

**MASTER'S PAPER WRITTEN BY HASMIK TOROSYAN**  
**MORTGAGE FINANCING OF APARTMENTS AND DWELLING HOUSES**

**INTRODUCTION**

My master's paper deals with the topic of mortgage loans for the purposes of residential housing lending. Mortgage financing is an up-to-date solution for purchasing an apartment or dwelling house by pledging a real property to a lender as collateral<sup>1</sup> for a mortgage loan. The below-mentioned description of mortgage loan process will enable the low-income population to be familiar with the mortgage loans system.

The main purpose of mortgage financing of apartments or residential dwelling houses is to provide the low or average income people (since they have difficulties for paying the lump sum for an apartment or a dwelling house) with housing conditions. In this way, they may pay the amount for procurement of an apartment or a dwelling house in installments, and may solve the problem of their housing needs when not having the entire amount. In regard to the aforementioned, mortgage financing of a real property appears to be the only financial instrument, therefore, development of mortgage market is of utmost importance for not only low-income population, but also for other private parties involved therein.

One of the participants of mortgage lending process are financial intermediation institutions (in other words lenders), which may be commercial banks or credit organizations. Acting as lenders, they provide the large sum of money for real property procurement and, as a rule; they obtain a certificate on pledge right in their name from the local office of State Committee of Real Property Cadastre under RA Government (pursuant to Article 26, RA Law "On State Registration of Property Rights"). Mortgage lenders take the real property as collateral for a loan, which will provide a claim upon that collateral and will take priority over other lenders. They gain much profit from annually fixed interest rates and therefore, pursue a great interest in mortgage market development.

---

<sup>1</sup> *Collateral* – is the security for the extended loan

The other participants are home buyers (Armenian citizens, residents with a special status of residency). They are greatly interested in mortgage financing, since they have an opportunity to purchase an apartment or a dwelling house by paying in installments for that property in case of low or medium income, and builders (housing construction companies). The above-mentioned two participants are referred to as mortgage borrowers. The principal function of mortgage borrowers in the process of mortgage loan provision is to provide real property to the mortgage lender as collateral. They receive the relevant funds for the real property purchase against the aforementioned collateral, make the required payments and maintain possession of the property, which is deemed to be collateral of the mortgage lender. The mortgage borrowers are entitled to have the mortgage discharged from the title, once the debt is paid. In the event of failure to repay the mortgage loan in compliance with the terms set forth by the mortgage lender, the latter is entitled to foreclose on the property.

Real estate agencies are also from the set of participants in the mortgage financing transactions. They also have their interest in mortgage market development, since the number of real property transactions will increase through mortgage financing and therefore, real estate agencies will be engaged in more and more real property sale and purchase transactions. Furthermore, they have a great interest, since very often commercial banks make a request to real estate agencies for collateral evaluation (since these agencies render also real property evaluation services), when the banks and home buyers do not have consensus in regard to the market value of the collateral.

Hence, taking into account the above stated purpose and high importance of mortgage financing institution and the interests of private parties involved therein, Armenia, as country with a transition economy, along with other developing and developed countries attach high importance to mortgage market development.

Nowadays, the Election Program of RA President, Serzh Sargsyan, is the primary and basic program, which directs and sets the key priorities for RA Government activities.

Particularly, Part 3 entitled “Competitive, Innovative Economy” envisages the continuation of RA Government’s policy related to deepening the financial intermediation institutions by stating that “financial services will be affordable and accessible all across Armenian territory. Any newly created family will have the possibility to purchase an apartment”<sup>2</sup>.

Thus, public policy being implemented by the state authorities of the Republic of Armenia in terms of developing mortgage financing mechanisms is as follows:

- Regulation of legislative field by making amendments and supplements in RA Legislation concerning the mortgage market regulation (RA Civil Code, RA Law “On Compulsory Enforcement of Court Decrees”, etc.), adopted on October 4, 2005<sup>3</sup>.
- Deepening the role of financial institutions in mortgage market by inputting the necessary mechanisms for private sector involvement therein. In order to stimulate the aforementioned mechanisms, RA Government has requested a number of international organizations, such as KfW (German donor bank dealing mostly with mortgage loans), USAID Head Office, USAID-funded Financial Sector Deepening Project, etc. Pursuant to RA Government request, KfW has taken the leading role among donor organizations in the development of housing finance sector.

