Strategies of Transitional Countries to Establish a Housing Finance System – the Russian Experience

By Dr. Victor Mints, Advisor on Housing Finance Issues for Vneshtorgbank, Moscow (Russia)

In all socialist countries including Russia, a major share of housing was in the public sector. Typically, citizens received housing units free of charge since construction of new houses was financed by the state. Due to the nature of the system, neither construction finance loans (loans to developers enabling them to build houses) nor housing finance loans (loans to people buying housing units) were necessary.

With the beginning of the transitional period, this situation changed. The government radically reduced the provision of finance for housing development. Construction companies were supposed to find financing themselves. In return, they obtained the opportunity to sell the houses built, which enabled them to cover the expenses and even earn a profit. At the same time, Russian citizens learnt that practically no one had the chance anymore to receive a unit in a public sector house and those willing to obtain a housing unit had to pay for it.

Since very few had enough savings to pay for the purchase of a house in a lump sum, a housing finance system became necessary. The naïve optimism in the beginning of transition that the "invisible hand of the market" would also govern the financial system was quickly abandoned. A housing finance system did not emerge although there was a great demand for it. Banks were reluctant to participate in the activity associated with housing finance. They did not provide mortgage loans to homebuyers.

It became evident that a housing finance system would not come out by itself. Its development must be rather promoted by special measures. In order to find out which strategy was the best to promote the development of the system, it was necessary to identify the hurdles to be overcome i.e. barriers restricting banks from providing mortgage loans to homebuyers.

OBSTACLES HINDERING THE DEVELOPMENT OF A HOUSING FINANCE SYSTEM

The opinion of Russian banks about the reasons preventing them from mortgage lending have been revealed recently by a poll conducted in 2003 by the Research Center of RMA (Russian Marketing Association)[1]. Banks were asked to name and rank the major barriers to mortgage lending. The obstacles nominated by the banks are presented in Table 1.

According to the table, banks identify as

Table 1 – Barriers to Mortgage Lending

The barriers to mortgage lending for banks	Rating of importance of the barrier	% of the banks mentioning the barrier
Lack of effective system of foreclosure and eviction	1	89%
Lack of long-term financial resources	2	85%
Unreported income of most of potential mortgagors	3	85%
High notary fees	4	64%
Complicated registration procedure	5	55%
High operational expenses	6	55%
Absence of a credit bureau	7	49%

[1] Source: Research Center of RMA (Russian Marketing Association) The Report from V International scientific conference "Competitiveness and modernization of economy" (on April 6-8, 2004) " Formation of accessible habitation market in Russia". Please see www.rc.ram.ru.

major obstacles to mortgage lending a weak legislative position (especially a lack of effective foreclosure and eviction procedures), difficulties in attracting long-term funds and the handling of unreported incomes in the underwriting process. Were these obstacles eliminated, the banks would start mortgage lending, even if less important risks (from their point of view) remained in place.

However, their views appear mis-judged. For example, banks underestimated the importance of credit bureaus. If they existed, they would assist banks in assessing the creditworthiness of borrowers. Without these bureaus, the bankers cannot know the past credit behaviour of the borrower. Knowledge of the past credit behaviour is considered a key factor which allows a bank to determine probable defaults. The reason why Russian banks regard credit bureaus as less important is that currently most potential borrowers have no credit history. As a consequence, the bureaus would not have any information about them.

In this context, it is It is also remarkable that Russian banks regard lack of income reporting similarly critical as an ill-functioning legislation. The importance of this fact highlights the magnitude of tax fraud and unreported income in Russia.

The following analysis of the applied strategies to implement a housing finance system in Russia takes into consideration the most important risks which banks have defined as hurdles to mortgage lending (according to the table 85% and above):

1. Risk of default that could not be managed because banks are not capable of assessing the borrower's income
2. Collateral risk. The risk that in case of the borrower's default the bank will not be able to evict the borrower and cover losses from the sale of the property.[2]
3. Mismatch risk associated with making long-term loans by the institution that has only short-term liabilities (both liquidity risk and interest rate risk)

If banks in a country do not provide mortgage loans because the barriers created by the legislation make it impossible to manage these risks, only two strategies may be used to solve the problem. The first strategy envisages reform of the relevant legislation to eliminate the barriers. The second one takes the given conditions and barriers for granted. It focuses on a specialized financial system that adapts to this particular environment. The system will develop instruments, which will allow for mortgage lending despite the given barriers. Certainly, both strategies can be combined.

