1. HOUSING POLICY IN THE TRANSITION PERIOD – GENERAL COMMENTS

As in other countries under economic transformation, a complete, efficient system covering housing needs and enabling effective development, allocation, and operation of the resource and beneficially affecting the entire economy has not been in place in Poland yet. Its weakest link has turned out to be the housing policy, the relevance of which was crucial because the system had to be built from scratch. From the transformation outset there was no comprehensive and based on foreign experience (while taking Polish particularities into account) concept of the sector’s mechanism in place.

First and foremost there was neither a vision of the institutional and regulatory structure, nor an implementation action plan. Some partial aims were pursued instead, and unrealistic solutions searched for to improve the population’s housing condition with no capital expenditure and at no social cost. These were typically found at financial institutions that were supposed to generate surplus capital by themselves, or in budgetary expenses that due to a multiplier effect were to convert into budgetary surplus. Changes in the sector were mainly prompted by external factors (inflation, budgetary deficit, banking system reform), while the housing policy was rather intermediate intervention oriented.

The residential sector by decision makers was treated as a social shock absorber and a political battlefield. Therefore more difficult decisions aimed at development of an efficient market structure were avoided (rent raises, evictions), political promises were made largely in vain, and the public housing resource was privatized by means of giving it away. In a similar manner, i.e. with prior assessment of neither decision purposefulness, nor target meeting effectiveness, the sector subsidising policy was implemented.

Analysis of the successive governments’ official housing programmes and practical actions thereby undertaken shows that over the last dozen or so years the housing policy was aiming at residential development, and not at the entire

1 Similar conclusions may be drawn from studies on housing policies of most of the countries under transformation. Compare studies and reports by MRI 2004 workshop in Budapest (www.mri.hu).
sector’s performance. Therefore largely unrealistic and politically targeted residential development programmes were drawn up. In the real life residential development was promoted regardless of its cost or social relevance. The main tool of such policy implementation was quite generous, if somehow chaotic, subsidising. In the first half of the 1990-ties mainly housing cooperatives were subsidised (so called old loans). New development subsidising (so called building relieves) had rational grounds then, as it contributed somewhat in slowing down a significant fall in demand.

In the second half of the 1990-ties, following the demand growth, the supply barriers appeared in large cities, and the subsidies were to a large measure capitalised in the ground rent and housing prices. Cycles which appeared on the construction market to a great extent were caused by a low supply flexibility (developable land availability, long construction periods). The goal, i.e. a significant increase in the development volume, was not accomplished. Quite chaotic changes in the subsidies’ scales and forms disturbed the market and contributed to the construction sector’s downfall in 2002 first, and then to its boom in 2005, eventually deepening the cycles.

**Developable land deficit** still remains a substantial barrier to construction sector growth, and it results from errors in the respective municipalities’ policies in this respect and the spatial planning act’s mismatch with the reality. Absence of a Developer Act and excessive consumer’s risk in buying a housing from a developer have reduced the demand. This risk translates also to the banking sector which avoids to finance developers’ residential projects.

Completely incomprehensible are the grounds for the unusually restrictive tenant protection provisions which push the rental (and subletting) housing market into the grey zone. At the same time the markets seems to be signalling that there are private investors and banks ready and willing to enter this segment of the market.

During the period some organisations necessary for market performance were established. First appeared the *developers*, and developer projects are nowadays the basic form of multi-family housing development in big cities. Residential development, after strong downturn in mid-1990-ties (resulting from subsidy withdrawal when loan system was not developed yet), has been subject to moderate long-term growing trends. The main driver there is the mortgage loan rapid growth and the need to balance the structural discrepancies, particularly in the big cities.

Throughout the period the residential market was doing quite well despite legal barriers, non-regulated agent status, risk, and the banking system’s still poor support, even if the system of information, its availability,. During the period *professional associations of real estate agents* were launched and had matured.
And though the quality of service provided by some real estate agents might have given rise to some doubts, their professional capacity had increased along with their quality of service. Besides competition, *The Real Estate Act* has contributed thereto providing for licensing the business and relevant eligibility criteria. A persistent weakness has been the absence of the national real estate information system.

*Property adviser* has massively debuted at the marketplace, which is required for the professional property valuation and banking risk management. As with agents, this profession itself, as well as the professionalism of the local providers, still evoke emotions, but it can be expected that licensing and competition shall enforce relevant standards soon.

*Notary public offices’* privatisation was followed by significant raise in the notary act prices, but has eventually resulted in a development of a real consumer-oriented market for the service. The progress in *the land register system* improvement has been very slow over the last dozen or so years, especially in the largest cities, despite the fact that this system is the basic warrant of real estate trading safety in a market economy.

Poland’s accession to the European Union as well as a (currently very slow) *unification of EU’s real estate and loan markets* shall have a positive long-term effect on the market, in terms of its further professionalisation, increased competition, and better regulatory environment. This shall increase the market’s professionalisation and safety of its players, although in the longer run it shall undoubtedly tie the residential market up with the interest rate effect.

Yet, so far, *the housing policy* was rather a risk-enhancing than a stabilizing factor in the sector. It also hasn’t been creating a coherent system. This situation has to be changed. Without *long term and complex housing policy* it will be impossible to build efficient system of covering housing needs. A rational housing policy should support housing supply, market growth (resource flexibility), and overhauls. Problems that have to be answered in the future, belong to a more general housing policy and the role of the mortgage loans system in it. This is connected to the problem of availability of homes for various income groups of the society. Authorities responsible for housing policy should decide how to cover this needs and how far to go with guarantee and subsidy programs in the mortgage market or in support of developed private or a semi public rental housing with modest rents. Finally, one of crucial elements of such a policy should be to lower the sectoral risk level, which is still high.

*The banking sector* has undergone some substantial changes in developing commercial mortgage loans, away from the official housing policy but with the assistance of international organisations (USAID, The World Bank). With the inflation and loan interest rates falling banks went to compete intensely, establish-
Development of housing finance system in Poland – lessons learned

ing their specialists departments. Specialist banks were incorporated, mortgage banks were established, and a state bank (BGK) was mandated to support the sector by means of the National Housing Fund. Mortgage loans are now the most promising and the fastest growing commercial banking area.

Essentially the residential loan financing system is based on universal banks and retail deposits. For various reasons the existing mortgage banking system has not been proven successful. However, its future resetting for increased financing from the capital market shall be necessary further on.

Errors in the financial system have not been avoided either. An example may be the housing fund programme which was supposed to make cheap loans available to poor customers. It eventually reached mainly the wealthiest social groups who enjoyed the high subsidies. At the same time loans under the programme have been much less available than the mortgage loans (so much criticised by the programme’s promoters), and failed to solve any material social problem whatsoever.

Erroneous regulations resulted in development of the fund’s financially non-liquid system with no supervisory regulation. Also the state, originally supposed to support the fund’s liquidity, has withdrawn from the programme. Therefore even if banks had willingly accepted customer deposits, still in the crediting phase they would adopt a lot of prohibitive regulations to avoid granting loans under the statutory terms and conditions. The programme’s positive elements have been its modest reach (ca. 60,000 covered) and relatively low scale adverse effect.

2. GENERAL DEVELOPMENT OF THE MORTGAGE LENDING MARKET

The system of real property financing in Poland after 14-year transformation period covers the financing of residential property, building plots and commercial property, as well as the financing at the investment stage or for the purchase of an existing object.

