
BANK AND CITY ASSESSMENT REPORT

Prepared for: USAID/Moscow

***DEVELOPMENT OF A REAL ESTATE MORTGAGE FINANCE MARKET
IN THE RUSSIAN FEDERATION***

*Contract No. EPE-0005-I-00-5070-00
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BANK AND CITY ASSESSMENT REPORT

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A. Our approach

Over the past several weeks, the Barents Team has worked on Phase I of the USAID Task Order. Our work focused on developing a preliminary understanding of the commercial real estate finance market in Russia and identifying potential pilot financial institutions and cities with which to work on developing the legal, regulatory and institutional infrastructure needed to support commercial real estate finance transactions.

Prior to visiting potential city and financial institution candidates, the team developed a set of selection criteria, which is explained in more detail in the next section. In addition, the team met with other USAID contractors, donor agencies and parties interested in real estate finance to understand their role in developing a commercial real estate market in Russia, how their work relates to our program, and which financial institutions and cities might be best to visit. Information was obtained on which cities were reform-oriented, involved in real estate finance, and had privatized a number of enterprises, land and residential properties.

The individuals/organizations with whom we met, outside of financial institutions, include:

	Moscow	Outside Moscow
Contractors	Urban Institute - Housing Reform - Ray Struyk/Jamie Cook REIS - Chemonics International - Richard Shepard REIS - Arthur Andersen - Leland Bunch World Bank - Construction Lending- Don McCarthy Public Information/Education Campaign - Alan Anderson	REIS - Pskov Novgorod St. Petersburg
Associations	Association of Mortgage Bankers Association of Russian Bankers The Russian Guild of Realtors	Leontief Center - Social and Economic Research/St. Petersburg
Other	RPC - Robert Matthews/Olga Grigorieva	Chief expert from Oblast Committee for State Property, Yaroslavl

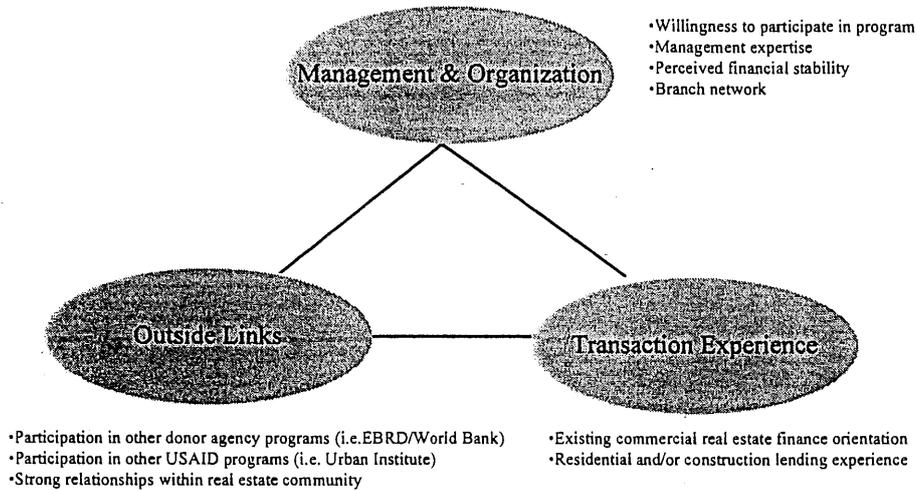
Based on information obtained in these meetings and on our selection criteria, we strategically selected cities and then banks to visit, to evaluate commercial real estate financing activities, obstacles to those activities, and the extent to which local banks were developing alternative methods to overcome these obstacles.

We interviewed several banks in each city visited. These banks were chosen because they met several of our bank criteria and/or were recommended as potential candidates by sources including other contractors who are currently providing technical assistance to the banks on real estate-related activity, such as residential and construction finance. We also drew on the resources of other Barents projects operating in Russia.

B. Bank selection criteria

Our bank selection criteria falls into three general categories (see chart) :

BANK SELECTION TRIANGLE



In general, the time frame allotted for this pilot project is very short. Consequently, we want to identify institutions that will allow us to quickly “add-value” to their current activities--either by improving the transactions they are presently doing, or by introducing a new and attractive activity to a willing and enlightened management that will help assure that the pilot project proceeds as far as possible in the following months.

Management & Organization

Willingness to participate in the program. A bank’s willingness and commitment to participate in the program is clearly a primary factor in the project’s success. To assess this, we evaluated the bank’s ability to commit time and resources to the program--i.e. by providing qualified personnel to work closely with on-site advisors, who are open to foreign technical assistance, and who are creative and willing to introduce changes to improve existing practices.

Management expertise. If management is knowledgeable about commercial real estate finance, the project will be more likely to get up and running quickly. More will be achieved in the limited time frame given for the pilot project. In addition, knowledgeable managers can contribute to the project’s intellectual leadership component. Thus, within each bank we evaluated whether the bank had qualified professionals trained in credit and

underwriting analysis, asset/liability management, collateral valuation, and legal issues. In addition, we assessed whether the bank had an operating commercial real estate finance department.

Perceived financial stability. A particular relevance for financial stability in this regard is that it improves a bank's ability to participate in the CRE market--to attract quality clients and funding at a reasonable cost and, to the extent possible, with attractive maturities. In addition, adequate capitalization increases a bank's ability to invest longer term and provides a cushion against losses due to interest rate fluctuations.

Branch network. A branch network may be important to the project's roll-out component. Thus, a bank with branches that can provide CRE financing in a locale with real estate infrastructure in place, including staff, is in a better position to deliver more products to more customers and to expand pilot efforts across the country.

