MAGYAR NEMZETI BANK

HOUSING FINANCE IN HUNGARY

Country paper prepared for the 3rd OECD Workshop on Housing Finance

by

Nagyné Erzsébet Vas and Gergely Kiss

I. MACROECONOMIC CHARACTERISTICS

Focusing on the EU accession, the Hungarian economy has been on a sustainable growth path in the past five years. Hungary has been gradually catching up with the EU countries, showing signs of improved adaptability to the market and considerably improving competitiveness. Following Hungary's EU accession in 2004, entry into the Economic and Monetary Union (EMU) will be the next major step in the country's European integration process. The expected benefits of introducing the euro are significantly greater than the expected costs. As a result, introducing the euro would increase Hungary's long-term potential growth rate and speed up real convergence towards the euro-zone.

Table 1. Key macroeconomic indicators

Economic indicator	1996-2000 (annual average)	2001	2002 forecast
	Relative to previous year (%)		
GDP	4.7	3.8	3.8
Household consumption	3.8	5.1	9.8
Gross fixed capital formation	9	3.1	7
Export	19.4	9.1	5
Import	20.1	6.3	8.6
Consumer prices	13	9.2	5.4
Unemployment rate	7.4	5.7	5.5
General government deficit (ESA 95 methodology) *	5.2**	4.1	6
Current account deficit*	3.5	2.2	4.4

** As a percentage of GDP   ** 1998-2000*

Source: National Bank of Hungary

Since Hungary is a small, open economy, and economic growth has been driven largely by exports in previous years, the relatively poorer export performance in 2001 resulted in a likewise marked deceleration of overall economic growth. **GDP growth** decelerated from quarter to quarter in 2001, as against the outstanding 5.2% rate in 2000. Meanwhile, **industrial output** grew at a slow rate in 2001, even as **construction output** increased rapidly on account of the government-financed infrastructure projects and the acceleration of housing construction.

Despite the slowdown, the GDP growth achieved in 2001 is high by international standards, at more than twice the estimated value for the euro-area. However, the change in the **demand components** of GDP was unfavourable. The share of investments necessary in the catching-up period has been inadequate: the volume of gross fixed capital formation (3.1%) lagged behind the 7.7% growth of the previous year. The government saw the stimulation of domestic demand as the response to the adverse global economic trends. The boost was noticeable in two areas. The expansion of **public investment** projects partly offset the low level of investments in the business sector due to the economic downturn. Furthermore, the extension of the benefits from the **housing subsidy system** gave renewed momentum to the construction boom. The faster-than-planned increase in wages in 2001 also implied a rise in **household consumption** at a rate higher than GDP. Both household disposable income and consumption is continuing to increase rapidly in 2002 on account of high real wage growth.

Due to the decreasing investment of the business sector, the demand for external funding dropped, despite the growing net borrowing of the general government sector.

Therefore the **current account** deficit as a percentage of GDP diminished considerably in 2001. While the reduction of the household financing capacity and the on-going fast fiscal expansion have exerted upward pressure on the external financing requirement in 2002.

An inflation targeting regime was introduced in August 2001, following the widening of the narrow exchange rate band (+/-2.25%) in May 2001. Since then, Hungary has been operating an ERM II-consistent exchange rate regime with a +/-15% wide band. Within the wider fluctuation band, the forint has appreciated some 10%, and **inflation** has dropped more than 6% points since May 2001, to 4.6% in September 2002, in line with the pre-announced inflation targets.

II. HOUSING SECTOR OVERVIEW

Housing policy

The government, which had to cope with the negative consequences of the transition, had **little support** for the housing sector during the previous decade. While the so-called *socio-political* support was provided for every child in the family, the amount did not give sufficient relief to most of the families.

The **housing programme**, which was launched in 2000 as part of the national modernisation plan (Széchenyi plan), introduced various forms of financial support, partly through the introduction of mortgage lending. The most important measures were the interest rate subsidy on loans for the purchasing and construction of new houses, and the interest rate subsidy on loans for purchasing used houses and for enlarging and modernising existing houses. These measures gave a substantial impetus to the construction, purchasing and modernisation of houses, along with the tax incentives in the personal income tax and VAT.[1]

In the future, while the government endeavours to maintain the real value of housing expenditures in the budget, it will also rely on the involvement of local governmental and business capital. Financial support will be of an increasingly **social/welfare nature**. The objective is that the lowest income groups should be enabled to improve their housing conditions by receiving government support. Target programmes providing support for the construction of houses for career starters and for pensioners will be continued. A new 'sub-tenants' housing programme will be launched to construct social rental dwellings for people finding themselves in a crisis. Apart from the subsidies provided so far for the disabled to render their houses easier to move about in, the government will also provide subsidies for the construction of special houses for handicapped people.