From the very beginning of the transformation period commercial property has been financed according to market principles. In the last 14 years the residential property finance system has considerably evolved, from a highly subsidised system, based on a single, state owned bank (PKO), to a commercial, and highly competitive system.

The market of commercial home loans, along with the residential property market, is the best-developed market segment of the Polish housing sector. At this market mainly universal banks compete, offering mortgage and mortgage-construction loans as well as ordinary construction loans to developers. Despite its still relatively low volume (in relation to the total amount of market transac-
tions), commercial banks compete fiercely in this market, bringing a high growth of portfolios and favourable credit terms as a result (Fig. 1). The subsidized part of the system consists of old co-operative loans and some new initiatives which do not exceed 10% of the market share.

**Figure 1** Housing loan portfolio in Poland 1994-2004
(nominal and real, prices 1994)

Fast growth of portfolios brought an increase of housing loans importance in the sector. Although basic sector indicators and macroeconomic ratios in this area considerably differ from the levels prevailing in developed market economies, they already constitute a significant element of the sector and are rapidly gaining in importance. (Table 1.)

Following facts prove the scale and pace of this market’s growth. In 1994 the World Bank and related organizations negotiated with large commercial banks in Poland their participation in the mortgage loan project, which is still under development. According to the opinion of majority of the banks, mortgage loans would not be accepted in Poland due to the high risk for the bank and lack of potential customers likely to take them out. Most of the negotiation participants saw the future of the construction industry in the continuation of the system from the socialist period, i.e. highly subsidized loans granted by the PKO BP, a state bank.

A USAID survey, conducted at the beginning of 1997, had shown\(^2\) that there were two groups of banks emerging in the sector, adopting different strategies.

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Table 1. Commercial housing loans vs. basic sector indicators and macroeconomic ratios

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<tbody>
<tr>
<td>Outstanding balance of housing loans, extended by commercial banks, as a % of GDP</td>
<td>0.1</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
<td>0.5</td>
<td>0.9</td>
<td>1.3</td>
<td>1.8</td>
<td>2.3</td>
<td>3.2</td>
<td>3.6</td>
<td>5.0</td>
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<tr>
<td>Share of commercial housing loans in banking sector assets (%)</td>
<td>0.2</td>
<td>0.4</td>
<td>0.5</td>
<td>0.7</td>
<td>0.9</td>
<td>1.6</td>
<td>2.2</td>
<td>3.0</td>
<td>3.9</td>
<td>5.5</td>
<td>6.2</td>
<td>8.1</td>
</tr>
<tr>
<td>Housing construction per 1000 inhabitants</td>
<td>2.0</td>
<td>1.7</td>
<td>1.6</td>
<td>1.9</td>
<td>2.1</td>
<td>2.1</td>
<td>2.3</td>
<td>2.7</td>
<td>2.6</td>
<td>2.6*</td>
<td>2.8</td>
<td>3.0</td>
</tr>
<tr>
<td>Housing construction outlay financed by commercial loans (%)</td>
<td>9.5</td>
<td>9.4</td>
<td>9.7</td>
<td>8.0</td>
<td>9.0</td>
<td>15.0</td>
<td>16.0</td>
<td>21.0</td>
<td>26.0</td>
<td>36.4</td>
<td>38.5</td>
<td>41.4</td>
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<tr>
<td>Transactions in the secondary housing market per 1000 inhabitants</td>
<td>2.9</td>
<td>3.1</td>
<td>3.9</td>
<td>3.1</td>
<td>3.6</td>
<td>2.9</td>
<td>2.8</td>
<td>2.8</td>
<td>-</td>
<td>2.9</td>
<td>3.0</td>
<td>3.2</td>
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<td>% Of turnover on the secondary housing market financed with commercial loans.</td>
<td>1.98</td>
<td>2.42</td>
<td>2.67</td>
<td>3.83</td>
<td>6.89</td>
<td>9.46</td>
<td>10.2</td>
<td>13.8</td>
<td>-</td>
<td>27.6</td>
<td>31.5</td>
<td>40.1</td>
</tr>
<tr>
<td>Outstanding housing loans as a % of the total housing stock value</td>
<td>0.05</td>
<td>0.06</td>
<td>0.08</td>
<td>0.10</td>
<td>0.17</td>
<td>0.24</td>
<td>0.30</td>
<td>0.42</td>
<td>-</td>
<td>0.87</td>
<td>1.06</td>
<td>1.52</td>
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Source: Author’s own calculations on the basis of IGM, GUS and NBP data.
*Without “paper construction” – the result of changes in building law

The first group consisted of banks wanting to specialize in this kind of activity. As a rule, they were characterized by a more complex approach to the mortgage lending. They wanted to introduce a package of products to the secondary market, as well as to finance construction of single-family and multi-family houses under various organizational forms. In organizational terms it stranded for establishing separate organization units at the head office level and specialization at the branch office level.

On the other hand, for the banks belonging to the second group, activity in this sector was of secondary importance. Their motivation to operate in the sector varied. Generally, it was the question of following the competitors and the market demand, as well as of exploring new potential opportunities. These banks were not fully convinced about the development of this market, but they didn’t want to loose the potential chance. They chose the simplest products without creating specialized structures.
In a survey conducted at that time, on a representative sample of ten banks from this second group which entered the sector, concerning their advancement level in comparison to the experienced banks present in the sector (PKO BP, PBG), on a scale of 100 points (100 points being equal to full professionalism under Polish conditions prevailing at that time), these second group banks scored mere 30 points.

At the end of 1998, that is after less than two years, that level was estimated at 40–50 points. And, in contradiction to 1994, no bank wanted to stay out of the business or claimed that mortgage lending had no future in Poland.

At present we may speak of full professionalism in this segment of activity for all large commercial banks, while specialized structures are functioning at all significant market participants. There are no banks adopting either a passive or an active position any more, and mortgage loans are generally considered as the best items in a portfolio.

The competition in the sector, particularly since 2000, has been rapidly increasing. It is reflected in falling bank margins in relation to the WIBOR 3M rate, the most frequently used benchmark, in spite of the risk remaining at a constant level. While in 1994–1996 the banks’ margins still reached the level of 7–9 percentage points, in 1999 they fell to 3.5–4.5%, to reach 2.0 – 2.5% in 2002. In the subsequent years the level of 1.0–1.5% is expected. Certain decrease in requirements concerning the assessment of creditworthiness, in particular the assessment of income stability (other sources of income, not only those related to a permanent employment contract are taken into account), and extension of repayment periods (initially 10-15 years, at present even 35 years) are further results of the increased competition.

3 DEVELOPMENT FACTORS AND THE REGULATION SYSTEM

Mortgage loans have never been the main objective of housing policy of subsequent governments. Until the end of the 1990s they were treated rather as a marginal solution, something for the rich. The opinion prevailed that whoever could afford a mortgage loan, could also afford to build a house without it. Such a system was purposefully and consistently developed in the years 1990-1994 only. It was ignored that a developed system of mortgage lending, alongside an efficient market of building sites, is the foundation of a market-oriented, efficient housing sector.

