

Guarantees to Banks for the Loans of House Owner Associations (HOA) Taken to Renovate Multi - Apartment Buildings

To be implemented in Latvia within the
framework of the World Bank Housing project

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Area: 64.589 sq.km

Population: 2.35 M

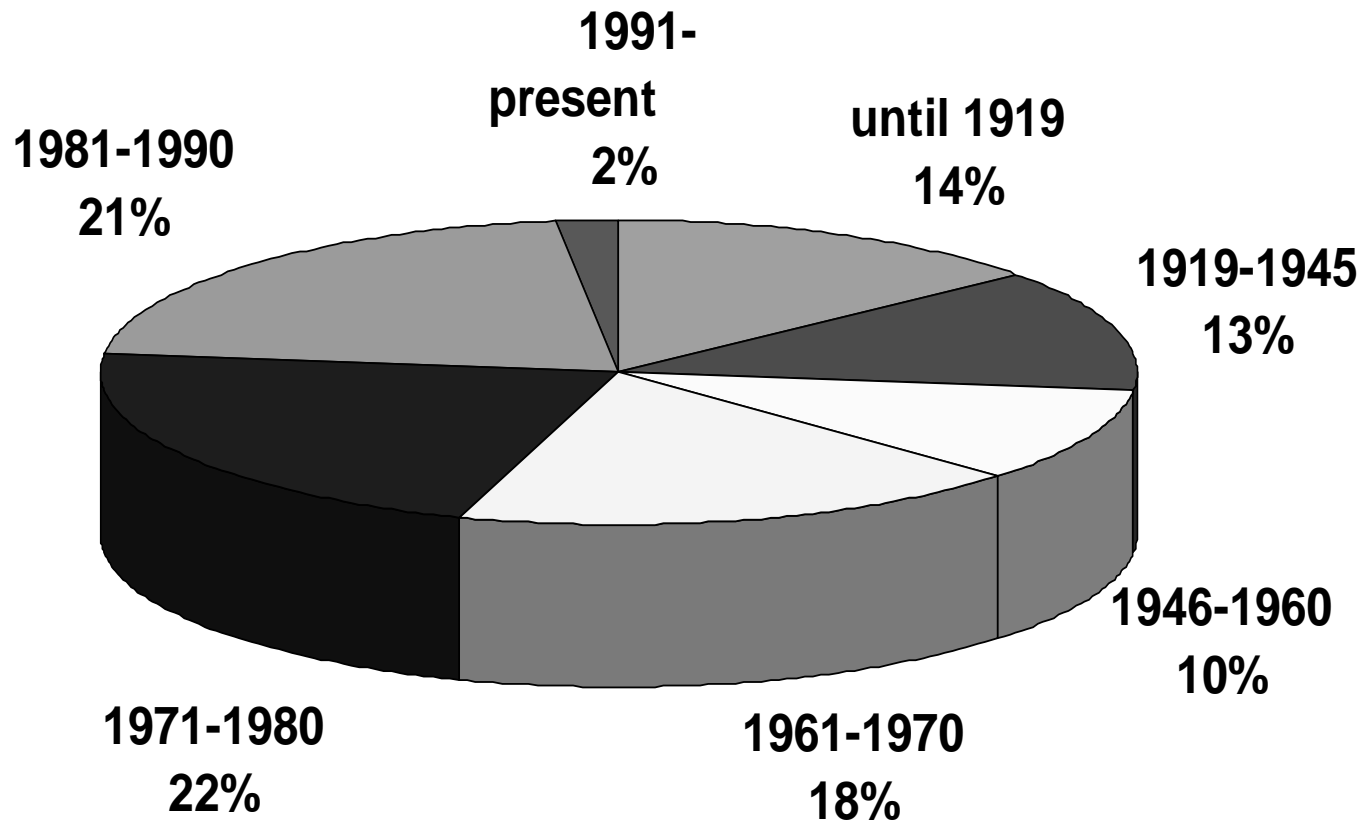
Urban Population: 68%



Multi-Apartment Buildings

- 68.2% of total population lives in multi-apartment buildings
- Total residential floor space is 53.450.000 m² (of which 34.238.000 m² constitutes multi-apartment buildings)
- Number of multi-apartment buildings is 34.000

