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## **Financial Regulation of Mortgage Relations**

### **Introduction**

The transition of the agrarian sector of economy to the market needs proper changes in the land relations towards the reformation of the land property structure. Denationalisation and privatization of agricultural lands created a wide range of landowners with different forms of ownership. Considerable fragmentation and ineffective utilization of agricultural lands objectively necessitates creating the mechanisms for further development of land relations in consideration of investment-innovative component.

But land is the national heritage, which according to the Constitution of Ukraine is under special state protection. It is created neither by labour nor by capital. It is granted from above and belongs to everybody, who lives on the territory of Ukraine. Forms of land ownership are just the ways of its rational utilisation. As soon as reasonable and fair land relationships have been created in Ukraine, the question of rational land-utilisation management will be raised automatically. It is impossible to support rational from the ecological and economic points of view land and rural territories utilisation with the financial resources that can be allocated by the state and small-holders. It is the creation of the land mortgage lending system that will allow to carry out budgeting of the projects on soil fertility protection and restoration, development of rural territories, and also to realize the complex state programmes in the agrarian sector development.

It should be noticed that the land mortgage is the most complex financial instrument the agricultural producers will have to work with. It is sui generis the litmus for defining efficiency of not only agrarian reforms but also of Ukraine's society upbuilding, as it requires clear legislative regulation of all the components and their parameters, organisational support, economic pre-conditions and creation of the up-to-date financial regulation system.

## Research Goals, Tasks and Methods

*Goal* of the research – to substantiate the main directions of mortgage relations financial regulation in consideration of historical, national and regional peculiarities on the basis of the estimation and analysis of the existing situation, tendencies and perspectives of mortgage lending development in Ukraine and generalization of mortgage relations regulation experience in the countries with the market economy.

The goal achievement stipulated the logical sequence solution of the following *tasks*:

- to investigate the historical aspects of mortgage relations development in Ukraine;
- to find out pre-conditions of mortgage lending development;
- to consider the main aspects of the financial regulations of mortgage relations in modern conditions.

*Key-note* of the research is the development of mortgage relations in Ukraine.

*The following methods were used in the research*: monographic, abstractly logical, calculation-structural and comparisons, generally accepted statistical methods.

## The Historical Aspects of Mortgage Relations Development

In most world countries, the system of the land mortgage crediting has been the classical instrument for the financial market for a long time. However, to apply the land mortgage in Ukrainian practice in perspective it is necessary to investigate it deeply both at the historical-genetic level and at the legislative one.

In general, the credit-financial system of Ukraine arose and developed as a component of Russian-empire one, that made it dependent and provincial. Provinciality showed up foremost in the fact that there were no own public credit institutions in Ukraine. At the beginning of XIX century only the branches of the Russian Empire's state banks operated on the territory of Ukraine. The State Bank had its offices in Kyiv, Kharkiv, Odessa and 24 branches in other cities. The peasant land bank had 9 branches in Ukraine. It granted loans to peasants in security for land, which they bought. The nobility land bank had 7 branches. In 1871 the first private joint stock land bank was founded in Kharkiv. At the end of 90th 10 such banks operated in Ukraine, while in Russia – 39. They granted long-term and short-term loans within the limits of the territory of their activity

in security for land or real estate. Terms of loan were different, but they couldn't be longer than 66 years and 2 months. The size of loan made 50–60 percents of mortgage cost. Already then long-term loans were granted as mortgage letters. At the beginning of their activity banks issued 6% mortgage letters. In the years that followed mortgage letters conversion into 5%, and later into 4,5% ones took place. That allowed to reduce borrowers' payments, and mortgage letters became popular on exchanges [Kruchek 2001].

Among joint-stock establishments of long-term credit a special group was made by banks on principles of reciprocity and solidarity. They granted loans secured on land. The land-bank of Kherson province was the most active of them. It granted loans secured on land for landowners of Kherson, Katerinoslavska, Tavriyska and Bessarabska provinces.

In the list of operations carried out by those banks there were loans secured on land (for the term from 1 to 12 years) and buildings in those cities, where the bank was (wooden buildings for the term of 3 years and stone ones to 8 years). The size of loan didn't have to exceed 50% of mortgage cost. On June 17<sup>th</sup> 1865 the municipal public bank was opened in Romny, in 1866 – in Bilopillia and Krolevets, on February 1<sup>st</sup> 1869 – in Sumy. The board of the bank included the so-called accounting committee, whose main function was to estimate the property in security for which credits were granted. At the beginning of XX century the activity of city public banks began to limit perceptibly the commercial banks and societies of mutual credit. On the eve of the First World War the Central bank was created, and the municipal public banks were reorganized into its branches.

Except of these banks busy activity was carried out by the State bank branches. Original bank institutions were the societies of mutual credit, which according to the nature of their activity took the place between the commercial banks and loan balanced societies. In March 1866 the society of mutual land credit was founded in Okhtyrka province. It granted short-term and long-term loans secured on land property. It should be also noticed that the private owners of Sumy region, foremost squires, mortgaged land in Kharkiv, Poltava and Kyiv joint-stock banks, as well as in public institutions such as Peasant bank (operated from 1883), Nobility bank (from 1880) and Special department of State nobility bank (Table 1).

