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| MONGOLIAN MORTGAGE CORPORATION LLC |
| ISSUES AND CHALLENGES OF MONGOLIAN MORTGAGE MARKET |
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Mongolia is a landlocked country bordering with the Russian Federation in the north and the People’s Republic of China in the south. Its population is 2.7 million where approximately 40% of its population lives in a capital city Ulaanbaatar and 59% of those people live in a ger area. 30% of the total population lives apartment and houses with there are no proper infrastructure the rest lives in ger areas.

According to the latest census in 2010 there are 713,780 households living in Mongolia.

Table 1.Total households living in Urban and Rural area. Source: *National Statistic office of Mongolia*

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| --- | --- |
|   | Total household number 713,780  |
| Total | Ger  | House, apartment | other  |
| 322,836 (45.2%)  | 382,808(53.6%)  | 8132 (1.1%)  |
| Urban | *Total Urban household 479,503 (67%)*  |
| 156,744 (32,7% )  | 316116 (65,9%)  | 6643 (1,4%)  |
| Rural | *Total rural household: 234,277 (33%)*  |
| 234,277 (70, 9%)  | 66,692 (28, 5%)  | 1493 (0, 6%)  |

The urban areas in Mongolia present two very different and distinct patterns of residential development which are highly correlated with poverty. The first involves planned areas based on Soviet-style planning practices and featuring multi-family housing surrounded by vaguely defined open spaces. The second involves ger areas characterized by long strips of large, not serviced plots with wide dirty roads on at least two sides. Mongolia’s poor population is concentrated in these ger areas. More than 36% of the total population of Mongolia lives below the poverty line, and almost 80% of the poor lives in ger areas in Ulaanbaatar in aimag (province) centers.

*A ger is the traditional circular felt tent of Mongolian nomads. Informal urban settlements, characterized by a variety of shelter types, predominantly ger tents, are referred to as ger housing areas.*

Picture 1. Ger area in Ulaanbaatar City. Picture 2. Mongolian Ger



Till early 1990 Government used to provide has free housing to the citizens. In mid-1997, the Government and the ADB began development of a sound legal and policy framework for the housing sector in Mongolia. In 1999, the Government approved the Housing Law, National Housing Strategy (NHS) Housing Privatization Law and the Condominium Law. Under the NHS, housing policies are now to be demand driven, with standards and regulations geared to adequate and affordable housing provided by individuals and enterprises.

Under the approved NHS was designed to: (i) transfer the financial burden of housing to the private sector; (ii) improve the quality of existing stock; (iii) establish a land registration and valuation system; and (iv) assist vulnerable groups.

In 2000 Asian Development Bank has conducted a housing demand supply study in Mongolia which was the driving force for start of housing finance through commercial bank in Mongolia. ADB implemented Housing Finance Sector Project (HFSP) starting in May 2003. Although before the ADB project took place some banks where already issued limited mortgage lending in 2001. However the process was kicked off with on-lending activities of the ADB Housing Finance Sector Project. Five banks participated in that program: Anod, Golomt, Mongol Post, Savings and Zoos banks. The ADB Housing Finance Project funds were fully disbursed in 2005 and principal repayments are used as a revolver to refinance additional loans. As of December 21 2007, over 2,400 loans totaling MNT 28.2 billion have been disbursed under this project. In 2007 the property price value has doubled. The banks, in particular, have seen problems with their lending to real estate developments and construction that built hundreds of upmarket apartments that are now partially completed but still unsold. On the other hand price increase made individuals harder to afford the housing loans.

