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BOSNIA-HERZEGOVINA

Collateral Law – Stimulating Secondary Market
for Assets Acquired through Foreclosure

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Emir Mehmedbasic, Project Management Specialist

Submitted by:
Chemonics International Inc.
Deloitte Touche Tohmatsu Emerging Markets Ltd.
National Center for State Courts

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FILE's Workplan for the six-month period ending June 30, 2005 contemplates meetings and roundtables with various stakeholders to discuss and develop recommendations for stimulating an active "secondary market" in auctioned assets. This report describes the results of such discussions relative to stimulating an active "secondary market" for assets acquired through foreclosure.

Interviews and Roundtables

A number of stakeholder interviews were held in March and April 2005, followed by roundtables on April 12th and 14th, to discuss various issues, including methodologies for liquidating foreclosed real estate and repossessed personal property.

USAID and other organizations have studied and documented problems related to the real estate market in BiH¹. An extension of this problem is experienced by lenders who have reported significant problems in liquidating real property acquired through foreclosure. Creditors are experiencing a very weak market for these properties and have great difficulty in selling them. They also report that there is a social taboo on foreclosed properties, particularly residences in small communities. Potential purchasers are reluctant to acquire properties from foreclosure, apparently feeling that they will bring bad luck. The situation is reported as most serious in foreclosures involving residences in small towns, where most potential purchasers already live in the community and personally know the defaulting mortgagor.

One of the problems cited by several stakeholders is that auctions do not attract quality bidders or quality bids. Anecdotes were noted of property appraised for millions of KM being sold for one KM to the lender, as no other bidders made an offer. Stakeholders were not sure whether there was a lack of demand or a lack of notice to those who might have offered higher bids.

In addition, stakeholders noted the problem of court involvement not permitting sales where there was questionable title over the property.² In some cases, courts would not permit foreclosure over rights of third parties in property owned by a government entity. In others, the problems appear to be that some judges do not understand the concept of risk, so that rather than let the foreclosure bidders accept property with potential title problems at their own risk (with consequent reductions in value), they deny the sale altogether. The first problem is a legal one, in that it is apparently not possible for a lender to foreclose on rights of possession or use of government owned property. The

¹ For example, see Real Estate Finance and the Real Estate Market in Bosnia: Unlocking Capital for Development, The Urban Institute *et al*, June, 2004.

² Although this is a bankruptcy issue that is outside the scope of this report, it is mentioned to demonstrate related issues.

second is one of understanding and practice in which paternalistic habits of the former system are impeding the transition to a market economy.

With respect to moveables, court officials report that they have no place to store seized properties prior to auction. The properties are left with the debtor, who is advised not to dispose of the property. The property must then be retrieved from the debtor after it is sold at auction. There is currently no delegation of retrieval or storage to private sector agents, and courts do not have facilities or staff to keep up with the demand for seizure.

Possible solutions to these problems, generated by the roundtables as well as one-on-one discussions, include:

- Establish a regular time and place for all auctions by a given court so that a market can develop more efficiently;
- Have a judge with auction skills or a professional auctioneer conduct all auctions;
- Have the government purchase the properties;
- Create an agency to market properties for all banks;
- Create a web site to advertise the properties, *e.g.* through the Bank Association of BiH;
- Create a single real estate company/brokerage to market these properties for participating banks;
- Continue the underwriting practice of requiring multiple guarantors to avoid the issue;
- Since bank regulations prohibit foreclosing banks from holding title to foreclosed properties indefinitely, auction sales of real estate to them should not be considered a taxable event and the excise tax for these transactions should be repealed as it results in unjustified double taxation;
- For moveables, the court should obtain access to a secure warehouse for storage of seized property by renting such space from private sector providers and charging the cost of such rentals to the debtor;
- Encourage the bank practice of bringing potential buyers with approved credit to bid at auctions to avoid double taxation, and having to book the property as a bank asset;
- Train judges to permit to buyers to assume risk in purchasing properties that do not have clear title;³ and
- Clarify the law with regard to foreclosure on use or possession rights in government properties, so that lenders can foreclose against the remaining term of such rights, or so the lenders cease to take such property as collateral.⁴

Recommendation

³ See footnote 2, *supra*.

⁴ See footnote 2, *supra*.

It is recommended that a short term Marketing Specialist be brought in to (1) analyze the existing market more closely and recommend strategies for strengthening the market for properties in foreclosure and (2) determine what, if anything, can be done in the short term or long term to overcome the social taboo on foreclosed properties.

Further, it is recommended that the courts immediately begin the practice of auctioning assets at a regular time and place. For example, auctions could be held on the first and third Mondays of every month at the court entrance or at a warehouse. Such regularization would actually reduce costs, increase efficiency, and increase publicity, thereby strengthening the markets for these goods.

To the extent that the market for property in collateral is restricted by culture (taboos) or by law (no foreclosure against use and possession rights in government-owned properties), banking regulations should be amended to downgrade the quality of such collateral for risk mitigation and reserve requirements.