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The author lived in Ukraine in 1993-95 and 1999-2000, and was in the country May-July 2002 on a Summer International Research and Travel Grant from Berry College.

Background on the Market

The conditions for a mortgage market began with the privatization of housing at the time of the breakup of the Soviet Union. Ukrainians could privatize the apartments or houses in which they had registered residence by filling out the necessary forms. The registration system, which still exists, requires the provision of a residential address to the civil authorities and a registration certification, called a *propiska*, to be stamped in the civil passport, which is the basic identity document in Ukraine.

In the cities, most Ukrainians live in apartments instead of single-family dwellings. The privatization of the apartments applied only to the apartments; the common areas and building exteriors remained the property of the municipality. Because of the municipalities' usually bad records of repairs and maintenance, apartment owners could form a communal group to take ownership of the common areas and exteriors, but rarely did so. Given the slow development of contract law, communal associations have limited leverage against a stubborn resident who refuses to join or pay dues.

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The privatization decision is not without costs. In state-owned apartments, utility rates are lower, and the State is responsible for repairs. However, the State's response to requests for repair services is often slow, at best. The lower rate on utilities is a significant percentage but not much more than the discount that pensioners receive on their utility bills and, in absolute terms, not more than several dollars. The benefits of lower utility bills and a slow, State-provided repair system are set against the inability to sell or bequeath a property. The result of this household cost-benefit analysis is that 53.64 percent of the residential space in Kiev was privatized by 2000, with 7.13 percent of these privatizations completed in 2000 (Kyiv Municipal Board of Statistics, 2001: 149 and 214).[1]

The first signs of a mortgage market began with the financing of the purchase of apartments under construction. The pioneer in this effort was a firm called Arkada Bank, which is the financial arm of one of Kiev's largest residential construction firms. Arkada provided two-year payment plans for apartments in planning and early construction stages, with all payments due at the time of move-in. This financing covered the shell only; the cost of fit-out with floor covering, fixtures, and wall-finishing was not financed. The arrangements were a method of reducing risk for the construction firm, which often acted as the seller of the apartments.

While apartments were privatized, the land underneath was not. The country's rich agricultural land remained unprivatized as well. The lack of property rights of agricultural land was a hindrance to the development of Ukraine's agricultural potential. The country has rich land but output is low because of poor mechanical and chemical inputs. When agribusiness companies could acquire machinery or fertilizer from Western suppliers, it was on credit with guarantees from the Ukrainian government. Thus, Ukraine's poor taxpayers found themselves liable for failed agribusiness ventures more than once due to the absence of mortgaging.

In October 2001, changes in the Land Code allowed private ownership of land and the sale of land to begin January 1, 2005. At that time, landowners can obtain credit on the security of land. Also, under the law, land can be pledged only in mortgage loans and not as security for any other type of transactions. Foreigners are prohibited from owning agricultural land, but with non-agricultural land, the rights of foreigners are the same as those of citizens, and the law governing mortgages makes no distinction between citizens and foreigners.[2] This new legal regime for land is a beginning that few observers thought would come in the parliament that passed the new rules, as communists and their allies had a substantial presence.[3]

The Nascent Market

For an idea of the potential size of the home mortgage market, a Kiev-based bank, Ukrsotsbank, estimated that new home sales were at $200 million in Kiev in 2001, based on new construction of 860,000 square meters at an average price of 1,200 Hr. (hryvnia, about $225) per square meter[4] in the city. According to *Vestnik Nedvizhomosti*, a bi-monthly real estate publication in Kiev, the average sizes of apartments advertised for sale in the outer districts of the city have recently been approximately 35 square meters (approximately 377 square feet) for one-room apartments and 50 square meters (538 square feet) for two-room apartments.[5] Housing prices have risen steadily as families have increased home equity with the rise in their incomes over the past several years with growth in real Gross Domestic Product (GDP). With these higher prices and even more construction, the bank estimates that Kiev's housing market[6] is worth about $400-500 million annually, with the country's market at approximately $3 billion (Ukrsotsbank, 2002: 2-3). Kiev also accounted for 36.23 percent of the 2.3 billion Hr. (over $425 million) in new residential construction in 2000 (State Committee of Statistics, 2001: 214). Precise numbers are hard to obtain because of problems with information flow and the distortions in reporting caused by widespread tax evasion.

