

CHAPTER 11. HOUSING FINANCE IN UKRAINE

by

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1. Supply and Demand of Housing

Providing with housing in Ukraine is inadequate. One third of Ukrainians live in unsatisfactory conditions i.e. have less than 9 m² of the floor area per person. Around two million households or six millions individual are registered on waiting lists for improving housing conditions. On average, a Ukrainian resides on 20 m² which is two to three times as little as in developed countries.

After long recession in the housing construction industry, it saw gradual revival in 2001 through 2003. For instance, in 2003 developers of all ownership forms put in operation 62,300 apartments totaling 6,433,000 m² that is 15,7% more as compared to the year of 2000. The growth is secured mainly due to increase in construction by private construction companies. In 2003 they placed into operation 61,4 % of all newly constructed dwelling units (59% in 2001 and 60% in 2002). It is important to emphasize that in 2003 the construction industry had the highest growth rate (23 %) and outpaced the GDP growth rate considerably. A similar situation was in the first quarter of 2004.

Nevertheless, the housing problem in Ukraine still remains unsolved (like it was under the Soviet time) even though construction of new high quality housing and improvement of existing residential buildings (through overhaul) enhanced the quality of available housing, primarily, in cities.

It is worth noting that people rarely seek free state housing because of long waiting lists and little volume of state housing construction. Therefore, households will be trying to solve the housing problem with their own funds.

Proper maintenance and preservation of the existing housing stock is another important solution of the housing problem. In particular, this relates to residential areas developed between 1946 and 1970.

As overhaul of dwelling units is funded from the state budget, budget constraints lead to shrinking of housing repair program, overall deterioration, accelerated depreciation, and decommissioning of the housing stock. According to the official statistics, 4,800,000 m² of housing was in the emergency condition as of 2003.

2. Housing Finance Market and System

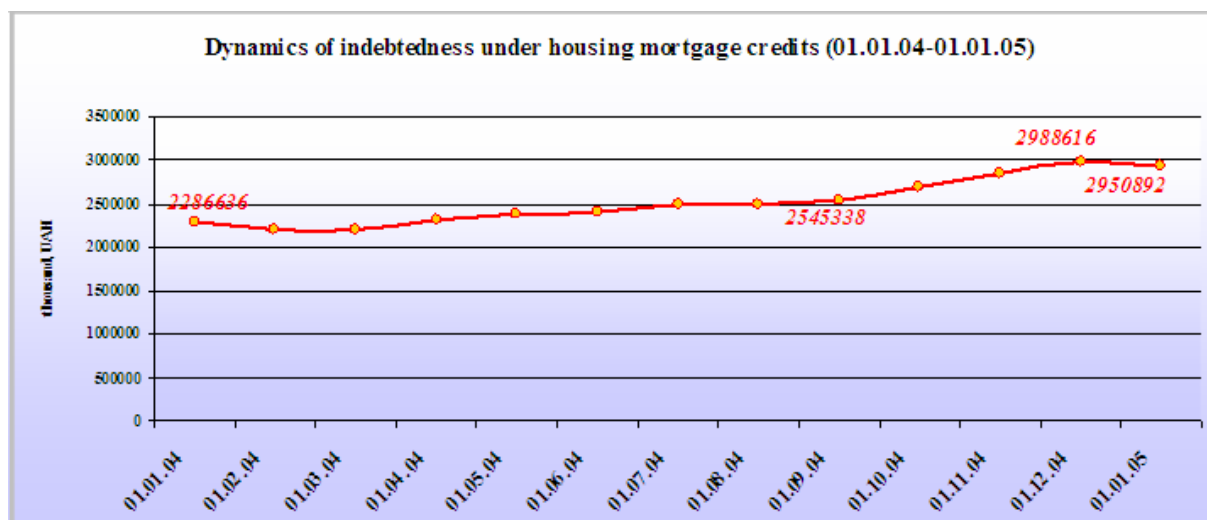
Primary Mortgage Market

As of April 1, 2004 the total amount of loans secured by mortgage or given for the purpose of funding construction was UAH 5,129,000 i.e. it had grown 3.6 times or by UAHD 3,694,000 from early 2002. As of April 1, 2004 the total debt to banks under credits given to individuals for housing purchase and