Nowadays, KfW is fully integrated in primary and secondary mortgage finance markets. In its turn, USAID’s Credit Review Board recently approved a new Development Credit Authority (DCA) guarantee. The bond guarantee to the First Mortgage Company (FMC) Universal Credit Organization will allow the latter to issue \$5 mln. in bonds with a maturity of up to 10 years.<sup>4</sup>

Increase of financial services affordability will be one of the results of the first key priority envisaged by RA Government Program (adopted in April 28<sup>th</sup> of 2008)<sup>5</sup>, which involves poverty reduction by fostering participation of the low-income population in economic and

---

<sup>2</sup> [http://www.president.am/library/program/program\\_eng.doc](http://www.president.am/library/program/program_eng.doc) (on 19<sup>th</sup> of June, 2008, at 15:08)

<sup>3</sup> <http://www.parliament.am/legislation.php?sel=alpha&lang=eng> (on 19<sup>th</sup> of June, 2008, at 15:20)

<sup>4</sup> <http://www.usaid.am/index.php/en/17/253/> (on 19<sup>th</sup> of June, 2008, at 15:34)

<sup>5</sup> [http://www.gov.am/enversion/programmms\\_9/pdf/cragir\\_eng2008.pdf](http://www.gov.am/enversion/programmms_9/pdf/cragir_eng2008.pdf) (on 19<sup>th</sup> of June, at 15:42)

civil life through targeted social policy, since people with low income will have access to real property market. Development of financial institutions will grant many possibilities to obtain the desired economic and social results, to develop housing construction, which will have a direct impact on the public. It will solve not only the problem of housing needs, but also employment. Moreover, development of financial institutions and well-regulated legislative field for mortgage market development will increase the process of making investments in Armenia.

## **ARMENIAN LEGAL FRAMEWORK AND IMPLICATIONS**

In the support of mortgage market development in Armenia, the state authorities have undertaken a lot of legislative reforms in respect to mortgage transactions. During the recent decade, the RA Government along with RA Central Bank (hereinafter referred to as CBA), a number of donor organizations involved in the development of this sector and commercial banks, other state agencies, such as State Committee of Real Property Cadastre under RA Government, have taken a lot of necessary measures for regulating the mortgage lending.

RA legal acts<sup>6</sup> are listed below with their relevant amendments:

**1. RA Civil Code - Articles 260-264, 1. General Provisions of §2 Mortgage**, with relevant amendments therein (adopted on 5<sup>th</sup> of May, 1998), which are as follows:

- **Article 260 – Concept of Mortgage**
- **Article 261 – Mortgage Contract (no amendment made)**
- **Article 262 Content of Mortgage Contract**
- **Article 263 – Form of Mortgage Contract**
- **Article 264 – State Registration of the Right of Mortgage**
- **Article 269 – General Provisions on Mortgage of Dwelling Houses (Apartments), Buildings and Constructions.** (no amendment made),

---

<sup>6</sup> [www.parliament.am](http://www.parliament.am) (on 1<sup>st</sup> of July, 2008, at 13:34)

- **Article 270 - *Mortgage of Apartments in Multi-Apartment Buildings***
- **Article 271 – *Mortgage of Dwelling Houses, Buildings and Constructions under Construction***
- **Article 272 – *Expropriation of the pledged dwelling house or apartment.***

RA Civil Code (adopted on May 5<sup>th</sup> of 1998 by RA National Assembly) covers also the legal framework for the right of pledge, which is mentioned below:

