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Latvia

Table of Contents

I. INTRODUCTION	3
II. MACROECONOMIC CHARACTERISTICS	3
III. HOUSING SECTOR OVERVIEW	4
3.1. HOUSING STOCK AND INVESTMENTS	4
3.2. HOUSING MARKET	9
3.3. HOUSING AND LAND PRIVATISATION	10
3.4. GOVERNMENT HOUSING POLICY	11
3.5. SOURCES OF HOUSING FINANCE	13
IV. MORTGAGE LOAN	13
4.1. MORTGAGE LOAN INDUSTRY	13
4.2. LEGAL AND REGULATORY FRAMEWORK FOR MORTGAGE LENDING	15
V. HOUSING FINANCE SYSTEMS.....	16
5.1. HOUSING FINANCE MECHANISMS	16
VI. CONCLUDING REMARKS.....	18
VII. ANNEXES.....	19
7.1. ANNEX 1: HOUSING SECTOR.....	19
7.3. ANNEX 2: HOUSING LOAN BUSINESS	19
7.3. ANNEX 3: SUMMARY OF MONTHLY BALANCE SHEET STATEMENTS OF BANKS AS OF SEPTEMBER 30, 2002	20
VIII. REFERENCES CITED	21

I. Introduction

The purpose of this Paper is to present basic and up-to-date information on the housing sector- specifically, housing finance- in Latvia. It has been prepared for the 3rd OECD Workshop on Housing Finance in Transition Economies. The data and information has been collected from a variety of sources and it attempts to provide a detailed summary of housing finance in Latvia. It should be noted that unofficial resources and statistics have been used to represent the housing sector in this report.

II. Macroeconomic Characteristics

During the period between 1997 and 2001, the average growth rate of Latvia's Gross Domestic Product (GDP) was 6.1% (at constant prices). In 2001, the growth rate reached 7.7%.

Despite the global economic slowdown in 2001 and 2002, Latvia has managed to maintain relatively high GDP growth rates. During the first half of 2002, GDP increased by 4.4%. However, due to the recent rise in economic activity during the second half of this year, Latvia's GDP growth rate is forecasted to be 5% for the entire year.

In the mid-term, it is expected that conditions will remain favourable for the economic development of Latvia. As a consequence, GDP will increase by 5 to 6 percent a year, which will be based on the growth of investments, export and private consumption.

Latvia's economy is developing proportionately; growth has been observed in all of the main sectors of the economy. However, private services and manufacturing are experiencing the highest growth rates and they are expected to remain the main driving forces behind GDP growth in the future.

In September 2002, the officially registered unemployment rate was 7.8% of the economically active population. Regardless of Latvia's rapid economic development, the unemployment rate decreased slightly, as the economic growth was mainly productivity-based.

Latvia's foreign trade turnover has experienced rapid growth over the last two years. The economic slowdown in the European Union (EU) caused a decline in export growth in the second half of 2001, nevertheless, the overall annual increase was reasonably high. Export growth in 2002 is expected to be 7%, which is similar to the previous year. The foregoing demonstrates the ability of Latvian exporters to adjust to the changing external environment.

The country also enjoys one of the region's lowest inflation rates-in September 2002 inflation was only 1%. In the mid-term, it is expected that inflation will not exceed 3%.

Latvia's macroeconomic stability is assured by the country's prudent fiscal and monetary policies.

For several consecutive years, Latvia faced a high current account deficit-in 2001 it rose to 9.7% of GDP. The Country's deficit is mainly covered by foreign direct investment and long-term borrowing. In addition, the foreign reserves of the Bank of Latvia are constantly increasing. In the mid-term, the current account deficit is expected to gradually decrease following growth in exports.

Latvia's prospect of full membership to the EU in the near future is an additional guarantee of the stability and further growth of the economy.

Please refer to Table 1 for further macroeconomic statistics:

Table 1. Macroeconomic Statistics

	1997	1998	1999	2000	2001
Population (at beginning of period), thsds	2479.9	2419.2	2399.2	2381.7	2364.3
GDP (at current prices), mln USD	5627	6088	6649	7175	7577
GDP per capita (at current prices), USD	2297	2527	2781	3024	3218
Gross fixed capital formation, % of GDP	18.8	27.3	25.2	26.5	27.3
Gross saving ratio, % of GDP	16.5	17.1	17.1	20.1	20.2
Inflation (annual), %	8.4	4.7	2.4	2.6	2.5
Wage (monthly average), LVL	120.0	133.3	141.0	149.5	159.3

III. Housing Sector Overview

3.1. Housing Stock and Investments

During the last ten years, there have not been any significant changes in the Latvian housing stock, which is revealed in the following table. Table 2 shows the total area of the housing stock, total area broken down by urban and rural housing and average area per inhabitant.

Table 2. Latvian Housing Stock

	1990	1995	1996	1997	1998	1999	2000	2001
Total Housing Stock, mill.m ²	52.9	52.7	52.8	53.0	53.2	53.4	53.4	53.5
Average per Inhabitant, m ²	19.2	21.4	21.6	21.9	22.2	22.4	22.6	22.8
Urban Housing Stock, mill.m ²	33.8	34.1	34.3	34.4	34.6	34.7	34.7	34.8
Urban-Average per Inhabitant, m ²	18.3	20.1	20.3	20.6	20.9	21.4	21.5	21.8
Rural Housing Stock, mill.m ²	19.1	18.6	18.5	18.6	18.6	18.7	18.7	18.7
Rural - average per inhabitant, m ²	23.3	24.3	24.5	24.8	24.9	24.9	25	24.8

Source: Central Statistical Bureau of Latvia, 2001; Ministry of Environmental Protection and Regional Development of Latvia

The urban housing stock has increased by about 3% and the rural housing stock has decreased by less than 2%, which translates into an increase of approximately 1% in the total housing stock. It should be noted that buildings completely worn out and dangerous to inhabit were included in the calculations of the above figures, therefore, the reality of the situation is worse than what it appears to be.

The average housing space per inhabitant in Latvia is about 30 to 50 m² smaller¹ compared to EU countries. As well, typical dwellings in EU countries consist of 4 to 5 rooms however, in Latvia, 1 to 2 room apartments are predominant.

