

THE EMERGING MORTGAGE MARKET IN RUSSIA:

An overview with Local
and Foreign Perspectives

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Preface

The rapid economic growth in Russia has brought along a boom in the real estate market. As the population income level is rising, more and more Russians are able to invest in housing. Consequently, a mortgage market as a source of affordable housing finance has started to emerge. The mortgage market in Russia is relatively young, but it has been developing extremely rapidly in the recent years. The significant growth of the market attracts many players, including foreign financial institutions. The aim of this report is to analyze the development on the Russian mortgage market, and assess its potential for foreign actors. This report presents an analysis of the existing legal framework, risks, and the main players in the Russian mortgage market. Moreover, perspectives of Russian and Nordic banks are examined to outline current problems and the future potential of the Russian mortgage market.

The study was conducted at the Helsinki School of Economics (HSE) Center for Markets in Transition (CEMAT). CEMAT, founded in 1998, is a center of research excellence and training focusing on emerging markets in Russia, Baltic States, Asia, and Latin America. Operating on external funding CEMAT carries out applied and academic research on economic development and enterprise strategies that are analyzed on macro-, meso- and micro-levels. Our multidisciplinary research program that draws on institutional theory covers in-depth studies of selected market areas, and comparative studies between regions/countries. The CEMAT Team specializes in International Business, Economic Geography, Finance, Law, Management, Economics, and Marketing.

This study was carried out by the following members of the CEMAT Team. Prof. Riitta Kosonen, director of the CEMAT, and project manager Piia Heliste supervised the work. Researcher, Cand. Sc. Olga Mashkina conducted the data collection, analysis and reporting of the results. Research assistant Kristo Ovaska participated in the data collection in Finland.

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Helsinki, 22 October 2007

Prof. Riitta Kosonen
Director
HSE Center for Markets in Transition

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Introduction

Along with the growth of the Russian economy and population income, Russians have become increasingly interested in investing in housing. As a result, the Russian real estate market has started to boom. Traditionally, investments in housing have been financed by personal savings or loans from family and friends. Recently, the emerging mortgage market has become increasingly important for the provision of affordable housing finance. Moreover, President Putin has declared mortgage lending a national priority as a part of the state program “*Affordable Housing*”. The program was launched in 2004 and its progress and problems associated with its fulfillment have been widely discussed in the Russian press.

The mortgage market in Russia is still relatively young and developing rapidly. In 2006, the mortgage market grew by 183% (RBC 2006). However, in absolute terms the mortgage volumes are still low. The mortgages issued in Russia amount to only 1-2% of the GDP, while the EU-average is 38% (Indicators of the mortgage market, 2006). Today, in Russia ca. 400 banks offer more than 1000 mortgage programs (RBC 2006) and the streets are filled with banners advertising the mortgage programs of different banks. Many banks have opened special mortgage service centers and departments, and regional mortgage markets are emerging as well.

The situation on the Russian mortgage market, however, changes almost daily. In the first half of 2006, the Moscow and St. Petersburg real estate markets witnessed an unprecedented increase in housing prices, which slowed down the growth of mortgage transactions. Nevertheless, there are also signs of institutional stabilization of the market. Following the adoption of new amendments in the mortgage legislation in July 2006 and increasing competition on the market, the mortgage interest rates have been decreasing, and the pay-back time of mortgage loans has been prolonged up to 25 years. In addition, the requirements for getting a mortgage loan have been softened, including zero down payment

and the possibility to count grey salaries. Finally, in 2006 several banks completed securitization and issued mortgage-backed securities.

The aim of this report is to examine the development of the Russian mortgage market, and assess its potential for foreign actors. This is done by first analyzing the existing legal framework, risks, and the main players in the Russian mortgage market. Then, securitization and refinancing possibilities are discussed, and the development in Russia is compared with other emerging mortgage markets in Central and Eastern Europe, and Latin America. Finally, the possibilities and strategies of Nordic banks to enter the Russian mortgage market are discussed. The study builds on multiple sources of data, including statistics, business periodicals, and reports on the topic prepared by banks and other financial institutions. In addition, 14 semi-structured interviews with banks and mortgage agencies operating in Russia were conducted. These include 5 Russian bank representatives, 3 mortgage agency representatives, and 6 Nordic bank representatives.

1 The housing market and the housing financing system in Russia

In contemporary Russia, the provision of housing to the population has become a critical issue. The main problems on the housing market in Russia include a shortage of housing stock, poor condition of housing and high housing costs. Along with the transition to the market economy, the housing situation and the mechanisms for housing financing have changed. Also, new organizations and institutions have appeared on the housing market. The following sections discuss the development of housing in Russia before and during the post-socialist transition¹. This is followed by an outline of the current situation. Finally, a brief description of the development of the banking sector is provided.

1.1 Housing before and during the post-socialist transition

According to the Constitution of the Soviet Union, each citizen had the right to housing (Constitution of the USSR article 44). The majority of the housing stock belonged to the state and apartments were allocated to people's use for unlimited time according to the state provision system, which was based on the families' place in the waiting list. It could often take up to 8-10 years for a family to get a new apartment.

Institutions that enable effective development of a housing market were largely absent in the Soviet Union. The administrative planning system and the lack of market mechanisms led to a constant deficit of construction resources and, consequently, to a lack of housing.

Housing construction was carried out mostly by the state. Although ca. 80 million square meters of housing was built annually, the average housing per capita in the Soviet Union was less than 15 square meters. Many families lived in communal apartments, where several families shared one apartment.

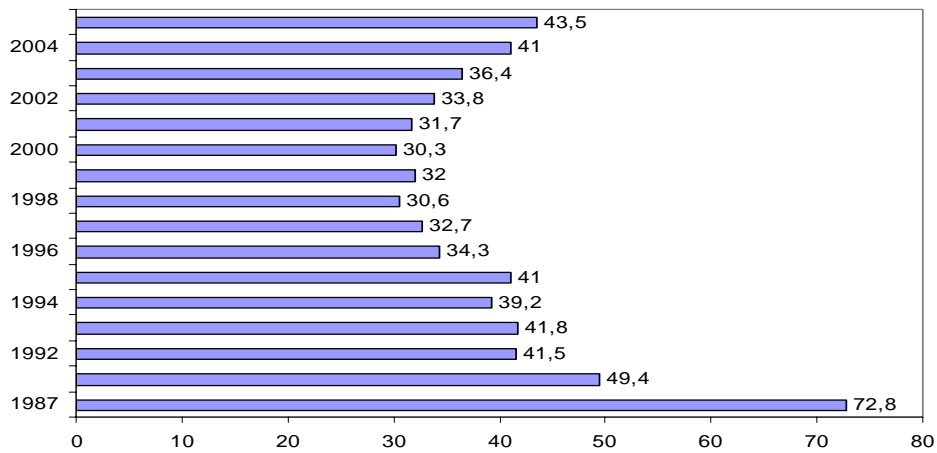
¹ In this report, the year 1991 (dissolution of the Soviet Union) marks the starting point of post-socialist transition. The year 1998 is the watershed when the post-socialist transition officially ended (the ruble crises and the following rapid growth of the economy).

The privatization of housing began in 1991 as the Law on Privatization of Housing was adopted. According to this law, tenants who were officially registered as occupants of apartments could purchase them. Tenants received free of charge a voucher, the value of which was calculated by multiplying the average price of a square meter of housing by the number of square meters the tenants were entitled to (18 square meters per person + 9 square meters per household). However, due to the novelty of the legislation, the lack of administrative procedures, and the continuing attractiveness of low rents in state-owned housing, only a very low percentage of housing was initially privatized (0.2% of housing stock). An important step in this process was a constitutional amendment in 1992, which allowed free distribution of housing. This broadened the categories of housing that could be privatized, and simplified the privatization procedure. By 1996, 39% of the urban housing stock in Russia had been privatized and by 2004, this indicator had reached 60% (RosStat 2006).

The privatization of housing resulted in a tenure structure with a high proportion of owner occupation. Prices for housing rose rapidly during the transition period due to inflation. For Russians, constrained with limited opportunities for savings and investment, housing appeared to be one of the few mechanisms for wealth preservation (Palacine & Shelburne 2005).

Housing construction fell drastically in transition years, from 72.8 mln square meters in 1987 down to 30.6 mln and 30.3 mln square meters in 1998 and 2000, respectively (see Figure 1).

Figure 1: Volumes of housing construction 1987-2005, mln sq.meters

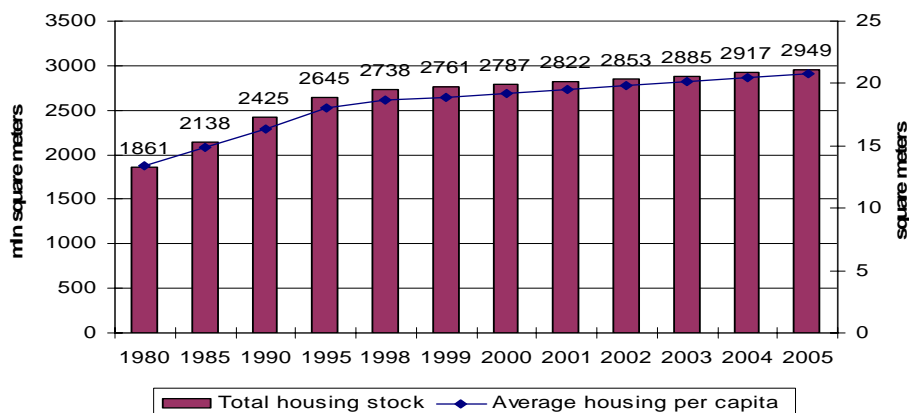


Source: RosStat 2005

After the financial crisis of 1998, the macroeconomic situation in Russia started to gradually improve. Rising population income, new financing mechanisms, and the general political and economic stabilization started to revive construction. In 2001-2005, the construction volumes grew by 40.6% (from 31.7 mln m² up to 43.5 mln m²). However, construction volumes continued to remain below the pre-transition period in Russia (Palacine & Shelburne, 2005). In 2005, the construction of new housing was still only 60% of the level of 1987 (Russian Statistical Yearbook, 2005). On average, the housing construction volumes have been growing annually by 6.7% since 2000. If other factors, such as improved construction materials and technologies are taken into account, it can be estimated that the residential housing sector has been growing up to 10 % per year in terms of volume (Kosareva eds., 2006).

Moreover, although the situation has gradually improved since the Soviet era, Russia is still significantly below the Western countries when measured by the level of housing per capita (Figure 2). On average, housing per capita is 20.7 square meters in Russia, while in the USA the corresponding figure is 70 square meters, in the UK 62 square meters, and in Germany 50 square meters (AHML 2006).

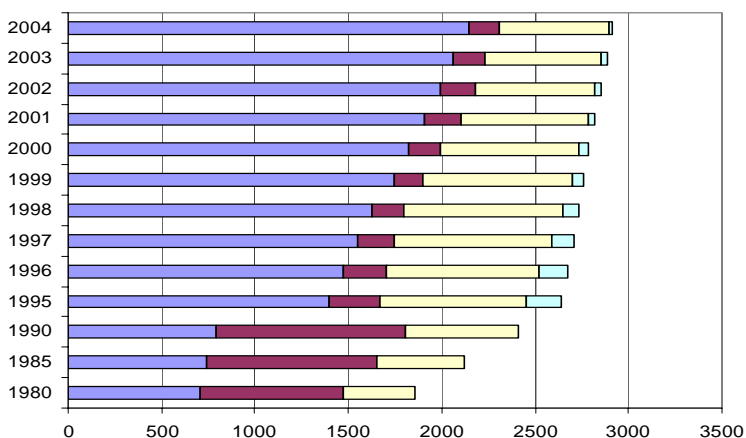
Figure 2: Housing stock and housing per capita in Russia in 1980-2005



Source: RosStat 2006

Overall, the total demand for housing in Russia is about 1.5 billion square meters, whereas housing construction meets only 1.5% of the demand. Nowadays, roughly 40 mln square meters of housing is built annually, while in the Soviet times, this indicator was 80 mln square meters. According to international norms, the annual construction volume of residential housing should be at the level of 1 square meter per capita. Thus, this indicator should be 145 mln square meters in Russia in order to meet the criteria, which means that it should be 3.5 times higher than the current indicators (Kosareva eds., 2006). During 2006, housing construction is estimated to be over 56 million square meters, and it is estimated to increase up to 80 million square meters by 2010. Along with the market reforms, non-state organizations have increased their role in housing construction substantially (see Figure 3).

Figure 3: New construction by ownership, mln square meters



Source: Russian Statistical Yearbook 2005

A growth in housing construction volumes is essential, as according to the data of the Federal Agency for Construction and Housing, 61% of Russian families needs an improvement in their housing conditions. More than half of the housing stock in Russia has been built before 1970. In addition, it is estimated that currently about 2 million people live in buildings that are in wrecking condition. Such buildings account ca. 4% of the total housing stock (RosStat 2005).

Before the transition, housing funds were mostly transferred from the state budget through 3 Soviet banks – State Savings Bank (Sberbank), PromStroiBank, and ZhilSocBank. Also, boosted by people’s savings and credits from the state, housing cooperatives were formed to build housing for cooperative ownership. These credits were subsidized: a 2% interest rate which was used before 1991 was below the bank interest rate and 1% higher than the official rate of inflation. Within the housing cooperatives, the interest rates were subsidized even more – and were only 0.5% (Kosareva eds., 2006). The collapse of the centralized system in 1991 resulted in growing inflation and high interest rates, which disabled most people from buying or building housing. In principle, only certain privileged groups of citizens, such as invalids and veterans, were able to act in the market thanks to special loans

with 0% interest rate. The situation started to change slowly as the Russian banking sector and later also the mortgage market began to develop. A brief overview of the general development of the banking sector in Russia is provided next before going into the development of the mortgage market.

1.2 The development of the banking sector in Russia

In the Soviet era, banking services were provided by the Gosbank, which combined the functions of a central bank and a commercial bank. In the non-monetary economy, the Gosbank's functions included issuing short-term loans for working capital, controlling the plan fulfillment of enterprises, and monitoring payments to the population. It was the single clearing agent and the sole provider of short term credit in the Soviet economy (Gregory and Stuart, 1998).

In the late 1980s, the first non-state banks were formed under the 1988 law on cooperatives. As a part of the economic reforms, the banking system moved away from the strictly centralized mono-bank system to a more diversified and functionally more specialized two-tier system. The central banking functions remained with the Gosbank, which in 1991 became the Central Bank of Russia (CBR). Commercial banking functions were allocated to five specialized institutions: Sberbank – savings; Vneshtorgbank – foreign trade; Promstroibank – industrial lending; Agroprombank – agricultural lending; and Zhilsotsbank – housing. (Chowdhury 2003).

During the early years of economic reforms, state enterprises and other organizations were also given the right to create their own financial institutions. This was the starting point for the development of financial industrial groups (FIGs), which have played an important role in shaping the Russian banking system². Large industrial enterprises established their own banks (sometimes called "pocket banks") to be used for intra-group transactions, for

² Such FIGs include Menatep, Alfabank, Incombank, Energomashcorporatsia, ONEKSIM as well as many others.

keeping the liquidity and for mobilizing investment resources. The position of the FIGs was further strengthened by the ‘loans-for-share’ privatization scheme, where state shares of large industrial enterprises were given to banks against loans for the government. As the state was not able to pay off these loans, the shares remained with the banks.

In the early and mid-1990s, the Russian banking sector evolved in an unregulated manner. The large-scale supply of the high-yielding government debt encouraged banks to buy and sell Russian treasury bonds (GKO). They were also involved in providing subsidized credits to enterprises, financing trade operations, foreign exchange speculations, and engaging in non-monetary exchange of commodities. Flexible regulation and licensing policies resulted in a rapid growth in the number of banks from less than 100 in 1988 to almost 2600 in 1995.

During the 1990s, the Russian banks faced three major crises. The first was in November 1994, when the ruble collapsed by 30% (the so called “Black Tuesday” of October 11, 1994). The second crisis was the liquidity crisis in the interbank market in August 1995, when a number of large banks defaulted. The third and the most large-scale was the government’s default on its ruble bonds and the subsequent ruble devaluation in August 1998 (Chowdhury, 2003).

The crisis of 1998 was triggered by the ruble devaluation and the freezing of the short-term treasury bill (GKO) operations. The Russian banks were vulnerable to the crisis due to the high concentration of assets among highly leveraged and badly managed banks, increased foreign borrowing, exposure to exchange rate risk, credit risk, risk of default by the government and the consequent loss of client confidence. Banks were exposed to both price and credit risk and were unable to repay their obligations on forward contracts when the devaluation actually took place in August. After the 1998 crisis the number of banks dropped to about 1600 (Chowdhury 2003).

The size of the Russian banking sector is still relatively small in international comparison. It amounts to some 45% of GDP, compared to 100-300% in the developed countries. There are also considerable structural problems prevailing, including complex legislation, cumbersome accounting practices and ownership structure. The combined market share of the public sector banks was initially 100% but declined to about 30% by 1998. The trend was then reversed and nowadays, the Russian public sector is steadily expanding its ownership in banking. According to official sources, the public sector banks' market share comprises currently one third, while some experts estimate it to be closer to 45%. In addition, the sector is highly concentrated as the "Big Four" state owned banks (Sberbank, the Vneshtorgbank group, Gazprombank and Bank of Moscow) control 40.7% of the total banking assets³ (Vernikov 2007). Sberbank remains the absolute leader in the market with over 25% share of the market. It is also the only bank that has a well developed regional network throughout Russia, inherited from the Gosbank's monopoly in the Soviet Union.

The share of private banks on the Russian market has been slightly decreasing lately, as the public sector banking is expanding. There are currently about 1300 private banks in Russia, which is a relatively large number. In general, they are relatively small in terms of assets as well as number of branch offices.

In 2006, there were 148 banks with foreign capital operating in Russia. These included 51 wholly foreign owned banks and 12 credit organizations with a majority non-resident capital share. The most successful foreign banks in Russia include Raiffeisenbank, IMB, CitiBank, DeltaCredit bank, Deutsche bank, and Societe Generale Vostok. Banks with foreign capital accounted for 11.5% of the total assets, 12.6% of equity capital, and 9.5% of loans to non-financial organizations. About half of them were located in Moscow (77 in 2004). Currently, foreign banks are not allowed to establish branch offices in Russia but have to either acquire existing operations, or to establish a subsidiary to Russia on a greenfield basis.

³ During the last four years, the top three banks in Russia have been public sector banks: Sberbank (with profit of 112 bln RUR in 2006), Vneshtorgbank (24,7 bln RUR) and Gasprombank (18,7 bln RUR.).

2 The development of the mortgage market in Russia

The history of the housing market in the post-socialist countries is very different from that of typical market economies. After the beginning of the market reforms, the housing sector became one of the most actively developing sectors of the economy. The limited availability of housing under socialism and the collapse of the construction industry during transition are legacies that add to the specific nature of the mortgage market development even today.

As the housing stock in Russia underwent privatization, new market mechanisms were needed to finance housing. Only a small percentage of people could afford to buy an apartment using their savings. To make housing more affordable, an efficiently functioning mortgage market was needed. Without functioning mechanisms, housing is passed on from generation to generation, rather than sold in the market (Palacine & Shelburne 2005).

2.1 The history and current state of Russian mortgage market

The first mortgage loans were issued in Russia in the mid-1990s, but the true beginning of mortgage lending was marked in 1996 when the legislation on mortgages was adopted. This legislation established the fundamental mortgage lending policies in the developing market (more on this in Chapter 3 on legislation). Also the Federal Housing Mortgage Lending Agency (AHML) was established in 1997 to create a nation-wide mortgage lending system. It is a state structure, which aims at developing conditions for mass housing loans based on universal federal standards. The agency has established a network of regional operators and service agents. It has also created a system of federal standards for mortgages, based on which mortgage loans had been issued in 63 regions by 97 organizations as of June 2006.

