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Methodological Bases of Definitions "Refinancing," "Recrediting" and Application Practice in Residential Mortgage Lending

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ABSTRACT

A mortgage loan is considered as one of the most difficult forms of credit relations, first of all resulting in need to attract long-term financial resources on the basis of its refinancing. The expansion of foreign banks in the domestic credit markets is accompanied by a high rate of growth of credit investments into the economy of the state, and it leads to disruption of "borders" of credit and a negative impact on its development. At the same time, they are responsible for development of advanced technologies in national credit markets to improve the quality of customer service and modern banking products best suited to their needs, which include relending to borrowers. The purpose of this paper is to study the content and methodological foundations of "refinancing" and "relending" definitions, their relationships, and to identify functional orientation of these concepts in development of mortgage lending. The results of the study deepen the theoretical foundations of mortgage, the methodological tools used in practice of mortgage lending in relation to considered definitions, which allows specifying their content and developing ways of improvement.

Keywords: Refinancing, Liquidity, Interest Rate, Relending, Financial and Lending Practices, Financial and Credit Instruments
JEL Classifications: G00, G21

1. INTRODUCTION

Ensuring the citizens of the state with affordable and comfortable housing is considered as the most important feature of its culture and self-sufficiency development. Mortgage lending is widely used as a mechanism to achieve this goal in the world practice.

Mortgage lending has developed in all countries with market-oriented and is a necessary institution, used by the state, both in economic and social policy. For successful implementation of the task on providing citizens with affordable and comfortable housing requires adequate functioning of housing, which stimulates development of related economic activities of the real sector and contributes to a competitive economy and its stabilization and modernization. Special attention is paid to savings increase of population motivation and transformation of savings into investments made by banks in housing owned mortgage lending. As a result of the mentioned factors mortgage lending reduces inflation, increases social and economic stability of society.

From the standpoint of global patterns of banking market development mortgage, a loan is considered as an integral part of the economy. However, mortgage lending is a complex financial and credit mechanism in realization of loan relations, its financing and service. Mortgage loan operates in two closely related market segments: Credit and financial. The nature of these relationships is so different, that is the basis to divide the mortgage market into the primary and secondary (Asaul, 2007). Simultaneous implementation of mortgage operations is due to long-term nature of credit relations between the borrower and the lender, which requires constant attraction of long-term financial resources, which is a condition of its functioning.

The mechanism of mortgage loan functioning is based on the financial and credit system as a set of methods to influence the process of mortgage lending and financial-credit tools, exercising their practical realization. In this context, it can be argued that financial and credit methods are the scientific and practical basis for mortgage lending and define the basic parameters of its development, and possibility of these methods implementation defined by the presence of financial and credit instruments (Solodilova, 2014).

According to IFRS 39 "Financial Instruments: Recognition, Assessment" - financial instrument is any contract in which one of the parties has a financial asset, and the other one is the financial debt obligations or equity nature (Financial Instruments: Recognition and Assessment).

Considering this fundamental definition of financial instruments at international financial reporting standards, it should be noted that the theory and practice of foreign countries determines the unity of the financial system, brings together independent elements of financial and credit relations. These processes are increasingly being reflected in the globalized economy (Savinova, 2011). The global financial system provides financial flows, forming the population of permanent, stable ties between its members on a contract basis, and it determines the content of the financial instrument. Significant place in these financial relationships is taken by mortgage that requires long-term and cheap financial resources for its development.

At the same time, Russian science and practice separates the concepts of financial and credit relations, both in theoretical and institutional aspects, and it causes a similar approach to consideration of nature, methods and tools. The mentioned methods and tools are closely linked to the mortgage system and the possibility of their complex use is determined by strategic development which is chosen by the state.

2. METHODOLOGICAL BASES OF "REFINANCING" AND "RELENDING" DEFINITIONS

2.1. Refinancing as a Tool for Long-term Resources Formation

First of all, it should be noted that the considered definitions have different scientific understanding, and are implemented by methods and tools which are inherent to each of them. In the practice of mortgage lending, they have their own functional orientation.