Any new private (single-family) dwellings in Latvia have primarily been developed in rural areas and construction of multi-apartment dwellings have been insignificant

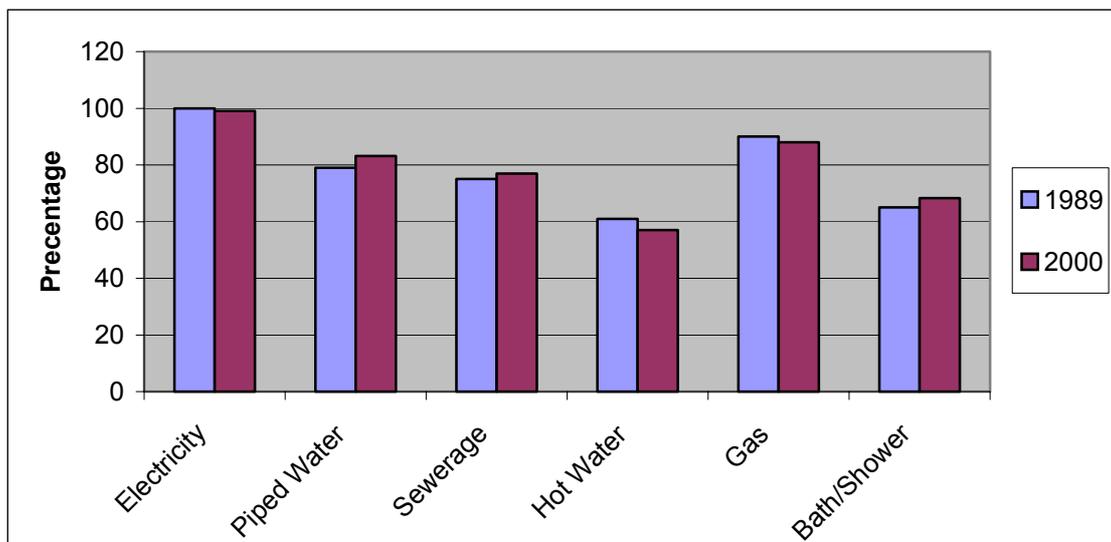
¹ Ministry of Environmental Protection and Regional Development of Latvia

(close to zero percent) since the early 1990s². Therefore, 98 % of existing residential buildings have been built before 1991. Multi-apartment buildings comprise about two thirds of the total housing stock in Latvia, of which two thirds were built during the Soviet era (1945-1991) and one third were built before World War II (1945)³.

In Latvia, there is an unequal distribution of housing in rural and urban areas. Approximately 65% of the housing stock are located in the cities and 35% in rural areas. Housing stock in Riga is about 30% of the total housing stock in Latvia⁴. Furthermore, there is a shortage of housing as well as overcrowding problems. For example, Latvia had about 375 dwellings per 1000 inhabitants⁵ in 2000 and the average space per person in the same year was 22.6 square metres⁶.

Additionally, in the last ten years, there have not been any significant improvements in housing quality, which is noted in Figure 1. The share of housing stock connected to piped water has increased from 79% to 83.2%. The percentage of population living in housing that includes a bath/shower has increased by 3.3% and access to sewer systems has increased to 77%⁷.

Figure 1. Housing Quality, 1989 Vs 2000



Source: Central Statistical Bureau of Latvia, 2002

Please note that the above figure uses housing stock with water and sewer systems, bathroom, central heating and kitchen or kitchenette as an indicator of housing quality. Housing costs are considerably lower compared to the EU countries (Figure 2), however residents spend a comparable share of their income on housing. The movement to a market-based housing system in Latvia- where households pay the full

² Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

³ Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

⁴ Central Statistical Bureau of Latvia

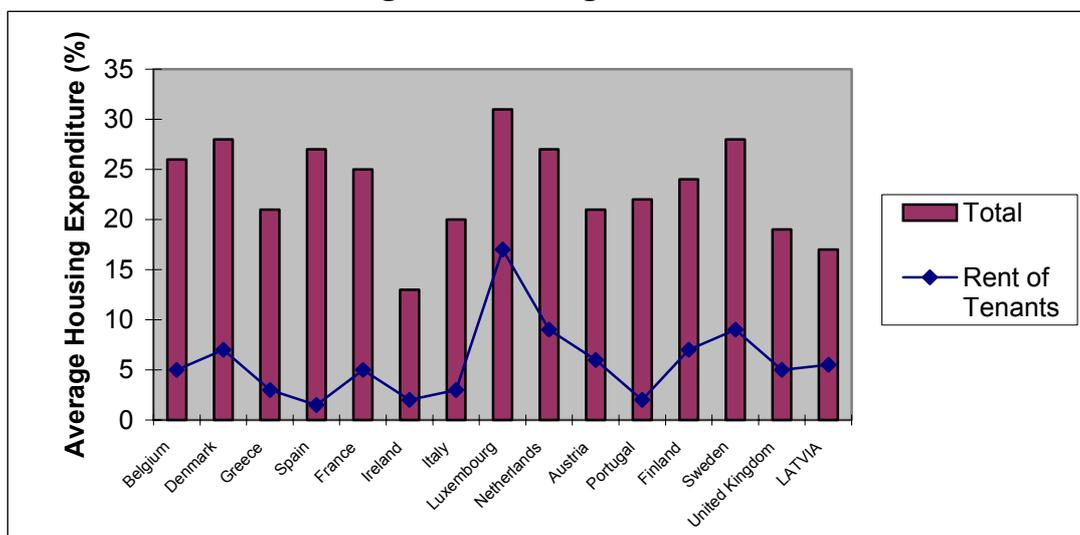
⁵ Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova

⁶ Central Statistical Bureau of Latvia, 2001

⁷ Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova

cost of housing services- has created major affordability constraints. Almost 55% of all households find it difficult to maintain their utility and maintenance payments⁸.