FIRST STRATEGY: LEGISLATIVE REFORM

In case of the first strategy, legislative changes are aimed at eliminating the major barriers and consequently making the major risks manageable.

- *Risk of default.*
  In the situation like the one in Russia where banks consider that the risk of default stems from their inability to measure the real income of potential borrowers, special measures should be introduced to make all citizens (including potential borrowers) interested in reporting their real income. If they start to report their real incomes, the banks will know it. The measures may include changes in fiscal policy, enforcement of police departments dealing with violations of tax law, education programmes, etc.

- *Collateral risk.*
  In order to improve the management of collateral risk, the legislative changes should focus on foreclosure and eviction procedures. Banks should have no doubt that the borrower will be evicted in case of default. They should have the information about the length and the costs of these procedures. This will enable the banks to assess potential losses and mitigate them by charging corresponding risk premiums.

- *Mismatch risk.*
  Typically, there are two types of types of risks: First, interest rate risk, which appears in the case of rising market interest rates. It is of particular concern if rates on short-term deposits are rising whereas rates on long-term mortgage loans remain unchanged. As a result, the cost of funds for the bank increases, which reduces the margin for the bank. Second, liquidity risk is also down to a duration gap between short-term liabilities and long-term assets. The bank may be unable to substitute short-term liabilities when they are due with the new ones (for example because of temporary shortages of supply of funds) and to turn assets (long-term mortgage loans) into cash.

The interest risk mitigation within the first strategy deserves a bit more detailed explanation. The risk can be mitigated in two ways:

First way. Interest rate risk can be shifted to the borrower by applying adjustable rate mortgages (ARMs). If this solution is used, the monthly repayment rate of the borrower is subject to changes the average market interest rates. Unfortunately, this solution is not applicable for most of the the developing countries. Interest rates in these countries are extremely volatile. Market interest rates rises may increase the monthly repayment rate to a level that a mortgagor could not afford. Apparently, ARMs reduce the banks' interest rate risk but at the same time increase borrowers' default risk.

To some extent, default risk increase may be handled through dual-index mortgages model. If this model is used, the required monthly loan repayment is recalculated in accordance with an index indicating changes in market interest rates while the actual monthly loan repayment is adjusted in accordance with the index indicating changes in average wages. The difference between the actual and required repayments is deferred and added to the loan balance. Thus, application of this model reduces interest rate risk for banks at

[2] Default risk and collateral risk can be both regarded as a form of credit risk.

the same time avoiding an increase of default risk.

However, in unstable economies with wages declining in real terms, the model may lead to negative amortization of loans. In this case, the loans may become practically endless (never repayable) causing serious social tension. Moreover, banks may face growing liquidity and collateral risk. Rising collateral risk is a result of higher LTV ratios. Liquidity risk growth is associated with an expansion of the asset side of the balance sheet by deferred payments without corresponding augmentation of the liability side.

Second way. Interest rate risk can be reduced by tapping long-term funds for mortgage lending. Insurance companies and pension funds may provide long-term resources by buying mortgage securities the banks issue in order to refinance their loans. Especially in developing countries this solution faces limitations. In most developing countries, insurance companies and pension funds either do not exist or – more often – do not have enough funds to meet housing loans market demand and are not capable of assessing the risks associated with mortgage securities.

A universal solution to solve the problem of mismatch risk in developing countries within the framework of the first strategy has not been found yet. Thus, decisions have to be made on a case-by-case basis.

RUSSIAN EXPERIENCE WITH THE FIRST STRATEGY

Starting from the mid 1990s, Russia has made strong efforts to implement the first strategy. The following measures have been taken in order to create favourable conditions for mortgage lending and to make risks manageable:

- *Default risk.*
  The government assisted banks in obtaining information about the real income situation of potential borrowers by eliminating incentives to receive salary in cash in order to avoid taxation. Personal income tax was reduced to a very low level and the progressive scale for income tax was abandoned. The tax became equal to 13% of the income earned irrespective of its size.

- *Collateral risk.*
  The Special Law on Mortgages enacted in 1997 clearly states that a borrower in default shall be evicted from a mortgaged house. In addition, the amendment of the mortgage registration process made it possible to register a mortgage on the house simultaneously with the registration of its acquisition. Previously, the registration took about one month. Hence, for one month after disbursement of the loan, banks had no collateral.

- *Mismatch risk.*
  The government decided to reduce mismatch risk through a system based on mortgage securities ie a secondary mortgage market. Necessary changes in the legislation were made and a secondary mortgage agency – Agency for Housing Mortgage Lending – was established as a government owned institution in 1996 to provide banks with long-term funds.

