

# Mortgage lending market: problems and development prospects

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## Abstract

The paper reveals the essence of the modern mortgage lending market carried out by banking institutions in Ukraine. The peculiarities of the market functioning and the factors that restrain its development in modern conditions are considered. The definition of the concept of “mortgage” is theoretically substantiated, and the general financial and economic characteristics of mortgage lending in Ukraine are provided. The paper considers main indicators of banking activities in mortgage lending in Ukraine for 2018-2021. The article reveals the analysis of consumer lending dynamics and proves that mortgages has been playing a key role in banking activities due to providing a significant part of income, proper consideration of the benefits and risks of working in this direction, as well as increase the stability of banks. To manage credit risk, the National Bank of Ukraine (NBU) has introduced risk factors for unsecured consumer loans. New credit approval standards for financial institutions were studied and it was established that the repayment term is one of the factors affecting the number of mortgage loans. It has been proven that the mortgage lending volume is greatly influenced by exchange rates.

Analysis of the situation in the primary market reveal that certain relations regarding the provision and repayment of the mortgage are formed between the mortgage lender and the borrower. The secondary market functions to refinance mortgage lenders and to attract loans through issuing mortgage securities, selling mortgage assets to banks, secondary professional non-bank mortgage financial institutions or use these mortgage assets as collateral. Secondary mortgage institutions must ensure the activity of mortgage lenders on the primary mortgage market with risks diversification and carrying out measures to refinance mortgage lenders at the expense of funds from the placement of mortgage securities. The secondary mortgage market was created due to the banking system seeking to finance long-term mortgages at the expense of short-term bank liabilities. That is why the creation of the secondary mortgage market is one of the main priorities of the state policy in the national mortgage system development. The interest rate on mortgage loans is one of the important factors affecting loans. Therefore, this factor needs a more profound analyzing.

**Key words:** market, mortgage loan, banking institution, long-term loan, interest, real estate, lenders, borrowers.

## Introduction

Despite the severe war in Ukraine, the market for long-term mortgages is still working. Moreover, the government makes relevant decisions regarding the restart of the subsidized mortgage

program. Being a modern financial instrument and an integral part of the market economy, mortgage is an important factor in the country's economic and social development. The growing demand for mortgage banking products, which is accompanied by positive macroeconomic trends and the extended transformation of the domestic market, requires a detailed study of mortgage lending impact on the economic system, since the efficiency of using mortgage mechanisms does not, for the most part, correspond to the huge economic potential these mechanisms have. Often, the participants of the mortgage system apply inefficient methods while the role of the state, which is especially important at the initial stages of the formation of these financial and credit relations, remains fragmented.

From the point of view of world experience, mortgage loans, being an integral part of the financial system, imply a relationship between the procedure for availability of a real estate pledge for obtaining special loans and the ratio between the actual obtaining of mortgage loans. Therefore, as mentioned above, the mortgage system combines economic, legal and social aspects. One of the peculiarities of the Ukrainian mortgage system, which differs from the international one, is that the mortgage market still does not use complex instruments and is not fully integrated into the national and even global financial system.

However, in the conditions of the global crisis, the influence of external factors, including negative ones, is extremely limited, and sometimes it is even imperceptible. The negative consequences are mostly indirect, due to the general state of the banking system, a decrease in the amount of available investment resources, formed mainly at the expense of population savings, exchange rate fluctuations, political and macroeconomic instability, etc. However, even the smallest manifestation of the crisis can harm the mortgage market with a short history and its multifactorial nature at the stage of formation.

The development of mortgage lending requires performing many tasks in various areas, from the development of guarantee systems and transparent conditions for the activities of mortgage market participants to the standardization and unification of mortgage lending procedures. However, the immediate priority is to expand the ability of banks to attract financial capital. This will lower mortgage rates and make it more affordable for people. In Ukraine, the deposit model of financing dominates, which significantly limits the amount of mortgage lending.

Issues of the development of the mortgage lending market are the subject of ongoing research in world economic science. A significant contribution to their study was made by foreign scientists such as: T. Galbraith, A. Gregory, J. Dixon, T. Copeland, G. Markowitz, A. Marshall, J. Soros, K. Steven, D. Ricardo, J. Richard, H. Paull, C. Walsh, G. Harrison, J. Hika, H. Herbolt, K-P. Follak and in the studies of domestic scientists, in particular, A. Danylenko, M. Demyanenko, V. Mesel-Veselyak, O. Yermakova, V. Kilocho, S. Kruchko, V. Kilocho, I. Liutiy, A. Martyn, P. Sabluk, V. Savych, M. Stupen, N. Tanklevska, A. Chupis, O. Shpychak and other scientists.