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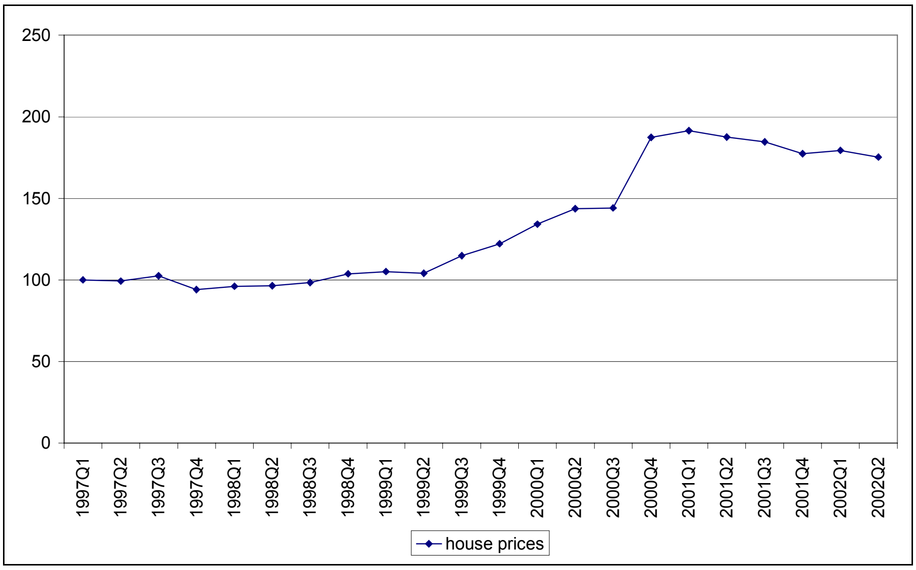
[1] A more detailed description of the subsidies may be found in Chapter 3.

The government is planning to increase the stock of housing available for tenants by continuing the **rental housing** construction programme, by purchasing some of the currently privately owned dwellings in blocks of flats, and by letting dwellings in state-owned real estates. In cooperation with local governments, the government will accelerate—through joint financing—the reconstruction of blocks of flats and apartment houses in a state of disrepair.

Developments in the housing sector

House prices showed a rather volatile pattern in Hungary during the '90s. In the uncertain economic situation before and at the beginning of the transition, there was an appreciation of real assets, such as houses and foreign currency. However, the fears of hyperinflation faded by 1992, and the economic outlook started to improve parallel with the local governments' privatisation of their stock of dwellings in the early '90s. As a result, house prices started to decline, and households started to re-allocate their savings from houses to financial instruments. House prices became stable only by the end of the '90s. House prices in Budapest[2] show that the rapid increase in house prices started in early 1999 and continued until the end of 2000. During the past two years, house prices adjusted for inflation have been stable. Despite this recent stability, however, the nominal price level has been significantly higher than in 1997. In the last two years, average real house prices in Budapest have been higher by about 75% than in 1997, and have almost tripled in nominal terms.

Chart 1. Real house prices in Budapest (1997Q1=100)

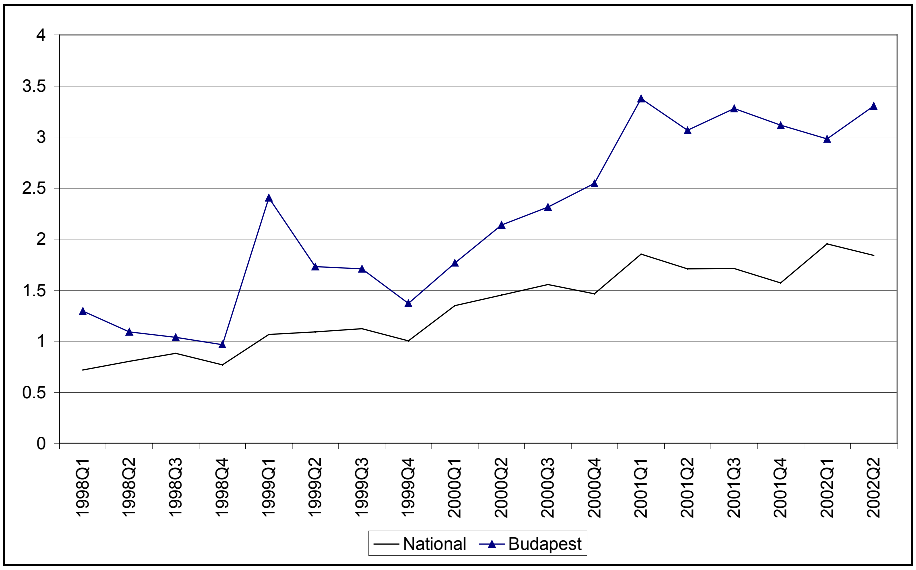


Source: Ingatlan.net website

[2] Given the lack of reliable and up-to-date national statistics, and taking into account the large number of transactions in Budapest—the largest Hungarian city with 1.7 million inhabitants—the house prices in Budapest appear to be a more reliable economic indicator.

In Hungary, the **stock of dwellings** reached 4.06 million in 2000, which translates to 247 persons per 100 dwellings on average. Meanwhile, the average size of a new apartment increased during the '90s, and reached almost 100 m^2 in 2000. Due to the long construction period, the leading indicator for future construction is the number of dwelling construction permits. In 2000, the number of construction permits doubled compared to the figure for 1997, with a more marked growth in Budapest, as a consequence of the new subsidy policy of the government. The number of construction permits reached 48,000 in 2001, and 22,500 in the first half of 2002. Both construction permits and finished constructions indicate that the share of house construction to GDP has increased substantially.

