

## **Mortgage Enforcement in Albania - Preliminary Review of Legal Framework**

### **Background**

This review has been prepared following an enquiry by BKT, EBRD partner bank in Albania. BKT CEO, Mr. Seyhan Pencapligil, is currently heading a working group ('Project') on "Improving Auction Procedures for Immovable Collateral under Foreclosure" under the SPI Programme. The Albanian financial sector - and banks in particular - are not satisfied with the current procedure according to which they can enforce their claims over debtors' immovable property. Mr. Pencapligil has approached the EBRD Resident Office in Tirana to seek its views on this issue, in particular:

- whether the current foreclosure system in place in Albania is comparable with that of other transition countries;
- whether the current proposal under discussion at present within the Ministry of Justice to privatise the bailiffs profession is sound;
- which alternative solution could be put forward.

### **Problem and currently proposed solutions**

The problem, as explained in the Project's Terms of Reference, stems from the Civil Procedure Code provisions (arts 560-580) on the "Enforcement on immovable property, ships and airplanes". The Bailiff (Executors) Office is in charge of organising the evaluation of the property's value (which will be the starting sale price) and the public auctions at which the property will be sold. The law only allows for two auctions and if no buyer qualifies at the end of the second auction, the only option left for the creditor is to acquire the immovable at the offered price (that is, evaluation price reduced by 20%) in repayment for the claim. If the creditor declines this option, the foreclosure procedure is deemed terminated and the creditor has to identify other ways to recover the claim. In case where the property has been appraised at a value higher than the claim, the creditor has to pay the difference to the debtor. Other mentioned problems are:

- Undefined time periods for the bailiff to notify the debtor so the process usually drags on;

- Subjectivity in determining the value of the property as there are no commonly set standards for real estate property valuation;
- Long and cumbersome auctions procedures.

As noted by the working group, this problem has economic consequences. Since banks take very little comfort from security over immovable property to guarantee their loans, this lack of confidence is reflected in the price of banks' products and services. In fact, it is widely believed that the problems encountered during the foreclosure procedure are an important factor holding back mortgage loan development in Albania.

Several initiatives to address the issues were launched:

- Between 2005 and 2007, the Association of Albanian Banks and the Ministry of Justice prepared some amendments to the Civil Procedure Code to tackle the problem. Despite the bill being sent to the Parliament and discussed, it seems that this initiative had stalled.
- Euralius (the European Assistance Mission to the Albanian Justice System) has studied the issue and published a full set of recommendations for the improvement of the Civil Procedure Code with focus on enforcement on immovable assets, mostly on how to improve the organisation and functioning of the bailiff service. In particular, the idea of privatising the Bailiff Office is seriously considered. Such initiative would follow the trend which exists in the region, e.g. in Macedonia.

None of these have been reviewed by the EBRD.

### **EBRD analysis and proposal**

From the EBRD perspective, it is surprising to see that Albania has not followed suit with most of its neighbours in reforming the legal provisions on mortgages, in particular to strengthen the means by which mortgages can efficiently be enforced. At present, the relevant Civil Code provisions governing mortgages do nothing but provide the mortgage creditor with a priority ranking. The only provision on enforcement is found in article 540, which forbids the mortgage creditor and mortgagor to agree that, upon default, the ownership of the property would pass to the mortgage creditor. Such rule is based on the so-called *lex commissoria* and is typical in Civil Law countries. The irony is that this is what seems to actually happen in practice in Albania against the creditors' will.

Compared with several countries in Central Europe and Central Asia, Albanian creditors have to rely on civil procedure provisions which apply to any creditor, secured or unsecured, when enforcing any claim over a debtor's immovable property. In contrast, other jurisdictions have recognised the need to allow for a specific treatment for collateral over immovable property (most often in the form of a mortgage) since the efficient enforcement of such mortgage is essential to the actual value of the collateral and the economic effect it has on reducing credit risk and encourage deeper access to credit.