The paper aims to scientifically substantiate theoretical and practical principles of bank mortgage lending in Ukraine and provide a detailed financial and economic analysis of one of the largest banks of Ukraine, JSC KB PrivatBank, and the financial condition of its insurance partners. The study also aims to develop recommendations on ways to optimize the provision of targeted mortgage loans and identifying possible prospects for cooperation of the bank under study.

## ***Material and methods***

A complex of general scientific methods was used to achieve the aim of the research. Observational and comparative methods were used to determine the analysis of financial commercial bank. We used a selective method, since the degree of integration of banks and insurance companies is always individual. Therefore, it is advisable for each institution to use a representative sample of several companies. The method of mathematical processing of time series was also in the research, since it

is the basis of horizontal and vertical analysis of the enterprise's activity, assessment of the financial state.

## **Results and discussion**

A mortgage is an important factor in economic development stimulation, it is a modern financial method, and its effective use will ensure an investment increase in the economy of Ukraine. The concept of "hypotheca" originated in Ancient Greece in the 7th-early 6th centuries. B.C. and deals with securing the liability of debtors who own land to creditors. Solon, one of the "Seven Sages", proposed transferring the debtor's personal responsibility to property. Therefore, it was customary to place a sign on the border of the debtor's property rights to the land stating that the land is the security of a certain number of claims. Later, special books called mortgage books appeared for this purpose. These records ensured publicity, which allowed each interested party to determine the status of the property without any hindrance. The mortgaged land is not transferred to the creditor, and the debtor continues to use it and earn a profit.

The Romans significantly expanded the scope of mortgage lending. In Roman law, mortgage was considered one of the three, along with fiducia and pignus, the most developed form of mortgage in Rome. Historically, the mortgage became widespread in the classical period of the development of Roman law and was formed taking into account the experience of using previous practical forms of debt security – fiducia and pignus.

The main essence of fiduciary is that after the conclusion of the contract, the right of the creditor to the pledged immovable property immediately arises, the subject itself is transferred to the trustee, and the creditor is obliged to return the immovable property in a timely and proper manner.

According to the fiduciary management agreement, the debtor transfers to the creditor (pledgee) the property agreed by the parties in exchange for the funds received, with the condition that the debtor returns the pledged property to the debtor when he fulfills his obligations. If the collection fails, even though the amount owed is significantly less than the value of the pledged property, the property still belongs to the creditor. In this case, the former debtor is only entitled to damages from the former mortgagee.

Pignus provides for the transfer of real estate as a mortgage, which is no longer the property, but possession, and only as a security for the fulfillment of the borrower's obligations. Such collateral will be sold at public auctions. If the amount received from the sale exceeds the amount owed, the balance is returned to the lienholder. Gradually, the mortgage was included in medieval European legislation. In Germany, it appeared before the 14th century, in France – from the 16th century. In Prussia, the mortgage system was introduced by statutes of 1783 and 1872, and in Austria – by the Civil Code of 1811 and a statute of 1871. Mortgages were common practice in Europe at the end of the 18th century, especially in England, France, Germany, and Russia, and were used by representatives of nobles and rich aristocrats to buy land.

Scientists consider the nature of the concept of "mortgage" from a legal and economic point of view. According to scholars, the legal aspect of a mortgage is that it acts as a special type of loan, credit, sale or lease agreement that secures a debt obligation and remains in the possession and use of the mortgagor. The economic aspect of a mortgage is that a mortgage is a combination of a real estate pledge and loan capital and acts as collateral for real estate to secure a debt obligation that is designated as a loan.

According to Art. 1 of the Law of Ukraine "On Mortgages", a mortgage is a type of securing the fulfillment of an obligation with real property that remains in the possession and use of the mortgagor, according to which the mortgagee has the right, in the event of non-fulfillment by the debtor of the obligation secured by the mortgage, to obtain satisfaction of his claims primarily at

the expense of the subject of the mortgage primarily the other creditors of this debtor in the manner established by this Law.