- **Articles 226-252, §1 General Provisions on Pledge, Chapter 15** with relevant amendments made therein (adopted on February 11<sup>th</sup> of 2005 year by Ra National Assembly).
2. **RA Law “On State Registration of Property Rights”** (adopted by RA National Assembly, dated April 14<sup>th</sup> of 1999) – Articles 26, 27, 28, 30.
    - **Article 26 – *State Registration of Pledge, Mortgage Right***
    - **Article 27 – *Certificate on Registration of the Right of Pledge, Mortgage***
    - **Article 28 – *Encumbrances (ban) on property Subject to Pledge, Mortgage***
    - **Article 30 – *Registration of the Right of Pledge, Mortgage and Considering the Certificate of the Right of Pledge, Mortgage Invalid***
  3. **RA Law “On Banks and Banking Activity”** (adopted on June 30<sup>th</sup>, 1996, by RA National Assembly) – Articles 34, 38, Section 4 “Regulation on Banking Activity”
    - **Article 34 – *Financial Transactions***
    - **Article 38 – *Relations between Banks and Customers***
  4. **RA Law “On Compulsory Enforcement of Court Decrees”** (adopted by RA National Assembly, dated May 5<sup>th</sup>, 1998, with respective amendments adopted on October 4, 2005, by RA National Assembly).
    - **Article 22 – *Delay or Extension of Enforcement of Court Decrees, and Change of Method and procedure of Enforcement.***

Hence, the aforementioned legal acts in respect to mortgage transactions in the Republic of Armenia being effective within the recent decade comprise a huge comprehensive package of realistic legislative tools for future development of such a financial tool as the mortgage financing. New amendments made in the above-mentioned legal acts manifest about the RA state authorities intention to improve and enhance the use of mortgage financing for apartments and dwelling houses procurement.

Thus, the primary RA legal acts in regard to mortgage and pledge are listed below with the pertinent extracts and relevant authorities underlined, as well as by making a reference to the aforementioned legal acts in regard to mortgage market improvement in Armenia:

- ***Article 260 - Concept of Mortgage***

“Mortgage is considered to be the pledge of real property, as well as the pledge of the right upon land parcel construction”.

- **Article 261 – Mortgage Agreement** (no amendment made)

“The pledgee, one of the parties of mortgage agreement, who is the creditor according to loan agreement secured by mortgage or other liability (fixed liabilities), has a priority right to satisfy his monetary demands from the value of the collateral among the other creditors of the pledgor”. (Mortgage agreements are drafted by Credit Departments of commercial banks).

- **Article 262 – Content of Mortgage Agreement**

“2. The subject of mortgage is determined by noting its name (title) and location (domicile) in the mortgage agreement and by a sufficient description of that subject identification. If the subject of mortgage is the right of pledgor, then the grounds of that right’s origination shall be described in the mortgage agreement.”

as well as the real property, upon which the pledgor has that right and the state registration body, which registered that right”.<sup>7</sup>

“4. If the mortgage-backed liability shall be made in installments, then the periods of respective payments or periodicity shall be mentioned in the mortgage agreement, as well as the sizes or the necessary conditions for those sizes determination”.<sup>8</sup>

“5. While providing a loan for purchasing a land parcel, the latter may be defined as collateral<sup>9</sup> in the mortgage agreement to secure the performance of liability”.

- **Article 263 – Form of Mortgage Agreement**

“1. Mortgage agreement may be both bilateral and multilateral”.

“2. Parties may conclude a mortgage agreement comprising elements of a number of agreements. Rules of the agreement, the elements of which are included in the mortgage agreement are applied on such agreement parties with respective parts, unless otherwise derived from the consent of parties or the essence of mortgage agreement”.

“4. Mortgage agreement shall be verified by the public notary”<sup>10</sup>.

- **Article 264 – State Registration of the Right of Mortgage** (implemented by the State Committee of Real Property Cadastre under RA Government).

“1. Right of pledge under a mortgage contract is subject to state registration”.<sup>11</sup>

---

<sup>7</sup> **This is a good point**, since the pledgor will be once more certain about his/her rights upon the pledged property.