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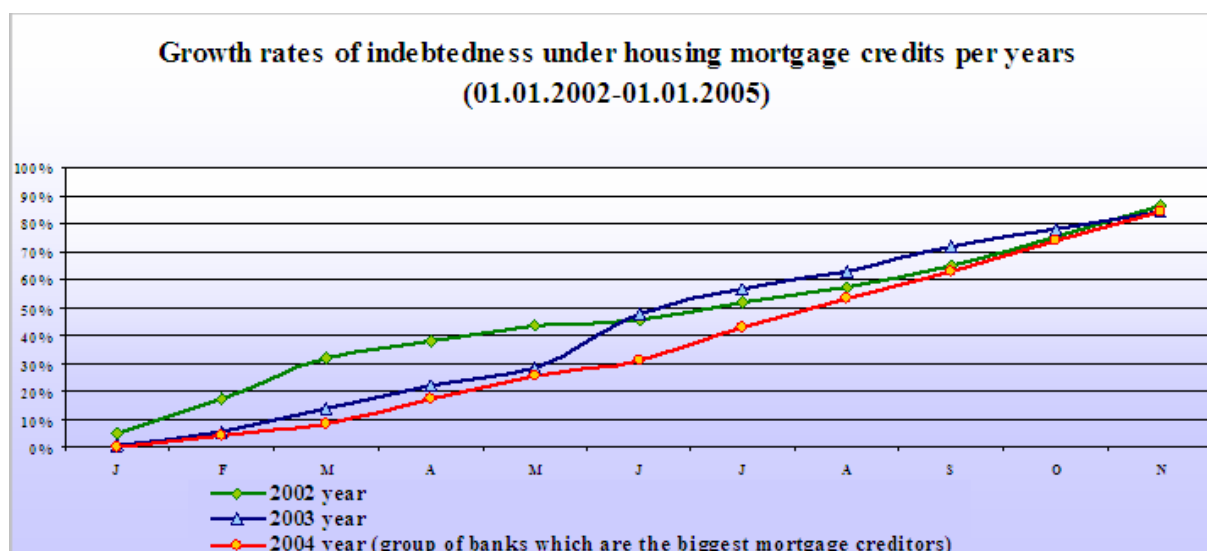
financing of housing construction was UAH 1,462,000 whereas that of legal entities was UAH 3,668,000.

As of 01.01.05 the total indebtedness under housing mortgage credits or given for housing construction financing totaled 2951 millions UAH that is, increased 9,3 times or 2633 millions UAH from the beginning of 2002.



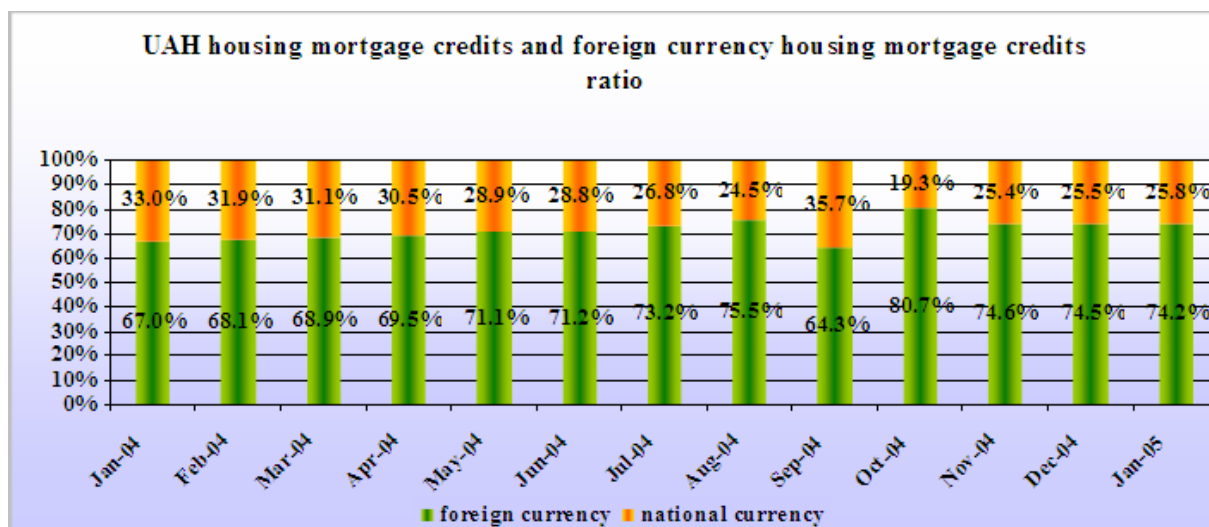
On the whole, the total of outstanding mortgage loans was increased by 257.4% between January 2002 and March 2004 or, in other words, it grew by 5.2% each month.

