondary market facilities).
Collateral risk (construction finance)	Issue legislation enabling to consider building under construction as a collateral against a construction loan.

Effects on risks of establishing contract savings housing finance system (mutual form)

Risks	Mitigation
Credit risk (collateral risk)	Eviction and sale of property is enforced socially since it is in the interest of borrower-in-default neighbors – co-owners of the lender.
Credit risk (risk of default)	Savings in even monthly installments prove a mortgagor's capacity to make equal regular loan repayments.
Interest rate (mismatch) risks	The system creates long-term resources by means of establishing system of long-term savings.
Collateral risk (construction finance)	The system can be easily combined with cooperative construction system.

Development of Mortgage lending in Russia

2001 year	1.7 billions of Rubles
2002 year	3.3 billions of Rubles.
2003 year	10.5 billions of Rubles.

(Estimation of Central bank of Russia)

2003 year

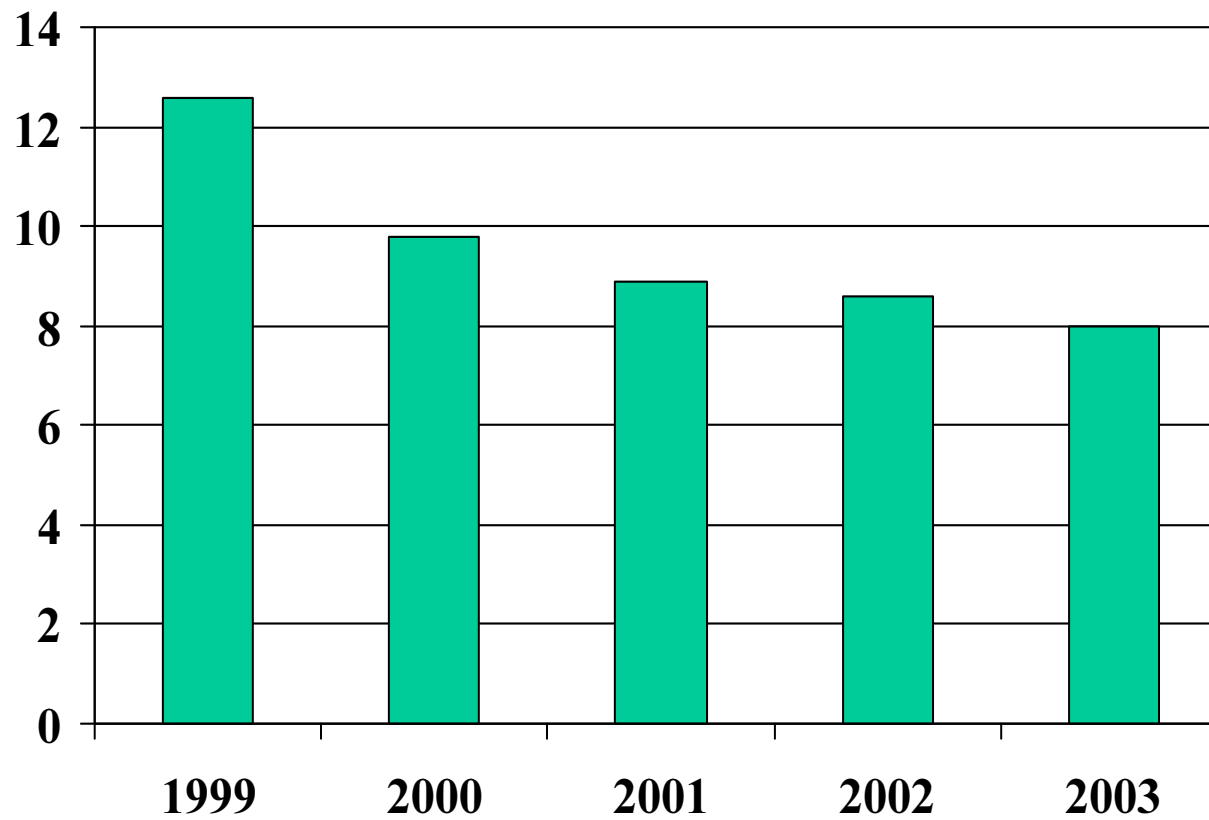
146 banks have mortgage programs.

Number of loans outstanding – 27 thousands.