<sup>8</sup> **This is a good point**, because in the event of payment in installments, it is necessary to mention the periods or periodicity, the sizes or conditions for their determination, since, first, it gives a forecast for the borrower, and secondly, it gives legal protection to the creditor in case of payment delay to define a fine, as well as to specify the problem borrowers as soon as possible.

<sup>9</sup> **Collateral** – is the security for mortgage transactions to secure the liabilities performance until the full redemption of the provided loan.

<sup>10</sup> **This is a good point**, since public notaries check the authority of three parties in mortgage transactions (seller, buyer, bank representative) and then verify the mortgage contract.

<sup>11</sup> **This is a good point**, since pledge right should be as secure as possible.

- **Articles 269-272, (3. Mortgage of Dwelling Houses (Apartments), Buildings and Constructions, §2 Mortgage)**, with relevant amendments therein (adopted on February 11<sup>th</sup> of 2005 year), which are as follows:

- **Article 269 – General Provisions on Mortgage of Dwelling Houses (Apartments), Buildings and Constructions.** (no amendment made)

“1. Mortgage is not permitted on state-owned or community owned multi-storey and individual dwelling houses and buildings”.<sup>12</sup>

- **Article 270 - Mortgage of Apartments in Multi-Apartment Buildings**

“2. In case of a mortgage of an apartment of a multi-apartment building under construction, before formulating the completion act of the building according to the defined procedure and after the state registration, the mortgage right is spread on the apartment purchased with an ownership right and its respective parcel in joint ownership and the part thereof”.<sup>13</sup> (The 2<sup>nd</sup> paragraph was amended on 22.12.05).

## **2. RA Law” On State Registration of Property Rights”**

- **Article 26. State Registration of Pledge, Mortgage Right, RA Law «On State Registration of Property Rights»:**

«1.State registration of pledge, mortgage right is carried out at the location of collateral by the local office of State Register of the Real Property.<sup>14</sup>

- **Article 28 Encumbrances (ban) on Property Subject to Pledge, Mortgage, RA Law «On State Registration of Property Rights»:**

«After registration of pledge, mortgage right, encumbrance is applied on the property according to the prescribed procedure. The application of procedure of encumbrance is defined by State Register of Real Property. During pledge,

<sup>12</sup> It means that title registration is as obligatory as any other obligation of the citizen, thus citizens with no title certificate shall not be involved in mortgage transactions.

<sup>13</sup> It enhances the possibilities of citizens to buy an apartment, despite the fact that the building is still under construction, it means that prices will be more affordable than after the completion act.

<sup>14</sup> State Committee of Real Property Cadastre under RA Government

mortgage right registration no document contradicting thereto shall be registered (implemented by the Local office of RA State Cadastre Committee).

- **Article 22 - *Delay or Extension of Enforcement of Court Decrees, and Change of Method and procedure of Enforcement, RA Law «On Compulsory Enforcement of Court Decrees»*** (amendments and addendums made in the 1st and 2nd provisions):

«.....The Court may delay or extend the enforcement of court decrees, if the debtor is ready to provide the creditor an equitable security, and it is obvious that the compulsory enforcement is not necessary, since the court decree will be implemented voluntarily within a reasonable timeframe».<sup>15</sup>

“2. The analysis of the application on delay or extension of the enforcement of the court decrees, on change of the method and procedure thereof does not cancel the enforcement proceeding, including as a security for the application”.<sup>16</sup>

Mortgage transactions are implemented pursuant to the above-mentioned legislation. The first step is when the seller of an apartment go to the Local Office of RA State Cadastre Committee and receives a reference stating that there are no encumbrances on the property and then with a buyer (hereinafter Borrower) go to the Bank (hereinafter Creditor) and all three parties conclude a mortgage contract.<sup>17</sup> Then the contract parties go to the notary office and verify it there.<sup>18</sup> After the notary’s verification, the Creditor goes to LO of the Committee and register the mortgage contract there and also encumbrance on the collateral.<sup>19</sup>

---

<sup>15</sup> This addendum is one more legislative reform made in regard to enhancement of mortgage transactions number.