As a whole, for the period from 01.01.2002 to 01.01.2005 the volume of indebtedness under housing mortgage credits has been increasing on average 4,7% per month. It's important to emphasize the relative stability of dynamics of increase of indebtedness under housing mortgage credits for last three years.



It is necessary to emphasize the considerable difference between volumes of crediting in national and foreign currencies. It is explained by the fact that in the secondary market payments are made in

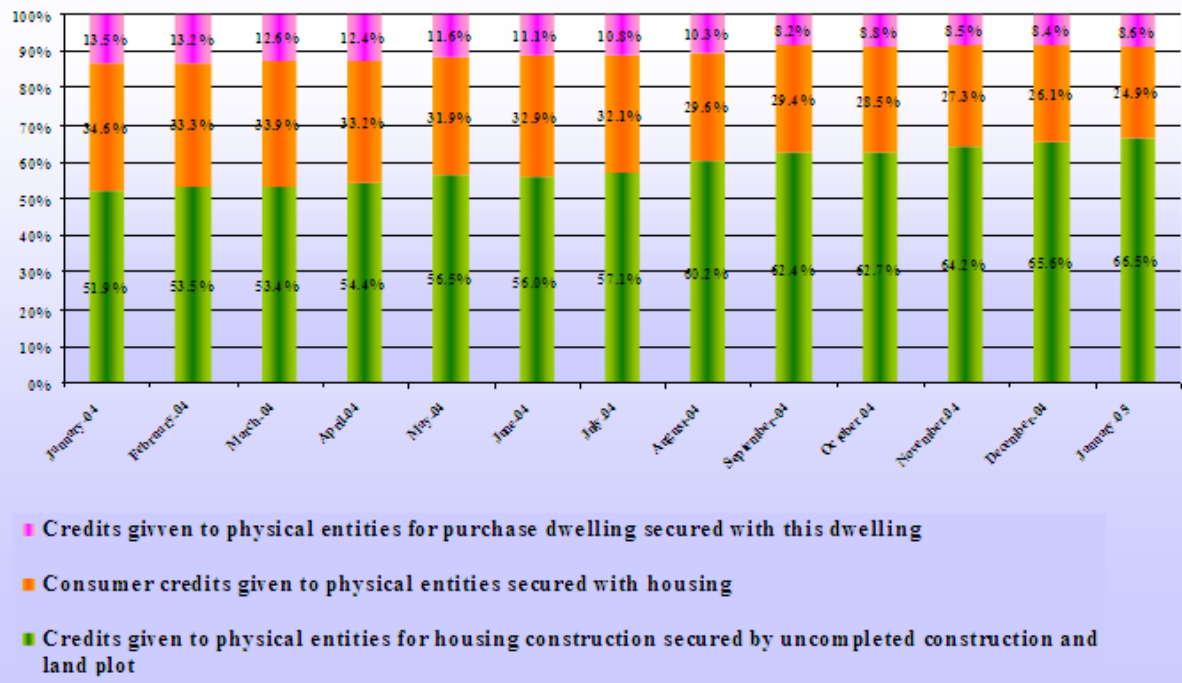
foreign currencies and by existence of a large grey sector of the Ukrainian economy and relatively high unofficial individual income, accordingly.



Undoubtedly, growth of mortgage lending in the national currency is hampered by lack of such risk management tools as, say, a variable interest rate, which is caused by insufficient objectivity (unreliable projections) of those measures which could be used as indicators to adjust the interest rate to.