The Market in Its Current State

Fewer than ten banks were working in the mortgage market in Kiev in early 2002, which is the largest single housing market. The typical market terms are 30-50 percent down payments, a maximum loan period of 5 years, and annual interest rates of 14 percent or more for loans tied to foreign currencies (primarily the dollar in early 2002) and 20 percent or more for local currency loans, in which the inflation risk is higher. Interest rates and terms are similar in other cities in Ukraine, with the same banks operating in those markets along with some local banks. Standard agreements prevent the borrower from selling, leasing, or in any other way transferring the use of the apartment during the life of the mortgage. Only the Oshchadbank, which is the country's state-owned savings bank, offers 100 percent mortgage financing, but for terms of two years or less and in hryvnias only (Ukrsotsbank, 2002: 2, 13). Table 1 summarizes rates and terms in various Ukrainian cities.

Banks may charge loan fees up to several hundred dollars. According to Ukrsotsbank, the fees at Praveksbank are 2,900 Hr. ($547.17 at the National Bank of Ukraine's exchange rate of 5.3 Hr. to the dollar in June 2002) for a $7,000 loan, 3,300 Hr. ($622.64) for $10,000, and 4,200 Hr. ($792.45) for a $15,000 loan. In the market for existing homes, banks traditionally appraised properties on which they made mortgage loans for 60 to 70 percent of appraised value, though now an independent appraisal industry is developing (Ukrsotsbank, 2002: 4-7).

Not counting Arkada, which works with its parent construction company, active mortgage lenders are among the largest banks in Ukraine. Six of the top

TABLE 1

City	Bank	Loan Period (Years)	Currency	Interest Rate	Maximum Percentage of Property Value Financed by Loan
Donetsk	Aval	5	Hryvnia	30%	50
Kharkov	Praveks	5	Dollar	15%	50
Kharkov	ZUKB	2	Hryvnia	27%	70
Kiev	Aval	5	Dollar	14%	60
Kiev	Praveks	5	Dollar	15%	70
Kiev	Privatbank	5	Dollar	16%	50
Odessa	Aval	2	Hryvnia	30%	50

12 banks in terms of assets are in mortgage lending. Assets in this group range from 5,094,000,000 Hr. (less than $1 billion) to 755,000,000 Hr. (less than $150 million Hr.). Profits in 2001 were mostly thin for these banks, with the exception of Prominvestbank, which had profits of 77 million Hr. ($14.5 million), which put it in the top 50 of Ukraine's profit list. This bank also had the largest amount of bank capital, at 773 million Hr., or about $150 million. The next largest bank in capital and profits was Privatbank, which had less than half of each respective amount (Ukrainskaya Investitsionnaya Gazeta: 16-17, 43). Shares in these banks are not actively traded, with only Aval Bank and Ukrsotsbank in the top 50 in share-trading volume in 2001, with only $4.7 million and $2.3 million in trades for the year, respectively (PFTS, 2002).

Conclusion

Kiev has a housing shortage that is both a legacy of the Soviet era and a symptom of the city's population growth. The capital is one of the few places in the country with population growth. Because of the housing shortage, the mortgage lending business is one that should continue to grow. Outside Kiev, even with population contraction, construction continues as increasingly prosperous Ukrainians want more and better housing to replace the often deteriorating Soviet-built supply. Financing this market would enable more buyers who have not yet accumulated sufficient wealth for a full payment in advance to buy housing.

Mortgage growth will be a function of new construction. The absence of a centralized system for checking liens and encumbrances on properties hinders the growth of lending to finance the purchases of existing properties. With a focus on new properties, the mortgage market will concentrate on Kiev, where more than a third of new residential construction by value took place in 2000, as mentioned previously.

Besides the volume of new construction, the development of a mortgage market depends on the development of the banking system. Low levels of trust in both banks and the national currency hinder this growth. Memories of the hyperinflation of the early 1990s with the previous currency, the *karbovonets*, still affect perceptions of the *hryvnia*, which has been stable except for one period of rapid depreciation during the Russian default crisis of August 1998, when banks had difficulties meeting dollar obligations. Cautious Ukrainians seek alternatives to bank liabilities for their savings instruments, and this must change before the supply side of the mortgage market can grow significantly, and that would include a secondary market for Ukrainian mortgages to further decrease mortgage interest rates. There is no legal barrier to foreign participation in residential mortgages and questionable barriers to this participation in loans on agricultural land, but questions about judicial procedures, especially in the sale of assets to satisfy debts, dampen enthusiasm.[7]