According to A. Dyachenko, a mortgage loan is granted to the borrower for the construction or purchase of a specific object, or another real estate object, or a future object built at the expense of the loan.

Like any phenomenon, the nature of mortgage lending is revealed through its principles, which are the general rules for the creation and operation of any mortgage scheme.

Lavrushyn O. gives the main principles of mortgages:

1. Loans are determined in the form of mortgage shares.
2. The possibility of leaving the property to the borrower.
3. Obtaining additional mortgage loans secured by the same real estate.
4. Loans are granted taking into account the insurance.
5. Loss of real estate in the event of undue payment of debts.

Yevtukh O. argues that an important principle of long-termism should be added to the category of financial and credit foundations.

The social and legal foundations of mortgages are covered in the most detail by I. Puchkovska. The author highlights the following principles of mortgage: specialty, obligation, transparency, credibility, irreversibility and seniority.

The principle of the specialty is that a record of the rights to the specified property, which is the subject of the mortgage, is entered in the book. For this purpose, a separate table is allocated in the book of mortgage loans. Accounting is carried out by the name of the owner and the name of the real estate object.

The principle of obligation is that the rights to the object must be recorded in the books. The legal consequence of the latter is that the right of ownership of real estate arises in no other way and no earlier than the moment of writing.

The principle of glasnost (publicity) is embodied in the rules regarding the availability of mortgage books to all interested persons for getting acquainted with their contents. The interested parties can learn not only about the economic (technical) characteristics of real estate, but also about other people's rights to real estate – lease, mortgage, easements from the book.

The principle of seniority boils down to the fact that the mortgage rights recorded in the accounting books are executed in the order they are recorded. Seniority is applied to both undifferentiated burdens and heterogeneous burdens.

Institutions that keep mortgage books (courts, mortgage agencies) must verify in each specific case the legality of the act of establishing ownership of real estate, thereby ensuring the principle of authenticity.

Yevtukh O. emphasized that these principles should be complemented by economic and social ones. The economic principles mainly include compliance with the principle of profit, since the following subjects act on the basis: the creditor, the investor and, under certain conditions, the borrower.

The principle of sociality consists in the social orientation of mortgage lending, primarily in the fact that it extends to a fairly wide range of the population. This principle provides for the possibility through the state to support certain socially vulnerable segments of the population in obtaining mortgage loans: large families, disabled people, young families, etc. All the above principles are interdependent and make up a system of mortgage principles on the basis of which the operation of any specific mortgage scheme is built.

Currently, the market of mortgage lending is characterized by the passive activity of banks before providing mortgage loans to individuals and legal entities. Until the end of 2021, not all banking institutions provided mortgage loans. In Ukraine, the cost and term of a mortgage loan are

difficult to fulfil for all groups of the population. Today, mortgage rates aren't in demand among the population due to their values.

The National Bank of Ukraine reports mortgage lending increase in the general structure in 2021 due to an increase in the average size of the loan. The NBU website reported that in 2021, Ukrainian banks issued 10,800 mortgage loans for a total of UAH 8.9 billion. This is the best result in terms of mortgage volume in 2018-2021. The increase in volumes is mainly due to the increase in the average amount of contracts: an increase of one-tenth per month (up to UAH 893,000).

Table 1 presents the dynamics of main indicators of the mortgage lending market in Ukraine, for 2018-2021.

The dynamics of the total volume of bank loans granted in Ukraine for 2018-2021 is heterogeneous. The largest amount of loans granted by commercial banks to individuals and legal entities was observed in 2021 with a total amount of UAH 254,385 million with the share of mortgage loans of 11.28%.

**Table 1 – Dynamics of targeted mortgage loans to households**

Loans	2018 (million UAH)	2019 (million UAH)	2020 (million UAH)	2021 (million UAH)	Deviation +-
Total loans granted, including	201 102	212 515	206 471	254 385	53 283
Consumer loans	151 625	173 702	170 719	214 134	62 509
For the purchase, construction and reconstruction of real estate	44 458	32 611	28 924	28 560	-15 898
Other loans	5 019	6 203	6 828	11 691	6 672
Of the total amount, mortgage loans	42 308	26 616	30 389	28 693	-13 616

**Source:** compiled according to NBU data

The share of mortgage loans in the total amount of loans provided by banking institutions of Ukraine in 2018-2021 changed to some extent. The specific weight of mortgage loans in 2018 was 21.04%, whereas in 2019, their share decreased by 8.51% compared to 2018 and amounted to 12.52% of the total amount of loans granted. In 2020, the share of mortgage loans increased compared to 2019 and amounted to 14.72%. In 2021, the specific weight of mortgage loans amounted to 11.28% of the total amount of loans provided by banking institutions of Ukraine.