<sup>16</sup> This amendment is a real tool in support of the 1<sup>st</sup> provision, to ensure the process of compulsory enforcement act.

<sup>17</sup> Article 38 of RA Law “On Banks and Banking Activity”

<sup>18</sup> Provision 4, Article 263 (Form of Mortgage Contract), RA Civil Code

<sup>19</sup> Article 28, RA Law “On State Registration of Property Rights”

In the end of a transaction, the Local Office of RA State Cadastre Committee issues a title certificate on Pledge Right in the name of Creditor.<sup>20</sup> The other procedures are implemented as prescribed by the mortgage contract.

The interviews with the Cadastre and bank management authorities<sup>21</sup> reveal that actually mortgage transactions are carried out in compliance with RA legislation. Moreover, banks and credit organizations are actively involved in mortgage lending operations, but they state that the process of legislative reforms should be continuous, so that to provide more incentives for the population to get involved in mortgage transactions.

### **International Best Practice**

Referring to the practice of countries with developed market economy, it should be noted that in these countries the development of mortgage market has been viewed as the significant component of the economic policy (e.g. in the USA – New Course of Roosevelt, in the Germany – Post War Reforms of Gerhard, in Chilly – reforms of Pinochet, etc.).<sup>22</sup>

It is worth mentioning that throughout the recent decades those highly developed countries have used a lot of techniques in respect to mortgage loans extension and increase of the population's affordability for procurement of apartments and residential houses through mortgage loans.

Furthermore, the lending process have been viewed from the social aspect, thus, the states with developed market economy assisted the role of private sector by making a lot of amendments in the legislation related to mortgage loans, the role of the state participation was also highly emphasized in regard to capacity enhancement for financial intermediary institutions by giving them a wide discretion to select the most appropriate ways for

---

<sup>20</sup> Article 26 RA Law “On State Registration of Property Rights”

<sup>21</sup> Mr. Mikael Pashayan, Head of International Department and Cadastral Projects' Implementation of the State Cadastre Committee under the Government of the Republic of Armenia, (personal interview on 25<sup>th</sup> of May, 2008) and Deputy CEO of “Ararat Bank” OJSC, Arthur Hakobyan (personal interview on 1st<sup>th</sup> of June, 2008),

<sup>22</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 16<sup>th</sup> of July, 2008, at 13:56)

utilization of a number of mechanisms in mortgage loans extension. Such financial intermediary institutions are mortgage banks, which were the most widespread institutions that allotted mortgage loans until the Second World War, and those banks autonomously issued mortgage securities to attract long-term financial operations and have been established on the so-called one-level system of mortgage lending. Such systems prevailed in Denmark, Sweden and Canada and were highly developed in Germany, Austria, Netherlands, Great Britain and Finland<sup>23</sup>.

Mortgage banks still exist and effectively operate in Germany, though first founded two centuries ago.

“In Canada, mortgage banks are the traditional type of lending institute. They are mostly engaged in lending of the real estate transactions, as well as in long-term investments in state and corporate securities. At the first stage, the objects of their activities were the lending to the field of agriculture, based on the wadset of soil, and later, lending to the housing construction. In Denmark there is an established real estate lending system, in which the mortgage obligations are secured by 100%, i.e. the latter are transferred into securities that are distributed in the markets with the aim of involving long-term loan proceeds. As a result of the latter, currently, Denmark is the owner of 29% of mortgage securities in turnover in Europe (the only leader is Germany with 44%)”.<sup>24</sup>

In support to presenting highly effective models known worldwide, American model (as an example of common-law country) and German model (as an example of civil-law country) are mentioned below with their advantages and disadvantages.

Furthermore, the German model is presented in a more detailed way, since both it is highly effective in Germany and has a wider usage all across the world than any other model, because of proper and favorable German legislation, especially in Eastern Europe many

---

<sup>23</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 16<sup>th</sup> of July, 2008, at 14:55)

<sup>24</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 16<sup>th</sup> of July, 2008, at 15:24)

countries have used the German model, since it is the one mostly corresponding to the economic reality.<sup>25</sup>

Two main mortgage lending models are known worldwide; these are the American and German Models.<sup>26</sup> The aforementioned models are known with their best working schemes and providing much affordability to the low-income population. They are presented below with their advantages and disadvantages.