Shares of Multi-Apartment Buildings by Year of Construction

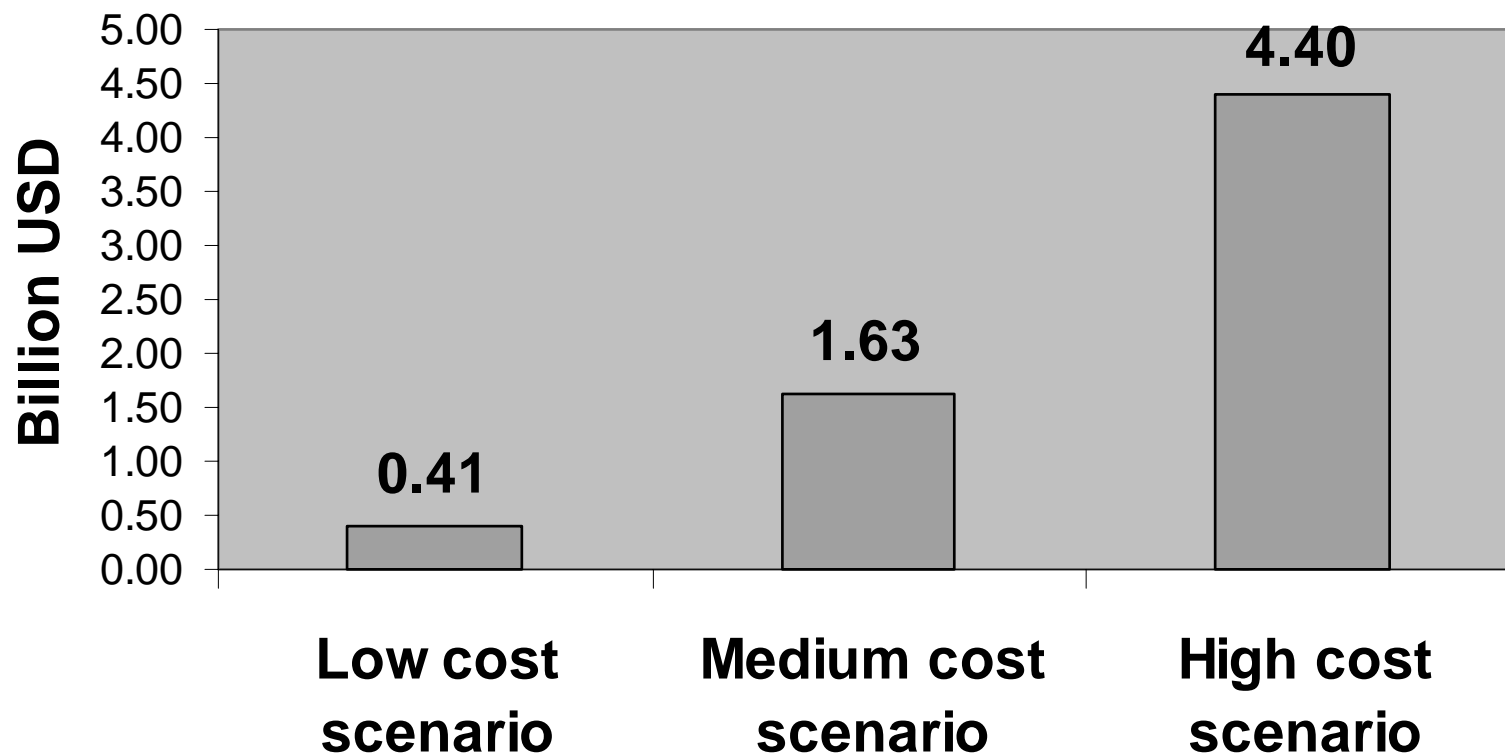


Energy Efficient Investments Required for the Multi-Apartment Housing Stock

Definition of Investment Scenarios

- Scenario I- Minimum repair or tightening of windows and doors
- Scenario II- Scenario I + reconstruction of heat substations, thermal insulation of pipes, and insulation of end walls
- Scenario III- Scenario I + II + window replacement, insulation of side walls, basement and attic, and reconstruction of ventilation system