Starting from 2018, the volumes of loans for the purchase, construction and reconstruction of real estate has been significantly decreasing. In 2018, they amounted to UAH 44,458 million, and by 2021 they decreased to UAH 28,560 million. However, in the structure of consumer lending, there is a tendency to increase their share in the total amount of loans granted – in 2018 their share was 75.4%, and in 2021 – 84.18%.

Consumer lending continues to play a key role in banks activities through providing a significant portion of revenue. To facilitate proper consideration of the benefits and risks of work in this direction, as well as to increase banks' resistance to credit risk, the NBU introduced risk factors for unsecured consumer loans. New credit approval standards for financial institutions are more stringent. One of the factors affecting the number of mortgage loans is their repayment term. (Fig. 1)

In 2018-2021, the largest volume is made up of long-term loans with a maturity of more than 5 years. During the analyzed period, the largest volume of long-term mortgage loans was granted in 2018, namely UAH 38,373 million. In 2019, compared to 2018, the volume of mortgage loans with a maturity of more than 5 years decreased to UAH 23,789 million, while in 2020 it increased again and amounted to UAH 26,785 million. However, in 2021, there was a reduction in long-term mortgage loans to UAH 23,502 million. Loans with maturities of 1-5 years account for a small share,

but they also increased. In 2018, they amounted to UAH 2,517 million, in 2019 they decreased to UAH 2,324 million. Since 2020, mortgage loans with a maturity of 1 to 5 years has begun increasing and amounted to UAH 3,109 million. In 2021 they made UAH 4,733 million.

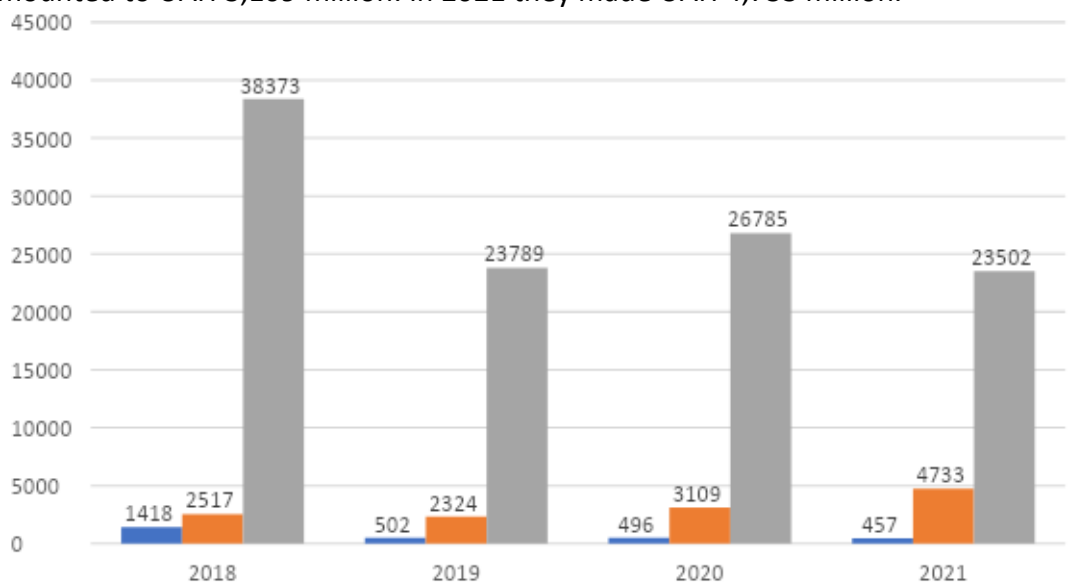


Figure 1 – Volumes of mortgage lending by maturity for 2018-2021

Source: compiled by the authors based on NBU data

The volume of short-term mortgage loans tends to decrease. In 2018, the volume of loans amounted to UAH 1,418 million, in 2019 it decreased to UAH 502 million, in 2020 – to UAH 496 million, and in 2021 – to UAH 457 million.

