

# The Issues and Challenges for the Mongolian Mortgage Market

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Mongolia is a landlocked country bordering the Russian Federation to the north and the People's Republic of China to the south. Its population is 2.7 million, with approximately 40% of its population living in the capital city, Ulaanbaatar, and 59% of the people living in ger districts. In Ulaanbaatar 30% of the people live in apartments, and 70% of the people live in ger districts where there is no proper infrastructure. According to the latest census in 2010 there were 713,780 households living in Mongolia.

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 districts characterized by long strips of large, unserviced plots with wide dirty roads on at least two sides. Mongolia's poor population is concentrated in these ger districts. More than 36% of the total population of Mongolia lives below the national poverty line, and almost 80% of the poor live in ger districts in Ulaanbaatar and 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.*

Until early 1990 the government used to provide 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 more demand-driven, with standards and regulations. The approved NHS was designed to: (1) transfer the financial burden of housing to the private sector; (2) improve the quality of existing stock; (3) establish a land registration

Photograph 1: Ger District in Ulaanbaatar City



Photograph 2: Mongolian Ger



and valuation system; and (4) assist vulnerable groups.

In 2000 the Asian Development Bank conducted a housing demand and supply study in Mongolia, which was the driving force to start housing finance through commercial banks in Mongolia. The ADB implemented a Housing Finance Sector Project (HFSP) starting in May 2003. Prior to the ADB project activities, some banks had already begun to issue limited mortgage lending in 2001. However, the process was kicked off with the 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 21 December 2007 over 2,400 loans totaling MNT 28.2 billion had been disbursed under this project. In 2007, the property price value had 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 increases made it harder for individuals to afford the housing loans.

The steady increase in mortgage lending in the banking sector continued until 2008. Most banks stopped

**Table 1: Total Households Living in Urban and Rural Areas**

Total Household Number 713,780			
Total	Ger	Houses, Apartments	Other
	322,836 (45.2%)	382,808 (53.6%)	8,132 (1.1%)
<i>Total Urban Households: 479,503 (67%)</i>			
Urban	156,744 (32.7%)	316,116 (65.9%)	6,643 (1.4%)
<i>Total Rural Households: 234,277 (33%)</i>			
Rural	234,277 (70.9%)	66,692 (28.5%)	1,493 (0.6%)

Source: National Statistical Office of Mongolia

issuing mortgage loans in 2008. Some of the largest banks reached their limits. The reasons of the decreased housing loans were: (1) banks reached their limits in housing and construction loans; (2) the lack of additional funding for banks; (3) banks' total housing and construction loan growth had been high in recent years; and (4) the pay-back period was long (5-10 years). Although banks have slowed down on housing loans, the demand for housing loans is still high. As a result, the banks increased deposit rates to get additional resources. On the other hand, there are the increasing prices of construction materials, and the lowered opportunities for the low-income population to pay for newly constructed apartments. Construction sector growth had also slowed due to the inability of people to pay for housing. Moreover, the decline in construction lending left many construction projects unfinished. The banks and the government took a series of steps to input funds into the construction sector. The Bank of Mongolia (BoM) took steps to lend resources to commercial banks in order to issue loans for unfinished construction. There was an improvement in the housing and construction loan trends from the first half of 2008. The situation improved further, when the banks received additional funding from domestic and foreign markets (Table 2).

Although mortgage lending was relatively low until mid-2010, a rapid recovery started taking place at the end of 2010, accounting for MNT 333 billion in mortgage loans lent to 19,700 borrowers. This figure doubled in 2011 with MNT 656 billion in mortgage loans-lending to about 24,000 borrowers. There are 11 commercial banks that run mortgage lending activities in Mongolia. The share of the mortgage market as a percentage of GDP increased to 6% in 2011 from 1.11% in 2005 (Table 3, Figure 1).

Although mortgage lending has significantly increased recently, demand for housing is also increasing. Mongolia's young generation, between 25-35 years old, is increasingly becoming financially able to afford investing in residential properties and is keen to move away from their current multigenerational housing units into more contemporary and spacious housing. The boom in the mining supply chain and the service industry are leading to a stronger-than-ever demand level in the housing sector. On the other hand, housing supply has intensively expanded allowing the creditworthy population segment to receive mortgage loans.

