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## Mortgage in the Bulgarian Agricultural Sector

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## Executive Summary

### Mortgage in the Bulgarian Agricultural Sector

A mortgage is the transfer of a right in immovable property as security (collateral) for repayment of a loan or the performance of an obligation. Laws to create mortgagability will not have the positive effects anticipated unless other conditions enabling farmers to take advantage of mortgagability are first satisfied. In addition to secure land tenure and the existence of a rural land market, these conditions include willing lenders; terms farmers find attractive; support services that can help ensure success in agricultural innovation; a political and legal situation that permits foreclosure if necessary; and prices for produce that permit recovery of costs of an investment. Secure and transferable land rights can have an extremely beneficial effect on a farmer's access to credit because such land rights can be pledged as collateral for loans.

### Existing Legal and Policy Environment for Mortgages of Rural Land and Other Immovable Property

Field research indicates that Bulgarian lenders, except for credit cooperatives, currently are not accepting agricultural land as collateral for loans, but are accepting other immovable property, including, apartments, houses, and other buildings. The reasons given for not accepting agricultural land as collateral include:

1. Lack of ownership rights and secure land tenure.
2. Lack of a land market.
3. The price for agricultural land is relatively low.
4. The legislation on mortgages is outdated because it is designed to apply to transactions between individuals and not between legal entities.

In spite of the current situation, most bank officials interviewed and all farmers interviewed expressed interest in using agricultural land as collateral for both long-term and short-term loans. The legal framework for mortgages is functional but should be reviewed and revised to reflect the transition to a market economy.

### Obstacles to Mortgage of Agricultural Land

For land to serve as collateral, legal rights to land must be both secure and transferable. In Bulgaria, agricultural land rights are often insecure because: the restitution process is still ongoing with many unresolved claims; land division plans can be re-drawn based on new evidence or new claims; many people do not understand which documents constitute clear title to land; and restituted land must be subdivided among the heirs or the heirs must agree to act as co-owners. The process of restitution should be expedited where possible and much more public information regarding the law and the process is needed.

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The agricultural land market is very underdeveloped, although a market does exist for the sale of peri-urban agricultural land. Farmers are unable to take credit for the purchase of land, and most leases are for only one year due to the uncertain rights of ownership. A lack of information regarding the land market is an impediment to further development. The land lease law needs to be amended to reflect the current land market and lack of secure land ownership rights.

The registration system has numerous problems, but is semi-functional and does not appear to be a significant obstacle to mortgage of agricultural land. Registration of ownership rights with the court registrars (entry judges) is not required unless a transaction occurs. However, lenders are confident in the information they receive from the registrar regarding encumbrances on immovable property. Mortgages and foreclosures are registered with the entry judges. Sharing of information between the entry judges, notaries, and land commissions will be critical in the further development of the registration system.

## Institutional Capacity

The courts, Ministry of Agriculture, and the land commissions are overwhelmed by restitution claims, slowing down the restitution process. A more expeditious judicial procedure and expert judges would expedite the restitution system and encourage the development of land-based lending.

## Priority for Further Analytical Work

Further analytical work is necessary in several areas:

- Preparation of a draft mortgage law.
- The possibility and wisdom of providing state guarantees for agricultural land mortgages.
- Dissemination of land market information.
- Alternative dispute resolution possibilities, particularly for restitution claims.
- The legal framework for farm enterprises.

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## I. Introduction

Establishing or expanding farming operations requires large outlays for capital assets such as land, machinery, livestock, and buildings. These large capital outlays are slow-maturing investments that provide returns over a period of years. Unless agricultural producers have sufficient liquid resources for the investment, they must secure medium-term or long-term credit. Access to credit is often an important determinant of a farmer's performance.

Secure and transferable land rights can have an extremely beneficial effect on a farmer's access to credit because such land rights can be pledged as collateral for loans. Collateral plays an important role in most lending decisions because it has several important and interrelated effects.<sup>1</sup> First, collateral partly or fully shifts the risk of principal loss from the lender to the borrower. Second, collateral creates an incentive for borrowers to avoid intentional default.<sup>2</sup> Third (as a result), the existence of collateral increases the likelihood that a lender will offer credit to an agricultural producer. Fourth, at a given interest rate, the amount of credit is expected to increase as the value of the collateral increases. Finally, for a given amount of credit, the interest rate will be substantially lower when collateral is used.

Immovable property is a preferred form of collateral when the rights are secure and transferable, and therefore valuable. Lenders prefer collateral that is easy to appropriate in case of default, does not easily lose value due to theft or damage, cannot be concealed, and can continue to benefit the borrower. Land satisfies all these conditions and is plentiful in most rural settings. As a result, land is the most common collateral for agricultural lending in developed countries and many developing countries.

Laws to create mortgagability will not have the positive effects anticipated unless other conditions enabling farmers to take advantage of mortgagability are first satisfied. In addition to secure land tenure and the existence of a rural land market, these conditions include willing lenders; terms farmers find attractive; support services that can help ensure success in agricultural innovation; a political and legal situation that permits foreclosure if necessary; and prices for produce that permit recovery of costs of an investment.<sup>3</sup>

In Bulgaria, the legal framework for private ownership of land, a precursor to mortgage, began to be developed in 1991 with the passage of the land restitution law titled, the Law "On the Ownership and Use of Farm Land Act" (hereinafter OUFLA).<sup>4</sup> This law has been and continues to be amended and is accompanied by many regulations and Government decisions. According to government statistics, 80 percent of land eligible for restitution has been restituted. In spite of this fairly high percentage, there are many outstanding claims, some of which affect land that has already been restituted. The restitution claims that are still pending and alterations of the land division plans have caused a

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<sup>1</sup> While collateral is an important factor in the lending decision, it is not the only factor. Other factors include the amount of the loan, the direct and indirect price (interest rate or tied buying and selling deals), the duration of the loan, borrower-specific information concerning the ability or likelihood of repayment (such as past credit history, reputation, ties to the locality, non-farming income), general information pertaining to large groups of borrowers such as forecasts of product prices, the costs of obtaining relevant information, and the relative administrative costs in proportion to the size of the loan. See GERSHON FEDER ET AL., *LAND POLICIES AND FARM PRODUCTIVITY IN THAILAND* 45 (1988); and John Bruce, *Do Indigenous Tenure Systems Constrain Agricultural Development?*, in *LAND IN AFRICAN AGRARIAN SYSTEMS* 44 (Thomas Bassett & Donald Crummey eds., 1993).

<sup>2</sup> Hans Binswanger & Mark Rosenzweig, *Behavioral and Material Determinants of Production Relations in Agriculture*, 22 *JOURNAL OF DEVELOPMENT STUDIES* 510 (October 1985).

<sup>3</sup> Bruce, *supra* note 2, at 44.

<sup>4</sup> Ownership and Use of Farm Land Act, (hereinafter OUFLA) Promulgated State Gazette No. 17/01.03.1991, (March 1, 1991) (Republic of Bulgaria).

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countrywide perception that land tenure is not secure and will not be until the restitution process is complete.

The legal framework for mortgages in Bulgaria includes the Law on Obligations and Contracts<sup>5</sup> and the Code of Civil Procedure.<sup>6</sup> The Banking Law also contains provisions that relate to collateral and mortgage of immovable property.<sup>7</sup> In many civil law countries there is both a Code of Civil Procedure, which covers judicial procedures and a Civil Code, which covers civil (as opposed to criminal) issues and transactions. In Bulgaria, there is no Civil Code. Rather, the Law on Obligations and Contracts and the Property Law contain the basic civil law provisions.

This paper will examine mortgage lending in Bulgaria and is based on background desk research, an analysis of the relevant Bulgarian laws, and field research conducted over a period of two weeks in March, 1999. The field research was conducted using Rapid Rural Appraisal techniques, which are designed to gather and process field information rapidly. Rapid Rural Appraisal involves semi-structured interviews with rural people who have valuable knowledge regarding issues that affect their lives. The author interviewed 66 individuals: 38 government officials including lawyers, lenders, parliamentarians, notaries, entry judges, and real estate professionals; and 28 agricultural producers including private farmers, cooperative farmers, tenant farmers, and rural enterprise managers.

The paper will discuss the impediments and present recommendations to help facilitate mortgage lending in the agricultural sector. Section II will provide an overview of the legal and policy framework for mortgages of rural land; Section III will discuss the obstacles to mortgage of agricultural land, including restitution of ownership rights, farm organization, land transactions, and registration of rights to immovable property; Section IV will discuss institutional capacity to handle the obstacles listed in Section III; Section V will provide analysis and recommendations for increasing mortgage activity; and Section VI contains a conclusion and recommendations for further research.

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<sup>5</sup> Obligations and Contracts Act, Promulgated State Gazette No. 275/22.11.1950, (November 22, 1950) (Republic of Bulgaria, hereinafter, Law on Obligations and Contracts.

<sup>6</sup> Code of Civil Procedure, Promulgated Izvestiya No. 12/08.02.1952, (February 8, 1952) (Republic of Bulgaria), hereinafter Code of Civil Procedure.

<sup>7</sup> Banking Act, Promulgated State Gazette No. 52/01.07.1997, (July 1, 1997) (Republic of Bulgaria), hereinafter Banking Act.

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## II. Existing Legal and Policy Environment for Mortgages of Rural Land and Other Immovable Property

Field research indicates that Bulgarian commercial banks are currently not accepting agricultural land as collateral for loans. Banks are providing loans to the agricultural processing industry and some loans to agricultural producers, but the loans are primarily short-term loans for working capital. Some non-agricultural immovable property such as apartment flats and buildings is being used as loan collateral, but not the most obvious and abundant asset in the agricultural sector: arable land.

Between 1991 and 1994, credit was fairly readily available in Bulgaria, and agricultural producers were able to receive loans to purchase machines and other farm equipment. In fact the Law on the Financing of Agriculture during 1993 (March 26, 1993) required commercial banks with more than 50 percent state ownership to provide credits to agricultural enterprises for certain specified activities. Borrowers had to pay back only one third of the interest due and the rest was covered by the Finance Ministry under the 1993 budget.<sup>8</sup> However, the banking crisis of 1994, the economic crash in 1996-1997, and the establishment of a currency board have severely reduced the availability of credit in the rural sector. Current bank regulatory requirements make it very difficult for agricultural producers to qualify for loans. The Bulgarian National Bank requires that the value of collateral for commercial loans be at least 125% of the loan amount, and banks discount the collateral value before applying its loan collateral formula. Of the commercial banks visited, the value of collateral varied from 125 percent to 250 percent of commercial loan amounts.

Few alternative sources of credit are available. Informal moneylenders exist, but are generally avoided. Several farmers interviewed had borrowed money from their families, particularly to purchase land.