Several additional measures were introduced in order to promote mortgage lending. Mortgage lending had been seriously hindered by the tradition of lowering the real house price in purchase agreements to avoid taxation. Agreements naming the price equal to 10-20% of the real one (price cut by 80-90%) were common practice. As a result of special legislative changes, the intention to understate the price of a home was radically reduced. Now, the proceeds from a sale of a home are excluded from taxation. Payments conducted by homebuyers are also exempted from tax (part of the income equivalent to the sum used to buy a house up to one million Rubles – approximately USD 35,000)[3].

A further measure aimed at stimulating mortgage lending was the introduction of debt interest reductions in the tax declaration.

Unfortunately, the newly implemented regulations did not produce the expected results. For example, it became evident that the law regulating eviction contradicted several other laws and in most cases could not work. As a consequence, collateral risk remained high.

In spite of income tax reductions and elimination of progressive scale for income tax, wages are still paid in cash and bankers still realize that the majority of potential borrowers cannot prove their income. Default risk is still difficult to assess.

The secondary mortgage agency established in 1996 conducted practically no activity till 2001. Hence, the housing loan market had only short-term resources.

In conclusion, despite all legislative changes, the opinion of the banks about their ability to manage the risks continues to be negative. It means that this strategy was not successful in Russia.

SECOND STRATEGY: SPECIALIZED HOUSING FINANCE SYSTEM

If the second strategy were selected, a special housing finance system would be designed and established. The system would be based on non-banking institutions of a special type. These institutions would have features allowing them to deal with the risks the banks were understood to be unable to manage.

This strategy was actively discussed in Russia. As the most appropriate solution, the establishment of a contract savings system in a mutual form was advocated.

Specific of the system is that mortgage loans are provided by depositor-owned contract savings institutions only to the

[3] Russian citizens were eligible for this rule only once in their life.

depositors of the institutions. The depositors become eligible for the loans by saving a certain minimum in fixed monthly instalments through a prescribed minimum saving period. The sources of funds for the loans are the deposits. It has been believed that this system provided an opportunity to mitigate all the major risks being associated with housing finance.

- *Risk of default.*
  Risk of borrower's default can be managed in this system since adequate information on every borrower's income (and credit behaviour) is obtained while he is a depositor. The person's ability to provide payments in even monthly instalments during the saving period may be used as a confirmation of his ability to make equal monthly loan repayments during the loan repayment period even if he cannot prove that he has a corresponding income.

- *Collateral risk.*
  Depositor-owned institutions are managed socially. If any mortgagor in default decided to remain in a mortgaged home using loopholes in the law, he would not only deal with the court but also with his neighbours – co-owners of the contract savings institution. They would treat the person in default as someone who tries to steal their money. It is practically guaranteed that they will force him to sell the mortgaged property and repay the loan even if he is not obliged to do it in accordance with the law.

- *Mismatch risk.*
  There is no interest rate risk since interest rates on contract savings loans depend only on the interest rates on long-term contract savings deposits. Both are fixed below market levels and are irrespective of market interest rate fluctuations. Liquidity risk is also very low. Massive withdrawals of savings from the contract savings institutions are unlikely to happen because of the mutual nature and transparency of the institutions. In addition, a saver would lose an opportunity to receive a cheap mortgage loan, which was his ultimate goal when he started making savings.

In spite of the fact that usage of the contract savings system makes all the major risks manageable, the plans to set up the system have not received strong support either from the Russian government or from foreign institutions. Several grass-root organizations of this type have been established but their scale of activity is rather modest.

A THIRD STRATEGY TO MEET THE CHALLENGE?

Both the first strategy ie changes of legal environment and the second strategy of establishing housing finance institutions adapted for the environment proved to be unsuccessful in Russia. Both strategies failed to promote a working housing finance system. Although it seemed absolutely impossible, a third type of housing finance strategy was invented.

The idea of the strategy was to persuade the banks that even under current conditions, it was possible to start housing finance programmes which would generate decent profits.

A major role in implementing this strategy was played by The US-Russia Investment Fund (TUSRIF)[4]. The fund started its mortgage program in 1998, refinancing mortgage loans issued by Russian commercial banks. In 2001, the fund established the first Russian bank specializing in housing finance business - Delta-Credit Bank.

Several years of activity demonstrated that the TUSRIF mortgage programme was highly successful. Thus, Russian banks followed suit and began mortgage programmes of their own. Starting in 2001, housing lending in Russia has gained momentum and the volume of lending has started to grow with fantastic speed. It has actually been rocketing.

