Emerging Housing Finance in Armenia

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A KfW Project Executed by

The Urban Institute

Basic Facts

- Population: 3.2 million
- 2002 per capita GNI: $790
- 2002-2004
  - GDP annual growth
    - 2002-03 > 10 percent
    - 2004 ~ 7 percent
  - Annual inflation ~ 3 percent
- Poverty rate in 2002: 49 percent of population

Financial Depth and Efficiency, 2002

	Credit from banking system/GDP (%)	Interest rate spread (% pts.)	Risk premium on lending (% pts.)
Armenia	7.3	11.5	6.4
Russia	26.6	10.8	3.0
Hungary	53.0	2.8	1.3
Germany	144.7	7.0	6.7

Banking system

- Highly liquid
- Interest rates moving downward
- Deposits concentrated in short term accounts
- Plentiful dollar liabilities
- Strongest it has been since the start of the transition

Mortgage Lending

Year	Loan volume ($ millions)
2002	2.8
2003	7.1
2004 (est. from voluntary survey of banks and credit orgs)	15.0

Mortgage Lenders

- Commercial banks – 11 of 20
- Credit organizations – 3 of 7
- Competition is developing; concentration: top 4 = 70%
- Lending very heavily concentrated in Yerevan and projected to continue to be so

Typical mortgage products

Interest rate	Fixed, 12-20%
Currency	Dollars
Max LTV	50-70%
Term	3-7 yrs
Insurance (life & property)?	Sometimes
Guarantors?	Seldom
Property appraised?	Always

Selected Bank Experience

- Registration process
- Foreclosure
  - Certainty
  - How long
- Loans now in default
  - Share of respondents
  - Share of their loans

- 9/12 “easy-routine”
- 10/12 done 1-5 days
- Foreclosure
  - Confident of prevailing
  - 6 to 12 months
- Default
  - 2 of 11 (small lenders)
  - ~4%

Primary market – credit risk: *weaknesses*

- Very limited experience, incl. with foreclosure
- Property outside Yerevan illiquid
- Variable quality in loan underwriting, servicing, and loan documentation
- Little staff training
- Significant absence of life and, sometimes, property insurance
- Prices in Yerevan are potentially volatile

Primary market – credit risk: *strong points*

- Legal basis for lending in serviceable, and GOA working group preparing improvements
- Mortgage loans have low LTVs
- Title and lien registration working effectively
- CBA-operated credit bureau in place, but with limited coverage
- Culture of paying debts

Primary market – interest rate risk

- *Weaknesses*
  - Fixed rate loans; bankers pleased to lock-in rate in environment of declining rates
  - Risk is essentially unmanaged
  - Obstacle to extending loan term
- *Strong point*
  - Likely to be mitigated by high loan prepayment

Primary market – other risks

- Liquidity risk
  - Banking system highly liquid overall
  - 45% deposits are demand
  - Mortgage loans are highly illiquid
- Exchange rate risk
  - Little: mortgages funded with dollar liabilities
- Prepayment risk
  - Prepayment rates may be high
  - Banks unsuccessful in imposing fees

Primary market – going forward

- Much work to do on managing
  - Credit risk
    - Improved underwriting, servicing, documentation; require insurance; intro contract savings (CS) through commercial banks, which would also expand range of borrowers
  - Interest rate risk
    - Variable rate loans in AMD; sale of loans; CS effective for its program
  - Prepayment risk
    - Variable rate loans or annual renegotiation

Mortgage Loan Refinance

- In both the CBA and MoFE concepts
- Could address
  - Interest rate risks and
  - prepayment risks
- A facility could be market-maker
- Significant impact on affordability by lengthening the loan term
- Very early in mortgage system development
  - Limited experience with lending
  - Clear need to improve primary lending

Mortgage Loan Refinance – is there a potential market?

- T-bills are essentially the only available financial investment
  - They are consistently over-subscribed; expansion in next two years will be quite limited
- Securities Commission and MoFE believe there will be sufficient demand for mortgage-backed bonds
- Demand
  - Mostly banks
  - Insurance companies are very limited investors; no private pension funds; state pension fund has no investments

Mortgage Loan Refinance – basics

- Competing options
  - Bonds issued by commercial banks
  - Refinance facility
- Preconditions for both
  - Strengthening of primary lending
  - Standardization
  - Require significant time to develop

Construction period finance

- Less than 10% of such finance is bank loans; particularly an issue for projects outside central Yerevan
- Installment sales are the rule
  - Inefficient
  - Risky for purchasers
- Banks reluctance
  - Underwriting ability appears limited
  - Possible issues of collateral

Summing Up

- Strong, but very young, market in mortgage lending
- Favorable legal environment and investment climate
- Support by Government and international community for further development
- Going forward
  - Primary market needs further development
  - Some form of refinancing would help manage risks, but it must be very carefully prepared
- Construction period finance: key but neglected component