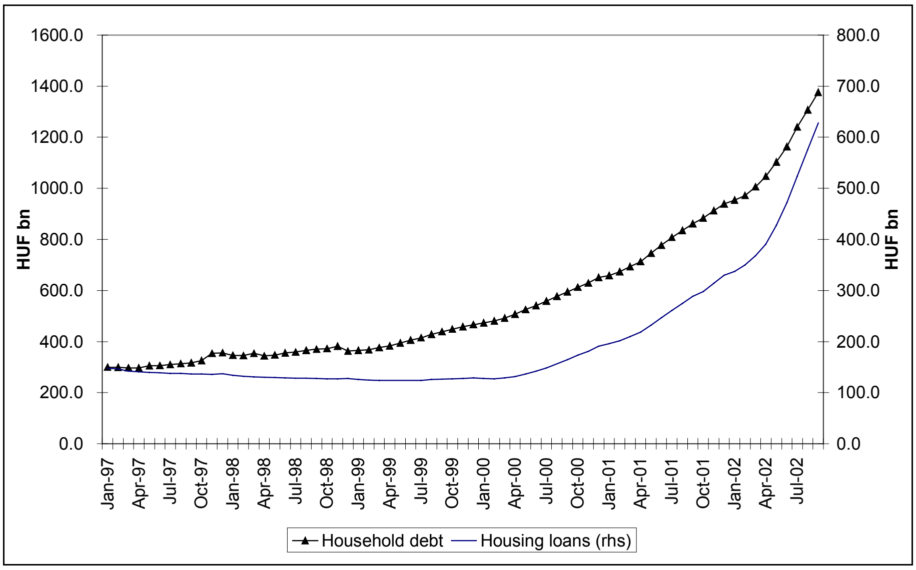
Chart 2. Residence permits (1997=1)



Source: Central Statistics Office

In the area of **housing loans**, an even more characteristic change has taken place since 2001. Household loans have started to grow dramatically from a minimal level. As a consequence of the high inflation and nominal interest rates in the '90s, households had practically no access to credit markets. Hence, the volume of credit—particularly long maturity housing loans—was insignificant, even declining to a level of less than 2% of disposable income in 1999.

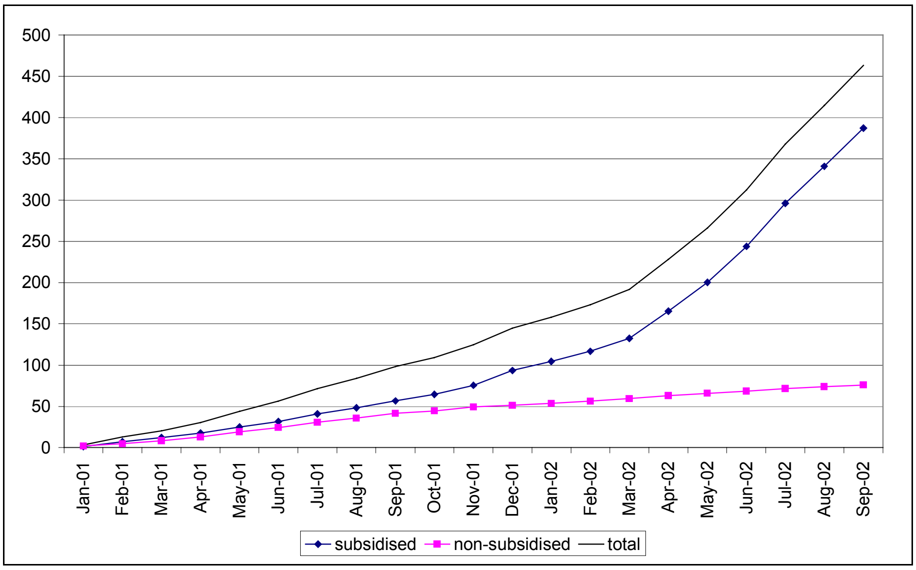
Chart 3. Outstanding debt of the household sector



Source: National Bank of Hungary

The rapid growth of housing loans stemmed almost uniquely from the subsidised loans, introduced in 2000, which were provided at an interest rate (4-5%) comparable to euro rates. The granting of new loans has grown continuously. By summer 2002, it has reached HUF 50 bn (app. € 200 million) a month, reducing the previously highly positive net saving position of the sector. As a consequence of the rapid credit growth, the indebtedness of the households has also been on a growing trend. As of September 2002, the liabilities of households equalled 12% of disposable income.

Chart 4. New housing loans since 2001 January (HUF bn)



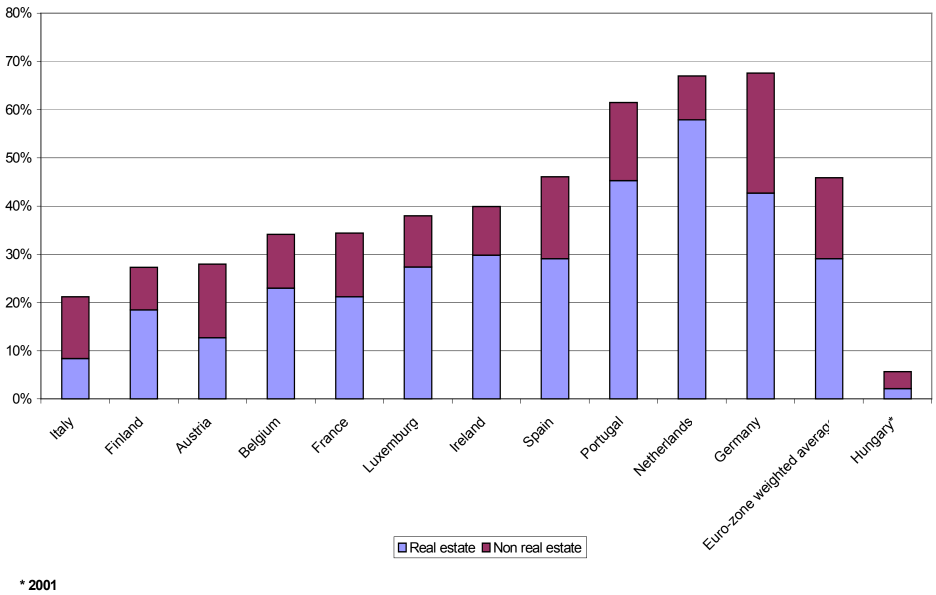
Source: Ministry of Economics and Transportation