3 Ibid.
The mortgage loan system is considered to be politically, macroeconomically and microeconomically risk sensitive. The dominant opinion, justified by a multi-year experience, was that certain minimum conditions have to be met to make the system functioning. Among these conditions, the following ones are usually mentioned:

- Macroeconomic stabilization and low (both nominal and real) interest rates as a requirement for broad availability of loans;
- Positive real interest rates on deposits as a condition for accumulation of the population’s savings in the banking system;
- Competition among banks forcing them to extend their offer by supplying mortgage loans;
- An efficient system of legal registration of real property and pledges on real property, supported by an efficient system of geodesic registration of real property, as a requirement for security of turnover and creditors;
- An efficient system of debt collection (and eviction) as a basis of the creditor’s security.

In Poland, at the beginning of the transformation, none of the above conditions was met. After eight years of transformation, in principle, two of them were fulfilled, i.e. real interest rates on deposits and competition among commercial banks. After fourteen years macroeconomic stability has been essentially accomplished, while the basic loan risk relevant requirements, i.e. the efficient real estate registration system and the efficient payables recovery system, have not yet been achieved. Despite that mortgage lending system is undergoing successful development.

A) DECISIVE FACTORS FOR THE SUCCESS OF THE POLISH MORTGAGE LOAN SYSTEM DEVELOPMENT WERE:

- Rapid commercialization of the banking sector and intense competition among banks;
- Experience of the PKO;
- Expiration of the co-operative housing loans in 1996;
- Participation of foreign institutions;
- Poor interest of the authorities in the mortgage loan system and, as a consequence, avoidance of failure of experiments and subsidies;
- Perceptible, progressing stabilization and consumer optimism in the largest cities during most of the analyzed period.

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4 USAID is of a similar opinion, considering that only a partial realization of those postulates is necessary. Cf. Solving Housing Problem, Lessons from Poland and Hungary in Creating a New Housing Finance System, USAID/RHUPO, Washington 2000.
It is very difficult to assess the weight of particular factors. Experience shows that they all were relevant, so that a clear synergy effect occurred. One should stress here the significance of long term, active involvement of foreign institutions, such as the World Bank, the US Agency for International Development, the European Bank for Reconstruction and Development and the Polish-American Enterprise Fund. Those institutions, in particular the World Bank and the USAID, launched very large, multi-year programmers supporting the development of this market. Those programmes were implemented in a sequence (first the World Bank, followed by the EBRD, and finally the USAID), assuring at the beginning the induction, and then, practically until 2000, support to the reform process. They concerned in particular developers and the banking sector. These programmers to a certain extent also had an impact on subsequent governments. In consequence, a mass flow of know-how took place, laying solid foundations for future development, without experiments or failures, typically incurred under such circumstances. Generally, the know-how concerned three areas

- Credit instruments operating under conditions of high inflation. This allowed the launch of mortgage loans already in mid-1990s;
- Standard documents and procedures connected with mortgage lending. They created the basis for future development.
- Experience related to the housing policy.

Assistance to the banking sector was essential in the sense that in spite of privatization of the largest banks and their takeover by renowned, world banking groups, the inflow of know-how from their owners in this area was rather small.

The state owned PKO, a bank traditionally specialized in this sector, also received such assistance. Even though in the process of adopting the World Bank experience, according to the bank’s own concept, major failures could not be avoided (the Alicja loan, based on the DIM type loan), a product was created. It was able to function on the market under conditions of high inflation and a lack of macroeconomic stabilization. The PKO’s significant success on this market demonstrated to other commercial banks that it was a prospective market, which was worth the effort.

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5 Dual Index Loan (DIM) is a special mortgage instrument developed for economies with high inflation. The borrower payment is set up once at the beginning and then adjusted by the income index. This payment in long run should cover real interest rate and principal payment. The outstanding balance is adjusted with the market interest rate. As a consequence part of the nominal interest is capitalized and the mortgage debt rise long time in nominal terms, but should decline in real terms. In practical use this is very complex instrument creating a lot of problems especially in underdeveloped banking system (in countries in which it is usually introduced). It helps to avoid payment tilt problem but increase several new substantial risks.
Further development of the mortgage loan market was only possible after expiration of the old, subsidized loans from the PKO, the legacy of socialism. A considerable success of the above-mentioned foreign institutions, and primarily of the World Bank, was in preventing the continuation of the subsidized loan programme. The USAID, on the other hand, has to be given credit for its large contribution in preventing the development of a contractual credit system based on German patterns (Bausparkassen). The examples of the Czech Republic and Slovakia show that a mass introduction of contractual saving schemes (Bausparkassen) is blocking the mortgage market development.

Another important factor was a relatively quick privatization of the banking sector, accompanied by a rapid growth of competition. It forced the banks to enter the retail banking sector and to search for new, unexploited areas.

Since mortgage loan programmes were operated by foreign organizations, which intentionally separated themselves from budgetary subsidies, this area hasn't been included in the official housing policy, especially after 1995. Thus, fortunately, experiments and changes in policies typical for cabinet changes, as well as idle promises, were avoided. At the same time, due to a fully commercial character of the market, favorable effects of competitive pressure, such as a wider variety of products offered, a reduction in banks’ margins and an improved service quality, became observable.

Another decisive factor, along with the involvement of foreign institutions, was the progressing economic stabilization and an increase in consumer income and optimism, in particular in the largest cities. This factor had a significant impact on banks, convincing them that the risk of mortgage loans is decreasing, and on consumers, persuading them to invest in real property by taking mortgage loans.

In consequence, the mortgage loan market got started without an efficient system of registration and debt collection, and with high interest rates. The banks compensated and still compensate their risk with relatively high margins and the still low average LTV (loan-to-value) ratio (the loan amount to the value of real property) which is still not more than 70%, on average. Further development of the market, understood as a further decrease in margins and increase in availability of loans, in order to be economically reasonable and not result in an excessive increase in risk, requires a limitation of risk connected with registration of property and collection of bank claims, as well as a firming macroeconomic stabilization. The latter factor, in particular, through a decrease in interest rates, has proven to be of crucial importance for the increased availability of mortgage loans to the average citizen.
The Polish system of mortgage banking has been created and has grown on the basis of universal banks and just one specialized bank. Other solutions have not gone beyond the experimental stage so far.

B) THE MORTGAGE FUND.

As far as the concepts of refinancing loans are concerned, until mid-1990s American concepts (securitization, central mortgage bank) dominated as target solutions for the period after the possibilities of financing with deposits were exhausted. In practice, due to the availability of resources and their cost, commercial banks and the PKO BP financed lending based on the short-term deposits of population, which prevailed in the banking system.

The project of the Mortgage Fund, the World Bank launched in mid-1990s, was based on the model of the Central Mortgage Bank refinancing the universal banks, with a mortgage portfolio. Initially the Mortgage Fund was fed from the budget resources and the resources of international organizations — ultimately it was to issue mortgage bonds. In the initial period they were to be supported by the government and international organizations. That is why the Mortgage Fund very restrictively and successfully watched over the quality of refinanced loans and the standardization of procedures.

The Mortgage Fund, and in particular the whole programme, including the technical assistance programme financed by the World Bank, the EBRD and the USAID, despite its large impact both on the credit standards and — indirectly — on the PKO BP (product), developers, and finally, on the government’s housing policy, proved to be a fiasco in commercial terms. Apart from other factors, which contributed to the lack of success, such as excessive liquidity of the banking system (especially in big banks), still poor demand, and a complicated product, the essential factors proved to be the following: banks’ reluctance to subordinate themselves to the rigours of standard credit procedures and ongoing monitoring of their portfolios, as well as (despite the hidden subsidies), a relatively high cost of resources in comparison to deposits. The high cost of resources was connected to the existence of the intermediary — The Mortgage Fund. However, the psychological aspect was equally important, since banks did not agree to share their profits with an institution, which practically bore neither the credit risk nor the costs of building the portfolios.