In spite of the current situation, most bank officials interviewed and all of the farmers interviewed expressed an interest in using agricultural land as collateral for both long-term and short-term loans. Most farmers interviewed had offered their land, for which they had clear title, as collateral, but this offer was refused by the banks. Farmers did express some concern in taking short-term credit because of market price swings. For example, two years ago there was a low supply of peppers, and the price for peppers was high. Last year, there was a pepper surplus and many hectares of peppers remained in the field.

For their part, banks appear to be interested in the agricultural sector as having great potential for profit and growth, but are reluctant to use agricultural land as collateral for loans to the agricultural sector because of the absence of an established land market. These issues will be discussed in greater detail below.

### A. Legal Framework for Mortgages

Bulgaria has not adopted new mortgage legislation during their transition to a market economy. The Law on Obligations and Contracts<sup>9</sup> deals with mortgage of land and buildings (immovable property) and the Code of Civil Procedure deals with the procedure for public sale and realization of the subject

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<sup>8</sup> Michael L. Wyzan, "Bulgaria: The Painful Aftermath of Collectivized Agriculture" *RFE/RL Research Report*, Volume 2, No. 37 (September 1993) 34,37.

<sup>9</sup> Art. 149-179.

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of mortgage.<sup>10</sup> This legislation, however, was written many years ago and does not take into consideration the possibility of a market economy. The Ministry of Justice is responsible for initiating an effort to amend or re-write mortgage legislation.

Currently, it does not appear that the government is drafting a new comprehensive mortgage law. However, the Bulgarian National Bank and the Bulgarian American Investment Fund are drafting a mortgage law that governs the secondary mortgage market, but not the primary mortgage market. Banks consider mortgages to be assets in that they yield income through interest charges. Mortgages can be grouped to form bonds that can then be traded. The drafters of this bill hope that this specialized bill will provide the means for financing long-term instruments. Then, if long-term instruments are available, the secondary mortgage market, which could provide profits for banks, will drive demand for primary mortgages. The drafters are following the Polish model which focused first on the secondary mortgage market and then on the primary mortgage market.

The drafters also stated that addressing all of the problematic issues presented by the current legislation on mortgage will take a major effort that will not necessarily be supported by the Ministry of Justice. This draft law excludes arable land mortgages from the secondary market.

Following is a discussion of key issues in the legal framework for mortgages:

### **1. Purchase Money Mortgages**

A purchase money mortgage is a mortgage in which the real estate being purchased is used as collateral to finance its purchase. Purchase-money mortgages allow potential buyers of real estate who lack sufficient cash and other collateral to afford real estate. Such mortgages greatly facilitate transactions in land or real estate by expanding the number of land market participants to include persons of more modest financial means.

In Bulgaria, the Banking Act specifies that purchase money mortgages are allowed for any type of real estate and are now used frequently for the purchase of apartments.<sup>11</sup> One bank stated that when real estate that has been privatized is purchased using a purchase money mortgage, the bank will only finance 50% of the purchase price. When a new building is purchased, the bank can finance up to 70% of the purchase price.

### **2. Contract Mortgages and Mortgages Created by Operation of Law**

There are two types of mortgages described in the Law on Obligations and Contracts: contract mortgages<sup>12</sup> and mortgages created by operation of law (lawful mortgages).<sup>13</sup> Lawful mortgages are created in favor of the seller whenever an installment contract is the instrument for selling immovable property or when a land parcel, which is co-owned, is partitioned, and one co-owner sells her share to another co-owner over time. A purchase money mortgage is considered a lawful mortgage.

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<sup>10</sup> Art. 237-255; 373-399.

<sup>11</sup> Art. 43.

<sup>12</sup> Art. 167.

<sup>13</sup> Art. 168.

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Lawful mortgages are very common in Bulgaria. The creditor is responsible for registering a lawful mortgage, and the mortgage comes into effect at the time of registration. Entry judges (registrars) are required to keep a separate registry for contract mortgages and lawful mortgages. See Section III (D) for further detail on registration of mortgages.

### **3. Priorities**

The priority of a mortgage over all other claims to an interest in immovable property is the crux of the mortgage instrument. Articles 136 and 173 of the Law on Obligations and Contracts describes the order of priority for satisfaction of claims. Article 136 provides that if the state has an interest in the property, the state has higher priority than a lender whose loan is secured by a mortgage. Lenders monitor this situation carefully and require proof of payment of taxes if immovable property is used as collateral. Tax liens do not have to be registered with the entry judges (registrars). Mortgage and pledges<sup>14</sup> have the highest priority for repayment under the Commercial Code bankruptcy provisions.

### **4. Foreclosure Procedures**

The mortgagee's<sup>15</sup> rights in the land after the mortgagor fails to perform are the essence of a land security transaction. These rights distinguish the secured mortgagee from unsecured claimants. If the mortgagor does not properly perform the obligation to repay the principal and interest, the mortgagee may commence foreclosure proceedings. However, because foreclosure is a harsh remedy, specific rules regarding notice to the mortgagor and an opportunity to cure the default are typically necessary. Without such rules, the mortgagor will be less likely to offer her land as collateral.

The bank officials interviewed were concerned about the potential for a lengthy procedure for realization of the subject of mortgage (described in the Code of Civil Procedure). Once default occurs, bank regulations require an increase in the interest rate and the application of penalties. Because of the increased interest rate and penalties, the collateral no longer covers the obligation owed by the time realization occurs in many cases. All bank officials interviewed stated that they prefer to restructure the loan rather than foreclose on the subject of mortgage. Article 152 of the Law on Obligations and Contracts states that an advance agreement providing that the creditor will become the owner of the property, if the obligation is not performed, is invalid as well as any other advance agreement that stipulates a manner for satisfying the creditor that is not provided for by the law.

In brief, the foreclosure procedure is as follows:

1. All banks and credit cooperatives require that a borrower sign an agreement promising to pay a specific amount of money. The creditor can apply for an enforcement order (writ of execution) from the court if he has this notarized agreement by which the mortgagor subjects his property to immediate foreclosure. This agreement is usually signed at the time the mortgage contract is created. If the mortgage is due but the creditor is not satisfied, the mortgagee can demand satisfaction out of the land and property to which the mortgage extends. The court must order any foreclosure sale.<sup>16</sup>

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<sup>14</sup> The term pledge is used to refer to the use of movable property as collateral as opposed to immovable property.

<sup>15</sup> The "mortgagee" is the lender who takes immovable property as collateral, and the "mortgagor" is the borrower who mortgages his property to the lender.

<sup>16</sup> Law on Obligations and Contracts, Art. 173; Code of Civil Procedure, Art. 237.

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2. The regional court issues a declaratory judgement honoring or rejecting the request for a writ of execution. This decision can be appealed within 7 days from the judgement for the lender, and 7 days from the subpoena for the debtor.<sup>17</sup>
  3. The debtor may challenge the claim based on written evidence that the sum is not owed, or present guarantees to the creditor.<sup>18</sup>
  4. If the debtor does not object within seven days, or if his request for a stay has been rejected, the debtor can still appeal through a court action.<sup>19</sup>
  5. If voluntary execution continues, the court orders an expert to appraise the immovable property. The debtor has the right to object to the appraisal on the grounds that it is too high or too low. The debtor has the right to appeal and ask for another appraisal by other experts.<sup>20</sup>
  6. If the appraisal is accepted, the executive judge has to sell the immovable property at a public sale, and must send notification to the debtor of the sale.<sup>21</sup>
  7. The debtor can appeal the sale if he does not receive notification. For 30 days the immovable property is open for sale. The auction is a silent auction. After the auction is announced, participants send in their bids in a sealed envelope. On the 31<sup>st</sup> day, the judge collects all of the closed envelope bids and chooses the highest bid.<sup>22</sup>
  8. There is an announced price based on the appraisal, and the highest bidder cannot have bid less than 80% of the announced price.<sup>23</sup>
  9. The bidder is obliged to pay within 5 days. If the bidder does not pay, the right to purchase goes to the next highest bidder. The lender has the right to bid, and the lender has the right to acquire the immovable property if there is no other bidder.<sup>24</sup>

The current legislation does not adequately address the treatment of underlying and overlying mortgages. Underlying mortgages are the first mortgage on a subject of mortgage. An overlying mortgage is basically a second mortgage on the same subject of mortgage. Sometimes the same lender is involved and sometimes a second lender accepts an overlying mortgage. The foreclosure procedure described in the Law on Obligations and Contracts does not fully protect underlying mortgagees.

The Law on Obligations and Contracts does give underlying mortgages priority over subsequent mortgages.<sup>25</sup> However, Article 175 provides that when the subject of a mortgage is sold at public sale, all other mortgages shall be extinguished. An exception will be made if the mortgagee consents to the buyer's assumption of the secured obligation. Therefore, as a general rule, if an overlying mortgagee forecloses, an underlying mortgagee will be forced into the proceeding as well.

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<sup>17</sup> Code of Civil Procedure, Art. 244.

<sup>18</sup> Code of Civil Procedure, Art. 241.

<sup>19</sup> Law on Obligations and Contracts, Art. 254.

<sup>20</sup> Interview with bank lawyer.

<sup>21</sup> Interview with bank lawyer.

<sup>22</sup> Code of Civil Procedure, Art. 376, 377.

<sup>23</sup> Code of Civil Procedure, Art. 378.

<sup>24</sup> Code of Civil Procedure, Art. 380.

<sup>25</sup> Law on Obligations and Contracts, Art. 153.

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In fact, the overlying mortgage should not affect the security interest of the underlying mortgage. If the overlying mortgagee commences foreclosure of mortgage proceedings, the underlying mortgage should be unaffected, and the immovable property should be sold at public sale subject to the underlying mortgage. Allowing the subject of mortgage to remain encumbered by the underlying mortgage even after a public sale is an important protection to underlying mortgagees. Overlying mortgages are always a greater risk than underlying mortgages, and are generally at a higher interest rate and for a shorter term.

Due to the concerns of banks over the length of the procedure, foreclosures are rare, although they do occur. All of the bank officials interviewed had had zero to two foreclosures over the last 2-3 years. However, one district court (out of 5 in Dobrich *Oblast*) had registered 29 foreclosures of immovable property so far in 1999 (January 1--March 1). The author was not able to interview any borrowers who had been through a foreclosure and, therefore, does not have first-hand information regarding the process as it relates to borrowers. However, from a reading of the law, there is an extremely limited time for curing the default (7 days), and notice provisions lack specificity. The foreclosure proceedings do allow the borrower to appeal the lender's actions at several points in the process, and thereby slow down realization of the subject of mortgage. No special rules exist for agricultural land that would enable a borrower to cure up to the time of the sale.

