

Valuation of Residential Premises for the Purposes of Securing the Receivables of the Creditor in Poland

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Abstract. The study presents an analysis of the theoretical and practical issues connected with securing the receivables of creditors, in particular the principles connected with the appraisal of real property value used for the purposes of granting loans in Poland. The scope of research included the basic elements of the functioning and organisation of the Polish banking system, legal forms of securing debt receivables and the principles of real property valuation for universal and mortgage banks. Additionally, the authors have conducted an analysis of the number and amount of loans granted in Poland in the years 2009 – 2016

1. Introduction

The study deals with the issues connected with the valuation of real property in order to secure the recoverability of loan obligations. Nowadays, loans and all the connected issues are an inherent part of small household budgets and an important element of the economy. With time, loans are becoming an increasingly important element of the economic life. They are often necessary to conduct business activity and for the development of enterprises. Loans play a major role both as instruments for the financing of ongoing operations and as a means to obtain funds for investments, also on the real property market.

The functioning of a bank as a lending institution involves a certain risk that leads to the necessity to provide sufficient collaterals. When granting a financial loan, the bank bears a certain degree of risk connected with the transfer of financing, regardless of whether it is a credit or a loan. In order to assess this risk, our creditworthiness is calculated [1].

Obtaining a mortgage loan and buying an apartment is a quick way to improve the standard of living. The bank granting a loan bears a certain risk connected with the fact that the debtor may be unable to repay it. Thus, certain mechanisms, including mortgage, have been developed to secure the interest of banks.

The aim of this study is to analyse the theoretical issues connected with securing the receivables of creditors in Poland, in particular the principles connected with the valuation of real property applied for the purposes of granting loans in Poland and the trends in loans granted for the purchase of residential premises in the years 2009 – 2016.

The scope of research included the fundamentals of the functioning and organisation of the Polish banking system, the legal forms of securing debt receivables and the principles of real property



valuation for universal and mortgage banks as well as a general analysis of loans granted for the purchase of residential premises in Poland in the years 2009 - 2016.

2. Fundamentals of the functioning and organisation of the Polish banking system

The structure and functioning of the banking system in each country is determined by the local banking law. This law specifies, among others, the types of banks that operate in the given state, their activities, and the role of the central bank as well as the duties of bank supervision authorities.

The legal scope of operations of the Polish banking system is governed by the Banking Act of August 29, 1997 (Journal of Laws of 2015, item 128) [2] supplemented by the provisions of the Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (Official Journal of the EU L 2006 No. 177) [3].

Apart from the aforementioned legal acts, the operations of banks in Poland are regulated, among others, by: the Act of August 29, 1997 on the National Bank of Poland [4], the Act of August 29, 1997 on covered bonds and mortgage banks [5] and the Act of December 14, 1994 on the Bank Guarantee Fund [6].

The analysis of the functioning of banks in Poland allows for their classification. The main types of banks in the banking system include:

- a. The central (issuing) bank is the foundation of the banking system, which refinances other banks and gathers money reserves;
- b. Commercial (savings and loan) banks – deal with accepting deposits and crediting funds in forms of granting loans and performing various types of non-cash clearances on the basis thereof. Here, cooperative banks may be distinguished, i.e. small, local banks that usually form associations that perform the role of clearance and financing centres;
- c. Development (investment) banks – their function is to gather funds in the long-term perspective, to issue long-term securities and to accept long-term deposits;
- d. Savings banks, also including savings societies that gather scattered individual savings and grant consumer loans basing on them or deposit the collected funds on beneficial, available terms;
- e. Special purpose banks that finance the performance of special tasks requiring a particular type of specialised banking services, e.g. banks that provide services for the construction sector, foreign trade or the stock exchange.

With the exception of the central bank, banks provide banking services. The most common type of banks are commercial banks. The objective of their operations is to satisfy the needs of their customers with respect to financial services while obtaining profit at the same time. Commercial banks, being universal banks by nature, are the most popular form of banking institutions in Poland [1].

Before granting an obligation, the bank may demand a specific form of securing the repayment of loan. As far as individual customers are concerned, five types of basic forms of securing the repayment of loans are applied. Currently used forms of securities include:

- Mortgage – this is a form of securing mortgage credits and loans. The prerequisite for granting such loan is the obligation to enter the creditor in the land and mortgage register of the given property. In the event of failure to repay the loan the mortgage creditor may pursue its rights from the real property, i.e. seize the real property towards the repayment of loan.
- Insurance – this is a very popular method of securing all types of loans. Banks oblige their debtors to take out temporary or permanent insurance against the occurrence of a given event, such as loss of work, temporary incapacity for work, or insurance of the debtor against death.
- Transfer of ownership and pledge – these securities are most often used for so-called car loans, i.e. special purpose loans granted for the purchase of vehicles.
- Promissory notes are commonly used as additional collaterals to secure mortgage loans. They are limited to the period of the loan.