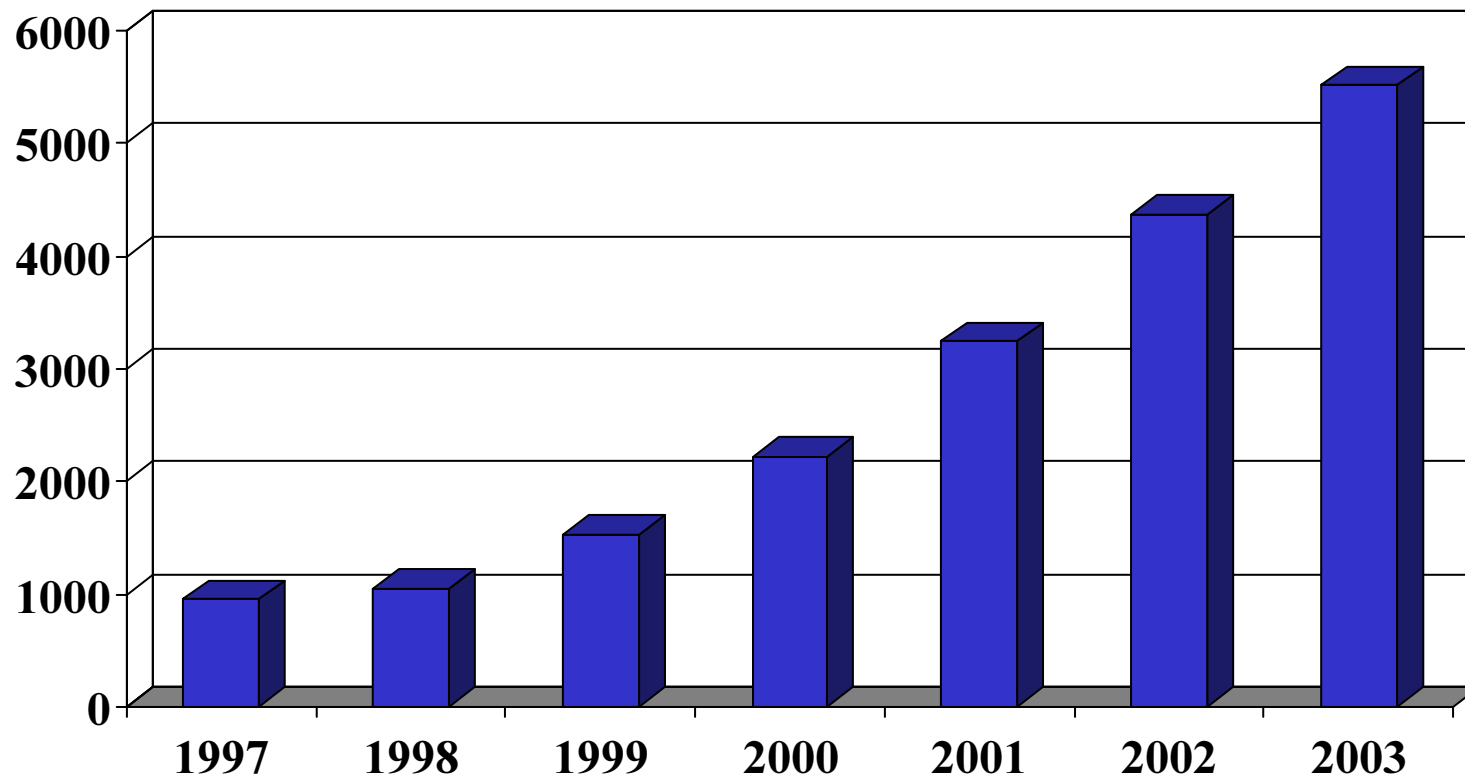
Value of outstanding mortgages – 15 billions of Rubles.