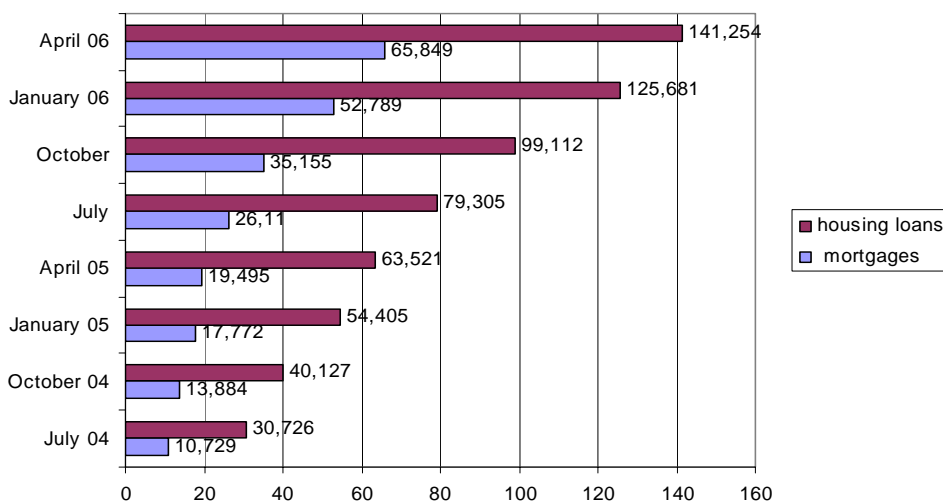
The 1998 financial crisis caused rising inflation and a decrease of the real population income, and practically paralyzed the stock market. Several banks defaulted and people lost

their savings, which ruined the trust in commercial banks for a long time. Also, foreign and domestic investors lost trust in the possibility to invest in long-term securities, including mortgage-backed securities. Only after 2000, the economic situation in Russia has become more favorable for the development of various mechanisms of housing finance, including mortgage loans. President Putin has declared mortgage lending a national priority, and the state program “Affordable Housing” was launched in 2004. Its progress and problems for its fulfillment have been widely discussed in the Russian press.

Prior to 2000, mortgages were generally offered through banks as simply one of their products. Since 2000, banks have started to separate mortgages from their general retail products and establish specialized structures covering the full life cycle of mortgages. Furthermore, specialized mortgage companies have emerged. The first banks offering mortgage loans included Sberbank, Delta Credit, and Raiffeisenbank. Recently, the number of banks specializing in mortgages has been growing. In 2005, consumers could choose among 200 different mortgage programs, while today, the top 70 banks offer more than 1000 mortgage programs. Despite this trend, the Russian mortgage market is still relatively monopolized. In 2005, mortgage loans exceeding 20 mln RUR were issued by only 12 banks, and the share of the top five banks was 82% of the total volume of mortgage loans (Indicators of mortgage market 2006).

The number of financial institutions offering mortgages has grown very fast. In 2004, the Central Bank of Russia noted that 200 banks were offering mortgages and as of Jan. 1, 2006 the number was 395 (Central Bank 2006). Since 2002, the mortgage lending volume has roughly doubled every year and in April 2006 it reached 65,9 bln RUR (Figure 4).

Figure 4: Volumes of housing loans and mortgages 2004-2006, bln RUR



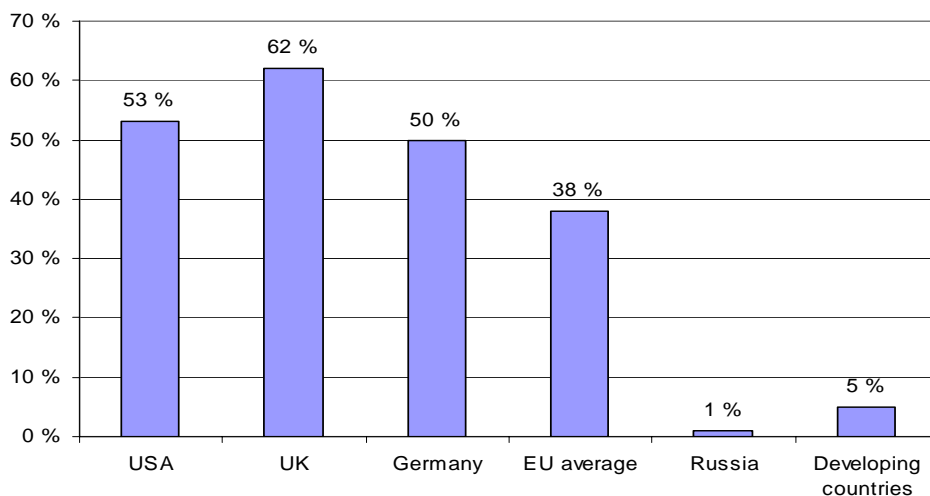
Source: Central Bank of Russia 2006

In 2005, the housing loans and the number of borrowers increased both in volume and in number. In 2004-2005, over US\$1 billion of mortgage loans were issued. In 2006 the Russian mortgage market continued to show good growth results as well: the volume reached 5 bln USD by the end of 2006 against approximately 3 bln USD of the beginning of the year. The year 2006 witnessed a boom in the mortgage market as the growth in volumes of mortgages was over two times more than the previous year indicators (RBC 2007).

2.2 Russian mortgage market development in international comparison

Despite the positive trend described in the previous section, when compared to other emerging economies such as the Commonwealth of Independent States (CIS), Central and Eastern Europe (CEE) and Latin America, the Russian mortgage market seems to develop more slowly. The share of mortgages in Russia is only ca. 1% of the GDP, which is a relatively low figure in international comparison (Figure 5).

Figure 5: Share of mortgages to GDP, %



Source: New perspectives, 2006

In Latin American countries such as Brazil, Columbia, Chile and Mexico, the share of mortgages of the GDP ranges between 4-10%. In comparison, the corresponding figure for developed market economies is notably higher, for example 62% in the UK and 53% in the USA (New Perspectives, 2006). The EU average is ca. 38%. In the CEE the figure is considerably lower, ranging from 4% to 16% (Palacine & Shelburne 2005).

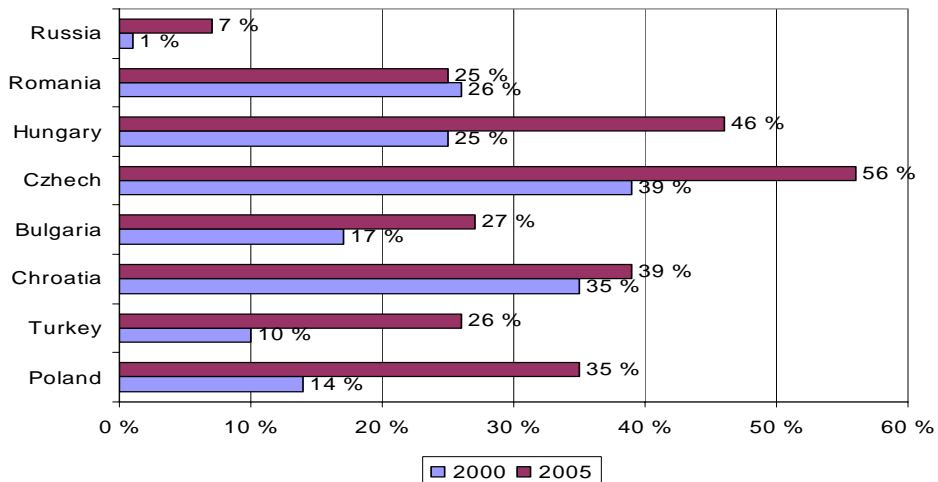
In per capita terms, the mortgages amount to 20 USD in Russia, 300 USD in Poland, and 931 USD in Hungary. Overall, in Western Europe the mortgage per capita is between 17000-25000 USD. In Russia, based on different estimates, only less than 2% of population has used mortgages for housing financing (RosStat 2006). At the same time, the general volume of consumer credits has been growing significantly in Russia (Table 1).

Table 1: Consumer credit market indicators in Eastern Europe and Russia, in 2005

	Mortgage, % to GDP	Consumer credits per capita, USD	Mortgage per capita, USD	Average monthly salary, USD
Czech Republic	6 %	631	631	703
Hungary	9.4%	653	931	520
Poland	4.9%	577	311	601
Romania	1.6%	214	54	200
Russia 2000	0.1%	22	2	150
Russia 2005	0.4%	266	21	300

Source: Orlova 2006

The fact that the mortgage market volume as compared to the average salary is considerably lower in Russia than in the Eastern Europe indicates that there are structural limitations on the Russian mortgage market. These include the slow development of the legal framework, and the fact that the latest amendments, which took away the limitation for securitization, were made only in July 2006. The experience of the Eastern European countries shows that the mortgage market growth follows the overall growth in consumer credits (Figure 6).

Figure 6: Share of mortgage loans in the total volume of credits, %

Source: Orlova 2006

In 2000, consumer credit volumes in Eastern Europe reached 7% of GDP, which is approximately the level which Russia is expected to reach in the next couple of years. In Hungary, the mortgage volumes grew from 1% to 9% in 2000-2005 due to the fast growth of salaries in the public sector. In Poland, the growth of 5 percentage points was mostly due to the decrease in the interest rates. In the Czech Republic, the share of mortgage loans in total credit loans grew up to 56% due to the state program that subsidized the mortgage payments for young people.

State involvement and the standardization of mortgages have been crucial for the mortgage market development in all countries. In Latin America and Eastern Europe, where the mortgage markets have developed quite successfully, the state has actively stimulated the development of the mortgage market. For example, in Brazil, special state institutions have been established for the development of the primary and secondary mortgage markets. The most popular forms of state support have been subsidies of interest rates for the low income families. In Mexico, the State Housing Fund seeks to boost mortgages to the middle-income sector via co-financing programs with local banking institutions.

According to the data of RosRegistration, mortgage loans constituted for 4% of the total number and 2.4% of the total value of all loans issued in 2005 in Russia (Central Bank of Russia 2006).

Table 2: Mortgages in Russia, mln. RUR

<i>Types of credits</i>	<i>1.7.2004</i>	<i>1.10.2004</i>	<i>1.1.2005</i>
Credit loans to individuals	547 280	856 531	1 212 871
Mortgage loans	6 342	11 630	18 461
Share of housing mortgages in total loans	1,16	1,36	1,52
Mortgage debts	10 729	13 884	17 774
Delinquency in mortgage debts	7	11	9
Share of delinquent debts in total mortgage debts, %	0,07	0,08	0,05

Source: Central Bank of Russia, 2006

The mortgage market potential in Russia is relatively large. About 20.8% of Russians who are not satisfied with their living conditions are planning to improve them (RosStat 2005, see table 3), and according to the Association of Russian Banks (2005), about 13% are planning to do this with the help of mortgages. This means 19 million citizens, while the number of issued mortgages so far has been only in the range of tens of thousands. With a 10% interest rate on mortgage and 20% to 30% annual price increase for residential property, mortgage lending can be regarded as a reasonably profitable investment. According to estimates, potential domestic demand for mortgage loans is US\$50 billion (Progonova 2006).

Table 3: Satisfaction with current living conditions, % 2005

All households, not satisfied with the current housing conditions	100%
plan to improve their housing conditions out of which	20.8%
are waiting to get state housing	5.7%
planning to buy or change to another housing	8.9%
planning to buy additional housing	1%
counting on inheriting housing	1.3%
building new housing	3.1%
other	2.1%
not planning to improve their living conditions	79.2%

Source: Rosstat 2005

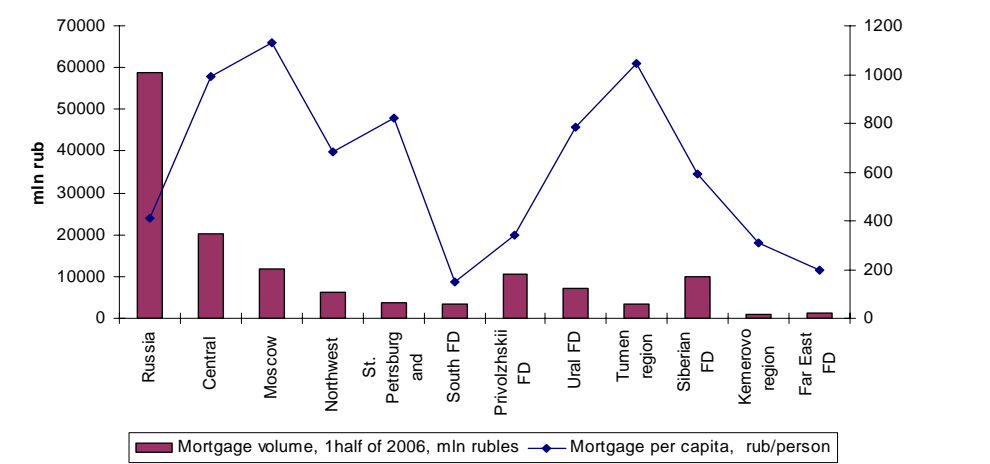
To sum up, the mortgage market has developed more slowly in Russia than in the other countries of the former Soviet block, and in emerging economies of Latin America. The economic crisis in 1998 harmed the macroeconomic situation, dropped population income level and destroyed consumers' trust in banks. Even if the mortgage market started to emerge before 1997, the 1998 crisis considerably slowed down the development. As a result, the mortgage market development was retarded for 4-5 years as compared to the other former Soviet republics. However, the market has grown significantly in Russia

during 2005-2006 and the perspectives look promising. A more detailed look into the development of the mortgage market in Russia and its regional characteristics are provided next.

2.3 Regional differences of the Russian mortgage market

On average, the share of transactions using mortgage was 6% of all transactions in the Russian housing market in the first half of 2006 (RosStat 2006). In Moscow, the share of transactions using mortgages was 7.5%, in Moscow region – 3%, in St. Petersburg and Leningrad region – 4%, and in Krasnodar region – 7%. At the same time, 25% of housing transactions were conducted using mortgages in Tyumen region, Khanti-Mansiisk and Jamal-Nenetsk regions. Also in Altai region the figure was as high as 24%, and in Udmurtia and Sakha republics – 15% (Indicators of mortgage market 2006). According to the Association of Regional Banks and BFI Consulting (2006), the share of mortgages in the regional banks’ balances was 22.7% in 2005, which is almost two times more than in Moscow banks. Thus, although 2/3 of all mortgage loans are concentrated in Moscow, mortgages play a very important role for regional banks.

Figure 7: Regional mortgage markets, volumes (mln rub.) and per capita



Source: AHML, 2006

On one hand, the regional differences in figures illustrate the smaller scale and more limited product offering of the regional banks. On the other hand, they also illustrate the substantial variation in housing prices between the regions. The price per square meter in 2004 varied from 42,132 RUR (about \$1,462) in Moscow to 4,626 RUR (about \$160) in Magadan. Between 2000 and 2004, the price per square meter of existing residence in Russia increased on average by 172 per cent. Regional variation was huge ranging from 445 per cent price increase in the Republic of Mordovia to 58 per cent in Perm. The increase of 173 per cent in Moscow was almost equal to the country average (Palacine & Shelburne 2005). The housing price differences naturally contribute to the mortgage scale difference. As a practical example, an interviewee of this study mentioned that two loans in Moscow will easily amount to USD 1mln, while the same two loans in Chelyabinsk would amount to USD 200 000 (Andrey Knyazev, IMB 11.2006). In addition, in Moscow and St Petersburg, mortgages are typically denominated in foreign currency, while in the regions loans denominated in ruble are dominating.

Also the customer base is different in the main cities (Moscow and St. Petersburg) and regions. In the regions, the income level of the population is considerably lower than in the main cities. As a result, the regional banks have a large number of customers with monthly income of \$500-\$1000, while in Moscow preference is given to clients with income of \$2000 and up, because the prices of housing are higher. At the same time, the Moscow banks have more liberal requirements for income proof. The majority of them are ready to give a mortgage to a client having partially “grey” income (officially not proved).

The initial mortgage payment in the regions is overall lower than in Moscow. Also, the Federal Housing Mortgage Lending Agency AHML is very active at the regional level. The mortgages purchased by the AHML are characterized by a high ratio of mortgage amount and cost of mortgage housing, and therefore they are more attractive for borrowers. In other words, regional banks have an opportunity to refinance mortgages, which are targeted to the segment of mass mortgages. The only problem with partnership with AHML is that the

bank is losing possibility to define its interest rate policy independently and as a result may face significant decrease of profitability.

Some of the regional differences in mortgage financing are determined by the regional peculiarities of the housing policy, transaction procedures and attitudes of the regional authorities. For example, in some regions mortgage programs are funded from the regional budget, i.e. regional authorities provide funding for subsidizing mortgage interest rates or initial payments. Also, the presence of large industrial companies in the region affects the development of mortgage market in the sense that it usually increases the construction volumes. In addition, large companies have lately started to offer special mortgage programs for their employees in order to improve their living conditions. This in turn fosters the development of the mortgage segment in that particular region/city and is a very attractive option for the local banks:

“Chelyabinsk has a very large metallurgy complex. The bank, which will have cooperation with this company, will have about 30% of all mortgages in the city.” (Andrey Knyazev, IMB 11.2006).

The number of players in the regional markets is still considerably smaller than in the capitals. Sberbank’s network is clearly dominating and its position will be challenging to undermine.

“People in the regions are still afraid of banks. For them only Sberbank exists. Its share is from 40 to 70%.” (Andrey Knyazev, IMB 11.2006).

Nevertheless, also other large Russian banks (such as Vneshtorgbank, CIT Finance) want their share of the regional markets. They are actively making investments in expanding their regional scope and developing regional networks.

“We have quite an aggressive plan for going to the regions. We expect to open a new additional regional office in every 2 days. So far, we can afford it, and moreover, we are still in profit.” (Anatoly Pechatnikov, VTB-24 11.2006).

As regards the mortgages, banks expect better growth opportunities in the regions due to more modest price growth for housing compared to the capital cities:

“St. Petersburg and Moscow don’t have such growth in mortgages. The price growth is higher there and, therefore, there are less possibilities of using mortgages.” (Olga Aleksandrova, CIT Finance 11.2006).

As regional banks have begun to issue mortgage loans according to the AHML standards and the capital banks are expanding operations to the regions, there is a tendency towards standardization and leveling out some of the regional differences.

“I think that with time the housing market will be more standardized. Now there are 78 subjects of the Federation and each of them has its own nuances, rules of business, and procedures for transactions. As a Federal level bank we need to analyze all of them and provide a solution in each region.” (Anatoly Pechatnikov, VTB-24 11.2006).

Until recently mortgage financing remained very complicated for regional banks. It is still relatively expensive activity for the banks and requires serious financial resources. Therefore, only midsize and large banks can actively work on this market segment. AHML programs in the regions allow also smaller regional banks possibilities to refinance mortgages and continue to develop.

The situation changed in 2006 and a mortgage boom in the regions was expected for 2007:

“2007 will be the year of regional mortgage market development. The share of the regions is growing. 2 years ago central and Northwest Federal Districts accounted for about 75-

80%. In the next 1-2 years about 40-50% of mortgage volume will be coming from the regions.” (Igor Zhigunov, City Mortgage Bank 11.2006).

In sum, the regional diversity in Russia shows also in the development of the mortgage market. So far, the regional mortgage markets have been developing mainly in the two main cities – Moscow and St. Petersburg. Mortgages are still quite rare outside these cities as people are not used to them and only during the last two years banks have begun to introduce mortgage products to the regions. The legal framework is continuously developing with the latest pieces of legislation adopted in the summer of 2006. The Agency for Home Mortgage Lending (AHML) has been very active in developing mortgage standards and refinancing the mortgage pools and preparing for securitization which would bring the development of the mortgage market to a different level. Nevertheless, challenges still remain in the implementation of legislation. These are discussed next.

3 The legal framework for the mortgage market

The relations between actors in the Russian mortgage market are regulated through several laws and amendments to them⁴. The main legal document, the Federal Law “*On Mortgages*” was adopted in 1998.

3.1 Mortgage legislation

The most significant development of the legal framework was made in 2004 when 25 Federal laws directed at the establishment of affordable housing markets were adopted. Among them were “*Housing Code of Russia*”, “*Town Planning Code of Russia*”, law “*On shared construction and housing cooperatives*” and several amendments to the acting laws on mortgages. According to Kosareva (2005), the laws that are regulating relations in the Russian mortgage markets may be grouped into five blocks:

The basic block includes the new “*Housing Code*”, which came into force in March 2005. It actually proclaims a new housing policy. The Code guarantees free accommodation in social housing only to the low-income population living in bad housing conditions. All other population groups are provided with necessary preconditions to buy, build or rent a home on the market.

The second block of laws is designed to boost the effective household demand for housing mainly through the development of mortgage lending. The proposed measures are expected to alleviate mortgage lending risks by streamlining foreclosure procedures, removing administrative barriers set by guardianship and trusteeship authorities, and making it illegal to occupy a sold dwelling by former owners’ families. The laws are expected to create

⁴ These include the laws “*On Mortgages*”, “*Housing Code of Russia*”, “*Russian Federation Civil Procedure Code*”, “*On Credit Histories*”, “*On State Registration of Real Estate Rights and Transactions*”, “*On Mortgage Securities*”, “*Russian Federation Law On State Duty*”, “*Russian Federation Tax Code*”, “*Town Planning Code of the Russian Federation*”, “*On General Principles of Regulation of Public Utility Tariffs*”, “*Russian Federation Budget Code*”, and “*On Housing Saving Cooperatives*”. See appendix 1 for a more detailed description.

necessary incentives for the reduction of mortgage loan interest rates, the improvement of mortgage loan affordability and the promotion of other forms of home purchase finance (direct shared financing of construction projects, housing saving cooperatives, etc.). The purpose of this block of laws is to provide financial schemes, methods and instruments with which Russians will be able to buy a home. Among other things, the development of mortgage insurance business will help to reduce payment requirements of banks and thus make mortgage loans more affordable for the buyers. The development of credit bureaus will also facilitate the credit underwriting and other procedures.