The volume of mortgage lending is greatly influenced by exchange rates. The dynamics of mortgage loans granted to households in the context of currency for 2018-2021 is presented in Table 2.

Table 2 – Mortgage loans granted to households in currencies for 2018-2021

Loans currency	2018		2019		2020		2021		Deviation +/-
	(million UAH)	%	(million UAH)	%	(million UAH)	%	(million UAH)	%	
Total, incl.	42 308	100	26 616	100	30 389	100	28 693	100	-13 616
UAH	11 681	27,61	10 558	39,67	13 660	44,95	19 938	69,49	8 257
\$	28 881	68,26	15 190	57,07	15 360	50,55	8 145	28,39	-20 735
Euro	801	1,89	480	1,80	843	2,77	323	1,13	-478
Other currencies	945	2,23	387	1,45	526	1,73	286	1,00	-659

Source: compiled according to NBU data

The US dollar was the main currency of mortgage loans granted by banking institutions during 2018-2021. However, the share of mortgage transactions in this currency during the period under study is decreasing. In 2018, foreign currency lending in US dollars amounted to UAH 28,881 million, or 68.26%, while in 2019 it decreased to UAH 15,190 million. In 2020, there was a slight increase to UAH 15,360 million, or 50.55%. However, in 2021, it almost halved to UAH 8,145 million, or 28.39% due to the growth of the exchange rate.

In 2020-2021, the share of mortgage loans issued in hryvnia increased. In 2018, the specific weight of mortgage loans in the total structure of loans provided by banking institutions was

27.61%, while at the end of 2021 it was 69.49%. The largest volume of mortgage loans was provided by banking institutions in 2021, namely 19 UAH 938 million.

Foreign currency lending in euros had significant fluctuations. In 2018, the share of loans amounted to UAH 801 million, in 2019 it decreased to UAH 480 million. A slight increase occurred in 2020 to UAH 843 million, or 2.77%, but in 2020, it decreased to UAH 323 million, or 1.13%.

Foreign currency mortgage lending in other currencies changed during the analyzed years. In 2018, foreign currency lending amounted to UAH 945 million, or 2.23%, in 2019 it decreased to UAH 287 million. In 2020, there was an increase to UAH 843 million, or 2.77%, but the next year it decreased again to UAH 286 million, or 1%.

According to the Concept of creating a national mortgage system, approved by the Cabinet of Ministers of Ukraine in 2004, the two-level model of the functioning of the mortgage market is the most effective for our country since it provides for the both a primary market and a secondary market.

In the primary market, a relationship arises between the mortgage lender and the borrower regarding the provision and repayment of the mortgage. The essence of the secondary market operation is refinancing mortgage lenders for attracting loans through issuing mortgage securities, selling mortgage assets to banks, secondary professional non-bank mortgage financial institutions or using these mortgage assets as collateral.

Secondary mortgage institutions must ensure the activity of mortgage lenders on the primary mortgage market with diversification of risks and carrying out measures to refinance mortgage lenders at the expense of funds from the placement of mortgage securities. The secondary mortgage market was created because the banking system seeks to finance long-term mortgages at the expense of short-term bank liabilities.

That is why the creation of the secondary mortgage market is one of the main priorities of the country's policy in the development of the national mortgage system. The interest rate on these loans is one of the important factors affecting mortgage loans. Therefore, this factor needs a wider analysis. Table 3 shows mortgage lending rates by terms on the secondary real estate market.

**Table 3 – Mortgage lending rates by maturity on the secondary real estate market**

<b>Term of a loan</b>	<b>Average effective rate as of 2021</b>	<b>Change per year, %</b>	<b>Number of banks providing the loan</b>
1 year	14.7%	0.59%	6(+1)
5 years	14%	0.17%	6(+1)
10 years	13.3%	-0.03%	5(+2)
15 years	13.1%	-1.14%	5(+1)
20 years	13.05%	-1.21%	5

**Source:** compiled according to the data of "Prostobank Consulting"

The research reveals that loan rates change in the secondary real estate market. Over the year, the interest rate on loans with a term of 1 year increased by 0.59% and averaged 14.7% per annum. The interest rate on loans with a term of 5 years also increased by 0.17% and averaged 14% per annum. Interest rates on loans with a term of 10 years decreased slightly and averaged 13.3%, but interest rates on loans with a term of 15 years decreased significantly by 1.14% and averaged 13.1% per annum.