Summarising the recent developments, it can be said that as a result of the new housing policy, loans became available to a large segment of the household sector, which gave a **big impetus** to house construction. The number of residence permits doubled at the national level in 3 years, and the growth was even higher in the more affluent capital. A new equilibrium in house prices was reached at a higher level of demand and supply.

III. HOUSING FINANCE

Despite of the gradual improvement in legal, institutional and market conditions in Hungary in the last decade, **mortgage financing is still relatively underdeveloped**. The overwhelming majority of mortgage loans extended to households is housing-related. The most important impediment in the expansion of land mortgage financing is the fragmentation of the domestic ownership structure and low value of land. Joining the EU may bring significant changes in this respect on the long run. There are also long run business opportunities in project financing, within that in municipality developments, since their weight is marginal compared to the level in the EU.

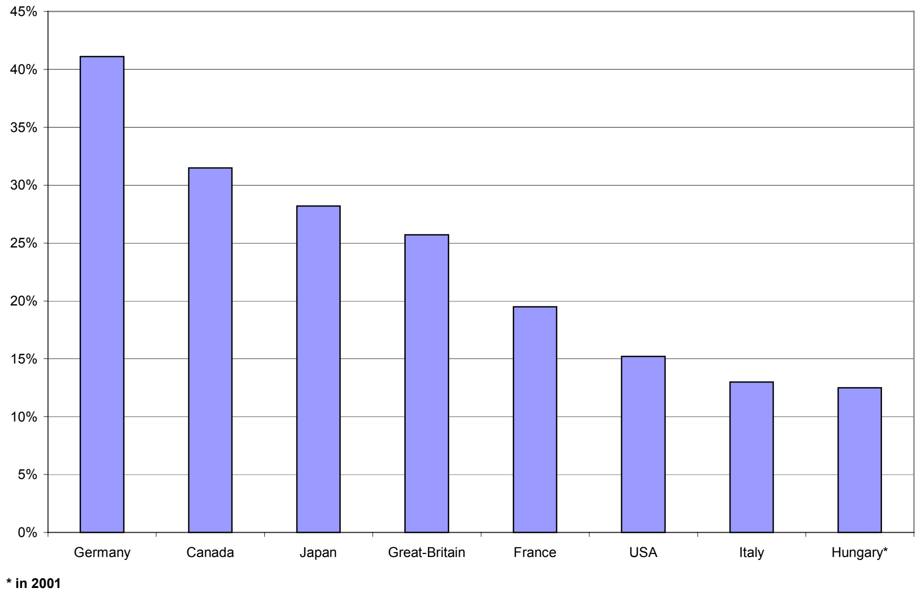
Chart 5. Households loans as a percentage of GDP (2000)



Source: ECB, cited by Banco de Espana Annual Report 2000, and NBH

The share of domestic mortgage type housing loans (hereinafter housing loans) as a percentage of GDP is low in international comparison (2.5% at end 2001), just as the share of housing loans in the asset structure of credit institutions (3.7% in 2001). The share of owner occupied homes, however, is high (around 90%). Both the low share of mortgage financing and volume of rented homes are the consequence basically of the development level of the Hungarian economy.

Chart 6. Households financial liabilities to financial assets (2000)



Source: OECD,NBH

Debt taking capacity of Hungarian households is weak in international comparison. Regarding the ratio of financial liabilities to financial assets (12.5% in 2001), however, the difference is not as much despite the low volume of credits. Lower debt taking capacity is basically the consequence of differences in living standard and the lower level of disposable income of Hungarian households. Debt taking capacity is further diminished by the exceptionally high proportion of real estate assets in the wealth of Hungarian households, which is partly the result of the attitude of households to invest in real assets. Adverse domestic stock exchange developments did not support the increase of the traditionally low risk taking willingness of Hungarian households. Accumulation of relatively high real estate asset volume of households, parallel with low level of indebtedness, is partly the consequence of the fact that a high proportion of homes owned former (in the socialism) by the municipalities were to be purchased at a fraction of market price.

The current low level of housing finance can also be explained by a decreasing trend in lending volumes until 1999, since –parallel with raising the old type subsidised loan's interest rate to the market level– a partial release of debts and prepayments in masses exceeded the granting of new credits. Real income of households declined to a considerable extent as a consequence of restrictive economic policy measures and a high rate of inflation due to the transition from a planned economy to a market economy , which –parallel with high interest rates- cut back demand for housing loans.

On the supply side, after the introduction of the two-tier banking system, the share of the biggest retail bank has declined at a very slowly rate in the retail loan market. The newly established or privatised banks turned first toward corporate banking, which required only a small number of branches, less expenditure, and seemed to be less risky. Thus, a lack of competition and a low level of supply has been characterised the retail loan market for a long time.