In 2004 it became possible to sell the apartment and evict the debtor in the case of non-payment of the mortgage (Civil Code 446). According to the previously active legislation this was impossible if the apartment acquired with mortgage was the debtor's only one. The powers of guardianship have also become more limited, as their intervention has caused problems with real estate transactions. Now, the approval of guardian committees is required only if there are individuals that are under guardians (mentally ill, under-aged without parents). This has provided families with children more chances to obtain mortgage loans. Earlier, banks were reluctant to issue mortgage loans to families with children because in case of nonpayment it was impossible to evict the debtor with a child according to the acting law.

The “*Law on Credit Histories*” came into force on 1 June 2005. The use of credit information may help lending institutions to reduce risks of fraud and default and therefore decrease their charges. The law has helped to attract also international institutions (i.e. Experian Credit Bureau) to participate in the process and to bring global standards to Russia. Although the credit bureau already works in several regions, the credit history data still remains decentralized and fragmented. However, the lack of transparency is expected to ease in the future as the processes and data acquisition develop further.

Also, an attempt was made to establish a system of credit risk insurance in residential mortgage financing by amendment to the law “*On the organization of insurance business in*

the Russian Federation”. This would allow creditors to reduce the required down payment and thus improve the affordability of residential mortgage loans.

The amendments also cancel the requirements for life and health insurance for individual mortgagors. The law also forbids using immovable property not insured against loss or damage as collateral for more than six months.

The third block includes laws designed to boost the supply in the housing market by creating better conditions for housing production. The key role in this block is assigned to the new Town Planning Code, which is expected to make the land-use and town planning regulation procedures more transparent and open to public. The Code breaks away from the current practice when land-use decisions are taken by bureaucrats on a case-by-case basis. The Code binds municipalities to use public procedures for design and approval of local legal zoning acts establishing land use and development rules. This will give a developer an opportunity to buy or lease out a land plot without waiting for the authorities’ instructions on what can be built on a plot and how. All such regulations will be incorporated into a public legal document on legal zoning.

Another important problem addressed by this block of laws is the communal infrastructure development of land. The territory of Russia is vast and sparsely populated. And yet, there is still a shortage of areas to be used for housing construction.

A considerable flow of investments into this sector is expected to be inspired by two laws: the law “*On investment agreements*”, and the law “*On Utility Tariff Regulation*”. The former was approved by the Federation Council on 13 July 2005. Its purpose is to provide a stable, effective and transparent investment regime that encourages investment in public projects in Russia. The “*Utility Tariff Regulation*” law came into force on 1 January 2006. It introduces the general principles of regulation of public utility tariffs, price premiums and connection fees, and delineates utility tariff regulation authorities of the federal, regional and municipal governments. It obliges all regulators and utilities to comply with the tariff

and price regulation procedures set by the law. However, taking into consideration all the deferred clauses in it, it has not started working with full power yet.

The fourth block of laws addresses the reduction of transaction costs on the housing market, and is concerned with tasks such as the state registration of real estate rights, provision of better protection to *bona fide* home purchasers, and abolition of mandatory notarization of mortgage contracts. On the whole, this block of laws helps to facilitate transacting on the housing market and strengthens the rights of various participants.

In 2004, the compulsory notarization of the mortgages was abolished both from the Civil Code of Russia and from the Federal law “*On Mortgages*”. This allows saving 1.5% of the transaction cost.

Amendments were adopted on 1.1.2005 to both the Civil Code and the law “*On state registration*” in an attempt to strengthen state guarantees for registered rights through the introduction of legal and financial guarantees for the rights of *bona fide* purchasers of real estate. These amendments also limited the power of guardianship authorities to forbid alienation of housing units belonging to owners with children, only to cases of minors without parental custody. They had also important consequences for the title history. Now, the transfer of title to a housing property to another person is a sufficient ground to terminate the rights of the former owners’ family members to use the property.

In order to provide greater security for the creditor by reducing the potential impact of undisclosed preferential rights, the amendments require defining limitations on a title and making them the subject of registration. The Unified Register must reveal all legal relations attached to a title clearly. The registration agency bears the responsibility for the timeliness and accuracy of entries in the Unified Registry, and the completeness and authenticity of information issued by the registry (Skyner 2005).

The fifth block of laws concerns the taxation policy (latest amendments were adopted in 2004 and came into effect on 1.1.2005 “*On making changes to the Russian Federation Tax Code*” 2004). Earlier, the seller obtained a property tax relief on home sale in full amount if he had had the ownership for 5 years. Now, the requirement for the length of the home ownership period has been reduced to 3 years. The new law also expands the property tax relief to include mortgage loans issued by Russian banks or other Russian institutions for the purpose of home purchase and construction. In addition, personal income tax deductions may be granted when home purchase or construction loans are provided by any organization. Earlier this applied only to bank loans. Also, loan interest is tax deductible.

The changes in the tax code have also cut down the tax on mortgage securities yield. Investors in mortgage securities (which are issued for 3 or more years) have got an incentive profit tax: for two years it was collected at a reduced 9 % rate (standard rate being 24%) and after 1 January 2007, at a 15% tax rate. This was expected to give an impetus to investments in housing infrastructure and mortgage securities businesses.

According to these amendments, transactions involving land and residential housing are not subject to value added tax. Property or funds received by mortgage agent as a part of its professional operations are not taxable.

As of 1 January 2006, the Federal Law “*On Land Fee*” has been abolished. The imposition of the land tax is now regulated by legislative acts adopted by municipal authorities (or regional bodies in Moscow and St. Petersburg) in accordance with the Chapter 31 of the Tax Code. Chapter 31 permits the use of different land tax rates when the project is under design and construction and when it is completed. This is expected to act as an incentive to complete construction projects. Local governments are allowed to transfer the incomes from selling or leasing out governmentally-owned land plots for housing construction purposes, to their local budgets in full until the division of the land property is done (according to the changes to the Budget code of RF). A summarizing table of the legal

framework for the mortgage market and its main changes in Russia is provided in Appendix 1.

Thus, the main components in the legislative framework of the mortgage market seem to have been formed. However, as the market is still very young and some pieces of legislation just came into force in 2006 there is so far only little experience in practical implementation and handling of different cases. These are discussed next.

3.2 The practitioners' views on mortgage legislation

Slow development of the legal framework has clearly impeded the development of the mortgage market in Russia. Other developing markets such as Kazakhstan and Ukraine started later, but have advanced further. For example, in Ukraine 15-16 % of all housing transactions use mortgages, while in Russia the figure is 6 % (Alla Tsytovich, DeltaCredit 11.2006). Despite the latest developments in mortgage legislation, the majority of the interviewed banks – both Russian and Nordic – and mortgage agencies find that considerable improvements are still needed in the mortgage legislation to reach the European standards. However, the interviewees pointed out that there is political will to develop the legislation, which is important for the market. Nevertheless, problems with the enforcement of the laws still prevail, which is at least partly due to the fast pace in drafting some of the laws without enough consideration on their practical implementation.

“Legislation is about 1/3 ready compared to the European level. There is still a lot of things to do and not only in the mortgage laws, but in corresponding areas: registration of the ownership etc., which impede the development. The law is as adequate now as it can be in the market that has existed only a few years.” (Alla Tsytovich, DeltaCredit 11.2006).

“Laws are there, but there is no experience and court practice of selling off the mortgaged real estate. Also, there are problems with State Registration. However, the number of

problems that we used to have with them is decreasing.” (Vladislav Nazarov, St. Petersburg Mortgage Agency 11.2006).

“Legislation is developing, there have been more laws coming out and generally things are going in a good direction concerning banking industry...Currency control was partially removed last summer and it is a good step.” (Anonymous representative of a foreign bank).

Overall, the banking legislation in Russia is perceived as complicated by Nordic banks. It is difficult to predict what is going to happen in the future, but all the banks unanimously noted that the development is definitely positive. For example, selling a mortgaged apartment in case of default has become easier. However, it seems that the Nordic banks are not fully up-to-date as regards the latest amendments as many still believe that there are problems with eviction in such cases, if the debtor who defaulted on payment does not have any other housing.

Almost all the interviewed Nordic banks also noted that the control is stricter on foreign banks than on Russian banks. Foreign banks have to be very punctual, otherwise they are penalized, while Russian banks have some flexibility.

“Foreign banks are under the spotlight what comes to supervision and control compared with Russian ones. Foreign banks can not cut any corners where as Russian competitors can take a shortcut. This is the same for all foreign business in Russia” (Kari Tolvanen, OKO Vostok capital 2.2007).

4 Actors and actions on the mortgage market

As in other countries, the key actors in the Russian mortgage market are organizations and individuals providing mortgage loans and associated services to customers. In addition, there are supporting institutions and services that provide financing for banks and other providers of mortgages. This chapter gives an overview of the key players in the Russian mortgage markets, and the financial instruments used for financing mortgage operations.

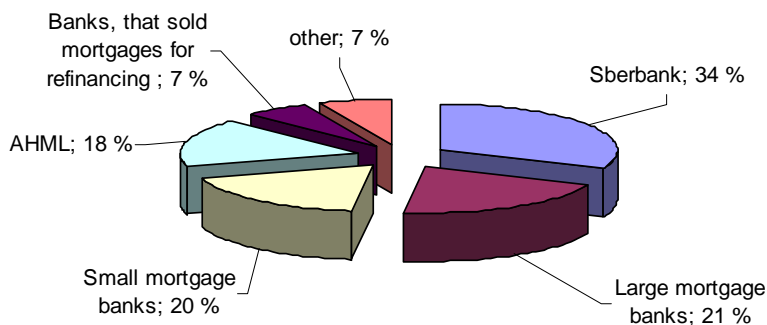
4.1 Banks, mortgage agencies and brokers

The key providers of mortgage loans and associated services to customers include banks that offer mortgage programs (large and small), specialized mortgage banks, mortgage agencies (Agency for Home Mortgage Lending and the others), mortgage brokers, and real estate agencies. These organizations and their role in the Russian mortgage market are reviewed next.

4.1.1 Banks

The number of banks that offer mortgage programs in Russia increased from 200 in 2004 to almost 400 by the beginning of 2006. These players include large state banks, such as Sberbank and Vneshtorgbank that offer a wide range of credit products as well as large foreign owned banks such as Societe Generale, IMB and Raiffeisenbank. There are also specialized mortgage banks, such as City Mortgage Bank, and Delta Credit Bank. Many smaller banks participate in the mortgage market by selling their mortgage pools for refinancing to AHML or other banks. Despite the large number of banks, the Russian mortgage market is relatively monopolized (see figure 8).

Figure 8: Shares of banks by the volume of issued mortgages in the 1st half of 2006



*Share of AHML was calculated by the number of the refinanced loans

Source: AHML 2006

Approximately 70% of the mortgage market is controlled by the top five banks: Sberbank, Delta Credit, Raiffeisenbank, City Mortgage Bank, and Vneshtorgbank. Large mortgage banks (which comprise 55% of the market) issue and accumulate loans for further securitization (such as Vneshtorgbank, Raiffeisenbank etc.). Banks in this group include also specialized mortgage banks, which issue mortgage loans and refinance loans of small and medium sized banks (CIT Finance, Delta Credit). Sberbank is playing in its own league with a 34% share of the mortgage market.

The leading players of the mortgage market have not changed very much in comparison with 2005. First two places are taken by the state banks Sberbank and Vneshtorgbank. Moscommerce Bank took the third place, and DeltaCredit Bank is on the sixth. However, when looking at these ratings one should take into account that they don't always reflect

real picture, as they include all types of mortgage products and depending on particular mortgage market segment the ranking might be slightly different.

“Official statistics on mortgages usually includes all types of housing loans, which is not the same as mortgage loans in its classical meaning (secondary mortgage market). The share of such loans in a bank portfolio can reach up to 50%, which can skew position on the mortgage market. Our bank indicators include the volumes of mortgages for the secondary market only, which is our main focus.” (Alla Tsytovich DeltaCredit).

Small mortgage banks (which comprise 20% of the market) issue mortgage loans and sell them to the Agency for Home Mortgage Lending (AHML) or other refinancing organizations. Often, these banks have problems with liquidity. The Agency for Home Mortgage Lending and its regional operators (comprising 18% of the market) issue and refinance the loans from the partner banks. Other banks and credit organizations, including housing cooperatives, comprise the remaining 14% of the market.

As can be seen in the Table 4, the difference between Sberbank and the other banks is significant both in the number and in the volume of mortgage loans. However, the growth figure for Sberbank is relatively modest when compared to specialized mortgage banks. The share of mortgage loans in the total consumer loans of the bank is highest in Moscommerce bank, and specialized mortgage banks like CIT Finance and City Mortgage bank. The share of mortgages in the foreign banks' (Raiffeisenbank, IMB and Societe General Vostok) total loans was lower: 26 – 38%.

Table 4: Mortgage banks' characteristics

Name of the bank	mortgages issued in 2006, thsd USD	changes from 2005, %	number of mortgages in 2006	mortgage portfolio 1.1.07 thsd.USD	Share of mortgages in total consumer loans on 01.07.06, %
Sberbank	4 295 301	143	165 767	5 841 002	-
VTB 24	756 550	409	8 939	930 556	-
Moscommercebank	620 000	474	3 377	598 490	90,59
Uralsib	337 000	259	9 200	395 000	27
DeltaCredit	291 000	160	-	421 000	-
CIT Finance	277 626	9004	5 685	408 687	97,74
Transcreditbank	241 359	3589	6 246	241 818	37,3
City Mortgage Bank	217 373	298	2 570	89 280	100
Gasprombank	195 488	139	3 869	306 432	38
Rosbank	192 891	1422	3 300	204 107	-
AbsolutBank	186 659	166	2 021	226 054	74,12
Societe Generale Vostok	181 843	198	956	182 016	38
Bank of House Finance	179 900	675	3 539	140 200	95,65
Vozrozhdenie	171 625	262	5 360	156 672	47
Raiffeisen	169 170	72	1 597	267 994	26
Zapsibcombank	166 777	290	3 653	185 433	48
Uniastrum	163 423	807	3 870	112 839	40,25
IMB	144 000	233	1 550	175 000	21

Source: RBC Consulting 2006

Sberbank is the leader of the Russian banking industry, accounting for over a quarter of national banking assets. Established in 1841 it gained its present status of an open joint-stock company in 1991. Sberbank remains the largest bank in Russia and Central and Eastern Europe in terms of Tier I capital and assets. The bank's total assets — RUB 2,513.1 billion — exceed the combined assets of the next 10 largest Russian banks. The Central Bank of the Russian Federation (CBR) is the majority shareholder (over 60%) with the rest of the shares dispersed among portfolio, private and other investors with the estimated shareholding of about 20% by foreigners. Sberbank shares are the only bank stock quoted and freely traded at major Russian stock exchanges as "blue chips". The competitive advantages of Sberbank are in its regional network and working with the ruble, and the system of annuitant payments, which are higher in the beginning of the loan term.

Vneshtorgbank (VTB) was established in 1990 as a private corporation with government ownership with a focus on handling foreign exchange for Russian companies and institutions at the time. In 1998, the bank was transformed into a public corporation. Presently, the Government of the Russian Federation is the major shareholder of Vneshtorgbank, with its share accounting for 99.9%. The bank's equity amounted at RUR 82.3 billion as of 1 January 2006, which makes it the second largest bank after Sberbank. It has a very successful mortgage program and wide regional presence. Also, VTB was the first bank to carry out the international mortgage securitization in 2006.

CIT Finance Bank is an independent Russian investment bank, providing financial services to corporations, institutional and individual investors. It was created in 2001. Now it has more than 25 offices in Russia and Eastern Europe, and provides a wide range of financial services, including mortgage lending. CIT Finance has attractive mortgage lending and refinancing program, and several special customers' mortgage centers. CIT Finance showed one of the fastest growth rates in mortgage market during 2005-2006.

City Mortgage Bank was established in 2004. It has developed very fast and is now among the top 5 banks working on the mortgage market. It is a specialized mortgage bank,

with own capital of more than 1 bln RUR. It was established with participation of Rossgosstrah – leader of the Russian insurance market. City Mortgage Bank has become the first Russian private bank to securitize a mortgage portfolio within the international market. The City Mortgage Bank was acquired by the US investment bank Morgan Stanley in December 2006.

Delta Credit Bank was the first specialized mortgage bank in Russia. Delta Credit is an important player in the mortgage market, taking the third place among all the banks in 2005. Since November 2005, Delta Credit has been a subsidiary of Societe Generale, a major international financial group and in 2006 it became 100% owned by the Societe Generale. Now, Delta Credit accounts for approximately 20% of Moscow mortgage market.

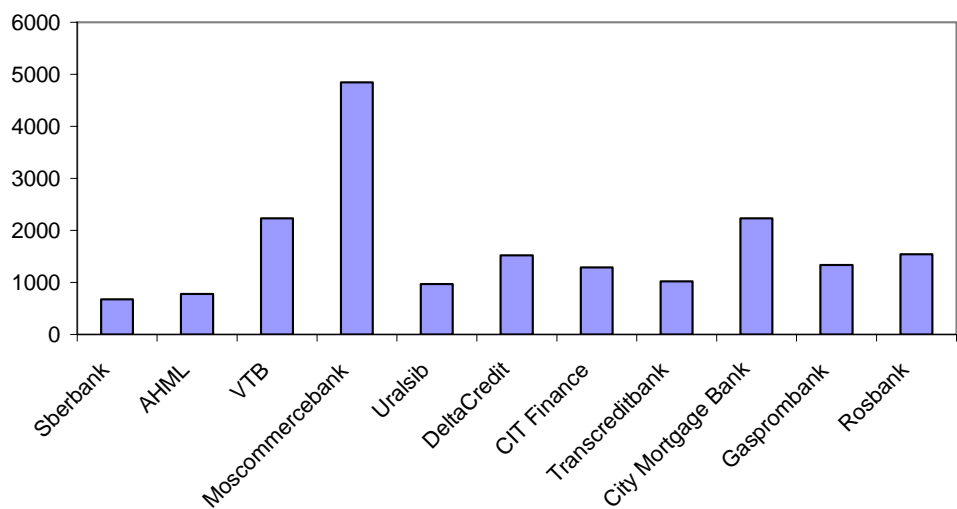
Raiffeisenbank was one of the first foreign banks that looked into the Russian retail market. It entered the market in 1999, during the financial instability and its slogan was very successful: “Your western partner in the Russian market”. In 2000, Raiffeisenbank introduced its own mortgage program and its mortgage portfolio had reached 166,3 mln USD by May 2006. Raiffeisenbank was also among the first banks to expand into the regions. Today, it has 20 service points in Moscow, St. Petersburg, Yekaterinburg, Samara, and Novosibirsk.

International Moscow Bank (IMB) was established in 1989. It was the first Russian (at the time Soviet) bank to attract investment from foreign banking organizations. For a long time IMB worked only with corporate clients. In 2001, IMB began to finance retail customers after a merger with the Bank Austria-Moscow, which already had 5 offices in Moscow. Nowadays, the bank is universal, servicing both corporate clients and individuals. In 2005, IMB showed the highest growth rates in mortgages among all the foreign banks. It works with both foreign currencies and RUR. By 2007, 95% of stakes belong to Bank Austria Creditanstalt, member of UniCredit Group. On the mortgage market IMB works predominantly on the primary market – financing already built housing.

Societe Generale has a long history in Russia, dating back to the pre-revolutionary and Soviet eras. The latest acquisitions include purchase of 100% of Delta Credit, acquisition of 10% stake of Rosbank and purchase of “Capital credit JSC” in 2006. On the mortgage market Societe Generale prefers to issue loans in foreign currency and mainly works with secondary market mortgages. However, in St. Petersburg the bank has made some agreements with the construction companies to finance also unfinished construction.

Average amount of a mortgage loan varies among the banks (Figure 9). Interestingly, the Sberbank is among the lowest, which likely due to its wide presence in the regions.

Figure 9: Average mortgage loan amount in 2006, 1000 rubles



Source: AHML 2006

Geographically, the main players of the mortgage market are not anymore limited to Moscow and St. Petersburg, as it was until recently (Table 5).

At the present there is a tendency that the Moscow-based banks expand to regional markets. Vneshtorgbank, Vozrozhdenie, Rosbank, Bank of Moscow, and others are actively

marketing their programs in the regions. Nevertheless, Moscow and the Moscow region account for 40% of all organizations (RBC 2006).

