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**The Concept of Mortgage Lending Development
in the Russian Federation**

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Introduction

Mortgage lending is one of the development priorities set by the government housing policies. This Concept is a follow-up of the special federal program «Own Home» approved by Russian Government Regulation #753 of June 27, 1996, defining the role of mortgage lending in housing finance, as well as the government strategy for the development of this business.

In pursuing the current housing policies, the government continues to focus on the needs of socially vulnerable people, making the new emphasis on resolving the housing problems of the bulk of working people who have middle income, savings, and homes in ownership after free privatization. The principal solution for these people is long-term mortgage lending, and this Concept reviews the possibility and requirement for its launching.

This document sets out the main objectives and guidelines for establishing a mortgage lending system with a view to the Russian laws and existing social and economic conditions. The Concept includes a detailed description of setting up a long-term mortgage lending system and an organizational and economic mechanism for raising credit resources.

The Concept outlines the areas of improvements in the legal and regulatory framework of mortgage lending at the federal level and at the level of the Russian Federation's subjects and municipalities.

The Concept is built on the practical experience of establishing and functioning of the mortgage lending mechanism both in developed and transition economies, and also capitalizes on the experience of housing finance in the Russian regions.

Under this Concept, the mortgage lending in Russia in its matured form will be a self-developing and sustainable system which would work well without additional significant government finance.

The government's main task in mortgage lending development is to establish legal and regulatory framework in order to reduce financial risks for the participants and make houses more affordable for the people.

The government funding will go for direct support to individuals whose incomes are not sufficient for independent improvement of housing conditions, assuming the form of designated and uncompensated subsidies for acquisition of homes.

This would bring about various market and social mechanisms that supplement each other and address the housing problems of people.

1. Main Goals and Principles of Mortgage Lending Development

1.1. Background

The pre-reform housing finance was in line with the housing policies, focusing on the centralized budget allocations for government housing construction, with subsequent free distribution among applicants eligible for the improvement of housing conditions. In 1987, government capital investments in the housing construction exceeded 80 percent, while funds of the public accounted for only 14.6 percent (including the funds of individual builders and members of housing construction cooperatives).

Before the economic reform, Russia did not have a market mechanism for helping people with tackling housing problems on their own. The free housing market hardly existed, long-term credits to individuals were insignificant in the total housing finance and were given mostly to individual builders, housing construction and housing cooperatives for building new houses rather than purchase already available homes.

The reforms of 1990-1998 have changed the housing finance dramatically. The commission of residential houses has differed significantly by the form of ownership and funding sources. The share of private sector has grown significantly, and the state is no longer the sole participant in this market. The share of state- and municipally owned companies in the total volume of commissioned houses has shrunk from 80 to 20 percent, including enterprises in federal ownership whose portion went down to 9 percent. In 1998, the federal budget was used to build only 1.3m square meters of the total residential houses, equal to 4.2 percent of the total volume. The main positive result of the reforms was a significant growth of houses erected by individual builders, almost a 3-fold increase between 1990 to 1998, amounting to 39.4 percent of the total annual volume of commissioned housing.

The housing market has evolved and is developing rapidly. The policies of free privatization of houses and lifted restrictions on the quantity and size of residential premises owned by the general public have altered the structure of the housing stock by the forms of ownership. Currently, 57 percent of the total housing estate in Russia is privately owned. According to estimates, each year 1.5-2 percent of privately owned apartments in Russian megalopolises is involved in sales deals.

The shrinking budget allocations for construction have caused an obvious decrease in the houses provided to eligible applicants for free. The free social housing decreased 3-fold between 1990 to 1998 and was available in 1998 only to 344,000 families, while over 6m families have registered their right to such housing. The annual distribution of social housing versus the number of eligible families went down approximately by half, making it clear that from now on the solution will take up more time.

Insufficient effective demand of most population for the newly built houses and the lack of loans for construction and acquisition of the ready houses have brought the volumes of housing construction down. The commissioned houses decreased from 61.7m square meters in 1990 to 30.7 square meters in 1998.

The property market created during the initial years of reform lacks the necessary funding mechanisms that could fill the gap caused by budget cuts for housing construction.

Facing the sharp budget cuts, the government focused primarily on the concerns of certain classes and groups of population not capable of resolving their housing problems on their own. The majority of population having relatively stable incomes and willing to acquire

apartments in ownership was not able to do so because of the lack of sufficient savings and long-term credits.

The task of the state in the new conditions is to maintain the effective demand of various groups of population in the property market by creating favorable conditions for the development of mechanisms for market mobilization of extra-budgetary funds and channeling them to the financial sphere through long-term mortgage lending, the transfer from the budget-funded construction of houses and their subsequent free distribution towards the acquisition of available houses in the free market by people who use both own funds and loans.

It is worth mentioning that the government continues to provide social housing to those individuals who do not have sufficient incomes for acquiring houses in ownership even through long-term loans and free subsidies that cover the partial value of the houses.

1.2. The Role of Long-term Mortgage Lending in Housing Finance

The definition of the principle areas and approaches to the establishment of an efficient market mechanism for housing finance that would provide for an integrated solution to the housing problem requires the identification of the following major interrelated blocks:

- long-term mortgage lending to the general public;
- housing construction lending;
- government budgetary support to the public for acquisition of houses (ear-marked subsidies).

Long-term Mortgage Lending to General Public

The proposed Concept is based on the creation of a market system for long-term mortgage lending to the general public willing to acquire available houses in the free market, including both the newly built houses and the secondary market.

Housing is a costly commodity of durable use. Its acquisition usually cannot rely on the current incomes or savings of consumers. In many countries across the world, the acquisition of houses on credit is the major solution to the housing crisis and the principle economic sphere, where the banks and other financial entities generating the required capital inflow play the key role. The state plays a regulatory role by creating the legal framework for efficient cooperation between all participants in housing lending, and, as far as necessary, exercises direct or indirect influence on attracting additional private investments into the housing sector, and offering assistance to various groups of citizens in acquiring houses.

The Concept proposes the creation of an integrated system of mortgage lending, which includes the long-term mortgage loans by commercial banks and other creditors to individual borrowers, and a mechanism for providing creditors with necessary long-term sources for lending.

The expansion of long-term mortgage lending needs sufficient volumes of long-term resources attracted from the financial and capital markets, which predetermines the importance of adapting a reliable mechanism for providing funds to creditors and guarantees to investors who send their capitals to the long-term mortgage loans market.

The Concept takes into account various models and forms applicable in the world practice for maintaining cooperation between participants of the primary and secondary mortgage loans markets. The primary market is operated by the creditors and borrowers (issuance and

servicing of mortgage loans), the secondary market is dominated by the creditors and investors refinancing creditors.

The population can obtain financial sources of long-term credits both through funds raised by the creditors on the primary market individually (one-tier system of mortgage lending) and through funds raised on the secondary market with the help of specialized operators (two-tier system of mortgage lending).

The key factors for attracting credit resources to long-term mortgage lending are the creation of favorable economic and political environment in the country, the development of the necessary legislative and regulatory framework and raising the living conditions of population. Of critical importance is the streamlining of offering and servicing mortgage loans, the rules for evaluating borrowers' creditworthiness, and financial instruments for raising funds.

Housing Construction Lending

For this vital segment of housing finance, investments will presumably be encouraged by offering bank credits to builders for housing construction (construction loans). The lending bank issues credits by disbursements to pay for the construction and assembly, conducting strict control over the progress, deadlines and quality of construction. The builders, who are the recipients of such credits, have an opportunity to repay the obtained loans on time, upon completion of and sale of construction asset.