Many low income people are still lacking access to finance for purchasing houses. Most of them could not even afford the upfront payment requirements. In addition to that, the continuously increasing price of imported construction materials, mainly from China, results in a rise in cost of the apartments. Many Mongolians who seek higher paid jobs and greater possibilities have relocated from other parts of the country to Ulaanbaatar. Most of these households are low income families and live in the sprawling ger districts of the northern districts that spread across the surrounding hills of Ulaanbaatar. Due to the lack of infrastructure for proper housing, the people who live in ger districts heat their houses and gers using coal or lignite burnt in iron stoves. The smog caused by coal burning in ger districts has made Ulaanbaatar the second most polluted city in the world during the winter season. Tackling these environmental and social problems caused by the ger

**Table 2: Core Market Indicators in Mongolia's Mortgage Market**

Market Indicators	2009	2010	2011
Debt Outstanding, MNT million	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, MNT Million	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 Borrower, MNT Million	13.47	16.94	24.78
Number 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%

Note: W.A. LTV = Weighted average loan to value ratio

Source: Bank of Mongolia and National Statistical Office of Mongolia

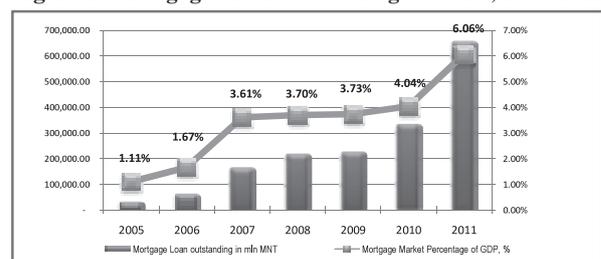
**Table 3: Mongolia's Mortgage Market Indicators**

	2005	2006	2007	2008	2009	2010	2011
GDP, nominal, MNT Billion	2,779.6	3,715.0	4,557.5	5,895.5	6,055.8	8,255.8	10,829.7
Systemic Loan Outstanding, MNT Billion	1,334.1	2,230.5	2,056.1	2,635.6	2,632.0	3,112.5	5,641.2
W.A.I.R. of Mortgage loan, %	14.73	17.83	15.96	18.71	17.73	15.75	14.8
Numbers of total borrowers	4,774	8,984	16,444	16,522	16,784	19,700	26,491
Mortgage Loan outstanding, MNT billion	30.8	61.9	164.6	218.0	226.0	333.8	656.5
Mortgage Market Percentage of GDP, %	1.11	1.67	3.61	3.70	3.73	4.04	6.06

Note: W.A.I.R. = weighted average interest rate

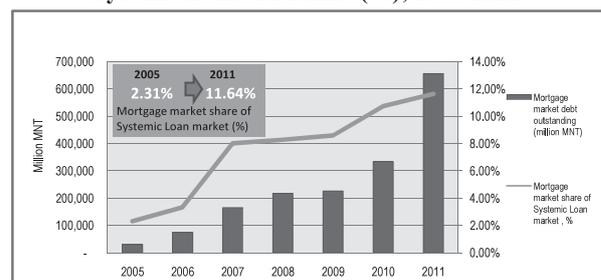
Source: Bank of Mongolia and National Statistical Office of Mongolia.

**Figure 1: Mortgage Market Percentage of GDP, 2005-2011**



Source: Bank of Mongolia and National Statistical Office of Mongolia

**Figure 2: Mortgage Market as a Percentage of the Systemic Loan Market (%); 2005-2011**



Source: Bank of Mongolia and National Statistical Office of Mongolia

districts has been a prolonged priority for the government.

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

The five major strategic objectives of this program are: (1) to establish new townships for housing units; (2) to improve the density of housing units in Ulaanbaatar and other urban centers and settlements; (3) to develop the ger districts; (4) to facilitate development of housing and real estate market relations; and (5) to support the construction material production industry and the capacity building of human resources. Later, this program was extended to a 100,000 housing program. This program is expected to have a major impact on the substantial percentage of ger districts. But the project will also require a substantial amount of supporting infrastructure, including roads, bridges, and water and canalization projects.

Also, the government resolution No. 15 of 10 February 2011 approved the establishment of the Development Bank of Mongolia (DBM) to provide long term financing for the infrastructure and industrial projects stipulated in the governmental programs, such as the New Development Medium-Term Target Program, and the State Policy on Railroad Transportation. The DBM will also fund the government housing programs by issuing government bonds.

Given the growing demand for housing, it is important to create a favorable legal regulatory environment that allows the creation of new funding resources for housing loans by issuing securities backed by the mortgage loan receivables that allow more liquidity to the commercial banks. This will make possible the refinancing of new mortgage loans and provide new sources for banks for new housing loans.

The Mongolian government resolution No. 116 dated 14 May 2003 approved the developing of a mortgage-backed securities market in Mongolia. It enabled the creation of a self-financing policy without government funding. Consequently, on 14 July 2009, the government approved the "Mortgage Law" followed by the Asset Backed Security (ABS) Law approved on 23 April 2011, which has legally enabled primary and secondary market developments.