Table 5: Subsidiary networks of the top banks

Name of the bank	Number of subsidiaries	Volume of consumer credits per office on 01.07.06, mln rub.
Sberbank	905	27,7
Rosbank	67	124
Uralsib Bank	41	61,4
Bank of Moscow	44	83,5
Vneshtorgbank	58	16,7
Uniastrum Bank	34	31,5
Gasprombank	34	84
Russian Standard	0	1 270,80
IMB	8	345,3
Raiffeisenbank	9	616,2
CIT Finance	1	71,5
Bank Societe Generale Vostok	3	310,3
Absolut Bank	3	196,5
Bank of Home Finance	2	95,5

Source: RBC Consulting 2007

4.1.2 Mortgage agencies

Mortgage agencies were established by the state and they are government structures aimed at providing mortgage opportunities based on the unified federal standards. They define the terms of mortgages and provide consulting to their clients. Mortgage loans are issued by partner banks, agencies buy the mortgage rights from their partner banks and hence become creditors for the full term of mortgage lending. So, the client has to decide whether to work with a mortgage agency or with the bank, which has its own mortgage program.

Agency for Mortgage Housing Lending (AHML) is one of the main players on the mortgage market. It was established in 1997 as a 100% state owned company. It has established a network of regional operators and service agents. In 63 regions, nearly one hundred organizations issue mortgages according to the federal standards. Backed with the state guarantees, AHML has issued six securities emissions for 10.42 bln RUR since 2003. These are traded at the Moscow Stock Exchange. This allows to attract significant funds to the federal refinancing system and to develop the regional networks.

The AHML has also introduced differentiated interest rates for mortgages, and hence expanded the number of credit programs. Now, in the Federal program, the interest rate is from 11,5% -14,5% in rubles with the initial down payment of 70%. Also, the pay-back time has been increased up to 30 years. During the first half of 2006, AHML accounted for 18% of mortgages (AHML 2006). The regional subsidiaries of AHML are located in almost every region of Russia.

St. Petersburg Mortgage Agency was founded by the city council in 2003 on the basis of the Northwest subsidiary of the AHML. The Agency aims at establishing and organizing the system of the mortgage lending issuance and refinancing according to the Federal standards of AHML. St. Petersburg mortgage agency is working on “City program of mortgage lending” which is part of the national project “Affordable housing”. It cooperates with 26 commercial banks, 6 insurance companies and 10 appraisal companies. [<http://www.ipoteka.spb.ru/>].

Leningrad region home mortgage agency (OblZhAIK) was established by the Leningrad region administration in 2005 to develop the system of mortgage finance and to assist in the regional programs of housing construction. Nowadays, the agency focuses on providing mortgages to people in the Leningrad region. It also refinances the mortgages issued by AHML. The Agency has signed contracts with banks as well as with appraisal and insurance companies. [<http://www.ipoteka-lo.ru/>].

“Baltic Mortgage Corporation” is an official representative of AHML and “ATTA Mortgage” which allows it to offer its clients various mortgage programs in addition to the Federal mortgage program. The company provides all the services needed for buying housing, including mortgage, appraisal, insurance, and all the related transactions in St. Petersburg, Leningrad region and other regions of Russia. It is not a middleman between the creditor and the borrower. Rather, it can independently issue a loan based on the Federal mortgage program, and also refinance a loan.

Moscow Mortgage Center has been working with real estates since 1999 and unites about 20 organizational structures. The companies of Moscow Mortgage Center Group are working in the area of construction investment, realtor services, and mortgages. It is also one of the leaders among the mortgage brokers on the market. [<http://mosipoteka.ru/about/>].

4.1.3 Mortgage brokers/real estate agencies

Lately, new agents have emerged on the mortgage market – mortgage brokers, or mortgage consultants. Their emergence is related to the growth of the number of credit organizations on the mortgage market. A mortgage broker is a specialist who can help a client to find the best option among the possible mortgage programs fitting his/her needs and possibilities.

Since these services are quite new, there are no definite standards to regulate them. The volumes and costs of mortgage broker services vary between companies. Currently there are two main types of mortgage brokers: independent specialized agencies of mortgage consulting and mortgage brokers in realtor companies. The main difference between them is in the volume of services.

Independent mortgage brokers usually work with clients only at the stage of selecting a mortgage program. Usually, in this case, a mortgage broker is not responsible if the bank refuses to grant the loan. Also, due to the novelty of these services, mortgage brokers have

not yet established their position among the consumers. This limits their activities and possibilities.

Mortgage brokers operating within realtor companies do not have the same shortcomings as independent mortgage consultants. Realtors became pioneers in the mortgage consulting in Russia, as they had to help clients obtain loans. Realtors' partnerships with banks (which are based on long term cooperation), allow them to quickly find appropriate programs for clients, and sometimes even to soften the banks' requirements.

The payment for the services varies from \$500-\$1500. In some agencies, mortgage broker services are provided free of charge, taken that the client buys housing with this agency. Mortgage brokers and real estate agencies with mortgage broker services include actors such as: "Moi Dom", "Dom Ipoteki", "ipoteka.ru" "LegkoCredit", "Mir Ipoteki", Independent Bureau of Mortgage credit *NBIK*, and Agency *MIEL*.

The mortgage brokers are not very popular yet due to the additional costs that are not always well-justified for clients.

"Mortgage brokers are still in the rudimentary condition. Their function is still carried out mainly by the mortgage departments of realtor agencies. The main reason that the mortgage brokers do not work actively yet is the cost of their services. Russian people understand that they can also easily find a bank and a program on the internet, and not pay 1-2 % for a mortgage broker. It is difficult for a client to understand why they have to pay extra 1-2 % for nothing." (Andrey Knyazev IMB 11.2006).

4.1.4 Non-banking organizations

Besides the banks and mortgage agencies there are other actors that are quite active on the Russian mortgage market. These include housing construction cooperatives and housing

savings cooperatives that were a very popular way for financing housing during the 1990s, and mortgage cooperatives, which is a new form that appeared only recently. The share of these cooperatives is 20% of non-banking organizations on the market. Business activity in the sector of housing construction has slowed down significantly when the new law “*On Housing Cooperatives*” (№ 215) became active in April 2005. Some experts call this law a “twin” of the federal law on shared participation (№ 214), which almost completely disabled the shared construction cooperatives. The law № 215 made it practically impossible to register new cooperatives. The latest amendment in the spring 2006 concerning the housing cooperatives allowed housing cooperatives to participate in shared construction of multi-apartment complexes as co-investors. However, the result is that nowadays the constructors have completely stopped making contracts of shared cooperatives participation and the amendments of 2006 are not likely to revive the activity of the used-to-be very popular cooperatives. The mortgage cooperatives are gaining popularity as the housing savings and construction cooperatives experienced a lot of problems due to the imperfections in legal framework. In 2006, there were about 70 mortgage cooperatives and 82 housing savings cooperatives in Russia.

Large oil and gas companies have their own ways of financing housing and participating in the mortgage market. Their share on the mortgage market among the non-banking organizations is 20%.

Construction companies also provide housing financing options and their share among the non-banking organizations is 12% (Analysis of the competitive advantages, 2006).

4.2 Financial instruments for mortgage programs

For a bank to have a mortgage program it is necessary to have access to reasonably-priced long term financing. For foreign banks that are operating on the Russian market this is not a problem, as they have access to the global financial institutions and are thus able to receive financing at a competitive rate. For Russian banks, getting access to long-term financing is

a major challenge. There are several ways for obtaining financial resources: issuing mortgage backed securities (mortgage securitization), refinancing mortgage loans and mortgage mutual funds (PIFs). The situation concerning these instruments in Russia is discussed next.

4.2.1 Mortgage securitization

Securitization is a process of issuing securities, based on the credit portfolio, which transfers the pooled assets into the securities backed by these assets. Mortgage securitization allows taking mortgage loans off the bank balance and minimizes credit risk.

In the Czech Republic, Slovakia, and Poland, mortgage securitization developed rapidly in 1995-1999. Also in Brazil, the securitization market grew by 47 times during 2002-2005. In Brazil, cross-border securitization still dominates while in Mexico, domestic emissions of mortgage-backed securities (MBS) are traditional. However, in the recent years there has been a tendency for domestic securitization also in Mexico. Russia seems to be going through similar stages as the countries in Latin America in securitization.

The securities market and securities transactions within the Russian Federation are primarily regulated by the Federal Law *"On the Securities Market"* adopted in 1996. The offering of corporate securities is regulated by the Federal Law *"On Joint-Stock Companies"* from 1995, and by the Law *"On Banks and Banking Activity,"* (1990).

The Federal law *"On mortgage backed securities"* which provided regulation of emission and circulation of mortgage securities was adopted in November 2003. This law contains provisions for the development of both mortgage-backed bonds (MBBs) and mortgage participation certificates (MPCs). Mortgage-backed securities (MBSs) are defined as securities issued by special mortgage institutions for which the performance is secured by a mortgage pool. The mortgage pool is pledged by the issuer, for the benefit of all holders of the bonds, in order to secure payments on the mortgage-backed bonds.

In addition, the law on “*On Mortgage Backed Securities*” allowed involving also the secondary market in construction financing and therefore allocating risk more effectively throughout the financial system. As a response, several Russian banks have launched mortgage programs, including Vneshtorgbank and National Reserve Bank. In July 2006, President Putin signed amendments to the federal law “*On Mortgage Backed Securities*”, which further expanded the range of mortgage-backed securities.

Vneshtorgbank was the first Russian bank, which carried out an international mortgage backed securitization (MBS) in July 2006 for the amount of \$88.3m. It is backed by dollar denominated mortgage loans issued by Vneshtorgbank to borrowers in Moscow and St Petersburg. The success of this pilot transaction encouraged the further development of securitization of larger volumes of mortgages. Vneshtorgbank plans to become a middleman for Russian banks in the West and to establish a special company – conduit, which will accumulate mortgage credits of Russian citizens for the purpose of its further securitization.

The example of Vneshtorgbank was soon followed by others. Later in 2006 securitization was done by the City Mortgage Bank (the first private bank in Russia to have international MBS). Now, the City Mortgage Bank is beginning to accumulate assets for making a second emission of MBS. This will also be a cross-border transaction and MBS will be allocated among western investors. The first securitization showed a great interest to the securities, and the investors were ready to buy much bigger volume that the bank could offer. The second emission is planned for about 200 mln USD.

Agency for Home Mortgage Lending (AHML) has been a major active player in the securitization. It has issued mortgage backed securities in August 2006, A7 (4 billion RUR), A8 and A9 (5 billion RUR each). The Russian government is providing state guarantees for 14 billion RUR for AHML bonds. This allowed beginning the domestic mortgage securitization era. In 2007 it issued mortgage backed securities for 3,29 bln RUR

through ZAO “First mortgage agent” and recently made a decision for planning to second issue of MBS for 10,727 bln RUR.

Gasprombank completed a mortgage securitization on the international market with the volume of 200 mln USD. This is different from the Vneshtorgbank securitization, as Gasprombank secures the mortgages with its subsidiary “Sovfintrade”(as of June 2007 this name has been changed to the joint-stock bank *GPB Ipoteka* as it began forming its own regional operators’ chain to provide, refinance and serve home mortgage loans.

Table 6: Selected securitization transactions

<i>Bank</i>	<i>SPV</i>	<i>Originators</i>	<i>Emission date</i>	<i>Term and year of repayment</i>	<i>Volume</i>	<i>Rating of the senior tranche</i>
Moscommerce bank	Moscow Stars B.V.	HSBC and Raiffeisen Zentralbank Oesterreich	July 2007	2034	\$184.4 mln A: \$163.2 mln B: \$16.6 mln C: \$4.6 mln	Moody's/Fitch: A: Baa2/BBB B: Ba2
DeltaCredit Bank	Red & Black Prime Russia MBS No.1 Limited	Societe General	April 2007	2035	Total \$206.3 mln \$173.2 mln \$14.5 mln \$18.6 mln	A/A2; BBB+/Baa2 BB+/Ba2.
Sovfintrade	"Mortgage Specialised organizations GPB Ipoteka	Gasprom Bank, Moscow Stock Exchange	November 2006	2036	3'000mln rub	Moody's: Baa2
Sovfintrade	Dali Capital PLC, Luxembourg	Gasprom Bank, Barclays Capital, HSBC Bank PLC	December 2006	2046	€168 mln	Moody's: A3
City Mortgage Bank	City Mortgage MBS Finance B.V., the Netherlands	Moscow Peoples Bank (London) Greenwich Financial Services (USA)	July 2006	2033	\$72.6 mln	Moody's: Baa2
Vneshtorgbank	Russian Mortgage Backed Securities 2006-1 S.A. (Luxembourg)	Barclays Capital, HSBC Bank PLC	July 2006	2034	\$88.3 mln	Moody's: A1 Fitch: A-
AHML	ZAO "First mortgage agent AHML"	Citibank	May 2007	2039	3294.8 mln RUR A: 2900 mln rub B: 264 mln rub C: 130,8 mln rub	Moody's: A: A3 B: Ba1

Source: Rusipoteka 2007

Also, the private mortgage conduit “*Russian mortgage accept company*” has been established, which specializes in forming the pool of mortgages and its further securitization.

Securitization is rapidly developing and during 2006 there were 12 securitization transactions for 3,4 bln USD, while in 2005 there were only 2 for 198 mln USD (Rusipoteka 2007). As the mortgage market is growing quite rapidly many large banks are aiming at increasing their finances by securitizing their mortgage loans. However, securitization is expected to remain an activity concentrated on only a group of banks with capital between 5-30 million euros.

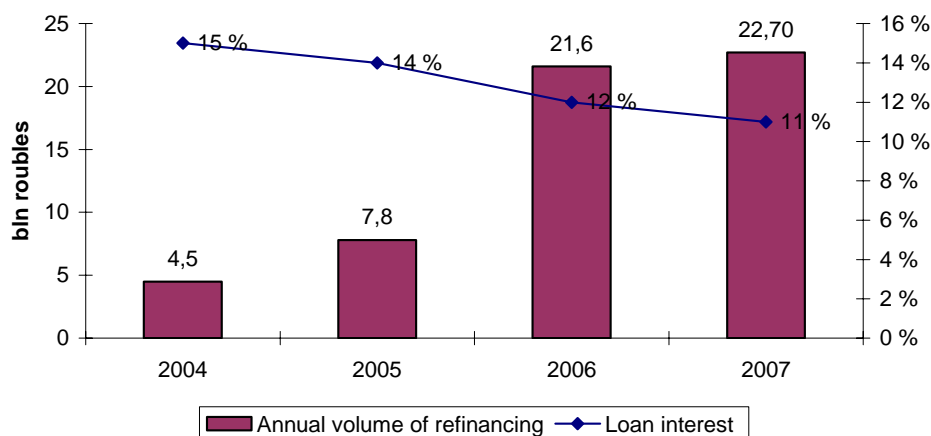
Several large banks (i.e. Vneshtorgbank, City Mortgage Bank), which were looking into carrying out mortgage securitizations in 2007, have decided to postpone the securitization due to situation on the US mortgage market and liquidity crisis until the situation becomes more stable.

4.2.2 Refinancing

Refinancing is also a tool for obtaining additional financing for the banks. So far, mortgages have largely been refinanced by the Agency for Mortgage Housing Lending (AHML). Since agency’s foundation in 1996, 100558 mortgage loans were refinanced with total volume of more that 70 bln RUR. The current share of AHML on the mortgage market is 10% (AHML 2007).

During the first half of 2006, several banks introduced their own programs of refinancing: Raiffeisenbank, CIT Finance, Vneshtorgbank, National Reserve Bank and IMB. Also, Absolut Bank, Uniastrum Bank, Bank “Vozrozhdenie” and others are going to refinance their mortgages.

Figure 10: Volumes of refinancing and interest rates 2004-2007



Source: AHML 2007

The refinancing scheme is usually the following. In cooperation with the bank that offers refinancing program, other banks, which are in need of long term financing, will grant mortgage loans on special terms, defined by the refinancing bank. Then, the bank with refinancing program will buy-out these mortgages, create pools and issue debt securities.

4.2.3 Mortgage mutual funds (PIF)

Due to the earlier inadequacies in the legislation for Mortgage Backed Securities in Russia, PIFs have been playing a role of securitization of the mortgage loans. Shareholders of PIFs are non-governmental pension funds and financial companies.

The legal framework for PIFs seems to be adequate and functioning relatively well. There is a network of experienced organizations, which is necessary for establishing PIFs (i.e. managing companies, registration organizations, appraisal and auditing companies).

Since 2005, PIFs have been buying a certain part of mortgages from the banks. Some experts call PIFs an alternative to mortgage backed securities, but so far PIFs are not

independent from the banks where they buy the mortgages, so they cannot ensure the investor's rights.

Each PIF is working with the mortgage products of one bank, as the mortgage products of different banks are not always compatible in one PIF. By 2006, there were 6 companies that had registered PIFs (see Table 7). The total volume of the mortgage loans securitized by PIFs was about 4 bln RUR.

Profitability of the PIFs is limited by the interest rate for mortgage loans, out of which 3-4% is going to the funds' infrastructure.

Table 7: Mortgage Mutual Funds - PIFs

Name	Managing company	Date of establishment	Bank	Closing date
UGRA Mortgage Fund	Region Development	Established 15.06.05	Banks of Khanty Mansi	14.05.20
NVK – City Mortgage	NVK	Established 14.09.05	City Mortgage Bank	01.09.10
Mortgage Fund №1	Collective Investment	Established 24.03.06	For servicing MIEL-real estate	10.02.11
First Mortgage Fund	KUI Jamal	Established 04.10.05	Mortgages refinanced by AHML	01.10.08
Second Mortgage Fund	KUI Jamal	Established 04.05.06	Mortgages refinanced by AHML	01.10.11
First United	Russian Capital PIF	Established 31.07.06	Sovintrade Bank	22.06.11
CIT Mortgage Fund	CIT Finance	Being formed	CIT Finance bank	3 years

Source: RBC Consulting 2006

From the liquidity point of view, the mortgage backed securities are more attractive than the PIFs. Transactions with PIFs are also more complicated than the ones with securities,

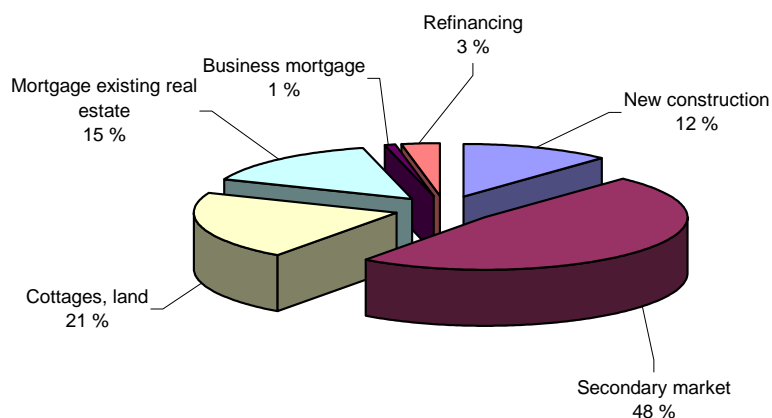
requiring more paper work. PIFs' shares are more profitable for a short term, while mortgage backed securities are more stable over a longer period of time.

Since January 2006, PIFs are allowed to have property rights for investment contracts of housing construction for up to 1 year. This partially solves the problem of investment in this sector. Moreover, the PIF's property can now include also financial requests, based not only on credit agreements but also on mortgage loans. It means that mortgage PIFs can start to refinance mortgage loans.

5 The types of mortgage products in Russia

There are several types of mortgage loans on the Russian mortgage market. The two most common are mortgages on residential housing on the *primary* market (unfinished construction) and *secondary* market (already built apartments). The third most popular type is the mortgage loan issued for already owned housing. Such loans are usually used to upgrade and renovate current housing. Also mortgage loans for cottages, country homes, elite housing, and pieces of land are a growing segment. The share of commercial or business mortgages is very small, but may be developing more in the future as banks are increasingly working with the developer companies. Figure 11 shows the distribution of different types of mortgage products on the market.

Figure 11: The market shares of different mortgage types in November 2006, %



Source: Analysis of the competitive advantages, 2006

New construction housing (or primary market) can be sold on all stages of construction. The specificity of this type is that construction is usually done on the investors' funding. So, those who buy housing in the primary market are not owners until the property rights

are transferred after the construction is finished and the house is accepted by the State Committee. It usually takes from 6 months to 1.5 years before a person who has paid for the housing becomes an owner.

Since 2005, unfinished construction objects are considered to be real estate. Therefore, also unfinished housing can be a mortgaged object. However, this does not apply to a purchase of an apartment in an unfinished multi-apartment house. It is only applicable in the case of cottage construction. Before the amendment, it was possible to get a loan for finishing house construction. However, because the unfinished house was not in the ownership of the individual, bank was not able to mortgage it.

