

PART II

FINANCIAL FRAMEWORK FOR THE HOUSING SECTOR

A. ANALYSIS OF TRENDS IN THE HOUSING MARKET AS WELL AS THE ACTORS IN THE HOUSING MARKET

After gaining independence in 1991, the housing policy of the State has undergone major changes. A privatization process ended with the public allocation of housing stock, for both the business and residential sectors, after which a new role for the Government was defined. According to Presidential Decree No. 1344 of 6 September 1993 on a New Housing Policy, the first State programme to reform the housing sector and its finance systems was developed, which foresaw decreasing the role of the Government in the housing sector to indirect management through a system of financial and economic instruments and the creation of the basic institutions of a housing market and their legislative regulation. The focus of this new approach was on the provision of support to people for the purchase of homes through mortgage lending.

At the end of 1999, the National Bank of the Republic of Kazakhstan (NBRK) initiated the development of a regulatory framework for mortgage lending. As a result, the “Concept on long-term financing of housing construction and development of mortgage lending system in the Republic of Kazakhstan” was approved.¹⁰¹

Law No. 2723 of 23 December 1995 on Mortgage of Immovable Property introduced mortgage lending in Kazakhstan. However, the lending conditions were characterized by high interest rates and down-payment requirements, as well as short loan terms. Therefore, mortgage lending at that time was not a popular tool for the people in solving their housing problems. On 7 December 2000, Law No. 110 on Housing Construction Savings was adopted to regulate the system of contractual savings for housing construction. In the same period, the JSC KMC was founded. Its main activity was to refinance the banks according to the KMC standards (see Part I, Chapter 5 for more detailed discussion on KMC).

The participation of KMC in the mortgage market has improved lending conditions – reduced down-payment; longer loan terms; and lower interest rates. For example, in 2001, mortgage interest rates in commercial banks were between 20 per cent and 24 per cent per annum, loan term was only five years, and mortgages were issued mainly in foreign currency. By 2003, it became possible to take out a loan at an annual interest rate of 12.6 per cent for a term of up to 20 years in the national currency. However, the granting of mortgages took place only in the main cities, such as Astana, Almaty and Atrau. The purchase of housing through mortgage lending was still not affordable to the majority of households, both in the terms of the lending conditions and the value of the real estate. One of the reasons for such a situation was the housing deficit caused by low levels of housing construction in the 1990s.

To address this problem, the Government developed the State Programme of Development of Housing Construction in the Republic of Kazakhstan for 2005-2007. The main purpose of this Programme was the construction of affordable houses for certain categories of people, and their subsequent sale under preferential mortgage terms. During its implementation phase, there was a high level of activity in the construction sector.¹⁰² Average house prices in 2007 doubled

¹⁰¹ Approved by Government Decree No. 1290 of 21 August 2000.

¹⁰² In particular, in 2005, the rate of commissioning of new housing was 93 per cent more than the level in 2004. In 2006, the rate increased by 25 per cent, and in 2007, the rate was 7 per cent more compared to the previous year.

from the 2005 level (from KZT 76,645 to KZT 148,750). One of the reasons for this rise was the significant “deferred demand” (lack of housing and finance), which was formed during the 1990s, when the annual volume of housing construction did not exceed 1.5 square metres per capita, as well as a significant increase in household incomes (for the period 2001-2007, it was 229 per cent).

The global financial crisis of 2008, triggered by a crisis in the subprime mortgage market in the United States, had a serious impact on the housing market of Kazakhstan. Citizens who invested in housing construction projects (co-investors) were greatly affected, due to the freeze in the construction of a large number of residential projects. At the beginning of the crisis, 62,889 co-investors were registered in the country, who were victims of the crisis. In order to help them, the Government invested about KZT 464.3 billion (representing 2.3 per cent of GDP in 2009) to facilitate the completion of 450 residential projects.

Along with this, in November 2008, the “Plan of priority measures to ensure stability of social and economic development of the Republic of Kazakhstan in the period 2007-2008” was adopted. According to this Plan, KZT 122 billion were allocated, with the goal of stabilizing the housing construction market (financing of “frozen” construction projects). In the case of mortgage lending, KZT 20 billion was allocated, including KZT 8.5 billion for the replenishment of authorized capital, and KZT 12 billion as a concessional budget loan (rate 0.1 per cent for 20 years) for the refinancing/purchase of mortgages from banks.

During the pre-crisis period, the country’s financial institutions had free access to foreign capital markets. Mortgages in foreign currency were available in almost all banks, and enjoyed popularity among borrowers due to more liberal conditions (mortgage loans in foreign currency amounted to about 50 per cent of the mortgage portfolio of the banking system)¹⁰³. The devaluation of the national currency in 2009, and the simultaneous decrease in incomes¹⁰⁴, has caused the real value of borrowers’ payments on such loans to increase sharply. This has, in turn, resulted in massive default on foreign currency mortgages. In order to prevent further deterioration of the situation, the Government launched a mechanism for refinancing foreign currency mortgage loans¹⁰⁵. The volume of financing of this programme was KZT 600 billion.

Beginning in 2011, the housing construction market slowly recovered. In 2011-2014, there was a gradual increase in the volume of housing construction, both industrial and individual, with average annual growth rates of 4 and 6 per cent, respectively. The average annual rate of growth in the value of real estate was about 15 per cent.

At the end of 2014, due to the decrease in the value of exported energy goods, Kazakhstan faced another financial crisis, which was worse than the previous one of 2007-2008. A more serious devaluation of the national currency took place, and the average daily value of the KZT in 2015 decreased by 25 per cent compared to the previous year.

The real estate market reacted with a significant reduction in demand and an almost complete stoppage of transactions. In the face of economic uncertainty, market participants took a wait-and-see attitude. The dollar equivalent price of real estate decreased twofold, while the price in the national currency “froze”. According to experts, demand for cheap economical housing now became preferable. Developers who let out large apartments are having difficulty renting them out. In some cases, they are forced to divide large apartments, which have already been

¹⁰³ Republic of Kazakhstan. National Bank.

¹⁰⁴ The average daily rate of the KZT against the USD decreased by 23 per cent, and the nominal income of the population decreased by 11 per cent in the period 2008-2009.

¹⁰⁵ Government Resolution No. 179 on Certain Issues of Refinancing of Mortgage Loans by Second-Tier Banks of 17 February 2009.

distributed, into smaller units. Transactions in luxury real estate are extremely rare, and occur only if the seller provides a significant discount.

According to the Committee on Statistics of the Republic of Kazakhstan, the value of real estate in the secondary and primary markets in 2016 amounted to KZT 188,600 and KZT 247,400 per m², respectively. Compared to 2015, the price of real estate in the secondary market increased by 7 per cent, which is more than two times lower than the inflation rate¹⁰⁶. The price in the primary market, on the other hand, showed a slight decrease (less than 3 per cent) from its 2015 level. In the main cities of the country – Astana, Almaty, Atrau, and Aktau - real estate prices are much higher. The cost of new housing varies between KZT 300,000 and 340,000, which is 30 per cent higher than the national average. In the secondary market, the cost of housing in these cities is in the range of KZT 262,000 and 340,000, which is almost 65 per cent higher than the cost of such housing in the rest of the country.

During 2017 there were no significant fluctuations in the real estate market. At the end of the year, there was a slight decrease in the value of real estate. In particular, the price for new buildings fell to 1.5 per cent, for secondary housing – 2.2 per cent.

At the beginning of 2018, real estate prices remained virtually unchanged and remained at the level of the previous year. According to the majority opinion, in the absence of any significant events that could significantly affect the economic situation in the country, the value of real estate this year will not change significantly.

The rental housing sector is well developed, but mainly in the main cities of the country where the need for such type of housing is high. Commercial rental housing stock consists mainly of small apartments that were inherited by citizens, or were acquired for subsequent leasing.

Information on the cost of residential rental housing is collected at the state level. According to the Committee on Statistics, in 2016, the cost of rental housing amounted to KZT 1,300 per m², virtually unchanged from the previous year. In Astana and Almaty, this indicator was fixed at KZT 2,300-2,400 per m².

Market Participants

The key participants of the housing market are the real estate developers. According to the Committee on Statistics, in 2016-2017, the number of developers stably varies between 7-7,5 thousand, and around 30 per cent of them operated in the cities of Astana and Almaty.