The major concern for any commercial bank offering a construction loan is a precise assessment of project feasibility, in particular the amount of non-completion risk and the risk related to liquidity of the erected residential building. The bank, together with the builder, has to make a careful analysis of a bunch of factors, including demand on this type of housing, market capacity, the builder's ability to comply with the deadlines and estimated costs during construction, so that at its completion the pre-planned prices remain valid and the initially proposed terms and conditions for sale do not change.

Construction loan is issued to the builder, provided that the latter disposes of (preferably by right of ownership or long-term lease) the site allocated for housing construction and the local authorities have given all authorizations for construction. The builder may use his share of investments not only to acquire land for build-up, but also for funding other initial expenditures. The risks are significantly mitigated for the bank, when the builder takes on the majority of the funding for project development. Risks can also be alleviated by pre-construction agreement between the builder and the bank that the potential buyers can obtain mortgage loans to acquire the built houses or apartments.

This mechanism works well together with mortgage lending to individuals who are buyers of apartments in the houses built under the following scheme: the obtained mortgage credits and own funds of individuals are used to pay for housing, the owners of the houses available for sale (the builders) have an opportunity to repay a previously obtained construction loan.

Government Budgetary Support to Public for Acquisition of Houses (the system of ear-marked subsidies)

The availability of housing, namely the ability of citizens to acquire houses in ownership through their own and debt funds, shows the level of the society's development. Ineffective demand of the population, the gap between the actual incomes and housing prices, unstable

incomes - all these factors have a negative impact on the possibilities of individuals to acquire houses even through mortgage lending. One of the key requirements of the long-term mortgage lending system is to ensure that not only high-income, but also middle-income people have access to mortgage loans. Mortgage lending has to be market-, not subsidy-oriented, be absolutely transparent and clear to all participants in mortgage lending.

The government support to individuals willing to get mortgage loans on the standard bank terms and conditions, but having insufficient incomes may be organized through the system of free subsidies for making the initial payment, obtaining mortgage loan (for instance, by government housing certificates), which would bring the required amount of loan down. Such funding, where own funds would cover 30 percent of the value of the apartment, government subsidies - from 20 to 50 percent on average (depending on the group of individuals), the remainder is paid through mortgage lending, will raise the availability of mortgage loans to individuals and encourage effective demand for housing.

The subsidies are distributed according to budgetary possibilities, from 5 to 70 percent of the market value of housing, under the social norms, depending on the class of citizens, level of incomes and time passed after registration for better housing conditions. According to law, certain classes of citizens (young families, fixed-budget families, citizens moving from the Far North regions and locations equated thereto, citizens resigned or facing resignation from the military service, etc.), may have more subsidies, under the established procedure. The subsidies may come from the federal budgets, the budgets of the Russian Federation's subjects, municipalities and funds of enterprises.

1.3 Objectives and Principles of Long-term Mortgage Lending Development

The principle objective of long-term mortgage lending development is to create a well functioning system for the provision of middle-income Russian citizens with housing at affordable prices, based on market principles of acquiring housing on the property market free of monopolists, through own funds of individuals and long-term mortgage loans.

Once in place, such system would help:

- raise the effective demand of citizens and bring the acquisition of houses closer to the majority of population;
- boost the property market;
- involve the privatized housing in the effective economic turnover;
- attract the public's funds to the housing sector, as well as other extra-budgetary financial resources;
- assure the development of the construction business;
- recover the nation's economy on the whole.

The Russian mortgage lending system has to rely on the existing international experience in the development of mortgage lending, to adapt it to the Russian laws, to consider the macro-economic conditions (typical of the transition economies), limited creditworthiness of the public, and high inflation.

Above all, it has to capitalize on the efficient use of raised funds from individuals, commercial lending banks, investors, rather than on the government budget. The rate and size of mortgage lending development in the regions have to be predetermined by the objective economic conditions there, the effective housing demand and supply, and the availability (or the lack) of necessary regional legal and regulatory framework and infrastructure.

To develop the mortgage lending system, the solutions to the following matters have to be considered:

- improvements in the legal and regulatory framework in order to apply the mechanism for this type of lending and efficient functioning of the primary and secondary mortgage lending markets;

- the development and installation of the universal mechanism for encouraging the inflow of long-term extra-budget finance to the mortgage lending market;

- the development of infrastructure to help with efficient cooperation between all participants in the mortgage lending market;

- tax incentives to individuals receiving mortgage loans, to creditors and investors providing refinance to creditors;

- the creation of level playing ground for free competition between the subjects of the mortgage lending market;

- the development of vehicles for social protection of borrowers from illegal actions of creditors, and their social adaptation during eviction, in case of inability to repay the previously obtained mortgage loan.

Strategic development for long-term mortgage lending shall include the following aspects:

- the current focus primarily on those classes of individuals who need small mortgage loans. With limited resources, this would allow to reach more borrowers. The percentage of those in need of small mortgage loans is great, no less than one third of those willing to improve their housing conditions, according to estimates;

- the possibility of paying for the new house partially due to the sale of the currently owned housing. For obtaining small loans, the borrower needs to have significant own funds, those who do not have enough cash savings can sell the old apartment and thus making partial payments for the new one;

- the provision of government subsidies to borrowers acquiring houses through mortgage lending. The citizens eligible for housing subsidies under the set procedure may use them to make partial payments for the house, in addition to their own funds and mortgage loan.

2. Organization of Long-term Mortgage Lending

2.1. Tasks and Functions of Major Participants in Mortgage Lending Market

Long-term mortgage loan is a credit or loan offered for 3 years and more by a bank (credit establishment) or legal entity (non-credit establishment) to an individual (citizen) for the acquisition of house against the house to be acquired.

The long-term mortgage lending market is operated by the following major participants:

- 1) borrowers who are citizens of the Russian Federation and who have concluded credit agreements with banks (credit establishments) or loan agreements with legal entities (non-credit establishments), where terms and conditions provide for the use of funds received as credits for the acquisition of house. The collateral for the execution of obligations under these agreements is the pledge of a house to be acquired (mortgage);

- 2) sellers of houses who are individuals and legal entities selling residential premises they own or owned by other individuals or legal entities, on their behalf;

- 3) creditors who are banks (credit establishments) and other legal entities offering to borrowers mortgage credits (loans) under the procedure established by law.

The major functions of the creditor include:

offering mortgage loan on the basis of the evaluation of creditworthiness and solvency of the borrower in accordance with lending terms and conditions;
formalization of a credit agreement (loan agreement) and mortgage agreement;
servicing of issued mortgage loans. According to mortgage agreement, the creditor is a pledge holder, who can, in case of borrower's failure to honor obligations under loan agreement, satisfy monetary claims to the debtor from the value of pledged residential premises, observing the priority order versus other creditors of pledge giver;

4) operators of the secondary mortgage lending market (mortgage lending agencies) which are specialized organization refinancing creditors and offering long-term mortgage loans to the public.

The major functions of the secondary market operators include:

refinancing loans under rules and regulations set for the mortgage lending procedures;
issuance of issuing mortgage securities;
attracting investors' funds to the housing sector;
assisting creditors in learning best practices for conducting mortgage lending operations and for the development of those types of mortgage loans, that are more available to borrowers and less risky to creditors;

5) state registrars of real estate rights and transactions, which are the state bodies conducting state registration of immovable property rights and transactions.