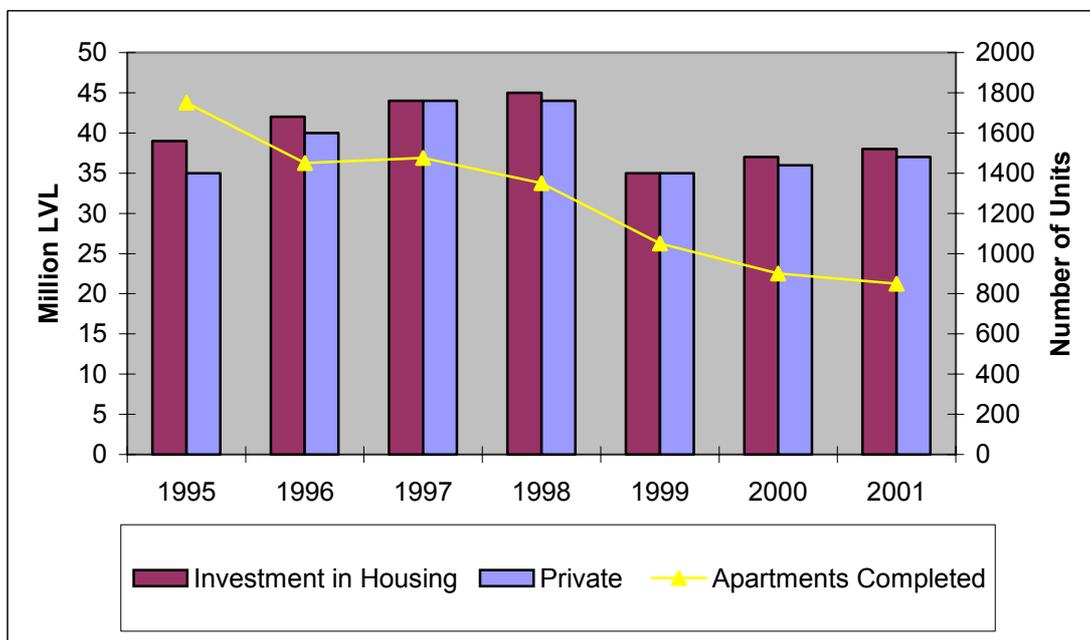
Figure 2. Housing Costs, 2000



Source: European Union, 2002; Central Statistical Bureau of Latvia, 2002

Housing investment in Latvia has been relatively stable over the last five years (Figure 3). However, its share in Latvia's GDP (about 1%) is insignificant as compared to EU standards⁹. The number of apartment units completed continues to decline (Figure 3).

Figure 3. Investment in Housing



Source: Central Statistical Bureau of Latvia, 2002

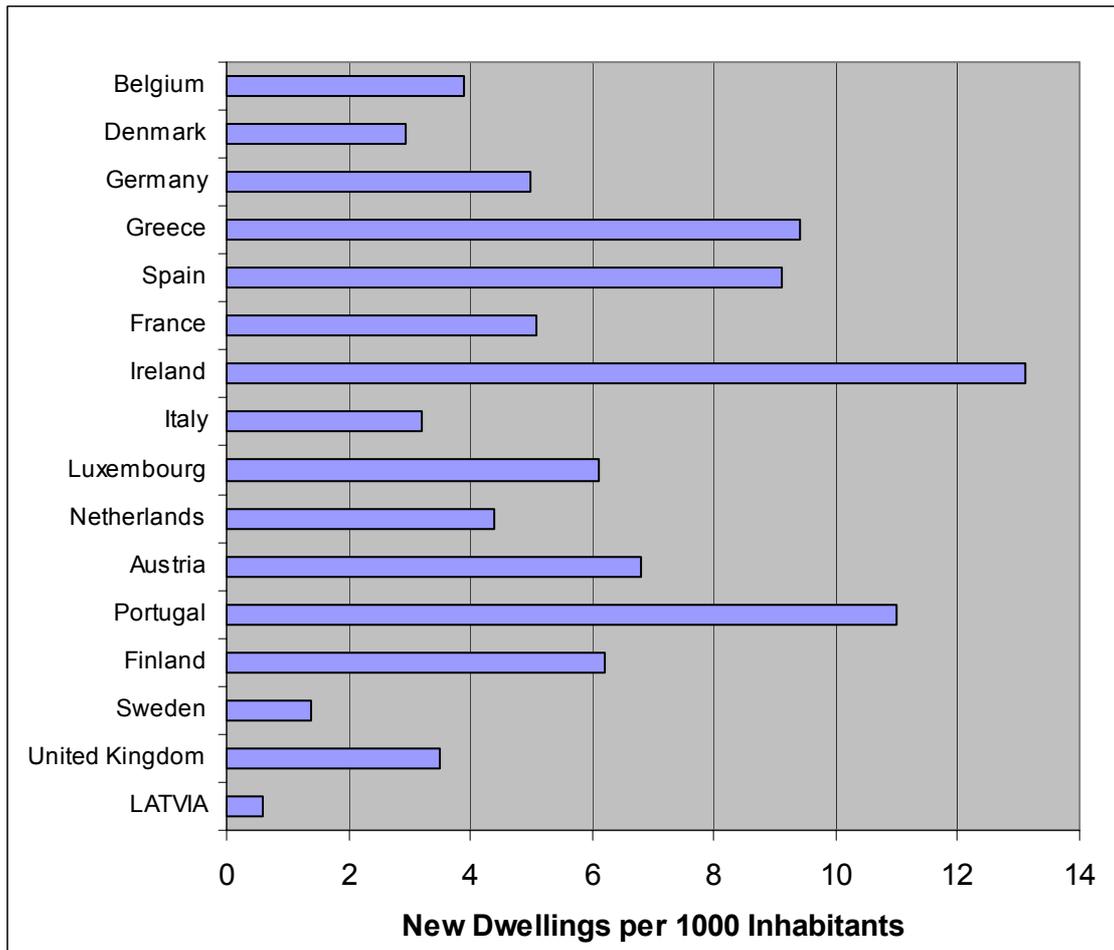
As well, new housing production is extremely low-0.6 new dwellings per 1000 inhabitants in 2000¹⁰- in relation to EU countries (Figure 4).