In October 2016, a new version of the Law on Equity Participation in Housing Construction came into force¹⁰⁷. This new Law introduces new provisions aimed at protecting the rights of participants of equity construction. In particular, the conditions under which developers could attract funds from co-investors are clearly regulated. In the previous version of the Law, developers could raise funds from co-investors through transactions that were not subject to legislative regulation. The new Law clearly regulates the conditions for, and methods of, organizing equity housing construction, defines the requirements for developers (Table 3), and introduces the option of liability insurance for developers.

¹⁰⁶ According to the Committee on Statistics, the inflation rate in 2016 in relation to the previous year was 14.6 per cent.

¹⁰⁷ Law No. 486-V ZRK of April 2016. This Law entered into force on 10 October 2016 and repealed the previous version (Law No. 180 of 7 July 2006).

Table 3

Requirements for developers, by method of organizing equity housing construction

| <i>Method 1</i> <i>Guaranteeing the shareholders' contributions</i> | <i>Method 2</i> <i>Financing of projects by second-tier banks</i> | <i>Method 3</i> <i>Construction of a residential building's frame at the expense of a developer's own funds</i> |
|--|--|--|
| <ul style="list-style-type: none"> • At least 3 years of experience in constructing residential buildings; • No performance loss in the last 2 years; • Borrowed capital does not exceed own capital by more than 7 times during the whole construction period before the facility becomes operational. | <ul style="list-style-type: none"> • At least 3 years of experience in constructing residential buildings of at least 18,000 m² total area in cities of national significance or in the capital, and at least 9,000 m² in other administrative-territorial units; • Availability of a land plot in the form of property or rent; • Availability of design estimate documentation (PED) with a positive conclusion of the state examination. | <ul style="list-style-type: none"> • Availability of the constructed frame of the residential building at the expense of the developer; at least 5 years of experience in constructing residential buildings of at least 60,000 m² total area in cities of national significance or in the capital; and at least 30,000 m² in other administrative-territorial units; • Availability of the land plot in the form of property or rent; • Availability of PED with a positive conclusion of the state examination. |

Under this new Law, the Housing Guarantee Fund (HGF) was established based on the existing Kazakhstan Mortgage Guarantee Fund.

According to the Charter, the fund carries out activities in two areas:

1. Guarantee of mortgage loans (servicing of previously issued obligations for mortgage housing loans). Under this option, the fund undertakes to reimburse the lender for part or all the losses incurred as a result of default of the borrower in the event that the amount from the sale of collateral is insufficient to cover the borrower's obligations. The maximum coverage was determined in accordance with a specific mortgage program for five models of guarantee. In this case, payment of 100 per cent of the amount of net losses of the creditor was provided only in the framework of state programs. In total, 36 thousand families took advantage of this guarantee scheme, of which 33,500 families were participants in various state programs. At the end of 2016, there were 14,184 guarantee obligations in the amount of KZT 46.5 billion, and the total number of guaranteed mortgage loans overdue for fulfilling obligations within 1-2 per cent of the total guaranteed mortgages portfolio. Due to the lack of additional capitalization, this type of activity was suspended.
2. Guarantee of housing construction. According to this direction, the Fund provides guarantees for the completion of the construction of a residential building. The Fund has the authority

to request qualification requirements for participants of equity construction on financial sustainability experience, and to apply control mechanisms over the targeted use of co-investors' money by engaging independent engineering companies, and to use best practices of risk management. In addition, the HGF will form a special reserve guarantee fund from the contributions of developers for the exclusive purpose of covering costs associated with the settlement of warranty claims. The amount of the guarantee contribution to the reserve fund is equivalent to 2 to 6 per cent of the project cost. In the case of an event covered by the warranty, the HGF has an obligation to complete the unfinished construction project. Warranty cases include the following: violation of the deadline for the completion of a residential building; non-targeted use of funds by the developer; and insolvency of the developer, established legally by a court decision.

According to the Development Strategy of the JSC “*Fund for the Guarantee of Housing Construction for 2016-2023 years*” in 2023, it is planned to issue guarantee obligations for KZT 279.3 billion, while the area of housing provided with a state guarantee should amount to 940.6 thousand m².

At the end of 2016, the Fund considered and preliminarily approved the application, according to which the BASIS-A corporation planned to implement the project for the construction of the facility in the amount of KZT 2.5 billion.

Market participants note that strict requirements established under the new Law on equity construction will help to withdraw smaller players from the market and, consequently, monopolize the housing construction market.

Along with developers, realtors and appraisal companies are other significant stakeholders in the real estate sector. However, not all market participants are regulated by legislation. Currently, there is no law regulating the activities of realtors. A non-profit association of professional real estate agencies, the “United Association of Realtors of Kazakhstan”, operates in the country.¹⁰⁸ This organization has its own standards of practice of realtor activities, which provide for the attestation and issuing of certificates for the provision of real estate services. Currently, a draft law on realtors' activities is being developed, which will protect the interests of participants of real estate transactions, and promote the full legalization of the realtor services market.

Law No. 109 of 30 November 2000 on Appraisal Activities in the Republic of Kazakhstan sets out the regulations in the implementation of real estate appraisal. The self-regulating organization, the “Chamber of Professional Appraisers of Kazakhstan”¹⁰⁹, operates in the country.

B. MORTGAGE MARKET

Although mortgages were introduced in 1995, the mortgage market only began to function from 2001, when the first mortgage loan was issued. From 1995-2000, the Government, together with the NBRK, have carried out work on the formation of the legislative base and the necessary infrastructure for mortgage lending. Unlike most ex-Soviet countries, the development of the mortgage lending system in Kazakhstan took place without the participation of international donors.

It is worth noting that two housing finance schemes operate in the country – the issuance of mortgage-backed securities secured by rights requirements for mortgages (the American two-

¹⁰⁸ It was formed through the merger of the Association of Realtors of Kazakhstan and the National Association of Realtors in 2009.

¹⁰⁹ It was established under the basis of the Kazakhstan association of appraisers.

tier model) and the system of housing construction savings (European model). An example of a state refinancing organization operating under the American model is the state JSC KMC.

KMC became a pioneer organization in Kazakhstan when it launched a securitization process - the issuance of mortgage-backed securities under the pledge of mortgage claims. KMC also was the primary implementing institution of public housing programmes, in particular the “State programme of housing construction development in the Republic of Kazakhstan for 2005-2007”¹¹⁰. Under this programme, the State’s lending standard of “10/10/20” was established (interest rate - 10 per cent, down-payment - 10 per cent, mortgage term - up to 20 years). Young families, employees of the public sector and civil servants have priority to participate in this programme.

The early stage of mortgage market development (early 2000s) was characterized by strict mortgage conditions: the size of the down-payment was almost 50 per cent, interest rates in the national currency were up to 20 per cent, and loan terms did not exceed 10 years. The appearance of KMC products on the mortgage market contributed to the softening of mortgage requirements and increased competition between commercial banks. Interest rates for mortgages in the national currency fell to 12-15 per cent per annum, the initial down-payment was reduced to 15-20 per cent of the value of the property, and the loan period was increased to 15 years. In addition, the banks actively offered mortgages in foreign currency and adjustable mortgage rates (floating rates). As a consequence, the mortgage market grew at a fast pace. While, in 2003, the mortgage-to-GDP ratio was 1.7 per cent, it reached 5.3 per cent in 2007.

Like many other countries, the global financial crisis had a profound effect on the mortgage market in Kazakhstan, which forced the Government to intervene. In order to prevent massive defaults on foreign currency mortgage borrowings, the Government launched a refinancing programme of such mortgages through second-tier banks (STBs). Loans in the national currency are issued with a less than 9 per cent interest rate for special categories of the population, and a less than 11 per cent rate for all other categories, for a term of up to 20 years. The condition for participation is that the borrower be the owner of a single apartment of up to 120 square metres.

As a result of the Government measures, the market gradually stabilized in the period 2010-2014. Banks started to participate again in the mortgage market, and an increase in mortgage loans issued was seen. In particular, the volume of mortgage loans increased almost three-fold - from KZT 85.1 billion in 2010 to KZT 248.5 billion in 2014. However, a new economic crisis in late 2014 caused a new round of devaluation of the national currency, which contributed to the sharp decline in the volume of mortgage lending and financing of housing construction.

