BULGARIAN Post BANK

Developing Secondary Mortgage Markets in Southeast Europe

Funding Methodologies:

Bank’s View –

On vs. Off Balance Sheet

A. Petropoulos,
Executive Director and Member of MB
Bulgarian Post Bank AD

The Market Scope

* In 2002, the household mortgage loans volume estimated EUR 95M;

* Virtually all Commercial Banks have mortgage loans in their books;

* 7 issues of mortgage – backed bonds by Banks so far, worth EUR 34.8M (36% of the mortgage loans extended);

* Due to BNB regulations, significant portion of the loans extended to companies are secured with mortgages (well over a third of EUR 2bn total corporate lending as at Dec '2002);

* Although an estimated EUR 760M of mortgage or mortgage-secured loans is available for issuance of mortgage bonds, demand is limited to other Commercial Banks and Pension Funds.

The need

1. Liability maturity vs. asset maturity profile:
   up to 1 month – 74%;
   up to 6 months – 25%;
   over 6 months – only 1%.
   Practically no deposits with over 1 year maturity.
   vs. Demand for loans of over 12 months is 45% of total loans demand.

2. Local currency availability:
   BGN Deposits – 45%;
   FC Deposits – 55%.

3. Volatile inter-bank market.

4. Needs extensive Branch network, since operations / transactions are primarily in cash, resulting in high collection cost.

5. Rates – practically no market-based rate for BGN to reflect demand and supply factors, resulting in not market defined money market rates vs. fixed mortgage bonds yield.

A solution?

1. Mortgage-backed bonds resolve to some extent the maturity and liquidity gap problems;

2. They offer a trade-off between network maintenance cost and higher yield on mortgage bonds than the interest paid on deposits.

3. A major problem is the institutional investor horizon (which limits currently issuers to 3-5 years maturity vs. over 10 years as ordinary in US and EU).

4. Secondary market is very limited (below EUR 1M) due to transferability issues and public lack of trust in the instrument.

5. Underlying asset – mortgages – is not liquid, information on the quality of mortgage borrowers is non-transparent.

The Distribution of Benefits

Party	Cost or best alternative	Revenue	Net Spread
Issuing Bank	7.5% (avg yield on 3-yr bond)	13.9% av. interest on loans	**6.40%**
Pension Fund	3.7% (BIR on 3-mth govt. bills)	7.5% (avg yield on 3-yr bond)	**3.80%**
Bank Buyer	2.9% LIBOR (placement)	7.5% (avg yield on 3-yr bond)	**4.60%**

* We consider EUR-denominations.

There are significant benefits for both parties. Currently, the mortgage bonds serve to distribute liquidity rather than transfer risk, explaining why non-mortgage backed issues have very similar yield to mortgage backed ones.

Expectations & Recommendations

* The issuers will likely remain limited to Banks with pro-active lending policies, seeking alternative resources utilization;

* The main buyers will likely remain Banks with excess liquidity and PFs/IFs seeking to invest in low-risk instruments with good yields.

** Necessity to develop mortgage register and a system for disclosure of underlying borrower quality.

** Attract foreign investors, especially in order to develop secondary market.

** Legal framework for mortgages selling and transferring.