The major functions of these bodies include:

registration of sales transactions with residential premises, formalization of ownership transfer;
registration of mortgage and mortgage rights agreements;
keeping and disclosure of information concerning ownership rights and pledge to all mortgage market participants;

6) insurance companies, which are the licensed insurance companies providing property insurance (insurance of pledged house), personal insurance of borrowers and insurance of civil law liability of mortgage market participants;

7) appraisers who are legal entities and individuals authorized to make professional appraisal of residential premises that are pledged assets in mortgage lending;

8) real estate firms that are legal entities licensed as professional brokers on the property sales/purchase market. Their functions include matching sales/purchases for borrowers and sellers, assistance in concluding sales transactions, arrangements for selling houses on behalf of other property market participants, participation in launching tenders for housing property subject to recovery;

9) investors who are legal entities and individuals acquiring securities secured by mortgage loans issued by creditors or secondary market operators. They include pension funds, insurance companies, investment banks, unit investment funds, etc.;

10) infrastructure links of mortgage lending that are notary public, registration services, trusteeship and custody authorities, legal advisers, others, which conduct due diligence for transactions with residential premises, registration of individuals at the place of their living (including in pledged apartments and houses), protection of rights of minorities at conducting transactions with real estate.

A special role, particularly at the inception of long-term mortgage lending for the general public, shall be played by the state.

The state draws up the concept of mortgage lending development and establishes the legal base for its reliable and efficient functioning, provides a safety net for the borrowers, conducts tax policy to encourage mortgage lending market participants, sets up institutions required for the organized market and participates in their administration.

Currently, long term mortgage loans are given to people by universal commercial banks. The expansion of such operations and the market will bring into existence specialized credit organizations that restrict their business by mortgage loans to the public. The establishment of credit organizations like «mortgage banks», «saving and loan associations», «construction savings banks» would help raise the professional standards and quality of services offered to the public by banks and credit organizations. Their opening and lending to the public will be mainly determined by the adequate development of the banking legislation and the regulations governing their operation.

In addition to commercial banks, a certain role in the development of surplus solvent housing demand may be played by other organizations currently set up in accordance with civil laws, including those functioning as creditors (funds for support and development of housing construction, credit unions, others). Such organizations will use own and raised funds to provide loans to the public for construction and acquisition of available housing within the framework of share capital or funds being created. As they are not credit organizations, they do not need CBR licenses for offering mortgage loans. The operation of non-credit organizations offering mortgage loans is not currently regulated by the government. They may issue mortgage securities, provided strict government control is imposed on their operation at the legislative level and a special mechanism for investors (individuals) protection is in place.

Today, all the participants are operating in the mortgage lending market this way or another. The goal is to help their efficient cooperation in order to open up prospects for the population willing to improve housing conditions.

2.2. Basic Standards and Requirements for Long Term Mortgage Loans

Long-term mortgage loans are given for 3 years and more (the best option at this stage is from 10 to 15 years). Long maturity makes the monthly payments of the borrower smaller.

The amount of a loan is not more than 60 to 70 percent of the market value of the house to be purchased, which is the collateral of the loan.

The initial payment that the borrower is obliged to make for part of the house at his own account usually ranges from 30 to 40 percent of its value.

The loan and interest thereon are refunded by monthly payments calculated as annuity (a monthly payment includes the full payment of interest accrued on the balance of the principle, and part of the loan itself, calculated so that monthly payments at fixed interest rate are equal for the entire credit period). This suits both the borrower (a possibility of planning the family budget) and the lender.

A monthly payment on the loan shall not exceed 30 to 35 percent of the aggregate income of the borrower and joint borrowers, if any, over the relevant accounting period. Evaluating the

feasibility of repayment, the lender uses officially confirmed information on the current incomes of the borrowers and joint borrowers.

The house acquired on credit serves as collateral against a loan (is pledged to the lender). In case of the borrower's failure to honor his obligations, execution is levied against the house with its subsequent sale in repayment of the borrower's debt to the lender. The remainder of the repayment, less expenses related to the recovery and sale of the house, is given back to the borrower.

The borrower and all major members of his family present a notarized consent for their removal, in case of recovery, from the residential premise acquired through credit sources and mortgaged.

The mortgaged house shall be free of any limitations (encumbrances), cannot be pledged as security of another obligation.

The house acquired on credit has to be used by the borrower primarily for residence. Rent is possible upon agreement of the lender, which is stipulated by loan agreement.

Requirements on mortgage loans have been established on the experience gained at home and abroad. These standards and requirements address risks for the lenders and borrowers.

The compliance with clear-cut standards and requirements for loan offering and servicing underlies the reliable functioning of the secondary mortgage loans market and fund raising from private investors, including through issuing mortgage securities and bonds.

2.3. Basic Stages and Procedure for Offering Long-term Mortgage Loans

Long term mortgage loan is issued on the condition of charging, term, refunding, and strict control over its use. The principle security for the repayment is pledged house to be acquired out of these funds.

The parties include the following clauses in their loan agreement: the amount of the loan to be issued; its term; interest to be paid by the borrower on the loan; priority order of repaying the loan and interest thereon; grounds for early termination and recovery of the loan and interest, and others.

The parties include the following clauses in their mortgage agreement: the subject of mortgage; the price of the mortgaged premise; the essence of the principle obligation secured by mortgage (offer of credit sources); the amount of the principle obligation secured by mortgage (the amount of the issued loan and interest for the use of monetary funds); the term of execution of the principle obligation secured by mortgage (the term of the issuance); the stipulation that the mortgaged property is used by the borrower (who is the pledge giver under mortgage agreement); requirements for insurance of the mortgaged property; the grounds for recovery, and others.

The rights and obligations of the parties under loan agreement and mortgage agreement shall guarantee to the lender and borrower the protection of their interests and the possibility of their defense.

In case the borrower is not able to refund credit sources, the lender has the right to levy execution against the pledged property.

The standard procedure for obtaining mortgage loan comprises the following main stages:

- 1) preliminary qualification (approval) of the borrower. The borrower has to obtain the required information about the lender, the terms of offering a loan, the rights and obligations arising from signing loan agreement. On his turn, the lender weighs the ability of a potential borrower for repayment;
- 2) the lender's evaluation of the possibility for mortgage loan repayment and identification of the maximum amount of the mortgage loan, giving consideration to the borrower's incomes, the availability of own funds for making initial payment, and the evaluation of the subject of mortgage. This procedure is called underwriting of the borrower. The lender checks the information disclosed by the borrower, evaluates his solvency and makes a decision on offering a loan or well-grounded refusal. Making a positive decision, the lender calculates the amount of the loan and puts together other important conditions for its offer (term, interest rate, repayment procedure);
- 3) the selection of an apartment satisfying the financial opportunities of the borrower and requirements of the lender. The borrower has the right to choose an apartment both before and after approaching the lender. Under the first scenario, the seller of the house and the potential borrower sign the preliminary sales agreement for the residential premise, which stipulates the priority right of the potential borrower for the purchase of the apartment in question, at the agreed price and term. In this case, the lender evaluates the house in terms of loan repayment and calculates the amount of the loan, giving consideration to the borrower's incomes, the first installment and the value of the house. Under the second scenario, the potential borrower is aware of the amount of the loan calculated by the lender and can select the affordable house and sign with its seller a sales agreement, provided the lender agrees to take the house in question as a suitable collateral for his loan;
- 4) the evaluation of the house, which is the subject of mortgage, in order to know its market value. Once an apartment is chosen for the purchase on credit, the appraiser, whose services are paid by the borrower, makes an independent appraisal of the house chosen by the borrower, and the lender matches the amount of the offered loan;
- 5) the conclusion of an apartment purchase contract between the borrower and the seller of the house and the conclusion of the loan agreement between the borrower and the lender, the acquisition of the house by the borrower and its pledge to the lender under mortgage agreement or by law. In case of a positive decision, the lender signs with the borrower a loan agreement, and the borrower credits his own money to his bank account, which is going to be used as initial payment.