EBRD recommendation would be to tackle the issue by considering providing legally efficient means by which mortgages can be enforced without requiring a public auction to be held and the involvement of the bailiff office. There are two reasons why Albania may want to take this route of action:

- Many of the countries in EBRD region have followed this route and offer mortgage lenders and borrowers the possibility to agree at the time of signature of the mortgage agreement on a private sale (or privately-held auction) of the mortgage property in case of default. Such realisation is subject to a number of conditions, such as that of a sale conducted in a commercially fair fashion.<sup>1</sup> There is informed evidence that the system works well in the respective countries and these experiences would constitute a mine of comparative materials from which Albania could draw. The chart below shows that achieving efficiency of mortgage enforcement is not beyond the reach of transition economies. See also in annex extract from the EBRD Publication *Mortgage in transition economies*, which explains the objectives of a sound mortgage realisation system, and the incentives and obligations of both parties.
- In 1999, Albania adopted in the so-called Law on Securing Charges which governs security rights over movable property. This Law contains provisions on the enforcement of charges, which provides that the bailiff office is to seize the property and hand it over to the creditor, who can then sell the charged asset as he chooses to do so (“by private sale, by public sale, including public auction or closed tender, as a whole or in commercial units, or part but always in commercially reasonable manner”).<sup>2</sup> If this approach has been adopted for enforcing security rights movable property, there is no economic rationale not to take the same approach for security rights over immovable property since the economic purpose of the two instruments is exactly the same.

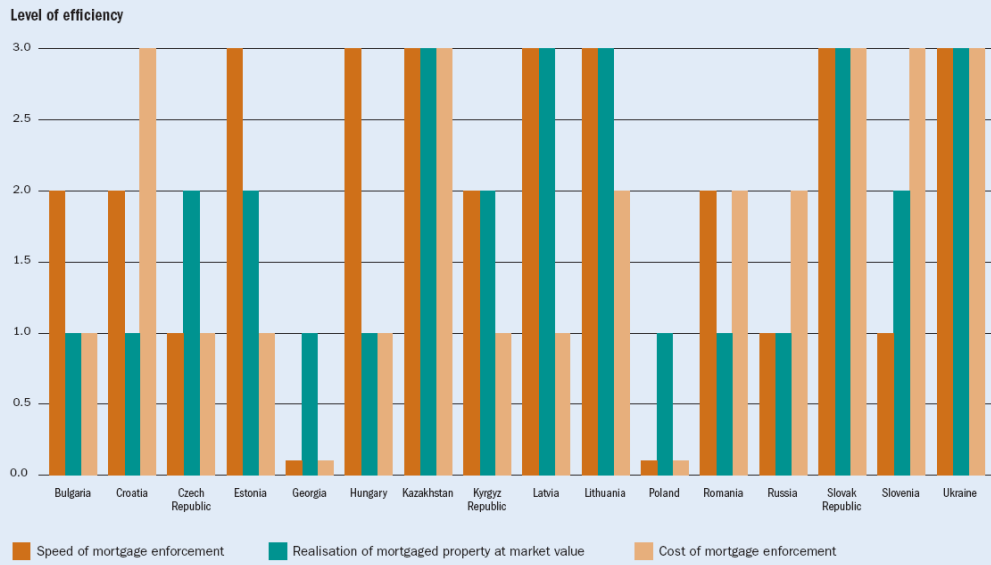
Whereas it may be a sound idea to reform the Bailiff Office (through privatisation or else) in Albania or indeed to amend the Civil Procedure Code on enforcement over immovable property to make the evaluation process more transparent, the process faster and simpler, these initiatives are likely to take some time before bringing tangible results for Albanian banks. A reform of substantive provisions on mortgage, especially as far as enforcement is concerned, would inject a dose of contractual freedom and parties’ responsibility which are currently lacking.