### **5. From Foreclosure to Realization of the Subject of Mortgage**

In Bulgaria, the bank holds the title to the mortgaged collateral. In the U.S., states that adhere to the title theory of mortgage give the mortgagee the right to possession of the mortgaged property when the mortgage is executed. Possession is significant because with it comes the right to rents and profits produced by the property. Physical possession of the property is not necessary.

The rules regarding possession, rents, and revenue are unclear in Bulgarian mortgage law. The Code of Civil Procedure gives the debtor the right to possession up to the time of sale.<sup>26</sup> In this instance, possession means physical possession, but there is no mention of revenue and rents. The Law on Obligations and Contracts provides that a creditor's claim, which is secured by a mortgage, has priority and that this priority extends to the income from the property from the date on which the owner must account for such income under forcible execution.<sup>27</sup> The provision does not provide any detail about effectuation of this priority right.

### **6. Bank Ownership of Assets**

Under the Banking Act, banks have to re-sell all foreclosed assets within two years.<sup>28</sup> Officials interviewed from the National Bank stated that this is not a sufficient period of time because there is such a limited market for both movable and immovable property.

Bank ownership of assets is particularly an issue for foreign banks because foreign entities cannot own agricultural land. Legal provisions allowing foreign ownership of agricultural land after a foreclosure procedure would be necessary for the Bulgarian American Investment Fund to lend to agricultural producers using land as collateral.

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<sup>26</sup> Art. 375.

<sup>27</sup> Art. 173.

<sup>28</sup> Banking Act, Art. 30.

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## 7. Standardized Forms

In Bulgaria, mortgage contracts must be notarized, and there are specific requirements for what the mortgage contract must contain. These forms, in addition to more detailed forms issued by commercial banks, explain the terms of the mortgage and the process of using immovable property as collateral.

Documents required to notarize a mortgage agreement include: legal status of the company; actual mortgage agreement; authorization for representing a bank or legal entity; decision for registration of the company; passport of an individual; and a loan agreement.

### B. Agricultural Land as Collateral: The Current Status in Bulgaria

Except for Credit Cooperatives, Bulgarian lenders are not willing to provide capital based on the use of agricultural land as collateral. The reasons provided by lenders for this are as follows:

- 1. Lack of ownership rights and secure land tenure.** The perception of all bank officials interviewed is that there are many disputes regarding ownership of agricultural land, and until these disputes are finally resolved, it will not be safe to use land as collateral. The process of restitution continues, and many lenders view this process as chaotic and uncertain. For example, even though the Supreme Court has decided that the land commission and notarized titles have equal legal value, one central bank and National Bank officials stated that the main obstacle to using agricultural land as collateral was that only 24% of restituted owners have notarized titles. Neither central bank nor National Bank officials knew whether the decision of the land commission would be sufficient proof of ownership without notarized titles. On the other hand, all of the branch bank officials interviewed stated they would not require notarized titles and would accept the decision of the land commission.
- 2. Lack of a land market.** Branch bank officials stated that land cannot be used as collateral because of an underdeveloped market for agricultural land not because of unclear ownership rights. The undeveloped land market means prices and demand for land are low and banks cannot afford to take the risk. Banks will use land under buildings as collateral.
- 3. Lack of land consolidation.** Restituted land parcels are generally very small, and many are leased to large cooperative farms. Private farmers have to conclude many separate lease contracts to acquire a land parcel that is large enough to farm. Restitution has caused great fragmentation of the land. The number of owners of land in 1947-56 have now been doubled or tripled by their heirs.<sup>29</sup>
- 4. The prices for agricultural land are relatively low.** Last year there was a significant decrease in the price of land because the market for agricultural produce was very poor. Moreover, many farmers stated that land prices are below the base price established by legislation. Since property rights are not well defined, land tenure is insecure. Rights to land, therefore, involve risk, and the prices for land are discounted for that risk.
- 5. The legislation on mortgages is outdated because it is designed to apply to transactions between individuals and not between legal entities.** The Ministry of Justice is responsible for drafting a separate mortgage law.

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<sup>29</sup> Small land plots create a perception of lack of mortgagability, but are not necessarily a detriment if land values are high and a land market exists. However in Bulgaria, in areas where the restitution is not completed, the land market is undeveloped, and therefore the market has not determined the optimum size of parcels or land holdings. Lenders appear to be confident that once restitution is completed, a land market will develop and land consolidation will occur.

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Bank officials did voice an expectation that in 5 years, agricultural land will be used as collateral for loans. In fact, many banks think that Bulgaria could have a comparative advantage over other industries in farming because farm products have been a major export item in the past.

The inability of cooperatives to own land is one serious limit to using agricultural land as collateral. The law does not allow cooperative members to contribute their land in ownership to the charter capital of the organization.<sup>30</sup>

While a lease market exists, most leases are for a one-year term. Moreover, while mortgage of a long-term lease right is possible, the concept has not been historically a part of the Bulgarian legal system.<sup>31</sup> Banks are concerned that such a mortgage would not be enforceable. Without an active market for long-term leases, mortgages on long-term leases are not attractive to lenders.

### C. Other Immovable Property as Collateral

While agricultural land is not being used as collateral for loans, other immovable property is being accepted. Banks appear to be most interested in apartments, dachas, and enterprise buildings. Agricultural producers are using their apartments or houses as collateral for short-term and medium-term loans. Other producers put up their agricultural machinery and future or harvested crops as collateral.

### D. Valuation of Immovable Property

The Ordinance of Current Market Prices of Agricultural Land is a starting place for valuation of land for the purpose of land transactions, tax, and mortgage of land. However, standard unified appraisal procedures are developed by each central bank, and there are no standard procedures for all banks. Some banks appraise property at 70 percent of what the buyer and seller decide on as a price. Several banks plan to develop a database that would list properties, their attributes, and the appraisal value. A comparable sales method of evaluation is being used more and more wherein banks look at actual sales and the existing market. Land and buildings are valued separately.

### E. Credit Cooperatives

The European Union PHARE program (Poland/Hungary Assistance for Restructuring Economy) organized credit cooperatives in villages, which lend only to private farmers. The credit cooperatives generally provide seasonal credits for inputs. Some cooperatives also provide longer term credit of 2 to 3 years.

One credit cooperative in Dobrich has 250 members. In 1998 each member was required to contribute 500,000 leva. Each member can borrow back ten times the amount of money he contributes. Farmers are familiar with credit cooperatives because the production cooperatives provided a similar service

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<sup>30</sup> Cooperatives Act, Promulgated State Gazette No. 63/03.08.1991, (August 3, 1991) (Republic of Bulgaria), Art. 10.

<sup>31</sup> Land Lease Law, Art. 11.

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called “mutual support accounts.” The Dobrich cooperative provides 1 to 3 year loans, mostly for working capital, inputs, livestock, and in some cases, machinery. It is difficult for the cooperative to provide enough financing for machines because of their relatively high cost. The largest loan ever made for the purchase of a machine was 10 million leva. The cooperative requires a maximum of 130 percent collateral for each loan and discounts collateral by 20 to 30 percent. The annual simple interest rate is 11.5 percent.

The Dobrich cooperative does use agricultural land as collateral. The cooperative requires the following documents: (1) document of ownership (land commission decision and drawing); and (2) contract for voluntary subdivision. The cooperative checks with the land commission and the entry judge regarding encumbrances. The cooperative has had no defaults.

A credit cooperative in Plovdiv requires members to contribute a minimum of 300,000 leva annually. For loans up to 3 million leva, only two co-signers who are members of the cooperative are required. For loans between 3 million leva and 10 million leva, collateral must be pledged, including animals, agricultural machinery, or land. For loans of more than 10 million leva, real estate must be pledged. The maximum amount of a loan is 15 million leva. The Plovdiv cooperative only requires 100 percent collateral. The interest rate on loans is 12 to 13 percent.

The cooperative allows members to use borrowed money to purchase land. However, no members have done this because the loan repayment period on all loans is one year. In Plovdiv, the price of one decare of land is one million leva.<sup>32</sup> However, one decare of land will not earn enough to pay back that amount within one year. In contrast, machinery loans can often be paid back in one year because, with a machine, an owner can generate sufficient revenue by way of his services.

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<sup>32</sup> One decare is equal to 1/10 hectare. One hectare equals 2.47 acres. One USD equals 1780 lev.

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### III. Obstacles to Mortgage of Agricultural Land

For land to serve as collateral, legal rights to land must be both secure and transferable. A lender will not make a mortgage loan to a farmer who does not have a secure expectation of continued possession of the land. If a farmer defaults, lenders want land to be readily transferable, for a price that will satisfy the debt. This confidence in the value of collateral typically requires not only the legal right to transfer and mortgage land rights, but also the existence of a land market with a reliable demand for land. Legislative reforms that permit mortgaging of land far in advance of the development of the demand side of the land market are likely to have little immediate impact because lenders will not be ready to accept land as collateral until they are convinced of its value as security.

The reasons cited by Bulgaria banks for not accepting agricultural land as collateral for a loan are listed above in Section II. The obstacles related to land titles and the land market are explored in more detail below.

#### A. Restitution of Ownership Rights

The Law on “Ownership and Use of Farm Land Act (OUFLA) and accompanying amendments and regulations provide the legal framework for the restitution process. This restitution law is complex and difficult to understand because it has been amended at least 20 times since it was promulgated in 1991. Some of the amendments have been incorporated into the original the text (when the amendments revise the original text) and some of the amendments were added to the end of the law. Moreover, the implementing regulations are 40 pages long. Certain provisions of the law have been interpreted by the Ministry of Agriculture and Forest (MOAF), and these interpretations have been described in letters to the land commissions. The Supreme Court has also interpreted various sections of the law. The restitution law continues to be amended to rectify problems created by earlier versions and revisions. An ongoing conflict exists between the desire for a slow but just reform, and the desire for a speedy end to a difficult and emotional process.

Ironically, the numerous amendments to the restitution law and subsequent changes in the restitution process have created the perception among lenders and others involved in the rural sector that land-based rights will not be secure until the restitution process is completed. This perception hurts the agricultural sector and agricultural producers in particular because it is an impediment to mortgage lending. The step-by-step process of restitution is described in Annex 2.

There are four central issues related to the restitution process and the ability to use agricultural land as collateral for a loan:

1. The restitution process is not yet completed, and unrestituted land is not able to be transferred. Official figures indicate that 80 percent of restitutable land has been restituted.
2. Land division plans can be re-drawn based on new evidence or new claims causing insecure land tenure, or at a minimum the perception of insecure land tenure.
3. It is not clear to all actors in the land market which documents constitute clear title to land.
4. Restituted land must be subdivided among the heirs, or those heirs must agree to act as co-owners.