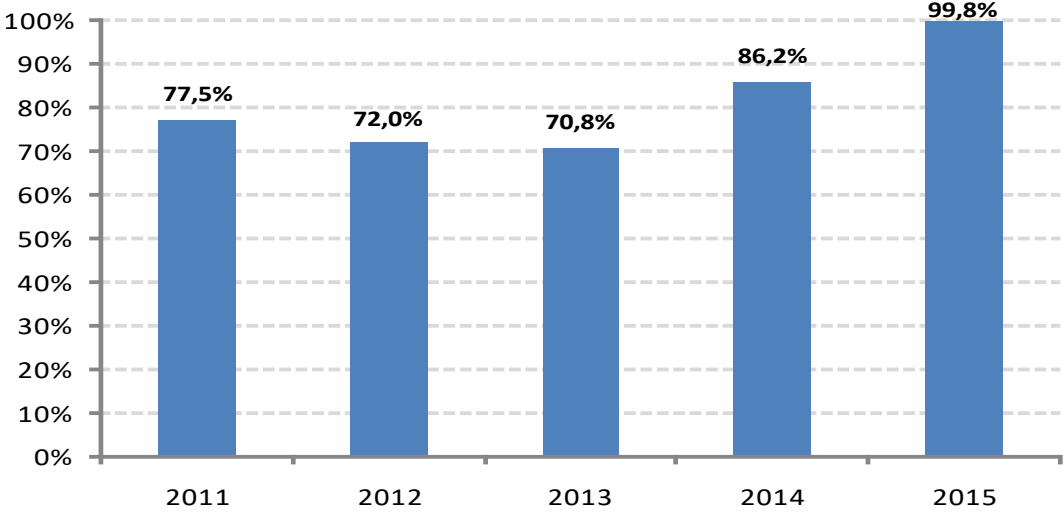
Many banks in 2016 declared that they restarted issuing mortgages, but the terms became significantly stricter: according to a website portal¹¹¹, the mortgage market is controlled by five major banks. At the end of 2015, mortgages issued by these banks reached almost 100 per cent of the total mortgage portfolio of banks (Figure 9). The three largest mortgage market participants were the JSC Housing Construction Savings Bank of Kazakhstan (HCSB) (31 per cent), the People’s Bank (22 per cent) and Bank Center Credit (19 per cent).

Strengthening the position of the biggest players took place against a background of stagnation of the mortgage market itself. Indeed, the volume of mortgages issued in 2016 amounted to KZT 195.1 billion, the lowest in the last four years.

¹¹⁰ It was approved by Decree of the President of the Republic of Kazakhstan No. 1388 of 11 June 2004.

¹¹¹ Monitoring of the economy of Kazakhstan. Available from <http://ranking.kz>

Figure 9. Share of the five largest banks in the mortgage market, 2011-2015



Source: Ranking.kz (www.ranking.kz). Calculations based on NBRK data.

Two players maintain the current size of the mortgage market – HCSB and the People’s Bank, which collectively increased their mortgage portfolios by KZT 134.5 billion in 2015. HCSB’s mortgage portfolio has been growing constantly since 2009 (an average growth rate of 33 per cent per year). As at 1 March 2016, the share of HCSB in the total mortgage portfolio of the banking system was about 33 per cent (28 per cent in 2014).¹¹²

Founded in 2003, HCSB has a special place in the system of housing finance of the country, being the only bank that implements the system of housing construction savings. It adopted the German system of contractual savings for housing, or the “Bauspar” model, wherein a housing loan is linked to a savings deposit. In this system, an investor and a bank enter into a contract for housing construction. The investor deposits money for housing construction that earns interest below market interest rates, and is entitled to a housing loan – also below market rates - once a minimum accumulated amount of savings has been reached, as stipulated in the contract (usually at least 50 per cent of the loan amount). The investor repays the loan with interest based on the agreed rate in the contract, which is fixed, and therefore does not depend on market conditions. From the time the system was implemented until 1 February 2018, the bank signed 1,548,423 agreements on housing construction savings, amounting to KZT 4.9 trillion; total depositors savings reached KZT 525 billion; and 173,359 loans amounting to KZT 919 billion were granted.

From 1 November 2016, in accordance with the Standard Terms and Conditions of the Contract for Housing Savings, HCSB started to offer four different tariffs or products for contractual savings for housing with different savings/loan periods and loan interest rates. Savings accumulation period ranges from 3.5 to 15 years, depending on the deposit plan, and the interest rate on all types of deposits is 2 per cent per annum. Note that all HCSB products require an accumulated savings of at least 50 per cent of the contracted amount.¹¹³ When the investor has reached the required amount of savings, he is entitled to take out a mortgage loan at an interest rate of 4 per cent to 11 per cent per annum, payable up to 25 years. HCSB also offers products

¹¹² Ibid.

¹¹³ In accordance with bullet 7 Chapter 2 of the Standard Terms and Conditions of the Agreement on Contract Savings, the contracted amount is the amount of funds necessary for the investor to improve housing conditions, which consists of housing construction savings and housing loans.

that help improve the living conditions of citizens who do not have the required amount of savings through preliminary and intermediate housing loans.

It should be noted that the PRSP is also one of the main operators of the state programme “Nurly Zher”, through which the corresponding task of the program is realized (Task 3. Construction of credit housing through the system of housing savings).

Since the beginning of 2018, the program to provide housing for the military personnel has been implemented, which will also be implemented through the PRSP. In particular, according to the legislative changes introduced at the end of last year, the funds for housing payments will be transferred to specialized accounts of the military personnel in the second-tier banks. The amount of deductions will be equivalent to the cost of renting 18 m² of housing per family member. The rate for such loans is stated at the level of 6.8-7.8 per cent, and the loan period is up to 15 years. At the first stage (during 2018), about 11 thousand people are expected to participate, and in the next five years it is planned to involve another 60 thousand people.

Currently, almost all banks have mortgage programmes for acquiring real estate in the primary and secondary markets, as well as for improving living conditions. The initial down-payment for these types of loans ranges from 15 per cent to 50 per cent, and the loan term is up to 30 years. Some banks grant mortgages without a down-payment if the borrower provides an additional pledge. Interest rates on mortgages in the national currency range from 15 per cent to 23 per cent per annum. Mortgages in foreign currency in USD are also available, but the borrower should provide an official confirmation of income in that currency. Some banks place a moratorium on loans, and charge penalties for early repayment.

There are also specialized mortgage companies that provide housing mortgages. As of 1 January 2017, KMC JSC “Almaty Regional Mortgage Company”, JSC “Mortgage organization” and Express-Finance have started granting mortgages. The terms they offer are similar to those offered by banks - loan term of 20 years, interest rate of 17-19 per cent per annum (depending on the method of confirmation of income), and 30 per cent down-payment for loans in the national currency.

In accordance with Government Decree No. 179 of 17 February 2009 on Some Issues of Mortgage Loans Refinancing of Second-tier Banks, nine banks are implementing a state programme for refinancing foreign currency mortgages since it was expanded in February 2016. For this purpose, the NBKR has allocated KZT 120 billion to these banks for the refinancing of foreign currency mortgage loans amounting to KZT 120 billion¹¹⁴. According to the terms of the programme, the foreign currency loans are converted to tenge, and refinancing is provided at an interest rate of no more than 3 per cent per annum, and the loan term is increased to 20 years. To qualify for refinancing, one must belong to a socially vulnerable group¹¹⁵; the mortgage loan must have been granted during the period 1 January 2004 to 31 December 2009; the outstanding principal balance on the loan should not be more than KZT 36.5 million; and there should be a delay in payments of more than 90 days.

Delinquency and defaults on mortgage loans are isolated cases and are regulated out of court. In theory, the lender has several options to impose foreclosure on the mortgaged property:

- foreclosure of the mortgage through court;
- foreclosure of the mortgage out of court; or
- transfer of the pledged property to the lender in case of failure of auctioning.

¹¹⁴ Resolution of the Government of the Republic of Kazakhstan No. 891 of 12 November 2015 on amendments to Government Decree No. 179 of 17 February 2009.

¹¹⁵ Socially vulnerable citizens are defined in Art. 68 of Law No. 94-I of 16 April 1997 on Housing Relations.

Law No. 401-IV of 28 January 2011 on Mediation also regulates the resolution of mortgage disputes out of court.

Currently, two credit bureaux operate in the country - the TTO “First Credit Bureau” and the JSC “State Credit Bureau”¹¹⁶. The legislation provides for the mandatory provision of information to the State Credit Bureau for the following organizations: STBs, organizations carrying out certain types of banking operations, microfinance organizations; and individual entrepreneurs or legal persons selling goods and services on credit or through deferred payment. Compliance with this provision will allow the State Credit Bureau to generate a reference database of credit histories. In accordance with Law No. 573 of 6 July 2004 on Credit Bureaus and Formation of Credit Histories of the Republic of Kazakhstan, the NBRK shall regulate credit bureaux.