Transaction Experience

Existing commercial real estate finance orientation. We would like to work with banks that are already booking commercial real estate finance transactions, so we can concentrate on improving transaction procedures and documentation as well as providing ideas for expanding their credit extension capabilities. Therefore, we assessed whether a bank is currently involved in some type of commercial real estate finance, *e.g.* making loans to small and medium sized businesses which are buying their facilities; has developed alternative methods to overcome legal and economic obstacles; and has established a commercial real estate/mortgage department.

Residential and/or construction lending experience. Banks that are doing residential and/or construction lending would be familiar with a myriad of real estate-related issues of importance to this project such as property appraisals, collateral documentation, feasibility studies, etc. They would be more likely to expand into commercial real estate finance faster than banks that are not involved in housing/construction finance. Thus, we assessed each bank's capabilities and experience in these two areas.

Outside Links

Participation in other donor agency programs. Bank's that are participating in other programs such as the World Bank Financial Institution Development Project have demonstrated a desire and/or an ability to compete on an international basis. In addition, banks that were selected by the World Bank already have been pre-screened for financial soundness to some extent. Thus, banks that are participating in this program would be attractive candidates given our limited time to adequately assess their financial viability.

Participation in other USAID programs. Bank's that are participating in other USAID programs such as the Urban Institute's project on Housing Reform have demonstrated

their willingness to work with technical advisors on developing their capabilities in mortgage lending and openness to new ideas. Banks that also participate in our commercial real estate program will be able to take advantage of the synergistic benefits of these real estate-related programs.

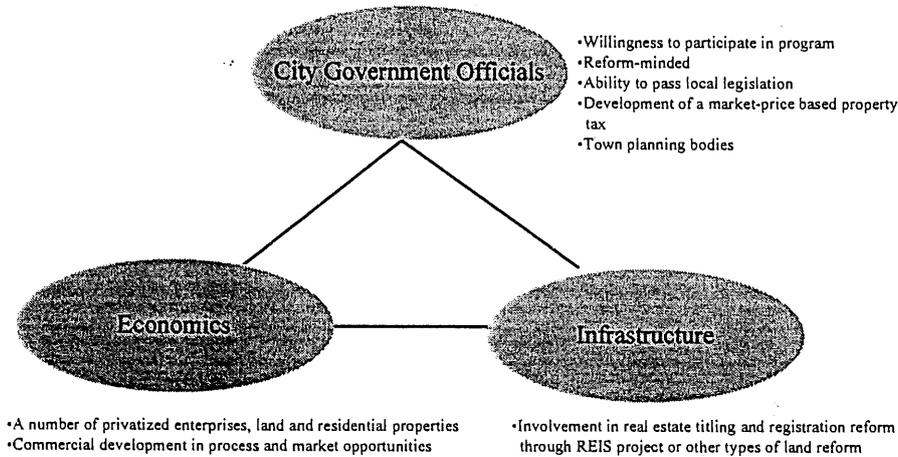
Strong relationships within real estate community. Banks that have strong relationships and contacts with developers, contractors, insurance companies, associations and guilds would be attractive candidates for our program--especially with regard to the intellectual leadership component. These banks will be able to discuss and exchange ideas with all of the players in the market ensuring that everyone's concerns/opinions are taken into consideration.

In summary, while conducting our bank assessment we targeted banks that would possess the majority of our selection criteria. However, the successful implementation of our project within the nine-month timeframe will depend greatly on several factors, in particular the bank's willingness to participate in our program and its experience in either commercial real estate finance, residential and/or construction finance. These factors weighted most heavily in our preliminary assessments.

C. City selection criteria

Our city selection criteria also can be grouped into three general categories (see chart) :

CITY CRITERIA TRIANGLE



As with the banks, we wish to work in cities where we can make the most progress in developing the legal and institutional infrastructure to encourage bank lending to commercial real estate transactions. Of most importance is the city's willingness to work with us, whether there is an existing REIS or registration system in place, and the local demand for commercial real estate transactions. The criteria listed below were used in making preliminary assessments of cities visited to date and will be employed more vigorously in the project's coming month.

City Officials

Willingness to participate in the program. As with the banks, this is a very important criteria in our city selection. It includes assessing the city government's willingness to play a role in the development of a commercial real estate finance market and openness to foreign technical assistance.

Reform-minded city government officials. This includes evaluating whether city officials have been proactive in their city's development, for instance-by supporting housing construction, housing management and maintenance, investment, urban planning reform, and infrastructure financing. In addition, the city authorities' ability to cooperate with private developers will help foster growth in commercial real estate finance. (For example, the city allots a construction site and installs the necessary infrastructure at its

own expense while private developers undertake the construction of commercial housing and other commercial properties.)

Ability to pass local legislation. The city's ability to take the initiative on legislative and registration reform issues will contribute to the successful implementation of our project--especially with regard to drafting and adapting recommendations on gaps in the legal framework for mortgage lending. We are targeting cities that have taken the initiative to approve documents and/or laws regulating mortgage lending at the local level.

Development of a market-based property tax. City governments that are actively involved in changing property tax procedures, for instance those that take into account market prices for property, and promote effective use of urban land, will be attractive to the project and help improve property valuation and information reporting on market prices and land-users.

Town planning bodies. The team would also like to work with city governments that have been active in preparing plans for land use (i.e. zoning plans) which will allow for issuing construction permits and promoting land privatization. This will help apportion sites to private investors, issue building permits in a timely manner, and so generate the need for financing.

Infrastructure

Involvement in real estate titling and registration reform through the REIS project or other types of land reform. A REIS city or a city with a registration system already in place will advance the timing of the project, making registration and information less of an obstacle to transactions. Our analysis will include looking at the composition of information on properties under registration, such as the land plot, structures, and sales results and the city government's capability and experience in registering and releasing mortgage transactions and discovering prior liens and encumbrances.