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Land that is not yet restituted is often land that is in an area where the soil quality and value of the plots vary greatly such as Plovdiv. Land is restituted in two stages. The first stage occurs after decision number one is passed by the land commission, in which owners receive rights to land in a specific area and of a specific quality, but not an actual location. In the Plovdiv area, for example, many (legal) claims typically are made after a decision number one has been issued, and each of these claims must be resolved before land will be restituted to the claimants and their neighbors. The second stage of restitution is marked by decision number two, which allocates a specific plot to a former owner. Decision number two is the final decision, conferring ownership on the recipient. Problems with survey companies have led to delays in issuing decision number two in some areas. In some cases the survey company is fired and a new bidding process for the right to survey for the land commissions must be instituted before specific plots can be allocated.

Several amendments to OUFLA allow land division plans to be re-considered in certain circumstances. First, a 1997 amendment<sup>33</sup> required land division plans to be re-drawn if new and conflicting claims were made. Between 1993 and 1995 land division plans were determined by land commissions without any input from former owners or their heirs. Many claims against the decisions of the land commissions resulted, and in 1995 the MOAF issued methodological instructions requiring assembly of those affected by each land division plan. In 1997, amendment #31 to OUFLA was passed to provide previously restituted owners who had not been involved in the process the chance to file claims against the land commissions. There is no charge for making these claims, which encourages frivolous claims. The amendment allowed claims to be made for one month after the amendment was published. Amendment #31 created major problems and delays for the land restitution process. Claims made in 1997 are still being litigated and have taken an enormous amount of personnel and financial resources. The MOAF, the land commissions, and the court system have all been bogged down by these claims.

Second, article 11.2 of OUFLA allows new claims for restituted land to be made at any time to a court of law. Unlike land commission claims, claimants to a court of law must pay the litigation costs. However, there is no deadline for these judicial claims. One land commission director stated that these claims double the work of land commissions. Land division plans can be altered based on these new claims.

A recent amendment (February 1999) to OUFLA's implementing regulations should decrease instances of redrawing land division plans and thus positively impact land tenure security. This amendment to the regulations provides that changes in the land division plans can be made only if there has been an "obvious factual error."<sup>34</sup> For cases with no obvious factual error, successful litigants will now be entitled to land from the municipal land fund. (See Section III.C.2c for a description of the municipal land fund.)

In cases where a land division plan must be redrawn and the land has been sold before the claim is settled, a successful litigant now will be entitled only to receive money or municipal land as compensation.

Finally, land commission decisions can be altered by interested parties or the Ministry of Agriculture if additional documents are found which dispute the land commission decision. The land commission can alter the decision within one year of discovering new evidence, but no later than two years after

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<sup>33</sup> Amendment #31.

<sup>34</sup> Art. 26 defines "obvious factual errors;" for example when the survey company has not shown an existing feature on the map, etc.

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real boundaries or the land division plan have been finalized. If a court decision occurs after the final plan has been announced in the State Gazette, the former owners are entitled to land of equal worth from the municipal land reserve.

Proof of ownership and title to land raises additional problems. While 80 percent of all land has been restituted, only 20 percent of those with restituted land have received a notarized title or deed. However, all those who have been restituted have received a formal, written land commission decision and drawing of the land plot indicating that a unique parcel belongs to the previous owner or his heirs, and a protocol entering the land into the possession of the previous owner. These documents constitute land ownership and are legally sufficient proof of ownership for most of the lenders, buyers, and government officials interviewed. The information contained on a notarized title is exactly the same information contained within the land commission decision. Moreover, a recent Supreme Court decision (1997) provided that possessing the combination of a land commission decision, a map of the unique parcel, and an entry into possession protocol is legally equivalent to possessing a notarized title. To clarify this issue once and for all, the MOAF and the Ministry of Justice are currently drafting an amendment to OUFLA providing that the land commission documents and notarized deed have the same legal value. The lenders, farmers, and government officials interviewed all indicated that they would welcome this amendment.

Farmers interviewed stated that obtaining a notarized title was unnecessary and time consuming and that they could dispose of their land without such a notarized title. Government officials interviewed often stated that a notarized title was necessary for transactions, but when asked further questions, it became clear that they were using the phrase “notarized title” or the word “title” to mean either notarized title or the combination of a decision, map, and protocol.

Neither the notarized title nor the land commission decision list the heirs of the original owner. This creates an impediment to land transactions even after land has been restituted. If the parcel is owned by the heirs of the former owner, the heirs have four choices for transacting with their land. First, the land can be divided among the heirs voluntarily, in which case each heir will receive a notarized title to his or her piece of the parcel.<sup>35</sup> Second, the heirs can initiate a claim in a judicial court asking the court to divide the land among the heirs. At the end of this process, each heir would also receive a notarized title to his or her share. The third option is that the parcel can be used and disposed of as a whole. The heirs can provide to the potential purchaser or lender a copy of the certificate of heirs, and each of the heirs can sign over the deed to the purchaser or lender. The Law on Property provides some guidance as to use and disposal of property owned jointly, although these rules are not comprehensive.<sup>36</sup> Finally, heirs can sell their share to one or two other heirs. This procedure is effectuated through a notary and registered with the entry judge.

Taxes are not paid on restituted land for five years after the land commission decision is issued. Ministry of Finance officials have suggested that taxing people for land immediately would help identify real owners and eliminate the problem of multiple heirs.

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<sup>35</sup> OUFLA, Art. 17.2.

<sup>36</sup> Ownership Act (often called Property Act), Promulgated State Gazette No. 92/16.11.1951, ( November 11, 1951) (Republic of Bulgaria), Art. 33-35.

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## B. Farm Reorganization

Field research indicated that neither private farms nor cooperative farms are currently able to use land as collateral for credit. Nonetheless, farm structure, which also has an impact on farm productivity, will undoubtedly have an effect on the legal ability (and propensity) of farms to receive commercial credit. Moreover, the decollectivization process and redistribution of both land and non-land assets has had a real effect on the viability of current farms. All farmers interviewed stated that they needed more machinery and that this was a higher priority than purchasing land or paying rent for land.

Farm reorganization and land restitution are intertwined processes in Bulgaria. OUFLA, which provides the legal framework for the restitution process also describes the legal framework for farm reorganization. Under the 1991 law, production cooperatives were to be reorganized by liquidation councils. Members who had brought land and equipment into the cooperative or those who had worked for the cooperative for more than five years were eligible to receive a share in the non-land property of the liquidated cooperative. These shares were distributed in coupons, which could be used to bid for the non-land property at an auction or could be contributed to the charter capital of the newly formed cooperative for those who chose to remain cooperative members. Farmers complained that the machines and other non-land property were stolen by wealthy outsiders or corrupt officials, leaving nothing for the remaining farmers. In many cases, much of non-land property was sold to pay off the debt of the former cooperative, and only the remaining property was distributed among the members.

Field research indicated that those who left the cooperatives during the initial reorganization are farming somewhat successfully. Most of them received some machinery when they left and credit for additional machinery was available early in the reform process. Those who chose to remain on the cooperative farm lease their land to the cooperative and are technically able to withdraw their property share if they choose to start a private farm or otherwise leave the cooperative. However, at this point, the property share is virtually worthless, and it is very difficult to obtain the necessary credit for purchasing machinery or land.

By the end of 1996, over 40 percent of all cultivable land in Bulgaria was still being farmed by newly formed cooperatives according to the National Statistics Institute.<sup>37</sup> An interview with an official in Plovdiv during field research indicated that in the three *oblasts* in the Plovdiv area, 55 percent of arable land used for grain was being tilled by cooperatives, but 98 percent of arable land used for fruit and vegetable production was being tilled by private farmers. A farmer in Dobrich estimated that 50 percent of the land was being farmed cooperatively and 50 percent privately in his village. An official from the Ministry of Agriculture in Sofia estimated that 25 percent of the land was cultivated by private farms and 75 percent by cooperatives. In most villages there is at least one cooperative.

### **1. Legal Structure of Farms**

Of the farmers interviewed, some were private farmers who were not registered as a legal entity, some were members of a cooperative that had been formed out of a of a former, larger cooperative, and some were members of a small newly created cooperative.

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<sup>37</sup> Keith S. Howe, *Politics, Equity, and Efficiency, in* LAND REFORM IN THE FORMER SOVIET UNION AND EASTERN EUROPE 221 (Steve Wegren ed., 1998).

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## a. Cooperatives

The smaller, newly created cooperatives were most often comprised of tenant farmers who leased in large plots of land and hired seasonal labor. These farmers typically were also involved in other rural businesses such as processing or export of farm products. Tenant farmers stated that they were organized as cooperatives because they hoped to receive the tax and other concessions promised by the Cooperative Act.<sup>38</sup> However, none of these farmers had yet received any of these concessions.

A cooperative cannot have less than seven members.<sup>39</sup> Several private farms registered adult family members who are not otherwise involved just to reach this minimum number. These newly constituted cooperatives call themselves private farmers, but are registered as cooperatives.

A second, more typical type of cooperative, is a cooperative formed out of the former agro-industrial complex. The agro-industrial complexes are generally divided into cooperatives, at least one per village. Interviews with cooperative members from these farms indicated that their cooperatives are failing, often not paying rent for the use of land, not farming much of the land that is available to them, and not able to secure any credit.

One tractor driver stated that there were only three tractor drivers left and no mechanics or other support workers. The cooperative "rented in" 12,000 decares (1,200 hectares) but there was no difference between the hired labor and cooperative members because the cooperative was not paying rent for the land. Last year, the cooperative gave 5 kilos of wheat per decare (50 kg per hectare) to each owner, but only for land that was actually tilled. Many of those without land on the cooperative own land somewhere else, in a village where they do not live.

Cooperative members retain ownership over their land.<sup>40</sup> Cooperative entities, therefore, do not own land and are not able to use land as collateral for a loan. Moreover, cooperative members must withdraw their exact land plots if they choose to leave the cooperative. Even with permission of the cooperative, several members cannot request other, contiguous plots to set up a private farm. If several cooperative members wish to leave together with contiguous plots, they would have to exchange their land plots with the individuals who own contiguous plots before leaving the cooperative. This is particularly problematic due to the small size of most land plots. Near Dobrich, for example, the average size of a land plot is 10 decares. The average size is much smaller in many other areas of Bulgaria.

Cooperative members were often granted some land for personal or household use during the collective period. In some cases, this land has been taken from that farmer without payment to give back to the restituted owner or his heirs. One farmer who had two decares of vineyard land, later (1995) paid for those same decares, but had the land taken by a newly restituted owner and had all of his vines uprooted and his pillars destroyed. He has received no compensation for these perennial plants and does not expect to receive compensation. This farmer took his case to court and appealed the case up to the Supreme Court. Although he and five others won their case, he does not expect to get any compensation for the taking.

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<sup>38</sup> Cooperatives Act, Art. 2.

<sup>39</sup> Cooperatives Act, Art. 3.1.

<sup>40</sup> Cooperative Act, Art. 10.2.

