On December 2-3, 2004 the Polish Bank Association organized The 1st Congress on Housing Finance in the Central and Eastern European Countries. This Congress was the beginning of a cyclical summit of professionals and institutions from the real estate finance market in the region. The main goal of the Congress is to integrate common activities by using joint experience, in order to raise the dynamic of real estate finance growth, without affecting the security of financial systems. The real estate finance market in CEE countries is a field where financial institutions are still barely visible. In Western countries the outstanding mortgage volume exceeds 50% of the GDP (in the EU-15 the average equal to 42%). In post-communist countries this process is delayed.

The Polish Bank Association decided to present the Polish experience in mortgage banking and invited banking associations and financial institutions from CEE in order to enable cooperation between countries in this region in implementing solutions and collaboration in sharing data and models used in particular countries.

Cooperation in the Real Estate Financing System

Housing plays an important role in every society. However it cannot function without an appropriate financing system. According to Professor Marek Bryx from the Warsaw School of Economics “there are no stable housing finance systems”. A system can be considered stable when all its partakers can keep up with it. The system should be secure, but when talking about a safe system means the intervention of regulatory institutions, which signifies the necessity of having a effective housing policy by the government, since a home is a essential good.

Dr. Krzysztof Rybiński, Vice-President of the National Bank of Poland, said that there is a number of factors that contribute to the development of the housing finance market in Poland: low and stable inflation and connected with it low interest rates, competition in the banking sector influencing dropping fees, stabilization of the economy including a gradual increase of wages. Other factors that drive the mortgage banking are: housing needs associated with the economical transformation, large share of private property, great restoration needs, the development of an insurance system to take over part of the credit risk. Among the negative factors there are: risky process of financing developers, low efficiency of mortgage register courts and associated risk of the purchase and collateral, the lack of the non-assessoriy land charge, and the unsure income of the borrower. There’s also a number of other factors, such as: high unemployment, political debate concerning housing and the risk of legislative changes, deficiency in experience on the housing market1.

According to the president of the Polish Bank Association, Krzysztof Pietraszkiewicz, housing finance is very important for the economy because of three main reasons. First of all a developed housing finance market allows to generate hundreds of thousands jobs. Secondly an efficient

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1 Dr. Krzysztof Rybiński „Mortgage Loans Determinants”
housing finance system allows to provide people their own home. The third reason is that this market is a chance for good business for many types of institutions.

Creating an efficient housing finance system requires the cooperation of all its stakeholders. Professor Jan Monkiewicz, Chairman of the Insurance and Pension Funds Supervisory Commission pointed out how important is the collaboration between banks and insurance companies. They can work together on many levels. The most important element is sharing information. Insurance companies possess vast knowledge on insurance statistics. Using the data it is possible for example to predict how many borrowers will die during the crediting period. As an example of a cooperation between institution Professor Monkiewicz mentioned the newly founded Mutual Insurance Company “Safety House” formed in cooperation with developers to protect their clients in case of default from the developers side.

Dr. Zbigniew Krysiak, Chairman of the Committee for Real Estate Financing of the Polish Bank Association pointed that the integration of institutions should have an international range. The purpose of the Congress is to integrate communities operating on the housing finance market in Central and Eastern European countries. One of the ideas is to create a body that would have a nature of a Committee for Real Estate Financing in Central and Eastern Europe, and would associate institutions from the region. The Congress will have an annual character and will be fit into the calendar of other major real estate conferences. However institutions should not only meet on this single annual basis. The members of the committee should convene more frequently in an organized manner with established frames of cooperation. The CEE countries should share information on their different approaches to housing finance, modeling and managing credit risk and information concerning the mortgage portfolio.

**Barriers and Perspectives for Housing Finance in Central and Eastern Europe**

An important factor in creating housing finance systems in Central and Eastern Europe is the involvement of the national government which comes in the form of a appropriate housing policy. Professor Marek Bryx presented the key elements of the housing policy in Poland. The most important element is the market economy approach to housing, which is unfortunately very risky for the buyer because his claims are very poorly protected. The TBS (rental social housing associations) are playing their role to a some extent, however the matter of ownership after many years of occupation remains unanswered. Local authority investments are minimal and concentrated primarily on low-income families. The tax deduction from personal income is very limited for example it has to be the buyers first home. The national budget also has to partially purchase interest accrued on “old credits” from the 1990’s. This costs ¼ of the budgetary expenditure for housing policy and there are no profits from it in the form of new homes. Other elements of housing policy in Poland are: premium refunds for long savings, termomodernization premium, and extra allowances for tenants in bad economic situation. Year by year governments reduce housing spending and unfortunately there is no consensus to housing policy among the political parties. According to Professor Marek Bryx it is impossible to talk about a safe and stable housing finance system in Poland.