Economics

A number of privatized enterprises, land and residential properties. The number of enterprises with privatized land sites is an important factor, as it may increase the opportunity to provide mortgage financing to an enterprise seeking to purchase its property/building or renovate an existing building. Our evaluation includes the extent to which land is owned and where sites are available for private ownership; commenced sales of land on which privatized enterprises are situated; and the extent of housing/apartment privatization.

Commercial development in process and market opportunities. Certainly the economic opportunities that promote the demand for commercial real estate financing is important. Therefore, we evaluated the extent of commercial development activity in process and the

potential for growth in this area and market demand for commercial type properties such as office building, business centers and retail shops.

In summary, while conducting our city assessment we targeted cities that would be most likely to possess the majority of our selection criteria. However, our preliminary recommendations were based upon cities that have the most important selection criteria, namely, a REIS system, reform-minded officials, the ability to pass local legislation and commercial real estate market opportunities.

D. *Preliminary assessment*

1. *Pilot Cities*

During November and early December, the team visited four cities: Moscow, St. Petersburg, Novgorod, and Pskov. These cities were selected on the basis of discussions with several USAID contractors, the World Bank, and other sources noted in the table in Section A. Below is our preliminary analysis of how these cities met our selection criteria:

- ***Moscow*** - Moscow met several of our city selection criteria including the city's: attractive opportunities for property development; location for leading financial institutions; ability to register mortgage transactions; and the amount of CRE financing taking place.
- ***St. Petersburg*** - St. Petersburg met several of our city selection criteria including: participation in the REIS project; reform-minded city administration; proactive administration in the development of a city code for registration of land transactions which will serve as a model for the draft Federal Law; attractive commercial real estate opportunities; number of enterprises (51) that have bought out land; number of enterprises (682) that submitted buy-out applications; and number of enterprises (41) located in central city districts.
- ***Novgorod*** - Novgorod met several of our city selection criteria including: participation in the REIS project; reform-minded city government; experience in registering (20) mortgage transactions in town, including (3) housing loans with the remaining being commercial mortgages; industrial sites being accepted as collateral for loans; centralized land registration functions; number of enterprises (4) that have bought out land; number of enterprises (2) that submitted buy-out applications; number of enterprises (3) located in central city districts.

However, our visits to these cities focused predominantly on meeting with bankers. Consequently, the team in January will revisit each of these cities, and will meet with city officials and other, non-financial institutions to gauge more intensively whether the city is appropriate for the project. (In addition, the team also evaluated and met with banks in Pskov, but at this point has decided not to pursue work in that city because of the limited market opportunity and the lack of banks experienced or active in CRE).

During January, our team will also identify other potential pilot cities to investigate, using information from those sources noted above as well as others. Again, of particular importance will be whether the city has a REIS or registration system, attractive ELS

candidates, Housing Finance-supported banks, and/or a very attractive bank with which to work (as in Irkutsk, where the progressive East Siberian Savings Bank is located).

2. *Financial Institutions*

Our plan is to assist at least two Moscow based financial institutions and two to three banks outside Moscow. Our assistance to Moscow-based financial institutions will consist of infrastructure building, including improving current policies and procedures, and/or building a relationship to create an exchange of new ideas and information on how to resolve current obstacles to financing commercial real estate transactions. Our assistance to banks outside Moscow will consist of infrastructure building and transferring knowledge and ideas to bank management obtained from market leaders in Moscow, to the extent they are relevant.

Of the banks interviewed in Moscow, St. Petersburg, Novgorod, and Pskov (see Appendix B), the team found the following to be candidates that should be pursued further:

a. *Moscow based:*

The team met with five banks in Moscow, each of which expressed considerable enthusiasm about working with the project (detailed meeting notes are included in Appendix A). Stolichny Bank and MosBusinessBank appear to be strong candidates for the program. Both banks are already doing commercial real estate transactions and could use assistance to improve their current operations and to identify ways to circumvent obstacles to commercial real estate finance.

Stolichny Bank is more advanced in its transactions and ideas. Our team could assist the bank in improving its procedures and also use the bank for exchanging and developing ideas on how to move the commercial real estate market forward. MosBusinessBank is less advanced; it could use more assistance for improving its procedures but also contribute to the exchange of ideas. By working with these two banks, or banks similar to them, the team could likely make practical contributions for improving commercial real estate financing transactions.

- ***Stolichny Bank*** - Stolichny Bank met several of our bank assessment criteria including willingness to participate in our program; management expertise in and knowledge about the real estate market; transaction experience in both the residential (the bank has originated approximately 500 mortgage loans) and non-residential areas (loans have been granted for the purchase of single and multi-family housing, and the purchase of facilities by consumer-oriented enterprises); and participation in the Urban Institute and World Bank programs in housing and construction finance, respectively.

- **MosBusinessBank** - MosBusinessBank met several of our bank assessment criteria including strong interest in receiving technical assistance, particularly for infrastructure building and training; qualified personnel who are active in legal reform issues and who are members of the working group on the "Law on Mortgages"; limited, but conservative, experience in commercial real estate finance and large multi-housing finance; and participation in both the Urban Institute's and the World Bank's programs on residential and construction finance, respectively.

The team met with Most Bank and would very much like to incorporate Most Bank into the project; however, the bank does not appear to need considerable technical assistance as it appears to have extensive knowledge in this area. We would like to build and maintain a strong relationship with this bank so it can contribute to our intellectual capital and leadership component. One approach may be to have Most Bank be a key participant on a working group formed by the project to promote ideas on improving commercial real estate finance procedures and practices.