As a result, almost half of the banks on the mortgage market nowadays offer programs also for unfinished construction. However, the interest rates for the primary market are 2-3% higher than those of already built housing. Banks do not want to encounter additional risks from constructors, since there is no property being pledged until construction is completed and the title is obtained. Each case is unique and requires information and documents on completion terms and property transition. Some banks, for example Sberbank, actively participate in this market, but the deals are usually backed by the state or corporate financing of the entire project. Also, as there is a growing demand for the primary market housing, some banks issue mortgages for unfinished construction but only in the presence of some additional back up, such as under the condition that the construction is done by trustworthy companies. According to the AHML statistics, in the 1st half of 2006 only 13% of mortgage transactions were made on the primary market (AHML, 2006). The constant increase in real estate prices and stable demand for housing have made many consumers use primary market deals not only to obtain new housing, but also as a very profitable investment project, with annual returns of up to 100 percent (Mortgage financing at the present 2006).

Mortgages of already built residential housing (or secondary market⁵) are the most common ones: 87% of mortgage transactions were done at the secondary market in the 1st half of 2006. There are certain peculiarities in these kinds of mortgages, as well. For example, it may be difficult to get a mortgage for purchasing an apartment if the seller (current owner) has made any unregistered renovation in the apartment. Also, the apartment history, i.e. previous owners, occupants and tenants, needs to be checked in order not to come across any unpleasant surprises with, for example, previous owners' distant family claims. Usually, it is the task of real estate agencies/mortgage brokers to find out these issues.

The mortgage transaction for purchasing a **countryside cottage** is very similar to the mortgage transaction of buying an apartment in the city. The potential problem here concerns the appraisal of the property. Bankers and realtors as well as mortgage brokers note that in contrast to city residential housing, country housing can be appraised only with some 40% precision. Thus, the creditors are facing the dilemma: if a real estate cannot be appraised precisely, it is impossible to forecast how easily and for how much it can be sold in case of the borrower's default.

The specificity of the **mortgage of a piece of land** is that both the land and the leasing rights can be mortgaged. By the law there is a special regime according to which the mortgage of these rights can be done only with the agreement of the owner of the land and for the term that does not exceed the lease term.

Recently, land mortgage has become a focus of attention, as it can be a source of funding for the preparation of the territory for construction, which usually requires substantial investments. Hence, with the land mortgage it will be possible to mortgage the piece of land in the bank and develop the territory for construction, which later can be sold at the auction, payoff the mortgage and receive profit as the developed piece of land costs more.

⁵ A newly constructed apartment belongs to the city and the first transaction is the transition of property rights to an individual or organization. Therefore, all the following transactions are secondary.

AHML is working on developing and introducing the mechanism of land mortgage and beginning pilot projects using land mortgages in Kostroma, Rostov and Kaluga regions. However, to make the land mortgage work properly, several amendments to the law “*On Mortgages*” and “*Budget Code*” are still necessary.

Commercial estate mortgage is very similar to the residential housing mortgage. The main difference is that the object has to be in the company’s (individual entrepreneur’s) property before the mortgage can be issued. In the case of commercial mortgage, the bank will issue the mortgage only after the state registration of the transfer of ownership rights to the borrower is completed. The banks issuing commercial estate mortgages include only a few banks that are mostly foreign. The share of this type of mortgages is only about 1% of the market. However, it is a growing segment, as the investments in commercial estate are steadily increasing as the number of offices, hotels and shops especially in the capital area is growing.

Mortgage loans backed by existing real estate property are targeted at people who already have housing but would like to improve their living conditions without paying an initial down payment for the mortgage loan. The market share of this type of mortgages is quite significant – 15%, which is slightly higher than the market share of the mortgages for new construction.

Mortgage loan refinancing is quite a common practice in many countries. Loan refinancing allows lowering the interest rate or term of a loan and saving money on payments. Many financial institutions are offering such deals even though they are not advertising them very much. If the borrower has a good credit history, then in the majority of cases the question about refinancing is usually solved within the original bank. The client can also apply to another bank, or mortgage broker⁶, who will find him a more appropriate mortgage program. When refinancing the loan the borrower has to carry the

⁶ For finding an appropriate refinancing program the mortgage brokers charge a fee, for example “*Fosborne Home*” - 1.5% of a new loan, “*Laurel*” – 0.5% of a new loan, and “*Moi Dom*” 17,5-35 thousand RUR.

same transaction costs as when getting the initial mortgage contract (e.g. account and commission fees). In addition, refinancing is not always profitable for the borrower, as he/she may have received tax or interest relieves, which may be lost in the other bank.

Refinancing programs have appeared on the Russian market only recently. Earlier, when the volumes of mortgage loans were smaller there was no need for refinancing. However, in the last couple of years the mortgage market has evolved significantly. As the interest rates decreased during 2006, many clients who got a mortgage loan before that may be willing to refinance it in order to get a lower interest rate. Also, many banks decided to start refinancing programs as a result of the high housing price growth in 2006, which decreased the number of people willing to get a mortgage loan. From the banks' perspective, it is often safer to attract the clients from other banks by offering them better terms, than to attract new clients. However, refinancing deals are not yet very common because there are not so many borrowers that can be refinanced.

5.1 The terms of mortgage loans

As new – including foreign – players are entering the Russian mortgage market, the competition is increasing. This has had very positive impacts for the consumers, as the competition between banks has made the mortgage loan conditions much more favorable. In 2006, it became possible to get a mortgage loan without an initial down payment, and many banks offer mortgage loans even without official proofs of income. Some banks have gone as far as adopting a policy where it is possible for the debtor to take into consideration also the incomes of relatives and friends. In addition, many banks have tried to simplify the procedure of documentation for mortgage transaction. A new concept of express mortgage has been introduced as many banks can now make a decision about issuing a mortgage within 1-2 days. Also, it is possible to put a lower price of the real estate in the mortgage contract in order to avoid taxes.

A common characteristic of mortgages in Russia, Latin America, Eastern Europe, and the CIS countries has been the short payback time of mortgages. Domestic credit institutions have not been able to provide long term loans. The average term of a mortgage loan has been 10 years or less due to the political instability, low savings, inflation risks, and uncertainty of real interest rates and exchange rates. However, the situation is changing. In Russia, the term of mortgage products increased from 10 up to 30 years in 2006 in many banks. This is mainly due to increased competition in the market. However, in many cases people are trying to pay back the mortgage loan before maturity⁷.

In many emerging mortgage markets it is typical to have mortgages issued in both local and foreign currency (USD, EURO). The mortgages in foreign currency have been quite popular and having a possibility to choose between both local and foreign currencies as well as fixed and floating interest rates, have provided a possibility to get insured against the currency risks. In some countries, such as Poland and Mexico, the dual index mortgage (DIM) has been used. This model usually uses two indexes (wage and interest rate) to determine the loan balance and payment amounts in case of high inflation. In the dual index mortgage, the interest rate is adjustable and can periodically rise or deflate depending on the market rate. This helps the borrower to maintain a stable debt-to-income -ratio. If the economy is doing well and wages are high, the borrower can pay off the mortgage in a shorter period of time. However, if the interest rates rise, the borrower will need more time to pay off the mortgage loan. Now, in Poland, mortgages with floating rates prevail and the majority of loans are issued in local currency. Also, there is a mortgage product which allows changing currency during the loan term.

Starting from July 2006, the differentiated interest rates for mortgages were introduced in Russia, which allowed increasing the number of credit products. Average interest rates for

⁷ The concept of “*being in debt*” is still quite new and scary for many Russians and they are trying to pay loans back before maturity. Also, in the majority of mortgage programs in Russia, the early payment of the loan is not subject for penalty or extra fee as in the West.

the mortgage loans in 2006 were 13 % in RUR, and 11 % in foreign currency (Zamulina 2006). The interest rates were in decline in 2006, but the real price of the mortgage loan cannot always be calculated based on only the interest rate, as there may be considerable hidden fees related to it.

Each bank has a program which in addition to different interest rate will have different conditions, such as mortgage account fee, application fee, safe box fee, etc. For example, fees for opening up an account are about 1% of the loan, and the mortgage application fee can be about 40-60USD. Also money transactions require usage of the bank safes, for which clients have to pay. So, even though the advertised interest rates can be lower in a bank it does not mean that the “real” interest rate that the client will end up paying is (see Table 8 for an illustration). An interviewee of this study well illustrated the situation:

“Everybody offers very similar products, but there are many skeletons in the closets. There are a lot of banners advertising mortgage loans all over Moscow. But in 95% of cases the declared conditions are not real and to receive them you have to be the middle manager of that particular bank. Many banks have the fee for the mortgage account and other fees that actually become a veiled interest rate and could reach up to 50%! At first it was difficult when we visited realtors and constructors offering our terms, and they said – they are the same as in other banks. But we knew that the others have different conditions. Similar conditions were offered by only 2-3 banks. But it was very difficult to persuade them. People take the loans and even if it actually becomes 13% instead of advertised 9% it does not matter for the constructors. The most important for them is that people take the loan.”(Andrey Knyazev, IMB 11.2006).

Table 8: Examples of mortgage loan conditions and fees in selected banks in 2006

Name	Announced interest rate	Term	Insurance, % of a loan	Commission s, USD	Real interest rate
Absolute Bank	10–11%	Up to 20 years	Insurance company	230–385	11,9%
Bank of Moscow	10–12%	Up to 25 years	1%	350–1000	12,6%
Vneshtorgbank	9,8–12%	5–25 years	1%	215–330	11,8%
DeltaCredit	9,7–12,5 %	Up to 25 years	From 0,8%	none	12,8%
MDM-bank	9,9–11,9 %	Up to 10 years	0,9–1,1%	200–1000	11,9%
Raiffeisenbank	9,25–14%	Up to 25 years	Insurance company	280–1030	12,0%
Sberbank	10,8–12,5%	Up to 20 years	Insurance company	Up to 4% of a loan	13,2%

Source: RBC 2007

Another problem of using mortgages is the specificity of the mortgage processing in Russia. Real estate transaction using mortgage is by far different from a basic real estate transaction. The difference is that while the majority of the transactions on a real estate market are done in cash, mortgage transactions involve a complicated and lengthy processing, which lacks flexibility. For example, in 2006, many mortgage contracts were canceled simply because during the processing of the loan application the chosen apartment grew up in price so much that the originally applied sum did not cover it once the borrower finally received the banks approval. The bank could also not reconsider the conditions and provide a larger sum quickly enough. In some locations, like Moscow and St. Petersburg, the prices of houses increased for more than 100% a month. Due to such price increase, about 50% of the mortgages approved by the banks were not used (Zamulina, 2006). Especially at the time when the prices are skyrocketing and the demand for available housing is very high, preference is given to the buyers with “live money” instead of mortgage loan certificates.

In order to increase the attractiveness of mortgage loans, many banks have lately introduced “express mortgage”, when the client receives approval within 24 hours. Also, in many

banks a client can nowadays get an approval for a larger sum of money in case the apartment will grow in price. This way the mortgage loan can still be used. However, in some cases using mortgages may turn out to be a more expensive alternative for the buyer.

“It is a standard practice on the Moscow market, that when a seller of an apartment finds out that the buyer is going to use mortgage loan, he says: “ok, but it will cost you x thousand USD on top, because I have 5 clients in line with suitcases of money who are ready to buy it now, so why should I wait for you for 2 weeks when my apartment will grow in price.” So, this way the seller is accounting for the price growth.” (Alla Tsytoich, DeltaCredit 11.2006).

Another specificity of a Russian real estate transaction is money handling. In Western countries the money is being transferred from one bank account to another and never being cashed during the transaction regardless of whether it is financed by a bank loan or own savings. In Russia, a typical transaction involves transferring bags of money from bank cashier to the bank safe, locked there until the state registration is complete and then the same way transferred to the seller. This involves extra costs of usage of the bank safe (about 50 USD). Also, very often the apartment that is being purchased is not a direct sale, but it may be in the middle of a chain of trading several apartments.

“The owner of an apartment which is being sold is buying another apartment or several apartments, and the client has another apartment which s/he is selling to put it as a down payment for mortgage. So, the mortgaged apartment can be somewhere in the middle of the chain of 5-8 apartment sales. In case of a mortgage loan, the rule is that mortgage deal money has to be stored in the safe of the bank that is making this mortgage transaction. So, all the participants have to come to this bank to agree on the access to money and sign necessary documents. Because the whole sum of money has to be divided between all the participants.” (Alla Tsytoich, DeltaCredit 11.2006).

Mortgage loans are on the average available to families with per capita income exceeding 1000 USD. In big cities, the income figure is even 1,5-2 times higher. However, the **verification of income** presents certain challenges. As many organizations/companies in Russia still do not pay salaries officially (referred to as “white salaries”) to avoid taxation it is impossible for a client to provide an official proof of income. Banks apply different strategies as regards such clients. Some banks accept only “white salaries” and official proofs of income, while others accept also “unofficial income statements” signed by the employer (but for example may demand an additional ~1% risk-premium). There is of course the risk that the employers overstate salaries if their employees request so.

“In the case when some part of the salary is “white”, we use the special official form and the other part of income can be proved in another way. For instance, both the general director and an accountant have to prove orally and in written form that the employee is receiving such a salary, bonuses and etc.. There should be the signature of the director, a stamp and a work phone. After receiving the document our analyst calls the director and confirms the income. We also compare the salaries with the average from the available labor market reports. Labor market is quite mobile in Russia now. As the length of mortgage is quite long, the client may change jobs several times: today it is a company with “grey” salary and tomorrow it may become “white.” (Alla Tsytoovich, DeltaCredit 11.2006).

Another peculiarity of the mortgage transaction is that in order to avoid paying tax it is possible to put **lower price of the purchased apartment** in the seller-buyer contract or in the mortgage contract with the bank. According to the tax code, the seller has to pay 13% tax of the transaction (sale price of the apartment) if he/she has been the owner of the apartment for less than 3 years. In about 60-80% of cases the price of the apartment in the mortgage contract is lower than the real one. Although such practice is not very beneficial for banks, about 15% of banks allow putting lower price of the apartment in the mortgage contract. When using this practice some banks increase the commission for mortgage loan

issuance (i.e. from 0.8% up to 3%) and/or put more strict requirements for the mortgage loan (Rusipoteka 2007).

Issuing mortgages for unfinished construction is not popular, because in many cases waiting for all the required permission documents is very time consuming. The solution is that some construction companies may start construction without obtaining all the necessary documents (i.e. illegally) and then pay the fines. In this case construction companies save both time and money. However, issuing a mortgage for such unfinished construction is problematic for a bank, as it can not sell an illegally constructed real-estate.

5.2 The mortgage loan defaults

One of the risks in the mortgage business related to customer default. In fact, the rate of default on mortgage loans in Russia is currently about 1%, which is a very low figure. This is explained by the fact that the first mortgages were issued only some 3-4 years ago. In the developed markets, various defaults start to show usually after 7-8 years of experience. Furthermore, the first mortgages have been issued to wealthier customer segments that are considered more credible borrowers. However, it is likely that the default rate will grow in the future as the market develops and the customer base having mortgages enlarges. This kind of a development has already been seen in terms of consumer credits, where the default rate has been on the rise.

“Mortgage markets are quite young and have been developing during the last 2-3 years. This is not enough time to talk about the statistics of defaults. The system of underrating is quite serious. The ability to pay the mortgage back is also being analyzed in addition to credibility. There have been a couple of cases of default on the market. However, the bank and the debtor usually make some kind of an agreement among each other, and the case does not go to the court. The real estate is sold. But there have been couple of cases where the court has made the decision in favor of the bank. So, legislation is quite clear now and

allows regulating the credit risk. In the world practice, banks usually include a 1-2% risk premium when they form the portfolio.” (Igor Zhigunov, City Mortgage Bank 11.2006).

Also, since some banks have softened their requirements for the clients (such as allowing unofficial income proof) there is a concern that this may increase the number of defaults on mortgage payments. However, some banks contest this view.

“The percent of default on mortgages is very low. And there is no difference between “white” and “grey” clients; they both pay back well on the mortgage loans.” (Alla Tsytovich, DeltaCredit 11.2006).

The interviewed bank representatives find explanation for the low default rate in the mentality, as Russians are not used to living in debt. Many people are scared of this word and would like to pay off the loan as soon as they can. Also, paying off the mortgage loan on time and even earlier has advantages for clients because the prices grow so fast in Russia.

“An individual is responsible for paying off the mortgage, and in Russia an individual has an additional stimulus to pay off the mortgage, as the prices grow very fast. They can pay mortgages off earlier and sell [the apartment] for higher price and receive profit.” (Alexei Rezvov, AHML 11.2006).

Earlier, the banks could not sell the apartment of a client who was not able to continue the payments if he/she did not have any other place to live in. This was also the case with families with children, as it was against the law to force them move from the mortgaged apartment if they did not have any other housing. That is why many banks were reluctant to issue mortgage loans to families with children. However, the situation has changed. Nowadays, if the borrower is unable to make payments that he/she has been making accurately, the issue is usually solved through negotiation and the bank will rearrange the payment plan. Usually, the situation is settled at this point. If a rearrangement cannot be

done, the bank (or the borrower) can sell the apartment to pay off the mortgage loan. When prices are increasing rapidly, this does not necessarily create any problems as the borrower can actually win money by selling his apartment for a higher price, paying off the bank loan, using the difference for buying a smaller housing, or as a down payment for another mortgage loan. So, the risks associated with borrowers' default are in fact considered relatively small as the legal procedure for asset recovery is quite transparent and not particularly complicated. In case the issue goes to the court, it is usually the bank that wins the case.

The *credit bureaus* that were established recently (based on the law on Credit Histories adopted on 1.6.2005), are not yet operational, and the relations between the banks and the credit history bureaus are not working properly. Valid and meaningful information can only be expected within a few years. Nevertheless, many bankers are optimistic about credit history bureaus, believing it is only a matter of time when the relations start to work (Art, 2006).

5.3 Mortgage insurance

The main problems of mortgage lending in transition countries relate to the existing credit and interest rate risks. As the capital market instruments are unlikely to be available to hedge the interest rate risk, the floating-rate mortgages are the norm. This means that borrowers face the interest rate risk, which increases their likelihood of loan default.

Mortgage insurance is a form of securing against the mortgage default. It is a specialized form of credit insurance. Mortgage insurance protects mortgage lenders against loss by reason of borrower default when the collateral property value is insufficient to pay off the outstanding debt (Blood 2004).

Mortgage insurance does not cover the risk of default on payments in case of job loss and unemployment. Such cases are considered as credit risks and many banks have their own ways to ensure that the client will not default.

The mortgage insurance market is growing fast together with the volume of mortgages in Russia. According to the estimates of “Renaissance Insurance” the volume of insured mortgages was 1.2 bln USD at the end of 2005. It was estimated that the mortgage insurance market would grow by 80% by the end of 2006 (Rossgosstrah 2006). The share of the Moscow market is 80% of this volume.

As the development of this market is almost completely determined by the development of the currently booming mortgage market, it is expected that not only insurance volumes but also higher growth rates will be seen in the future. At the present, the share of the insured home loans remains small.

There is no single system regulating the mortgage insurance system in Russia. This means that there are no unified standards neither for types of insurance, nor for choosing between systems of relations of banks and insurance companies. About 20% of all transactions are carried out according to the standards of AHML. The rest are done according to the choice of the bank in question.

The representatives of the insurance companies point to the growing attractiveness of this market segment. However, at the moment the segment is only just forming. In the future, new players will enter the segment, the spectrum of insured risks may expand, and the insurance tariffs may decrease. The leaders in this market segment are large universal insurance companies. Many insurance companies note that they would prefer to cooperate not only with banks but also directly with the borrowers.

Every mortgage program requires three types of insurance policies: insurance of property from damage; losing ownership for property; life insurance and temporary loss of work of

buyer/borrower. Such insurance services are provided by the insurance companies, which become partners with banks.

“In Russia there is no insurance against losing one’s income. It is insurance of the financial risks. Insurance companies have license for this, but there is a legal problem, which has not been solved so far by Rosstrahnsdor: in order to insure the loss of income they need to insure risks of individuals, but they have such license for organizations only. It is a new product. Until recently this market was not transparent. We estimate the possibility of a borrower to have the same job and income during the whole term of a mortgage loan. We take into account his/her job history and education, and estimate how possibly and quickly the client will find a job with same salary level in case of a job loss.” (Alla Tsytovich, DeltaCredit 11.2006).

Since the market for mortgage insurance is just forming, insurance companies have no statistics for insurance cases and no experience for regulating the losses. So far, the volumes of collected premiums by far exceed the volumes of payments, due to the short history of mortgage insurance development in Russia.

In Moscow, all the banks that issue home loans cooperate with insurance companies, such as the large accredited companies “Ingostrah”, Rossgosstrah, “ROSNO”, “NIKoil-insurance”, “Neftepolis”, “Moscow Insurance Company”, “Renaissance Insurance”, “Jakor”, “and “Pari”. Usually, a bank allows its clients to pick the program that suits him/her best out of the list of insurance companies that are in partnership with the bank. However, in some cases the partnership may involve a payment.