C. PUBLIC AND PRIVATE FINANCING OF THE HOUSING SECTOR

Since independence, the provision of housing has been one of the priorities of the State’s policy. The Government is aware of the importance of assisting citizens in improving their living conditions. Since the mid-2000s, the Government has adopted a number of programmes aimed at increasing the affordability of housing. In particular, the following programmes were approved:

1. State Programme of Development of Housing Construction in the Republic of Kazakhstan for 2005-2007¹¹⁷ (State Programme 2005-2007);
2. State Programme of Housing Construction in the Republic of Kazakhstan for 2008-2010¹¹⁸ (State Programme 2008-2010);
3. Programme for the Development of the Construction Industry and Production of Construction Materials in the Republic of Kazakhstan for 2010-2014¹¹⁹ (State Programme 2010-2014);
4. Programme of Housing Construction in the Republic of Kazakhstan for 2011-2014¹²⁰ (Programme 2011-2014);
5. Programme “Affordable Housing 2020”¹²¹; and
6. “State Program Nurly Zher”.

The main goal of State Programme 2005-2007 was to increase the affordability of housing for the population by stimulating construction and implementing various financial mechanisms. It involved the construction of housing at a reduced cost (KZT 56,500 per m², with a market value of KZT 126,000 and KZT 97,000 on the primary and the secondary market, respectively), which would help ease mortgage conditions for the population. In 2005–2007, KZT 1,113 billion of investments from all financial sources was allocated for housing construction, and 17.9 million m² of residential houses are already operational (another 15.8 million m² are planned).

State Programme 2008-2010 continued with the provision of housing at a reduced cost to priority categories of citizens. The number of potential beneficiaries was increased, to include those

¹¹⁶ Established on the basis of NBRK Board Resolution No. 213 of 4 July 2012 on Approval of the Foundation of the Joint Stock Company State Credit Bureau. State Credit Bureau is a specialized non-profit organization and NBRK owns 100 per cent of its voting shares.

¹¹⁷ Approved by Decree of the President of the Republic of Kazakhstan No. 1388 of 11 June 11 2004.

¹¹⁸ Approved by Decree of the President of the Republic of Kazakhstan No. 383 of 20 August 2007.

¹¹⁹ Approved by Decree of the Government of the Republic of Kazakhstan No. 1004 of 30 September 2010.

¹²⁰ Approved by Decree of the Government of the Republic of Kazakhstan No. 329 of 31 March 2011.

¹²¹ Approved by Decree of the Government of the Republic of Kazakhstan No. 821 of 21 June 2012.

who did not have enough funds for the down-payment through the application of a contract savings system based on a preliminary loan.

As mentioned previously, the construction industry was heavily hit by the global financial crisis, and it was at this time that State Programme 2008-2010 was being implemented. To prevent a slowdown in construction, the Government developed a plan of priority measures to ensure the stability of socio-economic development¹²². The main objectives of the action plan were: 1) to reduce the dependence of STBs on external funding; 2) to reduce the financing of small and medium business projects, as well as budgetary investment projects; 3) to ensure the stability of the mortgage market; and 4) to protect the rights of co-investors. The injection of budget funds in the sector of equity construction was considered by the Government as a “one-time action”, due to the need to prevent the collapse of the construction and related industries.

State Programme 2010-2014 continued with the objective of developing housing construction. Its main goal was to provide balanced sustainable production of building materials in the country. Increasing the share of building materials production to 80 per cent was among the goals of the Programme. Approved funding was KZT 38.6 billion.

Taking into account the substantial volume of public investments channeled into the sector of housing construction in 2008-2010, a significant decrease in the volume of private investments in housing construction also occurred. Private investment had financed more than 87 per cent of housing before the crisis, including 60 per cent of individual housing construction. The main reasons included the tightening of the requirements of supervisory authorities for the formation of STB provisions, the lack of cheap long-term funding in the domestic market from STBs, and the deterioration of STB collateral due to falling real estate prices. Furthermore, the lack of funding for the housing utilities infrastructure resulted in the decrease of the volume of individual housing construction. For example, under State Programme 2010-2014, KZT 10 billion was allocated for the period 2011-2012 for individual housing construction, including the budget for the utilities infrastructure. In previous years, KZT 30 billion was allocated annually for the same purpose, including KZT 10-15 billion for the construction of the housing utilities infrastructure.

On 31 March 2011, the Government adopted State Programme 2011-2014 in order to maintain the volume of industrial and individual housing construction and to attract private investment. The overall objective of this programme was to provide a comprehensive solution to the problems of the housing construction sector, which could help increase the affordability of housing for all groups of the population.

Within the framework of the Programme, new schemes of housing construction financing were envisaged: the implementation of a contract savings scheme through the HCSB; support for the construction of commercial, industrial and individual housing through the funding of STBs; and the construction/acquisition of real estate by JSC Samruk-Kazyna Real Estate Fund for subsequent rent/lease purchase and direct sale. The total amount of funding was KZT 488.3 billion.

Despite the achievements of the state programmes, housing was still inaccessible for most households. According to the Ministry of Economy, over 6 million people out of the 8.4 million economically active population still could not afford to buy housing on market terms. At the same time, the number of people on the housing waiting list continued to grow, and the level of provision of quality housing was rather low.

¹²² Approved by Decree of the Government of the Republic of Kazakhstan No. 1039 of 6 November 2007.

In order to address these challenges, an integrated audit and analysis of the existing programmes in the construction industry was conducted. Its results served as the basis for the development of new unified programme, “Affordable Housing 2020”. The programme envisaged 1) bringing the annual volume of rental housing construction to up to 1 million m² per year, 2) the development of rental-purchase mechanisms, and 3) establishing a set of measures for the development of the construction industry. In view of the devaluation of the national currency in late 2014, the programme was transformed. Effective 1 January 2015, the programme became the “Regional Development Programme 2020”, which combined the following five programmes:

1. “Regional Development”;
2. “Mono-cities Development Programme for 2012-2020”;
3. “Modernization of Housing Utilities and Communal Services for 2011-2020”;
4. “Ak Bulak for 2011-2020”; and
5. “Affordable housing 2020”.

The amount of funding from the State, local budgets and extrabudgetary sources amounted to KZT 2.2 trillion until 2019. In addition to these areas, the Regional Development Programme until 2020 provided funding for credit, commercial and rental housing in the amount of KZT 277 billion under “Nurly Zhol”¹²³.

The implementation of state programmes is mainly focused on increasing housing affordability in urban areas. Housing provision for 43.1 per cent of the rural population is 17.4 m² per person, which is lower than the 20.9 per cent national average. According to the Committee for Construction, Housing and Utilities, the number of people waiting for a 0.1 hectare land plot for individual housing construction is about 1.2 million, which is almost half of the number of people needing improvement in their living conditions. According to the Land Code of the Republic of Kazakhstan, only land plots with developed utilities infrastructure can be transferred to private ownership.

At the end of 2016, the Government adopted the new housing programme “Nurly Zher”¹²⁴. This programme aims to develop new approaches to stimulate housing construction, to improve housing affordability and to integrate various housing programmes into one.

Under this new programme, housing policy is focused on shifting the accent from budgetary to extra-budgetary funding. Funds for housing construction allocated under the state programmes “Nurly Zhol” for 2015-2019 and “Regional Development Programme until 2020” will be concentrated and redistributed into this programme.

Nurly Zher has seven goals, which refer to the specific tasks of the programme.

Task 1. Increasing the affordability of mortgages

In order to increase the affordability of mortgages, it is proposed to subsidize the interest rates of banks on mortgages for citizens. Subsidies are provided only for housing mortgage loans provided by the second tier banks, at a rate of no more than 16% per annum.

Annually, within the framework of the Program, subsidies are provided from the republican budget for reimbursing part of the interest rate equal to the amount of maximum 6% per annum of the interest rate on mortgage housing loans for purchasing of the housing (after the subsidy,

¹²³ Approved by Order of the President of the Republic of Kazakhstan No. 1030 of 6 April 2015.

¹²⁴ Approved by Decree of the Government of the Republic of Kazakhstan No. 922 of 31 December 2016.

the interest rate for the final borrower will be no more than 10% per annum) that will be channeled through the financial agent KMC.