“The essence of the German model is as follows: The main sources of mortgage lending are the deposits involved by specialized organizations. The investor takes the responsibility of transferring a fixed amount to the cumulative deposit account within a certain period of time. After the end of the cumulative period of time, after having accumulated the part (usually the half of the required amount) of the proceeds for the procurement of an apartment, the depositor receives the mortgage loan. The interest rates of the deposit and mortgage loans is lower than the set average interest rates in the market and are set in the Deposit Contract beforehand. Those proceeds, which the investor provides to the loan-savings bank serve as a long-term source of proceeds and use the cumulative period for the provision of loans by the same scheme for those depositors, who have already passed that period”.<sup>27</sup>

It should be mentioned that the model mentioned above has advantages, one of which is that the low-income population have chances to accumulate their savings in a bank and then after certain period of time to purchase an apartment through mortgage financing provided by the same bank and which is more important with lower interest rates than the ones existing in the market. The other positive side of the German model is that the lenders have more chances to learn about the borrowers’ creditability. In most developed countries (in Armenia as well) Credit Registry is established in the Central Bank, which allows the

---

<sup>25</sup>[www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 16<sup>th</sup> of July, 2008, at 17:34)

<sup>26</sup>[www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 16<sup>th</sup> of July, 2008, at 17:50)

<sup>27</sup>[www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 16<sup>th</sup> of July, 2008, at 19:07)

lenders to know about the credit history of each borrower and thus, make an opinion about the solvency of its customers.

The only negative side of this mortgage loan system is that there should be a great trust towards the banks operating in the country<sup>28</sup>, but since the mortgage market is developing only in the countries, where actually the universal commercial banks and credit organizations are established, in this respect it may not be viewed as the shortcoming of the model. The essence of the American model is presented below:

“The United States of America has the most active mortgage market all over the world. There are two main types of mortgages – fixed-rate mortgages and variable-rate mortgages. Fixed rates stay the same throughout the tenure of the mortgage, and variable-rate mortgages, which are known also as adjustable-rate mortgages, or floating-rate mortgages, which offer rates that may fluctuate or be adjusted”.<sup>29</sup>

“The specification of the American Model of mortgage financing is the division between the bank-lenders and sources of proceeds (issuance of mortgage securities). As a result of substantial government participation, the Agency of Housing Mortgage Lending has been established, and the securities issued by the Agency are insured by the federal budget.

In the US, people can get mortgages from government sponsored entities or GSEs, including Fannie Mae, Ginni Mae and Freddie Mac. These organizations operate under federal charter and are overseen by the federal American government.”<sup>30</sup>

Despite the fact that the aforementioned model works in an effective manner in the United States, most probably it may not be effective in many developing countries, since it requires developed securities market, which certainly is not yet developed in Armenia as well.

---

<sup>28</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 17<sup>th</sup> of July, 2008, at 15:22)

<sup>29</sup> <http://www.economywatch.com/mortgage/usa.htm> (on 17<sup>th</sup> of July, 2008, at 16:14)

<sup>30</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 17<sup>th</sup> of July, 2008, at 16:44)

What generalizes all the models existing across the world is the global problem in long-term mortgage crediting, which exists in both models, as well as in a number of models not discussed herein. That is the problem of attracting long-term funds. In the first model (German model) deposits are viewed as solution for that problem, in the American model issuance and allocation of mortgage securities are deemed to be the solution for long-term funds.

In comparison with the above-mentioned models of developed countries, Armenia has a problem, since the average salary in the Republic of Armenia is about 57000 AMD and mortgage financing through cumulative deposit accounts and construction savings bank is complicated. The reason is that for mortgage loan redemption you should monthly pay 30-35% of your income<sup>31</sup>, which is merely impossible. Therefore, for solving the insolvency of low-income population, the second generation reforms were set in the Election Program of RA President.