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## **b. Private Farms**

Field research indicated that many private farmers still hold their land in temporary possession because they have not yet received the final land commission decision necessary for full ownership. These farmers often have grouped together but have not registered as a legal entity, in part because they are unsure what the final land division plan will be. Some were concerned that they would not receive the land they were currently farming.

Private farmers generally have some machinery and work out mutually beneficial sharing arrangements with other private farmers. Very few service cooperatives exist. Itinerant tractor drivers that follow the seasons do exist. They harvest first in the south and then move north to Dobrich. Two years ago there were not enough drivers, but last year there were too many and prices dropped.

## **C. Land Market Transactions**

This sub-section describes field research findings regarding the land market in Bulgaria. None of the people interviewed had ever received credit or given credit to purchase land. Unfortunately, in this regard, a vicious cycle exists in which credit is not available for buying land because there is a very limited land market; and there is a limited land market because credit is not available for buying land. The issues are more complex than that, of course, but they do tend to be cyclical. Land values are low because demand is low, and demand is low because long-term credit is not available to most farmers. Low land values make it less likely that commercial banks will offer purchase money mortgages to purchase land. Without credit, farming is difficult and not profitable, making it less likely that banks will provide credit for farming.

Ironically then, the lack of a land market was the reason most often given by banks for not using land as collateral for any type of loan. This section attempts to dissect these cyclical issues.

### **1. Land Sales**

Field research indicated there is a limited market developing for arable land for agricultural purposes in areas where the restitution process is fairly well along (such as Dobrich). Some private farmers in Dobrich are buying land that they have been leasing for several years, and many of the private farmers are leasing in land. Where fewer land commission decisions have been issued and many conflicts exist that may change the existing land division plans, there is virtually no market for the sale of agricultural land. It does appear, however, that all over the country, arable land that is in the area nearest the city (peri-urban area) is being purchased and sold in the hopes that the developer will be able to receive permission to change the use purpose. All peri-urban land is being purchased by large companies and not by individuals or families.

Although there is limited demand for purchasing agricultural land, there appears to be great interest in selling and exchanging land and buildings of all types. Real estate agents estimated that the ratio of sellers to buyers is 90/10 for agricultural land. However, while there are many real estate agencies (40 in Plovdiv), there is virtually no information exchange between real estate agents in separate regions. This lack of information will hinder the exchange market as well as the purchase and sale market.

The basic contract provisions in the Law on Obligations and Contracts provide the legal framework for the purchase and sale of land. Contracts for the transfer of ownership and other rights to immovable property must be notarized.<sup>41</sup> The exchange of money for title actually occurs in front of the notary. Land commission decisions must be registered before a transaction can occur.

The notarized contract for sale generally contains the following information: passport data, name and address of participants, obligations of each in case of non-fulfillment, agreed price, and manner of payment. Although not standardized forms, similar forms are used throughout the country. Most real estate agents interviewed indicated that a legal standardized form would not necessarily be useful.

The real estate agencies check the court registry for encumbrances on immovable property and all real estate agents interviewed were confident that the information received from the registry was accurate. Real estate agents ask for the check on encumbrances to occur immediately before the exchange of money.

#### a. Sales of Arable Land for Agricultural Use

Farmers, processors, and real estate agents interviewed gave the following reasons for the undeveloped nature of the agricultural land market:

1. By far the most common reason given was lack of credit to buy land. One real estate agent stated that in 7 years of acting as an agent, she never sold any land for agricultural production, and this was primarily due to a lack of credit.
2. There is no demand because people do not want to invest in land; they want to invest in machinery.
3. Lack of agricultural land market information.
4. Cooperative members do not feel like owners and do not behave like owners because for 5 years after he receives ownership documents, he does not have to pay taxes.

Since the demand for agricultural land is low, the actual price for the sale of land is often lower than the "document price." The tax authority evaluates the price of land according to specific theoretical norms and this becomes the document price.

The only price information gathered was in Dobrich. In Plovdiv, the limited land market made it difficult to contact people who had purchased or sold land. Those who purchased land in Dobrich either borrowed from family members to pay up front, or paid in installments. Only private farmers and tenant farmers are buying land.

The following table illustrates the price information gathered in Dobrich:

200 decares of plowed land (Private Farm with two co-owners)	24,000—200,000 leva/decare
50 decares Summer of 1998; prices have dropped since due to drop in price of wheat	230,000 leva/decare
Real estate agent estimated	160,000 leva/dec
Prices near Dobrich	100,000—250,000 leva/decare
Prices farther from Dobrich	80,000 leva/decare

<sup>41</sup> Art. 18.

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## **b. Sales of Peri-Urban Land**

Arable land within settlements is called “regulation land.” Regulation land is designated for agricultural use, therefore the prices are relatively low. All real estate agents interviewed stated that there is a very active land market for regulation land. The buyer takes the risk that he will receive permission to change the land’s use purpose sometime after the purchase. The cost of requesting a change of use is fairly high, and peri-urban arable land is three to five times more expensive than other agricultural land. The cost to change use purpose ranges from 50,000 leva to 800,000 leva per decare. The cost increases the closer the land is to the city.

The procedure for conversion of agricultural land is complex. The mayor appoints a committee with representatives from regional services (transportation, police, sanitation). The committee decides whether the proposal can go forward and provides the Ministry of Agriculture with minutes from the committee meeting. Another commission from the Ministry of Agriculture and the Ministry of Public Works and Urban Development decide on whether to allow the change of use. A tax is paid on the land for conversion, depending on its quality. If the land plot is more than 30 hectares, the Council of Ministers must make a special decision. The decision of the commission goes back to the regional committee. The land commission changes the cadastral maps. There is no public debate or opportunity for citizen involvement in the change of use purpose process.

## **2. Land Leases**

Field research indicated that there is an active lease market, although most leases are yearly, due to uncertain land tenure security for those whose land has not yet been restituted. Leases that are for less than four years are called rental agreements and do not fall under the protection of the lease law. Generally rental agreements are written and re-signed every year and are not being notarized or registered with the land commission or entry judges. More or less standard lease forms now exist, although the Ministry of Agriculture has not endorsed these forms. Farmers interviewed indicated that annual land leases (rental agreements) cannot be used as collateral for loans because banks will not accept them.

The Land Lease Law requires written, notarized leases to be registered with the land commissions.<sup>42</sup> A lease cannot be for less than 4 years or more than 50.<sup>43</sup> Lifetime annuity land leases are allowed.<sup>44</sup> The maximum amount of land that can be leased in is 600 hectares (Article 5.1). Tenants must pay taxes and levies on the leased land (Article 7.2). The lease payment can be made in money or in-kind (Article 8.2). The lessee has a preemptive right to purchase leased land (Article 14.1). Movable items and crops are considered pledged in favor of the lessor as collateral for receivables under the contract for lease. Several people stated that it is difficult for lessors to enforce their rights under the Land Lease Law because people do not know their rights and obligations and have no experience with leases.

### **a. Leases to Private or Tenant Farmers**

Field research indicated that private farmers generally lease land from pensioners, urban dwellers, or cooperative farms. Although members of an agricultural cooperative own their own land and can

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<sup>42</sup> Republic of Bulgaria Law “On Land Lease,” Promulgated State Gazette No. 82/27.09.1996, (September 27, 1996), Art. 3.1.

<sup>43</sup> Land Lease Law, Art. 4.1

<sup>44</sup> Land Lease Law, Art. 4.3.

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withdraw this land at any time, they typically contribute the lease right to the cooperatives. It is therefore the cooperatives, not individual members, who lease out land to private farmers. By leasing from cooperatives, private farmers are able to get consecutive plots of land and able to make one agreement rather than dozens. The leases are generally for one year (rental agreements). It would be difficult for a cooperative to lease land for longer periods because cooperative members can withdraw their land at any time. Some private farmers interviewed preferred longer leases but others did not because the price for land changes from year to year.

Wide swings in the amount of land leased from year to year were reported, due to the profitability of farming in a given year. One farmer leased in 1,000 decares last year and 500 decares (50 hectares) this year. Another producer leased in 3,000 (300 hectares) decares last year and 1,000 (100 hectares) decares this year because the rent for the land was increased and prices for production dropped. Moreover, one month before the harvest last year, the cooperative from whom he was leasing increased the fees for renting the land. This farmer raises wheat and produces 2/3 of the bread in his village.

Several private farmers stated that they would prefer to rent land from the municipal land fund because the cooperative land was too contaminated with fertilizers (See section below for a discussion of the municipal land fund). These farmers had been leasing from cooperatives until they could win a bid for municipal land fund land.

Private farmer lessees appear to be paying higher rents to lessors than cooperative farm lessees. Farmers in Dobrich, for example, are paying approximately 30-35% of the average yield in-kind. Last year, one farmer paid 24,000 leva/decare. However, this farmer expects to pay less rent next year. (Rents paid by cooperative farm lessees are discussed in the following subsection.)

Farmers in Dobrich register leases with the regional agricultural services of the Ministry of Agriculture. The regional service keeps track of leasing of agricultural land and the terms of the lease. It is unclear whether this is done throughout the country.

#### **b. Leases to Cooperative Farms**

Article 33 of the Cooperative Law states that when individuals lease land to the cooperative, the lease has to be registered with the notary. This does not appear to be occurring. As discussed above, much of the law governing leasing does not apply because the leases are for less than four years, particularly in relation to cooperative farms leasing in land from their members. Generally, each member has a written lease contract with the cooperative. All of these leases on the farms visited appeared to be the same and did not take into account any variation in quality of soil or other factors that would affect the price of land.

Government officials and farmers alike agree that many people who are renting to cooperative farms receive nothing in return. Cooperatives do not pay rent when prices are low in order to avoid losses. Other cooperatives decide at the general meeting to buy machinery instead of paying rent to owners for their land.

Of those cooperatives that are paying rent, the rent is quite small. Last year one cooperative paid 12 kilos of wheat per decare, or 6% of the annual average yield of 200 kilos per decare. The cooperative members agreed to this amount at the annual meeting. On this same cooperative, the general meeting decided not to give dividends but rather to put the money toward the purchase of machinery.

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Another farmer leases 20 decares to his cooperative and is paid rent on 5 decares. This farmer stated that all of his income comes from the 1 decare of land he farms for his personal use.

Rent paid by production cooperatives in Dobrich are higher than in other parts of the country. One lessee near Dobrich leases 21 decares (2.1 hectares) to a cooperative and receives the average yield on seven decares (33% of the total). In villages with more than one cooperative, the competition for leasing in land creates higher lease prices.