Collateral against loan may be formalized by:

mortgage agreement for the acquired residential premise, duly notarized and registered with state agency;

three-party (mixed) purchase contract and mortgage agreement for residential premise, where three parties successively and almost simultaneously record, notarize and register the transfer of ownership rights from the seller to the buyer and the mortgage of the apartment in favor of the lender;

contract on acquisition of residential premise through credit sources, when mortgage of the residential premise to be acquired arise by law at the time of registration of purchase contract;

- 6) settlement with the seller of the residential premise. The borrower pays for the residential premise under purchase contract, using the initial payment and credit sources. It makes sense for the lender to participate in and control over settlement under purchase contract;
- 7) insurance of the subject of mortgage, life of the borrower, and, when possible, the rights of owner concerning the residential premise to be acquired.

Later on, the lender services the loan, namely receives payments from the borrower, makes book entries on repayment of the principle and interest, takes every action to service the issued mortgage loan.

The discharge of obligations under loan agreement results in repayment of loan, mortgage terminates, and the relevant entry is made in the state register.

The failure of the borrower and pledge giver to comply with terms and conditions of loan agreement or mortgage agreement results in lender's recovery of the pledged house either in court or outside court. The subject of mortgage is sold, and the proceeds are used to repay debt to the lender (the principle, interest, fines, penalties, etc.), to pay for the expenses related to recovery and sale of the subject of mortgage.

To alleviate credit risk (risk of non-repayment), the following steps should be taken:

the provision to the lender a feasible opportunity for recovery and sale of the pledged property, the creation of conditions for prompt consideration of cases related to pledge recovery in courts;

the installment of a reliable system for registration of land, real estate, mortgage and other rights in order to reduce for the lender the risk of unforeseen rights;

the adapting of underwriting mechanism for mortgage loans, raising the grounds for their issuance;

the development of reliable procedures for offering and servicing mortgage loans.

To reduce interest rate risk (when the cost of credit sources raised by the lender exceed interest rate of the issued mortgage loans), lenders may use various methods for the adjustments of loan payments, considering for inflation and borrower's incomes.

For this type of risks, the key point is the development of a system of reliable indicators reflecting changes in the market interest rate.

The mitigation of liquidity risk directly relates to the development of the secondary mortgage loans market, the creation of environment for attracting long-term resources to this sector, the provision of refinance for mortgage loans issued by the lenders.

2.4. Appraisal of Mortgaged Residential Premises

The appraisal of the residential premises acquired by credit sources is undertaken by specialized appraisal firms or professional appraisers. The appraisal has its specifics, because the lender views the residential premise in question as collateral securing repayment of the funds offered to the borrower. The lender has to measure the current market value of

the asset with a view to its potential change that may be caused both by its individual features (design and layout, used materials and their fire prevention properties and durability, compliance with norms and standards for residential premises, etc.) and its location (remoteness to transportation roads, environmental situation and other factors, including the development prospects of the area).

With various approaches and methods, the main focus should be made on the comparative sales, given different adjustment ratios and indices allowing for the correct appraisal of the residential premise as compared to the property market and its development prospects.

The task of the lender is to analyze the adequacy of the collateral against the size of the loan in question, based on the appraisal of the residential premise.

A special importance is given to the development and application of a unified pro forma report on appraisal of residential premise, which would help analyze and provide a full picture of the required properties of the house.

Standardization of the methods and forms of the appraisal report would help minimize risks related to possible mistakes during appraisal of residential premises and raise efficiency of the secondary mortgage loans market.

3. Organizational and Economic Mechanism of Attracting Credit Sources to Long Term Mortgage Lending

The problem of attracting credit sources to long term mortgage lending can be viewed as the most critical for the development of the mortgage lending in Russia. No commercial bank is able to put together a long-term loan portfolio relying on short-term sources. Mismatch between bank assets and liabilities by terms and rates would sooner or later lead the bank to the loss of liquidity and bankruptcy.

Long-term resources for mortgage lending can be attracted from the following sources:

- a) credit lines and loans offered by banks and other organizations (funds);
- b) funds offered by institutional investors (pension funds and insurance organizations, unit investments funds, and others) from 5 to 10 years;
- c) placement of issuing mortgage securities;
- d) earnings from selling special bond issues. A comprehensive and efficient system of mortgage lending that secures lenders' liquidity must rely on the workable refinancing mechanism and reach the primary and secondary mortgage loan markets.

As these markets develop, various patterns may apply for attracting long-term credit resources, including:

- 1) the issue by the lenders of issuing mortgage securities and their sale in the financial market;
- 2) refinancing of the lenders through collective investments;
- 3) refinancing of the lenders through operators on the secondary mortgage loan market.

3.1. Issue by Lenders of Issuing Mortgage Securities and Their Sale in Financial Market

The procedure for the issue and circulation of issuing mortgage securities needs improvements through amendments to the Russian laws. Such modifications are aimed essentially at providing a clear legislative definition for the «issuing mortgage security», including the requirements for collateral against such securities, disclosure procedure for the issuer, the requirements for the issuers, etc.

For the inclusion in the economic turnover of issuing mortgage securities as an individual type of securities, the relevant federal law should be adopted.

Below are the mandatory properties of the issuing mortgage securities:

- a legislatively established list of classes of legal entities authorized to issue issuing mortgage securities;

- an established collateral against such securities. The issuing mortgage securities can be issued solely against collateral, with legislatively determined composition and replacement procedure. In case of bankruptcy of the issuer, collateral against issuing mortgage securities should be either withdrawn from property included in bankruptcy estate or singled out as a separate bankruptcy estate;

- an increased reliability of issuing mortgage securities on the basis of specially established economic standards;

- an individual procedure for the issue and circulation of issuing mortgage securities.

3.2. Refinancing of Lenders through Collective Investments

The workable forms of collective investments in Russia are joint funds of banking management and unit investment funds.

Money of pension funds, enterprises, the general public, and other investors interested in the development of long-term mortgage lending in their region may be placed there.

There is a possibility of launching specialized funds to use their money solely for the purchase of mortgage deeds.

The merit of this scheme can be described as the development of a regional mortgage market and the creation on its basis of a sustainable refinance system, and an active involvement of regional credit organizations into long-term mortgage lending.

The following refinancing mechanism is proposed:

- 1) the lender issues a mortgage loan. A mortgage agreement is formalized and transferred to the lender with due state registration of rights to immovable property and transactions thereto;

- 2) the founders of joint funds of banking management or unit investment funds make cash contributions. The trust manager (or managing company) of this fund states in the investment declaration that money of the fund will go for the purchase of mortgage agreements;

- 3) the trust manager (or managing company) of the fund buys mortgage agreements from credit organizations, using money transferred to the fund by its founders.

For rights transfer under mortgage agreement, endorsement is made thereon in favor of the trust manager to whom the agreement is transferred. Rights transfer under mortgage agreement means the transfer to the same person of rights under obligation (loan) secured by mortgage. The trust manager (or managing company) should require from the authority that made state registration of the mortgage to register him as pledge holder.

Upon receiving from the new holder of mortgage agreement a written notice on registration of his rights to immovable property in the unified state register together with duly certified extract from the register, the debtor under obligation secured by mortgage makes interim and final payments.

The trust manager (or managing company) puts together mortgage portfolio to secure stable income to the founders of the fund.

When this pattern applies to raising credit resources, some aspects of mortgage as non-issuing security needs clarification.

Besides, more consideration is needed for taxation of joint funds of banking management (trust managers and founders).

3.3. Refinance of Lenders through Operators of Secondary Mortgage Loans Market

On the whole, an integrated system of long-term mortgage lending built on inter-action of the primary and secondary mortgage loans markets looks as follows.