⁸ Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova

⁹ Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova

¹⁰ Ministry of Environmental Protection and Regional Development of Latvia

Figure 4. New Housing Production, 2000



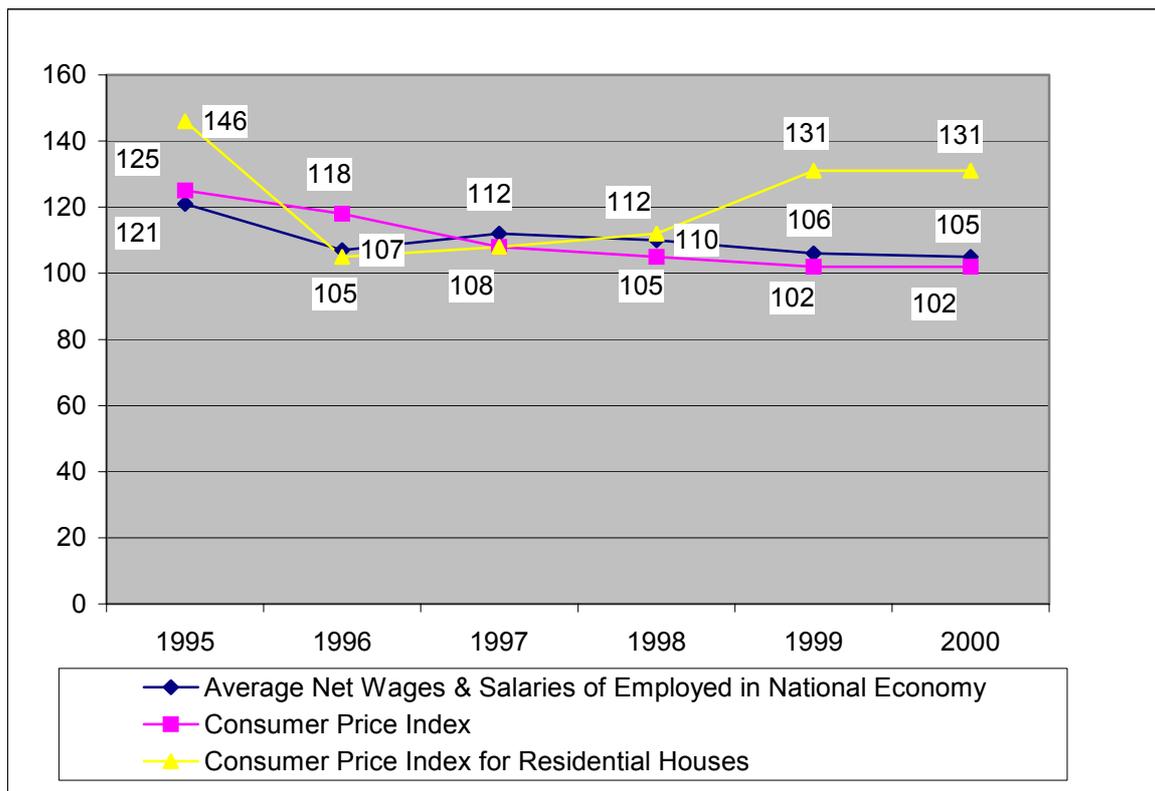
Source: European Union, 2002: Ministry of Environmental Protection & Regional Development for Latvia's estimates

Note: Data for UK, Portugal, Italy and Greece refer to 1999

The foregoing can be attributed to a significant increase in construction costs (Figure 5).

However, it should be mentioned that the construction industry is one of the most dynamic industries in Latvia, with stable growth over the last few years. After the Russian crisis, construction growth stabilised at a rate of 6 % in the year 2001. Currently, the majority of new construction is commercial, but an increase in housing construction is expected due to stable economic conditions. Construction activities not only include new buildings but also the renovation of existing stock. Presently, an increase in housing construction financed by individuals can be observed.

Figure 5. Construction Cost Index



Source: Central Statistical Bureau of Latvia, 2002; 2001

In 2001, merely 4% of all construction in Latvia was construction of housing which was mainly financed by residents. In the same year, the number of construction permits issued to build one-apartment houses (or to reconstruct an existing house) rose to 1606 from 1507 permits in the previous year¹¹. Furthermore, there were 34 permits issued for construction of two or more apartment houses in 2001, 16 of which were in Riga¹². As well, real estate developers have announced plans to construct at least 15 single family house villages in suburbs of Riga with a living area of about 200 000 m².

There are a number of factors that impede the construction of residential buildings. Firstly, construction costs are high as compared to the affordability of individuals. As a result, a disproportionate number of luxury houses are built to target individuals with high income. Secondly, renting out housing is not considered a business activity and finally, support from the State is inadequate; however, it is investigating measures to finance the construction of residential buildings. In particular, housing for middle income people. The State is also exploring the creation of incentives to encourage individuals to invest in housing. One of the options is a guarantee system to facilitate and stimulate construction and renovation of housing.

For the moment, government resources for housing will be mainly used to create a social housing fund with small, cheap apartments for urgent cases and specially adapted flats for senior citizens and disabled persons.

¹¹ Ministry of Economics of the Republic of Latvia

¹² Ministry of Economics of the Republic of Latvia

3.2. Housing Market

Because Latvia is lagging considerably behind EU standards in terms of quantitative and qualitative measures of housing, as mentioned in the previous section, investments in housing are expected. Activity in the housing market is increasing each year, which is observed in the primary and secondary markets. Housing market activity is closely related to other business activities. Therefore, the most active market is in the capital city, Riga, and in other larger cities of Latvia. Although the majority of housing is located in Riga and other urban centres, there is a shortage of housing in these areas due to high demand. In contrast, there is a housing surplus in other regions of Latvia.

Primary market - new construction of housing- mostly takes place close to urban centres in superior locations. These houses are targeted to individuals with high income. Consequently, only 800 new apartments and single-family houses were completed in the year 2001. It is expected that these numbers will increase in the year 2002.

The secondary market is more active due to higher demand. Driven by demand, the prices for housing have sharply increased. Last year, prices for apartments rose, on average, by 1 % per month. Up until 1997, the market for apartments had been relatively stable. Since 1997, prices have increased and are currently 700 USD per square meter in central locations. The prices for apartments in multi-apartment buildings in city districts have reached 250 –500 USD per square meter. The greater the proximity to the city centre, the greater the price of the apartment.

It is expected that the prices for apartments will continue to rise, particularly in the most demanded areas of Riga, until they are equivalent to the cost of construction of new housing.

The secondary market for single family houses is less active than the market for apartments. During the first half of 2001, only 6 % of all housing trades were transactions of single family houses. The foregoing is due to high prices. The prices for single family houses varies from 30 000 USD to 250 000 USD depending on the location and construction materials used.

Future development of the housing market, in terms of quantity, is the construction of single-family homes and multi-apartment buildings with fewer stories than what is the norm (e.g. 3 stories). Middle-income families are typically demanding the foregoing. In terms of quality, capital repair, internal repairs, and energy efficiency improvement measures of multi-apartment buildings are urgently required by the majority of the population since most individuals in Latvia reside in this type of housing¹³. The total amount of financial capital required for the improvement of residential multi-apartment buildings is estimated to be EUR 1050 million¹⁴.