### **c. State and Municipal Land Leases**

Agricultural land can be leased in from the state or municipal government. Municipal government land is generally used as replacement land during the restitution process but is also available for lease. Leases from the state or municipal land fund are for one year. Lessees are generally dissatisfied with the one-year lease term, but the state and municipal governments say this will not change until the restitution process is complete. The cost of leasing in land from the state or municipal government is significantly less than market price. One farmer quoted 13,500 leva/decare (\$76 per hectare) for municipal land, and 50,000 leva/decare (\$280 per hectare) for private lease of the same land. Another farmer quoted 6,000 leva/decare (\$34 per hectare) to lease in municipal land and 1/3 yield in-kind or 15,000-25,000 leva/dec (\$112 per hectare) for a private lease.

There are two groups of people who have priority to lease in state land, up to 10 decares, including land they already own: (1) people without any arable land; and (2) people with less than 5 decares of arable land. The general public can lease in land after the first two categories' needs have been satisfied. The land leases are for one year only. Longer term leases require approval from the Ministry of Agriculture

People who fall into the priority categories must bring documentation from the land commission indicating that they fall into these categories. The Ministry of Agriculture publishes a starting price for land by category, taking into consideration type of soil, yields, access to water, access to roads, etc. Those in the priority categories pay the listed price for the land.

If land is left after claims by those in category one and two are met, the Ministry of Agriculture can order an auction for lease rights to state land. The starting price is doubled for the starting price at the public auction.

Municipal land is generally used as replacement land for those who could not have particular plots of land restituted. The land may now have a building on it or may be contaminated, etc. Municipal land is usually land that was voluntarily surrendered; pasture land previously used by everyone in the village, or previously owned municipal land. The right to lease municipal land is also sold at public auction.

## **D. Registration of Rights to Immovable Property**

Effective land registration systems help banks and other lenders verify that the rights to land they are prepared to accept as collateral actually exist and are not encumbered, thereby reducing the risk of such transactions. Two key issues emerge regarding registration of immovable property rights in

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Bulgaria: (1) are rights to immovable property being registered? and (2) is information regarding such rights accessible to lenders?

The current system in Bulgaria is a deed registration system, which involves the registering or recording of documents affecting rights in land.<sup>45</sup> The district courts act as the land registrars. Documents affecting rights to land and other immovable property are registered in the district court where documents affecting the land are located. In Dobrich *Oblast*, for example, there are 5 district courts.

Notarized titles of ownership must be registered with the court in order to be considered valid, but decisions of the land commission and accompanying drawing are registered with the district court only on request of the landowners. In neither case does the court keep a copy of the documents on file. The land commission keeps a copy of each land commission decision, drawing, and entry into possession protocol, and the notary keeps a copy of these documents as well if a notarized title has been issued. The land drawings are only accurate for approximately six months, because of changes to the land division plans after claims have been litigated. Therefore, if someone wants to sell land, they go to the land commission for updated drawings prior to the registration of the sale. Land cadastre information and land registration information are maintained separately.

Ownership rights to land must be registered with the entry judge in order for a legal transaction to occur. Often, title to land is registered at the same time the transaction is registered with the entry judge. Transactions of rights to immovable property must be notarized.<sup>46</sup> Although the notaries are private, the fee schedule is set by law. There is some concern that private notaries will notarize improper documents because they are paid for each transaction, although the author found no evidence of such improper notarization.

Land commission decisions are registered with the land commission. The land commissions also keeps a file of encumbrances on each parcel of land. In Dobrich, the land commission collects information from notaries and the court registry every week. Entry judges are required to send notification of transactions on land to the land commissions<sup>47</sup> but the land commission in Dobrich retrieves the information as well, just in case there is a failure in the system. This system of the land commissions going to the court registries to retrieve information does not occur in other regions. .

The current law regarding registration of mortgages provides that mortgages must be registered in a separate mortgage registry and that a mortgage receives its priority rank upon its registration.<sup>48</sup> However, the registration is only valid for ten years from the date of the original registration unless the registration is renewed before the expiration of that time. If the time period expires, the mortgage can be registered again, but it will have a lower priority than those encumbrances registered since its initial registration.<sup>49</sup>

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<sup>45</sup> Two basic categories of land registration systems exist. The first to develop was registration of deeds (called land recordation in the United States), which involves the registering or recording of documents affecting interests in land. The second system is registration of title (also called land title registration or simply title registration).

<sup>46</sup> Law on Obligations and Contracts, Art. 18.

<sup>47</sup> OUFLA, Art. 7.5.

<sup>48</sup> Law on Obligations and Contracts, Art. 169.

<sup>49</sup> Law on Obligations and Contracts, Art. 172.

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Rules for registering rights to immovable property, including mortgages and foreclosures, are provided in Ordinance 339 of the Council of Ministers (1 September 1997). Contract mortgages and lawful mortgages must be notarized and are registered in separate books and foreclosures are registered in a third book. Even though these rules have been in effect since 1997, not all registration offices comply with the procedures and organizational guidelines set out in this ordinance. One entry judge told us that every registration office has its own organization and procedures. In that district court, mortgages and foreclosures were registered in the same book with all other encumbrances and transactions. The entry judge is following the registration instructions issued in 1951 instead of Ordinance 339.

For all its flaws, the current land registration system appears to be satisfactory to lenders at this time. No lender interviewed was concerned about unregistered or undiscovered encumbrances. Moreover, all lenders stated that the information required could be gathered quickly.

Two separate drafts of the land registration and cadastre law have been developed by policymakers. One draft was developed by the Ministry of Justice and the Ministry of Urban Development and Public Works and the second draft was developed by a parliamentary working group. Both drafts combine the registration and cadastre functions and create a unified data base. Both drafts create a title registry as opposed to the current deed registration system.

The major difference between the drafts is the issue of who will operate and maintain the registry. The Ministry of Justice and the Ministry of Urban Development and Public Works envision that the legal registry will be handled by the Ministry of Justice as it is now, and that the cadastre will be handled by the Ministry of Urban Development and Public Works. The Ministries' draft also envisions that all registries (pledge, trade, immovable property, legal entities, etc.) will be in the same location. The parliamentarians' draft envisions one new agency with united funding to handle registration and cadastre functions. Overall supervision of the agency would be provided by the Council of Ministers.

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## IV. Institutional Capacity Regarding Land Issues

The single biggest land market issue continues to be the land restitution process. As discussed above, thousands of claims have been filed, and all of these claims must be processed. This section describes the institutional capacity for processing land restitution claims and more broadly discusses the dispute resolution process.

### A. Courts

There are three levels of courts in Bulgaria. The highest court is the Supreme Court or Constitutional Court. The second level is the Court of Appeals. The third level is the regional or district courts. The district courts deal initially with all issues of general competence except for real estate or property claims that exceed five million leva, which are tried initially by the regional courts. The regional courts all handle appeals of district court decisions. The Supreme Court tries appeals of regional court decisions. The judicial system is an independent branch of power.

The decisions of higher level courts are to be mandatory in interpretations of law for lower level courts. There is a special procedure in which the Ministry of Justice can ask the Supreme Court for clarification of law. An interpretive decision has the power of law. A 1997 Supreme Court decision stated that the combination of a land commission decision, drawing, and entry into possession protocol constituted ownership and was legally equivalent to a notarized title.

Bulgaria also has a separate administrative court structure. The administrative courts have been delegated the authority to deal with claims against administrative acts. If a person is dissatisfied with a land commission decision concerning restitution of his individual plot of land, he would appeal to the administrative court. If dissatisfied with the administrative court decision, he would appeal to the district court. He may then appeal the district court decision to the regional court, which has the power to make a final decision. For land commission decisions regarding individual claims, there is no right to appeal to the Supreme Court.

For claims concerning the land division plan rather than the individual restituted plot, the claimant must go to the administrative court, then appeal to the regional court rather than the district court. A final appeal in these cases may be made with the Supreme Court.

There is no arbitration court for contract disputes between legal entities. There is no mediation process, and there is a lack of information regarding mediation and arbitration as an alternative dispute resolution system. There is much interest in expedited systems for handling land restitution disputes and for foreclosures of both movable and immovable property. The Ministry of Justice is drafting legislation to amend the Code of Civil Procedure to allow for an expedited process for foreclosures on both movable and immovable property. Some doubt was expressed as to whether the Ministry of Justice would support an extra-judicial procedure.

In Dobrich, the land commission hires a lawyer to represent the land commission in district court because the court cases require an enormous amount of time. In other areas, land commission directors go to court, sometimes on a daily basis.

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## B. Ministry of Agriculture and Land Commissions

The Ministry of Agriculture and Forests (MOAF) in Sofia, the regional offices of the Ministry of Agriculture, and the land commissions are all inundated with questions and claims regarding the land restitution process. The Ministry of Agriculture in Sofia has assigned two legal experts to the reception hall at the Ministry to service people who travel to Sofia to make claims regarding the land restitution process. Although the Ministry of Agriculture does not have the authority to solve restitution problems, the central office of the Ministry of Agriculture has materials regarding the law and many people believe they will only get relief if they go to the top first. Many people request information regarding the latest amendments to the law and advice concerning their cases. In addition, the central office of the MOAF will send the claim to an expert from the MOAF regional office where the land is located. The expert's opinion can later be used as evidence in a court case.

People often submit claims to the Ministry of Agriculture in Sofia. The Ministry sends the claims to the MOAF regional office where the land is located. An expert from the MOAF regional office collects data and discusses the claim with the land commission. The expert will then writes an answer to the claim and sends a copy of the answer to the claimant and to the land commission.

Parallel with submitting a claim to the MOAF, the claimant must also submit a claim to the court through the land commission. Other people go to the land commission for legal advice regarding the restitution process. One land commission director stated that an average of 70-80 people came to her office every day for legal advice.

The mass media often provides information regarding agricultural land issues. Radio, TV, and written publications provide information regarding changes to OUFLA. The local press also makes the land division plans available as well as announcing where the plans are posted.

## C. Agricultural Extension Services

Agricultural extension services in Bulgaria are partially funded by PHAR. The Bulgarian government pays wages of agricultural extension agents, and PHAR pays for office overhead and computers. Personnel at the central extension services offices would like to have a lawyer who has an expertise in finances and credit to feed information to the rural offices. They have recently purchased software so that they can read and search the legislation themselves. They also often seek assistance from the legal department of the Ministry of Agriculture.

Farmers often present questions regarding the restitution process or the land market, whether it is better to lease out land or sell it to agricultural extension agents.

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## V. Analysis and Recommendations for Increasing Mortgage Activity

### A. Mortgages of Rural Land and Other Immovable Property

While buildings and apartments are accepted as collateral for agricultural loans, agricultural land is not. A complex set of factors is at play, primarily a lack of ownership rights, secure land tenure, and the lack of land market activity. These issues are discussed in sections B and D below. Both lenders and borrowers, however, are interested in using agricultural land as collateral in the future. Borrowers are particularly interested in long-term credit secured by land to purchase machines and land.