Steady increase on mortgage lending in banking sector has continued till the 2008. On 2008 most banks has stopped issuing mortgage loans. Some of largest banks have reached their limits, The reason of decrease of the housing loans were: (1) banks reached limits in housing and construction loans, (2) lack of additional funding for banks, (3) bank’s total housing and construction loan growth was high recent years, (4) pay-back period was long /5-10 years/. Though banks have slowed down of the housing loans, demand for housing loans are still high. This resulted in deposit interest rate increase for banks to get additional resources. On the other hand, the increase of construction materials prices lowered opportunities for low-income population to pay for newly constructed apartments. Construction sector growth had also decreased due to inability of people to pay for housing. Moreover, decline in construction lending left many construction works unfinished. Banks and Government made series of steps to inflow funds to the construction sector. Bank of Mongolia /BoM/ took steps to lend resources to commercial banks in order to issue loans for unfinished constructions. The tendency with housing and construction loans after the first half of 2008 was to improve. The situation was improved after banks received additional funding from domestic and foreign markets.

Even though mortgage lending was relatively low till the mid 2010 rapid recovery has taken place at the end of 2010 reaching 333 billion MNT to 19700 borrowers. The number has doubled in 2011 with 656 billion MNT mortgage loans to some 24 000 borrowers. There 11 commercial banks mortgage using mortgage lending activities in Mongolia

 Table 2. Core market indicators in mortgage market in Mongolia. *Source: Bank of Mongolia and National Statistic Office of Mongolia*

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| Market Indicators | 2009 | 2010 | 2011 |
| Debt Outstanding (MLN MNT) |  226,040.64  |  333,776.60  |  656,491.07  |
| Mortgage market percentage of Systemic Loan market , % | 8.59% | 10.72% | 11.64% |
| Total Systemic Debt Outstanding /MLN MNT/ |  2,632,031.13  |  3,112,495.28  | 5,641,233.70 |
| Total Debt Outstanding Changes,% | 3.70% | 47.66% | 96.69% |
| Total Debt Outstanding Per Borrowers (MLN MNT) |  13.47  |  16.94  |  24.78  |
| Numbers of Total Borrowers |  16,784  |  19,700  |  26,491  |
| Market I.R /Annual, %/ | 17.73% |  15.75% | 14.80% |
|  Original W.A. LTV % | 78.95% | 77.30% |  56.28% |

One of the mortgage market development indicators would be mortgage market percentage in GDP 1.11% in 2005 has increased to 6 % in 2011.

Table 3. Mortgage Market percentage of GDP. Source: Bank of Mongolia and National Statistic Office of Mongolia

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| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** |
| GDP (MNT) | 2,779,578.26 | 3,714,952.83 | 4,557,500.00 | 5,895,534.10 | 6,055,800.00 | 8,255,800.00 | 10,829,689.60 |
| Systemic Loan Outstanding | 1,334,083.09 | 2,230,514.01 | 2,056,060.84 | 2,635,551.56 | 2,632,031.13 | 3,112,495.28 | 5,641,233.70 |
| W.A.I.R of Mortgage loan | 14.73% | 17.83% | 15.96% | 18.71% | 17.73% | 15.75% | 14.80% |
| Numbers of total borrowers | 4,774.00 | 8,984.00 | 16,444.00 | 16,522.00 | 16,784.00 | 19,700.00 | 26,491.00 |
| Mortgage Loan outstanding in mln MNT | 30,839.72 | 61,874.29 | 164,625.90 | 217,977.46 | 226,040.64 | 333,776.60 | 656,491.07 |
| Mortgage Market Percentage of GDP, % | 1.11% | 1.67% | 3.61% | 3.70% | 3.73% | 4.04% | 6.06% |

Graphic 1. Mortgage Market percentage of GDP. Source: Bank of Mongolia and National Statistic Office of Mongolia

Graphic 2. Mortgage Market as a percentage. *Source: Bank of Mongolia and National Statistic Office of Mongolia*

Even though the mortgage lending is significantly increase in each year the demand for housing still very much on the increase. The young generation between 25-35 year old people of Mongolia is increasingly financially able to afford an investment in residential property and is keen to move away from their current multigenerational units into more contemporary and spacious housing. The boom in the mining supply chain and the service industry are leading to stronger than ever demand level in housing sector. On the other hand housing supply intensively expanded allowing the segment of creditworthy population to receive mortgage loans.