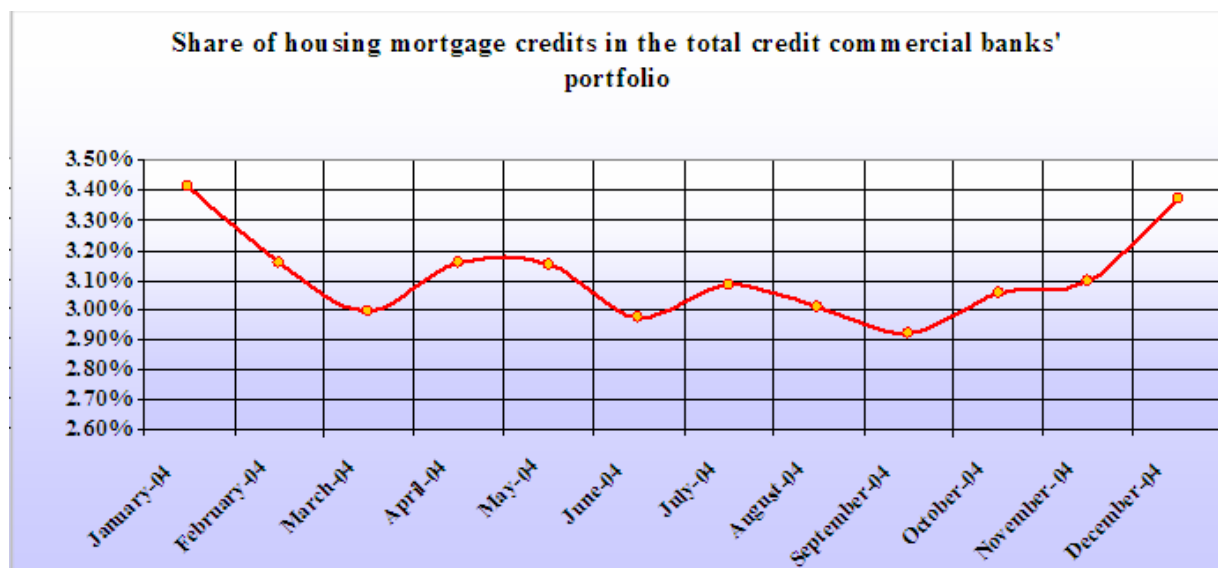
To the large extent, corporate relationships between some commercial banks and housing construction companies speed up growth of mortgage lending. That is, bank-controlled lending of housing construction as a source of funding at early stages evolves into lending of direct investors with the secured right of claim under investment contracts, which are secured by housing mortgage at the completion of construction.

Indebtedness under housing mortgage credits



Growth of housing mortgage lending and lending for housing construction purposes slowed down in early 2004 for a number of reasons directly affecting the lending market and demand for housing mortgage loans in particular.

Share of housing mortgage credits in the total credit commercial banks' portfolio



The first and foremost factor is probably expectation on the part of potential borrowers that prices for housing will grow at a slower pace if not go down. That is what actually happened: the growth did slow down; the prices were not decreased though. Prices for newly constructed housing became even higher because VAT concessions were eliminated for buyers at the primary real estate market.

The market reacted to the rapid growth of prices for property in the summer of 2003, which exceeded the projected growth, with falling volume of loans.

The prices for property began skyrocketing in the fall of 2001; sometimes the prices went up by 25% over a quarter. As early as in the fall of 2002 they exceeded the level before the 1998 financial crisis.

Since the Kyiv real estate market (both primary and secondary) is the largest in Ukraine, this report is based on information on price patterns at this particular market. For example, the Kyiv market accounted for 75% of the total Ukrainian market in 2003.

According to experts, prices for housing grew by 25% to 30% over 2003 on average. Therefore, prices for apartments in Kyiv were increased 2.5 times since early 2001. Unlike previous years, when small and cheap dwelling units saw the most rapid growth, in 2003 it was characteristic of high quality one and two room apartments. In some market segments, the growth reached 60 percent.

Another reason is legislative. Namely, despite the Law "On Mortgage" was enacted effective the beginning of this year, there was no law which would regulate ownership of real estate property. That is why banks found themselves in a rather risky situation and reacted accordingly.