(Estimation of Association of Russian banks)

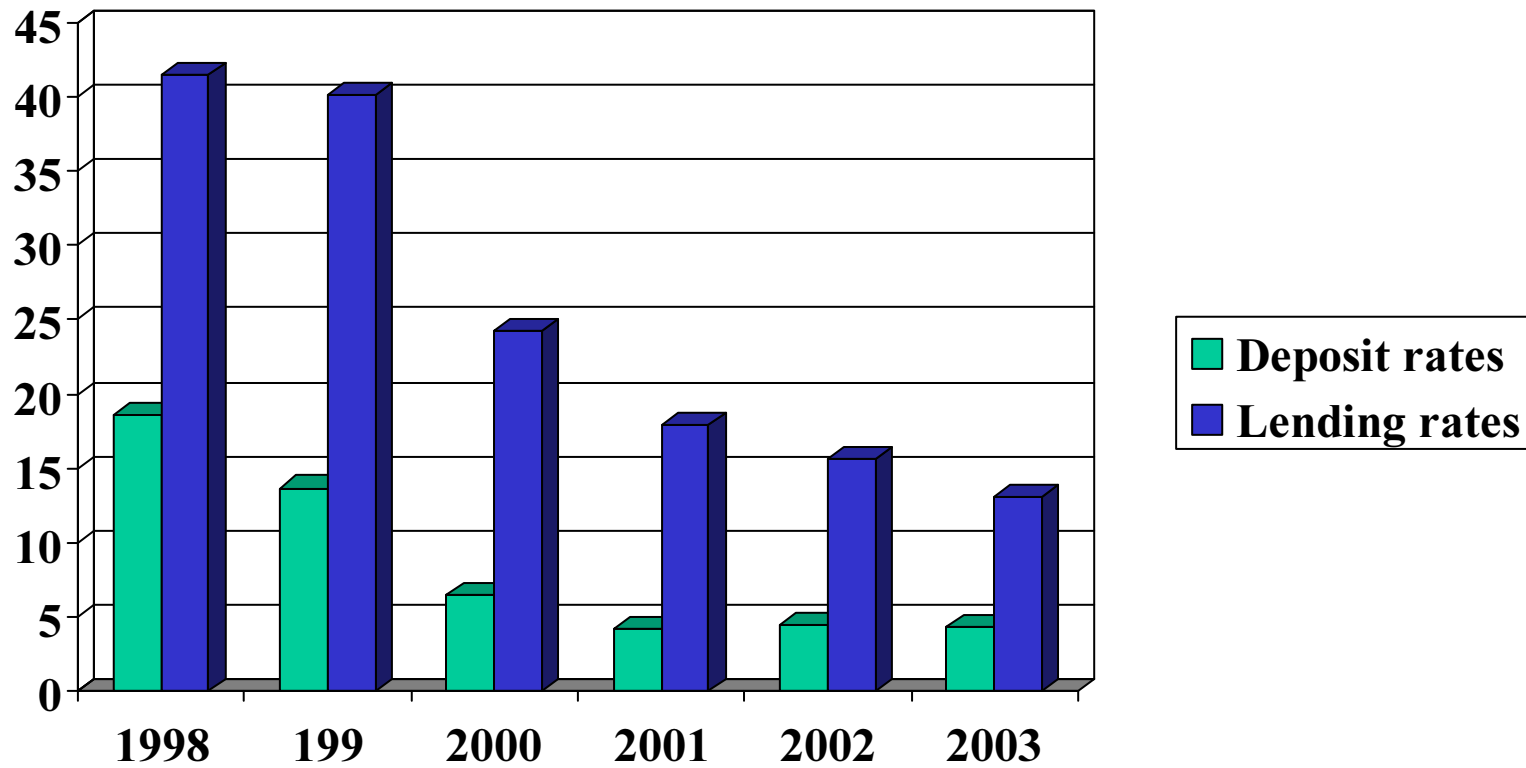
Unemployment rate



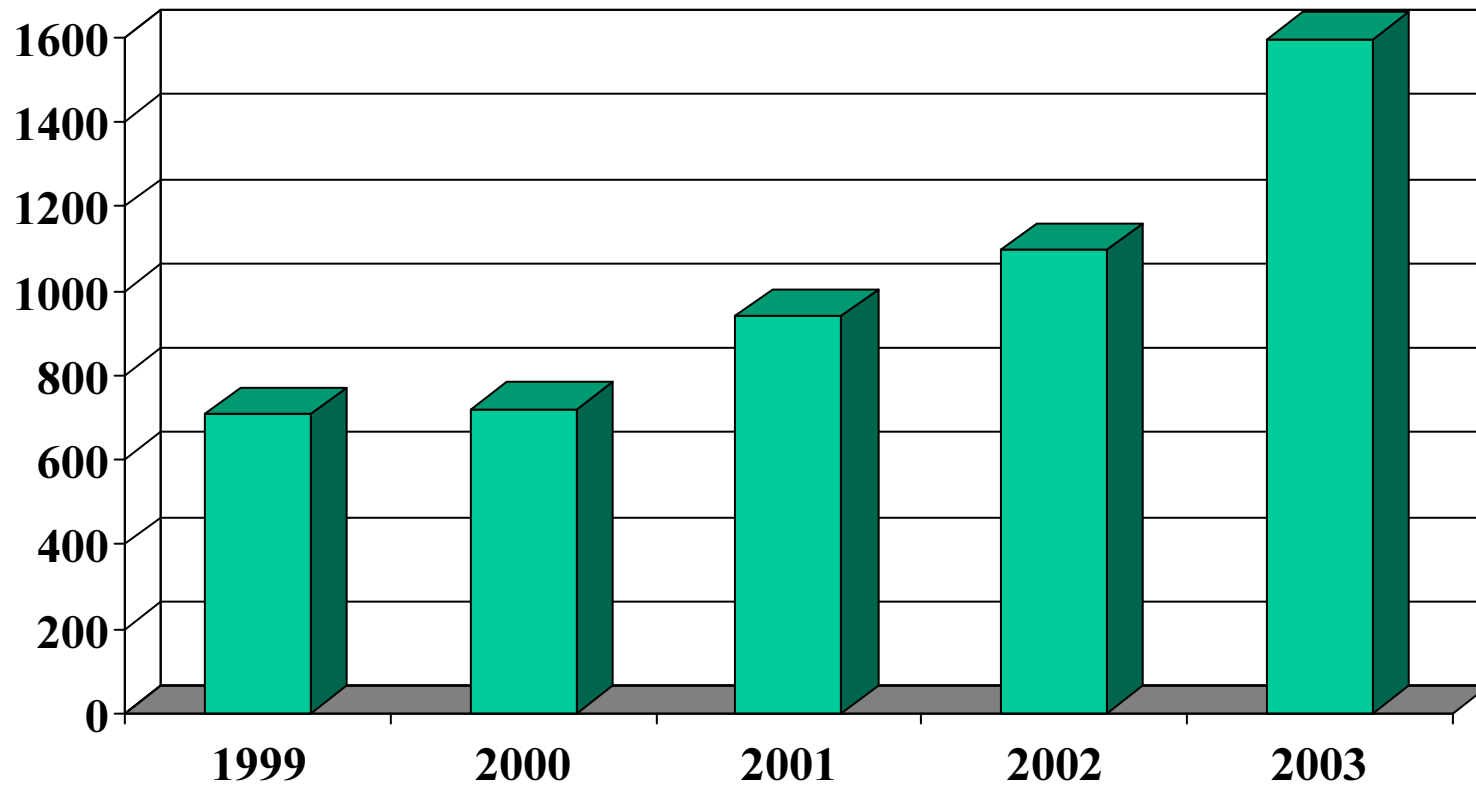
Average monthly wages



Interest rates



House prices



Risks in the current macroeconomic situation

Risks	Influence of current market situation on the risks.
Credit risk (collateral risk)	Is reducing because of rapidly growing LTV of loans in portfolios.
Credit risk (risk of default of the borrower)	Is decreasing with the reduction of unemployment and increase of wages.
Interest rate (mismatch) risks	Banks get additional profit keeping in portfolios loans with the interest rate higher than the market lending rate.

Sustainability of Housing finance system

**Positive tendency - Improvement of legal
and administrative
framework.**

**Negative tendency - Underestimation of
risks.**

Improvement of legal and administrative framework

(27 laws and amendments to laws)

- **Enforce foreclosure**
- **Reduce transaction fees and taxes**
- **Enable re-mortgaging**
- **Establish credit bureaus**
- **Enable mortgage insurance**
- **Create legal background for mortgage bonds issuance**

Underestimation of risks

- **Reduction of downpayment to 15% (without credit enhancement)**
- **Increase of effort ratio to 50% (front-end-ratio)**
- **Assessments based on unconfirmed income**
- **Provision of loans to borrowers buying apartments at the initial stage of multistory buildings construction.**

Major problems remaining

- Legislation is unfavorable for construction lending
- Rental housing does not exist
- Affordability of housing is low