Here, the cost of long-term loans changed the most. As of the end of 2021, the interest rate on mortgage loans decreased by 1.21% and averaged 13.05%.

Figure 2.2 shows the dynamics of average interest rates on mortgage loans on the secondary real estate market.

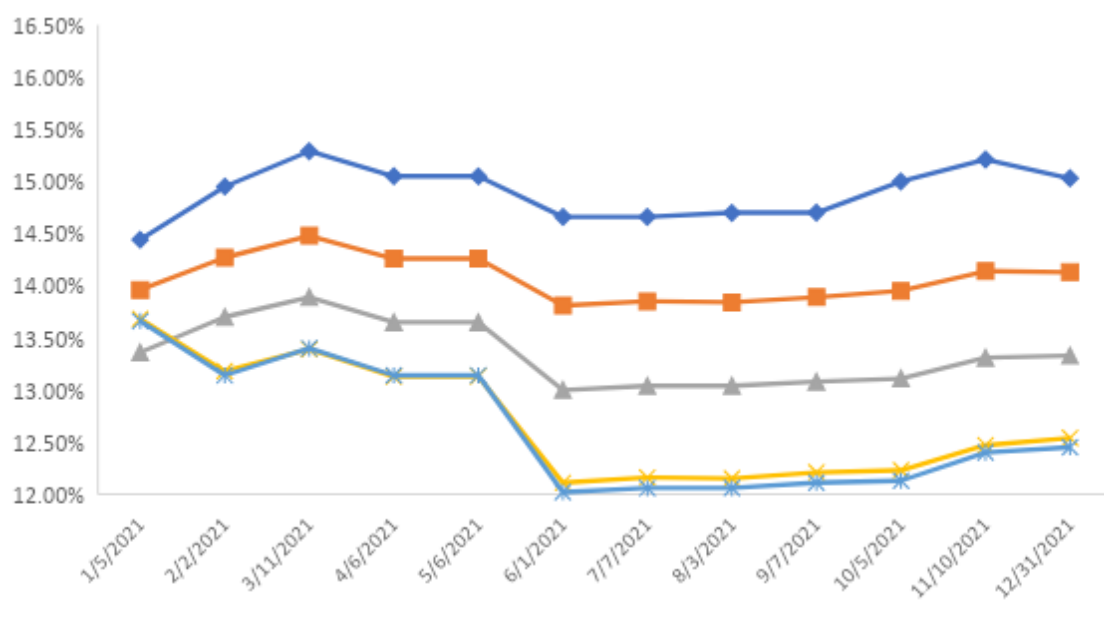


Figure 2 – Dynamics of average interest rates for mortgage loans on the secondary real estate market

Source: compiled according to the data of "Prostobank Consulting"

The rate of decrease in average rates on loans for the purchase of new housing gained momentum. Table 4 shows mortgage lending rates by terms in the primary real estate market.

Table 4 – Mortgage lending rates by terms on the primary real estate market

Term of a loan	Average effective rate as of 2021	Change per year, %	Number of banks providing the loan
1 year	11,46%	0,48%	6(+1)
5 years	13,68%	-0,69%	6(+1)
10 years	14,1%	-0,42%	5(+1)
15 years	13,82%	-1,37%	5
20 years	13,81%	-1,37%	5

Source: compiled according to the data of "Prostobank Consulting"

The data presented in Table 4 reveal that the largest decrease in average rates occurred in the provision of loans with a term of 15 and 20 years. The average interest rates for loans with a term of 15 years were 13.82%, for 20 years – 13.81%, and during the year they decreased by 1.37%.

Interest rates on 5-year loans have also changed, but only slightly. The decrease made only 0.69%. Interest rates on 10-year loans averaged 14.1% and decreased by 0.42% over the year. Only the rates for loans with a term of 1 year have increased. On average, the rates amounted 11.46% and increased by 0.48%.

Figure 3 shows the dynamics of average interest rates on mortgage loans in the primary real estate market.