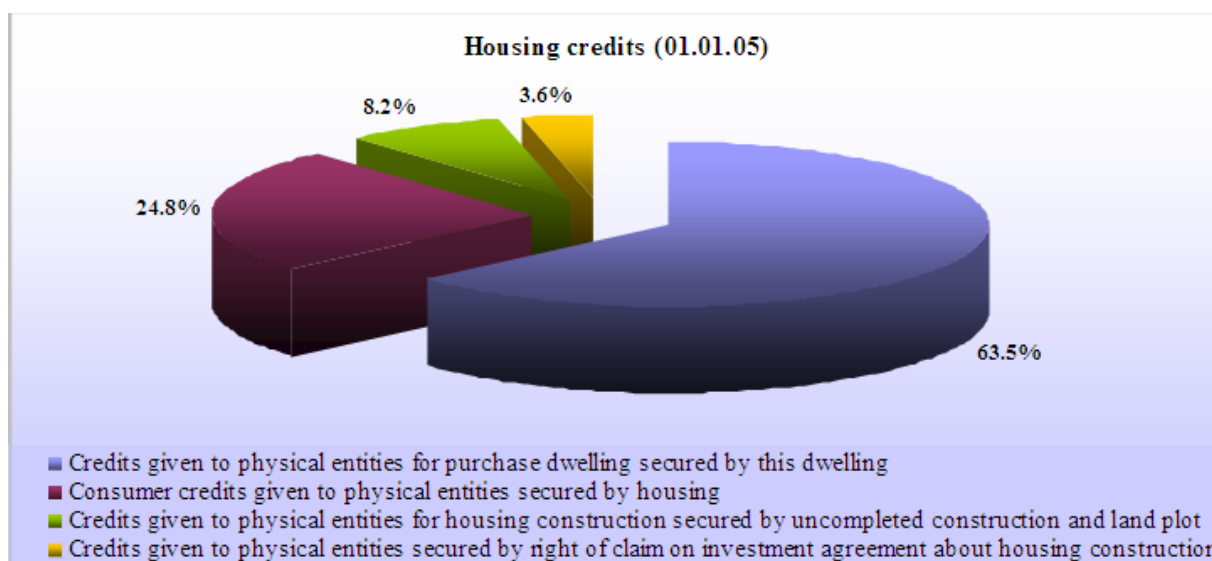
Some banks raised interest rates on mortgage loans in foreign currencies up to 17% to 18% although in some cases this increase in interest rates was caused by insufficient liquidity (lack of credit resources with creditor banks).

The situation improved significantly after the Cabinet of Ministers approved a temporary procedure for state registration of mortgages.

Secondary Mortgage Market

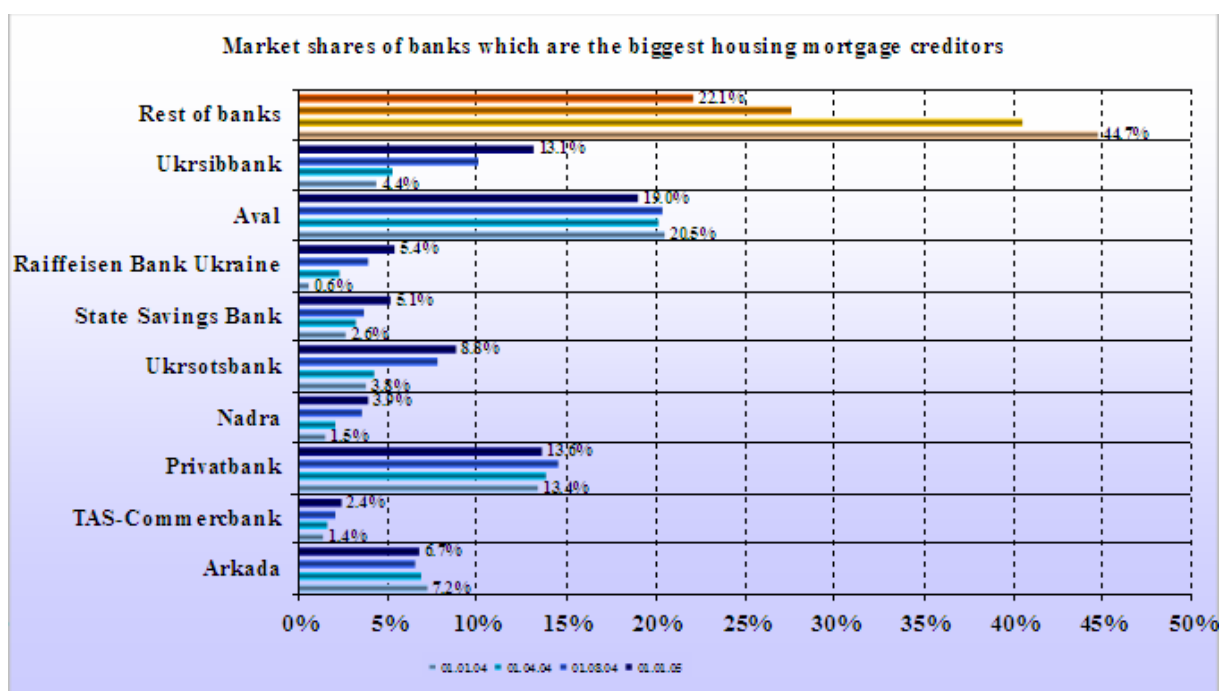
Until recently, mortgage loans were regulated by the Law "On Pledge" dated 1992. In June 2003 the Parliament of Ukraine (Supreme Rada) passed the law "On Mortgage". This law defines basic terms, first of all the mortgage, establishes requirements to the subject mortgage and its insurance, defines obligatory parts of the mortgage contract, clarifies rules for selling real estate. Besides, the Law defines a collateral note, an instrument used to secure a mortgage loan contract. Mortgage of agriculture land will be launched in 2005. The mortgage lending market is also regulated by such laws as "On Mortgage Lending, Transactions with Consolidated Mortgage Debt, and Mortgage Securities", "On Financial-and-Lending Mechanisms and Property Administration in the Process of Housing Construction and Transactions with Real Estate", "On Securities and Stock Exchange".