- Guarantee or suretyship – these forms of securing loans are becoming increasingly rare in services provided for individual customers. Suretyship is a form of securing loans where the repayment is guaranteed by another person (or, sometimes, an institution) who becomes the guarantor.

The U.S. mortgage provides many more options to borrowers than are commonly provided elsewhere: American homebuyers can choose whether to pay a fixed or floating rate of interest; they can lock in their interest rate in between the time they apply for the mortgage and the time they purchase their house; they can choose the time at which the mortgage rate resets; they can choose the term and the amortization period; they can prepay freely; and they can generally borrow against home equity freely [7].

3. Principles of real property appraisal

3.1 *Real property valuation for universal banks*

The only professional standard for property valuers in Poland being a legally binding regulation at the same time, are the Specialist National Valuation Standards – Valuation for Loan Security Purposes [8]. Loan security may be used for various types of real properties. They may be classified as:

- General purpose real properties – in this case valuation is always conducted according to market value for the current manner of usage and in certain cases also for the predicted usage. General purpose real properties include: Investment real properties, real properties occupied by owner, real properties under construction.
- Real properties valued basing on their economic potential include facilities that have been constructed and fitted with the aim to conduct a certain type of business activity to obtain profits, such as hotels, fuel stations, leisure facilities etc.

The basic assumptions of valuation that result from the professional standards of property valuers are as follows:

- Receivables may be secured by mortgage on real properties, perpetual usufruct of land and cooperative limited property rights,
- The basis for the valuation of real properties or rights on which the loan was secured should be their market value,
- On request of the creditor or ordering party, apart from the market value of the subject of valuation, the replacement value or another non-market value is estimated,
- If the loan is granted in instalments during construction, then the value of real property is appraised considering the construction progress stage as of valuation date or the value of real property after the construction has been completed, decreased by the expenses required for completion is calculated.

When performing valuation for the creditor, the valuer is particularly obliged to:

- Determine the existing encumbrances on the real property, to specify them in the valuation survey and to take them into account in the appraisal,
- To determine in the survey all events that might influence the risk of the creditor, e.g. potential income changes resulting from extension,
- To include a statement determining whether the real property may be accepted by the creditor as loan security and to indicate potential terms and conditions in the survey.

Valuation and credit risk assessment are two separate actions. A detailed analysis of the risk connected with the subject of the security may constitute a separate action for the real property valuer or may be a subject of a separate study, not being a valuation survey [9]. The creditor is always obliged to provide an opinion on the risk connected with establishing loan security on real property. When issuing an opinion on the risk, the creditor should take into account not only the valuation survey, but also the financial standing of the borrower and the general conditions on the banking market. The value estimated in the valuation survey is of an auxiliary nature for the bank, so it cannot affect the amount of loan granted.

3.2 Real property valuation for mortgage banks

The appraisal of mortgage lending value of real property is the estimated value of the real property constituting a security for the loan granted by bank (mortgage lending value, B-HWN). The valuation is performed by a surveyor appointed by the mortgage bank. The opinion is issued basing on the legal regulations, on the Act on covered bonds and mortgage banks and the rules and regulations for real property valuation by mortgage banks. In Poland, it is governed by: The Act of August 29, 1997 on covered bonds and mortgage banks (amendment of 2002, Journal of Laws No. 126, item 1070) [10], Recommendation F of the General Banking Supervision Inspectorate and bank rules and regulations on the determination of the mortgage lending value, approved by the Financial Supervision Authority.

The determination of the mortgage lending value of real property is based on conservative assessment of its saleability and eliminating the risk connected with the lack of stability on the real property market. Another important assumption is the evaluation of the current market situation and taking into account past experiences to evaluate the risk of negative changes occurring in the future. Valuation should be based first of all on the permanent characteristics of the real property, considering the long-term trends on the real property market. Distinct, clearly defined methodology should be applied.

The mortgage and lending value appraisal survey should contain a description of the real property along with an opinion on the long-term sale and lease prospects or an acceptable alternative use of the real property as well as a justification of the parameters adopted for valuation purposes.

The mortgage lending value analysis should result in obtaining a value lower than market value. This results from the conservative approach to preparing the opinion. This relation may be verified by the bank by means of ordering to prepare an additional valuation survey [11].

