

# **Legal Building Blocks for the Primary Mortgage Market**

**Presentation by Carol Rabenhorst  
The Urban Institute**

**USAID Conference on Developing Secondary  
Mortgage Markets in Southeast Europe  
Sofia, Bulgaria - 3-5 February 2003**

# 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	✓	✓	✓	✓	✓	✓