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KEY DETERMINANTS OF DEMAND, CREDIT UNDERWRITING, AND PERFORMANCE ON GOVERNMENT- INSURED MORTGAGE LOANS IN RUSSIA

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This research aims to estimate the effectiveness of government policy on affordable housing in Russia.

Due to the substantial variation in income distribution, part of the society can not afford to enlarge the property or increase its quality. However, the cover of housing requirements is one of the priorities of Russian Government public policy. That is why since 1996 housing policy is implemented through the affordable Government mortgage. Government mortgages are provided by Agency of Home Mortgage Lending (AHML) that develops special mortgage programs and originates it using its regional operators and commercial banks. Regional operators underwrite applications, originate loans, operate relationship with borrowers and sell issued mortgages to AHML if they meet “AHML standards”.

It is known that some part of AHML mortgage programs is competitive with market ones which are originated by commercial banks. Another part of programs are, so called, “special” and was developed for special categories of potential borrowers who usually treated as uncreditworthy by commercial banks. These potential borrowers are often linked with low documentation, lower income and high credit risk. This not allows commercial banks to make a positive expected profit on these loans. So banks reject those applications and applicants can not improve their housing conditions.

Special programs of AHML contain lower interest rates and downpayment for some groups of borrowers. This allows originating loans with uncompetitive conditions in exchange for the goals of housing policy. This project aims to estimate credit risk and expected profit (loss) for different categories of AHML borrowers including special ones and conclude about the cost of affordable housing policy for each borrower. Special loans are usually linked with lower downpayment are must be insured in terms of the third-party liability of the main borrower (obligatory if $LTV > 0.7$). Taking into account interdependence of underwriting, choice of mortgage terms and credit risk we study some patterns of borrowers' and bank's behavior and make recommendations on the mortgage programs and/or underwriting process improvement.

We found that having Government insurance increases the probability of being approved despite the fact that choice of having insurance is linked with riskier contracts: credits with higher LTV, interest rate, and maturity.

However, we did not found any evidence of an increase of the expected probability of default for loans with insurance with any other fixed. But the expected losses from one issued loan for such loans are substantially higher (155 thous. rub. for loans with $LTV > 0.7$ comparing with 28 thous. rub. for loans with $LTV \leq 0.7$ for each issued loan; 127 thous. rub. for loans with $LTV > 0.7$ comparing with 28 thous. rub. for loans with $LTV \leq 0.7$ for each loaned mln. of rub.; 46.5 mln. of rub. for the whole portfolio of loans with $LTV > 0.7$). This is due to the higher EAD (exposure at

default) from two main sources: higher loan amount with fixed value of property bought and higher maturity that leads to higher losses at a fixed date of default.

Taking a cost of insurance (usually 3-4% of loan amount) from the difference in losses between higher and lower LTV loans gives a cost of housing policy through affordable mortgage programs for some household. An approximate value is 100 000 rubles for each participating household. At the credit portfolio level, it reaches 54 mln Rus. rub. This value should be the starting point for analysis of the existing policy and trade-off between costs of it and benefits from the policy.