In view of poor results of the Programme, the generally low demand for mortgage loans and the lack of interest of commercial banks in the Mortgage Fund, the World Bank practically withdrew from active participation in it in 1996. At the same time, starting from 1996, there was a considerable increase in demand for mortgage loans, which soared in subsequent years. In spite of that, negotiations undertaken on a number of occasions by the USAID (being the only one
remaining foreign sponsor of the Programme in 1997–1998), on the privatization of the Mortgage Fund based on commercial banks as future owners, indicated a complete lack of interest of the latter. A failure of the Programme shows that the Polish banking system was not mentally ready for an advanced, two-tier mortgage system, notwithstanding whether it was compatible with the concept of securitization or of the central mortgage bank system.

German initiatives for a combined system of mortgage banks and the system of contractual loans, the so-called Bausparkassen, reached Poland in 1996. They both had been modelled on the solutions functioning in Germany and in several other European countries.

C) THE ACT ON MORTGAGE BONDS AND MORTGAGE BANKS

This Act passed practically without any comments from either the community of Polish bankers or the theoreticians of financial systems. It resulted from the still modest significance of mortgage loans in the banking system and a low level of knowledge in this area stemming from it. The problems, which the Act solved, i.e. the system liquidity and the potentially cheaper funds from the capital market were of no significance to the Polish situation, or the proposed solutions did not manifest the assumed benefits.

In the years 1997–1999 the situation on the mortgage loan market in Poland was subject to a number of changes. The decrease in inflation and interest rates was accompanied by a considerable increase in demand for mortgage loans and the banks increased their interest in the product. Acting under the Act, the first three mortgage banks were established, and actions were also undertaken to establish further three. However, the Act did not meet the expectations, proving to be both too restrictive and poorly adapted to the Polish legal system, as well as to the already entrenched practices applied on the mortgage loan market. The newly established mortgage banks could not enter into competition with the universal banks, due to a considerable limitation of the scope of their activities, a lack of a distribution network and more costly funds coming from the capital market.

Two of large universal banks withdrew from the concept of establishing mortgage banks, and a third one stopped its actions taken in that direction. Certain concepts of amending the Act appeared, among others allowing the issue of mortgage bonds by universal banks. In 2002 an initiative was undertaken to adapt the Act and related regulations to the conditions prevailing on the Polish mortgage loan market, via some eased prudential ratios and extension of the scope of banks’ eligible activities. Despite that, mortgage banks still constitute a marginal part of the market.
Except for the mortgage banks, which under the Act were subject to strict control, the mortgage activity of universal banks was subject to banking supervision according to general principles. It was connected with a low level of housing portfolios and their good quality, not differing from the international standards (the share of irregular loans is below 3%). The situation started to change in line with an increase in the share of mortgage assets in total banks’ assets and a decrease in the quality of portfolios.

Their quality is still good in comparison with other loans, but the share of irregular loans is systematically increasing (3.2% in 2000, 4.5% in 2001, 5.9% in 2002). Taking into account a high growth rate of the portfolios and the usual 2-3-year period after which the problems start to appear, a further increase in irregular loans may be expected, particularly when the growth rate start to fall. In the year 2001 principles of the mortgage and housing income control were implemented, and in the year 2004 the weights of risk on mortgage assets were made dependent on the LTV ratio.

4. FINANCIAL INSTITUTIONS

In the initial period of transformation, i.e. in 1990-94, the PKO BP had a monopolistic position on the residential property market. Therefore the development of that market was to a large extent conditioned upon its loss of such a position.

Loans granted to housing cooperatives still during the socialist period constituted the principal part of the PKO BP’s portfolio. Starting from 1994 there were already three entities on the market: the PKO BP, the PAMBank and several other banks grouped around the Mortgage Fund programme operated by the World Bank, with the PBG Bank in Łódź being the largest. The PKO BP and the PAMBank had two distinct strategies targeted at two different income groups: PKO BP — at the mass customer with a relatively low income (loans of the PKO BP were indexed and subsidized by the state), the PAMBank — at the elite customer with the highest income. The Mortgage Fund was located somewhere between those two groups.

In 1995 the state budget ceased to subsidise the mortgage loans of the PKO BP, and the Bank reacted by stopping the programme. New, indexed and not subsidized products (double indexed and a single index) were launched by the PKO BP in the last quarter of 1995. In this year cooperative projects signed in years 1988-1990, financed by highly subsidized loans practically expired, so there were no more cheap cooperative flats on the market. The resulting gap was filled up by other banks, which in such circumstances could enter the market with
their own, commercial products. In the subsequent years the PKO BP was gradually losing its monopolistic position on the market.

In spite of the loss of actual monopoly, the PKO BP retained its important position on the market. The essential factor was its huge distribution network and experience of its branch offices in granting housing loans, including the indexed ones. Another important factor was its image of a housing bank in the public and its identification with preferential loans, redeemed by the state.

An important element of success were its products. From 1995 to mid-2000 the PKO BP offered its own indexed loans: the indexed and the normative loan. The former was a single index loan with partial indexation; the latter was a classical DIM-type product with a regionally determined index of repayment only. It was complicated and difficult for the bank, not clearly understood, but anticipating a reduction in interest rates and favourable to the customer, particularly in the initial period. The bank had always calculated those loans incurring a considerable risk, counting on the support from the state.

The PKO BP as a bank also had a specific position, incomparable to other banks, taking into account its size, nationwide character and loyalty of a part of its customers. It assured the position of a leader on the domestic deposit market and allowed the bank to finance long-term loans, including deferred repayment loans financed by short term deposits.

Starting from 1998 the PKO BP was under increasing pressure from its competitors, who offered denominated loans as a financial instrument applied under high interest rates conditions. In line with the growth in competition and exhaustion of the best market of rich customers, all banks started deepening the market - to the customer with the average income, the traditional PKO BP customer. At the same time problems with the quality of double indexed loans portfolio stood behind the bank’s withdrawal from such instrument in 2000 and its temporary withdrawal from the mortgage loan market. The Bank did not offer other competitive products, in particular the denominated ones, and limited promotion to a considerable extent. Thus it lost again a large part of the market to the competitors. Starting from the year 2003 a renewed increase in the activity of this bank could have been observed.

At present practically all-large and medium-sized banks offer housing loans. From the beginning of the 90s the following banks actively compete with the PKO BP: Polish-American Mortgage Bank, currently GE Capital Bank (PAMB/GE), Powszechny Bank Gospodarczy SA (PBG), currently incorporated into the PKO SA, Bank Inicjatyw Społeczno-Ekonomicznych SA (BISE), Powszechny Bank Kredytowy S.A.(PBK), currently merged with the Bank Przemysłowo-Handlowy(PBH). In mid-90s they were joined by: PKO SA, Bank Śląski, Credi-
tanstalt SA, LG Petrobank. Other banks entered the market mainly in the years 1997–1999.

As a result of those processes the structure of the market has been changed: from a monopolistic position of the PKO BP, through the PKO BP as the market leader, to a market with a high level of concentration (five largest participants hold about 80 % of shares).