Loans account for roughly 45 percent of all transactions in the banking sector in terms of asset value (corporate loans – 84 percent, loans to individuals – 16 percent as of 2003). As far as loans to individuals are concerned, most are consumer credits while housing mortgage loans account only 20 percent to 30 percent.



During the last two years, some banks were particularly active and gained large parts of the Ukrainian mortgage lending market. These are Savings Bank, Ukreximbank, Nadra, Arcada, Praveksbank, Aval, Prominvestbank, Privatbank, Ukrsotsbank, Ukrsibank, Brokbiznesbank. They have nationwide network of branches and offices and compete with each other at housing mortgage lending market in large regional centers. Eleven major operators of the housing mortgage lending market accounted for 69.7 percent of the market in early 2002, 67.9 percent in early 2003, and 69.7 percent six months later.

Two more banks – Brokbiznesbank and Ukrsibank – joined the group of eleven major banks (those with more than 1% market share) in 2002. They covered 5.4 percent and 4.1 percent of the market, respectively. Therefore, the group of 13 major players took up 78 percent of the market in 2004.



The market shares of the major players (banks) at the housing mortgage lending market remained practically unchanged during the period under review. Despite the total value of each bank's loans was increased, their market shares changed insignificantly.

3. Regulatory Framework

The Government is interested in developing the mortgage system as an institute and supports operation of the mortgage lending market in Ukraine by passing enabling legislation.

Selected laws regulating the Ukrainian mortgage lending system are listed below:

- Civil Code of Ukraine
- Commercial Code of Ukraine.
- Law of Ukraine "On State Registration of Titles to Real Estate";
- Law of Ukraine "On Mortgage";
- Law of Ukraine "On Financial-and-Lending Mechanisms and Property Administration in the Process of Housing Construction";
- Law of Ukraine "On Mortgage Lending";
- Law of Ukraine "On State Statistics";
- Law of Ukraine "On Amending Selected Laws of Ukraine".

The full list of the enabling legislation is posted on:

http://unia.com.ua/Portal/portal/alias_unia/lang_en-US/tabID_3349/DesktopDefault.aspx

Major regulations in the area of mortgage technologies include:

- Procedure for partial reimbursement of the interest on commercial banks' loans;
- Concept for creating the national system of mortgage finance;

On the whole, technologies incorporated in the current legislative and regulatory frameworks are sufficient for operation of the mortgage lending system in Ukraine. However, new laws will be needed to ensure further development of mortgage relationship. The Association is actively involved in the process of drafting these laws.