¹³ Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

¹⁴ Ministry of Environmental Protection and Regional Development of Latvia

3.3. Housing and Land Privatisation

The privatisation process in Latvia began in 1991 and it is presently in the final stage. Its objective is to reduce State participation in the economy and to create a favourable environment for the development of private capital and initiative¹⁵. According to the Central Statistical Bureau, about 80 % of Latvian housing will be private property by the end of the privatisation process and municipalities will maintain only 20% of the housing as rental or social housing.

The privatisation process is performed by individual privatisation commissions- established in each municipality- and co-ordinated by the Central Apartment Housing Privatisation Commission. Privatisation certificates¹⁶ for the privatisation of apartments have been issued to private individuals based on age, working history, deportation and other factors.

There are two types of housing privatisation in Latvia which are the Regular or Full Privatisation and the Accelerated Privatisation. The latter is a temporary stage of the Full Privatisation. In the Regular or Full Privatisation, the entire building is privatised and registered in the Land Book and each apartment, with its respective joint ownership of common areas and land, is registered as a private property in the Land Book. In the Accelerated Privatisation, only the apartment is privatised without any assigned portion of the common areas and land. Ownership of the apartment is only registered in the Cadastre. Once the house is fully privatised, ownership titles of individual apartments and their respective joint ownership of the common areas and land are registered in the Land Book.

According to the Law, “On Privatisation of State and Municipal Apartment Houses”, by April 30, 2002, there have been 25 673 state and municipal apartment houses prepared and assigned for privatisation¹⁷. These apartment houses represent 480 893 apartments, which equals 96.17% of the total number of flats in Latvia. Privatisation notifications have been sent to 287 346 tenants¹⁸. There were 150 127 notifications sent, upon the conclusion of purchase agreements, to individuals who had privatised their flats prior to the privatisation of the entire building, and 193 547 flats were assigned for privatisation before privatisation of the building¹⁹. Please refer to Figure 6.

¹⁵ Ministry of Finance of the Republic of Latvia

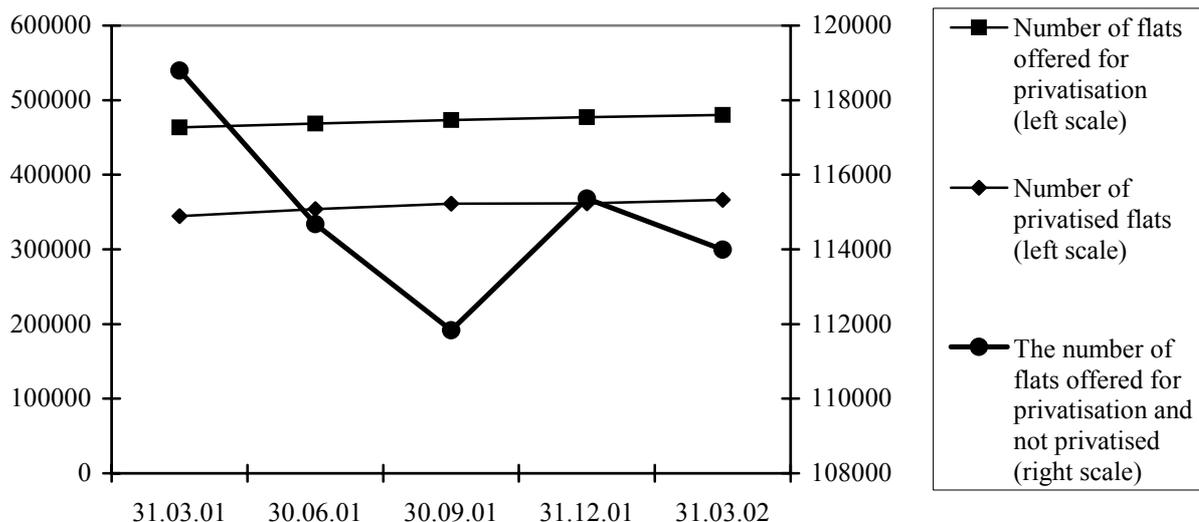
¹⁶ Dematerialised security granted by the State, which can be used once as a method of payment for privatised State or Municipal property (Ministry of Environment and Regional Development).

¹⁷ Ministry of Economics of Republic of Latvia

¹⁸ Ministry of Economics of Republic of Latvia

¹⁹ Ministry of Economics of Republic of Latvia

Figure 6. Privatisation of Flats in 2001-2002



Source: Ministry of Economics of Republic of Latvia

As of April 30, 2002, 367 687 state and municipal flats have been privatised, which is equivalent to 73.54% of the total number of flats in Latvia²⁰. In addition, 4540 apartment houses, including 2791 municipal residential houses and 1749 state owned residential houses²¹, were taken over by the owners to manage.

Once owners take over the rights of management from the previous owner (i.e. State or Municipality), they can choose from two general forms of housing management. One form is called an Agreement, which is based on the Civil Code and is between owners. The other form of management is the establishment of a Homeowners Association (HOA) regulated by the Law, “On Co-operative Societies”. Homeowners Associations are a legal representative body of all apartment owners if membership represents at least 51 %of apartments in the building²².

Municipal maintenance companies rather than private maintenance companies are still managing the majority of housing, including privatised buildings. The main reasons for this slow adoption of private maintenance companies include the wide range in income levels among apartment owners in each building, low awareness and sense of ownership of common areas, lack of knowledge and incentives, and long and difficult transfer procedures.

3.4. Government Housing Policy

According to the Latvia Concept of Housing Policy, which was approved in 1996, housing development in Latvia consists of specific economic, social and housing stock goals.

The Government’s economic goals of housing development are:

²⁰ Ministry of Economics of the Republic of Latvia

²¹ Ministry of Economics of the republic of Latvia

²² Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

- To manage housing stock so that maintenance costs are covered and profitability and regular returns on investments are ensured;
- To increase the use of energy saving solutions in existing and newly built residential buildings;
- To introduce water, heat and gas consumption metres and decentralise control of housing energy utilisation systems; and,
- To increase the number of habitable dwellings by reconstructing housing estates²³.

The social goal of housing development is to provide individuals with the possibility to choose and improve their housing situation. As well, to continue to make social housing available for low- income families.