The paper considers the methodology of these definitions.

One of the main problems of mortgage lending is formation of long-term resources. Banks, which are engaged in mortgage lending, need such resources due to their low capitalization and long-term loans. Special attention is paid to the reduction of a payment size for population, as well as to assistance to low-income segments of population who have the prospect of future sufficient gross income for loan repayment. In order to solve this problem, banks use a variety of refinancing tools.

The origin of the word "refinance" is associated with the English word "finance," i.e., "cash management" and the prefix "re" means "again," "back," "in a new way." The term "refinance" is widely used in different economy sectors. Regarding mortgage, its content can be viewed as the process of converting the stretched time cash flows, received in the form of payments to repay the loan, in a lump sum (one-time) getting them to a certain extent (Savinova, 2008). Their total value is determined by the current market conditions and accepted methods of refinancing implementation.

Refinancing as a tool for formation of financial resources is widely used in the practice of mortgage loans where this instrument is a necessary component in financial operations of this form of credit relations. Methodological basis for refinancing development Russia is provided by a unified system for refinancing mortgage loans, allowing expanding the scope of long-term resources significantly involved in mortgage lending (A letter from the Ministry of Economic Development March 28, 2005).

By means of refinancing it is possible to solve the second, no less important, problem of the primary lender reducing the risk of liquidity by increasing the cash requirements at the time of their full deployment in active operations.

The choice of methods to attract long-term investment in the mortgage market in the framework of the refinancing system is determined by various factors, among which are: The existing models of the mortgage lending system, the level of financial market development, the level of legal framework development. The mentioned factors identified the following ways and methods of refinancing:
- The sale of a loan pool;
- Issuing of covered bonds;
- Securitization of mortgage loans.

In the context of this study, we believe it is necessary to consider the general characteristics of refinancing methods and conditions of use in more detail.

When selling a generated pool of loans the assets are written off from the bank balance sheet and fully transferred to the balance of an acquiring organization. In this case, the lender can refund in a form of issued loans. The main factor determining the choice of this refinancing method is underdeveloped financial market, as well as the risk of liquidity loss as a result of a significant amount of long-term loans on a bank balance sheet. Another reason for the sale of assets with an increased risk is dictated by the need to bring them into compliance with mandatory standards of central banks. However, the direct sale of the pool in some cases can be used by banks in countries with developed financial systems in case the size of the bank and its reputation does not allow it to enter the securities market or pool of loans has a low rating, which could lead to a drop in the bank rating itself.

The second method of refinancing is associated with the issuance of mortgage-backed securities ensured by a generated pool of loans. In this case, the assets remain on the balance sheet of the bank, which continues to service loans or transfers them to the maintenance service agent. The payments on the bonds to investors are formed by the bank in accordance with the payments of borrowers under the loan agreements, entered into the pool. It is obvious that such a refinancing scheme works most effectively in countries with developed financial systems and with considerable capacity of the securities market. At the same time, the role of the state is improving conditions that increase the rating of securities and contribute to the growth of demand from investors.

The last method, i.e. securitization of mortgage loans, is widely used in the world.

The mechanism of securitization (securities) was developed in the United States (Ranieri, 1977). In a broader sense, it is considered as a form of financial engineering and aims to manage asset and liability balance for the purpose to change the structure of the portfolio and to transfer to a more secure form with the best cost and risk characteristics (Razumova, 2005).

The article considers the goals that are achieved through securitization. The traditional way of lending from deposits that are used by commercial banks is only possible for short-term operations. In this context, securitization helps leveling the problem by attracting long-term resources from financial markets. At the same time the second problem is solved - reducing the cost of borrowing, allows you to make a loan to the borrower. Securitization is important in bank liquidity management at expense of removing illiquid assets from the balance of the credit institution. In addition, securitization, as a method of refinancing, provides redistribution of risks between the parties of securitization transaction. The last operation is due to the fact that mortgage-backed securities have liquid collateral and are distinguished by their reliability.