“We work only with companies of the Federal level and the overlap of the networks with our bank should be at least 80%. We do not work with local insurance companies because it is not worth it – we would lose efficiency.” (Anatoly Pechatnikov, VTB-24 11.2006).

“It may look like the banks are forcing clients to use certain insurance companies. This insurance is not a source of additional income for banks. Our bank doesn’t use it, but of course there are cases, where insurance companies pay the banks certain share of clients’ money. The sum differs depending on a program.” (Andrey Knyazev, IMB 11.2006).

In case of an accident, an insurance company will transfer the money required for the repayment of the loan to the bank. The insurance premium is about 0.7-1% and it is paid once a year, as a percent of the total mortgage. Hence, with time the amount decreases.

“For our clients the most expensive is insurance, which is about 1% that they have to pay initially. But at least they understand why they need to do it.” (Andrey Knyazev, IMB 11.2006).

Beginning from 2007, the law on “*Organization of Insurances*” divides insurance companies into specialized (life insurance) and universal. Earlier, the clients had to obtain a combined insurance policy, but now with a division between insurance companies, specialized companies are not allowed to be in the mortgage market. According to the law, universal companies combine the insurance of property risks with the insurance of accidents, while the life insurances should cover only the life and health risks, because they are of a quite a different nature than other types of insurance.

6 Foreign banks' activities in Russia

Foreign banks are active players on the Russian banking sector. Foreign banks' expansion to Russia began in the late 1990s, when they usually entered the market following their clients. In the beginning of the operations, they typically were oriented exclusively at servicing foreign companies. With time they have broadened the customer base to include also large Russian corporate clients in the fields of oil and energy, metallurgy, and timber industries.

Russia is approximately at the same level as India and South Korea (about 8%) as regards foreign banks' presence in the market. In Central Europe, the share of foreign banks is typically over 50%, and even in Brazil it reaches 27%. China remains a yet more closed market with foreign banks accounting for only 2% (2004). However, "National banking system of Russia for 2010/2020", developed by the Association of Russian banks, projects the share of foreign banking capital to reach 20% by 2010 and 30 - 35% by 2020.

Foreign banks' direct access to Russian financial market has been widely discussed especially during the negotiations on Russia's WTO membership. As a prerequisite, the US asked Russia to open its financial market also to foreign banks' branches. The Russian response was that they will come back to the issue during the negotiation process for joining the OECD. This created a lot of discussion in the Russian media. As foreign banks' branches are not subject to the Russian banking laws, the authorities are afraid that because of that some Russian "laundering" banks will just go offshore. Therefore, they urge the Russian government to make radical changes in the current legislation and in the normative documents of the Central Bank to be able to allow the access of foreign banks' branches to Russia. At the same time, the Russian government does not want to give access to foreign bank branches motivating its position by security issues. Their claim is that allowing foreign banks' branches will complicate the control and monitoring over them by the Central Bank. On the other hand, there are also a lot of views that allowing foreign banks to have branches on the Russian financial market would be advantageous. For example, along

with increasing competition, the interest rates would decrease and the level of services would improve.

“I don’t share the fear that can be seen in the press that foreign banks will come and invade the Russian market, like it was in Eastern Europe. I don’t see it as a threat for the economy. On the contrary, I see it as a plus, as the Russian economy doesn’t have enough money needed for its development. In Russia there are not enough funds to finance all the projects.” (Alla Tsytoich, DeltaCredit 11.2006).

Foreign banks also bring along their service business culture, which was completely underdeveloped during the Soviet times.

“The main system that exists now is the Sberbank system, the same attitude. Russian banks are used to providing services, not to selling. Services are provided with the attitude that a banker is sitting behind a marble table and a client has to stand in line and then beg for service. I think that the advantages of foreign banks are more in business culture that they bring rather than the money. But of course the money is also important (Alla Tsytoich, DeltaCredit 11.2006).

Another advantage of the foreign banks that the clients are looking for, especially after the 1998 crisis, is their transparency.

“Our advantages are transparency and absence of hidden fees.” (Andrey Knyazev, IMB 11.2006).

However, so far the subsidiaries of foreign banks are working successfully in Russia and purchasing Russian credit organizations and banks. During 2006 there were several large acquisitions by foreign banks. The second tier banks (below top 100) as well as regional banks are in fact looking for buyers, as they understand that they may not be able to withstand the competition. Also the law on minimum bank capital, which has to be no less

than 5 mln. EUR together with the regular monitoring by the Central Bank leave small banks not so many chances for survival.

“After we became 100% owned by Societe Generale it became easier for us to obtain resources on the external market, not only cheaper resources, but also resources allowing us to grow. It is easier to get these resources for a competitive price than for the local banks.” (Alla Tsytovich, DeltaCredit 11.2006).

Since January 2007 there are new amendments in legislation that equalize the rights of Russian and foreign residents in acquiring shares in Russian banks. Earlier, Russian residents were required to report acquisitions of 1-5% of shares and to get permission in case of acquisition of more than 20% of shares. For the non-residents, getting permission was required in all cases. Now, both a Russian and a foreigner acquiring 1-10% of shares have to report it, and in case of larger acquisitions permission is needed.

As foreign banks earlier preferred to operate on the inter-bank credit market and provide credits and loans mostly for corporate customers, they are now moving into retail banking and consumer finance. They are interested in the wealthier customer segment and in the majority of the banks there is a requirement of minimum deposit of 1500 USD for opening an account. Out of this sum 500 USD has to always remain on the account in order to get a bank card. There seems to be an opinion that when Russia will allow direct branches, the most profitable alternative will be to have savings accounts in Russian banks and loans in foreign banks. (Butaev 2006).

What attracts foreign banks to Russia is the relatively high profitability of Russian banking business compared to profit margins in other countries. For instance, the banks that participated in this study, reported an average profit margin of 7 to 8% against the currently prevailing 2 to 3 % in the developed economies.

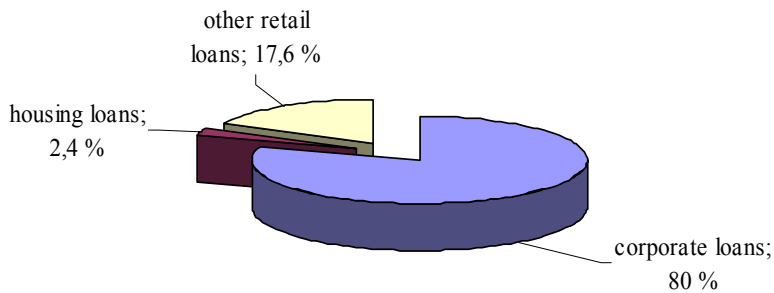
The latest statistics show that by July 2007 number of banks controlled by non residents grew from 58% (in 2006) up to 77%, and their share in the bank assets grew from 11.2% to 14%. (Ignatyev 2007).

6.1 Nordic Banks in Russia

There are several Nordic financial institutions that have operations or representative offices in Russia. These include Handelsbanken, SEB, Nordea, ZAO Danske bank, FIM, OKO-group and the Nordic Investment Bank. The involvement and strategies of these banks vary. In general, the Nordic banks are focused on Nordic corporate clients. Only some of them are looking into expanding to Russian corporate and retail banking. Therefore, the Nordic involvement in the Russian mortgage market is still quite minimal despite the opinion that it is a very appealing segment. According to the statistics, corporate loans dominate the Russian lending market accounting for 80% of all loans⁸, while other retail loans comprise only 17.6%. Out of all retail loans housing loans constitute 12%. (Central Bank 2006).

⁸ About half of all the corporate loans are issued in Moscow region (67 bln EUR) (Central Bank 2006). Corporate lending is mainly conducted in foreign currency as 73% is denominated in USD/EUR and 27% in RUR. It is also mainly short term financing (47% mature in less than 1 year and 39% in 1-3 years). Corporate lending is focused on trade & services and manufacturing (29% Trade & Services and 21% Manufacturing) (Central bank 2006).

Figure 12: The Russian lending market, end 2005, %



Source: Sampo bank presentation 2006

Handelsbanken has been in Russia since 1974, managing transactions between Nordic firms and Russian banks. Handelsbanken is mostly working with Nordic companies, providing them with all kinds of transactions, and also some financing services. It acquired a Russian banking licence in 2005 and a license for retail banking. In 2007 Handelsbanken opened a new office in St. Petersburg.

Nordea (then KOP) was one of the five international banks founding the International Moscow Bank in 1989. After the bank crisis in Russia in the early 1990s, Nordea and the German HypoVereinsBank acquired a majority holding in the bank in 1998. In 2004, Nordea increased its holding in IMB to 26.44% but divested it to Italian bank UniCredit in 2006. Recently, Nordea purchased a 75.01% stake in JSB Ogresbank in Russia. In this report we will use Nordea/Ogresbank for indicating Nordea's operations in Russia in Ogresbank.

Sampo Bank operated in Russia through ZAO Profibank which it purchased in 2006 and concentrated on corporate and Nordic customers. It has also issued some mortgage loans to their corporate partners. In February 2007 Sampo Bank and its foreign subsidiaries have been acquired by the Danske Bank. Since April 2007 ZAO Danske has been operational in

Russia. In June 2007 the name ZAO Profibank was changed to ZAO Danske Bank. As of now ZAO Danske Bank is located in St. Petersburg, and is fully licensed for all banking operations in all currencies. In the report the name Sampo/ZAO Danske Bank will be used when refer to the views of the bank's operations in Russia.

OKO Group operates in Russia through representative offices: OKO Capital Vostok in Moscow since 10/2005 and St Petersburg office since 5/2006. OKO operates with correspondent banks and does not have own operations. It focuses on providing services and networks for Finnish corporate clients. It has not announced plans to expand to Russian customers.

FIM Group is a publicly traded Finnish investment company operating in Finland, Sweden and Russia, established in 1987. The Group offers asset management, securities brokerage and investment banking services. It has had securities brokerage and corporate finance operations in Moscow since 2005. In Russia, FIM Group operates through ZAO FIM, which is a dealer and provides asset management services (05/2006). From March 2007 FIM is a part of Glitnir Group and the name of ZAO FIM has been changed to the ZAO Glitnir, however, in this report we will use the name FIM because this was the name at the moment of conducting the interviews.

MDM Bank has signed a 7-year, EUR30 mln credit agreement with **Nordic Investment Bank**. Under the terms of the agreement MDM Bank can obtain funds from Nordic Investment Bank to finance Russian investment projects in which a part of the goods or services involved originate from Scandinavia or the Baltic states. The funds can be used to pay for imported goods and services and also import duties, taxes and construction costs associated with the projects.

SEB has a full scale banking license in Russia and it plans to start retail expansion in St. Petersburg. In February 2006, it acquired a small bank in St. Petersburg, and is currently building the operation.

Hansabank – a Baltic bank whose main shareholder is Swedbank – is trying out Russian mortgage market as well. Its segment is corporate clients and individuals with incomes above average. The bank offers loans for both primary and secondary market for up to 15 years term with 15% initial down payment. The interest rates for primary market are 12% fixed rate for period of property title registration and LIBOR+6% p.a., but not less than 9% p.a. after property title registration.

6.2 Opinions of the Nordic Banks about the Russian mortgage market

The majority of the Nordic banks' representatives interviewed for this study acknowledged the positive developments in the Russian banking sector: credit ratings of the banks are rising, the general trust to banks is increasing, balance sheets are getting larger and the intra-bank markets are working better, which helps banks take deposits.

All of the Nordic banks' respondents see Russian retail banking and mortgage markets as developing and offering a good potential. Even though the mortgage markets' volumes are still quite modest, majority of the Nordic banks see a good potential for the future.

"Mortgage markets are very small, approximately at same level than in Estonia... We don't see it as bad, on the contrary, it has a huge growth potential." (Esa Teräväinen, Nordea/Ogresbank 3.2007).

One of the respondents noted that the whole banking sector is inefficient in a way because there is no need for it to be efficient, as there is so much money coming in anyway.

"Russian banks are less efficient than international competitors, the banking sector has not yet come to situation when efficiency is needed. Markets still have room to grow, so efficiency is not as crucial as in the West." (Esa Teräväinen, Nordea/Ogresbank 3.2007).

All of the Nordic banks' respondents noted the positive development of the legislation for the Russian mortgage markets.

"I have been talking a lot to those who know well the legal framework and they think that during last five years the legal framework has become much better in many ways." (Esa Teräväinen, Nordea/Ogresbank 3.2007).

As in the past it was impossible to pledge apartment, now the legal framework for pledge exist, but implementation remains complicated.

"If you bought flat five years ago it was really difficult to pledge a flat because there were no housing corporation and no share certificate that could be changed. There were right of possession of certain parts to that flat and the pledging and registration of that it was impossible, but today it can be done, it takes a bit more work but it is possible." (Esa Teräväinen, Nordea/Ogresbank 3.2007).

The development of the mortgage markets is easier and better in the big cities. There is good market and the prices are known. On the contrary in the rural areas it is more difficult to assess the prices for housing.

Also, regional differences in the mortgage financing are determined by peculiarities of the housing policy of the regional authorities. In some regions there are mortgage programs that are financed from the regional budget. Each of the regions has its own nuances, rules of business, and procedures for transactions that need to be taken into consideration

Finnish respondents call for **further development of the legislation** to improve the situation with apartment assessment. Russian banks have solved this problem by partnering with appraisal companies and real estate agencies, which are specialized in this matter, but for Nordic banks it is not such an easy option. So, the difficulty to assess the pledged

apartment both in terms price as well as apartment history is seen as one of the major risks for Nordic banks.

“The first risk occurs when buying apartment. The buyer has to be sure that apartment is really available for sale and the seller has a right to sell the apartment. This is done by checking that no one has a right of residence on that apartment. The classical problem is that once you have moved in, somebody rings the doorbell and shows you a proof of right of residence that has been lost or forgotten or the owner has been an emigrant or in jail. So, then he is entitled to the right of residence, and then we all are really happy.” (Kari Tolvanen, OKO 2.2007).

Getting risk ratings for customers has not improved according to the Nordic banks' respondents and it is still done case by case, and that is why it is expensive and difficult. Each customer has to be personally evaluated. For example, in order to verify the salary of a client, one has to go to the client's workplace and check it with the boss. This lack of transparency and transferring of income to holding companies in order to evade taxes makes it difficult to get information about the financial standing of both companies and individuals. However, several respondents noted that grey salaries are diminishing and a bigger part of salaries is paid directly to the bank account. This makes it easier also for international banks to enter and work on the mortgage market.

“There is great difference in credit risks between Russian and Nordic customers. In Russia, for example, very little data about credit risks, no credit records available, and that's why it is much harder to estimate the credit risk here than it is in west. It may be easier with individual customers than with corporate customers because it is possible to estimate individual's income and then to get idea about the creditworthiness.” (Antti Urvas, Sampo/ZAO Danske bank 2.2007).

Also, another concern of the Nordic banks is **how people will take care of loans**, as the earnings are not so high for those who need loans. Consumer loans have a high risk of

default that is why it is considered the most risky market and should be entered in the last stage, after corporate and auto loans. The default rate on the mortgages is still rather low, however Nordic banks are aware of its existence. One of the respondents noted that there has been a growth of bad mortgage loans from 0.5% to 1.5 %.

Bureaucracy is still a problem according to the Nordic banks. It slows down processes and makes work much more difficult. For example, the interviewees mentioned that licensing and work contracts are still very complicated. Nobody knows what kinds of papers are needed for work permits and employment papers. Also the Russian government was criticized for complicating the operations of foreign banks in favor of Russian banks.

“If the things are going too well the government puts a break. For example it was such a case with leasing, when Nordic banks were doing well but then government introduced the tax- so now it became unprofitable.” (Tapio Aho, Swedbank 2.2007).

Another risk which was noted by Nordic banks is the exchange rate risk EUR/USD/RUR. However, it has now become possible to hedge the funds against the currency risks also in Russia. Currency control has been released and it makes it easier to get the finance (long term) from domestic companies. Also Russia's WTO accession should further improve the financial markets.

Up till now many Nordic banks find it risky to go into the Russian mortgage markets. Their opinion is that in 1-2 years the market will develop and they will be ready to enter the markets. These opinions are backed up with Nordic banks perceptions that **competition is not very high** on the Russian mortgage markets and that there is time to wait for the market to develop further before entering it. This is in clear contradiction with the perceptions of the Russian banks that find the competition is quite fierce. Also, it seems that there are still some outdated perceptions among the Nordic banks about the length of mortgages, as some respondents believed that it has been extended up to 5-10 years, when it has actually increased up to 25 years in the majority of Russian banks.

Many Nordic banks think that if they have good experience with the Baltic States, they will do well also in Russia. However, as one respondent pointed it out, the Baltic States have a free market economy, the legislation is transparent and it does not change so rapidly as in Russia.

Among the problems that Nordic banks face in Russia are **cultural differences** and the role of personal relations. However, only Swedbank emphasized the importance of this issue.

The competition over employees is quite high in the banking sector and the Nordic banks have faced the problem with a lack of skilled employees. Banking professionals also change jobs frequently after higher salary offerings.

“...it is difficult to find qualified employees, so the bank has to hire more people, in order to have a “buffer”.

“Russian banks has all the time over capacity of personnel, more than business should allow. This is because of the growth and lack of employers.” (Esa Teräväinen, Nordea/Ogresbank 3.2007).

6.3 Competitive advantages and entry modes

Both the Russian and the Nordic respondents consider the competitive advantages of the banks with foreign capital to be in well-developed technologies and access to cheap long term resources. This enables them to offer better interest rates for loans. In addition, they have a more reliable brand and are considered more stable and less risky by Russian customers. According to one of the Nordic banks respondents, it may actually be easier for foreign banks to finance large Russian companies than international large companies, as the Russians are not as demanding.

In general, international companies have more strict terms and procedures. They also have good knowledge of international practices and are considered as more efficient. However, so far foreign banks have a relatively small share of the Russian market.

Advantages of Russian banks are first of all in their network, geographical presence, wide client base and flexibility. Nordic bankers point out that thanks to the Russian banks' better knowledge of the customers, they are better able to assess the credit history and risks of the client.

“Russian banks have been practicing retail banking much longer and thus know their clients better than a foreign bank that has just entered the Russian market”.

Flexibility is the Russian banks' competitive advantage as the timing and quick processing of a mortgage certificate become vital for a client especially under rapidly changing conditions of the real estate market.

“It is my subjective opinion, but I believe that foreigners are trying to establish a very technological business, like in a metro: put 5 kopeks – go through. But as of now it doesn't work like that yet. It doesn't work. They for example establish the maximum of EUR 300 000 and if the price is higher than this sum, they have to send a request to Austria. In Russia it is not real: the client will not wait for about a month and will just go to other Russian bank. Russian banks are more flexible.” (Anatoly Pechatnikov, VTB-24 11.2006).

Beginning from January 1, 2007 the main currency limitations protecting the national financial system were abolished, which is expected to sharpen the competition between Russian and foreign credit organizations that are already expanding presence of their subsidiary banks and companies at the Russian market. Entry of the foreign investors will be beneficial for a consumer: having more of significant financial funds available, foreign banks can lower the interest rates, while Russian banks do not have such a possibility.

“International banks can arrange longer refinance and longer credit, it certainly comes in future possible to apply credit via internet and that is going to increase the effectiveness of banks... International banks drive the whole markets forward via innovations and increase efficiency and competition.” (Esa Teräväinen, Nordea/Ogresbank 3.2007).

As it is prohibited to establish a branch of a foreign bank in Russia, there are basically two modes of entering the Russian market: obtaining a license or acquiring a local bank. The main differences between these two modes lie in the speed of entry and the control over the activities.

Obtaining a license is a slow process but it allows the foreign banks to remain in full control of activities. It usually takes 1,5 years to get a license and another two years to get the retail banking license. Also building up the network of offices and recruiting and training the personnel takes time and financial resources.

Acquisition of a local bank offers a faster mode of entry. The advantage is that the licenses and networks of offices are obtained right away. Acquiring an existing bank with own retail network may also turn out to be cheaper for foreign investors than entering the market from zero under its own name. However, the disadvantage is that the foreign investor does not necessarily know what the acquired bank is doing and has less control over the operations. That is why many foreign banks (and Nordic banks in particular) prefer to play it safe and obtain own licenses.

Western bank giants, who have entered the Russian market, got established by servicing corporate clients as well as reliable representatives of the Moscow and St. Petersburg middle class. Such a strategy allowed them to feel comfortable. However, it is impossible to get into the top five banks only by organic growth. Acquisition of other credit organizations becomes necessary at some point.

“At the moment the only reasonable possibility for foreign banks to integrate to Russian markets is to buy a local bank. The three years that it takes to get banking license is too long, nobody knows what the situation in markets in three years will be. That is also how most foreign banks have done. Only to buy a bank makes sense, because otherwise it takes too long time.” (Kari Tolvanen, OKO 2.2007).