Refinancing is the repayment of a mortgage loan in one bank at the expense of a new loan issued in another bank. At the same time, the amount of the loan does not change, but the terms of its return become acceptable for the borrower.



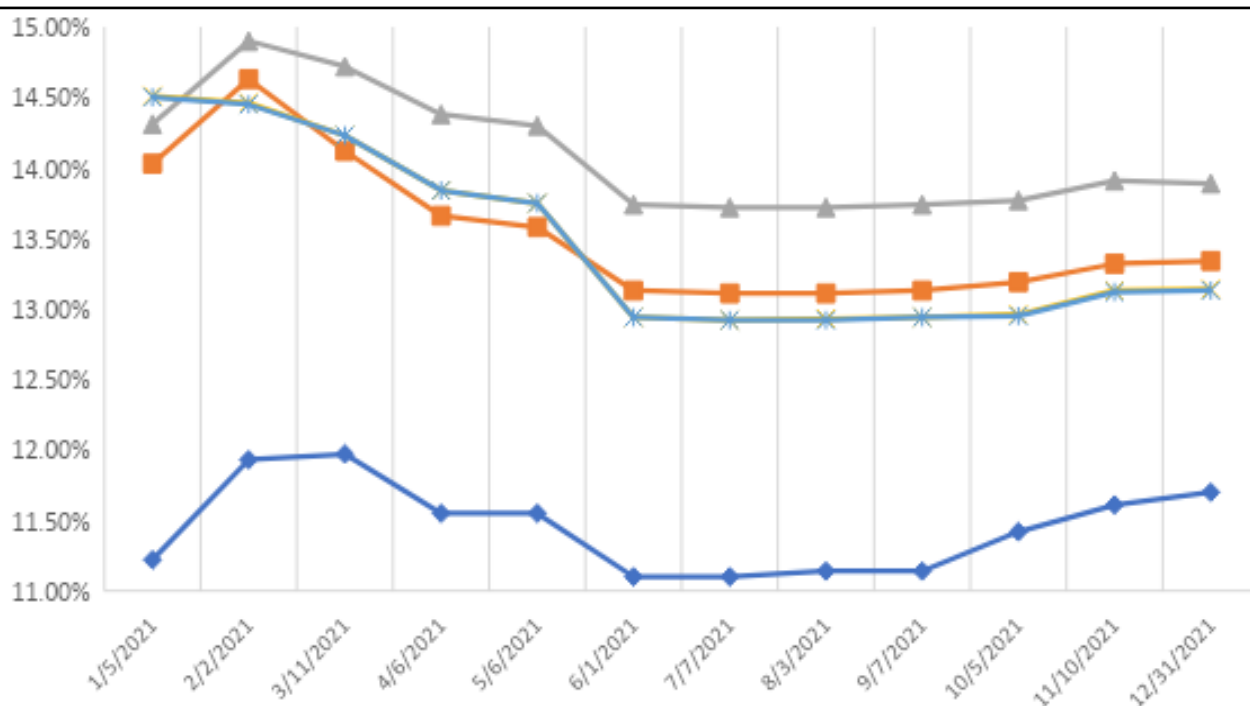


Figure 3 – Dynamics of average interest rates on mortgage loans in the primary real estate market

Source: compiled according to the data of “Prostobank Consulting”

The mortgage loan refinancing rate is an indicative rate for refinancing operations by the State Mortgage Institution of primary lenders-banks by assigning the rights of claim on mortgage loans granted in accordance with the requirements of the Standards of DIU (mortgage loan refinancing). The refinancing rate of mortgage loans is determined by the Management Board of DIU, it is subject to approval by the Supervisory Board of DIU and takes into account the cost of attracting financial resources by DIU to carry out mortgage refinancing operations.

Rates for refinancing loans as of 2021 are presented in Table 5.

Table 5 – Average rates for refinancing loans as of 2021

Term of a loan	Average effective rate as of 2021	Change per year, %	Number of banks providing the loan
5 years	13,22%	-2,03%	3
10 years	13,32%	-2,64%	3
15 years	13,49%	-3,19%	3
20 years	13,48%	-3,21%	3

Source: compiled according to the data of “Prostobank Consulting”

In 2021, average real rates on refinancing loans decreased in line with market trends. In particular, according to the research of the company “Prostobank Consulting”, they decreased by 2.03-3.21% for credit programs with a term of 5-20 years. Figure 4 shows the dynamics of average rates for refinancing loans as of 2021.