Thus, securitization is a sale and withdrawal of assets with risk characteristics from the balance sheet of the lender in order to further issuance of mortgage securities as a means of attracting long-term resources in mortgage lending.

This refinancing method differs by its complexity, the number of participants increases, while in contrast to other considered methods there is a real division of lenders and financial intermediaries (operators of the secondary market). The financial component of the mortgage loan is also implemented in the population of financial instruments, one of which is mortgage-backed securities. Issued securities will be placed on the market, a rating agency will be invited to assess the riskiness of the pool, that according to the analysis of its characteristics and bank conditions determines the specification pool and assigns it a rating. Sometimes to improve the ranking and (or) reduce the yield on securities there are various financial institutions in the scheme. The role of state structures, providing some guarantees regarding the guarantee payments on securities to investors, is significant. Issue of securities and their placement is generally carried out by specifically organized companies (Special Purpose Vehicle), that have a license to perform such operations (The Federal Law "Mortgage Securities," dated November 11).

In a broad sense, securitization is transformation of illiquid long-term bank assets in long-term bank debt securities for sale to investors.

Revealing the nature, content and methods of refinancing, we can conclude that the bank-creditor is the initiator of refinancing in order to create long-term resources for mortgage lending.

2.2. Relending as a Process of Increasing the Availability of Housing Mortgage Loans to Borrowers

The term "relending" is not reflected in the theory of mortgage, and to some extent it can be explained by the fact that it is seen as a part of the loan process. In countries with a long history of mortgage lending development relending operations are widely practiced. One of the causes to develop these operations is the use of loans with variable interest rates, the level of which is determined under the influence of a particular index, often LIBOR or interest on government securities. Periodicity of interest rate revision is set of conclusions of the loan agreement and is usually done in 6 months or a year. In this case, the borrower will have the right to enter into a new credit agreement for suiting his terms in the same bank and repay the existing loan agreements. In addition, in some credit markets there are often cases where the borrower changes one lender to another, that can offers the best conditions. In this process, lending initiative comes from the borrower.

In the Russian practice the concept of relending and refinancing are considered identical, and most often in the following interpretation: "Relending of a mortgage loan - is refinancing …" or vice versa "refinancing of a mortgage loan - is relending …" The study of the nature and targeting of the lending process allows us to describe it as a process of getting a loan with a lower interest rate to repay the loan with a higher interest rate.

Relending is applied in case of changes in market conditions, thereby there is reducing of the loan coast. Competition in the mortgage market has serious impact on these processes, and as a result different banks may have some differences in credit conditions. In addition, in case of decreasing the solvency of the borrower, the loan for longer periods makes it possible to lower your monthly payments to repay the loan.

For a more detailed study of the lending content the author represents the main stages of this process.

If the borrower relended under existing credit commitments, the creditor bank, on the basis of a supplementary agreement, reduces the interest rate on the loan to the borrower. It does not require re-registration of collateral relations between the bank and the borrower.

If in the process of lending there are two lending banks (the original, in which the borrower received a loan, and the subsequent one, which offers the best credit terms compared to the original), this process is complicated and involves the following steps:

1. The borrower receives approval from the subsequent bank and later receives a confirmation for a loan to repay the debt on the loan in the original bank;

2. The borrower requests primary lenders for calculation of his debt on the loan in order to justify the loan amount required to obtain it in the subsequent bank;
3. The subsequent bank provides a credit in the amount that is necessary to repay the bank loan in full;
4. Having liquidated the loan debt to the original bank, the borrower and the subsequent creditor bank carry out operations aimed at removal of encumbrances from the collateral and repayment of registration in the Unified State Register of Rights to immovable property (The Federal Law “State registration of rights to immovable property and transactions with it,” 1997);
5. The borrower and the subsequent bank enter into a contract of mortgage of immovable property that is uncharged (The Federal Law “Mortgage” No. 102, 1998).

Thus, we can conclude that relending includes only credit processes and operations accompanying them.