Summarizing the experience of mortgage relations development in 1861–1917, it is necessary to state, that the stem of their development was the state support both in direct and indirect forms, that allowed to form the ramified mortgage infrastructure and on this basis completely solve the problem of credits for agricultural producers by redistributing the land and concentrating it in the hands of effectively working proprietors.

**Table 1**

Property and Lands Mortgaged by the Private Owners of Glukhiv, Krolevets and Konotop Districts on January 1, 1885

Districts	To the Poltava joint stock bank		To the Kiev joint stock bank		Nobility		By the special department of the state nobility bank	
	Property	Tithe	Property	Tithe	Property	Tithe	Property	Tithe
Glukhiv	13	4 137	5	2 231	62	22 798	4	4 178
Krolevets	21	7 286	1	1 732	17	12 583	–	–
Konotop	87	15 877	6	431	34	12 435	8	3 833

Source: Mishenko 1999, p. 32.

## Pre-conditions of Mortgage Lending Development

It is impossible to form and develop the landed mortgage relations without creating economic, legal and organizational pre-conditions. The economic pre-conditions for the introduction of the land mortgage crediting at the state level include:

- stability and parity of prices;
- stability of national currency exchange rate;
- moderate cost of the borrowed capital;
- general economy growth.

Stability of prices and exchange rate of national currency are extremely important pre-conditions of mortgage. Long-term investments become impossible when the level of inflation is high, and «short» money eliminates the possibility of large investment projects financing [Evtukh 2001].

The unsatisfactory financial state of the majority of agrarian enterprises results in depreciation of their fixed assets including the real estate. The mortgage of the depreciated property does not give enterprises the possibility to attract considerable financial resources, and it narrows their investment possibilities sharply, at the same time low solvency of most agricultural producers can result in too wide use of forced mortgage realization.

Uncertainty in the Ukrainian currency stability, especially during the last 6 months, makes unpredictable the prospects for the long-term crediting, and high lending rates sharply narrow its possibilities.

One of the important pre-conditions of the mortgage crediting is the general economic growth, which would be accompanied by the substantial increase of agricultural enterprises profits, level of bank economies, and correspondent development of market capitals.

Specific legal pre-conditions for introduction of the land mortgage crediting are the following:

- the legal guarantees of private ownership for agricultural plots of land;
- the legal unity of the plot of land with buildings and long-term planting situated on it;
- the legal safety of the landed mortgage;
- the legal regulations of mortgage banks organization and activity [Dem'yanenko 2005].

Thus, mortgage is impossible without the legal guarantees of the private ownership on the real estate. The legal unity of the plot of land with buildings and planting situated on it is another very important pre-condition of the mortgage lending development. Only in this case the real estate can be used as loan security without limitations.

Legal safety of mortgage expects the presence of the effective registration system for immovable property and related to it property rights as well as clear legal norms for the forced realization of the compelled property.

Next legal pre-condition of the land mortgage lending is the legal support of the forced realization of the land mortgage object in the case of the default on obligations by the bank borrower. Such realization enables the mortgage bank to execute the obligations before creditors. Thus, risks of applying forced realization directly influence reliability of mortgage securities and liquidity of the banking system.

For the normal functioning of mortgage credit it is necessary that tax requirements, employees' requirements, the requirements of social insurance fund and some other should be included into the system of real estate registration as well as the mortgage should be and according to the time of appeal recoveries should have preceding or following rank with respect to other rights. Creation of legal grounds has an exceptional importance for organization and activity of mortgage banks, especially in relation to the conditions of mortgage crediting, estimation of the compelled real estate and the order of mortgage securities emission and redemption [Chupis 2007].

Economic and legal pre-conditions are closely connected with the following institutional pre-conditions:

- formation of the specialized mortgage banks;
- availability of cadastre services network and organization of state registration of rights on the real estate;

- the development of spheres of notarial services, of evaluation and insurance activity;
  - presence of the real estate market and exchange equity market.
- Taking into account mentioned above pre-conditions it is possible to create the effective and transparent system of the mortgage crediting.

## **Basic Aspects of the Financial Regulations of Mortgage Relations in Modern Conditions**

In modern conditions of mortgage relations development in the agrarian sector, the financial regulation expects introduction of the mechanism for stage-by-stage redemption of the land shares by the authorities from those proprietors, who do not want or are unable to use them on their own on the basis of mortgage with reverse annuity.

A mortgage with reverse-annuity is the reverse rent mortgage, or reverse mortgage instrument. In the classic understanding while using a mortgage with reverse annuity a borrower gets a loan which he returns by the next assignment of rights on the real estate within term defined by the agreement [Sazonets 2006].

Adapting the mentioned above financial instrument to our conditions, we offer the following mechanism of crediting at a mortgage with reverse annuity. The buyer (authority body), the seller (land share owner or heir), the creditor (bank establishment, state or non-state pension fund in the case of necessity) make a contract that includes the following terms:

1. The right of land share ownership is passed to the buyer.
2. The creditor opens the personal account for the seller and obligates to transfer monthly or quarterly during the period marked in the agreement the sum of money, which on occasion is possible to be called as additional pension welfare.
3. The buyer makes a contract with the creditor according to which the creditor contracts to transfer the sum marked in an agreement on the seller's personal account (Table 2), and the buyer is to compensate the proper sum together with a certain percent [Chupis 2007].