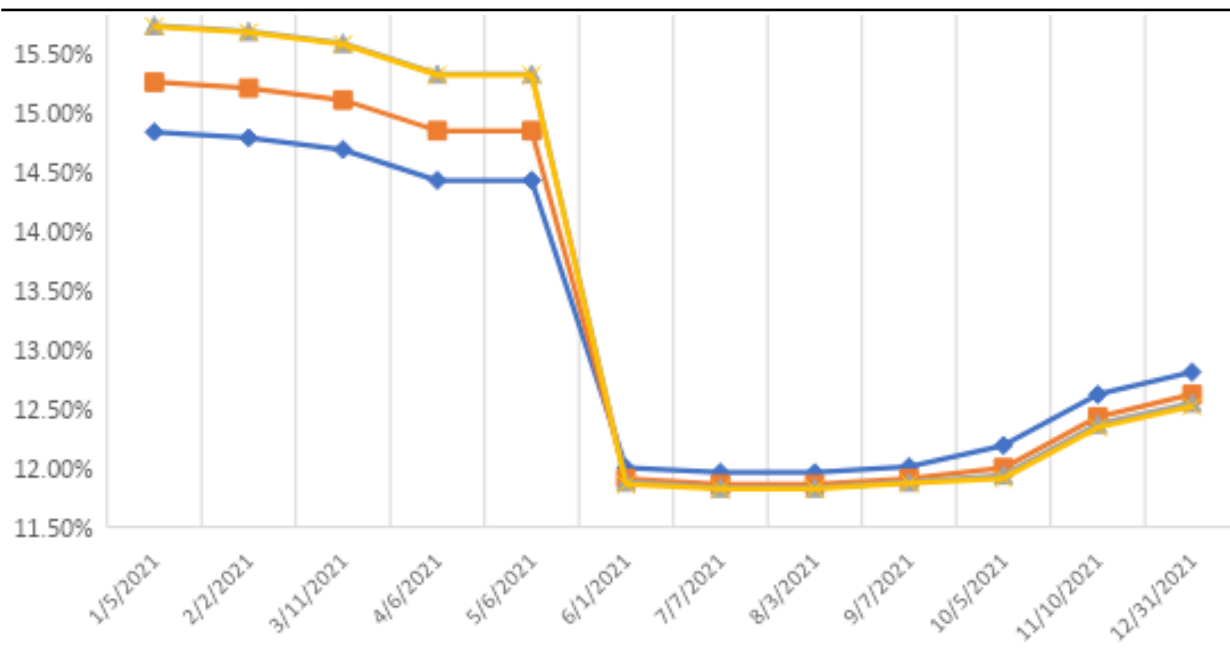


Figure 4 – Dynamics of average rates for refinancing loans as of 2021

**Source:** compiled according to the data of “Prostobank Consulting”

In recent years, not all banks offer mortgage loans. The banks that disbursed the largest amount of mortgage are: Oschadbank JSC – 13% market share, Ukreximbank JSC – 10%, Ukrgasbank JSC – 6%, Praveksbank JSC – 5%, PrivatBank JSC – 4% %, JSC “Kredobank” – 3%, JSC “Raiffeisen Bank Aval” – 3%, etc.

Banks offer mortgage loans on the housing market on approximately the same terms. However, some banking institutions, such as JSC “Kredobank”, JSC “Pravex Bank”, provide mortgage lending services with loan fee. For example, unlike other four competing banks, JSC “Oschadbank” applies a fixed rate for mortgage loans, which does not depend on UIRD fluctuations.

## Conclusions

Therefore, mortgage lending, which existed before the crisis period, has not yet reached large scales. Banks cannot establish attractive parameters for borrowers through financing mortgage loans at the expense of short-term expensive resources and public funds. However, some positive developments in the field of mortgage bank lending can be observed today. It is worth noting that the development of mortgage lending was influenced by the legislative framework on mortgage lending, high interest rates on mortgages, the high cost of residential real estate, a conflict of interests between lenders and borrowers, as well as general economic and political uncertainty – all these hindered the improvement of the situation on the housing real estate market. Based on the results of the research, it can be concluded that the real estate lending market in Ukraine needs significant improvement.

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