Mortgage Bonds in Poland

Jacek Łaszek

National Bank of Poland

I. Development of the Primary Mortgage Market in Poland

1. Poland has tradition with mortgage loans and banks

- before II Word War
  - ⇒ mortgage bonds and
  - ⇒ credit societies
- socialist period
  - ⇒ mortgage loan was eliminated
  - ⇒ on limited scale PKO-bp issued mortgages for single family houses

2. <u>1992-1995 first practical experience after 50 years</u>

- **dollar denominated mortgage loans from PAM Bank**
- **World Bank Project - dual index loan (DIM)**
- **PKO-bp - DIM type Alicja loans**
- **first banks enter the market**
- **Major problems of mortgage market development in the early 1990s were typical.**
  - ⇒ **still exists subsidized loans to cooperative and thus limiting demand for commercial lending**
  - ⇒**lack of knowledge and practical experience**
  - ⇒**high inflation forced complex indexed or risky hard currency denominated loans**
  - ⇒**ineffective mortgage lien registration system**
  - ⇒**unreliable valuation of real property collateral**
  - ⇒**eviction is a complex problem**

3. After 1996 the industry start booming

- **last subsidized cooperative loans, no more state unfair competition**
- **fast growth of currency denominated and indexed loans; some banks offer conventional zloty loans**
- **risk level isn’t much lower, but banks recognize profits**
- **State become more active - development of additional elements of housing finance system: Housing Fund (rental subsidized housing), contract savings (2 different schemes) in 1996, Mortgage Banking Act very similar to German (1997), amended in 2002. Performances are rather weak.**

4.1998 till now fast development

- **Falling interest rates increased affordability, mortgage portfolios still booming, 50% of the loans are in złoty (Table 1).**
- **Competition is very strong, margins decline, in 2002 150 BP margin to the WIBOR isn’t rare. In 1998 350-400 BP was standard. Practically all the banks compete, more them 30 banks on the market.**
- **In relation to the housing sector the level of banking financing is still low (Table 2)**

Housing portfolios in banking system

Bank/ end of the Year		95	96	97	98	99	00
1	PKO BP	73,6%	74,6%	71,5%	68,7%	59,8%	50,1%
2	PKO SA			2,0%	2,1%	4,4%	10,3%
3	PBG	3,4%	5,7%	5,3%	4,1%		
4	PAMB/GE	14,1%	8,7%	6,5%	4,0%	3,2%	4,8%
5	Bank Śląski	4,3%	5,3%	4,4%	3,1%		2,6%
6	B. Zachodni	0,7%	1,0%	0,7%	1,0%	1,6%	1,9%
7	BPH			0,9%	0,6%	2,3%	6,9%
8	PBK			3,7%	3,4%	3,7%	5,9%
9	WBK				0,2%	1,1%	
10	BGŻ			0,8%	0,5%	0,6%	3,2%
11	BIG-Bank			0,2%	0,1%	0,2%	
12	Kredyt-Bank				1,3%	1,5%	2%
13	LG Perto				0,3%	2,0%	3,1%
14	GBG		0,7%	0,8%	1,6%	1,9%	
15	Bud-Bank	1,8%	1,3%	1,3%	2,0%	1,8%	
16	other banks	2,2%	2,7%	2,0%	6,9%	16,0%	9,2%
Total - PLN bln		**0,24**	**0,74**	**1, 5**	**2,1**	**5,0**	**9,5**
Increase PLN bln		**0,24**	**0,49**	**0,78**	**1,4**	**2,1**	**4,5**

4 PLN = 1 US$; Years-2000–2002 portfolios increase approx. 7 bln PLN.

Potential versus effective demand for mortgage loans in the end of 2000 in billion PLN

sector needs	14,0
consumers ability	40,0
effective demand	4,7
housing loans portfolio	16,0
Share of housing construction financed by loans	16%
Share of transaction on existing stock market financed by loans	1,5-2%
Share of mortgage in assets side in banking system in Poland	2 – 3%

II. Difficult way of the mortgage banks in to the mortgage market in Poland.

5. Mortgage Banks in the Market

- **There are 3 mortgage banks on the market (1999 – 2000), one more will come this year,**
- **They were established by the universal banks as a specialized entities in the bigest capital groups formed around this banks,**
- **Mortgage banks portfolio total (2003) - 1,5 billion PLN,**
- **Housing portfolio (2003) 0,5 billions PLN - 3% total housing portfolio,**
- **Mortgage bond portfolio 250 millions PLN, only commercial loans (2002), private placement (mother banks). This year first public issue. In next 5 years probably will be 800 000 millions PLN, only a fractions will be housing loans.**

Why mortgage banks perform rather badly in Poland when housing finance industry developed very well?

Why don’t refinance from capital market using mortgage bonds?

Minimum practical conditions for the mortgage banks to compete on the market

- **Competitive products and structure on lending side**
- **Competitive cost of funds**
- **Demand for mortgage bonds from capital market**

<u>Lending side.</u> Even after amendment in 2002 the mortgage banks act is restrictive in Polish case on lending side because of the security of investor.

- **no mortgage financing for cooperative flats - mortgage banks miss an access to 60-70% of the housing market**
- **limited use of temporary collateral (before amendment no use at all), typical situation on the market**
- **independent, external property valuation according to special standards in any loan (costs)**
- **LTV after amendment up to 100% of long-term mortgage value (practically 80-85%), but refinancing with the mortgage bonds only up to 66%. Necessities of commercial lending to compensate this effect, or lend relative big loans.**

From practical point of view this regulations shifted mortgage banks in the top segment (15-20%) of the market.

<u>Additional problem</u>

- Internal competition between universal and mortgage banks. Problems with use network branches

To buy mortgage liabilities on the market to prepare pools for standardization isn’t easy solution:

- **Banks are overliquid and don’t want to sell mortgage loans to the mortgage banks.**
- **Similar product on the market doesn’t mean similarity from technical point of view. Market is far from standardization**
- **Transfer of loans generate additional costs and is cumbersome**

<u>Cost of funds.</u> In several theories funds from capital market should be cheaper and more secure solution. Especially when cost of network branches may be diminished. This is so far not a case of Poland.

- **Cost of branches in groups build around universal banks still exist**
- **Capital market is very volatile and not cheap. Typically cost of funds are WIBOR plus 20 – 30 BP, LIBOR, EURIBOR plus 50 – 70 BP. It means that margins are low and profitability weak**
- **Banks are overliquid and looking for good assets, not for refinancing**
- **Existing shares of portfolios don’t generate liquidity risk now and in 3 – 5 years future**

Demand side for the mortgage bonds.

Good news, there is no problem with capital. Even with some limits pension funds, insurance companies, investment funds have potential far beyond sector needs for many years.

<u>General conclusion:</u>

Mortgage Bank isn’t easy vehicle to solve real estate and housing sectors problems. It have to be several preconditions, the development of the system took time and cover only a part of the market.