The lenders operating on the mortgage loans market offer mortgage loans to the general public. To ensure prompt repayment of credit resources and address liquidity, the lenders may transfer claims on loans or mortgages to specially created organizations, namely operators of the secondary mortgage market (mortgage lending agencies). In this case, a relevant agreement on claims transfer under loans and mortgages is concluded between the original lender and the agency, and a trust management contract in respect of acquired claims is signed. This allows the lender to continue strict control over the borrower, receive commission for servicing loan and extend credit operations through funds obtained from the agency.

The agency's partners may be lenders satisfying its qualification requirements. The lender has to guarantee to the agency that loans or mortgages meet the set requirements and standards, to disclose the required financial and other information on a regular basis, and to provide access to documents concerning their relationships.

The agency conducts regular sample inspections of mortgage loans. If inspection reveals violations of the set requirements and standards, the lender is obliged either to eliminate violation or repurchase loans and mortgages. In case of improper execution by the lender of trust management contract, the agency has the right to rescind contract on cooperation therewith and hand loans over to another credit organization for servicing .

The agency sets binding for the lender criteria for repayment feasibility, which include the analysis of the borrower's creditworthiness, discharge of the previous financial obligations (credit history), equity, and the appraisal of the value and condition of property to be pledged.

Under trust management contract, the lender maintains control over borrower's timely payments of taxes on the pledged property and insurance premium. In case of bankruptcy of

the original lender, the mechanism of trust management of acquired claims under loans protects the interests of the agencies, as long as such claims are not included in the property comprising bankruptcy estate.

The use of trust management accounts for servicing clients provides for the obligatory monthly reports, which helps maintain efficient control over operations of the agencies and lenders by the Central Bank of the Russian Federation.

The operation of a specialized institution on the secondary mortgage loans market will contribute to risk allocation in mortgage lending. What is meant here is the reduction of liquidity and interest rate risks arising from inconsistencies between assets and liabilities of the original lenders and their transfer to the agencies.

This organizational model for refinancing of credit organizations would allow to incorporate other options for attracting credit resources to housing lending. For instance, the agency for mortgage lending may be trust manager of a joint fund of banking management or unit investment fund, which can also issue bonds or mortgage securities.

4. Improvements of Legislative and Regulatory Framework for Long-term Mortgage Lending

The principle function of the state during the development of market system of long-term mortgage lending is to create the adequate legislative and regulatory framework in order to provide legal protection of lenders who are pledge holders and investors offering long-term credit resources, and to provide social safeguards to individuals acquiring houses through mortgage loans. The task is to establish the reasonable balance of rights, making the lending system profitable and less risky for banks and affordable and reliable for individual borrowers.

While the system develops, the state can also create some favorable conditions for its development and take on some risks.

For this end, the following steps should be taken:

- improvement of legal norms for exercising rights to mortgage;
- regulation of mechanisms for attracting long-term financial resources;
- creation of favorable tax environment for mortgage lending to individuals;
- establishment of efficient conditions for the operation of credit organizations on mortgage loans market.

4.1. Current Condition of Legal and Organizational Base for Development of Mortgage Lending System in Russia

The focus was made on the development of legislative and regulatory framework necessary for promoting housing finance. The principles are set out by the RF Law on Fundamentals of Federal Housing Policies.

For the development of the above Law, the following documents were approved:

Regulation of the Council of Ministers and Russian Federation Government #595 of June 20, 1993, on Government Program «Zhilische»;

Presidential Decree #2281 of December 24, 1993, on Development and Application of Extra-Budgetary Investments in Housing Sector;

Presidential Decree #1180 of June 10, 1994 on Housing Loans;

Presidential Decree #1182 of June 10, 1994, on Issue and Circulation of Housing Certificates;

Presidential Decree #430 of March 29, 1996 on Government Support to Individuals in Construction and Acquisition of Houses;

Presidential Decree #431 of March 29, 1996 On New Stage in Implementation of Government Program «Zhilische»;

Government Regulation #753 of June 27, 1996, on Federal Program «Own House»;

Regulation on Provision to Russian Citizens Eligible for Improvements of Housing Conditions of Free Subsidies for Construction or Acquisition of Houses, as approved by Russian Government Regulation #937 of August 3, 1996;

Federal program Government Housing Certificates, as approved by Russian Federation Government #71 of January 20, 1998, which assumed the status of the presidential program by virtue of Presidential Decree #102 of January 28, 1998.

The critical step in the development of the federal legislation on mortgage lending was the adoption of the Civil Code of the Russian Federation.

The Civil Code has set out the general rules for securing loans against pledged real estate, residential property including, the rules on ownership right and other real rights to residential premises, the grounds for recovery of pledged residential spaces.

In addition to that, the Civil Code provides for the subsequent adoption of special federal laws regulating state registration of immovable property rights and transactions, and mortgages (pledge of real estate).

For the compliance with the requirements of the Civil Code, the Federal Law on State Registration of Immovable Property Rights and Transactions was approved in 1997.

The second important legislative step was the Federal Law on Mortgage (Pledge of Real Estate) approved in 1998, which provides much more opportunities for using mortgage as a reliable security against loan.

Later on, for the execution of the above federal laws, the Russian Government approved the following regulations concerning, in particular, mortgage lending:

Russian Government Regulation #219 of February 18, 1998, on Approval of Rules for Keeping Unified State Register of Immovable Property Rights and Transactions;

Russian Government Regulation #248 of February 26, 1998, on Establishing Maximum Amount of Payment for State Registration of Immovable Property Rights and Transactions and for Disclosure of Information on Registered Rights.

An important step in organizational arrangements for the functioning of the mortgage lending system was the creation, as an operator of the secondary mortgage loans market, of the Mortgage Lending Agency in the form of a public company, with controlling interest held by the state (in accordance with Russian Government Regulation #1010 of August 26, 1996, on Mortgage Lending Agency). Its charter capital is currently 80m RUR, all its shares belong to the state.

The Agency is mandated to develop and implement the scheme for refinancing lenders, where monitoring can be conducted by the Russian Central Bank, the Federal Commission on Securities Market, potential and effective investors, and rating agencies.

During the implementation of the Agency's pilot project in Saint Petersburg, standards and procedures were developed and tested for offering, refinancing and servicing long-term mortgage loans, maintaining the reliability of the entire scheme of functioning and interaction of the primary and secondary mortgage loans markets. In Saint Petersburg, a required regulatory framework was created for favorable conditions helping the efficient operation of all market participants, including the attraction of investors under regional mortgage program.

Dissemination of this experience, including through Agency's branches and cooperation with executive authorities of the subjects of the Russian Federation, would allow for the gradual creation of conditions for the development of the unified long-term mortgage loans market nationwide, bring down potential credit risks, raise the reliability of the refinancing mechanism and finally cut on the cost of loans for the borrowers, making them available for more Russian families.

In this context, the government support to the Agency responsible for the coordination of the development of the mortgage lending system in the Russian Federation may be rendered both through the establishment of the charter fund of the Agency, and through the system of government guarantees (of the Russian Federation or its subjects) in order to raise resources for refinancing lenders.

Today, the legislative framework is in place for the functioning of the mortgage lending system, and the operation of all professional subjects of the mortgage market (banks, appraisers, real estate agencies, insurance companies) is regulated. However, further improvements are needed for the legal mechanisms for exercising mortgage rights, as well as for the regulation of raising long-term resources to the mortgage lending sector, favorable tax environment for participants and conditions for their efficient work.