Much low income population is still lack access to financing for house purchases. Most of them could not even afford the down payment requirement. With the increase in price of construction materials being imported from abroad resulting rising price of construction many of households still living in the houses and ger’s where there is no proper source of power and heating. As many Mongolians who seek for higher paid jobs and greater possibilities have relocated from other parts of the country to Ulaanbaatar city. Most of these households who are low income and live in the sprawling tents cities of the northern districts spread across the surrounding hills in Ulaanbaatar city. Due to the lack of infrastructure for proper housing the people who live in ger districts heat their houses and ger using coal or lignite burnt in iron stove. The smog caused by coal burning ger district has made the Ulaanbaatar city the second most polluted city in the world during the winter season. Tackling these environmental and social problems caused by the ger districts has long priority for the government.

In order to increase the affordability and supply for proper housing government has initiated several acts. One of these activities is that the Government has approved 40,000 Houses Program project on 27 June 2005 to increase the total national supply and finance for housing. In order to implement Government’s policy and programs for provision of housing as well as undertake mortgage lending and investment Ministry of Road, Transportation, Construction and Urban Development /MRTCUD/ former Ministry of Construction and Urban Development/MCUD/ has established Housing Finance Corporation dated November 2006 jointly with Ministry of Finance /MoF/ and the Mayor of Ulaanbaatar City.

The five major strategic objectives of the program are to establish new townships for housing units, to improve density of housing units in Ulaanbaatar and other urban centers and settlements, to develop the ger district, facilitate development of housing and real estate market relations and to support construction material production industry and capacity building of human resources. Later the program was extended to 100,000 houses program. This program is expected to have a major impact on substantial percentage of ger district. But the project will also require substantial amount of supporting infrastructure, including roads and bridges and water, canalization projects.

Also the government resolution No. 15 of February 10, 2011 approved Development Bank of Mongolia /DBM / long term financing of infrastructure and industrial projects such as New Development medium term target program, state policy on railroad transportation. DBM will also fund government housing programs by issuing government bonds.

When the housing supply is expanded and the growing demand for housing, it is important to create a favorable legal regulatory environment allowing the creation of new resources for housing loans by issuing securities backed by the mortgage loan receivables. This will make possible to refinance new mortgage loans and provide new sources fund for banks for new housing loans.

In 14th May 2003 Mongolian government resolution #116 has approved to develop mortgage backed securities market in Mongolia. By approving so Mongolian government enabled creation of self financing policy without government funding. Consequently 14th July 2009 Government has approved “Mortgage Law” followed by the Asset Backed Security /ABS/ law approved on 23th Apr 2011 legally enabled primary and secondary market development.

The development of the secondary mortgage market through the establishment of the “Mongolian Mortgage Corporation” /MIK/ has emerged with the initiative of USAID- EPRC project. In 2006 Bank of Mongolia /BoM/ and ten commercial banks have established private sector controlled secondary tier mortgage institution. The MIK main goal is to develop primary and secondary markets by issuing and selling Mortgage-backed securities on domestic and foreign capital markets and to create and ensure a smooth functioning of a long-term financing system to improve access to housing and promote in the future modern urban development.

Creation of the first commercially operated, private sector controlled secondary mortgage market institution enabled boarding and deepening the financial market. Well functioning secondary market will need supportive legal and regulatory framework, sizable and standardized primary mortgage markets, and well-developed bond markets.

