

Developing Secondary Mortgage Market in Southeast Europe Sofia, Bulgaria



Polish Mortgage Securitization

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Developing Secondary Mortgage Market

The case for Poland and S.E. Europe

- Mortgage Market Environment in Poland
 - Fast growing pool of primary loans
 - Large number of participants of different competitive profile
 - Big Commercial Banks
 - Small Commercial Banks
 - Mortgage Banks
 - Aspiring Lenders
 - Falling interest rates closing the foreign currency gap
 - Expanding demand for interest bearing securities from Pension Funds, Insurance Companies and Investment Funds



Mortgage Origination Market

- **Market is Evolving and Segmented**
 - **Large Banks: Large Deposit Base**
 - Develop ability to securitize before need is acute
 - Near-term: securitization manages foreign exchange exposure
 - Securitization is important for future growth
 - Liquidity, risk management, capital ratios and shareholder value
 - **Small Banks: Limited Deposit Base**
 - Securitization is a funding source
 - Liquidity, risk management, capital ratios and shareholder value
 - Fee income
 - **Specialty Players**
 - Enhanced product mix for established distribution channels
 - Personal Finance Companies, Insurance Companies, Consumer Finance Companies



Mortgage Market

- The Mortgage Market is Developing
 - Total Residential Mortgages : USD 3.4 bn
 - Mortgage Debt / GDP: 2 %
- 3.3 persons per household is one of the highest among countries likely to form an expanded EU
- Mortgage Growth Forecast
 - 3-year CAGR in mortgage loans of 38%

Source: Merrill Lynch Estimates, *GEM BankNotes, Emerging Market Mortgage Lending – Killer Application?*, November 28, 2001



Developing Mortgage Refinancing in Poland

- **Opportunity for a centralized solution**
 - Market imbalances are converging to create a climate for major growth in mortgage finance
 - A catalyst is required to create and leverage business opportunities
- **Business concept and strategy**
 - Build a global best practices secondary market facility to securitize mortgages
- **To build a business positioned between imbalances in two sectors in Poland**
 - Capital Markets
 - Housing
- **A mortgage securitization vehicle is the intermediary between the capital markets and housing finance**
 - The opportunity is demand driven by the capital markets



Mortgage Refinancing Market :

A Two Tier Approach

- **Mortgage Banks: Covered Bond Product**
 - Easy to structure
 - Dependent on origination volume
 - Commercial real estate application
 - Highly capital and credit intensive
 - Attractive Investment Instrument into Banking Sector
- **Mortgage Securitization Conduit: MBS**
 - Requires international structuring know-how
 - Overcomes volume issues by bundling assets
 - Needs statistical information and standardization of terms to succeed
 - Cash flow of collateral is determinative of credit worthiness
 - Removed from bankruptcy risk of originator
 - Collective market service provider including mortgage banks
 - Origination multiplier



Legislative and Regulatory Considerations

- Needs legal segregation of asset pools
- Needs effective asset transfer mechanism together with collateral
 - Mortgage registration
- Needs effective execution rights to ensure quality
- Needs standardization of product
- Needs efficient and well developed systems data generation support at originator's level
- Needs critical mass for cost efficiency and attractiveness to investors



“PolieSec” Business Model

- PolieSec is a securitization conduit (management company under Polish investment fund law)
 - Structures highly rated securities collateralized by residential mortgages
 - Derives revenue from structuring fees
- PolieSec establishes special purpose vehicles: closed-end investment funds to issue mortgage backed securities (MBS)
 - Revenue: annual management fee
 - Applies credit enhancement methods



“PolieSec” Business Model

■ Business Activities

- Negotiates terms and process mortgage acquisition and securitization, which in time becomes standardized
- Structures securities
- Monitors and manages outstanding issues
- Manages own portfolio of subordinate bonds

■ Income

- Structuring Fee
- Own Portfolio Management



Capital Markets Demand for Products Exceeds Supply

- Poland has well established collective investment vehicles
 - Insurance
 - Pension Funds
 - Mutual Funds
- Investable assets of pension fund industry alone are projected at over \$16 billion by 2004
 - Pension reform in the late 1990s makes asset growth virtually guaranteed



New Investment Products are Needed

- Fixed Income Investments are limited to Government Bonds
 - Benchmark “long-term” security is five year treasury bond
 - 2002 offering of twenty-year bond was oversubscribed by six times at yield of 7.215%



PolieSec Aligns with Government Policy

- PolieSec's concept addresses two public policy priorities
 - Creation of domestic investment instruments for the pension fund system
 - Improvement in the housing finance system
- Poland's need for domestic investment means that government policy to keep assets invested locally is unlikely to change with EU accession
 - Collective investment industry has limited ability to invest in foreign assets
 - Poland has successfully negotiated to keep domestic asset investment requirement in place for pension funds after EU accession



Development Team and Future Service Providers

- Development Team
 - **International Finance Corporation**
 - **Dewey Ballantine**
 - **MCF**
- Potential Partners and Third Party Service Providers
 - **Citibank: custody, distribution and liquidity**
 - **National Depository: depository and paying agent**
 - **Fitch: bond rating**
 - **Other service providers**
- Legislative Amendments drafted with SEC
- Legislation being processed through Parliament
- Develop regulations and company licensing documents with SEC concurrently with legislative process



Capital Market Demand

- Capital Market demand and lack of product creates opportunity to shape PolieSec's MBS product offering and the MBS market
 - Attractive to investors
 - Profitable and cost-effective for sponsor
 - Central approach captures and molds the MBS market in Poland



Conclusions

- The opportunity is ripe to develop the mortgage finance system in Poland
 - Global best practices tailored to fit Polish law and conditions
- To build mortgage-backed securities industry in Poland requires
 - International expertise in global best practices
 - International capital and credibility
 - Commitment and support of Polish supervisory authorities
 - Experienced on-the-ground project manager
- MBS prototype for Southeast European markets
 - Dispersed mortgage originators
 - Relatively small volumes
 - Existence of Pension and Investment Funds
 - Centralized conduit provides liquidity