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<sup>1</sup> This includes: Czech Republic, Hungary, Kazakhstan, Kyrgyz Republic, Moldova, Serbia, Slovak Republic, and Ukraine.

<sup>2</sup> Article 35 of the law. It is also provided that the creditor could purchase the collateral or any part of it only at a public sale and only for a price that is close to the commercial value of the collateral.

**Chart 6**  
**Efficiency of mortgage enforcement**



Note: Data are based on the Mortgage Regional Survey (MRS), which asked the following questions: Is realisation of mortgaged property rapid? Is realisation likely to be at market value? Is mortgage enforcement inexpensive? Answers were graded according to efficiency ranging from 0.1 to 3, where 3 = very efficient, 2 = efficient, 1 = some inefficiency, 0.1 = inefficient. For more information see the MRS composite table in Annex 2. There are insufficient data for Serbia as the law is too recent for enforcement practice to have developed.

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## ANNEX

# Mortgages in transition

## The legal framework for mortgages and mortgage securities

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### EXTRACT

#### **5.2 Realisation procedure: incentives and obligations**

Realisation of the mortgaged property can entail many different procedures but its objective is always the same: generating money from the property which will be used to repay the outstanding secured debt. If it is to be efficient, realisation should happen in a simple, fast and inexpensive manner and the proceeds should be close to the market value of the property.<sup>3</sup> For a picture of the current situation in transition countries see Chart 6. The EBRD's approach has always been that there is no one-size-fits-all approach to enforcement and there is a need for the legal framework to adapt to the context and to give the mortgage creditor a choice of solutions.<sup>4</sup>

##### ***a. Method of sale***

In many jurisdictions the traditional view has been that imposing detailed rules for the method of sale ensures a fair and satisfactory result. In particular, public auction has been promoted as the optimum solution, and often this is the only method of sale permitted with the process being closely regulated (for example, in Czech Republic, Croatia, Georgia, Kazakhstan, Latvia, Lithuania, Poland and Romania. However, the results of enforcement through public auction do not in practice produce consistently good results (see Section IV 2.).

The most suitable method of selling a property will depend on the market and the circumstances. For an unusual and highly desirable property, sale by auction may achieve the best price, whereas for a relatively standard property the auction process may put off potential acquirers. For a specialised production plant where interest is limited to a handful of market players, a closed tender may be the best way to sell. The

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<sup>3</sup> See core principles 4 and 6, Box 1 and Annex 1.

<sup>4</sup> See F. Dahan, E. Kutenićová and J. Simpson "Enforcing secured transactions in Central and Eastern Europe: an Empirical Study", *Butterworths Journal of International Banking and Financial Law*, 19 (2004) pp 253-257 and 314-318.

interests of both the mortgagor and the mortgage creditor are that the property should be sold rapidly with minimum costs, and should realise as near as possible to market value. The chances of achieving this are unlikely to be enhanced by restrictive regulation of the sale method.

It is preferable for the mortgage creditor to be given the right to choose the most suitable method of sale, either by law or in the mortgage agreement. The risk of the creditor abusing this right can be mitigated by ensuring that he is under a duty to act diligently and will be sanctioned for any failure to do so (see Section III 5.4 d.). It is sometimes provided that the parties can agree on the method of sale at the time of enforcement (especially to opt out from a court-led enforcement, for example, in Estonia, Russia and Slovenia), but this gives little comfort as the creditor cannot rely on obtaining such agreement. It is always open to the mortgage creditor to reach a separate agreement with the mortgagor, and indeed that may avoid formal enforcement happening at all. However, enforcement rules are there to cover precisely the case where the parties are unable to agree a mutually acceptable solution.