4.2. Improvements of Legal Mechanisms for Exercising Mortgage Rights

To improve the legal mechanisms for exercising mortgage right, the federal legislation and regulative acts have to be amended with respect to:

- clarification of the procedure for exercising the right of disposal of the pledged residential premise;
- recovery of the pledged residential premise;
- concluding transactions with residential premises, where the rights belong to minor citizens;
- creation of social protection mechanisms for individuals, when execution is levied against the pledged residential premise.

Recovery of Pledged Residential Premise

The risks associated with long-term mortgage loans is aggravated in Russia by difficulties of levying execution against the pledged property, in case of non-repayment and eviction of the pledge giver and his family. Those risks can be substantially reduced by eliminating conflicts between the rules of law incorporated, on the one hand, in the Federal Law on Mortgage (Pledge of Real Estate), and, on the other hand, in the Civil Code of the Russian Federation and RSFSR Housing Code concerning consequences of the borrower's failure to honor obligations under loan and mortgage agreements.

This concerns the rights of use of residential premise by members of owner's family, who live in the residential premise he owns, which was acquired through loan and is currently pledged.

The Federal Law on Mortgage (Pledge of Real Estate) envisages that, after recovery of the pledged residential house or apartment and its sale, the pledge giver and members of his family living with him shall remove, within one month and at request of the owner of the residential house or apartment, from the occupied residential premise, provided that:

the residential house or apartment was pledged under mortgage agreement as security of repayment of a loan offered for the acquisition or construction of this residential house or apartment;

family members living together with the pledge giver have signed, before concluding mortgage agreement, or later, if they moved to the pledged house or apartment, - before their settlement, a notarized obligation to remove from the pledged house (apartment), in case of recovery.

At the same time, the rule provided by article 292 of the Russian Civil Code presents a serious obstacle for the development of mortgage lending and housing market on the whole.

A number of amendments is needed in the above laws with respect to grounds and procedure for recovery of the pledged property and eviction in order to provide a clear understanding of the rules incorporated in the Federal Law on Mortgage (Pledge of Real Estate).

Besides, the issues related to consideration of judicial cases concerning recovery of pledged residential spaces and eviction of mala fide borrowers and members of their family need to be summarized by the Supreme Court of the Russian Federation. Today, there is no definite answers to these questions.

Creation of Mechanisms for Social Protection, in Case of Eviction of Individuals from Residential Premises due to Recovery of Pledged Residential Spaces

Amendments are required to the RSFSR Housing Code, that would address the importance of setting up a legal mechanism for providing residential spaces to the borrower and his family, in case of recovery of the pledged residential premise.

For this purpose, a legislative rule is needed in the RSFSR Housing Code (and subsequently in the Housing Code of the Russian Federation) allowing for the creation of a specialized, not subject to privatization housing estate for interim habitation, which would be used for resettlement of individuals in the relevant cases.

Improvement of Procedure for Concluding Transactions with Residential Premises, where Rights Belong to Minor Citizens

The current legal gap should be filled with respect to mortgage of residential spaces, where minor members of the owner's family have rights.

Under the Russian Civil Code, transactions with real estate where minor members of the owner's family have rights shall be conducted only upon consent of authorities of guardianship and trusteeship. At the same time, the grounds for such consent are missing at the federal level.

4.3. Improvement of Legal Rules for Attracting Long-term Financial Resources to Mortgage Lending Sector

The laws of the Russian Federation concerning the issue and circulation of securities often do not satisfy the needs of the development of mortgage loans market and attraction of long-term financial resources through the issue and circulation of issuing mortgage securities.

In order to create a comprehensive technological mortgage loans market that addresses the interests of its participants (above all, investors), the following steps are needed:

to introduce amendments to the Federal Law on Mortgage (Pledge of Real Estate) concerning the procedure for recovery of pledged property and procedure for completing, issuance, pledge and rights transfer under mortgage agreement;

to introduce amendments to the Civil Code, Federal Law on Insolvency (Bankruptcy) and Federal Law on Insolvency (Bankruptcy) of Credit Organizations with respect to exclusion from debtor's property comprising bankruptcy estate or separation as particular bankruptcy estate of collateral satisfying lenders' claims under issuing mortgage securities;

to introduce amendments to the Federal Law on Protection of Rights and Legitimate Interests of Investors in the Securities Market concerning the inclusion into the list of information to be disclosed by the issuer, information about collateral against securities and obligations of the issuer to provide for investors' familiarization documents on collateral against mortgage securities;

to develop a draft federal law on issuing mortgage securities, which would legislatively incorporate the procedure for the issue and circulation of mortgage securities, their specific features, the group of issuers and procedure for supervision over the issue and circulation of mortgage securities;

to develop a draft federal law on credit consumer societies, which would regulate the operation of specific type of consumer society offering loans to their members and raising funds from its members in various forms established by law;

to develop a draft federal law on insurance of liability for conducting mortgage housing lending, which would reflect the specific features of insurance in this sector and provide for insurance of liability under contract.

It makes sense to offer to an association of insurers working in the mortgage loans market to develop, together with organizations involved, standard rules on the use of obligations secured by mortgage that are observed on a voluntary basis.

4.4. Creation of Favorable Tax Environment for Development of Mortgage Lending

Tax Benefits for Individuals

Tax benefits on mortgage lending are an efficient economic incentive for the development of the primary mortgage market. They make long-term mortgage loans much more available for the population. In accordance with the RF Law on Income Tax for Individuals, two tax benefits are currently effective for individuals: first, the exclusion from the aggregate taxable income of individuals of those amounts that come from the sale of apartments, to the extent not exceeding 5,000-fold minimum wage established by law; second, the exclusion from the aggregate taxable income of those sums that go for the new construction or acquisition of houses, within 5,000-fold minimum wage established by law taken over a 3 year period, and of those amounts that are used by individuals for repayment of loans received for the above goals, and interest thereon.

The limitation of the benefit for repayment of loans and interest thereon by a 3 year period is an obstacle to extending terms of mortgage lending.

Mortgage lending contributes to a more tighten tax discipline of individuals, as long as one of the major bank requirements in offering mortgage loans is the official documentary confirmation of the borrower's creditworthiness, including by presentment of tax declaration (statement from tax authorities on tax payments). A widespread mortgage lending will therefore help collect taxes through more complete declaration by individuals of their incomes, increased volumes of transactions, extended taxable base, which would off-set losses from tax benefit and maintain growth of tax charges.

Taking into account the foregoing, amendments are needed to the RF Law on Income Tax on Individuals concerning:

more exemption from income tax for individuals, up to 25,000-fold minimum wage established by law, and the extension of the period for those who received a loan for the construction and acquisition of houses for the entire period of loan repayment;

more exemption from the aggregate taxable income of individuals with respect to earnings from sale of apartments and residential houses individuals owned by ownership rights, up to 25,000-fold minimum wage established by law.

Lower State Duty on Notarization and State Registration of Mortgage Agreement

In accordance with the Federal Law on State Duty, the state duty on mortgage agreement is charged today in two instances:

for notarization of mortgage agreements (state duty is 1.5 percent of the contract value);

for state registration of mortgage agreement (state duty on the state registration of contract on pledged immovable property (mortgage agreement) and for the issuance of a document on registration, payment is 2-fold minimum wage for each act for individuals, and 5-fold minimum wage for legal entity.

Since the RF Civil code does not require notarization of sales contract for apartments, those who acquire housing through mortgage lending pay 1.5 percent more. The state duty for notarization of mortgage agreement has to be lowered.

The following steps are therefore required:

to separate mortgage transactions with residential premises as an individual category and establish much lower state duty for their notarization (within one minimum wage);

to do away with double payment for one action and cancel or diminish the state duty on state registration of mortgage agreement, because the Federal Law on State Registration of Immovable Property Rights and Transactions establishes payment for state registration of contracts with real estate (including mortgage agreements) in the form of registration duty.