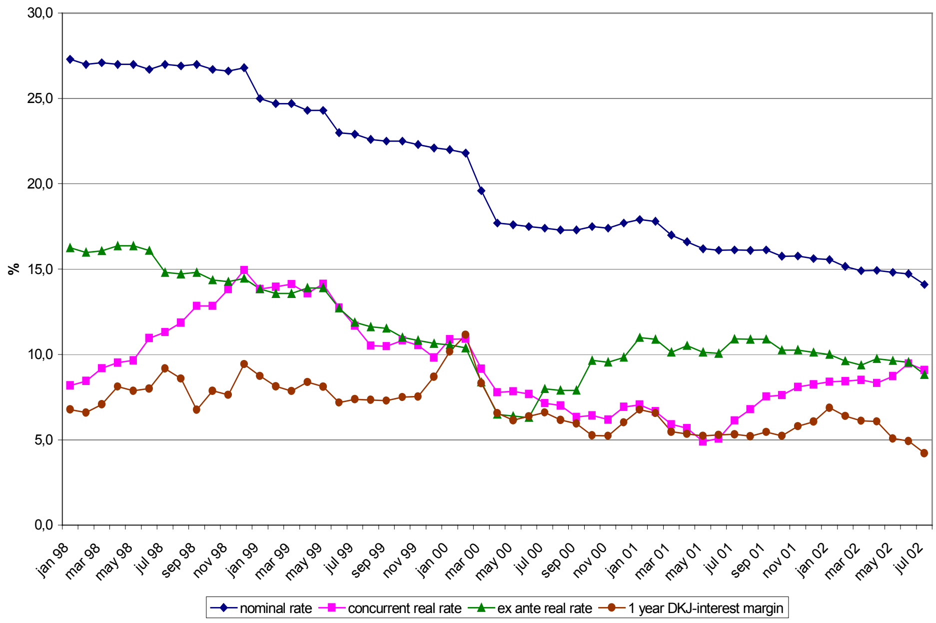
Parallel with the saturation of the corporate market the changing attitude of banks toward retail banking manifested first in the market of consumer and other non-housing-related credits. The legal framework and market conditions were not adequate for the development of mortgage financing, thus consumer credits represented lower risk since the shorter maturity and lower volume of loans was less burdensome for households. The shorter maturity of these loans was more favourable regarding banks' liquidity risk too. In line with the supply side the improvement of income expectations of households and the impatience due to postponed consumption in former periods resulted in a significant credit demand in this segment of the market.

Following the creation of the fundamental legal conditions of mortgage financing, due to the gradual expansion of the new housing subsidy system -introduced by the government early 2000- and the introduction of the independent mortgage in 2001, the volume of housing loans has been growing at a fast pace in the last two years, although from an extraordinary low basis. Banks' efforts to open up towards housing loans are indicated by the significant decline in interest rates of the newly disbursed housing loans in 1999. In the first half of 2000 the significant decline of interest rates continued due to the competition created by subsidised loans. The spread between the interest rate of newly disbursed housing loans and risk free market yields has been fluctuating around 5-6.5% since that time. Real interest rate calculated with forward looking inflation –used in the pricing practice of banks- has been 10-11 % in the last one and a half years, whereas real interest rate calculated with concurrent inflation –as usually used by households- increased significantly in the last one year or so[3]. The impact of the latest significant widening of the housing subsidy system[4] is reflected both in the decline in real interest rates and the interest rate spread of housing loans and also in the decline in new disbursements of not-subsidised loans as well as in a significant shift towards subsidised loans in the structure of housing loans. Eventually, it should be mentioned that the real interest rate of domestic (not-subsidised) housing loans is more than double of the level in the Euro area . The interest rate of subsidised housing loans to be paid by clients, however, is extraordinary low (around 3-6%).

[3] Significant differences in the real interest rates calculated with forward looking and concurrent inflation as of the second half of 2000 and its diverging trend is the result of the continuing disinflation process -after a temporary interruption.

[4] The subsidy can be used for the purchase of second-hand homes too.

Chart 7. Housing loans market rates and spread in Hungary



Despite of the expansion of housing loans started only two years ago and the sharpening competition going parallel with it, concentration is still quite high in this market.

IV. SOURCES OF HOUSING FINANCE, INSTITUTIONAL STRUCTURE

Financing of real estate loans with mortgage bonds is at an early stage, its share in the domestic capital market is negligible. The value of domestic mortgage bonds made up only 0.3% of that of government papers at the end of 2001.

The most important players in the domestic housing loan market are big and medium sized mainly foreign-owned **commercial banks**. The increase in maturity transformation carried out by commercial banks has accelerated in the last one year since the source of the growth in longer term housing finance were mostly short term client deposits. Although banks try to improve the maturity structure by issuing long-term securities – mainly bonds– the share of these securities within the liabilities is for the time being minimal (1-2%). However, in line with international tendencies, securities are expected to become increasingly significant in banks' funding.

