

Legal Building Blocks for the Primary Mortgage Market

Presentation by Carol Rabenhorst
The Urban Institute

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Relationship between Legal Framework and Credit Risk

- Banks evaluate strength of legal framework to assess credit risk
- Strong legal framework helps deter and cure default
- If legal framework weak, banks compensate:
 - Higher rates of interest
 - Shorter terms
 - Low loan to value ratio
 - Other security required
 - Small, select portfolio or no mortgage lending at all

Effect of Weak Legal Framework on Financial Development

- Capital not freed up from fixed real estate assets
- Owners do not realize value of property rights
- Other economic activity constrained
 - Less housing and commercial construction and renovation
 - Less small enterprise development
 - Fewer jobs, less production of materials
- Mortgages not available for capital markets

Critical Building Blocks in Legal Framework

1. Clear title and ownership rights
2. Property registration and cadaster system
 - dependable, complete, transparent, public
3. Efficient procedures for lender to seize property after default (foreclosure)
4. Ability to evict debtor after foreclosure
5. Appropriate priority of payment from foreclosure proceeds

Relevance to Secondary Market

- Past performance of loans and success of loan recovery recovery procedures help determine quality and pricing of bond or security
- Rating agencies review primary legal framework
- Due diligence includes evaluation of legal framework
- Bottom Line: Without strong deterrent to default and predictable access to collateral, locked out of secondary market

Status of Property Registration in SEE

- Bulgaria
 - Generally speedy process and complete records
 - Properties registered by owner, not parcel number
- Croatia
 - Property records incomplete and inaccurate
 - Conflicting claims in post-conflict areas
 - Restitution incomplete
- Romania
 - Generally speedy process and complete records
 - Registration not required

Status of Foreclosure and Eviction in SEE

- Bulgaria
 - Court procedure required - slow and uncertain
- Croatia
 - Court procedure required - slow and uncertain
 - Fiduciary mortgage requires court order for eviction
- Romania
 - Substantial legal reform - lender has executory title
 - Eviction can be delayed 90 days

Comparison of SEE with other Transition Countries and Western Europe

	West. Eur. (generally)	Poland	Hungary	Bulgaria	Croatia	Romania
Clear titling procedures	✓	✓	✓	✓	✓	✓
Reliable registration	✓	✓	✓	?	NO	✓
Foreclosure without court procedure	✓	✓	✓	NO	?	✓
Ability to evict debtor	✓	✓	✓	?	?	?
Appropriate priority for mortgage	✓	✓	✓	✓	✓	✓