The mortgage portfolio of Russian banks increased in four years nearly 50 fold. In 1999, the total amount of mortgage debt outstanding was about 300 millions Rubles (approximately USD11 million) in less than 500 mortgage loans. By the end of 2003, Russian banks already had in their portfolios 27,000 loans with outstanding debt of approximately 15 billion Rubles (about USD 0.5 billion).[5]

The growth is still speeding up . According to the Central Bank of Russia, six thousand mortgage loans were issued with a total volume of 3.3 billions Rubles in 2002, which was twice the volume of loans issued in 2001 (4,000 loans amounting to 1.7 billion Rubles). The volume of new loans provided in 2003 was more than three times higher than in 2002 – 14,000 loans worth 10.5 billion Rubles. We expect that the results of 2004 would show even faster acceleration of new mortgage loan origination because several strong players joined the market in 2003 but started active operations only in 2004.

What has made banks so active in mortgage lending in spite of the risks that they have faced and (from their own point of view) have not been able to manage (see Table 1)? The answer to this question is that during the last five years the macroeconomic climate has concealed the risks.

As it is shown in table 2, the Russian economy has been rapidly growing from 1998.

The level of unemployment was reduced by approximately 9% every year (from 13.2% in 1998 to 8% in 2003). Average monthly wages increased during this period more than five times. The cost of funds for banks fell sharply. Average deposit rates reduced more than three times (from 13.7% in 1999 to only 4.4% in 2003). During this period, inflation was modest. The Ruble-dollar exchange rate practically did not change.

[4] TUSRIF was funded by an USAID grant.

[5] Estimation of the Association of Russian Banks.

Table 2[6] - The Russian Economy 1998-2003

	1998	1999	2000	2001	2002	2003
Unemployment rate (%)	13.2	12.6	9.8	8.9	8.6	8.0
Average monthly wages (in rubles)	1,052	1,523	2,223	3,240	4,360	5,509
Average deposit rate (%)	18.6	13.7	6.5	4.2	4.5	4.4
Average lending rate (%)	41.5	40.1	24.3	17.9	15.7	13.1
Average house prices ($/m2)	630	708	720	940	1,096	1,594
Rouble/Dollar exchange rate	20.65	27.0	28.16	30.14	31.78	29.45

However, real estate prices were soaring. In Moscow, for example, average house prices tripled in the last six years.

How did these favourable macroeconomic circumstances influence the risks? Collateral risk has been rapidly decreasing because rising real estate prices lead to reduced LTV ratios of already allocated loans. Default risk has also been decreasing due to lower unemployment and higher wages. Lack of actual defaults underlined the ostensible stability of the system. (There has not been even one case of a mortgage borrower default in Russia yet).

Lack of defaults is partly due to the fact that mortgage loans have been granted to the higher income deciles of the population. Heads of the departments in charge of mortgage borrower's underwriting in several Russian banks – leaders in mortgage activity – have been interviewed by the author and have stated that they have not been able to remember even one manual worker borrower. Typically, borrowers are highly qualified experts and managers of foreign and leading Russian companies.

Declining interest rates and the increasing liquidity of the banks facilitated management of mismatch risk. Even when deposit markets were being rattled by massive withdrawals of savings from several banks in July 2004, mismatch risk of mortgage lending did not reveal itself in losses. Fortunately, banks with big portfolios of illiquid mortgage loans were not hit by this panic. The most severe blow was received by the biggest private bank in Russia – Alfa Bank – that did not have a mortgage programme.

It is very important to stress that the declining interest rates did not entail a considerable amount of prepayments. In Russia prepayment levels have been rather modest because the legislation is extremely unfavourable for re-mortgaging.[7] In Russia, the borrower cannot take out a new mortgage loan to repay the old one. Banks do not provide such loans because according to the law, eviction of such a borrower is not allowed.

All banks which introduced housing finance programmes in 2000-2002, have achieved high profits. In the environment of reducing interest rates, they keep in portfolios mortgage loans with the rates much higher than the average on the market and at the same time do not suffer from bad loans. On the whole, the business seems to be extremely attractive. It is not surprising that by the end of 2003, 146 Russian banks have been actively competing for a share of the extremely profitable mortgage market.

A positive outcome from these activities was that practical experience in issuing mortgage loans made the banks understand housing finance specifics and the shortcomings of the current Russian legislation. Thus, they have started to lobby for changes in the present legislation in order to better manage the risks associated with mortgage lending.