Finally, the Government's housing stock goals are to increase the supply of family houses and multi-apartment buildings with fewer stories and to continue the privatisation process in order to increase the number of apartments inhabited by apartment owners.

In November 2000, the Strategy of Energy Efficiency was established. It includes regulations that permit the installation of hot and cold water metres, the certification and inspection of meters and the licensing of installation companies. The payment for water usage under this process is based on actual consumption. Although the Government established this strategy, it is unable to financially support energy efficiency measures in the near future.

On September 4, 2001, the Government adopted the Concept for Improvement of the Legislation Base and Institutional Structure in the Field of Housing and Rent (The Concept). The Concept states that the duty of the apartment owner is to participate in decision making on important housing maintenance issues and the possibilities of securing owners' liability in the case of borrowing²⁴. Furthermore, The Concept clarifies the responsibility of the apartment owner for covering all expenditures for the maintenance and renewal of the house²⁵.

With the adoption of The Concept, the Government has agreed to increase the capacity of the Ministry of Environment Protection and Regional Development (MoEPRD) Building Department and to establish a housing agency under the supervision of the MoEPRD in order to improve institutional structure and housing policy.

In 2001, a pilot housing programme was introduced. This programme is based on a LVL 20 million credit line with State guarantees. It is co-ordinated by the Mortgage and Land Bank of Latvia. This pilot programme provides financing for the reconstruction and renovation of common areas of multi-apartment buildings, the renovation and purchase of private housing and the completion of unfinished housing.

²³ Ministry of Environmental Protection and Regional Protection of Latvia

²⁴ Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

²⁵ Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

Presently, the Government is in the process of drafting two national programs related to housing which are the National Program on the Regional Development of Latvia and the National Program on Construction. The latter program entails harmonising the regulatory base of construction with the directives of the EU, maintaining and updating the data base on construction (data base on licensed companies is already operating), and organising seminars and information events for construction specialists.

As the State began privatisation in 1991, State housing sector subsidies discontinued. Consequently, local governments were left with the burden of subsidising the housing sector. Municipalities provide social housing and housing allowances for rent, heating and fuel to individuals with low-incomes. There is also a general housing subsidy through the establishment of rent ceilings however the latest amendment to the Law, "On Rent of Living Space (passed in 2001) provides for the gradual elimination (by the year 2005) of rent ceilings.

3.5. Sources of Housing Finance

There are limited options available to individuals for housing finance in Latvia. The main sources are inhabitants' own resources and mortgage loans from financial institutions. However, present conditions set by banks for mortgage loans are unattainable for the majority of the population-a mere 10% of society²⁶ can meet the conditions. The remainder of the population experience difficulties investing in housing due to a lack of savings, low income and inability to provide sufficient loan collateral.

In most of the cases, funds for housing are accumulated through private savings (for those who are able to save); often, owners become developers and builders of their own housing. Or, development companies organise future homebuyers into associations, which enables access to development finance²⁷.

For low-income residents, local governments provide social housing and housing allowances, which was discussed in a previous section.

Please refer to Annex 1 statistical data on the housing sector.

IV. Mortgage Loan

4.1. Mortgage Loan Industry

The recent developments in the mortgage loan industry include the decrease of lending rates and the increase of loan maturities and loan-to-value ratios. The main factor that prompted the foregoing developments is that the majority of individuals' incomes are insufficient to comply with existing loan requirements.

²⁶ Energy Savings in Houses-Public Information Campaign & Institutional Assistance, Feasibility Study, Blezurs Consultants Ltd.

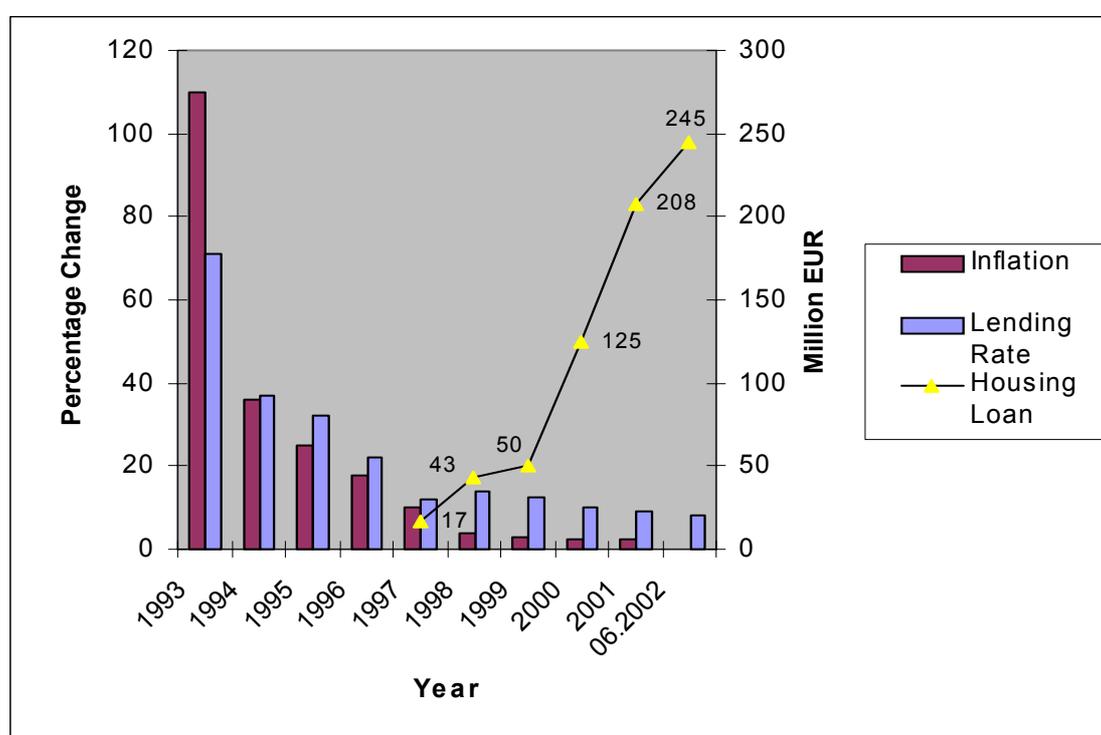
²⁷ Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova

Loan terms were typically quite short, but banks have recently started to offer 20 to 40 year mortgage loans. As well, many financial institutions offer fixed and floating interest rates. In the past, banks required down payments that were as high as 30 to 40% of the property value but the recent trend has been towards lower requirements, such as 10 to 20%.