Studies show that almost in all the countries with developed economies and banking systems, the development of mortgage credit markets through universal commercial banks is very common.<sup>32</sup>

Thus, Armenia is on the right way to mortgage market development, since mostly the universal commercial banks extend the mortgage loans.

## **REFORM**

The two models (German and American) were both much efficient in the USA and Germany, despite their disadvantages existing therein, but the application of these two models in such a developing country as the Republic of Armenia should be considered after taking into account all the risks inherent to the mortgage market of Armenia. In addition, the economic and social status of the country should be taken into consideration, since not only

---

<sup>31</sup> [www.fsdp.am](http://www.fsdp.am) “Guide to Credits and Loans”, (on 22<sup>nd</sup> of July, 2008, at 11:24)

<sup>32</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 22<sup>nd</sup> of July, 2008, at 12:32)

the application, but the development of the mortgage market is directly connected with the social-economic indicators of the country.

In regard to the development, many of the indicators may seem to be impediments for these two models application, since the models were applied in the developed countries and a great difference between the average salaries exist. Furthermore, the trust towards the banking system and the real estate market stability has just started to increase. Thus, the aforementioned may be deemed as risks for applying the models, the trust toward the banking system is not a great risk, but it still exists and depends mostly on the country's economic and social growth tendencies, regional sustainable situation, political developments and, certainly, on the volumes of residential construction, the same factors exist in determining the sustainability of the real property market. Besides the risk factors mentioned above, there are other risks like the interest rates, which depend on the fact whether the interest rates of the state bonds are stable or not, and whether the interest rates used during the lending process are sustainable or changing types of interest rates. In respect to the risks existing in the application of foreign countries' models in Armenia are assets quality and cash flows, which may be deemed as factors depending on the assessment of the real estate, lending, the basis of which is considered to be the collateral.

The other factor of determining the possible risks in the mortgage market development are financial intermediary institutions and infrastructures, their stability and the legal framework covering all the activities thereof. Development and financial stability of the private sector infrastructures are also highly valuable in this regard, since they should meet the economic demands and have sufficient funds for loan extension.

Hence, the last risk is the utilization of the mortgage market, which is mostly connected with the government participation, and in this respect the Central Bank should be the responsible state authority.

After determination of all the risks existing or most probably will exist when applying the model, all the risk mitigation solutions should be taken into consideration, since only after

the risk factors determination the model may be selected by decision-makers of the mortgage market development.

The Government of the Republic of Armenia suggests applying a combined variant of European-American models in the Republic of Armenia, since our experience has shown that both models have their positive sides and have already proved their viability by means of efficient activity in the economy. The basis for the formation of this approach is the fact that the European and American models have already been used.<sup>33</sup>

“Taking into consideration that Armenia is on the way to the EU, we thereto consider that the priority should be given to the European Model. In other words, it is important to apply in Armenia 4 non-exclusive (in some cases even supplemental) options, in which some new approaches are also applied.”<sup>34</sup>

The only factor of high importance for applying the foreign country’s model should be the actual situation and existing risks in the given country.

Thus, taken into account the aforementioned risk factors and the economic indicators, the current situation in the banking system and in the real estate market, application of the German model as the basis for reforms implementation is highly recommended. Furthermore, considering the fact that nowadays many Armenian citizens have time deposits, current accounts, cumulative accounts as their savings in the universal commercial banks of Armenia, and the high level of trust towards the Armenian and foreign commercial banks operating in Armenia exists in parallel with the increasing social-economic indicators of the country, this model may be of great importance and highly effective.

For Armenia, as a developing country, the application of the German Model may give an opportunity to save the state budgetary resources, since it does not require high state expenditures.

---

<sup>33</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 22<sup>nd</sup> of July, 2008, at 17:00)

<sup>34</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 22<sup>nd</sup> of July, 2008, at 18:11)

There are a lot of opportunities for the universal banks to start cooperation with the borrowers, since they are the depositors and to have a wide knowledge about the creditability of the borrower before the mortgage loan extension.