The situation of developers is a very important matter in Poland that needs fast regulations. Currently the only entity on the real estate market which is not required license for its operations is the developer. The fact is that anyone can become a developer without any special capital requirements. The system has to protect buyers against unfair or negligent practice from the developers behalf. The new initiatives that could help this situation are the mentioned earlier mutual insurance company and the escrow account.

Most of the dwellings in Poland are built and sold based on the so-called developer contracts. These contracts usually stipulate that the future buyer down-pays for the home during the
construction, often before even starting it. The developer only has to buy the land and receive construction permits. This system is very beneficial for the developer since it allows him to function without the necessary capital for the investment. In the opinion of Dr. Ryszard Matkowski, president of JW Construction, it is estimated that the developer can start a new construction site having only 20-30% of the required capital. In a system like this most of the risk is on the client's side. The client is buying a home that it actually not even finished and has an unsettled property title. The client’s risk can be eliminated by using escrow accounts. They are created based on cooperation between three parties: the developer, buyer and bank. The account is set for a specific cause in order to collect funds and work as an intermediary between the stipulated in the contract buyer and seller. The buyer puts his money in the escrow account. The money will be later transferred to the developer accordingly to the amount of work completed in the construction. According to Dr. Matkowski establishing the escrow accounts would civilize the Polish developer market. However the legislature remains unchanged. In Fall 2002 the no longer existing State Office for Housing and Urban Development prepared fundamental legislature for the creation of mandatory escrow accounts but it hasn’t been passed till this date\(^2\).

**Financing Mortgage Loans**

Mortgage loans in Poland are primarily financed through current accounts. Marek Kempny, President of Śląski Mortgage Bank S.A., informed that for the past 10 years banks’ assets have been growing and the most significant growth was recorded in mortgage loans. For the past few years bank deposits have started to be insufficient to finance the growing demand for mortgage loans. The tendency shows that mortgage loans will be increasing its share in the banks’ credit portfolio. Deposits on the other hand are expected to drop as a result of growing competitiveness of alternative forms of investing capital i.e. investment funds\(^3\).

A second form of financing mortgage loans in Poland are Covered Bonds called “listy zastawne”. Currently 22 countries have legislations allowing the issuance of Covered Bonds and in a few years the number will be 30. According to Dr Otmar Stöcker, General Director of the German Mortgage Bank Association, building a mortgage loan finance system is long term activity. In Hungary it was possible thanks to tax relieves cumulating a large part of the outstanding mortgage volume in the influence of specialized mortgage banks and to acquire financing from foreign markets. Until September 2004 there have been 69 issues of Covered Bonds in Hungary for a cumulative value of 3.8 billion euros. In comparison in Poland there were 15 issues for a total value of 240 million euros.

In the process of financing mortgage loans there should be considered a variety of sources of capital. The German banks are also considering refinancing loans with MBS in order to finance the mortgage loans not covered in the mortgage bonds. In the opinion of Dr. Stöcker the best situation is where there is legislation which regulates different types of securities and the open market decides which one of them will function. Countries with those kind of regulations will attract foreign investors the most. Alicja Malecka, Malecka Capital Formation, explains that the market formulates its needs and it will force solutions.

According to Professor Jolanta Zombirt, National Bank of Poland, securitization is not a ordinary issue of debt securities, it is also not an issue of covered bonds by a specialized mortgage bank where the securitized assets stay on the balance sheet. Securitization is the process where the a Special Purpose Vehicle (SPV) issues securities that are collateralized by mortgage loans

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\(^2\) Dr Ryszard Matkowski „Selected housing finance issues and escrow account implementation”

\(^3\) Dr. Marek Kempny „Mortgage Loans Finance in Universal Banks”
(Mortgage Backed Securities). In this process the credit risk is separated from the originators risk (the bank). Securitization is also notable from other transactions with its stratification process, where there is a requirement of at least two tranches with different risk scoring. The assets that are the collateral have to be standardized.

In the opinion of Boleslaw Meluch, Polish Bank Association, standardization signifies the integration of all participants of the mortgage market in a single system, which would allow an electronic data and documentation exchange, bringing that way decision-making tools and setting the possibility to access automated tools, service and information on mortgage loans. Standardization allows to reduce costs, increase asset effectiveness, manage risk, and increase profit4.