Similar changes in tax benefits for individuals and state duty have to be introduced in the draft second part of the Tax Code of the Russian Federation, as approved in the first reading by the State Duma of the Federal Assembly of the Russian Federation.

Incentives for Secondary Mortgage Loans Market

Of critical importance are such bank operations as issuance of surety for the borrowers under transferred loans and trust management of claims under mortgage loans. Currently, these types of business are not included in banking operations, substantially limiting their practical use. In this context, lower cost of loan for the borrower is worth consideration.

4.5. Creation of Conditions for Efficient Performance of Credit Organizations in Mortgage Loans Market

Regulation of Activities of Credit Organizations in Mortgage Loans Market

The extension of activities of banks and other credit organizations in the mortgage loans market, including offering loans, their service, finance and refinance, and the requirement on lower risks and their efficient allocation among the participants call, on the one hand, for the extension of the range of authorized operations, and, on the other, for stricter control and regulation.

The following steps are proposed:

to develop a CBR instruction on regulation of activities of credit organizations in the mortgage loans market, governing, in particular, risks of credit organizations associated with operations in the mortgage loans market;

to introduce amendments in CBR Instruction #63 on Conducting Trust Management Operations and Their Accounting by Credit Organizations of Russian Federation, providing for the opportunity of claim transfer under mortgage loans into trust management of other credit organizations for servicing loans.

Improvement of Registration of Rights to and Transactions with Mortgaged Housing

In accordance with the Federal Law on Mortgage (Pledge of Real Estate), the residential building or apartment acquired into ownership through loan of a bank or another credit organization is recognized as pledged from the time of state registration of sales contract on the residential building or apartment. This form of mortgage makes, by law, the cost of transaction by 1.5 percent lower (the amount of state duty for notarization of mortgage agreement).

It is not, however, established how registration of pledge rights is made in this case, which is important for the exclusion of a second pledge of already pledged housing, without notifying the holder of subsequent mortgage.

It is also important to set forth state registration of change of pledge holder under mortgage agreement, when claim under loan agreement secured by mortgage is transferred to the new lender, under which the expressed will of the original and new lenders, who are pledge holders, would be enough grounds to register change of pledge holder in the unified state register of rights to immovable property.

The proposed procedure is based on articles 382 and 384 of the Russian Civil Code, under which rights transfer to the new lender entails the transfer of right securing the discharge of obligations, namely the right of pledge. The grounds for change of pledge holder will appear not upon rights transfer under mortgage agreement, but after claims transfer under loan agreement secured by mortgage, resulting in change of pledge holder.

It is important:

to develop and approve for justice bodies that are registrars of immovable property rights and transactions an instruction of the RF Ministry of Justice on registration of mortgage arising by law or contract, and registration of change of pledge holder after claims transfer under mortgage loans;

to confirm the possibility of registration of mortgages arising from mixed and packaged civil law contracts containing terms and conditions on mortgage, and send explanations of the RF Ministry of Justice to justice bodies that are registrars of immovable property rights and transactions.

Recognition of Rights Transfer under Mortgage Loans in Accounting Standards of Credit Organizations

In order to streamline accounting standards for claims transfer under mortgage loans, the procedure needs explanations in the letter of the CBR to credit organizations that are secondary market operators.

Improvement of Criteria for Security against Long-term Loans

To Stimulate commercial banks for offering mortgage loans and to make adequate assessment of credit risks, changes are proposed in the approaches to criteria for security against long-term loans issued by credit organizations to individuals for the acquisition of house and secured by mortgage of the house in question.

For these purposes, the relevant amendments are proposed for CBR Instruction #62a of June 30, 1997, on Provisioning and Use of Loan Loss Reserve concerning the establishment of criteria for securing interest payments on long-term loans.

5. Role of Executive Authorities of Subjects of Russian Federation and Local Governments in Promoting Development of Mortgage Lending System

The role of regional and local authorities at this stage of establishing a mortgage lending system is of great importance. The solution of housing problem and coordination of

activities of all subjects of property market is much dependent on the operation of executive authorities at all levels.

The influence of the executive authorities of the subjects of the Russian Federation and local governments may be exercised along the following lines:

maintenance of effective demand for housing through budget allocations for designated support to those who are in need of better housing conditions, in the form of free subsidies for the initial payment;

budget allocations for offering guarantees (sureties) for securities issued by secondary market operators (mortgage lending agencies) in order to raise funds from private investors. Such guarantees substantially lower «the price of borrowing» for cash funds, raise reliability, and lower the price of financial instruments through which long-term resources could be attracted to the regional property market.

Active efforts of the executive authorities of the subjects of the Russian Federation and local governments aimed at creating favorable conditions for various property market participants should not be limited by budget policies.

A special emphasis is made on the development of the efficient regulatory framework at the regional and local level. The main objective is the development of rules established by the federal laws in order to expedite and simplify procedures related to sales/purchases, mortgages and creation of an efficient system of state registration of such transactions and rights.

At the local and regional levels, the following legislative and regulatory acts are recommended for approval in order to help the development of mortgage lending market:

a law of a subject of the Russian Federation on the development of long-term mortgage lending in order to address the issues of creating reserve estate for interim habitation of individuals who have failed to repay mortgage loan, during recovery and sale of houses, and interim habitation after recovery, when earnings from sale of pledged houses are not sufficient for the acquisition or rent, according to norms for registration of those who need better housing conditions;

an instruction of a body of justice of a subject of the Russian Federation, which is registrar of immovable property rights and transactions, describing specific features of registration of mortgage of residential premise to be acquired through credit funds in order to secure prompter registration with bodies of justice of sales/purchase contracts and mortgage agreements on residential spaces (in line with the instruction of the Ministry of Justice of the Russian Federation);

a regulation on launching informational inter-action between the bodies for registration of individuals at place of their residence and lenders (pledge holders) offering mortgage loans, as approved by the order of local authorities;

a procedure for decision making by bodies of guardianship and trusteeship concerning consent on transfer of residential premises, where minority citizens have rights, into mortgage (pledge) and recovery of this premise, and for maintaining cooperation between commercial banks and bodies of guardianship and trusteeship during mortgage lending.

5.1. Providing Finance for Acquisition and Construction of Residential Premises in Regions of Russian Federation

In a number of regions of the Russian Federation, including Moscow, Saint Petersburg and others, legislative and organizational foundations are in place for the functioning of a mortgage lending system. In Moscow and Saint Petersburg, concepts have been drafted for the development of a mortgage lending system build on the two-tier model. In Moscow, it relies on the established Moscow City Agency for Mortgage Lending, in Saint Petersburg - on the branch of the Mortgage Lending Agency set up at the federal level. Banks are getting more involved in mortgage programs of Moscow and Saint Petersburg.

At the same time, the nascent lending system, low incomes and subsequently insufficient effective demand for residential spaces in couple with the lack of savings have forced authorities of the subjects of the Russian Federation and local governments, as well as construction companies to seek interim solutions to the funding of construction of residential premises.

Below are described the principle approaches to the solution of attracting funds from the general public to the housing sector and raising the availability of housing premises.

Share Construction and Sale of Residential Spaces by Installment

The use of these options for attracting funds from the general public was initiated by the builders. Given the lowering effective demand for residential premises and limits on bank lending, the builders addressed the liquidity of the built residential spaces and their own survival through autonomous attraction of cash resources from the public, offering share participation in construction or purchase of ready residential premises by installment. Installment is offered on average for 1 to 2 years, from 30 to 50 percent of the value of the residential space.