A case that is often regulated is the right of the mortgage creditor to appropriate the property for himself in satisfaction of the debt in case of default, without any sale procedure (*lex commissaria*). Since Roman times the law has discouraged this practice, which can clearly lead to the creditor profiting at the expense of the debtor. Most transition countries expressly prohibit it. This is the case in 15 out of the 17 selected countries, namely in Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Romania, Russia, the Slovak Republic, Slovenia and Serbia. However, there is no reason why the mortgage creditor should not have the right to buy the property upon enforcement, subject to adequate safeguards to ensure that the price is fairly set.

Immediate sale may not always be the most effective mode of realisation: administration of the mortgaged property by the mortgage creditor allowing him, for instance, to collect the rents generated by the property may, particularly in the case of commercial real estate, be a more effective option.

#### ***b. Who is responsible for sale?***

The traditional view that realisation should be by auction is often linked with the view that the best institution to oversee the sale is the court. But the single most important issue on sale is to ensure that the price is maximised. The motivation of the persons who are responsible for the sale is likely to have a major influence on the outcome. The case for the mortgage creditor being given responsibility, subject to appropriate safeguards, for conducting the sale, or at least selecting the method of sale, is cogent and is being increasingly accepted. The court may have a role (in the background) to ensure that the sale is conducted fairly and that the rights of the parties are respected, but maximising the price is not a court's direct remit.

The sale of property is a market operation, essentially commercial in nature, and the best course is often to appoint external specialists to take care of the sale. The case for having those experts appointed by the court is open to debate. In some countries the procedures involved are bureaucratic and legalistic, the costs are high, and the

motivation to achieve a rapid sale at a good price may be low (this was the case, for example, in Bulgaria where private bailiffs were recently introduced to help overcome the inefficiency of the court bailiffs).

Conversely, in the Baltic states and Slovenia, enforcement seems to work relatively efficiently despite court involvement (see Section IV 2.). Whoever a country decides, in the context of its own institutions, to make responsible for the sale, the determining factor always remains whether they will be able to deliver a commercially acceptable result.

As well as being given the right to choose the method of sale, the mortgage creditor should also be entitled to appoint property professionals to conduct the sale for him, subject to an appropriate obligation to act diligently. A few countries in central Europe (the Czech Republic and the Slovak Republic, for example) have created a professional body of “private auctioneers”. By contrast to the “public auctioneer”, who acts on court orders and is subject to the full civil law procedure provisions, the private auctioneer is able to conduct public auctions in a way that is more flexible and generally faster and less bureaucratic. The existence of private auctioneers should not, however, exclude the right of the mortgage creditor to appoint any other person to advise him on the sale or to conduct a private sale on his behalf.

The responsibilities on sale should reflect the nature of the mortgage agreement. Mortgage is a private agreement and if enforcement becomes necessary it is primarily the duty of the mortgage creditor to organise the sale. He should be given wide scope to control how the sale is conducted and to ensure that the proceeds are maximised, not only in his own interests but because he owes that duty to the mortgagor and, indirectly, to the mortgagor’s other creditors (secured and unsecured).

### ***c. Transfer of the mortgaged property to the purchaser***

In realisation proceedings the purchaser needs to be assured that he will obtain as good a title in the property as that previously enjoyed by the mortgagor, free from the mortgage. The procedures for transfer and registration, and the authority of the mortgage creditor or other person selling to sign the necessary documents and take other steps, need to be clearly provided. The purchaser may be required to check that the mortgage creditor is selling under enforcement procedures (for example by checking that commencement of enforcement has been registered in the mortgage register), but he should not have to verify the seller’s compliance with all relevant procedures.

The mortgagor’s rights to challenge the sale should cease at the moment the sale is completed, unless there are exceptional grounds, such as fraud or collusion between mortgage creditor and purchaser. Allowing a right to challenge the sale for a limited period after it is completed (for example for three months in the Czech Republic, Kazakhstan and Ukraine) may seriously discourage bona fide purchasers in enforcement proceedings. Many purchasers may not be prepared to take on the risk of the sale being later reversed for reasons outside their control. Ultimately this issue can have a major impact on the value of the security to the mortgage creditor.