4. The market of mortgage loans for residential purposes

According to the AMRON-SARFiN Report 4/2016 [12], it was determined that the number of active loan agreements in Poland as of the end of 2016 was 2 057 170. In the period from the year 2009 to 2016, the number of active mortgage loan agreements for residential purposes increased by over 680 thousand. However, during that period the banks granted approx. 1 558 thousand new loans, which means that a major part of the loans was repaid (Figure 1).

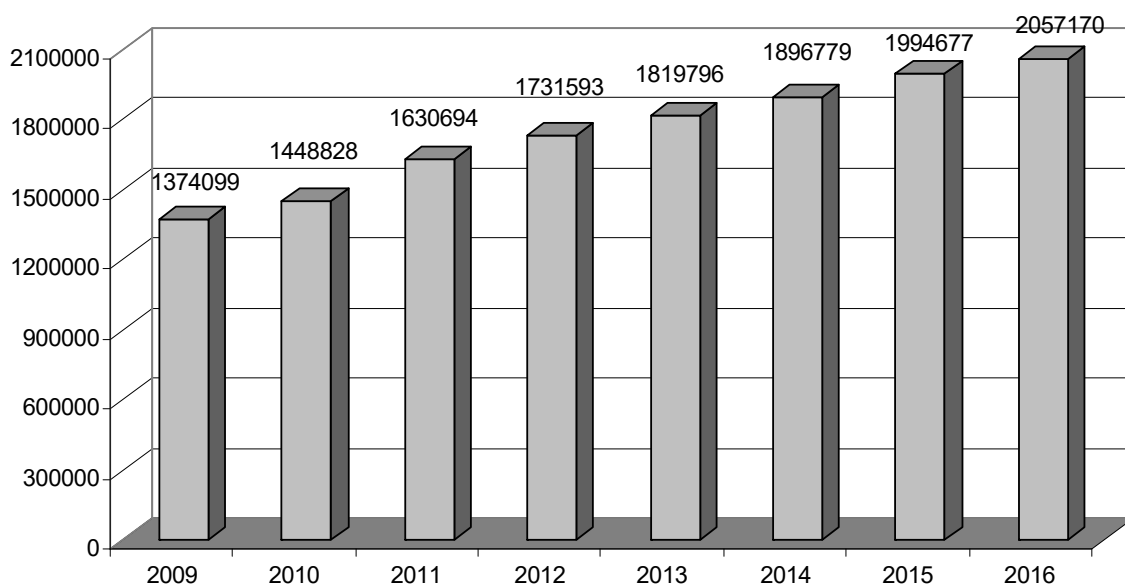


Figure 1. Number of active mortgage loan agreements for residential purposes in the period 2009 – 2016

As of the end of 2016, the total value of debt due to residential mortgage loans amounted to PLN 393,367 billion. The change in household debt due to incurred mortgage loans for residential purposes (in billions PLN) since 2009 is shown in Figure 2.

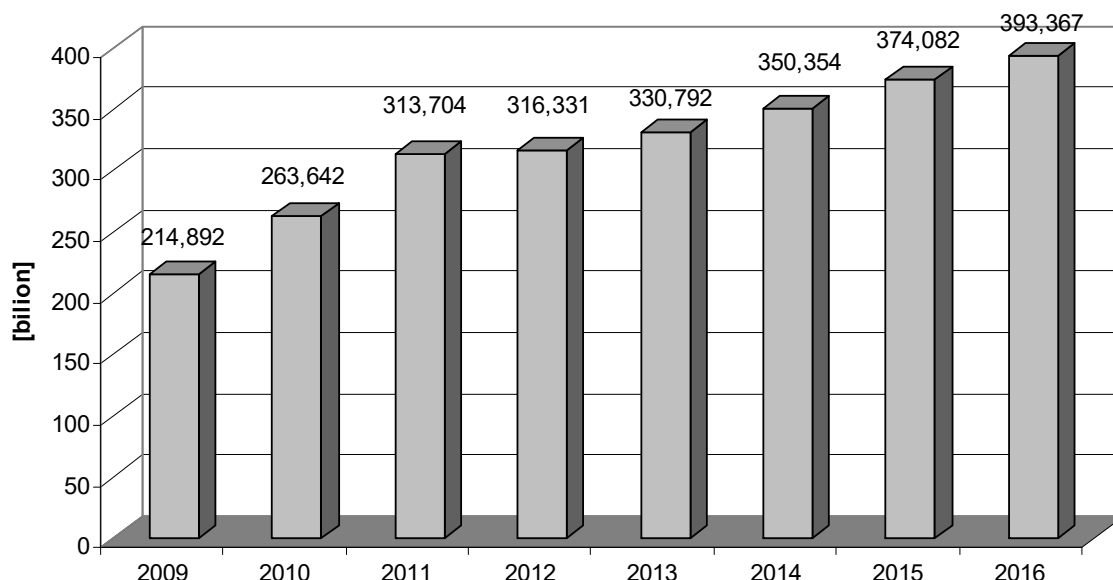


Figure 2. Total debt due to mortgage loans for residential purposes (in billions PLN) in the period 2009 – 2016.