This scheme has a drawback of unjustified delay in erecting residential buildings, allowing the builders to use the attracted funds of individuals almost free of charge. There is also risk of incomplete construction or overruns as cost may be getting higher during construction. The installment scheme gives to the buyer the right of ownership to the residential premise only after full payment.

Housing Savings Programs

Relying on the foreign banking experience, a number of banks (Sberbank of Russia, SBS-Agro Bank, and others) have attempted to develop and apply long-term ear-marked housing savings schemes, combining savings and mortgage programs. The essence of housing savings programs can be described as follows:

an individual concludes with a bank a contract, under which he undertakes to save, over a specified period (more than 1 year), a certain amount of cash which is the initial payment for receiving mortgage loan;

the bank undertakes to provide to a customer a mortgage loan for the acquisition of residential premise, provided the latter complies with the terms of savings and bank requirements for the issuance of mortgage loans.

Many banks view the opening of long-term mortgage savings accounts as the first stage of working with customer during lending, which helps gather additional information about customer's incomes, solvency, sources for receiving funds. Given the advantages of housing deposits and their favorable role in the formation of the similar to credit histories data, banks are showing a substantial interest in housing savings programs and start considering them as essential element of their credit operations.

Noting the positive role of savings accounts as a source of attracting long-term resources by banks, it has to be mentioned that in the current conditions the citizens fear to place substantial amounts on long-term savings deposits because of on-going inflation and certain mistrust to bank institutions. Besides, there is no government support to housing savings and guarantees for safe-keeping of deposits in the forms similar to those existing in Germany or France.

Facing the drop in effective demand for housing, the builders start implementing the schemes for attracting funds from individuals to construction of residential premises through the system of construction savings or savings and loan banks (Moscow, etc.). The system works basically as follows. The potential buyer of a residential premise shall save, within a certain period (from 1 year to 2 or 3 years), up to 50 percent of the value of the apartment on a special savings account. Later on, he acquires the ready residential premise, the remaining 50 percent of its value is paid by installment from 2 to 5 years. The apartment is formalized in borrower's ownership only upon full payment.

Such schemes are directly linked with certain residential assets under construction and have therefore local nature. It is worth noting that they are implemented by organizations that do not have banking licenses, which results in the lack of control by the Russian Central Bank over savings of and lending to the general public and is associated with higher risks of non-designated and inefficient use of funds raised from the public.

Such schemes allow for delays in construction and commission of houses, making them more costly and risky for the people, as all the risks associated with construction finance are there.

An efficient functioning of savings systems requires an adoption of the relevant legislative acts protecting the rights of individuals who save their funds for the purchase of residential premises or act as joint investors in the construction.

Regional Programs Relying on Regional and Local Budgets

These programs capitalize on the active role of executive authorities of the subjects of the Russian Federation and local governments in tackling the issues of attracting funds of individuals to the construction sector and use of regional and local budgets.

Administrations in a number of cities accept the idea of creating special extra-budget funds for support of housing construction (the city of Sarov, the Nizhny Novgorod oblast). Using budget and partially tax revenues (local taxes, and for the closed administrative and territorial entities - the federal taxes), those funds finance housing construction. The housing is sold to those individuals who agree to sell to the fund the existing housing, pay up the remaining amount partially from their own funds and partially by installment. The cost of the old housing usually amounts to around 50 to 60 percent of the cost of the new one, from 20 to 25 percent is paid by own funds, for the remaining 15 to 30 percent installment is offered. Every ruble of a loan invested by the fund in the housing construction attracts several times more funds from the general public.

The success of these programs is predetermined by the regional budgets, volumes of housing construction and the effective demand for housing in the secondary property market.

Some other cities and regions (the Orenburg oblast, the Republic of Udmurtia, others) prefer lending schemes at a lending rate substantially lower than market rates, through setting up extra-budget funds. Advantageous interest rates for loans create difficulties for attracting extra-budgetary funds of investors to mortgage lending. This limits such schemes by the size of lending, and they are heavy burdens on the regional budgets which are for the most part underfinanced.

A number of Russian regions (the Belgorod oblast, the Republic of Bashkortostan, others) have applied, primarily in rural areas, a lending scheme without credit and finance. In the Republic of Bashkortostan, the borrowers receive a credit (loan) in the form of construction materials, in the Belgorod oblast, consideration is given to the yield from the borrower's household plot. The borrower's solvency is not assessed in the classical sense, as repayment of a credit (loan) is made in-kind, in the form of farming produce subsequently selling at prices set by the organizers of such lending.

The replacement of monetary instruments by in-kind ones can lead to discrepancies between costs and results. Besides, it is pretty hard to guarantee repayment of a loan without effective monetary equivalent to in-kind payments under loan and its compliance with the size of credit resources.

Municipal Housing Bonds

One of the common form of attracting funds from individuals and legal entities to housing construction is the issue of municipal housing bonds or housing certificates (Moscow, Saint Petersburg, Saratov, Ulianovsk, others).

Bond issue is basically aimed at providing the population with possibility of gradual saving for the acquisition of an apartment through the purchase of bonds, with each bond entitling for a certain size of housing area (for instance, 0.1 square meter). The term of circulation of such bonds may reach 10 years. Accumulating the adequate package of bonds, an individual has the right to exchange them for an apartment of the relevant size. As a rule, these bonds give the right to acquire housing spaces in houses built by municipality. The price of bonds is set on the basis of construction cost and is adjusted to changes in the cost of housing construction. If a bond holder refuses from acquisition of an apartment, he has the right to receive the relevant monetary equivalent, and bonds are repurchased at their current nominal price.

The proposed scheme does not provide individuals with opportunity of selecting an apartment, they are given the right to acquire residential spaces only in certain houses, where quality does not always meet their requirements.

To make municipal housing bonds attractive, the following steps are needed:

they have to perform the accumulating function, with fixed income and adjustment to changes in the financial market;

they have to become liquid financial instrument, assuring the wide involvement of investors' funds in the housing sector.

Companies' Lending Programs for Acquisition of Apartments

Under these projects, companies provide employees with loans for paying from 70 to 80 percent of the cost of an apartment, the remaining 20 to 30 percent is paid out of own funds. Loan is issued by a company usually at beneficial terms: long period (from 10 to 15 years), interest-free or advantageous interest, the possibility of subsequent partial or full forgiveness of debt to the company.

When a company has its own construction capacities, employees are offered residential premises built by the company, at construction cost or at 20 to 40 percent payment of the cost. The remaining portion is paid by the company through its own resources. The acquisition of residential spaces at beneficial terms is often linked to obligations of employees to work at this company for a certain period.

Such scheme works at profitable and stable companies interested in keeping personnel for a long period.

The above approaches to attracting the public's funds to the housing sector are typical of transition period and reflect the current development of the Russian economy. They boost the housing market and are necessary for the development of a full scale mortgage lending system built on the market mechanisms.

For the radical breakthrough, a system approach is required at the government level to the development of mortgage lending for population. Otherwise, sporadic attempts at tackling the problem would fail because of the economic reality and lacking regulatory norms for this type of business.

Conclusion

The macroeconomic conditions in Russia evolving after the financial crisis of 1998 have emphasized the importance of long-term mortgage lending to population developed not through individual initiatives of commercial banks or regions, but as a comprehensive system with direct involvement of the government.

Regional mortgage lending programs may be built on this concept.

Mortgage lending is one of the tested by world practice and reliable options for attracting private investments to the housing sector. Mortgage allows for most efficient combination of interests of all participants: people - in improvement of housing conditions, commercial banks and other creditors – in efficient and profitable work, the construction sector - in dynamic load of its production, and the government - in the general economic growth.