Task 2. Stimulation of housing construction by private developers

In order to increase the supply of housing by private developers, it is proposed to subsidize interest rates on loans issued by STBs to private developers for the construction of new housing (subsidies will be provided only for mortgages disbursed by the STB, at a rate not exceeding the base rate of the NBRK by more than 5 per cent, relevant for the time of the decision to subsidize). From 2017, the State, through the JSC “DAMU Entrepreneurship Development Fund” (EDF Damu), an investment arm of JSC “NMH Baiterek”, will grant subsidies of up to 7 per cent of the interest rate on loans to private developers.

However, the loan term and the term of subsidizing of the interest rate must be the same, and must not exceed 36 months. Under this programme, the developer is required to sell at least 50 per cent of the commissioned housing to participants of the contract savings system through the HCSB at fixed prices – up to KZT 260,000 per m² in Astana, Almaty and their suburbs, and up to KZT 220,000 in other regions. The volume of funding for 2017 is expected to be KZT 157 billion.

Task 3. Construction of credit housing through the contract savings system

Under the framework of this task, credit housing construction will continue, including for those people registered in the waiting lists of LEAs. The funding mechanism for credit housing construction will be implemented as follows:

- 1) the issuance of two-year LEA bonds with the redirection of funds previously allocated for new construction projects;
- 2) the placement of “conditional” deposits in STBs (interest rate on the “conditional” deposit should not exceed 3 per cent per annum, and the effective rate on loans granted by STBs should not exceed more than 7 per cent per annum); and
- 3) the attraction of funds from international financial institutions under guarantees by quasi-public sector entities.

Construction of credit housing through LEAs will be financed by borrowed funds from the quasi-public sector entities through the issuance of securities with a maturity of up to two years and a coupon of 0.15 per cent per annum twice a year.

Additionally, the Government provides the right to allocate loans from the national budget to LEAs for the implementation of HCSB housing construction projects at a rate of 0.01 per cent per annum.

Financing of credit housing construction by LEAs will be implemented through the issuance of securities and raising funds for purchasing from the following sources:

- 1) KZT 67 billion from the JSC “National Management Holding Baiterek” (JSC “NMH Baiterek”) in 2016 to purchase debt securities (bonds) of LEAs;
- 2) Redirection in 2018 of KZT 113 billion provided by JSC “NMH Baiterek” in 2016 for the construction of rental and credit housing; and
- 3) Redirection in 2018 of KZT 97 billion provided by JSC “Samruk-Kazyna” in 2016 for the construction of commercial housing.

An additional mechanism for financing the construction of credit housing is the placement of “conditional” deposits in STBs. It is also assumed that JSC NMH “Baiterek” will raise funds from international financial organizations under corporate guarantees for financing credit housing construction. It is expected that, by 2021, the volume of housing construction under this task will reach 1.8 million m² per year.

Task 4. Creation of rental housing stock for the socially vulnerable population

Involves the target transfer of the state budget to regional budgets and to the budgets of the cities of Astana and Almaty for the design and construction of rental housing by LEAs for socially vulnerable groups of people who are on the waiting lists of the LEAs. At the same time, the construction of rental housing at the expense of the budgets of the LEAs without purchase option is allowed.

The planned annual commissioning of rental housing is 150,000 m² per year.

Task 5: Development of individual housing construction

In order to finance the construction of individual houses, LEAs may channel the funds raised through the issuance of debt securities under the direction “Construction of credit housing through the system of contract savings”. People on the waiting lists participating in pilot projects have the right to buy finished individual houses with the land plot that is provided with housing utilities infrastructure, or to obtain a loan from the HCSB for its purchase.

The HCSB provides loans with reduced interest rates for the purchase of individual houses. Under the direction “Increasing the affordability of mortgage lending”, the Government provides grants of up to 7 per cent per annum of the lending rates on preliminary and intermediate housing loans in order to reduce the borrower’s annual interest rate on a loan to up to 5 per cent, for a maximum period of five years. The interest rates subsidy ends after this period. For these purposes, the HCSB raises funds on the market. It is expected that, under this task, the volume of housing construction will reach 5.5 million m² per year by 2021.

Task 6. Creation of commercial and rental housing stock

Within the framework of this task, the implementation of the following areas of housing construction, previously stipulated in the programmes Nurlı Zhól and Regional Development until 2020 will be completed:

- 1) rental housing for people on LEAs’ waiting lists and for young families;
- 2) rental housing with purchase from KMC;
- 3) JSC Bayterek development rental and credit housing ;
- 4) commercial and rental housing with purchase from JSC Samruk-Kazyna.

Task 7. Support of equity housing construction

This task will continue the implementation of previously provided mechanisms for the protection of housing equity contributions, the financing of HCSB housing projects with private developers, and the pilot project of the emergency demolition of housing in the city of Astana. It is expected that the volume of contributions, accumulated in the HGF to guarantee equity construction, will increase from KZT 100.5 billion in 2017 to KZT 199.1 billion in 2021.

The funding for the implementation of the programme will come from the state budget; private investments, including those from the quasi-public sector; and other funds raised from the capital market, including funds from the Single Accumulative Pension Fund. The total volume of funding for the period 2017-2021 is KZT 1.542 trillion, of which KZT 802.8 billion will come from the state budget and KZT 739 billion from extra-budgetary sources.

Despite the considerable amount of investments in housing construction by the State, its share in the total amount of funding is no more than 10 per cent. The largest volume of construction was financed by the population, which has significantly increased in the last two years (from 43 per cent to 51 per cent in the first nine months of 2016). At the same time, the number of apartments commissioned by individual developers over the past three years accounted for 40 per cent of the total volume of commissioned apartments.

Table 4

Investment in housing construction by financial sources (in billions of Kazakhstani tenge)

| <i>Sources of financing</i> | <i>2014</i> | <i>2015</i> | <i>As at 01 December 2016</i> |
|-----------------------------------|-------------|-------------|-------------------------------|
| National budget | 89 | 84 | 46 |
| Local budget | 47 | 35 | 42 |
| Own funds | 331 | 435 | 487 |
| Including funds of the population | 222 | 309 | 330 |
| Bank loans | 54 | 63 | 55 |
| Including funds of foreign banks | 0.5 | 0 | 0 |
| Other borrowed funds | 92 | 102 | 65 |
| Including funds of non-residents | 0.08 | 0.03 | 0.07 |
| <i>Total</i> | <i>614</i> | <i>719</i> | <i>695</i> |

Source: Committee on Statistics of the Republic of Kazakhstan

D. LINK BETWEEN HOUSING POLICY AND THE BANKING SYSTEM

Banking System

To date, the banking sector is the largest and most dominant segment of the financial market. According to the NBRK, as of 1 January 2018, 32 STBs were operating in the country, 13 of which had foreign participation, including 11 subsidiary STBs.

Until mid-2007, credit organizations actively borrowed from the international capital market (syndicated loans, debt financing). After the global financial crisis, the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Market and Financial Organizations¹²⁵ took measures to increase banks' capitalization requirements regarding liabilities to non-residents; to increase the capital adequacy of banks in relation to real estate loans and consumer lending; and to improve the risk-management system and internal control of STBs.

Starting in 2011, the banking sector started to show gradual recovery. However, growth dynamics indicate a lack of efficiency of the banks on the reallocation of resources in the economy, and in meeting the demand for loans (Table 5).

¹²⁵ Decree of the President of the Republic of Kazakhstan No. 25 of 12 April 2011 transferred the functions and powers of the Agency to the NBKR.