Some respondents suggest that a mix between two offer the best advantages: buying a smaller local bank, so it is easier to deal with the negative factors and still have the advantage of not starting from zero and saving time.

“If the time is crucial – it is better to buy a bank, if it is more strategic – develop own. Another possibility is a mix: buying a small bank, so basically buying a license. In this bank the negative factors could be forecasted. In the large banks nobody can estimate what negative factors/skeletons could show up.” (Andrey Knyazev, IMB 11.2006).

Several respondents mentioned that it is very important to look at the personnel requirements and the existing networks as well as conversion costs when considering whether to buy a bank or establish your own network.

“It is not easier to open own new bank network than to add existing network. In some cases it is the opposite. If you are a new player on the market ...ProBusiness is going with the way of buying regional banks. But the expenses are extremely high. It is easier to close all of them and to open own offices in their places. The value of a purchase of a bank – is the network and personnel. If the people leave, the business leaves.” (Anatoly Pechatnikov, VTB-24 11.2006).

“To build own network takes longer and is more expensive but it is also more reliable and predictable. You can set up your own standards and requirements for personnel, because personnel requirements could drastically vary from the requirements of the foreign financial group. If you have to change the whole team, you may loose the client base, but

then you would have the right people. I believe that purchase of local banks could be dangerous, if you choose it only by financial characteristics and not personnel requirements. Because if the personnel culture is different from the culture of the foreign financial organization, it may take years to change it and it will be a shock for a system and the bank may lose time in its development.” (Alla Tsytovich, DeltaCredit 11.2006).

However, bankers recommend not to change the strategy for Russia when entering Russian market whether it is buying a bank or establishing own subsidiary.

Foreign banks are aware of the legacy of the recent past of Russian business in the 1990s and this in some cases influences their decision for opening own subsidiary instead of purchasing Russian banks.

“Foreign banks are afraid of the past of the Russian banks, because in the 90s banking was associated with criminal spheres, oligarchic structures, pocket banks etc.” (Andrey Knyazev, IMB 11.2006).

When a foreign bank makes a decision on entering mortgage market, including regional mortgage market by means of buying an existing bank, the challenge is that there are not many mortgage banks with regional networks to choose from:

“There are not so many banks with extended regional networks. These banks usually are large, have a wide product range, and cost pretty much. So, to buy such a bank just for mortgage and over pay for all other products doesn’t make sense.” (Andrey Knyazev, IMB 11.2006).

Another strategy is to create a specialized mortgage bank by purchasing existing regional banks as it is cheaper than to establish own chain from zero (Progonova 2006). However, it may take 3-5 years.

The interviewed Nordic bankers seem to be following a rather careful strategy in the Russian market. They are gradually expanding from Nordic corporate clients to large Russian companies, then to Russian small and medium sized enterprises (SMEs) and only then to the Russian retail.

So, for example, ZAO Danske bank believes that when you start entering the market you should start with Nordic and European based customers operating in Russia. At a second stage local companies linked to core clients should be considered, possibly mortgage and car loans as well. Since the transparency of the local SME clients is challenging, the consumer sector may be more interesting and easier to manage in the longer run.

According to OKO, theoretically the entry to the Russian market should expand from Finnish banks to large and known Russian companies, like construction companies, telecommunication and machine building. After that they should aim at SMEs and after that only the retail banking.

Nordea's strategy is different from the majority of the Nordic banks: it is going to enter straight away to Russian retail and mortgage markets. Nordea acquired Ogresbank and is pursuing the mortgage market as well as SMEs financing. Nordea sees very little problems with mortgage loans and finds SMEs an interesting sector as they use a lot of collaterals. In general, financing SMEs in Russia is considered more risky than e.g. in Finland because of the shorter history of SMEs and difficulties in assessing their credibility. They rarely apply international accounting standards, which is why the banks need to have very good personal relations with the SME to check the accounts and cash flows to investigate and assess the risks before financing. This is obviously very time-consuming. Nordea is confident that the risks can be avoided.

Based on the conclusions of a recent report on housing construction market in Russia (Boltramovich et al 2006), the most promising market segment for Finnish construction companies would be buyers of a medium priced apartment, who are interested in buying

finished newly constructed apartments. Until now, according to Boltramovich et al. (2006), Russian construction companies have been able to offer only poorly finished apartments. Residents want to finish their flats themselves because of the past experience with poor quality of the finished work. Based on this, it is possible to suggest that one of the promising and just developing directions on the Russian mortgage market would be financing Finnish (or other foreign) construction companies or trusted partner Russian companies, which would perform construction of the finished apartments. This has already been tried out by some banks.

“It is not possible to estimate the risks of the construction companies or of the concrete object. So, at the moment we can estimate some kind of reputation risk, but nothing else. Usually, construction company doesn’t have any judicial relation with the company that positions it. We are trying to find an additional way to secure our risks. The scheme that we are using with our project in St. Petersburg (Lentek) is connected very much with the Finnish mother companies and they provide additional reliability and that’s why it is working well. We also have some projects that are not related with foreign companies, but there are not many of them. In these cases it is done through our corporate block when we credit the constructor for purchasing the land and we know the constructor and we know all the structure of cash flow and it is just easier this way.” (Andrey Knyazev, IMB 11.2006).

6.4 Future perspectives

Finnish respondents noted that the Russian credit markets have been growing very fast as they started from zero. Therefore, the growth figures are not expected to be so huge in the future as they have been in the recent years.

Margins are much higher for banks when operating in Russia (some Nordic banks estimate it even at 10%) and there is a huge potential because the number of mortgages issued is still quite low. However, many respondents expect the margins to decrease in the future.

So far, all the Nordic banks are concentrating on servicing mostly Nordic corporate clients. The competition in this sector is obviously high and the fight for customers is tough. Therefore, for the majority of them Russian customers both in corporate and in retail banking seem to be an appealing and potentially more profitable alternative than the Nordic clients.

“Next five years it is probably corporate banking where profits come from, developing of retail banks takes a lot of investments and before it becomes profitable it takes several years. But once it starts to run most likely more of profit will come from retail banking.” (Esa Teräväinen, Nordea/Ogresbank 3.2007).

“Also, it may be interesting for Nordic banks to finance Russian companies as Nordic banks have advantages in the telecommunications and forestry as they know these sectors very well.” (Esa Teräväinen, Nordea/Ogresbank).

Overall, Nordic banks see no major threats for the mortgage market development in Russia. According to the respondents the only threat is the price for oil, which in the case of decrease may slow down the economic growth. Hence, a macroeconomic shock would affect and impede the development of the mortgage markets. However, as the government has the Stabilization Fund this threat should not be so severe, because in the case of default, the banks should be able to recover their assets. The main hindrances for faster mortgage markets development are the high interest rates and housing prices (especially in Moscow). However, respondents noted that development of the mortgage markets in Russia has a great potential and show positive trends in development.

7 Conclusions

Development of the mortgage market in Russia began in the end of 1990s after the main law “*On Mortgages*” was adopted. Mortgage lending is currently one of the fastest developing sectors of retail banking in Russia and more and more financial institutions, both local and international, are entering this sector. Also President Putin and the Russian Government are trying to support the growth of mortgage lending by declaring mortgage development as a key element in completing the “*Affordable Housing Federal Program*” aimed at increasing the Russians’ living standards.

So far, Russian mortgage market has shown considerably slower development in comparison to mortgage markets in Latin America and the former Soviet block countries. In Latin America mortgages comprise 4-10% of GDP, and in Central Eastern Europe 9-16% of GDP, while the figure is only 1% in Russia. However, it seems that the Russian mortgage market is following the tendencies of development in Latin America and the CEE. The state support played a vital role in these countries and it resulted in high growth rates of mortgage volumes.

In Russian case the mortgage market development was slowed down by the financial crisis of 1998 when people lost trust in banks. It also resulted in a considerable decrease in the real population income as well as in the housing construction. Therefore, even though the mortgage legislation was adopted in 1998, the actual development of the market started only after 2001 when the macroeconomic situation began to improve. It increased the need to create new mechanisms for housing financing. In 2004, several amendments to the legal framework were adopted, which spurred the mortgage market into rapid development. As a result, the growth rates witnessed in 2005 and 2006 were extremely high.

In 2006, the volume of mortgages amounted to 5.5 bln USD, which was almost two times higher when compared to the previous year. The prices for housing reached an unprecedented growth rate during spring-summer 2006. From the second half of 2005 until

August 2006 the price of a square meter of real estate in Moscow grew by more than 90%. Growth rates in the regions remain lower but are still very high ranging between 40-60%. At the same time, the interest rates on the mortgages were constantly going down.

Price growth dynamics was significantly affected by speculative demand. As the prices grew up, apartments became more attractive as an investment object. According to some estimates about 80% of transactions on the market are speculative transactions.

In September-October 2006 the market stagnated. The number of mortgages issued in all banks decreased to the level of the same period in 2005. At first, the real estate price growth facilitated the mortgage market because it became impossible to purchase a real estate without a mortgage. However, at some point the price growth outran the possibilities of mortgage issuance. Overall, in 2006 the volume of the market increased, while the number of mortgages issued was actually less than in the previous year.

The perspectives for mortgage markets growth still remain positive. With the high oil prices and GDP growth the real incomes of the population are growing. Experts agree that mortgages will become common in Russia by 2008 and the number of consumers that can afford a home is forecasted to be at the level of 15% of Russian families. In addition, 70% of the population is estimated to be looking for improvement in their living conditions. Some analysts assume that the market has potential to increase to about 3% of GDP by 2010 (The New Russia: Perspectives and Opportunities, 2006). The volume of mortgages is expected to continue to grow also because of increased trust in banks among people. More people are bringing money to banks, while the number of people who can pay for real estate by bringing a “*suitcase of money*” is decreasing.

Mortgage legislation has been under continuous development since 1998. The “*New housing code*” (2005) and amendments to “*Tax code*”, “*Investment code*”, “*On the organization of insurance business*”, “*On Credit Histories*” (2005), “*On State Registration of Real Estate Rights and Transactions*” as well as the latest amendments to the law “*On*

mortgage backed securities” (2006) set up the legal framework for mortgage market operations. A considerable improvement was the adoption of the bank’s right to sell a collateralized home in case of default, procedures for pledging an apartment and obtaining a court decision for realization thereof. Government and market players believe that the regulatory background is functioning relatively well. The massive mortgage-campaigns of Raiffeisenbank, IMB and other Russian banks indicate that they believe the risks are manageable. However, problems still remain in proper implementation of the laws due to lack of experience. So far, there have been only a few court decisions.

Competition in the mortgage market is tightening: currently altogether 400 banks offer competitive mortgage programs. However, the market is very concentrated. There are five banks controlling the market: Sberbank, VTB 24, DeltaCredit, City Mortgage Bank, and Raiffeisenbank. Sberbank is still an ultimate leader comprising 34% of the total market. Consolidation of the banking sector is expected to continue also in the future, which increases the barriers of entry for foreign banks via greenfield investment. The marketing campaigns of the mortgage programs show everywhere and include newspapers, flyers, banners, street banners, TV and radio advertisements (including the latest CIT finance campaign-completion where the winner gets 500 000 RUR towards the down payment on the mortgage loan).

Because of the increased competition **the terms and conditions of the mortgage lending** have changed significantly. In 2006, the **requirements for obtaining a mortgage were softened**, which increased the number of people applying for a mortgage loan. However, because of the increased demand and price growth for real estate, the sellers often refused to deal with clients with mortgage certificates, as these transactions required more processing time. As a result, the banks have shortened the **length of time required to get the approval** for a mortgage loan, and now the majority of the banks offer an express mortgage (from 24 hours to 3 days).

Due to the considerable housing price increase, several banks began to offer mortgage loans **without the initial down payment**. The move was intended to spur the demand for mortgages across the younger part of the market.

The **interest rates have also decreased** from 14% to less than 10%. In January 2007, the Central Bank decreased the refinancing interest rate to 10.5% RUR. This resulted in further decrease in the mortgage interest rates.

Mortgage transaction in Russia involves many hidden costs, such as fees for mortgage accounts, or a fee for safe deposit of the money as majority of transactions still use cash. So, real interest rates end up to be several percentage points higher than the advertised rates.

Income verification continues to be a major problem as many Russians have “grey salaries”. Now many banks, however, have their own system of income verification and some even allow counting the incomes of relatives for mortgage application.

Also, the type of real estate that can be an object for mortgage has expanded: now it includes land, cottages, unfinished housing, and already owned apartments. Banks began to work with developers for issuing mortgages for unfinished construction. The mortgage of elite suburb housing is also growing – every 5th such transaction is conducted using a mortgage loan. The share of mortgages of already owned real estate is currently some 20% in Russia. This is still a relatively low figure compared to the Western countries, where about 50% of the real estate is mortgaged.

Mortgage markets in Europe and America focus on refinancing existing mortgages, while in Russia **refinancing** of the loans is not so widespread yet. This is due to the small size of the market (currently mortgages comprise only 6% of all real estate transactions and less than 1% of GDP). Therefore, the majority of mortgage transactions are first timers.

Development of the Russian mortgage market has not been homogeneous throughout the regions. The mortgages have been concentrated mostly in Moscow and St. Petersburg. It can be due to the fact that the incomes are higher as well as the real estate price growth has been huge in the two main cities. Due to the price growth, purchasing of an apartment has become a profitable investment, which many people are eager to exploit. As the Moscow and St. Petersburg markets are becoming saturated, the future of the mortgage markets is in the regions. However, regional differences complicate the expansion. For example, different regions have different requirements for state registration. A lot depends also on the regional administration and the presence and participation of the industrial sector in the development of local housing conditions.

Another difference between Moscow and the regional mortgage markets is the currency of the mortgage. In Moscow, mortgages in foreign currency are still in high demand, while in the regions preference is given to the ruble ones. According to an analytic report made by the Association of the Regional Banks together with a consulting group BFI Consulting, the share of the mortgages in the bank balances in regional banks was 23%, which is almost two times more than in Moscow banks. Although 2/3 of total national mortgage loans are concentrated in Moscow, mortgages play a very important role for regional banks (BFI 2006). This is also highlighted by the fact that in regions such as Tyumen, Khanti-Mansiisk and Jamal-Nenetsk 25% of transactions in the housing market are conducted using mortgages. In Moscow, the respective figure is 7%. (Indicators of mortgage market 2006). This illustrates the wider scope and product portfolio of the Moscow banks compared to smaller regional banks.

There is a substantial variation in the housing prices in the regions of Russia: the price per square meter in 2004 varied from 42,132 RUR (about \$1,462) in Moscow to 4,626 RUR (about \$160) in Magadan. Between 2000 and 2004, the price per square meter of existing residences in Russia increased by 172 per cent; regionally the price increase varied from 445 per cent in the Republic of Mordovia to 58 per cent in Perm; the increase of 173 per cent in Moscow was close to the country average.

Despite these regional differences mortgage market in Russia becomes more standardized. The Agency for Home Mortgage Lending is aiming to create a unified system by introducing common federal standards and requirements as well as a unified information system for all its partner banks.

A critical element in the further development of the mortgage market is the banks' access to financial resources. Mortgage securitization and refinancing the mortgage pools are ways to attract necessary financial resources. The special law on mortgage backed securities was adopted already in 2005, but become more operational only in July 2006. Vneshtorgbank was the first Russian bank to carry out an international securitization of mortgage portfolios and issued Eurobonds in 2006. Their example was soon followed by the City Mortgage Bank and also other large banks are preparing for securitization. The Agency for Home Mortgage Lending (AHML) has also issued ruble mortgage backed securities. Instead of securitization, the smaller banks can increase their assets by refinancing the mortgage pools with the Agency for Home Mortgage Lending, which is the leader on the market for refinancing the mortgage loans.

Even though foreign banks have been active players on the Russian mortgage markets, the Nordic banks position is very different. Nordic banks seem to consider the Russian mortgage market still relatively risky and are in most cases planning to wait for 1-2 years for the markets to develop (with the exception of Nordea). At this point, the majority of the Nordic banks are concentrating on Nordic and large Russian corporate clients. Retail banking, auto loans, mortgages, and consumption credits follow later. The main risk perceived by the Nordic banks in the mortgage market is the difficulty to get risk ratings for customers (regarding the salary, price and history of the apartment).

Also, Nordic banks believe that there is a growing risk of default mortgages, and the process of recovering assets is complicated. For example, all of the Nordic bankers interviewed for this study believe that making a defaulted borrower vacate the pledged

apartment is very complicated. Based on the interviews with Russian banks, this is a somewhat old-dated view as the legislation has been amended in the banks' favor in the case of borrower default.

There seem to be also other differences in the views of the perspectives and risks of the Russian mortgage market between the Russian and Nordic banks based on the interviews (Table 9).

Table 9: Comparison of the Russian and Nordic banks' views on mortgage market

Issue	Nordic Banks		Russian Banks	
Development of the market	– Positive development, considerable potential		– Rapid development, market is already divided by major players, entry costs are high	
Competition	– Would like to enter in 1-2 years, when it develops		– High, especially difficult for a foreign bank to enter the regional market	
Market entry	– Not very high, it is possible to wait 1-2 years		– Market is consolidated and the entry costs are high.	
	– Gradually: Nordic corporate clients-Russian corporate clients-auto loans- Russian retail banking		– Investment in regional network of mortgage banks is necessary.	
	– Risks are high for expanding to Russian customers; however the potential and profits are better.			
Own office vs. acquisition of existing bank	– Acquiring a Russian bank is risky and very expensive, but the advantage is in its regional network and clients.		– Need a good regional network to use the potential	
			– Good bank with wide regional network is expensive. Finding a bank for acquisition is difficult, different business culture, past history	
Legislation	– Positive development, but problems with implementation.		– Legislation is adequate to such young market, and it is developing into a good direction.	
	– Legislation control is stricter to foreign banks than for Russian banks.		– Problems with implementation.	
Risks	– Default risks are low, but growing.		– Default risks are insignificant.	
	– Difficulties in assessment of customers' risk (grey salaries), pledged apartment (history and price). Vacating the borrower and selling the pledged apartment in case of default is complicated.		– Clients are eager to pay off the mortgage earlier, due to the high price growth, mentality and because they consider it a good investment.	
	– Housing bubble			
Advantages and disadvantages of foreign banks	– Better resources, Russians have more trust in foreign banks.		– Better resources, business culture, stability and international brand.	
	– No knowledge of clients, difficulties with the bureaucracy.		– Lack of regional network, flexibility, stricter requirements, preference of the RUR loans in the regions	
Barriers and problems	– High interest rates, grey salaries, non-transparency, risks with apartment assessment and loan default.		– Dominance of cash payments, high price growth, high interest rates, limited construction of new housing.	
Future development, market potential	– Positive, main threats the macro economic situation and consumer wealth. Market potential is huge.		– Positive expectations. The future of the mortgage market is in the regions.	

One of the **main differences** includes the perceived level of competition on the mortgage markets. Nordic banks consider the competition to be at a relatively low level, while the Russian banks note that competition has become fiercer during the past two years. Also, perceptions of the risks differ significantly. The Russians perceive mortgage market risk as very low and report hardly any loan defaults. At the same time, the Nordic banks think that there are many risks involved, which is why they prefer to wait for a further development of the market before entering it. Moreover, there seems to be a lack of updated information on the Nordic banks' side about the recent developments in the mortgage issuance conditions. On the other hand, both parties agree that the legislative framework and in particular the implementation of the laws still need further development in order to reach the European level. Nordic banks further point out that the foreign banks' activities are monitored extremely closely by the Central Bank and other authorities, which is seen to complicate their operations.

It seems that the majority of the Nordic banks are not actively expanding on the Russian mortgage market, even though all of them recognize it as a very perspective market. However, while some of the Nordic banks have representative offices or obtained banking licenses (OKO), others (like Nordea and ZAO Danske bank) got involved in the Russian market by purchasing Russian banks, and have thus been more actively involved also in the mortgage market. One of the possible and perspective niches for a foreign bank (Nordic) is purchasing a bank with developed regional network and focusing on the mortgages on the primary markets and working together with Finnish/ trusted Russian construction companies that build finished apartments. This segment is just developing and has much more potential than the secondary mortgage market.

Epilogue

During the writing of this report in 2006-2007 the Russian mortgage market continued to develop rapidly. Hence, it is important to highlight the most recent turns on the Russian mortgage market.

According to the bank of Russia, in 2006 the mortgage market grew approximately 3 times. The number of banks that provide mortgages increased from 395 to 720. During the first half of 2007 the Russian mortgage market grew by 50% up to 20 bln. USD. Experts estimate that by the end of 2007 it may reach 30 bln/ USD and in 2008 exceed 54 bln.USD (RBC 2007).

The growth in the number of banks that provide mortgage financing has significantly increased competition on the market, which led to the further decrease of interest rates as well as in an increase of the marketing campaigns.