Banks will benefit from the availability of long-term credit instruments. In 2000, 17.89 percent of bank credit extended in the country was classified as long-term (State Committee of Statistics, 2001: 72), which is not clearly defined but, for comparison, 27.62 percent of SunTrust's loan portfolio was in residential mortgages in December 31, 2000 (SunTrust Banks, 2001: 11). However, given the state of financial markets in the country, development with foreign participation that will drive interest rates down even more is in the future. For a perspective on the financial markets in the country, in 2001 the First Securities Trading System, which accounts for 80 percent of Ukrainian in-country share trading, had only $200 million in trades for the year, according to the PFTS Public Relations Office. This contrasts with $24.3 billion in equity trades, or more than 100 times the PFTS volume, on the Moscow Interbank Currency Exchange, which is the leading stock exchange in Russia, when Russia's GDP was less than 10 times larger than Ukrainian GDP, according to the World Bank.[8]

Endnotes

1. The common spelling of Kiev is from the transliteration of the Russian name for the city. The alternative spelling of Kyiv comes from the Ukrainian. Spellings contained in references from sources are in accordance with the language of the source. The default spelling in the paper will be the Russian transliteration. According to the Kyiv Municipal Board of Statistics (p. 214), the amount of privatized residential space in Kiev increased by 1,584,800 square meters from 1999 to 2000 (1 square meter = 10.76 square feet), which represents a 6.44 percent increase in the amount of privatized residential space. The total mount of residential space in Kiev in 2000 was 48,856,900 square meters. For reference, the Kyiv Municipal Board of Statistics estimated the city's population in 2000 at 2,631,900 (p. 158).

2. The Ukrainian law governing mortgages is the Law on Pledges. An English translation is available at http://www.ebrd.com/pubs/sectrans/survey/laws/ukraine.pdf. Section II of the Law on Pledges defines and specifies mortgage agreements, and Section VII applies to all pledges in international transactions. Because of the prohibition on foreign ownership of agricultural land, a problem exists on foreign banks' mortgage activities in that sector, but observers have pointed out a loophole in the Land Code that allows foreign purchase of a legal entity that may own agricultural land.

3. That parliament changed, after enactment of the Land Code, with the elections of March 31, 2002, when the communists, who were opponents of the legalization of the privatization and alienability of land, lost half of their seats so that they now account for slightly more than 10 percent of the parliament.

4. The exchange rate of the hryvnia (abbreviated Hr.) to the dollar has been fairly stable since its introduction on September 1, 1996, except for the period following the Russian default and devaluation of August 1998. In December 2000, the exchange rate was approximately 5.44 Hr. to the dollar. The *hryvnia* appreciated to 5.39 to the dollar in June 2001 and further to 5.29 in December 2001. It has fluctuated around this rate in 2002. Historical exchange rates are available from the National Bank of Ukraine (the central bank) at http://www.bank.gov.ua/Kurs/Engl/last_kurs1.htm

5. In Ukraine, the number of rooms is in addition to the bathroom and kitchen. A one-room apartment would be equivalent to a studio apartment in America, and a two-room apartment would have one room typically used as a living room and another as a bedroom, in addition to the kitchen and bathroom. The bathroom may be a combined commode/shower facility or these uses may be in separated rooms.

6. Kiev's housing market is a point of focus because of its population growth, which makes it unique in a country in which all 24 oblasts (regions), including Kiev oblast, which surrounds the capital and the one autonomous republic (Crimea), lost population from 2000 to 2001 (State Committee of Statistics, 2001: 321-22). In 2000, it had net migration of 16,900 people from the rest of the country, and a net loss of 4,000 in international

migration, for a net gain of 12,900 (State Committee of Statistics, 2001: 337). This is significant in a country that has lost 6 percent of its population since its independence in 1991.

7. Questions about the sale of assets and bankruptcy in general arose with bankruptcy proceedings followed by rigged auctions involving two energy companies, Luganskoblenergo and Donbassenergo, in 2001. These companies were among Ukraine's top 50 income earners, and their assets were sold at opaque auctions for a fraction of their estimated value.

8. The data for the Moscow Interbank Currency Exchange are from a January 15, 2002, press release available at http://www.micex.com/news/releases/2002/150102_2.html. The World Bank's GDP data for member countries are available at http://www.worldbank.org/data/countrydata/countrydata.html. The numbers there for 2001 were GDP of $310 billion for Russia and $37.6 billion for Ukraine's GDP, measured at exchange rates at the time of publication.

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