Rough estimates of market shares and their growth dynamics for the largest market participants are presented in Table 2.

Table 2. Estimated mortgage loan portfolios in the Polish housing sector, %
(biggest players, as of December 31)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>PKO BP new portfolio</td>
<td>73.6</td>
<td>74.6</td>
<td>71.5</td>
<td>68.7</td>
<td>59.8</td>
<td>50.1</td>
<td>40.7</td>
<td>36.0</td>
<td>35</td>
<td>34</td>
<td>33</td>
</tr>
<tr>
<td>PKO SA</td>
<td>2.0</td>
<td>2.1</td>
<td>4.4</td>
<td>10.3</td>
<td></td>
<td></td>
<td>12.6</td>
<td>13.1</td>
<td>10</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>PBG</td>
<td>3.4</td>
<td>5.7</td>
<td>5.3</td>
<td>4.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PAMB/GE</td>
<td>14.1</td>
<td>8.7</td>
<td>6.5</td>
<td>4.0</td>
<td>3.2</td>
<td>4.8</td>
<td>7.6</td>
<td>7.9</td>
<td>10</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>WBK</td>
<td>0.2</td>
<td>1.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4.5</td>
<td>6.3</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Bank Zachodni</td>
<td>0.7</td>
<td>1.0</td>
<td>0.7</td>
<td>1.0</td>
<td>1.6</td>
<td>1.0</td>
<td></td>
<td>4.5</td>
<td>6.3</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>BPH</td>
<td>0.9</td>
<td>0.6</td>
<td>2.3</td>
<td>6.9</td>
<td></td>
<td></td>
<td></td>
<td>11.2</td>
<td>10.2</td>
<td>14</td>
<td>15</td>
</tr>
<tr>
<td>PBK</td>
<td>3.7</td>
<td>3.4</td>
<td>3.7</td>
<td>5.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kredyt-Bank</td>
<td>0.7</td>
<td>1.3</td>
<td>1.5</td>
<td>2.0</td>
<td>3.4</td>
<td>4.6</td>
<td>5</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage banks,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.3</td>
<td>0.5</td>
<td>1.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s own calculations.

5. MORTGAGES AND HOUSING LOANS, THEIR PRICES AND TERMS

The quantitative development of the Polish mortgage and housing loan market is accompanied by a development of lending instruments, although in comparison with developed market economies, the variety of its products is still rather modest. From its very beginning a characteristic feature of the Polish market has been a high share of indexed loans. At the beginning of the 1990s double indexed product, offered mainly by the PKO Bank, prevailed on the market, but at the beginning of 2002 products indexed to the exchange rate were dominant. While the former ones provided a hedge against high inflation, the latter protected against high real interest rates, at the cost of exposure to the foreign exchange risk.

Another characteristic feature is a short repayment period in comparison to the offered possibilities. In spite of the already mentioned considerable extension

6 Cf. J. Łaszek, op. cit.
of the maturity of offered loans, it is estimated that products with a maturity of 10-15 years prevail, and such is the real life cycle of the products. **Prepayments** are still common, and the share of loans refinanced in other banks also increases in line with the increase in competition.

The third characteristic feature is a **relatively small size of the loans**. This is a consequence of low incomes, high interest rates that used to prevail over a long period of time, prudential policies of banks and borrowers’ attitude.

**Table 3. Indexed vs. traditional housing and mortgage products on the market (estimate, as of Dec. 31)**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total loans (USD mln*), of which</td>
<td>238.4</td>
<td>378.3</td>
<td>553.2</td>
<td>854.4</td>
<td>1,471.5</td>
<td>2,195.4</td>
<td>3,425.1</td>
<td>4,890.8</td>
<td>7,617.3</td>
<td>9,851.1</td>
<td>15647.3</td>
</tr>
<tr>
<td>Zloty loans (%), of which:</td>
<td>99.84</td>
<td>98.02</td>
<td>92.15</td>
<td>91.28</td>
<td>91.05</td>
<td>77.24</td>
<td>50.27</td>
<td>41.30</td>
<td>36.80</td>
<td>43.34</td>
<td>36.38</td>
</tr>
<tr>
<td>Indexed zloty loans (%)</td>
<td>10.37</td>
<td>42.18</td>
<td>53.44</td>
<td>58.95</td>
<td>53.10</td>
<td>33.08</td>
<td>22.46</td>
<td>8.52</td>
<td>3.45</td>
<td>2.01</td>
<td>1.50</td>
</tr>
<tr>
<td>Denominated loans (%)</td>
<td>0.16</td>
<td>1.98</td>
<td>7.85</td>
<td>8.72</td>
<td>8.95</td>
<td>22.76</td>
<td>49.73</td>
<td>58.70</td>
<td>63.20</td>
<td>56.66</td>
<td>63.62</td>
</tr>
<tr>
<td>Indexed and denominated zloty</td>
<td>10.53</td>
<td>44.16</td>
<td>61.28</td>
<td>67.68</td>
<td>62.05</td>
<td>55.84</td>
<td>72.19</td>
<td>67.22</td>
<td>65.90</td>
<td>58.67</td>
<td>64.64</td>
</tr>
<tr>
<td>loans (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth of portfolios (USD mln *)</td>
<td>92.2</td>
<td>139.9</td>
<td>174.9</td>
<td>301.2</td>
<td>617.1</td>
<td>723.9</td>
<td>1,230.3</td>
<td>1,464.3</td>
<td>2,726.5</td>
<td>2,166.2</td>
<td>5,803.8</td>
</tr>
</tbody>
</table>

Source: NBP data, own calculations

* year average UDS/PLN

**The average size of loan granted** in the years 1997−2000 varied at the PKO BP between PLN 30,000 and PLN 40,000 (roughly USD 7-10.000), at the BPH SA between PLN 40,000 and PLN 50,000 (USD 10-12,500), at the PKO SA between PLN 60,000 and PLN 70,000 (USD 15-17,500), and in the case of loans drawn from the Mortgage Fund — between PLN 50,000 and PLN 60,000 (USD 12.500-15.000). Surveys conducted in the years 2000-2002 by the Polish Bank Association indicated that the average size of loan varied from PLN 50,000 to PLN 60,000 (USD 12,500-15.000). As for mortgage loans then, those amounts were relatively small.

Loans offered within the framework of the Mortgage Fund are typical examples of double indexed loans, where the interest is calculated with an index of 13-week treasury bills plus the 1–2% margin of the Fund plus the margin of the participating bank. The GUS (Official Statistic Bureau) average wage index was applied as the repayment index. At present only the BISE offers them.
As already mentioned, from 1995 to mid-2000 the PKO BP offered its own indexed loans: the indexed loan and the normative loan. The PKO BP loans in the years 1995–2000 were based on the interest rate of 12-month deposits at 5 largest banks excluding the PKO BP, plus the bank margin amounting to 5 percentage points.

The basic segments of mortgage housing loans in Poland are the loans that serve to finance: newly built flats, flats purchased from the existing stock of residential property, and repairs and modernizations.

**Classic mortgage loans**, i.e. loans for the purchase of the existing flats, built by a developer or purchased from the existing stock, constitute certainly some 50–60% of the banks’ portfolios. According to the NBP data the portfolio of mortgage loans amounted at the end of December 2005 to over USD 15 billion; it is not known, however, what part of the existing portfolio would receive mortgage collateral.