MIK has become the liquidity provider to the financial institutions which had an access to long term funds primarily through international financial institutions and donor programs. Over the past 5 years MIK has actively worked with both government and regulating agencies to set up legal regulatory framework of the secondary market in Mongolia. One of the prerequisite for secondary mortgage market institutions is to buy standardized mortgage loans. During the time of MIK establishment commercial banks had its own standards procedures for issuing mortgage loans. One of the main objectives of MIK was to standardize all the loans issued in the market. Therefore MIK together with representative of commercials banks developed Mortgage Standardization Procedure that is approved by BoM in 17Oct 2008 for all the commercial banks to apply in their mortgage lending activities. MIK has also taken a major role on drafting the approved Mortgage and ABS law.

On the cooperation side MIK engages with the many internationally recognized financial institutions. Over the past few years MIK implemented several important projects with International Finance Corporation /IFC, United Nations –Economic and Social Commission for Asia and the Pacific /UN-ESCAP/, Asia Pacific Union for Housing Finance /APUHF and German Development Bank /KFW/ and Housing Finance Network /initiated by Wharton business school/.

More specifically in 2009 MIK have implemented / to adaption of Mortgage Lending toolkit in Mongolia project with International Finance Corporation /IFC and Shorebank International. The objective of this project was to standardize the mortgage lending activities by introducing internationally accepted toolkit. Under this project MIK has translated the toolkit adapted into Mongolian market standards and published the toolkit to all commercial banks including the financial institutions undertakes mortgage lending activities. By doing so in June 2009 and June 2010 MIK has also organized a workshop for the commercials banks to introduce the toolkit in detailed manner.

With the successful completion of the above project IFC has requested to implement second “Housing Micro Finance” project in Mongolia. During the implementation of the HMF project MIK has done comprehensive market assessment in two cities in Darkhan and Ulaanbaatar city. The assessment not only concentrated on the demand side f the market to determine the demand for micro housing loans which comparable short term in tenor with relatively high interest rate compared to mortgage loan but also supply side of the supply factors affecting the HMF lenders. MIK has successfully completed the project by preparing valuable recommendation to IFC to develop HMF market in Mongolia. Furthermore with the approval of the Parliament to support promotional activities in the housing finance sector MIK is provided by financial resource German Development Bank /KFW/ starting November 2009.

On the cooperation side MIK engages with the internationally recognized financial institutions. Asia Pacific Union for Housing Finance /APUHF/ is the union and platform acting as an experience sharing networking among the South Asian countries. As representing Mongolia in the union the MIK has proposed and successfully organized union’s first regional form in Ulaanbaatar Mongolia June 2011 bring officials together from South Asian countries. Starting January 2012 is actively engaging in union’s activity and has become one of the advisory board members. Meanwhile MIK is also member of the International Union for Housing Finance /IUHF/. Also MIK is an advisory board member of the “Asia Pacific Housing Journal” published by Government Housing Bank of Thailand.

Under the core activity of the company to provide liquidity to the commercial banks by selling mortgage backed security to capital market in total MIK has purchased 21 billion tugrig of mortgage portfolios from 9 different banks. Standards of MIK loan purchase criteria enabled MIK to purchase best performing loans from the banking sector. Even though the bond market is not well developed, absence of rating agency and institutional investor December 2009 MIK has issued 6.3 billion tugrig of covered bond to commercial banks and insurance companies with longest maturity up to 5 years.MIK bonds qualify as a Repo financing instrument by BoM. In 21st of March 2012 Financial Regulatory Commission of Mongolia /FRC/ approved MIK as a housing finance company “Special permission “to engage in securitization activities in capital market.

MIK will continue to work towards extending the mortgage market in Mongolia by building well functioned secondary mortgage market creating local institutional investors to boost the local capital market as well as to issue mortgage backed bonds and securities to the international market capital market. Ultimately by raising funds from capital market MIK will contribute increase in long term, low interest rate affordable of housing loans to Mongolian citizens.

The stable, growing Mongolian economy will encourage the growth of the housing finance system through lower inflation, lower interest rates, and lower systemic risk. However proper housing finance infrastructure based on policy integrated public and private cooperation will insure sustainable Mongolian Mortgage Market development.