The Association initiates drafting of many laws intended to modernize existing mortgage lending technologies in Ukraine. Many of these draft laws have been already registered in the Parliament and decisions on them will be made soon. These are:

- Draft Law "On Mortgage Securities"
- Draft Law "On State Land bank"

- Draft Law “On Trust Management of Property”
- Draft Law "On Mortgage Institutions"
- Draft Law "On Land Market"
- Draft Law “On Financial-and-Lending Mechanisms of Housing Construction"

At the moment, mortgage loans account for 0.7 percent of all loans in Ukraine. Despite rapid growth of this percentage, the share of mortgage loans is still too small to include complex mortgage lending schemes or the illegal schemes you mentioned. All mortgage contracts in Ukraine are executed as loan contracts together with a pledge contract i.e. borrowers pledge ownership of property. These are primarily commercial banks’ loans for purchase of real estate property on the security of this property. The refinancing system is at the development stage and, thus, not operable in Ukraine. The Government of Ukraine is in the process of developing an operation system for the 2nd level mortgage institution and cooperates closely with our Association in this matter.

The Ukrainian mortgage lending market is regulated by laws shown in the table below. Most of them were passed last year which suggests rapid growth of this market.

| Main Regulations | Enforced Date |
|---|---------------|
| 1.The law “On mortgage” | 05.06.2003 |
| 2. The law “On mortgage lending operation with mortgage funding and mortgage certification” | 19.06.2003 |
| 3. Civil Code of Ukraine | 16.03.2003 |
| 4. The law “ On securities and stock exchange” | 18.06.1991 |

4. Housing Policy

Privatization of housing in Ukraine began in 1992. By now, more than a half of the housing stock has been privatized. With allowance for private housing and construction cooperatives, individuals own some 80 percent of the Ukrainian housing stock today.

By allowing individuals to own housing, the Government revises the fundamentals of its housing policy. The Parliament adopted the Concept of the State Housing Policy on June 30, 1995 which envisaged:

- To enable individuals to buy or construct housing according to their needs easily;
- To provide housing to vulnerable categories;
- To give loans for purchase or construction of housing to households on housing waiting lists and to young families;
- To encourage state housing construction;
- To develop construction of more comfortable housing;
- To provide separate housing units to residents of communal apartments; to move out households residing in apartments built under Khrushchov;

- To create and develop the housing and utility sector in rural areas;
- To bring the housing sector up to the 100% cost recovery level on a phased basis;
- To redistribute responsibilities among government authorities, local governments, and organizations/companies involved in housing construction, renovation, and maintenance with a view of decentralization as economic reforms go

The "Concept" accentuates that one of the major factors necessitating the reform of the housing and utilities sector is "an excessive monopolization of construction, reconstruction and habitation maintenance", and the main ways of realization of the state housing policy are "continuation of privatization of the state available housing, creation of the housing market and market structures in housing sector".

Such way has been described in "the Concept of the state housing policy in which "the obligatory unification of owners of apartments in apartment houses in societies is proposed with the purpose of securing appropriate maintenance of houses and adjacent territories.

In order to speed up local decision-making processes on establishment of societies and regulation of their activities, by Resolution of the Cabinet of Ministers of Ukraine № 588 as of 31.07.1995 has been approved the Provision on establishment and activity of societies of co-owners of apartment houses. For performance of this Resolution, the Derzhzhytlokomungosp (the State Housing and Utilities Facilities) of Ukraine in April, 1996 has developed and approved the "Typical statute of societies" and "Provision on the procedure of their state registration". At the same time, the State Committee on land, the State Committee on town-planning and architecture, the State Committee on housing and utilities services and the State Property Fund approved "the Provision on establishment and fixing borders of territories adjacent to the houses", their granting as the common property or for the common use to societies of co-owners of housing apartment houses.

The law of Ukraine "On re-structuring of arrears of wages, payments for the housing and utilities services, consumed gas and electric power" as of February, 20, 2003 № 554-IV has established as of July, 1, 2003 the mechanism of re-structuring of debts during the period within 60 months by conclusion the contract with the public utilities supplier. In this contract the amount of monthly payments of the debt sum is mentioned, taking into account, that together with the current payments, it should not exceed 25 % of the income of a citizen which has concluded the contract.