- **Most Bank** - Most Bank met the majority of our bank selection criteria including extensive experience in underwriting transactions and in constructing and developing residential and commercial properties; highly qualified personnel in construction and housing finance; in-house experts on collateral valuation who are members of the Institute of Appraisers; close relationships with developers and contractors and insurance companies; and ability to attract financing from abroad.

The following Moscow-based banks are also being considered as possible participants in the program:

- **TverUniversalBank** - TverUniversalBank met several criteria including experience in commercial real estate financing such as the sale and renovation of a dental clinic that was taken as collateral; creative ideas in finding alternative methods of financing; large enterprise deposit base; and ability to sell bank notes to finance portions of its commercial mortgage loans.
- **Rossiyskiy Kredit Bank** - Rossiyskiy Kredit Bank met several criteria including some experience in real estate lending, e.g. the bank favors working capital loans where real estate is offered as collateral; interest in the program (the bank feels there is market demand and borrowers are looking for this type of financing); the ability to raise capital as shown by last year's note offering of \$85 million dollars; and participation in relevant technical assistance programs from EBRD and TACIS.

During the first weeks back in Russia, our team will revisit some or all of the above banks, and other financial institutions that provide funds for commercial real estate transactions, to work towards finalizing our selection process.

b. Outside Moscow:

The team would like to select two to three pilot banks outside Moscow, in cities which meet most of our selection criteria. Several banks were visited during November (see Appendix B), many of whom expressed strong interest in working on the program. Two potential candidates at this time are Baltiyskiy Bank in St. Petersburg and NovoBank in Novgorod.

- ***Baltiyskiy Bank - St. Petersburg.*** Baltiyskiy Bank met several of our bank selection criteria including strong interest in our program; cooperative management; experience in providing financing to shareholders and customers for developing commercial properties and large apartment buildings; knowledge of the local real estate market; aggressive training program for its employees; and participation in the World Bank Financial Institution Development Project as well as the Urban Institute's Housing Program.
- ***Novobank - Novgorod.*** Novobank met several of our bank selection criteria including experience with commercial real estate finance (approximately 90% of its portfolio is secured by commercial real estate such as office buildings, industrial sites, etc); trained personnel in legal issues and valuation of real estate; and close relationship with the city government (Novobank is the designated depository for the city administration's funds).

The team will revisit each of those banks during January to hold more detailed discussions on bank operations and the bank's participation in our program. (To date, several of the banks visited have telephoned the team requesting follow up meetings on the program.) Working again with other USAID contractors (particularly the Housing Finance Project), the team will identify other banks to meet in selected cities, will meet with those institutions, and work towards finalizing our selection process. One bank of particular interest at this time is:

- ***Eastern Siberia Commercial Bank - Irkutsk.*** This bank is known for being progressive. It is also apparently receiving donor funds to support its residential real estate activities, which will leave the bank with other funds available that might be used for making commercial real estate loans. The bank is said to be working closely with local developers on the construction of new housing and plans to expand its activity with local enterprises.

E. Key next steps

The first month of work in 1996 will essentially complete Phase I of the project--in that it will select pilot cities and financial institutions--and add an intellectual leadership component. We will finalize our selection of pilot financial institutions which are interested in working with us and who we feel would be qualified candidates for carrying out the program. Therefore, we plan to revisit those banks in St. Petersburg and Novgorod, visit additional banks in other cities of interest (including possibly Tver and Vladimir) and visit other financial institutions in Moscow who can play lead roles in the market's development.

In addition, the team will perform more "due diligence" on the cities of interest to complete our city selection criteria assessment to assure there are no obstacles to doing commercial real estate transactions.

APPENDIX A:
BANK CALL REPORTS

Attached are detailed call reports for the following banks:

- Stolichny Bank
- MosBusinessBank
- Most Bank
- TverUniversal Bank
- Rossiyskiy Kredit Bank

**CALL REPORT
FOR RESTRICTED CIRCULATION**

Bank: *Bank Stolichny*

Date: December 13, 1995

Representing the Bank: Andre Podkolzin, Manager
Sergui Gandzyouk, Assistant Manager

Purpose

The purpose of our call was to briefly explain our program, gather information on the Bank's mortgage lending activity, determine the obstacles to mortgage lending and discuss solutions with regard to these obstacles. Our team had previously met with Bank personnel involved with residential lending and this was a follow-up call. Following introductions we communicated through a translator and stated our purpose for the meeting (see first sentence).

Bank Structure

The Commercial Mortgage Department was established one year ago when the Bank realized that privatization was leading to real estate credits/issues that were best handled by a separate department. All real estate functions are handled in this department.

Current Activity/Transactions

The loan portfolio consists of three types of real estate loans:

- *Construction/Renovation Loans*
 - Residential Loans - Single family and multi-family units are financed over a short term basis, 6-18 months. At maturity the borrower is expected to either find a buyer for the unit or refinance the loan. Either way the Bank is repaid. In the case of multi-family (condo) or PUD-type of financing, the Bank receives guarantees that foreign contractors will comply with the building schedule. For mixed-use projects having residential and commercial (office) components, the Bank does not create different promissory notes. The World Bank and the Urban Institute have reviewed the Bank's practices in this department.
 - Non-Residential Loans - The borrower is typically a developer who owns land and wants to construct a building for leasing purposes. At the time of

the loan, the borrower can pledge the land lease but, under Russian law, the building can not serve as collateral until construction is completed. Some developers are taking advantage of Government Renovation projects where the developer who wins the bid to renovate a building also receives 50% of the ownership rights to the property after it is renovated.