Currently no increased activity related to mortgage loans is observed. Although the government has initiated a programme supporting residential development “Homes for the Young” (“Mieszkanie dla Młodych”) even this offer has not led to a huge increase in the number of granted loans. In spite of a growing interest in the said programme, resulting from the fact that its scope had been extended to cover the secondary market, the subsequent quarter brought a further decrease both in the number and value of newly granted mortgage loan agreements. The main factor that contributed to the falling demand for mortgage loans was the fact that the limits available under the “Homes for the Young” programme were exhausted. In the opinion of banks, another reason for the decreasing demand was the introduction of more strict criteria for granting mortgage loans (increasing the required own contribution).

In the end of 2016 the value of newly granted loans amounted to PLN 9 780 billion. In comparison to the preceding year, the average overall loan value very little increased as well as the value of loans granted in Polish zloty and also the average value of loans denominated in foreign currencies during the analysed period 2009 - 2016. However, the average value of loans denominated in foreign currencies plummeted by 35.15 % in 2015. Polish zloty remains the main currency in which loans are granted. Changes in the average overall loan value, the average value of loans denominated in foreign currencies and the value of loans granted in Polish zloty since 2009 are shown in Figure 3.

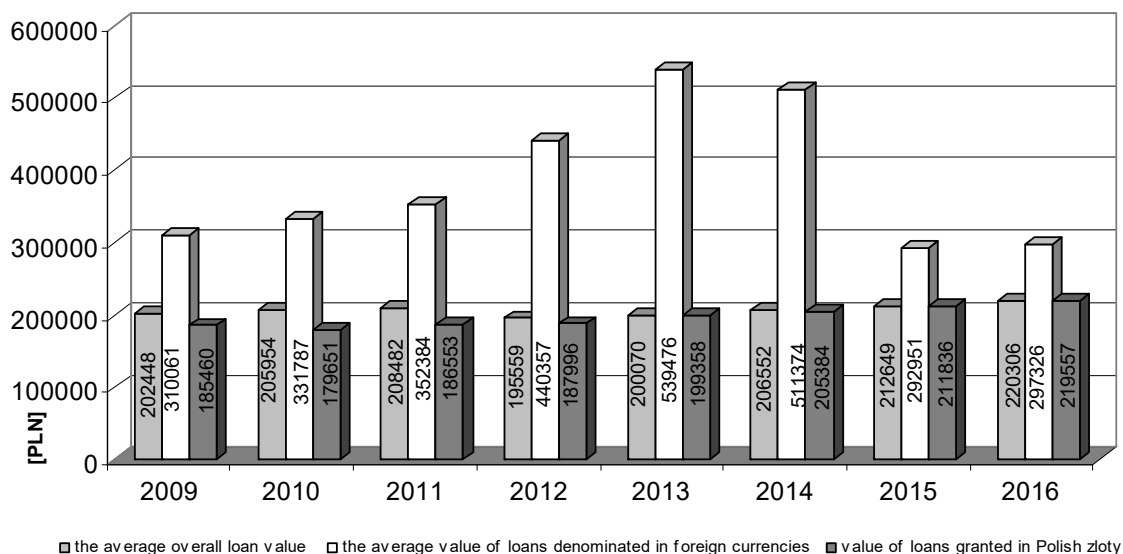


Figure 3. The average overall loan value, the average value of loans denominated in foreign currencies and the value of loans granted in Polish zloty in the period 2009 – 2016.

5. Conclusions

Financial obligations in form of loans are quite common in the modern world, as they foster economic development and allow to improve living standards in a relatively short period of time.

In Poland, there are different standards for real property valuation for loan security purposes for universal and mortgage banks. For loans granted by universal banks, the market value of the real property is appraised, while for loans granted by mortgage banks it is the mortgage lending value. For valuations performed for mortgage banks, a mortgage lending value report is prepared. The value resulting from the mortgage lending value analysis is lower than the market value, which results from the principle of conservative appraisal applied for preparing the report.

The most common loan securities in Poland, used for individual customers who conclude transactions on the real property market are mortgage and insurance.

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