The remaining part of banks’ portfolios is composed of mortgage construction loans, aimed at individual customers for advance financing of the construction costs of a flat, (by a developer or a building co-operative), and of housing loans. In the case of mortgage construction loans, the mortgage collateral appears within a long period of time (following the completion of the construction of flats and the establishment of a perpetual book) or does not appear at all, where the loan is repaid before the maturity date established in a loan agreement. Creation of such a product was enforced by the developers’ market, imposing the advance financing for flats under construction, and still unsold newly built flats for which the developer is still unable to secure a mortgage loan. The classic mortgage loans are, at the initial stage, (due to the time-consuming process of registering mortgage claims at the perpetual book courts or the necessity of establishing a perpetual book), most frequently secured at an insurance company.

From the point of view of the loan size, its maturity, valuation and collateral, it is possible to make a distinction between mortgage and housing loans, although such a distinction does not exist in official analysis.

**Housing loans** are not secured with a mortgage, their maturity period is up to five years and they amount to below PLN 30,000–50,000 (USD 7,500-12,500). These are usually repair loans, or supplementary loans at the purchase of a real property. Loans exceeding these amounts may be qualified as mortgage loans. As an alternative security to the mortgage, the PKO BP offered loans pledged by shares in the Pioneer investment fund.

Taking into consideration the availability, the mechanism of repayment and the hedging against inflation, the market offers loans to be repaid according to the annuity formula, the so-called averaged repayment loans, the so-called decreasing installment loans, denominated loans, i.e. foreign currency-indexed loans and double indexed loans.
In most cases loans offered by banks are *classic variable interest rate housing loans*. In the repayment formulas of loans financing the purchase of a flat or a house, systems of decreasing repayments or annuity repayments prevail. Only certain banks applied the averaged repayments formula. Apart from the Mortgage Fund programme and the PKO BP and the PBK, none of the banks offered loans with the double indexation formula or the formula of deferred payments.

At the beginning most banks based the interest rates of their products on the so-called *bank’s base rates*, which usually included bank’s costs of funds, risk premium and profit. They varied as a result of changes in costs or the market competition. Now, similarly to countries with developed lending market, most banks use external indexes, such as central bank interest rates or cost of money on the interbank market (the most popular ones: WIBOR 3M and 1M). This is a sign of the ongoing civilizing process of the market and an increase in the importance of the money market as a benchmark of alternative costs. *The capital market*, due to its weakness, is not yet considered to be a benchmark in this respect. In the year 2000 mortgage *loans with fixed interest rates* appeared on the market for the first time.

From the very beginning, the inflation, accompanied by the related high interest rates on zloty loans, has been one of the principal barriers to the development of the market. In the 90s, in particular in the first half of the decade, the interest rates on zloty loans were very high, amounting to several dozen percentage points. This was the reason for the dominance of denominated and indexed products on the market. In a long-term perspective, however, the level of interest rates on zloty loans was steadily decreasing (cf. Figure 2).

Figure 2 Interest rates on housing loans in Poland 1994-2004
The historically lowest level of interest rates on zloty loans was recorded at the end of 1998, only to increase since 1999 by 6–7-percentage points. At that time banks offered housing loans for up to 20 years (e.g. the DOM loan of the PKO SA), with a variable interest rate only, in the zloty or in convertible currencies: USD, DEM, ATS or FFR. The lowest interest rates (on zloty loans) were offered by the BPH (16.15%) and the PKO BP (16.4% p.a. — at the base rate of 11.4%). For loans in convertible currencies the margin added to the index (LIBOR/FIBOR 6 M or 3 M) amounted to 6–8 percentage points. The commissions varied from 0.5 to 3.5% of the loan amount, and only certain banks charged for the application processing and fees for administering the loan.

**Maximum amount of the loan** varied between 60−80% of the real property cost/valuation. The mortgage on the credited property was and still is the basic security required; temporarily, since it is established, some other security is required (endorsement, pledge, guarantee, blockade of funds). The recurrence of inflation in 1999 resulted in an increase in interest rates on zloty loans up to the level of 20–24% in the case of variable rate loans (the fourth quarter of 2000). The fall of inflation in 2001 resulted in a decrease in interest rates on zloty loans to the level of 13–15% (the first quarter of 2002), and a year later even up to 7.5–8%. The competition also forced a decrease in the margin on denominated loans up to 3–4%. Due to the recession and low interest rates, loans denominated in euro, Swiss francs and yen became a hit on the market.

### Table 4. Changes in the basic mortgage credit conditions in the years 2001-2004, as exemplified by three market leaders

<table>
<thead>
<tr>
<th>Bank</th>
<th>Q1, 2001</th>
<th>Q1, 2002</th>
<th>Q1, 2003</th>
<th>Q1, 2004</th>
<th>Maximum repayment period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Interest rates, %</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PKO BP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PLN from 20.3</td>
<td>PLN from 11.31</td>
<td>PLN from 7.28</td>
<td>PLN from 6.48</td>
<td>2001 – 20 years</td>
<td></td>
</tr>
<tr>
<td>USD from 5.9</td>
<td>USD from 4.9</td>
<td>USD from 6.14</td>
<td>USD from 2.99</td>
<td>2004 – 25 years</td>
<td></td>
</tr>
<tr>
<td>CHF from 9.06</td>
<td>CHF from 4.75</td>
<td>CHF from 4.10</td>
<td>CHF from 2.29</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EUR from 10.21</td>
<td>EUR from 6.35</td>
<td>EUR from 5.30</td>
<td>EUR from 3.92</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| **PKO SA** |          |          |          |          |                          |
| PLN from 17.5 | PLN from 9.5  | PLN from 7.24 | PLN from 5.55 | 2001 – 22 years |
| USD from 3.11 | USD from 5.41 | USD from 4.56 | USD from 5.06 | 2004 – 25 years |
| CHF from 7.81 | CHF from 3.98 | CHF from 3.33 | CHF from 4.17 |          |

| **BPH PBK** |          |          |          |          |                          |
| PLN from 20.91 | PLN from 10.7 | PLN from 7.6 | PLN from 6.64 | 2001 – 25 years |
| USD from 10.71 | USD from 5.54 | USD from 4.62 | USD from 2.62 | 2004 – 32.5 years |
| CHF from 9.2 | CHF from 4.80 | CHF from 3.99 | CHF from 1.45 |          |
| EUR from 10.41 | EUR from 6.59 | EUR from 6.15 | EUR from 3.39 |          |

Declining inflation causes a fall of interest rates, whereas competition on the market enforces a gradual decrease in margins, extension of loan repayment periods and better tailoring of loans to the financial conditions of the borrower through the differentiation of the product offering. **Amortization periods** offered
Development of housing finance system in Poland – lessons learned

on the market (up to 35 years) practically do not diverge from those prevailing in the countries with a developed market economy, whereas margins and interest rates still remain higher (cf. Table 4).