- *Privatization Related Loans*
 - Owner Occupied Transactions - Small, consumer oriented enterprises who lease from the Government (bakeries, shops, etc.) can buy their facility at a below market price, which can be as low as 33% of the market price. Consequently, the borrower usually qualifies for additional financing for renovation, additional inventory, etc. The loans are fully amortized over the life of the loan, usually up to 18 months. Typically, the existing cash flow of the business is adequate to cover the projected debt service. The Bank has approved "many of these loans" without a default or problem. After the loan is fully repaid, the real estate collateral is used for other working capital purposes. These loans range from \$500 thousand to \$2 million.
 - Non-Owner Occupied Transactions - Same as above with two major differences: 1) the buyer is a developer or investor, not the user of the facility (i.e. an investor who wants to lease the facility to its user), and 2) the purchase price is set at the market price which can run as high as \$3 thousand per square meter. The Bank is underwriting exclusively against the leasing rights and has to exercise more caution as the higher selling price means higher loan to value ratios. Although the borrowers are often formidable businessmen, the borrower must prove its ability to repay the loan. The Bank tries for shorter maturities on these deals, one year maximum. Deals are often with small to medium sized banks, insurance or investment companies that want to lease out office space they own.
- *Privatization with Syndication's* - The developer or investor buys the building from the Government, keeps a portion for their own account and sells portions to other buyers.

Market Observations:

- Region - The Bank is comfortable making real estate loans in Moscow because the city has a registration system for the title and collateral. It is hard to verify title and to evaluate real estate in other cities.
- Loans - Loans are made in rubles and dollars, although mostly dollars. Some fixed rate loans are made but with the written understanding that the Bank is permitted to raise the borrower's rate should a significant increase in rates occur. The customer has the option to repay the loan early if it does not want to take the higher interest rate.

- *Funding* - Funding is achieved through deposits and the interbank market. For more information on funding issues, we must talk with the Treasury Department. A senior treasury officer sits on the loan committee that approves the transaction (no dollar limits were stated). The Bank lost out on one transaction where the borrower needed a three year loan and the Bank was unable to fund the deal. Mr. Podkolzin offered a possible solution: allow U.S. pension funds to provide the banks with long term funds, either through deposits or loans. The banks would then have at least one, reliable long term funding source.
- *Legal* - The legal process upon default can be very time consuming. The Bank's strategy in the event of default is to give the borrower two options: 1) deed the property to the Bank who would sell it to repay the loan, or 2) vacate the premises and allow a leasing agent to lease the property and repay the loan from the lease payments.

The Program

We described our selection process for the project. Certain suggestions involving training, risk management and other areas were made for the Bank to consider. The Bank was not impressed with one training session it received recently from a non-USAID source as it sent experienced personnel to a class that was designed for "beginners". Mr. Podkolzin appeared interested in obtaining tailored training on commercial real estate activities for his staff. He also noted that the Bank received useful assistance from the Urban Institute's Housing Finance Program for the Bank's residential mortgage activities. The implication is that our project might provide similar assistance for CML activities.

Given the high quality and volume of information we have and will receive from this bank (meeting notes, annual report, draft of journal article on real estate lending, etc. expected later), we can spend our next visit further promoting the project.

**CALL REPORT
FOR RESTRICTED CIRCULATION**

Bank: *MosBusinessBank*

Date: December 14, 1995

Representing the Bank: Galina A. Sokolovskaya, Head of Mortgage Department

Purpose

The purpose of our call was to briefly explain our program, gather information on the Bank's mortgage lending activity, determine the obstacles to mortgage lending and discuss solutions with regard to these obstacles. Our team had previously met with Bank personnel from another department.

Current Activity/ Transactions

Galina started by saying that legal uncertainties and other difficulties have prevented the bank from actively participating in mortgage lending. Consequently, the Bank is very selective and has only approved a few loans. Her department is relatively new and has been operating for less than two years. The Bank received consulting advice with regard to forming Galina's department from the USA, Italy, Germany and even India.

The following details were provided about the commercial mortgage transactions approved by the Bank:

- Dollar size:* \$100,000 to \$800,000.
Maturity: 6 months for the largest loan. The Bank is willing to lend up to 2 years.
Rate: Up to 30% per annum.
Fees: The Bank does not impose a fee but the borrower is responsible for the notary fee of 3%, and any fees charged by the Moscow Property officials for registration of the collateral. Any other costs for the loan including appraisals are paid by the borrower. The mortgage documents are drawn up by in-house counsel, paid by the Bank.
- Loan to Value:* 60% maximum.
Collateral: Because of the status of the current laws, the Bank's collateral consists of "spaces" in the building for which financing is being received that are critical to the business. The reason for this is that the owner rarely has the certificate proving who owns the building. To stay clear of any title issue with its' collateral, the Bank avoids words like "land" or "outer

walls” of the building when drawing up the collateral document. The borrower is required to purchase what was called “normal real estate insurance”. (We will research this further.)

Loan Process The loan application is assigned to a loan officer who must screen the information before the next step is taken. Next, an independent appraiser is assigned and the value is determined. If the loan is not rejected, it is assigned to an underwriter for further screening and presentation to the Mortgage Loan Committee, for loans up to \$1 million (Galina is the Chairman), or to the Bank’s Loan Committee, for loans over \$1 million (Galina is a voting member).

Insurance: The borrower is required to purchase insurance.

The Bank has a number of pending commercial mortgage applications as well as some large multi-housing loans (\$3 million to \$7 million) in connection with a World Bank program.