The leading players of the mortgage market have not changed very much in comparison with 2006. First two places are taken by the state banks Sberbank and Vneshtorgbank Group. Moscommerce Bank is on the third place. One should take into account that these ratings include all types of mortgage products and depending on a particular mortgage market segment (i.e. classical secondary mortgage market) the picture might be slightly different.

Some banks showed incredible growth dynamics, reaching hundred of times (i.e. the volume of mortgages issued by Company of Retail Credits grew by 1057% and UrsaBank grew 10 times and Impeks bank showed a significant growth of 930%) (RBC 2007).

The newest trend on the mortgage markets is the appearance of the mortgages in different exotic currencies, in addition to USD and EUR loans.

Legislation on mortgage loan securitization still needs amendments to allow for more uniform enforcement in the fragmented market environment. Also, there is still no business (commercial) mortgage law that would allow offices, warehouses and shops to be acquired with mortgages.

In addition to the lowering of the interest rates and increasing the length of the mortgage loans, new products entered the market in the beginning of 2007. These include for

example mortgage loans without down payment. However, experts think that these mortgage products will leave the market in the next couple months as they will become too risky. Also, because of increased competition, banks are tightening their mortgage lending terms. However, the interest rates are unlikely to go down, as there are no necessary market mechanisms.

Moreover, because of the recent liquidity problems on the foreign markets, Russian banks may have problems to refinance their foreign loans, and as a result they will have to limit/suspend the issuance of the new loans and to raise the loan interest rates.

The mortgage crisis in the USA raises concerns about the Russian mortgage market as USA and Russian mortgage markets are quite alike. Both have used lower requirements, no down payment, and the interest rates have been going down. Both in the USA and in Russia people prefer buying to renting (on the contrary to Europe), and fixed mortgage rates are preferred to the floating rates.

Hence, according to industry reports, five or six Russian banks have already partly or fully suspended mortgage operations. Among them is *Uniastrum Bank*, which was the first among the Russian banks to suspend its mortgage loans in USD (Dorofeeva, 2007).

Experts note that liquidity problems will force those banks that are not in top 50 to suspend their mortgage programs. The first stage of this process can be the suspension of the mortgage loans denominated in USD. An additional reason for suspending mortgages in USD is the difficulties in securitization/refinancing of the USD mortgage loans, as the AHML buys the mortgages in RUR, and the USD are being bought by the commercial banks (like DeltaCredit, Raiffeisenbank, Absolut bank). Therefore, some banks, such as VTB and City Mortgage Bank, have either postponed or dropped securitization plans until the situation stabilizes.

However, a mortgage crisis in Russia is not foreseen, as the main players on the market are state-owned banks which have no liquidity problems. Also, the effect any mortgage crisis could have on Russia is limited by the still relatively small size of the sector.

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Appendix

Summary table of legislative proposals

Document title	Proposed changes	Become effective
1. Housing Code of the Russian Federation, № 188-FZ, 12.29.2004	Regulates core legal relations in the housing sector. Delineates the housing sector authorities of the federal, subfederal and local governments. Regulates rights and duties of homeowners and their family members. Determines criteria for identifying units in social housing as low-income households. Establishes procedures for allocation of units in social, departmental, and special-purpose housing stock, and for regulation of the use of these types of property. Determinates the legal status of common-use property in multifamily buildings. Sets main principles of multifamily building management. Provides regulations for associations of homeowners, housing construction, and housing cooperatives. Regulates the policy of rent and service fee collection and the policy of providing social assistance in making payments for housing and utility services.	March 01, 2005
2. On Carrying the Housing Code of the Russian Federation into Effect, № 189-FZ, 12.29.2004	Establishes the procedure and terms for carrying the Housing Code of the Russian Federation into effect: Declares "stale" the Housing Code of the RSFSR (except as provided), RF Law "On Fundamentals of the Federal Housing Policy", federal law "On Associations of Homeowners" and several other legislative acts; Terminates free privatization of housing; Regulates procedures for keeping records of households put on the waiting list before March 01, 2005 as eligible to improve their housing conditions and procedures for allocating units in social housing to them for social rent. Binds housing/housing construction cooperatives, in which all equity contributions are paid, to re-register as associations of homeowners. Regulates the transfer of land under multifamily buildings to homeowners living in them for common (equity) ownership.	January 13, 2005. Free privatization and de-privatization will be cancelled on January 01, 2007 (those who become tenants of public and municipal housing after March 01, 2005, are not eligible to privatize housing free of charge). Housing/housing construction cooperatives, which have all equity contributions paid and failed to re-register as associations of homeowners, will be liquidated from January 01, 2007.

3.	On Introducing Amendments into Article 446 of the Russian Federation Civil Procedure Code, №194-FZ, 12.29.2004	Stipulates that mortgaged residential units and land plots, the foreclosure on which is regulated by the federal mortgage law, should be withdrawn from the privately-owned property forbidden for court-sanctioned foreclosure.	January 09, 2005
4.	On Introducing Amendments into Part One of the Russian Federation Civil Code, № 213-FZ, 12.30.2004	<p>Cancels the requirement to have mortgage contracts mandatory certified by notary.</p> <p>Limits the power of guardianship authorities to forbid alienation of housing units belonging to owners that have minor children registered in them, only to cases when residential units are inhabited by persons that are under guardianship or by minors without parental custody.</p> <p>Stipulates that the transfer of title to a housing property to another person gives a sufficient ground to terminate the right of family members of the former owner to use this property.</p> <p>Recognizes uncompleted construction projects as real property objects.</p> <p>Stipulates that in event of a land mortgage, buildings or uncompleted projects located on this land should be also included into the loan cover if not otherwise provided by a contract.</p>	January 01, 2005
5.	On Changes in the Federal Law “On Mortgage (Pledge of Real Estate)”, № 216-FZ, 12.30.2004	<p>Permits to change the term and interest on a mortgage loan acknowledged by a mortgage deed.</p> <p>Cancels the requirement to have mortgage contracts mandatory certified by notary.</p> <p>Extends the mortgage effected by law to include land plots purchased out of borrowed funds (or purpose loan) and land plots (land leases) on which a residential property is constructed or purchased out of loan (borrowed) funds.</p> <p>Stipulates that in case of extension of a loan for improvement of living conditions, the property subject to foreclosure and termination of use by the former owner and his/her family members should include not only a residential property acquired from loan proceeds but any other residential property as well.</p> <p>Restricts unreasonable interference of trusteeship and guardianship authorities into mortgage lending procedures.</p> <p>Provides the legal base for mortgage insurance development that will help to reduce down payment requirements.</p>	January 10, 2005
6.	On Credit Histories, №218-FZ, 12.30.2004	Permits the disclosure of fair credit information about borrowers to lenders (commercial banks) through regulation of credit history bureaus.	June 01, 2005 Article 5, Part 3 (obliging credit institutions to provide a credit bureau with information on borrowers with their consent) will come into force from 01.09.2005.

7.	On Making Changes in Selected Legislative Acts of the Russian Federation in Connection with Enactment of the Federal Law “On Credit Histories” №219-FZ, 12.30.2004	Brings the effective legislation in line with the federal law “ <i>On Credit Histories</i> ”. Introduces changes into the Russian Federation Civil Code (clarifying the concept of bank secrecy), changes into the Russian Federation Code of Administrative Violations envisaging sanctions for violation of rules of credit history maintenance and safekeeping and information disclosure, and changes into the federal law “ <i>On Banks and Banking</i> ” obliging credit institutions to provide information to at least one credit history bureau.	June 01, 2005 Article 1, Item 1 and Item 3 (Para “b”), making credit institutions liable for non-disclosure of information to a credit bureau, will come into force from September 01, 2005.
8.	On Introducing Amendments into the Federal Law “On Mortgage Securities” №193-FZ, 12.29.2004	Specifies the procedure for sale of mortgage coverage in event of default (bankruptcy) of its issuer. Stipulates that the size of coverage of mortgage securities issued by credit institutions may exceed the size of obligations under them for no more than 20 percent. Permits issuance of housing mortgage bonds. Permits credit institutions to issue mortgage-backed certificates. Provides a means for issuing mortgage securities with variable interest rates.	January 09, 2005
9.	On Making Changes in Selected Legislative Acts of the Russian Federation in Connection with Enactment of the Federal Law “On Mortgage Securities” №192-FZ, 12.29.2004	Introduces changes into the Russian Federation Civil Code specifying the size of the mortgage coverage that will serve as an upper limit of the total mortgage-backed securities issued by corporations, and changes into the federal laws “ <i>On Insolvency (Bankruptcy)</i> ” and “ <i>On Insolvency (Bankruptcy) of Credit Institutions</i> ” forbidding to include assets used as mortgage loan coverage into bankruptcy estate of credit institutions.	January 09, 2005
10.	On Making Changes in the Federal Law “On State Registration of Real Estate Rights and Transactions” №196-FZ, 12.29.2004	Reduces transaction costs and risks on the housing market, market for mortgage and housing construction loans, and establishes: Reasons for imposing encumbrances (limitations) subject to mandatory registration in the State Register; A requirement to enter into the Register diminishing capacity data and data on family members living with the homeowner that are under guardianship or left without parental custody; A more clear definition of registries’ liabilities; A more facilitated procedure for state registration of rights to uncompleted construction projects;	January 01, 2005

		<p>A wider access to the State Register database, in particular, to statistics;</p> <p>A permit to use notarized copies of constituent documents for registration of rights and transactions;</p> <p>A requirement to record the date of application for registration in order to make it relevant in law.</p>	
11.	<p>On Making Changes in Article 223 of Part One of the Russian Federation Civil Code and the Federal Law “On State Registration of Real Estate Rights and Transactions”, № 217-FZ, 12.30.2004</p>	<p>Provides for legislative and financial security of rights of bona fide purchasers of real estate, including home purchasers</p>	January 01, 2005
12.	<p>On Making Changes in Article 4 of the Russian Federation Law “On State Duty”, № 104-FZ, 08.20.2004</p>	<p>Significantly reduces the state duty charged for notary certification of mortgage contracts for a period until the mandatory notification requirement is cancelled by the law “On Introducing Amendments into Part One of the Russian Federation Civil Code”, № 213-FZ, 12.30.2004.</p> <p>Terminates collection of the state duty for registration of mortgage contracts and issuance of registration certificates and State Register abstracts about state registration of mortgage contracts as one duplicating the registration fee.</p>	<p>September 23, 2004</p> <p>The Law “On State Duty” ceased to be in force from 01.01.2005 when Chapter 25.3 (“State Duty”) of the RF Tax Code, stipulating the same comes into effect. Mandatory notarization of mortgage contracts is canceled from January 01, 2005.</p>
13.	<p>On Making Changes in Article 146 and Article 149 of Part Two of the Russian Federation Tax Code, № 109-FZ, 08.20.2004</p>	<p>Treats home and land sale transactions as VAT-exempted</p>	January 01, 2005

14.	On Making Changes in Article 284 of Part Two of the Russian Federation Tax Code, №107-FZ, 08.20.2004	Reduces profit tax on investors' yield from mortgage securities and municipal bonds issued for not less than 3 years to 9 percent till the end of the transitional period (till January 01, 2007); Fixes the after-2007 tax rate on mortgage securities yield at 15 percent.	January 01, 2005
15.	On Making Changes in Article 220 and Article 224 of Part Two of the Russian Federation Tax Code, №112-FZ, 08.20.2004	Reduces the length of the homeownership period from 5 to 3 years to provide the property tax relief on sale of a privatized home in full amount; Specify more concretely the structure of actual costs of new home construction or purchase that can be subject to the tax relief; Changes the mechanism of provision of the property tax relief so that it can be provided by a tax agent (prime employer) of the home seller/buyer (mortgagor); Expands the property tax relief to include mortgage loans provided for the purpose of home purchase and construction in the Russian Federation by Russian banks or other Russian institutions; Levies 13 percent tax on interest savings from mortgage loans provided for the purpose of home purchase or construction against documents certifying the appropriate use of the loan; Cuts down the tax on mortgage securities yield of individual investors to 9 percent rate till the end of the transitional period (January 01, 2007)	January 01, 2005
16.	On Making Changes in Article 250 and Article 251 of Part Two of the Russian Federation Tax Code, №105-FZ, 08.20.2004	Introduces changes reflecting specificity of mortgage agents' activities and relations with initiating bodies by excluding assets of mortgage agents, including their monetary claims and/or property rights received in the result of their charter operations, from the property subject to profit tax.	January 01, 2005
17.	On Making Changes in Article 8 of the Russian Federation Law "On Land Fee", №116-FZ, 08.20.2004	Permits using different land tax rates when the project is under design and construction and when the project is completed as an incentive to complete construction projects.	January 01, 2005 this law and the law "On Land Fee" will seize to be in force from 01.01.2006 when Chapter 31 ("Land Tax") of the RF Tax Code stipulating the same will come into force.

18.	<p>On Making Changes in Article 60 of the Russian Federation Budget Code, №111-FZ, 08.20.2004</p>	<p>Permits local governments to transfer proceeds they receive when sell or lease out governmentally-owned land plots for housing construction purposes, to their budgets in full till the completion of land rights sharing between governments of all levels.</p>	<p>January 01, 2005</p> <p>Article 60 of the Budget Code will seize to be in force from 01.01.2006 when the federal law “On Making Changes in the RF Budget Code for Regulating Intergovernmental Fiscal Relations”, which includes the similar clause into Article 61 of the Budget Code, will come into force.</p>
19.	<p>Town Planning Code of the Russian Federation, №190-FZ, 12.29.2004</p>	<p>Improves legislative regulation of urban planning and construction activities through: delineation of land use and town planning authorities of federal, regional and local governments; determination of the contents and rules of execution and approval of land-use planning documents; determination of the contents, structure and rules of execution and approval of local zoning regulatory acts - land use and development rules; determination of the contents and rules of execution and approval of layout documents; requirement of mandatory organization of public hearings before approval of town planning regulatory documents; determination of the contents of project documentation and rules of execution and issuance of permits for starting and managing building activities, exercising building inspections and state building supervision, commissioning of completed projects; determination of the contents and rules of management of town planning information support; Establishment of liability for violation of the town planning legislation.</p>	

20.	<p>On Enactment of the Town Planning Code of the Russian Federation, №191-FZ, 12.29.2004</p>	<p>1. Specifies deadlines for putting in force specific clauses of the RF Town Planning Code and legal effects that will arise after expiration of them:</p> <ul style="list-style-type: none"> - Prohibition to reserve and seize lands for public or municipal purposes, as well as to transfer them from one category to another in default of land-use documents – from January 01, 2006; - Prohibition to execute layout documents in default of land-use documents - from January 01, 2006; - Prohibition to perform any kind of state expert review of project documentation except the unified state expert examination - from January 01, 2007; - Prohibition to perform any kind of state control over construction or general modernization projects except the unified state supervision - from January 01, 2007; - Prohibition of preliminary land allocation for construction purposes and issuance of building permits in default of land use and development rules – from January 01, 2010. <p>2. Introduces changes into the RF Land Code, in particular,</p> <ul style="list-style-type: none"> - determines specifics of public or municipal land allocation for housing construction purposes including the requirement to sale or lease out such lands through public auctions, and to follow the specific procedure for allocation of land plots for integrated residential development; - specifies public and municipal projects, for which seize (buy-out) of land plots is permitted 	<p>January 09, 2005</p> <p>Clauses requiring to allocate land for housing construction purposes only through public auctions and regulating such auction procedures will come into force from October 01, 2005.</p> <p>Chapter <i>On Town Planning Information Support</i> will come into force from July 01, 2006.</p>
21.	<p>On Making Changes in Article 256 of the Russian Federation Tax Code, №110-FZ, 08.20.2004</p>	<p>Permits private operators to depreciate the property they are authorized to use throughout the whole term of the investment agreement.</p>	<p>January 01, 2005</p>
22.	<p>On General Principles of Regulation of Public Utility Tariffs, №210-FZ, 12.30.04)</p>	<p>Introduces general principles of regulation of public utility tariffs, price (tariff) premiums and connection fees. Delineate utility tariff regulation authorities of the federal, subfederal and local governments. Obliges all regulators and utilities to comply with tariff and price regulation procedures set by the law.</p>	<p>January 01, 2006</p> <p>Clauses permitting to exceed the cost of electric and heat power based on tariffs and price premiums paid for electric and heating goods and services will come into force from June 01, 2008</p>

<p>23. On Making Changes in Selected Legislative Acts of the Russian Federation in Connection with Enactment of the Federal Law "On General Principles of Regulation of Public Utility Tariffs", №211-FZ, 12.30.2004</p>	<p>Introduces changes into the RF Civil Procedure Code increasing administrative responsibility of officials for violation of the established tariff regulation rules and procedures. Introduces changes into federal laws "On Electric Power Production", "On Public Regulation of Electricity and Heat Tariffs in the Russian Federation", "On Amendment or Recognizing Ineffective Selected Legislative Acts of the Russian Federation Due to Enactment of federal laws "On Changes and Additions to the Federal law "On General Principles of Organization of Legislative (Representative) and Executive Bodies of State Power in the RF Subject" and "On General Principles of Local Self-governance in the Russian Federation" clarifying tariff regulation procedures for local natural monopolies – heat and electric power producers. "On Gas Supply in the Russian Federation" to set more clear procedures for regulating tariffs of natural monopolies – gas, heat and electric power providers</p>	<p>January 01, 2006</p> <p>Changes to the RF Civil Procedure Code and Federal Law #122-FZ approved as of 08/22/2004 will come into force from January 02, 2005.</p> <p>Changes to the federal law #41-FZ approved as of 04/14/1995 permitting to exceed the cost of electric and heat power based on tariffs and price premiums paid for electric and heating goods and services will come into force from June 01, 2008.</p>
<p>24. On Participation in Shared Finance of Multifamily and Other Property Construction Projects and On Appropriate Changes to Be Made in Selected Legislative Acts of the Russian Federation, №214-FZ, 12.30.2004</p>	<p>Protects rights and interests of private and corporate investors of cost sharing projects of housing and other property construction (excluding industrial projects) through:</p> <ul style="list-style-type: none"> - Reduction of risks of investors of cost sharing construction projects by providing them with information on developers and housing construction projects (project declarations); - Specification of compulsory clauses and procedures for signing, modifying and execution of contracts on shared finance of construction projects; - Making obligatory registration of contracts on shared finance of construction projects as a measure making infeasible the transfer of the title to one and the same unit to more than one persons at a time; - Ensuring that a developer will pay back investors' funds in case of non-fulfillment of a contract by using mortgage of a land plot and a project under construction located on it as a security deposit; - Exercising state control over cost sharing construction projects; - Establishing administrative liability for permitting unauthorized persons to attract funds for construction purposes, disclosure of inadequate information in the project declaration, violation of reporting requirements by a developer 	<p>March 31, 2005</p>

25.	<p>On Housing Saving Cooperatives,</p> <p>№215-FZ, 12.30.2004</p>	<p>Reduces risks and ensures transparent use of private investments of members of housing savings cooperatives through:</p> <ul style="list-style-type: none"> - restriction on types of activities a cooperative is permitted to manage; - restriction on the number of cooperative members (50 – 5000) and registration of new members in registers of legal entities; - making cooperative members liable for losses at the limit of their equity contribution; - prohibition to conclude fee-based contracts between a cooperative, the subject matter of which is caused by the membership relations; - specification of types of information and documents and procedures under which they can be provided to cooperative members and other applicants; - specification of requirements to forms of members' participation in the cooperative activities, procurement (construction) and allocation of residential units for use; - specification of types of contributions to co-op share fund and rules for collecting and using it; - ensuring the members' right to control activities of the cooperative management; - specification of the procedure for paying back the real value of the member's share in case of his/her withdrawal from a cooperative; - specification of the procedure for taking ownership in housing units by cooperative members; - specification of requirements and standards of financial sustainability of a cooperative; - specification of the procedure for exercising the state control over the cooperative's operations; - providing a self-regulating status to cooperatives. 	<p>March 31, 2005</p> <p>Clause on self-regulating status of cooperatives will come into force after approval of the law on self-regulating organizations.</p>
26.	<p>On Making Changes in Part Two of the Russian Federation Tax Code and Several Other Legislative Acts of the Russian Federation,</p> <p>(passed the first reading)</p>	<p>Permits local governments to impose local real estate tax on residential property (home units, summer and garden cottages, garages, land plots under them and land plots allocated for construction of these types of property) based on large-scale market-based assessment of property value, uniform tax rates for both corporate and individual taxpayers and a tax-exempted minimum provided for individual homeowners.</p>	
27.	<p>On Conclusion of Investment Agreements in Public Service Sector</p>	<p>Calls for involvement of private operators into municipal infrastructure management and development as a measure to solve one of the key problems slowing down the housing production growth— the lack of developed land plots</p>	<p>draft federal law # 1721-4</p> <p>(passed the first reading)</p>

Source: Institute of Urban Economics (2006)

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