And as a result, the changes in the legislation necessary to make major risks manageable finally took place! A set of 27 new laws and amendments to the existing laws has been carefully developed. Currently, this set of laws and amendments is being actively pushed through the approval procedure in the Duma (Russian parliament). As soon as they have been enacted, these changes will eliminate contradictions between different pieces of legislation and make eviction really possible. This will finally enable banks to better manage collateral risk.

In addition, the new laws will substantially reduce transaction costs. For example, new legislation stipulates that notary fees for registering a mortgage of a house may not exceed 1.5% of the house price agreed in the sales contract.

On the whole, this set of new laws and amendments lays the foundation for a viable and functioning housing finance market. Besides the above mentioned the set provides for the following: re-mortgaging will be facilitated; credit bureaus will be established; the introduction of mortgage default insurance will be regulated; a special law will regulate the issuance of mortgage bonds, etc.

The recent legislative package points out that the strategy Russia has pursued was in fact the first strategy ie eliminating barriers created by an unsatisfactory legal environment in order to establish a housing finance system. However, only the sequence of the events was turned backward: first, the housing finance system was established in spite of barriers created

6 Source: Bureau of Economic Analyses "Review of economics of Russia #55", March, 2004. Please see at www.beafnd.org

7 Re-mortgaging is defined as taking out of a new mortgage loan to use the cash for repayment of the old one.

by unfavourable legal conditions. Second, changes in legislation eliminating the barriers were introduced.

Today, there is a strong belief that the reversal of the strategy finally paved the way for the legal reform. If the housing finance system had not been established in a first step, the legislation would not have changed since there would have been no institution interested in changes and qualified to professionally develop them and lobby for them. The banking community turned into such an institution when it became involved in housing finance activities. Actually, the banks promoted the reform in legislation necessary to develop housing finance in the country.

As a result the reverse strategy turned out to be highly successful in Russia. A mortgage lending system has emerged in the country and is developing at extremely high speed.

The question is whether the system is sustainable. Will it survive when the macroeconomic situation changes? It is not just a curiosity because the situation is currently changing[8]. For several weeks, the growth of house prices has stopped. Interest rates have started to rise slowly since July 2004. High oil prices still support the economy; thus, unemployment is still very low and average incomes are growing but the situation may change.

SUSTAINABILITY OF THE SYSTEM

It is not easy to predict what will happen to the Russian housing finance system when the economy slows down. The problem is that the strategy is based on persuading banks to issue loans in spite of the underlying risks. One of the results of the strategy implementation is that banks become inclined to underestimate the risks and in some cases even to ignore them completely.

While competition has been increasing, banks have been accepting more and more risks. Many banks have gradually reduced their down-payment requirements from 30% to 15% of the price of a dwelling. In developed countries, such low down payments are typically covered by mortgage insurance. But in Russia, mortgage insurance does not yet exist.

Simultaneously, debt-to-income ratios of the borrowers have been increasing. In developed countries, there are two types of debt-to-income ratios: front-end ratio and back-end ratio. The front-end ratio is the housing-debt-to-income ratio. The back-end ratio is defined as the total-debt-to-income ratio. The total debt comprises both housing and non-housing debt of a borrower.

Many Russian banks accept a front-end-ratio of up to 50%. (In the US, underwriting guidelines generally recommend a front-end-ratio of up to 28%)[9]. The back-end-ratio in Russia is usually not calculated. Without credit bureaus, it is impossible to find out whether the borrower has loans outstanding in other banks. If the front-end-ratio is 50%, the back-end-ratio may turn out at around 70–80%. (In the US, it is usually recommended that the back-end-ratio should not be higher than 36%).

It was mentioned above that the assessment of the income is problematic in Russia since a major portion of the salary of the potential borrowers is paid in cash. Therefore, Russian banks require the borrower to confirm his income by a letter from his employer (in a special form). Typically, this letter provides information about the borrower's actual monthly salary during the last 12 months. Since the letter is often faked, banks used to check the information provided by the borrower. They compare the salary mentioned in the letter with the average salary on the market of those people who have the same experience and the same position. When competition between banks has increased, more and more banks have begun to accept unconfirmed income statements and have neglected to check the information about the income provided by the borrowers.

Mismatch risk is also rapidly increasing. Although the Agency for Housing Mortgage Lending has been very active, its activities have not reduced concentration of mismatch risk in the system.