Market Observations

As a member of the Working Group on Mortgage Law and as a banker, Galina shared her concerns as follows:

- *Funding* - Although this is handled in another area of the Bank, it is clear that medium to long term funding for the banks is not possible until economic stabilization occurs. Individual depositors will deposit for only 3 to 6 months. Business deposits may be for longer terms but the “residual” cash (i.e. deposit amount) from most enterprises is small.
- *Real Estate as Collateral* - (See above description of collateral.) The owner of a privatised enterprise does not receive a “fee simple interest” in the property. He (she) receives a leasehold interest for perhaps 30 years with no right to sub-lease the property or renew the lease. While there may be some value for this leasehold interest, it would be worth more as collateral if the owner had more rights to pledge to the bank. Perhaps the new Draft Law on Mortgage will improve the situation. In St. Petersburg the owner gets no leasing rights in writing at all. This is a “political” issue - does the country want to transfer a fee simple interest in state land to private owners?
- *Credit Evaluation* - Currently there is no way to assess an individual’s payment history, unlike in the U.S. where bankers are able to utilize Credit Bureau Reports to assess a customer’s credit history. For enterprises, creditworthiness is also difficult to assess; the most the bank can do with periodic balance sheets is determine operating trends.

- Appraisals - The Bank has experience in appraising residential property but is less comfortable with commercial property. It has seen valuations by professionals but is not sure that the right methods are being used. Since it is dealing with improvements and movables, the Bank is unclear about the practical value of walls, equipment, etc. There are statistics for residential properties, but no known statistics for commercial transactions. At this point, it is more important for the Bank to know that a buyer can be found for the collateral if things go wrong.

The Program

We presented two promotional packages and explained that we were finishing the selection process and were anxious to work with Russian Banks. Galina stated that her Bank would like to participate in our program and would welcome our assistance with any of the areas stated on page four of our brochure.

**CALL REPORT
FOR RESTRICTED CIRCULATION**

Bank: *Most Bank*

Date: December 14, 1995

Representing the Bank: Dr. Andrei V. Tsimailo, Executive Vice-President

Purpose

The purpose of our call was to briefly explain our commercial real estate mortgage finance program, gather information on the bank's current and future commercial mortgage lending activity, and determine the obstacles to mortgage lending today, given the current environment, and discuss solutions with regard to overcoming these obstacles.

Bank Structure

Mission - The bank's current mission is to be a universal bank with a large retail network. The bank plans to open 20 additional branches in several areas including Ekaterinburg and Krasnodar. Most Bank specializes in financing and granting loans for the construction, renovation and modernization of premises, cottages, factories and the bank's branch offices. For example, the bank's customers used its loans to participate in programs sponsored by the City of Moscow to develop plots of land for housing. A major customer (Mosremstroy) used its loans to overhaul municipal buildings in Moscow.

Ownership - Approximately 90% of the Bank is owned by the Most Group (MG), an organization comprised of several special firms involved in the real estate area. Although the MG is practically the sole owner of the Bank, the EVP with whom we met is functionally over the Group and can, at his discretion, turn down or intervene in a deal. If MG disregards the opinion of the Bank, MG may continue with the project but must seek funding for the deal elsewhere. The EVP explained that the Bank has turned down deals in the past.

Insurance - Most Bank's investments in the insurance business are represented by its participation in the chartered capital of the joint-stock company Max Insurance Company and the insurance company Rosno.

Mortgage Lending Department - The bank has a team of about 20-25 people in the Department of Construction Finance. Within this department is a small Division for Mortgage Lending. The Construction Finance Department is comprised of experienced individuals in construction, many of whom were heads of construction companies in the

Soviet era. Four to five people have experience in monitoring and verifying construction budgets. Three people are also qualified to appraise properties and are members of the Institute of Appraisers and of the Russian Society of Appraisers. The Head of the Mortgage Lending Division, who was not available to meet with us, is actively involved in making recommendations on current legislative issues. She is also writing her thesis on mortgage lending and would be an excellent resource.

Other Technical Assistance - The Bank was not selected by the World Bank as an International Standard Bank, primarily because of its exposure to real estate which is due to the Bank's relationship with the Most Group. The Bank is currently receiving technical assistance from Ernst and Young on housing/construction finance. In addition, it is in the process of hiring additional consultants in the area of strategic planning and management.

Current Activity/Transactions

Commercial Real Estate Lending - The bank has carried out several commercial real estate mortgage finance transactions and has conducted assessments of the real estate units which were taken as collateral. Currently the bank is financing real estate development projects that in aggregate exceed \$100 million. The Bank would like to increase the amount of commercial lending it provides because of its extensive experience in the field and the increase in demand from the market; however, it is waiting to see if the interest rate policy of the country will change, as it is concerned about currency instability. The EVP explained that projects in the past have been very profitable but now margins are decreasing because financing is very expensive. As a result the Bank has been focusing on lending to its best clients who need credits. He explained that no one wants to borrow in rubles nor lend in dollars given the current state of the economy and political situation.

As of January 1995 most loans were made with terms of under one year, which results from the country's general economic situation and the lack of opportunities for stable refinancing in the domestic market for medium terms.

The Bank is involved in similar transactions to those described by other banks, i.e. lending to enterprises to buy their premises from municipalities. These transactions are conducted for both affiliates and non-affiliates. One problem with this type of transaction is the condition of the collateral. The Bank prefers to take property inside the center of Moscow rather than an industrial plant outside the city, because it can use the property or sell it. Property outside of Moscow is not as salable.

Property Development - The Bank is involved in property development (for the Most Group), project finance and venture capital type deals. One deal involves buying a premise for developing an office food supplier business. The Bank put money into the business by buying the building and will have several partnerships to run and manage the company.

One year ago the Bank received approval from the city government to purchase a land plot for \$300 to \$400 million dollars. The Bank would like to build a shopping mall on this plot with underground parking, an office center and perhaps apartments, but needs to find long-term financing. It is thinking about having a foreign developer, BBT, construct the project. In addition, it plans on working with George Kline, a general developer who will bring in subcontractors. The Bank will look for debt financing from abroad, perhaps some type of debt/equity transaction, and might create a separate company and sell its shares to raise funds.