The development of the secondary mortgage market through the establishment of the "Mongolian Mortgage Corporation" (MIK) has emerged with the initiative of the USAID-EPRC project. In 2006 the Bank of Mongolia (BoM) and 10 commercial banks established a private-sector controlled secondary-tier mortgage institution. The MIK's 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 modern urban development in the future.

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

The MIK has become the liquidity provider to the financial institutions, which had access to long-term funds primarily through international financial institutions and donor programs. Over the past 5 years, the MIK has actively worked with both the government and regulating agencies to set up a legal regulatory framework for the secondary market in Mongolia. One of the prerequisites for secondary mortgage market institutions is to buy standardized mortgage loans. At the time of the MIK's establishment, commercial banks had their own standard procedures for issuing mortgage loans. One of the main objectives of the MIK was to standardize all the loans issued in the market. Therefore the MIK, together with representatives of commercial banks, developed a Mortgage Standardization Procedure that was approved by the BoM on 17 October 2008 and will be applied by all the commercial banks in their mortgage lending activities. The MIK has also taken a major role on drafting the approved Mortgage and ABS laws.

The MIK engages in cooperation with many internationally recognized financial institutions. Over the past few years, the MIK implemented several important projects with International Finance Corporation (IFC), the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), the Asia Pacific Union for Housing Finance (APUHF), the German Development Bank (KfW) and the Housing Finance Network, initiated by the Wharton Business School.

More specifically, in 2009 the MIK together with IFC and Shorebank International implemented a project to adapt the Mortgage Lending Toolkit in Mongolia. The objective of this project was to standardize mortgage lending activities by introducing an internationally accepted toolkit. Under this project, the MIK has translated the toolkit adapted for Mongolian market standards, published it, and distributed it to all commercial banks, including other financial institutions undertaking mortgage lending activities. Within the framework of this project, the MIK also organized workshops for the commercial banks in June 2009 and June 2010 to introduce the toolkit in detail.

Upon the successful completion of the above project, the IFC has requested being able to implement the second "Housing Micro Finance" (HMF) project in Mongolia. During the implementation of the HMF project, the MIK has carried out comprehensive market assessments in two cities, Darkhan and Ulaanbaatar. The market assessment conducted during the HMF project has not only concentrated on the demand-side of the market but also on the supply-side of the market.

The MIK has successfully completed these projects by preparing valuable recommendations to the IFC to develop the HMF market in Mongolia.

With the approval of the government of Mongolia, the MIK has become the project implementing body to support promotional activities in the housing finance sector. Under this project the German Development Bank (KfW) granted long-term loans to the MIK starting in November 2009.

The APUHF is a union and platform that acts as an experience sharing network among the South Asian countries. As the MIK represents Mongolia in the union, the MIK on its own initiative has successfully organized the union's first regional form in Ulaanbaatar in June 2011 bringing together officials from the South Asian countries. Starting from January 2012, the MIK has been actively engaging in the union's activities and has become one of its advisory board members. Meanwhile, the MIK is also a member of the International Union for Housing Finance (IUHF). Also, the MIK is an advisory board member of the "Asia Pacific Housing Journal" published by the Government Housing Bank of Thailand.

Under the core activity of the company for providing liquidity to the commercial banks by selling mortgage-backed securities to the capital market, the MIK has purchased a total of MNT 21 billion of mortgage portfolios from 9 different banks. The standards of the MIK's loan

purchase criteria enabled the MIK to purchase the best performing loans from the banking sector. In December 2009 the MIK has issued MNT 6.3 billion of covered bonds to commercial banks and insurance companies with the longest maturity up to 5 years. The MIK bonds qualify for a Repo financing instrument by the BoM. On 21 March 2012 the Financial Regulatory Commission of Mongolia (FRC) approved the MIK as a housing finance company and issued a "Special Permission" to engage in securitization activities in the capital market.

The MIK will continue to work towards extending the mortgage market in Mongolia by building a well-functioning secondary mortgage market and creating an environment for local institutional investors to boost the local capital market, as well as to issue mortgage-backed bonds and securities to the international capital markets. Ultimately, by raising funds from the capital market, the MIK will contribute to increased long-term, low-interest and affordable housing loans to Mongolian citizens.

The stable and growing Mongolian economy will encourage the growth of the housing finance system through lower inflation, lower interest rates, and lower systemic risk. However, a proper housing finance infrastructure based on policy that integrates public and private cooperation will ensure sustainable Mongolian mortgage market development.