Another possibility to improve maturity structure, in the case of larger banks, is to establish own **mortgage bank**, which finances lending with issuing long term mortgage bonds. Currently, there are two banks owned by commercial banks in Hungary. One of them took up activities in 1999 (up to now its activity concentrated mainly on the corporate segment, but in the future it wants to open up towards the retail segment of the market too), the other started working in 2002[5]. Another theoretical possibility to improve maturity structure would be to sell mortgage loans in some form. The state owned domestic mortgage bank, established in 1998, elaborated such a construction. In this project commercial banks extend loans to 99 % out of their own funds, which the Land Credit and Mortgage Bank Ltd. buys out in 30 days. Commercial banks, savings co-operatives, however, kept the loans -with restructuring assets and supplemental funding- mainly in the hope of maintaining or increasing market share, or of higher yield. Therefore regulations were amended and independent mortgage was introduced in 2001, similar to the regulation in Switzerland. The loan covered with mortgage remains in the balance sheet of the bank, it sells, however, the mortgage right -serving as the coverage of the loan to the mortgage bank issuing mortgage bonds[6]- against refinancing loan cheaper than the market price. The bank buys back the independent mortgage in the pace of the clients' redemption of the loan, and along with that it cuts back the volume of refinancing loans taken out. Coverage of mortgage bonds issued is the independent mortgage in the ownership of the mortgage bank. Risks of refinancing are minimal for the mortgage banks and thus for mortgage bond investors too, since in the case of non-payment of the commercial bank mortgage credit institution is entitled by law to own the mortgage loan secured with independent mortgage. Thus the real risk –taking into consideration the time length of the legal assignment- is only one month of redemption instalment, which is to be cut back further by diversification. A next problem similar to that might be the prepayment of the client to the commercial bank, this namely might not refuse prepayments. At the same time in order to protect the interest of the mortgage bond investors the mortgage bank might stipulate in contract the refusal of the prepayment, or, calculating high fees which may limit the prepayment. Commercial bank might roll over this fee to the client. Further on, limits in the act on credit institutions on taking high risks may cause another type of problem since the refinancing ability of mortgage banks is strongly limited due to their relatively low level of adjusted capital. Mortgage bonds based on independent mortgage was not yet issued abroad, so the risk evaluation was not effected in the international securities market.

Regarding the demand side of the domestic issue of **mortgage bonds** it is clear, that the absorption capacity of the market is quite limited. On the one hand, regulators imposed limits for institutional investors against similar type of investments or investments of the same issuer, although parallel with the development of institutional investors the volume of limits is increasing too. On the other hand, investment funds might not invest into private papers according to the Hungarian rules. Although, both investment funds and private persons might purchase publicly issued mortgage bonds,

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[5] Due to the lack of proper legal regulation there were no mortgage banks earlier in Hungary.

[6] Characteristics of mortgage bonds and the requirements of its issuance are stipulated by the act on mortgage credit institution and mortgage bond of 1997 (amended several times), mainly on the basis of the German type direct financing. Issuing mortgage bonds is bound to mortgage credit institutional activity, licensed and controlled by the banking supervision. Mortgage loan might be extended only with real estate coverage and independent mortgage registry, which are made by the land offices out of turn (within 8 days). There are legal prescriptions regarding the proportionality of claims and limiting investments. In case of the falling of the mortgage bank the mortgage bond investor has a legal priority also against the remainder assets of the issuer if the mortgage coverage is insufficient.

the absorbing capacity of these segments of the market are highly limited due to the keen competition provoked by the government securities, which enjoy advantage due to the higher liquidity of the huge quantities and to the easy access of (primary and secondary) marketing channels. It is especially time consuming and requires high marketing costs to make households interested in mortgage bonds. Accordingly, the pricing of domestic mortgage bonds is expected to be relatively high, and, on the medium term, the issue of mortgage bonds is expected to turn towards the international market.

Next players of the domestic housing finance market are **savings co-operatives**, which have only 6.5% aggregated share in the total balance sheet, however, their weight is much higher in the retail sector (at the end of 2001 their market share in the aggregated volume of deposits was 13%, in the volume of loans 19%). Clients of savings co-operatives are traditionally households of smaller communities, small enterprises in those regions, and deposits collected from them represent the majority of their funds. Savings co-operatives rank themselves as the banks of the countryside. In the last few years, however, lending activities of savings co-operatives is clearly shifting towards the cities. Savings co-operatives place clients' deposits collected on site more and more in the cities. Domestic savings co-operatives represent in their present form a significant risk, since regulations relating them are in many aspects much more lax than that concerning commercial banks and there are some features which might significantly increase moral hazard due to the segregated form of ownership[7]. The development potential of savings co-operatives indicates some more problems. Savings co-operatives –due to their small sizes– dispose of less sophisticated credit scoring, monitoring and risk management systems. As evidence to that, the quality of the savings co-operatives sector's portfolio is worse than that of the banking sector. In addition the value of the coverage extended to the loans for housing in smaller communities in certain regions of the country is quite questionable due to the probably very low market value of the real estate (there is no liquid real estate market). Moreover, on the basis of the number of recently issued building licenses and their regional breakdown a significant decline is expected in the number of home buildings in the countryside. The majority of their problems could be solved by a much tighter integration than the present one, common market appearance, which has several examples in the developed countries. Development of the domestic savings co-operative sector could be supported in addition to adequate modification of regulation with tax exemptions too (i.e. tax payment in groups).