#### 1. Legal Framework

The legal framework for mortgages is insufficient, although functional. The National Bank, together with the Ministry of Justice, should begin work on a draft mortgage law that would better balance the interests of the lender and borrower. The following recommendations might be considered for a new mortgage law:

1. **Purchase Money Mortgages.** Continue to allow purchase money mortgages. Specifically permit the use of purchase money mortgages for the purchase of agricultural land.
2. **Tax Liens.** Currently, tax obligations have priority over registered mortgages. This issue may become very important when land taxes on restituted land are imposed five years after the land has been restituted. This issue needs to be reviewed.
3. **Foreclosure Procedures.** Carefully review foreclosure procedures. The procedures contained in the Law on Obligations and Contracts and the Code of Civil Procedure are too lengthy according to bank officials interviewed. Moreover, the procedures provide inadequate protection for borrowers. Lenders interviewed request: rapid judicial procedures (including requiring only one subpoena for the whole case); and a provision allowing collateral to be transferred to the ownership of the bank upon default. Review of the mortgage law should include a consideration of out-of-court public sales.

At the same time, borrowers must have sufficient time to cure their default before foreclosure procedures are initiated and must have some chance to reclaim their foreclosed property.

The US state of Iowa provides one possible model. In Iowa, if a creditor believes that a borrower is in default on an agricultural mortgage, the creditor must give the borrower notice of default and of his right to cure the default. The borrower has the right to cure unless the creditor has given the borrower notice of right to cure with respect to two prior defaults on the obligation secured by the mortgage. The borrower also does not have the right to cure the default if the creditor has given the borrower notice of the right to cure within 12 months prior to the default.<sup>50</sup> If the borrower has the right to cure a default, the creditor cannot accelerate the debt or otherwise enforce the obligation until 45 days after notice of the right to cure has been given. During the 45 days, the borrower can either pay the unpaid installments, plus a delinquency charge of the scheduled annual interest rate plus up to five percent per annum for the period between the giving of the

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<sup>50</sup> See, e.g., IOWA CODE ANN. § 654.2A.(2)(3).

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notice of the right to cure and making the payment, or the amount stated in the notice of the right to cure, whichever is less, or by tendering any performance necessary to cure the default.<sup>51</sup>

Other US states have right of first refusal statutes, requiring that the purchaser of collateral at a foreclosure sale, upon receiving an offer to purchase or lease from a third party, must give the original borrower a preemptive opportunity to purchase the collateral at the offered price before he accepts the third party offer.<sup>52</sup> The borrower must exercise his option within a specified time of receiving notice of the offer (within ten days, for example). The seller is not required to offer the original borrower financing or other concessions.

4. **Underlying and Overlying Mortgages.** Provide clear guidelines and priorities in law for underlying and overlying mortgagees. Protect an underlying mortgagee's interest in the collateral in case of foreclosure of the overlying mortgage. Allow the subject of mortgage to be sold subject to the underlying mortgage.
5. **Possession, Rents, and Revenue.** Provide in law more specific details regarding possession, rents, and revenue upon default but before realization of the subject of mortgage. This is an area of particular interest to bank officials interviewed. For example: what are the rights and obligations of a lender and borrower? Who should maintain and pay the rent on an apartment flat between foreclosure and realization? Who has the right to receive the rents and profits arising from the property?
6. **Public Sale.** Reconsider the public auction procedures in the Code of Civil Procedure. On one hand, a silent bidding process may not drive up the price of the auctioned property because there is not open competition. On the other hand, one Bulgarian bank lawyer stated that with an oral auction, there is much more possibility of an advance agreement between bidders not to raise the price. More information should be gathered on the public sale procedures from both the borrower and the lender's viewpoint.
7. **Bank Ownership of Land.** Revise the current rules restricting foreign bank ownership of land. Allow foreign banks who foreclose on agricultural land to hold the land for up to two years. If foreign banks are allowed to hold land for a period of time, they will be more likely to lend to agricultural producers. Although bank officials do not think the two years is long enough time given the current market, it is probably sufficient. The two year rule should ease fears that banks want to buy and hold land as an investment.

## **2. Mortgage of Agricultural Land**

Agricultural land is more likely to be used as collateral after an agricultural land market is more fully developed which is unlikely until the restitution process is completed. Meanwhile, farmers and bankers offered three recommendations for facilitating land market activity.

1. **Access to Land Market Information.** Farmers need access to all types of market information. As a first step, regional ministry offices, land commissions, and/or extension offices could keep track of prices for leasing and selling agricultural land. The prices should be available free of charge to whomever is interested. Further research should be done on the availability of market information.

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<sup>51</sup> *Id.* at §654.2A(4).

<sup>52</sup> Leif C. Jensen, *Agricultural Lending in the 1980's: An Insurance Company's Perspective*, MEMPHIS STATE UNIVERSITY LAW REVIEW 353, 359-361 (1988).

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2. **State Guarantees.** Bankers would like state guarantees for mortgages on agricultural land and see this as the only way to encourage mortgage lending. State guarantee programs exist in the Czech Republic, Latvia, Poland, Hungary and Slovakia, for example. If such a state guarantee program is implemented, the guarantee should not reach 100%, and both the banks and farms should share an adequate risk for credits. Further research on this issue is essential.
  3. **Assignment of Lease Regulations.** In addition to drafting a new mortgage law, well functioning regulations on assignment of leases will be necessary before lease rights can be mortgaged.

## B. Restitution of Ownership Rights

The following recommendations related to restitution might assist in completing the restitution process in an equitable and efficient manner:

1. **Promulgate public information regarding the restitution law.** The restitution law, its amendments, regulations, and interpretive decisions are incomprehensible to many land owners and heirs. The Ministry of Agriculture publishes new amendments and generally makes an effort to be informative about changes to the law. However, several people interviewed stated that more public information regarding restitution would be helpful. For example, single-issue, one-page fact sheets or brochures answering recurrent questions could be developed and distributed from the Ministry of Agriculture and the land commissions. Although many people will continue to have questions and claims specific to their situation, printed information could at least reduce confusion regarding legal rights and process.
2. **Expedite outstanding claims to land.** Completing the restitution process means resolving all of the outstanding and ongoing claims to land rights. One land commission director stated that each case takes up to two years to resolve. Special judges who were assigned to deal only with land restitution cases might expedite the process. Many of the judges are unfamiliar with the restitution law and with related provisions in other laws, such as the inheritance law. With expert judges, restitution issues may be resolved more quickly and fairly. In addition, a shortened procedure for dealing with restitution claims could be implemented.
3. **Publicize and enforce the recent amendment to the regulations that only allows changes to the land division plan when there has been an “obvious factual error.”** As long as the land division plans can be easily re-drawn, there will be the continued perception that land tenure is not secure.
4. **Amend the OUFPA to provide that a combination of the land commission decision, a drawing, and entry into possession protocol, constitute legal title to land and have the same legal weight as a notarized title.** Notarized titles cost the Ministry of Agriculture 10,000 leva each and carry the same legal information as the already existing land commission decision land drawing, and entry into possession protocol. Lenders, farmers, land commission directors, notaries, and registry judges stated they would welcome such an amendment, which would confirm the recent Supreme Court decision.
5. **Consider using the land restitution expert judges for material rights of heirs claims.** More research is needed on a new legal procedure for establishing the material rights of heirs, including, how it could be expedited, and whether it is reasonable to have the same judges hear both types of cases.

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## C. Farm Reorganization

Further research is necessary regarding farm organization and the laws that affect farm organization. The current enterprise legislation needs to be evaluated to determine:

- whether the law favors either private farms or cooperative farms;
- whether the law encourages or discourages the break-up of large collective farms;
- whether private farms are negatively affected by not being registered as a legal entity;
- whether the law facilitates or encourages consolidation of small plots and the creation of private farms;
- and whether landless cooperative members are having their personal land taken from them without a fair legal process.

The Ministry of Agriculture should encourage the development of a legal framework that supports productive agricultural enterprises of all sizes while still allowing free choice.

## D. Land Market Transactions

### **1. Land Sales**

Long-term credit for the purchase of agricultural land would stimulate the land market as would clear title to land. Although the restitution process has been a hindrance to the development of a land market, it has also created a situation in which a land market is both desired and necessary in Bulgaria. Many people own land far from their homes including many urban dwellers who own agricultural land they have never seen.

### **2. Land Leases**

The land lease law is not effective because land market conditions do not support long-term, high-value lease rights. Particularly, the requirement that the lease term be at least four years is not reasonable given the market situation. At least some, if not much of the land leased is held in temporary use possession and cannot be leased for more than one year at a time pending restitution. Moreover, the market is volatile and unpredictable, and a four-year lease requirement will not and is not honored. The four year minimum should be eliminated and individuals who contract for one year should be protected under the lease law even if the contracts are not notarized or registered.

The one exception to at-will contracting should be cooperative members who contribute the lease right to their land to the cooperative. The cooperative law should be clarified to indicate that cooperative members who contribute their lease right to land cannot contribute the lease right for than a minimum period of time, for example three years. Cooperative members should have the flexibility to leave the cooperative to start a private farm when conditions warrant.

While most of the land leases are written, leases between cooperative members and the cooperative are not necessarily followed. Cooperatives still hold a great deal of power in villages and members and private farmers alike do not feel as if they have any recourse to a cooperative that changes the written

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terms of a lease contract. There appear to be no other enforcement mechanism for lease contracts than the courts. A mediation or arbitration process for resolution of non-payment of rent or contract disputes might empower private land owners who are leasing from or to large cooperatives. Public information regarding the rights and obligations of lessors and lessees under the land lease law would also assist in the development of the lease market.

Once the restitution process is finished, much of the land that is currently leased to individuals from the state or municipal land fund should be sold to the lessees. Although neither officials nor farmers thought the state and municipal land funds interfered with the land market, the potential exists because the land is consolidated and available at a low cost. Guidelines for the sale of state and municipal land should favor producers, especially those without land or with small amounts of land.

## E. Registration of Rights to Immovable Property

### **1. Registration of Ownership Rights**

If Bulgaria moves to a title registration system, it will be critical that all rights regarding land, including ownership, are registered in the legal register. It may be useful to begin the process of automatically transferring the information from the land commissions to the entry judges prior to the change. Moreover, the law should require that rights to ownership evidenced by land commission Decision Number 2 be registered with the entry judge. These decisions should not have to be notarized, only registered.

More stringent requirements for communication between the land commissions and the entry judges are critical. All transactions affect the land maps and changes in the land division plans will affect the land descriptions listed in the land register. One land commission office requires that if someone wants to enter into a transaction with their land and come to him for an updated drawing, he must bring a statement from the entry judge saying that no other transactions have occurred on the property. It is a customary procedure to require an updated drawing before entering into a transaction because the land maps frequently change, at least as to the neighboring property. This is probably a rule that should be considered for duplication throughout Bulgaria.