Table 5
Comparative dynamics of some banking indicators, 2011-2016

| <i>Indicators</i> | <i>2011</i> | <i>2012</i> | <i>2013</i> | <i>2014</i> | <i>2015</i> | <i>2016</i> | <i>2017</i> |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <i>Billions of Kazakhstani tenge</i> | | | | | | | |
| GDP | 27 572 | 31 443 | 34 443 | 38 624 | 40884 | 44 354 | 48 392 |
| Banking sector assets | 12 817 | 13 870 | 15 462 | 18 239 | 23 780 | 25 561 | 24 221 |
| Banking sector liabilities | 12 975 | 11 873 | 13 384 | 15 880 | 21 290 | 22 716 | 21 130 |
| <i>Percentage</i> | | | | | | | |
| Assets/GDP ratio | 46.5 | 44.1 | 44.9 | 42.7 | 57.6 | 57.6 | 57.7 |
| Loan portfolio/GDP ratio | 38.0 | 37.1 | 38.8 | 36.7 | 37.7 | 35.0 | 28,1 |
| Return on equity (ROE) | -0.94 | 26.52 | 13.15 | 13.17 | 15.4 | 15.18 | -0,63 |
| Return on assets (ROA) | -0.1 | 1.61 | 1.77 | 1.64 | 1.96 | 1.64 | -0,08 |
| Share of the five largest banks: | | | | | | | |
| In the assets of STBs | 65.3 | 60.0 | 55.4 | 52.4 | 59.2 | 58.2 | 57,5 |
| In the total loan portfolio of banks | 70.9 | 65.3 | 62.1 | 58.9 | 63.4 | 60.6 | 56,6 |
| In the total deposits of clients | 62.2 | 57.5 | 54.4 | 51.0 | 60.6 | 58.2 | 57,5 |

Source: NBRK.

From 2011 to 2017, banking sector assets have almost doubled, from KZT 12,817 billion to KZT 24,2 billion. However, in relation to GDP, the volume of banking assets increased only by 11 per cent. The situation of the loan portfolio of the banking sector is similar. As of 1 January 2018, it was KZT 13,6 trillion, an increase only of 58.7 per cent from its 2011 level. However, the loans/GDP ratio, which reached a maximum of 66.7 per cent in 2007, remained low at 28 per cent by the beginning of 2018. Therefore, there is a decrease in the level of assets and the volume of loans in relation to GDP, which can be attributed to unbalanced lending to sectors of the economy, low diversification of the loan portfolio, and short-term funding. The portfolio of issued loans is characterized by an increasing concentration in the non-productive sector; a high proportion of turnover, mainly in the trade and services sectors, which brings quick and high returns but does not participate in creating the final product and increase of real GDP.

At the same time, a serious challenge to the adequate and balanced development of the economy is the high concentration of the banking sector in the five largest banks, whose assets share is nearly 60 per cent.

One other problem of the banking system of Kazakhstan is its fund base. Historically, deposits of firms and individuals formed more than half of the fund base of the banking system. After the global financial crisis, access to foreign capital markets for Kazakh financial institutions became limited due to the increased financial risk and decreased interest of potential foreign investors in the debt instruments of the country. This situation provided the impetus for banks to use domestic funding sources. Since 2013, banks began to use undistributed earnings as an additional source of capital (Table 6).

Over the last five years, there has been a growth in the deposit base of the banking sector, due to currency revaluation. Given that a substantial part of the deposits is fixed-term deposits, which depositors could claim ahead of schedule, the deposit base is regarded as a relatively stable source of funding only because of its high exchange rate volatility. Therefore, banks are forced to provide loans in foreign currency or bear credit risks.

The stock market currently remains weak, especially due to the pension reform and the reduced demand for securities, previously provided by private pension funds. As of 1 September 2016, the amount of funds raised through the issuance of securities was less than 8 per cent. Thus, the resource base of the banking sector is quite expensive due to the shortage of long-term sources of funding, which in turn affects the cost of long-term loans to final borrowers.

Table 6
Structure of funding sources of the banking sector
 (Percentage of the total liabilities)

| <i>Liabilities</i> | <i>2011</i> | <i>2012</i> | <i>2013</i> | <i>2014</i> | <i>2015</i> | <i>2016</i> | <i>2017</i> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Interbank deposits | 0.8 | 1.2 | 1.8 | 2.1 | 2.1 | 1.6 | 1,3 |
| Loans received | 4.8 | 4.4 | 3.8 | 5.4 | 43 | 4.8 | 3,4 |
| Deposits of clients | 60.8 | 61.5 | 63.7 | 62.2 | 65.6 | 67.6 | 68,9 |
| In foreign currency | 32.7 | 31.3 | 37.2 | 57.8 | 69.2 | 53.8 | 47,6 |
| Issued securities | 11.7 | 7.2 | 6.3 | 6.7 | 8.8 | 7.0 | 5,5 |
| Share capital | 20.0 | 20.1 | 18.2 | 15.9 | 6.6 | 6.3 | 8,2 |
| Reserve capital | 3.1 | 3.2 | 3.3 | 2.6 | 1.2 | 1.1 | 1,1 |
| Undistributed net income (loss) of the current year | 0.3 | -1.5 | 1.5 | 1.6 | 0.9 | 1.6 | -0,1 |
| Other liabilities | -1.5 | 3.9 | 1.3 | 3.6 | 10.5 | 10.0 | 11,8 |

Source: NBRK

A high share of “non-performing” loans has destabilizing effect on the banking activity. Over the last few years, starting from 2010, the share of non-performing loans (4 and 5 category¹²⁶) in the loan portfolio of the banking system was consistently high at 36-37 per cent. This indicates that the potential use of “classic” banking instruments for improving asset quality, such as debt restructuring, is almost exhausted. In this regard, several mechanisms for improving the quality of bank assets were implemented in 2012. The mechanisms are the following a): sale of distressed assets to JSC “Fund of problem loans” and subsidiaries of banks that acquire doubtful and bad assets of parent banks; and b) the extension of terms for the remission of “bad” debts to end-2015 without incurring additional tax liabilities for the banks. This move has brought down the share of loans in arrears from 23.6 per cent in 2015 to 8 per cent in 2016.

¹²⁶ 4 category – doubtful loans that have arrears of 61-90 days; 5 category - unprofitable loans with arrears of more than 90 days.

The banking sector has slowly recovered after the global financial crisis but challenges remain. International rating agencies outline the following factors hampering full recovery: a) extremely high credit risk due to aggressive underwriting standards and a weak payment culture; b) a significant mismatch between foreign currency loans and deposits; and c) low profitability adjusted for risk, due to lower margins and rising of provisioning costs. Moreover, economic risks in the country remain high, as the economy, which depends on raw materials, is pressured by low and volatile oil prices against the backdrop of a significant weakening of the national currency from August 2015.

The level of banking industry risk also remains high because Kazakh banks are still dependent on a significant amount of currency swaps in the interbank market and by the NBRK, taking into account the very high, albeit decreasing, level of “dollarization” of deposits. The rating agency, Standard & Poor, also predicts a decline in the level of savings and increased volatility of deposits of state companies, firms and individuals.¹²⁷

Microfinance

As of 1 October 2017 (the latest available data of the NBRK at the time of writing), there were 147 microfinance organizations (MFOs) registered in the country. Previously, MFOs were not under the control of the NBRK. On 26 November 2012, the Law No. 56-V on Microfinance Organizations was adopted, which required all MFOs to register with the NBRK before 1 January 2016.

According to the latest available data of NBRK, the volume of MFO assets is KZT 180 billion, an increase of 41.3 per cent from the beginning of the year. Originated loans (84.2 per cent) occupy the largest share in the assets of MFOs, followed by share deposits (6,5 per cent). The volume of total liabilities of MFOs is KZT 120 billion, of which 95 per cent are attracted loans. Such a high proportion of loans to total liabilities is due to government programmes supporting businesses through microfinance that focuses only on providing lower interest rates to final borrowers (households) and do not take into account the interests of the MFOs themselves. Traditionally, high rates of microfinance products are the result of large transaction costs of loans rather than high risks of default, as evidenced by official statistics. According to the NBRK, the share of NPLs as of 7 January 2016 was only 4 per cent, while the same indicator for the banking sector was 8 per cent. Legislative restrictions of MFOs through the issuance of securities or in attracting deposits significantly affect the cost of financial resources for MFOs.

The Government recognizes the importance of the development of the micro lending industry, and is taking some actions in this direction. In particular, the EDF Damu in its Development Strategy for 2014-2023 had planned to invest about KZT 1 billion in 2016 as initial support to MFOs.

In particular, within the framework of the Programme for the Development of Productive Employment and Mass Entrepreneurship, it is envisaged to introduce microcrediting of entrepreneurial activities in cities, as well as to provide state guarantees for microcredits for self-employed and unemployed people who plan and implement projects in cities. According to this program, it is planned to issue about 2500 loans. It is planned to provide micro-loans for up to KZT 16 million with a final interest rate of 6%.