In the year 2000 mortgage loans with fixed interest rates were launched on the market. The most spectacular and renowned, through an extensive promotion, was the product of the Deutsche Bank. The bank proposed the interest rate of 15.75%, compensating its risk with a 10% commission (vs. regular 1.5−2%). The loan was granted for a period from 5 to 25 years, with the fixed interest rate binding for the period of 5 years. After this period expired a change in the interest rate level was to take place, or the customer could switch to the variable interest rate. Another offer of this type by the BRE-Rheinhip was of a similar nature. Its interest rate was based on 52-week treasury bills. The refinancing period amounted to 2, 3, 4 or 5 years, and the early repayment fee equaled −2% of the prepaid amount. Both products were then of a highly speculative nature and intended to have a marketing effect; therefore they did not win customers’ recognition.

In 2002, in connection with the decline in inflation and the expected decline in real interest rates, products of that type appeared with interest rates at the level of 12–13%, thus still of a much speculative character. However, starting from 2004 products with a fixed interest rate at a level close to the market conditions began gaining popularity but with the contractual period of the binding fixed rate limited to one or two years. Therefore an increase in the popularity of products with fixed-variable interest rates, common in Europe, may be expected.

A product that has already been present on the market to a limited extent, and now is increasing in its popularity is the insurance of the pledge on a loan. In Poland, due to high interest rates, the loan-to-value (LTV) ratio at the level of 75–80%, applied by the banks, was a barrier the borrowers could not cross. A decline in interest rates, introduction of indexed loans and differentiation of the levels of income among the public resulted in a situation where at the end of the 1990s this parameter remained a barrier only to certain customers. In consequence a product insuring loans up to the level of 100% was launched by certain insurance companies.

The most recent products, an innovation on the market, are credit line type loans. They are patterned after corresponding products offered quite recently in the USA and Great Britain. Just like in those countries, due to their flexibility they may turn out to be a desirable product among customers.

On the other hand the offering of the lease-back products (allowing the capital invested in property to be regained without changing its ownership rights) is relatively poor. Loans pledged by mortgage are offered by most of the large commercial banks, while no products of the Reverse Mortgage type have been launched in Poland.
New phenomena are also taking place in mortgage products distribution. In the 1990s, basic distribution channel consisted of a network of branch offices. The development of insurance and pension funds at large banks induced the involvement of brokers working for those funds in the sale of mortgage products. However, their share in total sales has never become dominant, similarly to the sale of products performed by developers and real property agents. After 2002 large domestic and foreign companies, acting as an intermediary in the sale of consumer credit, also got interested in that market. Their market share shows an increasing tendency. According to surveys, certain retail banks, in particular the smaller ones with a lower capital base but with good access to customers, are also interested in the intermediation or resale of mortgage loans.

6. Banks’ Prudential Regulations

Among the banks’ prudential regulations, which are another factor limiting the availability of mortgage loans, the following are most often adopted:

Debtor income: documented fixed income from the last six months minimum. At higher customer-specific risk banks may request documented income from the last year or even last two years. Income amounts usually adopted by banks are at minimum 1.5 of the average salary in the country and not less than 0.5 of the average salary, or the minimum salary per family member, remaining after payment of monthly payables (the loan and other monthly liabilities). Maximum 38% share of loan repayment in debtor’s income (MDR) is usually considered by banks as a safety threshold. Some banks do not apply the minimum income surplus requirement and calculate MDR at low level of 25%.

Profession or occupation in the industries, in which no downturn of positive growth trends is forecast;

Age: below 50 years, for the longest loans (due to the long term of the loan and the life insurance coverage required by some banks);

Place of domicile/credited property location: because the real estate market is still in its infancy, access to reliable information on the recoverable value of mortgaged properties is limited, and possible eviction out of property are socially disapproved, banks limit themselves to properties located in cities;

Loan to property value (LTV): with no additional security banks in Poland typically accept the 75–80% ratio at maximum;

Security: first priority mortgage on credited property is obligatory, and until the mortgage is set other known banking securities, including loan insurance by an insurance society, are taken;

Valuation: banks commission valuation by external chartered experts or make valuations in-house,
Mortgage loan minimum profitable amount: from time to time some banks used to require that minimum loan amount should exceed PLN 30,000 (USD 7,500).

As already mentioned, only a few years ago in the banking community quite popular was the notion of mortgage loan’s high risk and low profit. Now this is a highly competitive market, which means that banks have better recognised the risk on one hand, and that they have learned how to get along with it on the other. It is compensated with relatively high margins and still low LTV (up to 70% on average). Relatively low mortgage financing is to blame that neither more advanced research of the risks, nor an attempt to manage them has been so far undertaken. Banks are focused on the loan risk mainly and apply quite conservative loan requirements. The discussed requirements are somehow differentiated, which is related to individual banks’ market strategies.

The analysis of banks’ policies from the last five years shows the following two trends: (i) pursuing formalisation and standardisation of requirements, and (ii) some liberalisation of requirements, especially of those practically enforced. This results form certain experience that enables assessment of risk and determination of knowledge and know-how transfers to banks. Approach to debtor income has been particularly liberalised and rationalised and now banks accept also income from specific work and mandated work contracts. All they require now is a document of the income’s long-term availability and apply a risk coefficient. On the other hand practices of extending large residential loans based on assessment of debtor’s last three months income are abandoned.

Whereas originally banks credited up to 50−60% of property value, now they credit up to 80% without special security and sometimes up to 100% (subject to insurance of the top 20% at the same bank), and having the property valued by external or in-house experts is becoming a de facto standard in respect to loan amount exceeding certain threshold. Competition has made banks abandon the mandatory life insurance with transfer of a property to the bank and to cut commissions and fees for considering a loan application.

After incurring rather unfavorable experience (up to 30% of irregular loans), banks have become much more reluctant to finance developers’ investments with classical building loans. They are in fact financed indirectly by construction-mortgage loans, where the entire risk is borne by the future buyer of the flat. The model of developers’ sector in Poland is a separate issue, which has been pending a reasonable solution for a long time.

Generally, since they are already available to high- and mid-income households, from the bank’s safety perspective, mortgage loan’s availability seems to be growing. Banks specialised in loans to mid-income households do not request mortgage as a condition for the loan and apply low TDR index. But a low, 25%
TDR is detrimental for high-income households, so banks specialising in large loans to wealthy households adopt value 38% for the TDR index. Eliminating thus less wealthy customers by means of a high surplus income per family member required remaining after the high TDR index is applied. It may be expected that growing customers’ income as well as the competition shall make the banks to target their offers more to the market „in depth”. Also the state’s rational indirect intervention (loan warranties for low-income households, subject subsidies to loans) should follow this direction.

7. MORTGAGE LOANS, HOUSING NEEDS AND AFFORDABILITY PROBLEM.

Mortgage loans are an important, but just one of the elements determining the development of the sector. Thus questions arise to what extent it will contribute to satisfying housing needs and what are the principal barriers of its development in Poland. Table 5 presents approximate creditworthiness in relation to housing loans of the population divided into deciles group in the year 2002.

