

Legal Gap Analysis: Primary Market Issues In Croatia and Romania

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CROATIA

Highlights of Update

- Execution Law amendments - adopted Oct. 2003
- Registration Reform Project underway
- Boom in consumer credit led to Central Bank cap on growth of 4% per quarter (22% of GDP -highest in region)
- New Credit Bureau to open soon
- Donor aid for movable pledge registry
- Still no push from banks for secondary market - strong deposit base, large spreads, access to parents' funds
- Housing loan market remains restricted by conservative underwriting and security practices

Areas of Concern in Primary Market

- Registration slow and incomplete, especially in Zagreb
 - judge-based
 - backlog for conflicting claims
- Enforcement slow and uncertain, even with fiduciary deed
 - 300,000 cases, 25% of total court backlog
 - new borrowers financially undisciplined
 - problem with jurisdiction for execution - bank HQ
- Enforcement problems lead to under valuation of property, over-collateralization
 - impediment to standardization

Immovable Property Registration

1. Registration Law (1999) basically sound; no amendments in 2003
2. Problem is backlog and incomplete records
3. World Bank project underway - eventually will make system faster and more accurate
4. Court cases for conflicting claims take up to 10 years - inexperienced judges, lack of resources
5. Move to take registration out of judicial system - caught in political issues
 1. Recommendation: Registration Clerks
6. Restitution still incomplete

Conveyancing; Transaction Costs

- Contracts often prepared by parties, may slow down registration
- Transfer tax - 5% of value, usually paid by buyer

Registration of Mortgages

- Mortgages registered in land book
- Registration of mortgages not a problem if property has been registered
- Accelerated procedure - can be done in one week
- If conflicting claims, goes into court system

Registration of Movables

- None in effect now. Govt. of Norway grant to establish.
- Property often given over as security - possession adequate to protect from bankruptcy

Mortgage Collateral and Security

- Very cautious and conservative - almost no true mortgage lending
- Employment and family income are key, not value of property
- Direct salary deposit, automatic attachment if default
- Guarantors required (2-3)
- Agreement on value to set auction price
- Underwriting, valuation, types of security not standardized

Foreclosure and Eviction

- Regular mortgage: court procedure required - slow and uncertain
- Fiduciary deed - no court procedure required
 - ownership transferred to lender and registered
- Law on Execution amended to allow process to move during appeal, but courts may not enforce
- New Law on Execution amendments:
 - lender required to sell property after foreclosure unless parties agree after default

Insurance

- Mortgage insurance available through Croatian Insurance Company
- Security same as mortgage - employment, guarantors.,
- After default, property transfers to CIC
- Use only fiduciaries mortgages
- One time fee, about 5% of value. Price not regulated.
- No restrictions on insurance companies as capital market investors

Bankruptcy

- Good security for secured lenders under Bankruptcy Law
 - first priority
 - right to execute outside of bankruptcy proceedings
 - interest accrues until date of payment
 - family home not exempt
 - loan due upon debtor filing in bankruptcy
- No personal bankruptcy in Croatia

Bank Regulation - Growth Cap

- Consumer lending boom seen as risky - Central Bank set cap on growth at 4% per quarter; excess must be used to buy CB bills at 0.5%
- Greater impact on small banks
- Unclear how long cap will remain in effect

Secured Transactions

- Lender may pledge mortgage rights, including future rights
- No pledge registry. Pledges published in Official Gazette - cannot be easily researched
- “Rule of Speciality” - no “floating” pledge
 - cannot exchange assets in pool without amending pledge agreement

ROMANIA

Highlights of Update

- Boom in mortgage market all over Romania
- More true mortgage lending
- Tax deduction for mortgage interest
- Strong will to adopt legal framework for secondary market - market driven, donor assisted
- Acceptance of standardization
- Contract savings accounts to start next year

Legal Issues in Primary Market

- Legal framework strong on fundamentals
 - registration slow but proceeding toward modernization
 - non-judicial enforcement accepted
- Housing loans under Banking Law must be converted to mortgage laws to be securitized
- Need for harmonizing documentation, processing, underwriting
 - banks recognize
- Remaining confusion about regulation of banking sector and secondary market - roles of NBR and NSC need clarification

Transaction Costs

- Major expense is notary fees - 1.5% of transaction value
- Registration fees reasonable - in line with European standards
- Real estate commission usually 6%, split between buyer and seller.

Registration of Property

- Law provides adequate procedures and protections of property rights.
- Primary problem is administrative - World bank project underway to computerize and update system

Registration of Mortgages

- Reasonably fast - 2 weeks. Priority established upon submission of documents.
- Confusion about registration of construction loans made under Mortgage Law
- No central registry of mortgages - need clarification of fees and procedures if loans are transferred or sold on secondary market

Collateral and Loan Security

- True mortgage lending increasing
- Confidence in control of credit risk
 - good enforcement framework, few defaults
 - conservative underwriting on basis of employment and salary
 - relationship with bank not required
- L-to-V about 75%, but discount.

Prepayment Risk

- Gray market salary not reported, many borrowers can afford to prepay (unlike Croatia, salary not automatically deposited)
- Mortgage Law requires that prepayment be allowed. Fee can be charged (usually 2-3%)
- May create problem with pricing MBS

Enforcement of Mortgage Loans

- Court procedure not required - foreclosure and eviction carried out by licensed professionals
- Few cases because of low default rate; some experience indicates that system works well

Insurance

- Property insurance required
- Mortgage insurance available, but not required
 - low credit risk to date
 - not regulated
 - cost about 1.5% annual payment on declining balance

Bankruptcy

- Bankruptcy stops all action against debtor including secured creditor (unlike Croatia)
 - Secured creditors need order from Bankruptcy Judge to proceed against assets
 - Should be addressed in Securitization Law
- Interest continues to accrue on secured debt
- Little experience under new Bankruptcy Law

Taxation

- Mortgage interest payments deductible up to set limit - incentive to market growth
- No tax on transfer of financial instruments - VAT not applicable
- 1% transfer fee on capital market transactions
- New Fiscal Code expected 2004
 - will clarify taxation of revenue, dividends, interest and principal paid to bond investors

Secured Transactions

- Central electronic archive for secured interests in movables - available on internet, priority as of registration, small registration fee
- Law covers and permits:
 - possessory and non-possessory charges
 - interests in future property
 - floating charges
 - debt in foreign currencies