However, it should be noted that relending processes are accompanied by significant additional costs to the borrower to do this procedure, in particular, repeated assessment of the mortgaged property, its insurance, the state registration of mortgage and others. It is possible to avoid these costs when there is relending in the same bank, where the borrower got a loan. However, Russian banks are reluctant to do it: At the time of mortgage registration the bank provides loans without collateral, while increasing the interest rate in order to reduce its risks. As a result, relending becomes effective in the difference in interest rates by 2-3%. In this context, we note that in foreign countries with a long history of mortgage lending development, these operations are widely practiced and are beneficial to the borrower with the difference in interest rates in percent.

It can be concluded that in Russian practice, in fact, there is a new service provided by banks which redeem the loan from the original creditor bank. This procedure is perceived as refinancing in practice but it is not true. The primary creditor bank does not aim to raise money at the same time due to lack of its credit. In this case, the primary creditor bank rather loses its customer and interest income from credit operations with him.

There is no doubt that this service may be sufficient in demand. Since commercial banks develop various credit products, the borrower can use this tool to reduce the overpayment for purchased housing. However, it should be noted that the high requirements to borrowers, rawness of procedures, which is connected with high additional costs, cause low availability of this program for mortgage loans borrowers.

In conclusion, the paper systematized refinancing and relending and their features (Table 1).

Thus, refinancing and relending operations have independent content and target function and play an important role in development of mortgage lending.

3. DISCUSSIONS

Despite the fact that the system of refinancing is widely regarded in laws and regulations, there is no common understanding of this concept. In English “refinancing” means repayment of debt capital by issuing new debt. Most often, the essence of refinancing is considered in the context of credit operations of commercial banks with the Central Bank. So, according to the Article 35 Section 7 of the Federal Law “The Central Bank of the Russian Federation (Bank of Russia)” a refinancing system is a tool of monetary control (The Federal Law, 2002).

At the same time, scientists present a broader definition of refinancing. So, V. V. Kiyatkina considers refinancing as a process of cost movement, having its circuit at which there are conversion of cash flows and emergence of new obligations (Kiyatkina, 2010).

According to Graznova, commercial banks can refinance in the interbank money market, through issuance of Eurobonds in international financial markets, as well as through syndicated loan (Financial and Credit Encyclopedic Dictionary, 2002).

A similar approach has Maslenchenkov who describes refinancing of commercial banks as mobilization of resources to meet current outstanding loans or credits. He also considers the interbank market resources, including their international component - the Euromarket as a source to refinance central banks (Maslenchenkov, 1998).

Table 1: Comparative characteristics of the content and methodology of refinancing and relending operations

Indicators	Refinancing operations	Relending operations
Objectives	Formation of long-term financial resources; Increase of lender liquidity	Lowering the interest rate on the loan in order to reduce the cost of purchased housing
The initiator of the operation	Lender	Borrower
The content of operations	Assignment of claims Dissipating of assets from the balance with non-market characteristics and replacement on marketable securities	Getting a loan at the bank to repay the original loan
Regulatory and legal software	Is based on the regulatory and legal framework	There are no regulations for operations
Scientific and practical tools	Methods and techniques Sale of a loans pool; issuing bonds Securitization of mortgage loans Financial instruments Mortgage-backed securities, certificates of participation, funds	Methods and ways Loans, reservations, collateral Credit instruments Assessment of the borrower creditworthiness, valuation of collateral, interest rates, LIBOR rate, monthly payment, loan quality category

In the context of this study it is important to consider the definition represented by Raizberg, Lazouskaya, Starozubtseva in modern economic dictionary where refinancing is defined as “redemption, reimbursement of the old state debt by issuing new loans, mainly by replacing short-term liabilities by long-term securities or obligations, for which there is a deadline for repayment, by other new obligations” (Raizberg et al., 1999).

Studying the nature and content of “refinancing” from the perspective of some authors, it is possible to conclude that its functional purpose is formation of financial resources on this problem for the purpose of mortgage lending. In the last two authors’ approach to understanding of refinancing we can clearly see the instrument used for mentioned purposes - the bank’s assets with non-market characteristics that are replaced by more liquid assets primarily in securities and it defines the essence of securitization.