At the moment there are the following laws concerning the secondary mortgage market in Poland: Banking Act, Mortgage Bonds and Mortgage Bank Act, Investment Fund Act. The Securitization Act is awaited but basing on the mentioned legislatures the securitization process is still impossible to carry out5.

**Mortgage Loan Risk**

According to Professor Robert Van Order, who was the chief economist at Freddie Mac for 15 years, risk control should be concentrated on conforming the equity to the value of the property. To do so the information about the property is needed. The data should be used to set the value of owner’s equity at the moment of credit approval, dependent on the initial value of the property and changes in property values which are the key elements of change is equity value during the crediting period6.

The project that allows to gather information on real estate prices is the AMRON System (Real Estate Transaction Analysis and Monitoring System) organized and run by the Polish Bank Association. The system gathers and processes data about many types of property, allowing to generate statistical reports on average prices per square meter and analytical models permitting to set trends, future values, indicate the risk rate and discount rate. The AMRON system’s purpose is to provide fast access to data necessary for credit analysis and risk assessment related to the property as collateral. Jan Robert Nowak, Rheinhyp-BRE Mortgage Bank S.A., explained that access to the AMRON system will allow to limit market risk, assessment risk and risk linked to the LTV.

Roger Blood, Mercer Management Consulting Group, just 5 years ago had in Poland a number of speeches introducing principals of default risk and he observes how important this subject has become. Currently 30 countries have programs for credit default insurance. In majority these are new structures that have not even gone through stress situations. In Roger Blood’s opinion banking supervisory bodies should put more attention into mortgage insurance.

According to Anna Solberg, Fair Isaac UK Corporation, there are four existing key business needs in risk management. Precision – making the right decision with a high degree of accuracy and more profitable and targeted decisions. Consistency – in executing decisions according to a well defined strategy. Control – managing decisions from a central point and controlling data. Agility – the system has to able to follow the changes.7

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4 Boleslaw Meluch „Standardization as prerequisite for securitization”
5 Prof. Jolanta Zombirt „The role of legal environment in secondary mortgage loan market development”
6 Prof. Robert Van Order „Credit Risk Controlling”
7 Anna Solberg „Credit Risk of Mortgage Loans Management and Matrix Transition”
Managing credit risk should be in undertaken from the moment the credit is given till the end of its payment. It requires an established method. In Poland as well as in other Central and Eastern European countries the experience of the mortgage market is very small, and the credit history too short to create a risk management model for every type of risk. That is why it is crucial at this moment to gather as much data as possible.

Summary

The cooperation between institutions on the housing finance market and housing market is essential for Poland and CEE countries. The most vital elements are: data collection and exchange, creating legal and economic environment for an effective mortgage market, securing developer activities, enabling fast and easy property appraisal. It is necessary to have laws which allow efficient functioning of the housing finance market and allow to introduce solutions for strong mechanisms of mortgage loan insurance.

In the opinion of one of the speakers Jan Sinke from Holland, the idea of organizing such Congress is not primarily associated with the technical aspects of housing finance but with creating a better standard of living for the society. Housing finance has a great influence on the economy, prosperity, and most of all on creating homes for people. Creating a proper housing finance system is not the goal, but the means to a specific economic policy.

Warsaw, December 23, 2004
Opening session

Jan Monkiewicz Chairman of the Pension Funds and Insurance Supervision Commission, Krzysztof Pietraszkiewicz President Polish Bank Association, Zbigniew Krysiak Chairman Committee for Real Estate Financing at Polish Bank Association, Marek Zawisłak Director Ministry of Infrastructure, Krzysztof Rybiński Vicepresident National Bank of Poland

The audience: Bankers, Insurers, Developers, Academicians, Press
Polish Bank Association

The Prelegents

1. Frantisek Pavelka, Czech Banking Association
2. Roger Blood, Senior Associate, Management Consulting INC
3. Jacek Łaszek, Advisor to the President of the National Bank of Poland
4. Janusz Góral, General Inspectorate of Banking Supervision (GINB)

Jan Sinke MRE MRICS
1. Wojciech Lipka, Rating Advisor
4. Professor Marek Bryx, Warsaw School of Economics
2. Dr. Otmar Stöcker, Managing Director, German Association of Mortgage Banks

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<td>Dr. Ryszard Matkowski, President, J.W. Construction, Member of Investment and Real Estate Department at Warsaw School of Economics</td>
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<td>Dr. Peter Gurtner, Director Swiss Federal Housing Office</td>
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Andrzej Liwacz, Marsh Sp z o.o.

Bolesław Meluch, Expert, Polish Bank Association

4. Professor Jolanta Zombirt, National Bank of Poland

Jan Robert Nowak Director AMRON CPBił

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