The range of mortgage products is limited in Latvia, which is the case in most transition economies. Loans can be denominated in Lats or in foreign currency.

Between 1993 and 1999, the volume of mortgage lending increased dramatically. The foregoing can be attributed to lower inflation, macroeconomic stability and growing consumer confidence²⁸ (Figure 7).

Figure 7. Mortgage Volumes and Lending Rates (1993-1999)



However, mortgage lending in Latvia is still under development. Mortgage debt is 6% of GDP, which is significantly lower as compared to EU countries.

In 1998, the Latvian Parliament adopted the Law on Mortgage Bonds, which provides the legal basis for the issuance of mortgage bonds. Mortgage bonds in Latvia are typically liquid and secure; therefore they are highly demanded by investors.

The Bank of Latvia uses mortgage bonds in their monetary operations, which ensures the bonds' liquidity. Furthermore, all mortgage bond issues are quoted on the Official List of the Riga Stock Exchange. Mortgage bonds issued by the Latvian Mortgage and Land Bank have a rating of A3 (Moody's) which was assigned in November 2001 and confirmed in April 2002.

²⁸ Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova

Despite the favourable developments-in mortgage conditions-to borrowers, banks still consider long-term mortgage lending to be risky due to the low solvency of the majority of residents in Latvia.

The major obstacles for sound growth of the mortgage loan industry in Latvia are the low borrowing capacity of the population and a mental resistance to borrow as a result of the Soviet era, where the majority of investments were financed through personal savings.

Please refer to Annex 2 for statistical data on the housing loan business in Latvia.

4.2. Legal and Regulatory Framework for Mortgage Lending

The primary law that forms the mortgage lending system in Latvia is the Law on Mortgage Bonds, which was adopted in 1998. However, there are other laws governing the system, which are the Land Book Law, Civil Law, Civil Procedures Law (foreclosure procedures etc.), Credit Institutions Law and Securities Law. In order to obtain full legal protection of real estate rights, mortgage loans must be registered in the Land Book. Another registration authority is the Cadastres which holds data on physical characteristics of dwellings and its' inhabitants.

In 2001, there were several changes made to the legislation governing the mortgage lending system. The following is a list of them:

1. Amendments were made to the Mortgage Bond Law. The major amendments are:
 - A mortgage loan together with the debts previously entered in the Land Book shall not exceed 75 % of the pledged real estate which is used for permanent living throughout the year or 60% of the market value of other types of real estate
 - The articles related to the bankruptcy of mortgage bond issuers were added to the Law
 - The principles of over-collateralisation were introduced, i.e. coverage of the mortgage bonds outstanding must be at least 10 % higher than the face value amount.

In addition, respective financial supervisory authority adopted the Regulation on the Register of Mortgage Bond Coverage;

2. The previously adopted amendments to the Land Book, which stipulated the introduction of a computerised system of united land books, became effective; and,
3. The amendments to the Credit Institutions Law related to the establishment of Financial and Capital Markets Commission became effective on July 1, 2001. The Financial and Capital Markets Commission is responsible for the supervisory functions of credit institutions, insurance companies, and

securities market participants. As a result, management of the mortgage bond market is performed by one institution.

It can be concluded that the legal framework for mortgage lending is in place. However, the Law on Apartment Property requires modification in order to ensure safe and prudent ways of financing the renovation of common areas in multi-apartment buildings.

The Mortgage Bond Law does not require a specialised bank for the issuance of mortgage bonds. The primary reason for this is that the financial market in Latvia is very small, which does not justify the establishment of new specialised mortgage banks. The only requirement of the Mortgage Bond Law is a separate structural unit to ensure segregated management of assets, entered into the Mortgage Bond Cover Register²⁹, from other assets of the bank.

Thus far, the Mortgage and Land Bank of Latvia has initiated all issues of mortgage bonds. Therefore, in order to encourage private issues, appropriate measures must be taken.

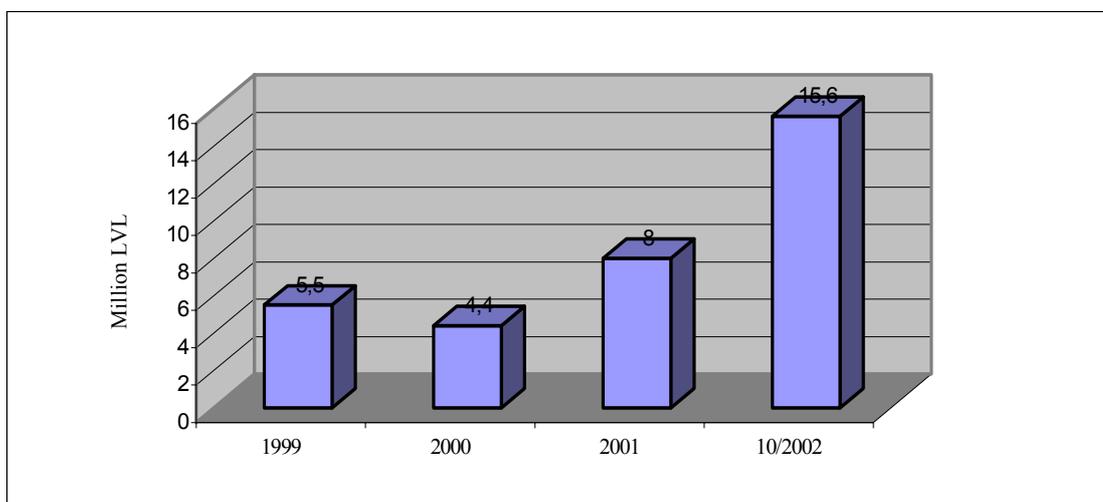
V. Housing Finance Systems

5.1. Housing Finance Mechanisms

Mortgage loans in Latvia are issued by non-specialised banks and are typically financed from deposits, foreign borrowings and equity.

A limited amount of mortgage loans are financed through the issuance of mortgage bonds. Currently, the total outstanding volume of mortgage bonds is 15.6 million LVL (about 27 million USD) which comprises approximately 5% of the total debt securities market (Figure 8)³⁰.

Figure 8. Mortgage Bonds Outstanding



²⁹ Cover Register is the main management and control of the mortgage bond system.