Cost of Energy Efficiency Investment Program Under Each Scenario

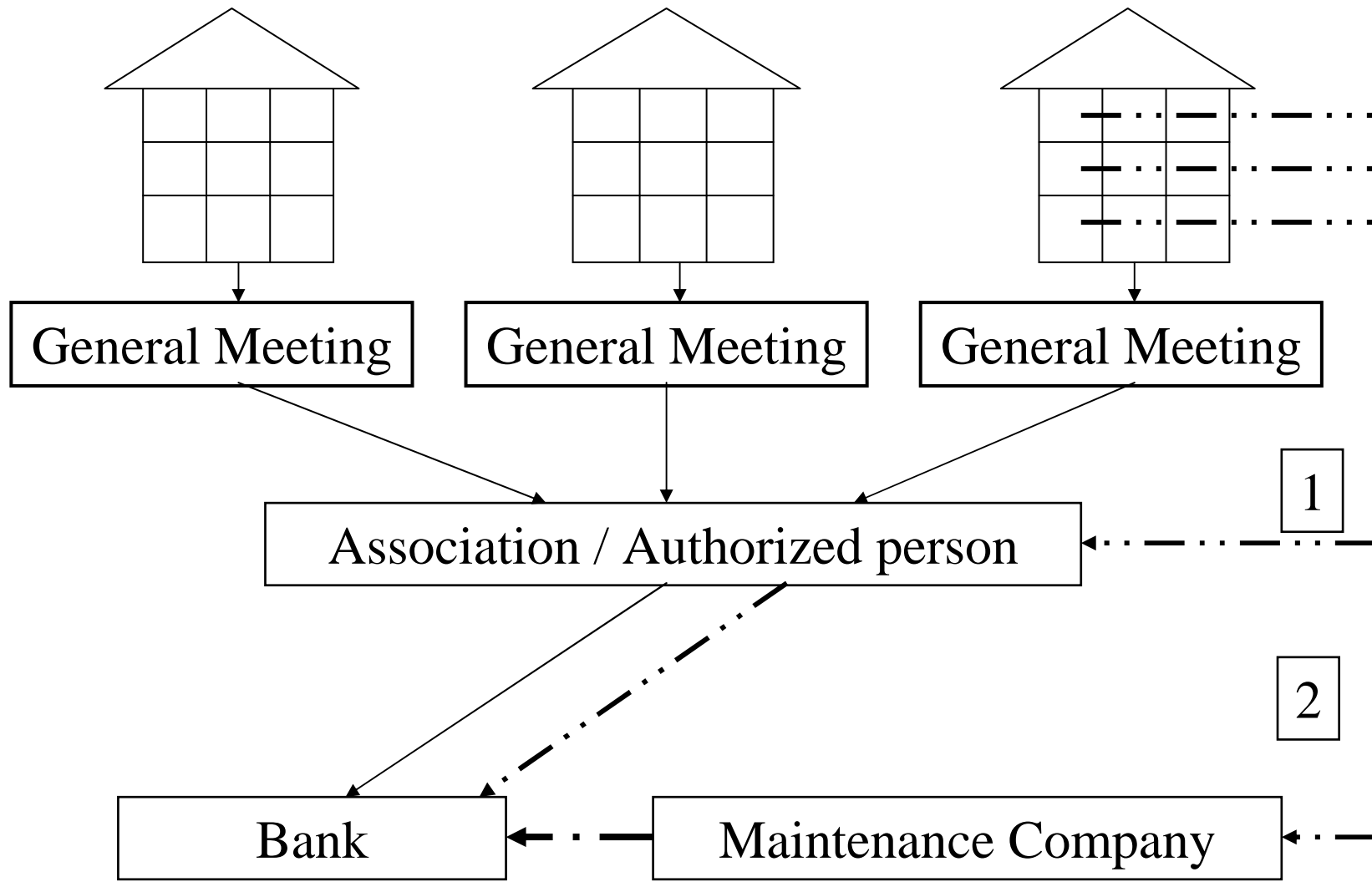


Current Situation

- Issued about 50 loans for the renovation of multi apartment buildings. Total portfolio 1.2 million USD
- Average loan size about 20 000 USD
- Interest rate range: 8.5 -12 % p.a.
- Loans denominated in local currency
- Loans initiated primarily by apartment owners or maintenance companies

Main Constrains for the Financing of Multi-Apartment Buildings

- Low actual demand for loans
- Large administrative costs
- Unclear foreclosure options
- Complicated legal structure of the HOA and the Loan Agreement



—————> Decisions
 - . - .> Cash flow 1 or 2 (depends on concluded agreements)

Main Risk Areas

- Financial risks associated with creditability of the HOA (evaluation of the cash flow)
- Legal risk associated with legal environment (appropriate legislation, legal structure of HOA and legal agreement, and foreclosure)

Guarantee principles for the HOA loans

- Risk sharing with bank: 70 % - Guarantor, 30 % - Bank. Proportion of risk sharing remains for the life of the loan
- Guarantee is provided only for the loan principal
- Guarantee is paid out before foreclosure begins (loan in arrears for 91 days)
- Bank is authorized to carry out foreclosure on behalf of Guarantor

Requirements to Reduce Financial Risk

- HOA is established and has operated for at least 6 months before submitting loan application
- At least 80 % of apartment owners pay invoices on time
- There no arrears of payments for utilities
- Multi-apartment building is insured
- Loan is paid out only for works completed and materials provided

Requirements to Reduce Legal Risk

- Decision to take the loan is supported by at least 75 % of apartment owners
- HOA limits its activity exclusively to management of multi-apartment building
- Bank is given right to claim against each apartment owner for loan payments
- The HOA pledges the cash flow from the multi-apartment building (claims for maintenance against each apartment owner)

Conclusion

- Development of a guarantee system can be an effective method to motivate banks to finance HOA
- Introduction of collateral options (e.g. mandatory mortgage, priority rights etc.) required for long term development
- Standardization of HOA operations and loan applications must be implemented

Conclusion (cont.)

- Education of apartment owners is crucial in the financing of multi-apartment building
- Studies carried out in Latvia indicates that the investments in the renovation of multi-apartment buildings result in high returns with respect to energy efficiency