According to our estimates, if the state buys back 10% of land shares annually (half of them on terms of mortgage from reverse annuity), it will be necessary to spend from 3 to 9 milliard UAH annually.

**Table 2**

Periodic Payments at a Mortgage from Reverse Annuity on one Man at the Middle Size of the Landed Share 4 Hectares

Term of payments	Sum of payments, UAH			
	the cost of hectare of plough-land is expected by direct capitalization of rent – 1328,57 UAH/ha		the cost of hectare of plough-land equals a normative money estimation on a 01.01.2007 – 9036 UAH/ha	
	quarterly	monthly	quarterly	monthly
2 years	664,28	221,42	4 306,36	1 435,44
4 years	332,16	110,71	2 153,16	717,72
6 years	221,42	73,80	1 435,44	478,48

Source: Author's presentation.

To use a fee-farm (the right to use somebody else's plot of land for agricultural purposes) as mechanism of plot of land transmission is reasonable for the effective owners on two reasons:

- 1) there must be an alternative to the leasing relations in agriculture;
- 2) according to its social-economic setting and legal maintenance, a fee-farm is an institution which has many general features with the institution of land leasing. Basic differences between them lie in the fact that the right for a fee-farm, in contrast to the right for the land lease, can be set for indefinite term (generally accepted 99 years) and, what is important, today it can be alienated on the basis of civil legal agreements, that is it can be passed in gage at the land mortgage crediting.

Now let us make an attempt to consider if the offered technology does not contradict the obligations accepted by Ukraine at entering WTO. In general, according to appendix 2 to Agreement about agriculture all measures concerning state support of agriculture are divided into three groups, or put into the small boxes of various colours: «green», «blue» and «yellow» [Kvasha 2008].

In our opinion the measures offered above refer to the government costs within the limits of «green small box», and they can be classified as an «improvement of land-tenure», «assistance to the structural alteration of agricultural production», «environment protection» and can be financed without any limitations.

## Conclusions

On the basis of the conducted researches it is possible to make the following conclusions:

1. Summarizing historical experience of mortgage relations formation, it is necessary to point out that, at first, in Ukraine the land mortgage as legal institution lost its importance after abolishing in 1917 the right on land property and means of production (in Galychina and Volyn' the mortgage system existed up to 1939, in North Bukovyna and South Bessarabia – to 1940 and in Trans-Carpathian Ukraine – to 1945) and its revival is indebted to the Law of Ukraine «About mortgage»; secondly, the experience in the long-term crediting secured on land, the variety of credit-investment technologies and infrastructure in the area of mortgage of the real estate undoubtedly played an enormous role in the development of new investment and mortgage instruments.

2. The prospects of development of mortgage in Ukraine substantially depend on the legislative support, economy growth, stability of prices and exchange rates of national currency, improvement of the credit-financial system, and development of the market of the real estate, including market of land. The adjusted mechanism of mortgage of the real estate and emission on its basis of mortgage securities will allow to mobilize population savings and direct them on the development of perspective industries of economy.

3. The financial regulation of mortgage relations in the agrarian sector nowadays must be based on the consecutive introduction and use of such financial instruments as a mortgage loan with reverse annuity, assignment of rights for using plots of land on the basis of fee-farm and, potentially, mortgage of material rights on the real estate. The offered directions of regulation have debatable character, need proper legislative, methodical and institutional support, however can solve the problems of investment-innovative development of the land relations and increase the efficiency of using Ukraine's land fund in the agrarian sector.

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## **Finansowe uregulowania w relacji do hipoteki**

### **Streszczenie**

Zgodnie z przyjętym celem i omawianą tematyką w opracowaniu rozpatrywany był historyczny aspekt rozwoju hipoteki w podejściu regionalnym. Na podstawie badań postawiono wniosek, iż na terenie „nowej” Ukrainy kredytowanie na podstawie hipoteki zaciągniętej pod zastaw ziemi rozwinęło się dzięki spółkom akcyjnym oraz państwowym instytucjom bankowym. Wynika to ze statystycznych opracowań tego zagadnienia. Kluczowe zagadnienie, jakim jest kredyt hipoteczny, ze względu na ekonomię, prawo oraz aspekty organizacyjne, analizowany był w odniesieniu do realiów współczesnej gospodarki. Wnioskiem z tych badań było stwierdzenie, iż tylko pełna ocena i objaśnienie wszystkich uwarunkowań pozwoli na stworzenie efektywnego i transparentnego systemu udzielania kredytów hipotecznych. Współczesne mechanizmy związane z hipoteką dotyczą również rolnictwa. Prognoza stworzona na podstawie regionu Sumy została przeprowadzona z oszacowaniem oferowanych mechanizmów oraz po spełnieniu warunków stawianych przed Ukrainą w celu przystąpienia do WTO.