From among domestic players of the housing finance market **contract savings institutions** should be mentioned too. At present three closed contract savings institutions are working, which were set up in 1997-98. One of them is owned by a domestic commercial bank, the other two are in a majority foreign ownership (German, Austrian). Originally the state provided subsidy up to 30% of the amount deposited, but maximum up to HUF 36 000 a year. The precondition of the subsidy is that the interest rate of the housing loan should not be over 10%. This pre-saving construction, however, is now in a disadvantaged position compared to the housing

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[7] For an analysis of domestic savings co-operatives' risks see the August 2000 Report on Financial Stability prepared by the HNB.

loans with new forms of subsidy introduced in the meantime. Namely the amount of the loan available with contract savings is very low, whereas subsidised mortgage loans are available at an interest rate of 3-6% , without any previous saving period. Market position of the contract savings institutions is deteriorated also by the fact that in the case of subsidised mortgage loans debtors might cut back their taxes by 40 % of the redemption payment or maximum by HUF 240 000 in a year. As of January 2003 the amount of state subsidy in the case of contract savings will be doubled (to HUF 72 000 a year), by that the optimal amount of loan will rise to HUF 2.4 million, which is still very low compared to the price of an average home.

Since home financing combined with previous saving has lower risks due to its nature (the debtor proved its solvency regularly for many years), it would be desirable to enhance the role of contract savings institutions in the Hungarian market, which has some chances. On the one hand, in the first four years of operation accumulation of funds was emphasised due to the design of the construction, lending will be typical in a later phase. And the disadvantage due to the present subsidy forms might decline in the future or even cease entirely (different proposals were made for this purpose). As a third factor, with accomplishing of the structural adjustment of Hungarian households, with the improvement of their income position, they will be able to accumulate more savings, which will increase the amount of the loan to be taken out.

Finally, **insurance companies** should be mentioned. As of January 2001 they are entitled to mortgage financing. They are not significant competitors[8] yet since in the present regulation their mortgage loan volume is strictly limited, it can be as high as 5% of their life insurance premium reserves. However, their long-term cheap funds to be used for mortgage financing will proportionally increase in the next years.

Government subsidy system

The present housing subsidy system consists of many elements. There are two types of interest subsidy forms, which can also be used together. For building or purchasing new flat supplementary interest rate support can be drown on once by the family until maturity of 20 years and worth of HUF 10 million. In this case the sum of interest rate and service charges might not exceed the reference rate of the fitting Treasury bond plus 4% point. However, the sum of interest rate and service charges paid by the client is limited in 6%, because the bank receives from the state supplementary interest rate support on the level of the fitting Treasury bond minus 2% point. Same form of subsidy can also be used by enterprises and companies in construction sector up to 70% of the building-costs and max HUF 10 million per flat. As for loans (in max amount of HUF 30 million) supported on the liability side the state subsidises the banks through the interest rate of the issued mortgage bonds with the max maturity of 20 years. Accordingly, the sum of interest rate and service charges is limited by the rate of mortgage bonds minus 2% point, but might not exceed 6%. In this case the

[8] According to estimations only 1-2 insurers are expected to turn up in this market.

mortgage bank receives from the state interest rate support on the level of the issued mortgage bond plus 2% point, but not more than 10%.
Besides the above-mentioned subsidies in cases of acceptable home claims one can make use of the not refundable support against dependent children (so-called social policy), tax relieves (VAT, personal income tax), benefits of handicapped and subsidies of local governments to those in need.

The above-mentioned supporting forms are very beneficial but due to the low level of the average income in Hungary needy people can make less use of these opportunities.

Banking risks of housing finance

One of the essential conditions of reducing the probability of default is the existence of a well-developed **credit reference service**. At present, the setting up of a high-level credit information system has, however, several obstacles in Hungary due to the legal environment. Regarding the growing risk of the significantly increasing volume of credits this problem is to be solved at any rate. EU-accession requires the harmonisation of the related legal rules too. Joining the international debtor and credit information systems, which is inevitable due to the future expansion of cross-border services, can also be accomplished only with a high-level domestic service. At present there are two firms established in the Hungarian market. The scope of data collected is narrow, and according to the present regulation debtor-registering systems may list only private persons who defaulted on payment and thus they are not sufficient to evaluate the creditworthiness of debtors, and, moreover, the data available are often unreliable. The central bank participates actively in the development of the credit information system and in the execution of the necessary regulation amendments, thus a significant improvement is expected in the future in this field.

The **quality of banking portfolios** is not deteriorating, which is necessarily the case in a period of strongly increasing credit volumes starting from a low basis since default occurs usually a few years after the extension of the credit. Dynamic increase in retail lending has started only a few years ago in Hungary, thus the credit risk is presumably much higher than the present loan loss proportion (2.27% at the end of 2001).

Due to the state housing subsidy system even **lower income households** have the possibility to raise long term, higher amount loans. Even a small tremble in the income situation of these people may cause defaults , in a worse case total insolvency. It is possible that banks loosen the conditions of loans due to the competition provoked by the subsidised credits, which might result in the deterioration of the composition of the clientele. At the same time, according to international experiences, the probability of default of **loans used for investment purposes** (and not for buying or building first home) is higher than that of home-related lending. Regarding the fact, that the present housing subsidy system does not distinguish in this respect, the proportion of loans used for investment purposes in order to make use of the subsidy will presumably grow, which means the increase of risks too.