Source: Mortgage and Land Bank of Latvia

The structure of financing sources in Latvia has created a mismatch between assets and liabilities. At the end of the second quarter in 2002, the majority of deposits were demand (59.5%³¹) or short-term deposits (30.9%³²) and only 9.5% were term deposits of 1 year or longer. However, there is high liquidity in the financial sector and deposits exceed the total loan portfolio of banks by a significant amount.

Insurance companies and credit unions provide housing finance in addition to general-purpose banks however their volume is insignificant.

Please refer to Annex 3 for a summary of the monthly balance sheet statements of various banks as of September 30, 2002.

³⁰ Mortgage and Land Bank of Latvia

³¹ Bank of Latvia

³² Bank of Latvia

VI. Concluding Remarks

1. Remaining stable economic growth; the number of mortgage loans will increase. According to research conducted by Hansabanka, Latvia's financial sector has a capacity for 350 000 mortgage loans with a total of 3.5 billion EUR in the next five years.
2. The competition between banks will increase. It is expected that interest rates will decrease slightly however, banks will widely exploit other features of mortgage loans such as the loan to value ratio, loan maturity, loan processing fees, time, and etc.
3. Growing demand for housing will contribute to the construction of new housing.
4. There is an urgent need for financing renovation and energy efficiency measures in multi-apartment buildings. However, banks will remain reluctant to provide capital based on forecasted cash flow from multi-apartment buildings unless additional guarantees are provided or changes in legislation with respect to collateral are made.

VII. Annexes

7.1. Annex 1: Housing Sector

	1996	1997	1998	1999	2000	2001
Total Housing Stock (mill. m²)	52.8	53.0	53.2	53.4	53.4	53.5
Ave. Area per Dwelling (m²)	21.6	21.9	22.2	22.4	22.6	22.8
New Residential Buildings Completed (thsd m²) (Note: units not available)	215.6	227.8	224.7	200.5	191.1	188.5
Number of Apartments & Single-Family Houses Completed (units)	1483	1480	1351	1063	899	800

7.3. Annex 2: Housing Loan Business

	1997	1998	1999	2000	2001	06.2002
Mortgage Loans Outstanding (EUR, % of GDP)	0.3	0.7	0.8	1.7	2.6	6.0
Mortgage Loans Outstanding by Lender (million EUR)	17	43	50	125	208	245
Total Loans (million EUR)	813	1208	1397	1826	2749	3080
Mortgage Loans as a % of Total Loans	2.1	3.6	3.6	6.9	7.6	8.0

7.3. Annex 3: Summary of Monthly Balance Sheet Statements of Banks as of September 30, 2002

Summary of Monthly Balance Sheet Statements of Banks as of September 30, 2002

	in thousand lats			In comparison to previous period, %	
	31.12.2001.	31.08.2002.	30.09.2002.	31.08.2002.	31.12.2001.
Assets					
Cash	121,470	104,687	109,846	5	-10
Claims on the Bank of Latvia	82,428	119,468	88,552	-26	7
Demand deposits	60,428	119,038	88,122	-26	46
Term deposits	22,000	430	430	0	-98
Reverse repo*	n/d	0	0	0	-
Claims on credit institutions	835,893	984,605	949,718	-4	14
Latvian credit institutions	99,114	95,601	117,000	22	18
OECD credit institutions and central banks*	n/d	841,288	780,790	-7	-
Credit institutions and central banks in other countries*	n/d	47,716	51,929	9	-
Loans	1,635,748	1,838,514	1,907,530	4	17
to central and local governments	51,970	53,020	49,089	-7	-6
to financial institutions	194,733	236,537	243,127	3	25
to state enterprises	83,724	87,286	98,715	13	18
to private enterprises	1,033,995	1,099,317	1,134,529	3	10
to private persons	245,156	341,682	361,515	6	47
to non-profit institutions servicing private persons	8,117	11,396	11,458	1	41
Transit loans	18,053	9,277	9,098	-2	-50
Central government securities	244,273	276,947	288,460	4	18
Other securities	348,922	408,977	401,961	-2	15
Non-government bonds and fixed income securities	317,402	367,936	361,043	-2	14
Shares and other floating rate securities	31,520	41,041	40,917	0	30
Derivatives*	n/d	8,645	7,500	-13	-
Holdings in share capital	19,094	23,314	23,582	1	24
Fixed and intangible assets	123,825	124,648	124,553	0	1
Other assets	20,649	24,164	35,513	47	72
Prepayments and accrued income	26,194	24,519	23,736	-3	-9
Total assets	3,458,495	3,938,488	3,960,952	1	15
Managed assets	209,094	380,213	431,744	14	106
Liabilities					
Liabilities to the Bank of Latvia	18,833	27,743	40,065	44	113
Liabilities to credit institutions	520,095	500,436	564,112	13	8
Latvian credit institutions	99,868	95,190	117,268	23	17
OECD credit institutions and central banks*	n/d	338,135	372,959	10	-
Credit institutions and central banks in other countries*	n/d	67,112	73,885	10	-
Deposits	2,329,717	2,778,262	2,700,460	-3	16
by central and local governments	67,520	97,492	57,200	-41	-15
by financial institutions	26,594	32,227	35,827	11	35
by state enterprises	85,053	96,971	94,795	-2	11
by private enterprises	1,436,793	1,717,991	1,670,515	-3	16
by private persons	696,401	814,763	822,929	1	18
by non-profit institutions servicing private persons	17,355	18,819	19,193	2	11
Transit funds	21,264	10,441	10,269	-2	-52
Issued bonds and securities	24,288	23,296	25,516	10	5
Derivatives*	n/d	16,413	15,345	-7	-
Other liabilities	128,026	121,705	136,596	12	7
Deferred income and accrued expenses	23,601	21,129	22,460	6	-5
Provisions	56,629	55,865	56,456	1	0
Special loan loss provisions	35,801	36,456	36,794	1	3
Subordinated liabilities (subordinated capital)	27,578	24,299	24,347	0	-12
Capital and reserves (equity)	308,465	358,899	365,326	2	18
Undistributed profit for the reporting year	49,566	33,391	39,264	-	-
Total liabilities	3,458,495	3,938,488	3,960,952	1	15
Managed liabilities	209,094	380,213	431,744	14	106

*item in effect as of 01.01.2002.

**until 01.01.2002. liability and claims on central banks were shown as a separate items.

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