The bonds which the Agency issues in order to refinance housing loans of the banks have a government guarantee. Thus, the Agency issues government debt. Due to the limited amount of long-term funds of institutional investors (insurance companies and pension funds) in Russia, the maturities of the bonds do not exceed six years. However, the terms of the loans which the Agency refinances, are up to 23 years. As a result, the Agency has turned out to be a vehicle shifting major risks (including mismatch risk) to the government.

In this context, it must be mentioned that the banks do not often use the vehicle and do not refer to the Agency to refinance their loans. At the end of 2003, more than 90% of outstanding mortgage debt was kept in banks' portfolios and was financed by short-term resources of the banks. Banks (ignoring the risks) prefer to maximize profits holding the loans in their balance sheets.

Banks have also started to enter into extremely risky type of mortgage lending associated with construction of new houses. At present, a major portion of new housing in Russia is constructed in the form of multifamily condominiums. Typically, the developer finances only the acquisition of the land and the preparation of the drawings. The prospective owners of the apartments finance the rest.

As soon as the construction of the building has started, the developer begins to sell the apartments. In most cases, the prospective

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[8] The paper was presented on 22 September 2004 at the Joint Congress of UN-HABITAT and EFBS on "Housing Finance in Emerging Markets - Experiences and Challenges" in Berlin.

[9] Michael Lea. "Prerequisites for a Successful Secondary Mortgage Market: the Role of the Primary Mortgage Market," Housing Finance International, December 2000.

owners pay the whole price of the apartments in a lump sum at the beginning of the construction. These lump-sum payments are often financed through bank loans. Since these payments constitute the only source of funds for the construction of the whole house, both the buyer and the bank need sophisticated techniques to gauge and to manage this type of business, which is associated with the following risks:

First, fraud is the most common risk. Often, developers have sold the same apartment to different buyers. The fraud is only detected when the construction of the house is completed and several owners apply to register ownership of the same apartment in the registry.

Second, there is the bankruptcy risk of the developer or the contractor. The buyer of the apartment faces difficulties to assess this risk since he often does not have the expertise necessary to analyze the financial documentation of these companies. In most cases, he does not even have this documentation.

Third, there is a high risk of construction termination, which is down to violation of building codes, lack of necessary permissions, etc. In Russia, the process of receiving the necessary permissions is so complicated that construction is often started without them. Typically, the permissions are successfully obtained later but in some cases the construction is proclaimed illegal and stopped.

Fourth, market risk is also of major concern. Typically, the buyer pays the price of the apartment at the initial stage of construction. His money is invested into the project. To further continue the project the developer must find other buyers. If they are not found the buyer may lose his money entirely since the developer does not have the funds to finish the construction or to return money that has already been converted into the partly constructed building. Market risk becomes especially serious when house prices decline. Instead of buying an apartment in unfinished buildings, people prefer to wait in order to pay less for already finished apartments.

Since the system of construction finance is based on payments of the prospective owners, practically all new houses are sold during construction of the buildings. Due to the rising competition and the fear of losing market share, banks have provided housing loans for payments conducted by buyers at the initial stage of construction despite the inherent risks. The collateral for the loans is the obligation of the developer to provide an apartment to the borrower.

It is clear that if a bank provides such loans, all the above-mentioned risks are shifted to the bank. In case the developer does not fulfil its obligation and does not provide the apartment to the borrower, the latter will lose an incentive to repay the loan. At the same time, the value of the collateral will dramatically decrease and may become equal to zero. The banks cannot manage the risks but since they consider that all housing finance risks are negligible many of them provide such loans.

CONCLUSION: APPLICABILITY OF THE RUSSIAN STRATEGY IN OTHER TRANSITION COUNTRIES.

To date, the Russian strategy to create a housing finance system has been successful. Housing finance has started in the country and is still developing at extremely high speed. Legislative changes eliminating barriers that hinder mortgage lending have been thoroughly developed and will be soon enforced. However, it remains open to debate whether this strategy is recommendable for other countries.

One component of this strategy lies in the neglect of thorough risk assessment. Thus, a considerable concentration of risks within the banking sector is likely to emerge. This approach can be successfully implemented only during periods of substantial economic growth when the risks are expected to be absorbed by rising stability and increasing incomes of the borrowers. However, in case of an abrupt economic slow-down, it is not clear how banks and politicians will manage a highly risky mortgage market. The situation will aggravate if the decline takes place before the reducing-risk legislation is enforced and after total mortgage portfolio grows to a substantial amount. Russia seems to be lucky to avoid the problem. Legislation will be approved very soon while total mortgage debt outstanding is still less then one percent of GDP.