Mortgage financing has no long history in Hungary and there is no experience on the consequences of the bursting of **real estate price bubbles** (the extent of decline in prices, the deterioration of banking portfolios). Thus it is difficult to evaluate the safe magnitude of **real estate coverage**, conditions should be more stringent (i.e. lower Loan to Value proportion is needed). The majority of Hungarian banks extend loans maximum up to 50-60 % of the market value of the real estate. This, however, is not an effective limit, since not more than 30% of the funds needed to buy or build up homes is covered by loans (earlier not more than 10%), which is still far behind the usual level in the EU. Parallel with growing competition in the real estate credit market, presumably more and more banks will grant loans to an increasing proportion of the market value of the real estate. Although the possible decline in the real estate prices might cause problems, on the medium term, however, the risk arising from the price bubble will not be extraordinary high due to the possible improvement in the value of real estates because of the EU-accession. Moreover, in the case of real estate loans financed with mortgage bond issuance the related act stipulates that the loan might be as high as 70% of the credit insurance value, which is about 60% of the current market value of the real estate. It seems to be a safe upper limit.

The probability of default of household loans is also influenced by the social, information and legal “costs” of non-payment of the loans “paid” by the debtors. Concerning the social “cost”, **payment moral** is quite low compared to developed countries. Non-payment does not mean a social denunciation. Due to the underdevelopment of the credit information service the information “cost” is not necessarily significant either. Concerning legal “costs” it can be said that **legal rules** are now more or less sufficient. The amendment to the Mortgage Act, introduced in September 2001, allows the mortgage lender –if it is arranged in advance with the client– to sell the real estate without court decision or foreclosure in the case of non-payment. In the lack of this possibility, the legal risk of mortgage financing was very high, especially, since foreclosure proceedings are very long in Hungary. Thus the present solution -with taking into consideration the requirements of credit institutions– has considerably eased mortgage foreclosure. However, the mortgaged property, which will be auctioned, is generally occupied which obviously means lower collateral value, since there is no guarantee that the person living in the property will leave it voluntarily. If the latter is the case, the new owner has to initiate a civil nonsuit procedure, which is time consuming and it is burdened with further legal risks. Concerning mortgage registration, it should be mentioned that the length of the procedure is still very long (especially in the capital) and forging attempts are quite frequent. These problems slow down the lending process considerably.

Risk of **prepayment** is probably not as high in Hungary at present, partly due to high additional loan-related fees . In the case of a subsidised housing loan, prepayments are not likely. The gradual extension of subsidies, however, might provoke a change (and therefore prepayment) of market rate loans into subsidised loans.

Chapter III. Housing loan business	1997*	1998	1999	2000	2001**
Mortgage loans outstanding (in HUF million), year end	135 574	132 921	134 720	206 171	370 516
Mortgage loans outstanding (in USD million), year end* **	666	607	534	724	1 328
Mortgage loans outstanding (% of GDP), year end	1,6%	1,3%	1,2%	1,6%	2,5%
Mortgage loans outstanding (% of GDP), average		1,3%	1,2%	1,3%	1,9%
Mortgage loans outstanding by lenders (%)	100%	100%	100%	100%	100%
Commercial Banks	92,2%	90,7%	85,7%	75,4%	72,8%
Mortgage Banks	0,0%	0,2%	0,5%	4,1%	8,2%
Contract Savings Institutions	0,0%	0,0%	0,3%	1,2%	1,4%
Savings Co-operatives	7,8%	9,1%	13,4%	19,3%	17,6%
Mortgage loans outstanding by borrowers (%)		100%	100%	100%	100%
individuals		94,8%	94,3%	91,1%	87,2%
corporations, co-operatives		5,2%	5,7%	8,9%	12,8%
Average interest rate of mortgage loans without subsidy, december	27,1%	26,8%	22,1%	17,7%	15,6%
Average interest rate of mortgage loans without subsidy, year	28,6%	26,9%	23,4%	18,4%	16,4%

period - no data
Non-mortgage housing loans are not significant

gross credit portfolio
* in 1997 only loans to inhabitants
** Self-employed (enterprises individuelle) from 2001 in households, before in corporate sector
*** NBH middle rate end of year (1997 - 203,50 HUF/USD, 1998 - 219,03 HUF/USD, 1999 - 252,52 HUF/USD, 2000 - 284,73 HUF/USD, 2001 - 279,03 HUF/USD)

Chapter IV. Housing loan business	1997*	1998	1999	2000	2001**
Housing loans in the total asset of commercial banks (%)	2,3%	1,9%	1,6%	1,9%	3,0%
Contract savings					
Lending in contract savings (in HUF million)	8	2	462	2 549	5 157
Lending in contract savings (in USD million)* **	0	0	2	9	18
Saving in contract savings (in HUF million)	2 776	18 444	40 008	65 708	94 224
Saving in contract savings (in USD million)* **	14	84	158	231	338
Mortgage bond issuing (in HUF million)		780	2 040	6 680	19 136
Mortgage bond issuing (in USD million)* **		4	8	23	69
Mortgage bond outstanding (in HUF million)		780	2 820	9 500	28 636
Mortgage bond outstanding (in USD million)* **		4	11	33	103

Asset/mortgage backed securities - nothing
Balance sheet of specialised housing finance institutions - nothing

gross credit portfolio
* in 1997 only loans to inhabitants
** Self-employed (enterprises individuelle) from 2001 in households, before in corporate sector
*** NBH middle rate end of year (1997 - 203,50 HUF/USD, 1998 - 219,03 HUF/USD, 1999 - 252,52 HUF/USD, 2000 - 284,73 HUF/USD, 2001 - 279,03 HUF/USD)