In the same year, microfinance institutions were to receive financial support from the World Bank, the Asian Development Bank, the European Bank for Reconstruction and Development

¹²⁷ S&P Global Ratings’ Credit Research, *Latest Banking Industry Country Risk assessment on Kazakhstan Published* (New York, Alacra Store, 2016). Available from <http://www.alacrastore.com/s-and-p-credit-research/Latest-Banking-Industry-Country-Risk-Assessment-On-Kazakhstan-Published-1722583>

and European Investment Bank. Funds received from international financial organizations would be issued to EDF Damu and the NBRK, which would provide the MFOs with liquidity in the local currency.

EDF Damu estimates that the total volume of microfinance funding until 2020 will reach about KZT 15 billion, which will allow loan provision to 27,000 borrowers. Moreover, a special loan product is being developed, wherein EDF Damu will act as guarantor for a loan.

Currently, microfinance is mainly used for lending to business activities (financing of working capital) in private farming and for renovation to improve the energy efficiency of housing. For a private farming business, the borrower can apply for an unsecured loan of up to KZT 500,000, with a collective guarantee of 3 to 10 people, payable for a period of up to 18 months. For the purposes of improving the energy efficiency of housing, the loan amount could be up to KZT 1 million, payable in 36 months. The maximum loan amount that MFOs extend should be in accordance with the regulations of the Law on Microfinance Organizations, that is, the loan amount should not exceed 8,000-fold of the monthly calculation index (MCI)¹²⁸ for the respective year.

Stock Market

The stock market is currently underdeveloped and does not function as a means to attract funding for banks and organizations. Currently, the lion's share of trading volume is in the sectors of foreign currency and repurchase agreement (repo) transactions (38 per cent and 60 per cent, respectively). However, the volume of trading of corporate debt securities accounts for less than 1 per cent (Table 7).

In particular, the market of mortgage-backed securities is not well developed, and not even considered by credit institutions as a separate full-fledged source of funding. However, the necessary infrastructure to ensure the effective mechanism of issuance and circulation of mortgage-backed securities¹²⁹ is available in the country. Banks issuing mortgages do not issue mortgage-backed securities, and keep the mortgage loans on their balance sheets, or refinance them through the KMC under government programmes.

The main reason for this situation is the lack of large institutional investors in mortgage-backed securities, for example, private pension funds, which were merged into a single state pension fund – Unified Accumulated Pension Fund (UNPF) during the government pension reform. According to the NBRK, as of 12 January 2016, the UNPF will be the only organization that will carry out the accumulation of obligatory pension contributions. The UNPF acts in accordance with the investment declaration¹³⁰, which defines the subjects of investment, and the conditions and restrictions on investments of UNPF assets. According to the declaration, the permitted amount of investment should not be more than 20 per cent of the portfolio in securities secured by real estate, and in assets with ratings (either of the securities and/or the issuer) of not less than BBB- on the scale of the S & P rating agency or a similar level from another international rating agency. As of 1 September 2016, the amount of pension savings of citizens amounted to KZT 6.6 trillion. Therefore, the potential amount of investment in mortgage-backed securities in the sector of pension savings alone is KZT 1.33 trillion.

¹²⁸ MCI is established by the Law on Republican Budget for the relevant period, and is used to calculate benefits and other social payments, as well as for the application of penalties, taxes and other payments in accordance with the legislation.

¹²⁹ The issuance of securities is regulated by the Law No. 461 on Securities Market of 2 July 2003.

¹³⁰ Approved by the Law No. 105-V on Retirement Insurance in the Republic of Kazakhstan of 21 June 2013.

Table 7
Volume and structure of the stock market

| <i>Sector of stock market</i> | 2016 | | 2015 | |
|-------------------------------|---------------|-------------------|---------------|-------------------|
| | <i>Amount</i> | <i>Percentage</i> | <i>Amount</i> | <i>Percentage</i> |
| Foreign currency | 36 124 | 38.2 | 66 202 | 72.0 |
| Government bonds | 556 | 0.6 | 428 | 0.5 |
| Stocks | 250 | 0.3 | 900 | 1.0 |
| Corporate bonds | 507 | 0.5 | 1 229 | 1.3 |
| REPO operations | 57 114 | 60.4 | 23 214 | 25.2 |
| Bonds of investment funds | 0.5 | < 0.1 | 0.1 | < 0.1 |
| Bonds of MFOs | 0 | 0 | 0 | 0 |
| Futures | < 0.1 | < 0.1 | 0 | 0 |
| Total | 94 552 | 100.0 | 91 972 | 100.0 |

Source: Kazakh stock exchange

As measures to reduce long-term liquidity shortage, in 2016, the NBKR started to create the conditions for the formation of a yield curve, designed to serve as a benchmark for money value in the domestic market. Furthermore, the volumes of credit notes placed by the NBRK were increased and terms of the notes were extended. For the first time since 2008, credit notes with a maturity of one year were issued. In September and November 2016, two auctions were held where the demand for notes was significantly oversubscribed. Moreover, the interest of foreign participants in Kazakh debt instruments was observed.

Since 15 November 2016, the NBRK has started to transact in the secondary market with government securities of the Ministry of Finance, with maturities of from two to five years. It is important to note that these measures could contribute to an increase in the volume of long-term liquidity in the national currency.

E. HOUSING AFFORDABILITY, AVAILABILITY OF HOUSING FINANCE, FINANCING OF HOUSING IMPROVEMENT

According to the latest available data of the Committee on Statistics, housing provision in 2013 was 20.9 m² per capita – 23.7 m² in urban areas and 17.4 m² in rural areas¹³¹. This indicator is much higher in developed countries; in Germany, the value is 45 m²; in the UK, 62 m²; and in the US, 75 m².

At the same time, according to official data of the CCHCS, as of 1 September 2016, 2.3 million people were in need of housing, including the following categories: people on the waiting lists of akimats (more than 400,000), depositors of the HCSB (more than 700,000), and those on the waiting list to receive 10 acres of land¹³² (more than 1.2 million).¹³³ Thus, about 14 per cent of the population is officially recognized as in need of better housing conditions.

¹³¹ Republic of Kazakhstan, Committee on Statistics of the Ministry of National Economy, Statistical digest of the Republic of Kazakhstan “On housing stock 2009-2013”, (Astana).

¹³² In accordance with Art. 50 of the Land Code of the Republic of Kazakhstan (land plots are provided to citizens for housing construction in the amount of 0.1 hectare at no cost).

¹³³ Comment of the Ministry of national economy on further changes in prices for public housing. Available from <http://kds.gov.kz/index.php/ru/component/content/article/15-novosti/239-v-minnatsekonomiki-prokomentirovali-dalnejshhee-izmenenie-tsen-na-goszhile>

According to the Committee on Statistics, in December 2016, the average price of real estate in the secondary market was KZT 190,000 per m². In the cities of Astana and Almaty, it was more than 1.5 times the national average (KZT 317,000 and KZT 337,000, respectively). This price level is unaffordable for the majority of households: the average housing affordability index (HAI) for the country is 5.0¹³⁴, and 4.6 and 3.6 for the cities of Almaty and Astana, respectively.

Many banks offer loans for housing repair or renovation. People can avail of such loan through the guarantee of the mortgaged real estate, and loan conditions vary depending on the currency of the loan, the presence of collateral, the income verification method, and the availability of bank commissions. For loans in the national currency with commission (which is usually equivalent to 1 per cent of the loan amount), interest rates start from 20 per cent per annum, and 22 per cent for loans without commission. Interest rates on dollar loans start from 13 per cent. Loan amounts granted range from KZT 600,000 to KZT 10 million, with terms ranging from 12 to 360 months.

The World Bank's "Kazakhstan Energy-Efficiency Project" aims to improve the energy efficiency in public and social facilities, as well as improving the conditions for the establishment of financial mechanisms for energy-saving projects. The Swiss Agency for Development and Cooperation provided a USD 21.8 million grant for this Project through the Trust Fund administered by the World Bank. The grant agreement on the Project was signed and approved on 1 June 2015.

F. ROLE OF NATIONAL AND LOCAL HOUSING FINANCE AUTHORITIES

The implementation of housing policy is considered one of the most important objectives of the state policy. A number of government housing programmes are available. However, a comprehensive market research of the demand and opportunities of the population, STBs and developers was not conducted.

According to Law No. 148 of 21 January 2001 on Local Government and Self-government in the Republic of Kazakhstan, LEAs act as the executors of government housing programmes.

The CCHCS is responsible for the development and implementation of housing policy in the country. A number of government institutions implement government housing programmes. There is no single state body (for example, in the form of an institution for development) responsible for the formation and implementation of state policy in the housing sector, and for the development of long-term objectives in the field of housing finance.