Thus, the main stakeholders for the public sector, in this respect, are the RA Ministry of Finance, the State Committee of Real Property Cadastre under the Government of the Republic of Armenia, the Central Bank of Armenia. And from the legislative respect, the main decision-maker is RA National Assembly. Each of them has its unique role and responsibility in reforms implementation regarding the mortgage market.

While implementing the reforms and thus, mitigating the aforementioned risks, the Government should take into consideration the main purposes, such as market relations and private sector role strengthening, mitigation of the State participation in the mortgage market. “International studies have shown that direct participation of the State in the process of development of the mortgage market (in spite of the presence of system-defined risk) can be efficient only in case of maturity of capital and mortgage loan secondary market, direct and permanent participation of the State puts market into unreasonable dependence from the State”.<sup>35</sup>

The State should be mostly involved in making effective amendments and addendums in the legal acts related to the mortgage market, since a number of economic and social reforms are implemented in the country. The State should also be engaged in the development of financial intermediation institutions, which is of great significance for the population, since the more developed financial institutions will be, the more actively the population will use mortgage loans provided by the latter. One of the important roles that the State must be involved is the increase of public awareness and in this respect, assisting the private sector in the aforementioned activities. One of the major activities may be considered to be the Mortgage Borrowers Guide developed by the USAID-funded Financial Sector

---

<sup>35</sup> [www.minfin.am](http://www.minfin.am) “Concept Paper on Mortgage Market Development in the Republic of Armenia” (on 22<sup>nd</sup> of July, 2008, at 19:41)

Deepening Project. It enables the future and current borrowers to have the appropriate information. It also provides the mortgage customers with the checklist of financial institutions to enable them to select the best deal in Armenia. The project is also involved in increasing the low professional capacity in the mortgage market, enhancing the opportunities of lenders so that they will be able to identify and diminish the risks regarding lending of the real estate. There is a need to educate them in mortgage lending techniques, risk management, valuation and appraisal methodologies. The regulatory body, (the Central Bank of Armenia), which oversees banks that have mortgage and real estate lending portfolios, also needs capacity building in these areas<sup>36</sup>.

In the result of public awareness increase not only the population will be actively engaged in real estate transactions, but also many private sector actors will start more actively participating in the mortgage loans extension.

All the aforementioned approaches will provide a significant basis for the economic reforms implementation in the country, and first of all, the most important incentive for mortgage market development and housing construction enhancement should be the goal of the State to ensure decent life for its population, which is highly emphasized in RA President Serzh Sargsyan's Election Program<sup>37</sup>, based on which the Government of the Republic of Armenia has developed the Government Program (adopted in April 28, 2008).<sup>38</sup>

---

<sup>36</sup> <http://www.fsdp.am/index.php?p=11&l=eng> (on 23<sup>rd</sup> of July, 2008, at 17:09)

<sup>37</sup> [www.president.am](http://www.president.am) (on 24<sup>th</sup> of July, 2008, at 20:18)

<sup>38</sup> [www.gov.am](http://www.gov.am) (on 24<sup>th</sup> of July, 2008, at 10:14)

## **BIBLIOGRAPHY**

[www.president.am](http://www.president.am)

[www.parliament.am](http://www.parliament.am)

[www.gov.am](http://www.gov.am)

[www.minfin.am](http://www.minfin.am)

[www.economywatch.com](http://www.economywatch.com)

[www.fsdp.am](http://www.fsdp.am)

### **RA legal acts and programs used in the master's paper**

**RA Civil Code** (adopted on May 5<sup>th</sup>, 1998)

**RA Law “On State Registration of Property Rights”** (adopted on April 14<sup>th</sup>, 1999)

**RA Law “On Banks and Banking Activity”** (adopted on June 30<sup>th</sup>, 1996)

**RA Law “On Compulsory Enforcement of Court Decrees”** (adopted on May 5<sup>th</sup> of 1998)

**RA President’s Election Program** (effective after 2008 presidential elections)

**RA Government Program** (approved on 28<sup>th</sup> of 2008)