Despite well-developed practice of using this method, there is no clear understanding of its essence in theoretical research.

The term “securitization” comes from the English word “security.” Special attention is paid to the study of this issue in foreign and domestic scientific and educational literature. However, scientific approaches to the definition of securitization by foreign and Russian scientists are different. Foreign authors consider securitization as a form of asset transformation with non-marketable characteristics into more liquid ones, i.e., securities, while Russian scientists use this instrument to reduce the risks of mortgage transaction. The article considers the individual positions of Russian and foreign scientists.

Baire gives the following definition of securitization: “Asset securitization - is an innovative financing technique in which a differentiated pool of financial assets is allocated to the bank’s balance sheet, or other entity and acquires legal independence by sending to a specially created entity that carries out its refinancing in the international capital market or money market through issuance of securities” (Baire, 2007).

Daily describes securitization as “action, in accordance with that we take existing assets of the bank such as loans, then accede to other similar assets, and then issue securities, directly or indirectly associated with these assets, which are later sold in the secondary market” (Selivanovsky, 2005).

Rose believes that “asset securitization - is selection of earning assets group and issue of securities to raise additional funds” (Rose, 1997).

In IFRS 39 “Financial Instruments: Recognition and Assessment” the definition of securitization is presented “as a process of financial asset transformation into securities” (IAS - 39 “Financial Instruments: Recognition and Assessment”).

In the same context, however, the content of securitization is more completely illustrated in the textbook “Securities Market,” edited by the Russian scientist Galanova, where this process is presented as a “tendency of transition of funds from their traditional forms (savings, cash, deposits, etc.) in the form of securities; tendency to transform capital in the form of securities; tendency of transition of one form of securities into other, more accessible to a wide circle” (The securities market, 2006).

Selivanovsky represents securitization as “financing or refinancing of any company’s assets, which bring income by transition of such assets into traded, liquid form through issuance of bonds or other securities” (Selivanovsky, 2005).

However, the draft of the Federal Law “On securitization” interprets its essence as actions aimed at direct or indirect adoption of risks associated with human requirements, other assets, third parties’ activities, and issuance of securities, the price and yield of which depend on these risks (The draft law of the Federal Law “Securitization,” 2009).

The similar definition is presented by Tuktarova, who considers the definition of securitization in the same context: “Aimed at reducing economic and legal risks involved in refinancing cash requirements through placement of securities” and is described as “a specific set of rules which allow you to refinance contractual cash requirements effectively due to the stock market” (Tuktarov, 2008).

4. CONCLUSION

The purpose of this study was to investigate methodological foundations of “refinancing” and “relending” definitions caused by the need to supplement the theory of a mortgage loan in the scientific substantiation of the concepts under consideration, as a fundamental basis for practical application in development of mortgage lending.

It can be concluded that refinancing operations, including through securitization, allow commercial banks to perform the following tasks:

- To maintain the current liquidity of banking institutions, as well as the banking system as a whole;
- To maintain the resource base of banks, adequate to the real demand of enterprises and individuals;
- To increase the financial stability of the banking sector, as well as stabilization of credit institutions, which face financial difficulties.

The world practice shows that the process of refinancing affects a significant number of participants, united by a common purpose of generating financial resources for development of mortgage lending. However, the processes of refinancing vary depending on tools and techniques. In the aggregate form this process in many countries is becoming standard and expresses itself through a certain model of refinancing. As classic models are a single-level model, including a model of the universal bank, a model of the mortgage bank and savings and loan institutions (savings banks) and a two-level model, including the secondary market, based on securitization.

Relending is an element of credit relations, which members are the lender and the borrower. Compared with refinancing, this process is characterized by its simplicity. However, it includes operations that require development of the methodology for their implementation. Such operations include collateral when there is relending, state registration when there is the change of the creditor, borrowers' cost optimization, the definition of loan quality at relending and others. The author of this article was not able to develop a methodological support of the relending process and it determines the direction of his research in the future.

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