To perform Decree of the President of Ukraine № 1165 of December, 4, 1996 "On additional measures concerning realization of the state youth policy" the State Fund for the Assistance to the Youth House-Building was created that is the state specialized financial institution, subordinated to the Cabinet of Ministers of Ukraine which acts on the basis of the Provision approved by the decision of the Cabinet of Ministers of Ukraine № 1604 as of October, 26, 2000.

At the present, the Fund carries out such kinds of activity:

- according to the resolution of the Cabinet of Ministers of Ukraine № 584 of May, 29, 2001 "On the procedure of granting lax long-term credits to young families and lonely young citizens for construction (reconstruction) of habitation" gives long-term credits for construction and purchase habitation by young families, the age of husband and wife makes till 30 years inclusive, and also to lonely young citizens till 28 years inclusive. The maturity of credit – to 30 years.

- according to the resolution of the Cabinet of Ministers of Ukraine № 853 of June, 4, 2003 " On approving the procedure for partial reimbursement of interest on commercial banks loans to young families and lonely young citizens for construction (reconstruction) and purchase of habitation " the partial reimbursement of interest on commercial banks loans is given to young families and lonely young citizens for construction (reconstruction) and purchase of habitation. According to this resolution the borrower receives reimbursement to the sum of discount rate of the National Bank of Ukraine.

The Fund is a responsible executor of the State Program on providing youth with habitation for 2002 - 2012, that is approved by the resolution of the Cabinet of Ministers of Ukraine №1089 of July, 29, 2002. The present Program allows not only to solve housing problems, but also assists to improvement of the demographic situation in the country.

The Government of Ukraine pays a significant attention to the development of the youth housing construction. 65.5 millions uah from the State budget of Ukraine were allocated for the State program on provision youth with habitation in 2005. According to results of the year the Fund was financed in full. Besides, for the first time, according to the Fund's proposal, the basic volumes of financing of the Program in 2005 were envisaged for the spring-and-summer period - optimum for building.

It's worth noting, that according to results of 2002, the Fund and its regional branches were financed in volume of 50.1 millions uah from the state budget funds, that makes 65.1 % from the annual purposes, envisaged for Fund by the Law of Ukraine " On the State budget for 2002". For 2004 the Government action plan envisages to triple a number of credits for construction and habitation purchase for youth, countryside inclusive.

For 2004 the State budget of Ukraine envisaged for youth housing crediting:

- 100 millions UAH from the general fund of the State budget
- 6.7 millions uah. From the special fund of the State budget (funds received from old loans repayment)

The Law of Ukraine " On amending the Law of Ukraine " On the State budget of Ukraine for 2004 " № 1801-IV of June, 18, 2004, envisages for the Fund increasing of funds for the youth housing crediting up to 130 millions uah. (plus 6.7 millions uah. of funds from the special fund)

Based on what has been mentioned above, it is possible to make conclusion that after the acting Government came, financing of the State program on providing youth with habitation was not only stabilized, but the volumes of financing have considerably increased too. As of 01.09.2004 from the state budget the Fund is financed for crediting in the sum of 65.3 millions uah., that makes 100 % from the annual planned purposes for the present period.

In total, for 6 years of Fund's activity, the Fund has provided with habitation by means of different mechanisms of support in receiving long-term credits for construction and habitation purchase more than 6,2 thousands young families. The program has received nation-wide development. For the past and this year 25 oblast programs on providing youth with habitation and the program in the city of Sevastopol have been approved as well as 43 regional programs and 31 city programs providing youth with habitation. Besides, it is worth noting that it's in 2003 began the essential growth of volumes of financing of the State program on providing youth with habitation from the funds of local budgets.

The common work of the State Fund for the Assistance to the Youth House-Building and the Cabinet of Ministers of Ukraine assists to the introduction of new forms and mechanisms of long-term housing crediting. Namely: in the last year the Fund, for the first time, introduced the mechanism of credit granting in the secondary housing market, corresponding changes were made to the Provision on crediting approved by the resolution of the Cabinet of Ministers of Ukraine.

Besides, the resolution of the Cabinet of Ministers of Ukraine "On approving the partial reimbursement of interest on commercial banks loans to young families and lonely young citizens for construction (reconstruction) and habitation purchase". At present, around 500 credits with partial reimbursement of interest have already been given.

For 2005 the Government of Ukraine plans to allocate funds from the state budget for realization of the State program on providing youth with habitation totaling 220 millions uah.

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