Residential Construction and Housing Finance - The EVP explained that the bank is also very involved in constructing "cottages" or dachas development.

Branch Real Estate Activity - All mortgage activity is done in Moscow. The Bank does not have any specialists in the regions. The branches have local market knowledge but they always go back to head office for decisions. There is limited lending at the branches.

Market Observations

- Registration - Mr. Tsimailo explained that the registration system is much more advanced in Moscow than in other regions and that it is centralized. However, there are areas for improvement. For instance, it takes a long time to get information on prior liens and encumbrances. This information is not readily available. Moreover, it is not routine to have this information compiled in a report and to have it in a timely manner.

Mr. Tsimailo also explained that registration of collateral is expensive. It costs 3% of the collateral value to have it notarized (this is a flat fee), and there is a 1 1/2% registration fee. It is negotiable whether the client or bank pays the fees. The total cost of registering collateral is therefore somewhere around 4.5 to 6%. If the loan had a twenty-five year maturity, these fees would be acceptable. But normally credit requests are for 6 months to one year and so the additional fees make financing very expensive.

- Legal - There are many contradictions in the current laws, especially with regard to the Housing Law and Collateral Law. One can take an apartment as collateral but the Housing Law forbids the tenants from being thrown out. Therefore, they have no right to evict tenants especially when the family is residing in the home. They also can not buy the place and sell it themselves. They would have to give up the collateral to a public auction and would only get compensated for the loan amount plus interest, not the real market value of the property. For example, if a property is valued at \$3 million dollars and the bank lent \$1.5 million, the bank will be compensated only for \$1.5 million plus interest in case of default.

Banks have developed schemes for getting around the foreclosure laws. One is a lease purchase agreement for housing financing. Another is setting up real estate companies which can sell the property in case of foreclosure.

Another problem in this business is the lack of control over contractors and a lack of experienced contractors. EVP explained that it is very important to work with contractors who have experience in Russia.

**CALL REPORT
FOR RESTRICTED CIRCULATION**

Financial Institution: *TverUniversal Bank*

Date: December 14, 1995

Representing the Bank: Vladimir Alexandrovich Churakovskiy, Chief Economist

Purpose

The purpose of our call was to briefly explain our program, gather information on the Bank's mortgage lending activity, determine the obstacles to mortgage lending and discuss solutions with regard to these obstacles.

Current Activity

The Bank is restricting its commercial real estate (CRE) exposure to the city limits of Moscow because of legal issues and other uncertainties. Generally, the loans they are providing result from privatization transactions where the owner can only buy and pledge the building itself, not the land. The Bank has roughly three years of experience with CRE loans and is very selective. Written evaluations of the properties, or appraisals, are prepared by Realtors. Sometimes the Bank estimates the values itself by retrieving sales statistics from the Property Committee or Realtors familiar with similar transactions, although it is understood that this is not an exact science.

The Bank is not working with any other international consulting firm right now and has agreed to review our material. The next visit should include a senior manager and decision maker for the Bank.

One example of a CRE transaction involved the privatization, sale and renovation of a dental clinic. Details of the loan are as follows:

<i>Amount:</i>	\$1.5 million
<i>Rate:</i>	24%
<i>Maturity:</i>	2 yrs
<i>Financing:</i>	Long term lease rights and buildings
<i>Loan to Value:</i>	100% (Collateral As Is) 50% (Collateral As Completed After Renovation)

Market Observations

- Collateral - The Bank will only take collateral it can use itself should it have to take possession of the collateral in the event of default. The only apparent exception is collateral that the Bank knows it can readily lease or sell. Residential collateral is preferable to commercial because the Bank believes that housing units are easily sold.
- Valuation of Collateral - The CRE Market is largely an undeveloped market because of the lack of financing due to the difficulties involving valuations and comparable sales data. Although the banks can rely to some extent on the realtor's evaluation for Moscow properties, there is no reliable information outside Moscow. Sometimes the parties understate the sales price to avoid a high profits tax. Also the buyer must pay the lawyer 3% of the collateral value (if the sale is financed) and a lower sales price will reduce the legal cost.
- Funding - Lack of appropriate funding is a well known problem. Three banks recently had to walk away from a \$350 million (non-CRE) transaction for a large customer because of lack of funding. The same problem exists for CRE loans. The Bank is funding many loans by disbursing Bank Notes to the borrower at settlement instead of cash; the borrower is free to pass the notes on to his suppliers/vendors. The Bank Notes may be held until maturity or cashed in the marketplace for a discount. The Bank has a Note Circulation Desk that tracks the circulation of the Bank Notes. (The transaction mentioned above was disbursed in Dollars, not a Bank Note, to allow the borrower to pay his offshore vendors in cash.) Otherwise, CRE loans will be funded with Bank Notes. We will research the bank note market with the Central Bank. Finally, while household deposits are available, the Bank has not tried to attract these funds. This may change.
- Loan Demand - If the problems are solved with regard to CRE financing and there is a large demand for real estate loans, many banks may be forced to merge because they will not have the ability to increase their deposit or capital base. Mr. Churakovskie said that his bank will survive because of its large enterprise deposit base and ability to sell bank notes.
- Loan Quality - All loans are short term and high quality. The Bank has not had any problems to date with CRE loans
- Loan Process - Applicants are required to submit a written application and business plan. There are no written underwriting standards but normally an expert reviews the financial information and collateral and asks for any additional information. Mr. Churakovskie is one of the experts for real estate loans. The expert reaches a conclusion and presents the transaction to the Loan Committee who review loans over \$200,000.