<table>
<thead>
<tr>
<th>Docile group</th>
<th>Available credit (PLN)</th>
<th>Available amount of square meters</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>23,000.47</td>
<td>12.78</td>
</tr>
<tr>
<td>2</td>
<td>33,387.77</td>
<td>18.55</td>
</tr>
<tr>
<td>3</td>
<td>40,065.33</td>
<td>22.26</td>
</tr>
<tr>
<td>4</td>
<td>46,742.88</td>
<td>25.97</td>
</tr>
<tr>
<td>5</td>
<td>53,420.44</td>
<td>29.68</td>
</tr>
<tr>
<td>6</td>
<td>60,839.94</td>
<td>33.80</td>
</tr>
<tr>
<td>7</td>
<td>69,743.35</td>
<td>38.75</td>
</tr>
<tr>
<td>8</td>
<td>122,926.37</td>
<td>68.29</td>
</tr>
<tr>
<td>9</td>
<td>149,992.72</td>
<td>83.33</td>
</tr>
<tr>
<td>10</td>
<td>253,747.08</td>
<td>140.97</td>
</tr>
</tbody>
</table>

The estimates were calculated with the use of prudential criteria commonly applied in Polish banks. For lower income groups that do not fulfill the prudential criteria of banks the adopted acceptable proportion of loan cost to income equals 15%. (PLN to USD rate was around 4:1)

Source: Author’s estimates.

Table 6 presents estimates of the overall households creditworthiness in 2000 and 2002 and predictions for the year 2008 in Poland.
Table 6. Global creditworthiness of households in 2002 in Poland

<table>
<thead>
<tr>
<th>Year</th>
<th>2000</th>
<th>2002</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global creditworthiness in billion PLN</td>
<td>15</td>
<td>43.5</td>
<td>60</td>
</tr>
</tbody>
</table>

The presented data indicate that in the period 2000-2002 there was a considerable, nearly threefold increase in creditworthiness of households. It explains the reasons for significant growth and the scale of gain in portfolios. It resulted both from the decline in inflation and the related decline in nominal interest rates on zloty loans, change in the structure of loans towards an increased share of cheaper denominated loans, as well as a decrease in interest rates on those loans. The most important factor in terms of market development — the decline in inflation and the related decrease in interest rates — explains at least 40% of the phenomenon.

Considering changes in global creditworthiness in the horizon of 2008, such impressive changes should not be expected any more, since the increase in creditworthiness of the population achieved in 2002 (to a large extent thanks to denominated loans), has largely discounted the future decrease in interest rates. Consequently, assuming a moderate yearly growth of income at 1.5–2.5%, a yearly increase in creditworthiness to the level of PLN 55–60 billion can be expected. A question arises about the relation of this theoretically calculated creditworthiness to the housing needs of the population and the sector.

The presentation of consumers’ creditworthiness (PLN 43.5 billion) against housing and sector needs (PLN 25.1 billion), presented in Table 7, even under the assumption of a rough estimation of the calculations, suggest that at the macro scale it does not constitute any obstacle to the development of the sector. It shows that the mortgage loan should become the primary instrument for covering housing needs in Poland. The basic tool for increasing the availability of these loans is appropriate macroeconomic policy allowing a low level of inflation and, in consequence, low interest rates to be maintained. State guarantee programmes and targeted subsidy programs should become an important element of the housing policy, allowing housing loans to penetrate the market and reach groups of lower income, who — under general conditions — are crowded out to the social sector or to an undetermined group.
Table 7. Current demand for mortgage loans; housing needs and sector needs
(estimate, PLN billion).

<table>
<thead>
<tr>
<th>Purpose of loan</th>
<th>New mortgage loans issued in 2002</th>
<th>Demand for mortgage connected with potential housing needs (rough estimation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing construction</td>
<td>4.8</td>
<td>7.5</td>
</tr>
<tr>
<td>Repairs</td>
<td>0.7</td>
<td>4.2</td>
</tr>
<tr>
<td>Secondary market</td>
<td>4.5</td>
<td>13.4</td>
</tr>
<tr>
<td>Total</td>
<td>10.0</td>
<td>25.1</td>
</tr>
</tbody>
</table>

The latter have been estimated with an assumption of an increased repair rate to the level of 3% yearly (50% of the value financed with loans), increased number of transactions on the housing market to the 5-6 annually per 1000 households (40% of the value financed with loans), and an increased size of market housing construction to the level of 90-100 thousand per year (60% share of loan in the value).

8. CONCLUSION

Presented estimates show that, contrary to the prevailing opinion, neither the income nor demand becomes the principal obstacle to the development of the housing sector. Changes in consumer preferences toward other kinds of consumption, in particular to the less capital-consuming ones that do not require long years of sacrifices in the form of savings and repayment of long-term loans, seem to be equally important. These behavioral patterns are strengthened with extended tenants protection and highly subsidized rents of flats to let, which, particularly in large cities, have a large share in the market. An important factor limiting the households demand is the high risk of losing money due to the model of housing construction based on advance payments, commonly applied in Poland.

Poorly operating market of construction plots, combined with excessively time consuming procedures for granting a building permission, and a lack of information are to blame for the emergence of strong economic cycles in the housing construction market in large cities. It increases the general risk in the sector and exerts a dampening effect on the building demand and on banks (60-70% of value of the newly constructed units is financed by the loans).

Until the mid-2000 no speculation bubbles appeared that would significantly raise banks’ risk. But from early 2000 onwards the construction market in big cities was growing in cycles, and, considering foreign investment funds’ willingness to speculate on short-term price rise, the first speculation bubbles may be expected soon prompted by supply limitations. A huge raise in prices at the War-
saw market in 2005, resulting mainly from the rigid supply (due to the Spatial Planning Act), is an indication of what may happen in this regard.

In matured market economies portfolios of residential and commercial development financing loans may account for over 30% of all banking assets. As also shows the history of the world banking crisis and so called financial crisis\(^7\) over the last dozen or so years real estate and commercial real estate in particular, were often essential drivers or catalysers of such crisis\(^8\).

In Poland, except a few banks, no real estate loan portfolio volume has yet reached a level that might threaten an individual bank or the banking system as a whole. Since the banks’ activities has been prudential, the problems of this kind were translated into the banking sector only to a limited extent. But, this situation is subject to rapid changes: mortgage portfolios soon will constitute a significant item of assets, and competition will enforce a higher risk. It may then be expected that future experience will not have such an unequivocally positive character for the banks. This leads to the conclusion that Polish banks should start paying more attention to the risk assessment and risk management. Both activities should be controlled by Bank Supervision, whose engagement should be appropriate for growing portfolios.

Also, the portfolio quality so far has not been much different from the international standards of high performance real estate and financial sectors countries. There is no guaranty however that this condition shall not rapidly deteriorate. Yet another better risk control enforcing factor may turn out the banking supervision’s caution requirements. In Poland, in a very basic scope, only the banking supervision controls the banking system’s exposure in the real estate sector, but this is sure to change as the mortgage financing grows in scale. On the other hand the market complexity should be expected to grow further and new risks should be expected to appear.

Another problem to solve is a better consumer protection (it hasn’t also been really solved in EU yet). Although Poland has adopted general rules concerning consumer loans and mortgage loans, mortgage agreements and consumer information, are in many cases unfavorable for the clients.

The problem of entering the mortgage market is in many cases connected with the required down payment. This problem may be solved by contractual saving system or a mortgage insurance. So far experiences with contractual saving systems, especially similar to closed German model were unsatisfying, but politicians and lobbyists introduced these systems in an inconvenient economic environment. Private insurance’s systems covering different risks (especially long

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\(^7\) Michael Lea (1999b)

registration of the mortgage) are developing gradually and successfully in the sector, so this way may be a logical choice for housing policy makers.

Challenges connected with the development of mortgage system address the issues which have been solved in different ways in other countries. So far the Polish system is based on universal banks, household deposits, and variable interest rates, but future development will raise interest rates and liquidity risk, so access to the capital market will be necessary.

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