One of the largest public institutions, the National Managing Holding "Baiterek", is composed of four companies, and its activities are concentrated in the area of housing finance:

- JSC "Mortgage organization Kazakhstan Mortgage Company" - implementation of government programmes on rental housing, as well as refinancing STBs by purchasing rights of claims on mortgage loans;
- JSC "Baiterek Development" - implementation of investment projects in the residential and commercial property sectors, and production of building materials; and return of funds allocated for anti-crisis measures and completion of financing of projects of equity housing construction that were frozen;

¹³⁴ When calculating the HAI, the area of the purchased apartment was accepted at a rate of 54 m², and the size of the household at 3.6 people. The average nominal income per capita was used, adjusted for the subsistence level (67 112 KZT for the Republic of Kazakhstan; 128,956 KZT for Astana; and 111,530 KZT for Almaty).

- HGF (on the basis of the Kazakhstan Fund of Guarantee of Housing Loans)¹³⁵ – provision of guarantees to co-investors for the completion of construction of residential houses or buildings if developers fail in this respect;
- JSC “Housing Construction Savings Bank of Kazakhstan” – development and implementation of the contract savings system.

Separately, the JSC “Real Estate Fund Samruk-Kazyna”¹³⁶ was established to promote the development of the construction industry and the real estate market by investing in the use of “green” and other innovative technologies in construction. It is currently one of the operators of the State programmes “Regional Development until 2020” and the infrastructural development programme “Nurly Zhol”. It was expected that JSC Real Estate Fund Samruk-Kazyna would start implementing large-scale projects in the field of “green” development and development of commercial real estate in 2017.

According to Article 55 of the Tax Code of the Republic of Kazakhstan, 13 kinds of taxes, 1 state duty, 5 types of registration fees, and 10 different types of fees are levied by governments at various levels.

Funds received from taxes and other obligatory payments are allocated in accordance with the Budget Code of the Republic of Kazakhstan and the Law on the Republican Budget.

According to the Budget Code, the tax system of the country can be described as three-tier and, depending on the types and the source, taxes are distributed to:

- national budget;
- regional budgets, city budgets of city of national importance (Almaty) and the capital (Astana); and
- regional budgets, budgets of cities of regional importance.

However, local/regional budgets are sort of “transit” budgets, as funds transferred from the national budget are subsequently redistributed directly to the budgets of the cities and regions where they are actually spent.

Proceeds from land and property taxes are directed to regional budgets, as well as the budgets of cities of national importance. The object of taxation of land tax is all land according to its purpose specific category. The tax base for the calculation of this tax is the area of the land plot. The base rates on agricultural lands are established per hectare, and are differentiated by the quality of the soil. Base rates for agricultural land provided to individuals for personal household (auxiliary) farming, gardening and countryside construction, including land occupied by buildings, are established as follows:

- with an area up to 0.50 hectare – KZT 20 per 0.01 hectare; or
- with an area of more than 0.50 hectare – KZT 100 per 0.01 hectare.

Tax base rates for land settlements occupied by housing stock are set at KZT 0.96 to KZT 5.2 per m².

The objects of taxation of property tax for individuals are dwellings, buildings, cottages, garages and other structures and premises belonging to them by right of ownership. The rate of property tax of individuals is progressive, and is calculated as follows: a fixed payment plus a percentage of the amount exceeding a certain limit.

¹³⁵ Established under the framework of the Law “on equity participation in housing construction”.

¹³⁶ Established in accordance with Decree of the Government of the Republic of Kazakhstan “On some measures to solve problems in the real estate market” No. 265 of 6 March 2009.

The minimum property tax rate is 0.05 per cent of the value of the object of taxation up to KZT 2 million. The maximum rate (KZT 2.9 million) is charged when the value of the property is more than KZT 450 million, plus 2 per cent of the amount exceeding KZT 450 million.

Despite the large number of various taxes and fees levied in accordance with Kazakhstan's legislation, the rates of major payments to the budget (income tax, value-added tax, excise duty, etc.) are low compared to other CIS countries in particular and to the world in general.

The role of local authorities is to implement the tasks that are set at the federal level. Local executive bodies usually do not make any significant changes to the mechanism for implementing the state program, and because of the limited financial resources they do not implement their own programs.

Conclusions on Financial Framework for the Housing Sector

Housing policies have been a major government policy priority in the Republic of Kazakhstan since the country gained its independence in 1991. The Government has always placed much focus on addressing citizens' "housing challenges." Among other things, it adopted many government programmes containing a number of mechanisms to provide citizens with housing. However, it is worth noting that, despite such massive funding, the country still experiences a significant shortage of housing, the housing being unaffordable for the population even within the framework of existing government reimbursement programs. This situation is partly due to the following reasons: there is no regular monitoring of actual needs and means of the population when government housing programmes are developed; government programmes are focused only on homeownership, not sufficient consideration was so far given to other ways of meeting the needs of the population (for example, by means of non-profit rental housing stock). At the same time, one of the objectives of the recent ambitious government programme "Nurly Zher" is the construction of rental housing with no purchase option (at the end of 2017, there were constructed 50 thousand such apartments), which will diversify the range of available tools to improve the affordability of housing for the citizens and increase their labour mobility.

Currently, all government programmes are implemented only at the national level. In practice, local executive authorities (hereinafter referred to as LEAs) play the role of mere executants of government programmes, and at the same time because of their limited finances and legislative powers they cannot adequately develop and implement housing programmes.

As far as the population is concerned, the primary way of acquiring property, both upon the market conditions and through government programmes, is by means of mortgage lending or contractual savings (implemented through the House Construction Savings Bank of Kazakhstan). At the same time, the bigger share of loans belongs to the HCSB (about 75% of the total amount of housing loans in the country), which is due to much more favorable loaning terms.

Specifically, while under the house construction savings system the maximum amount of interest rates on loans is 5% with the loan period of up to 25 years (on condition of accumulation of half of the contracted amount¹³⁷), the mortgage interest rates in second-tier banks (hereinafter referred to as STBs) are much higher (from 15 to 23% per annum according to the amount of the initial instalment) with the loan period of up to 30 years. It should be noted that in the

¹³⁷ According to paragraph 5 of Chapter 1 of the Standard Terms and Conditions of the Housing Construction Savings Agreement of JSC Zhilstroybank of Kazakhstan, the contractual amount is the amount of money necessary for the investor to carry out measures to improve housing conditions, consisting of housing construction savings and housing loans. The contract amount is determined by the Depositor independently at the time of signing the Application for Joining the Housing Construction Savings System.

context of the house construction savings system, depositors can be awarded a bonus from the Government (up to 20% of the amount of savings).

The product range of STBs currently does not include loans targeted at improving energy efficiency of homes. The banks' product range includes standard loans for repairs, which borrowers can use for improving the energy efficiency of their homes. Specialized energy efficiency loans are offered only by microfinance organizations. However, they have limitations in terms of the loan amount and cannot fully meet the demand in this segment. To cover this quite significant lending segment, at the national level it is necessary for the government to implement policies aimed at the introduction of international lending practices to improve housing energy efficiency, which will grant some preferences to the borrowers (e.g., reduction of the amount of utility payments).

Such limited loan product range of STBs is due to the lack of sustainable long-term funding in local currency and significant dollarization of the country's economy. The funding base of the banking sector consists of almost 70% deposits, of which about 50% are those in foreign currency. To reduce the risks, banks now prefer short-term loans with a quick turnover period. Also, the country's stock market fails to function as a channel to attract long-term debt financing, and the domestic market of securities and institutional investors needs to be developed. Notably, the mortgage-backed securities market is currently underdeveloped due to the lack of investment in long-term assets.

Overall, it should be noted that in practice there is no long-term funding from foreign institutional/private investors. Foreign investments are attracted only on a short-term basis. The Government should provide incentives to the local businesses engaged in large-scale housing projects.

The housing construction sector in the Republic of Kazakhstan is not transparent. Despite a fairly large number of developers (about 7.5 thousand), this industry faces significant administrative barriers, poor competition, and lack of transparency. Moreover, the requirement to deduce 2-6% of the cost of projects to the Housing Construction Guarantee Fund established in October 2016 will work towards the exit of smaller market players, which will entail further monopolization of the housing market.

In this regard, the government needs to take action to improve the transparency of the construction industry in order to increase competition within the sector, including through arrival of foreign players, reduction of housing prices, and increased housing affordability for the citizens.