The Program

We reviewed our promotional material and the technical assistance offered on page four of our marketing booklet. As a next step in evaluating the Bank, we would like to receive the banks annual report and financial statement. The annual report and financial statements are sent through the Public Affairs Officer, which must approve the distribution. Mr. Churakovskiy agreed to make the request for us.

**CALL REPORT
FOR RESTRICTED CIRCULATION**

Bank: *Rossiyskiy Kredit Bank*

Date: December 18, 1995

Representing the Bank: Yuri Prygaev, Deputy Chief Credit Officer
 Irina Shulpino, Counsel
 Natalie Kroupnova and Mariya Goryacheva, Correspondent
 Banking

Purpose

The purpose of our call was to briefly explain our program, gather information on the Bank's mortgage lending activity, determine the obstacles to mortgage lending and discuss solutions with regard to these obstacles. This was the team's first visit to the bank.

Bank Structure/Organization

Rossiyskiy Kredit Bank is a universal bank. It is structured as a limited liability joint stock company and has approximately 60 shareholders from diversified companies representing such industries as insurance, trade, and commercial. The Bank:

- Has 51 branches with 25 of these located in the Moscow Oblast.
- Perceives the sphere of real estate lending as quite promising. The Bank used to have a mortgage banking division, but in an effort to develop a more centralized system, has reorganized the personnel under the Credit Department. All lending of this type is done out of the Head Office.
- Is currently waiting to hear whether it has been accepted by the World Bank to participate in the Financial Institution Development Project to become an international standard bank. The Bank is already receiving technical assistance from the EBRD and TACIS.
- Successfully completed a bank note offering last year and increased capital by \$85 million.

Current Activity/Transactions

The Bank limits its real estate lending to the Moscow city and oblast. It favors "earmarked loans" (see Bank Stolichny report) or working capital loans where real estate is offered as collateral. Loans to enterprises to finance privatization are not documented correctly by most lenders and the Bank would only offer such assistance for their very best customers. Mr. Prygaev feels that the legal basis for the transaction and collateral is "not properly developed" at this time for the Bank to take the risks. He would prefer for the customer to purchase the property with capital and use it as collateral for a non-real estate purpose loan. The Bank will consider loans where the collateral is of practical value to the Bank's operations. Otherwise, unfavorable foreclosure procedures that can last over several months (Moscow Property Management takes three months alone) do not make the transaction attractive should a default occur.

When asked if the Bank's attitude would change upon the passage of clearer legislation, Mr. Prygaev stated that the Bank would be interested in making more real estate loans for the right kind of customer.

In regard to the terms and conditions of commercial mortgage lending:

<i>Amount:</i>	\$50,000 to \$2 million
<i>Interest:</i>	40 % - 50% per annum for hard currency loans, 110% - 120% for Ruble loans. The interest and currency depend on the district and customer. Most are hard currency loans.
<i>Fees:</i>	Customer is responsible for all fees: notary, registration, etc.
<i>Term:</i>	Six months: the law requires 180 days or less for dollar based loans. The Bank routinely allows a renewal if the borrower is current and has a good payment record.
<i>Funding:</i>	Obtained on a short term basis because of the economic situation

In addition, Mr. Prygaev noted that:

- Appraisals are required and performed by licensed realtors in Moscow. The Bank is confident in the valuations now that prices have stabilized.
- The overall credit quality for mortgage loans is acceptable and no higher than other classes of loans.
- The Bank prefers non-real estate purpose loans. They are simpler and easier to deal with. Unlike the real estate loans, the Bank does not need to go to the courts to determine its rights if a customer defaults.

- Mr. Prygaev is responsible for reviewing real estate loans and presenting them to the Credit Committee. Again, the decision on whether to extend a loan will largely be made on collateral considerations. Properties considered are:
 - Property the bank can use in the event of a default.
 - Marketable and completely finished office space, with Western engineering.
 - Industrial facilities, because the prices are lower.

There are “many” real estate transactions in the pipeline and the Bank will consider them in accordance with the above stated criteria for their good customers. There are more borrowers looking for this financing than the banks can satisfy at this time; this is definitely the “peak period”.

Market Observations

- *Legal Perspective* - The legislation allowing for these kinds of transactions is only three years old and needs updating. Thus far there is no regulation allowing for the sale of land in Moscow. That needs to be passed before borrowers can pledge land as collateral. The Bank does make a significant number of loans where real estate property is pledged as collateral, i.e. leases, improvements, etc. This lending is strictly limited to the Moscow city limits, where registration of collateral occurs, and within the local oblast boundary. Beyond this area a National Law is needed. Part One of the Civil Code and Russian Regulations provide for real estate to be pledged as collateral but the law mentions a National Law on Mortgage which, as yet, has not been passed. There are other gaps in the laws with respect to the rights of the lenders to the collateral. Finally the law stated that only specially licensed banks can take mortgages as collateral; does this mean that an unlicensed bank has no collateral rights with respect to the mortgages?

APPENDIX B:

LIST OF BANKS INTERVIEWED DURING TWO MONTH PERIOD

Moscow:

ForoBank
IpoteckBank
MosBusinessBank
Most-Bank
Rossiyskiy Kredit Bank
Stolichny Bank
TverUniversalBank

Novgorod:

NovoBank

Pskov:

PskovAkobank
Agroprombank

St. Petersburg:

Baltiyskiy Bank
Bank St. Petersburg
Credit St. Petersburg
IpotechniBank
Petersburg Lespromshleni Bank
PromstroBank - (meeting to be rescheduled)
St. Petersburg Bank for Reconstruction and Development
TverUniversalBank - St. Petersburg branch
Vita Bank