A new law on registration of immovable property and land cadastre will help provide essential uniformity to the registration system. Currently the system is not uniform, and it is difficult to know whether this is a lack of regard for the current law or a misunderstanding about what the current law requires.

### **2. Registration of Mortgages**

The registration of mortgages is only valid for ten years from the date of the original registration. This provision is unnecessary and does not adequately protect creditors. Once a mortgage is registered, it should have a priority right for the term of the agreement without being renewed. Provisions for terminating the mortgage exist within the rules for registering real rights to immovable property and such provisions should be sufficient to cover concerns over indefinite mortgages.

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## F. Institutional Capacity

The institutional capacity to handle land restitution claims and questions is the most significant institutional capacity impediment. A greater number of expert judges and an expedited dispute resolution system would speed up the restitution process.

Several lenders mentioned a desire to see a special commercial court established for dealing with mortgage and foreclosure issues under the Chamber of Commerce. The judiciary opposes such a proposal. Further research should be done regarding this possibility.

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## VI. Conclusion and Priority for Further Analytical Work

Mortgage of agricultural land will not occur until land rights have been restored and a land market is evident. It is important to note that in areas where land has been restituted, there is in fact the beginnings of a land market. Field research indicates there is widespread agreement that the land restitution process is a mess. Improving and expediting the restitution process is crucial to facilitating the development of mortgage lending. Information regarding the restitution process, the law, the clarifications of the law, and the land market will be very important in gaining the trust of lenders. Furthermore, active assistance must be provided to land commissions and courts who are mired in restitution claims.

Further analytical work should be considered in the following areas:

- Preparation of a draft mortgage law.
- The possibility and wisdom of providing state guarantees for agricultural land mortgages.
- Dissemination of land and product market information.
- Alternative dispute resolution possibilities, particularly for restitution claims.
- The legal framework for farm enterprises.

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# Annex 1

## Actors Involved in Restitution Process

### I. Land Reform Directorate

- One Deputy Minister of Agriculture over the Land Directorate: Karkamov
- The Land Directorate coordinates the restitution process
- Three deputy heads (north, south, and information support) of the land directorate handle problems with land restitution

### II. Land Commissions

- Offices located throughout the country
- Heads are appointed by the Ministry of Agriculture
- Financed by municipal budgets; severely under-funded and poorly staffed
- Perform the on-the-ground tasks of restitution
- Issue documents of ownership and keep a registry and map of each unique parcel
- After restitution is completed will maintain land cadastre and provide information to land registry institution (currently the courts). This function could be affected by the draft law on registration and cadastre

### III. Survey Firms

- Selected through competitive bidding by the Land Directorate; most firms were selected at the beginning of the restitution process
- Financed from the government budget and EU grants
- Prepare restitution and cadastre drawings and maps
- May be private or state owned

### IV. Notaries

- Privatized at the beginning of 1999; formerly employees of the Ministry of Justice.
- Fees are established by legislation.
- Notarized titles are not a mandatory requirement.
- No fees are charged to individuals for a notarized title. The cost to the Ministry of Agriculture for such titles is 10,000 leva. (1780 leva/USD)

### V. Entry Judges

- Employed by the Ministry of Justice; the judges are all lawyers.
- Function as registrars for land transactions
- Initial registration of ownership with the entry judges is not mandatory unless a notarized title has been issued. Initial registration of ownership occurs at the land commission.
- Registration of the three documents establishing ownership in lieu of a notarized title (land commission decision, drawing, and entry into possession protocol) can be voluntarily registered at any time, but must be registered before a transaction occurs.

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## Annex 2

### PROCESS OF RESTITUTION

Law on “Ownership and Use of Farm Land Act (OUFLA),” No 17, (March 1,1991),  
as amended

#### Timeline for Filing Restitution Claims

From March 1, 1991 to August 4, 1992 claims were filed with the land commission by former owners or their heirs. After the August 4, 1992 deadline, claims had to be filed with the courts.



#### Claimant Files a Claim

To file a claim, the claim must either have been:

**(1) accompanied by the following documents:**

- A document stating that the claimants are legal heirs of the deceased. This document was issued by the municipalities. If all legal heirs were not listed, the unlisted heirs can litigate at any time.
- Documentation of ownership of land, including old titles, former production cooperative records, or old registries.

**(2) or accompanied by a declaration of ownership signed by a notary.**

- The declaration included the type of property, location, and neighbors during the period of 1991-1992 when the claim was filed.
- A 1995 amendment to OUFLA (Article 12.5) states that the land commission or the court must verify these claims on site. Where a Land Division Plan or maps with real or re-installed boundaries have not been finalized, this procedure of checking claims on site continues.



#### Land Commission Reviews the Claim and Issues Decision #1

- For claims with documents, the land commission reviews only the documents.
- For claims without documents, the land commission investigates by talking to elderly people about former boundaries, etc.
- Decision number one includes the location, the area in size, the type of land, and the name of the real owner. Decision #1 is issued in the name of the former owner.
- There were timelines for completion of these decisions, but they were too short and not obeyed.



#### Individual Claimants Receive Land Commission Decision #1

- Claimants receive Decision #1 by registered mail or in person.
- From the moment the decision is received, the claimants have 14 days to contest the decision to the district court through the land commission. This objection is free of charge.



**If an objection to the decision is filed:**

- The court determines ownership.
- Decision #1 claims are still in the courts.
- The Land Division Plan can be finalized in spite of these claims.
- If the decision of the court occurs after the draft of the Land Division Plan is finalized and has been announced in the State Gazette, the claimant is eligible for compensation from the municipal land fund.
- If the Land Division Plan draft has not been announced, the decision of the court has to be implemented in the final Land Division Plan.

**If no objection is filed:**

- Decision #1 is accepted automatically.
- If later the claimant decides to object, he must go to a court of law directly, not through the land commission.



**Former Owners and Heirs are Notified of a Meeting of All Neighbors within a Specific Area**

- Former Owners (and heirs) are notified via the State Gazette that they must go to a specific territory with the neighboring owners to claim their land on a particular date. (Participation of half of the owners is required).
- The owners, surveyor, and the land commission all come together, and the owners show the surveyor where they think their land was.



**Maps of the Restituted Area Are Drawn**



**If the old boundaries still exist or can be re-established:**

- If real boundaries (existing) or boundaries which can be re-established (re-drawn using old maps) exist, a survey is done at the time of the on-site meeting.  
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- The survey company produces digital maps and gives them to the land commission.  
↓
- If owners are unknown, the land is identified on the map as unknown.  
↓
- Later if someone wants the right to this land, he must go to the land commission to file a request. At this point, he must pay a fee for the survey.  
↓
- The Land commission advertises in the State Gazette that the maps are finalized (approximate time is 30 days).  
↓
- The owners have 14 days to review the drawings in the land commission office.  
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- Owners who disagree with the drawings must make their claim in written form to the land commission.  
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- The land commission orders the surveyor to make necessary changes to the maps based on claims of discrepancies.  
↓
- The land commission issues Decision #2 and an accompanying drawing, which constitutes ownership documents for the parcel of land.

**If the boundaries are unknown:**

- A draft Land Division Plan is prepared by a surveyor based on the input of those at the meeting.  
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- The prepared map is announced in the State Gazette.  
↓
- Owners have 14 days to review the map and file complaints with the land commission. Drawings are not final and ownership documents are not given to anyone within the plan until all non-litigious complaints are resolved.  
↓
- The land commission will correct any obvious errors with the survey company. The survey company amends the plans and resolves the differences, if possible.  
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- Owners waiting to be restituted hold their land in temporary ownership and cannot perform any transactions with this land.  
↓
- The State Gazette announces the schedule for implementation of the final plan.  
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- The final plan is displayed at the land commission for 14 days. During that time claimants can file a complaint with the district court through the land commission. The land division plan will be drawn, but the disputed claims will not be included in the drawing.  
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- After 14 days, the schedule is announced for demarcating the land on the ground. The date is set 30 days in advance.  
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- At the scheduled time, everyone has to appear at the site. The land surveyor marks the land on the ground.  
↓
- Land commission issues a land commission decision, a drawing of the individual's land and the neighboring plots (unique parcel number),

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and an entry into possession protocol. These three documents constitute ownership rights of the claimant.



- An absent owner within a land distribution plan cannot receive entry into possession document. In this case, the municipality has the right to lease out his land for one year to anyone.



- An owner or heir who later appears must pay the survey company for the document.



- Since 1997, the land commission also submits the application for notary title to the notary commissions. Prior to this date, notarized titles were issued only at the specific request of the new owners. Since 1997, the request for restitution has been deemed a request for a notarized title. One copy of notary title is filed with notary office and another copy with the land commission



- Notary Commission may return the title application to the land commission if the application was improperly prepared



- Notaries issue titles within 7 days after submission to notary.



- Notarized titles must be registered with the entry judge.



- In 1997, the land commission was ordered to issue notarized titles for previously restituted lands administratively. (1997 Amendment to Article 14. See last sentence of Article 14).



- Notarized titles were not actually issued for previously restituted lands until January 1999 because there was confusion about who would pay for the notarized titles (10,000 leva/title) once the notaries were privatized. Once the process of distributing titles retroactively began, there were many problems because the land commission did not always know about subdivisions and transactions. (Entry judges have one month to provide information, but this does not always occur).



- The Ministry of Agriculture ordered this process halted at the beginning of March 1999. Another amendment to OUFLA will be passed that will state that the 3 documents of ownership are equal to a notarized title.

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**Subdivision of Restituted Claims  
Between Heirs**

- Claims do not need to be subdivided between heirs.
- Disputes regarding material rights to land between heirs have to be resolved in a court procedure. The heirs must pay for the court procedure.
- Subdivision disputes can be brought to the court at any point in the process. Original restitution is only to original owners of land, but an heir can go to court in the name of a deceased owner. There is no deadline for these claims. The land commission is a party to each of these disputes.
- Voluntary Contracts for subdivision are notarized and registered with the entry judge.

**Summary of Potential Areas of Litigation**

- Claims can be made against original land commission decisions (Decision #1). (District Court). While this litigation does not stop the process of drawing the land division plan, all litigants and their neighbors are not included in the plan until the claim is resolved.
- Land commission decisions can be altered by interested parties or the Ministry of Agriculture if additional documents are found which dispute the decision. The land commission can alter the decision within one year of discovering new evidence, but not later than 2 years after real boundaries or the Land Division Plan have been finalized. If a court decision occurs after the final plan has been announced in the State Gazette, the owners shall have the right to be indemnified with land of equal worth from the municipal land reserve. (District Court).
- Article 11.2 of OUFLA allows those who did not request restitution of land from the land commission before August 4, 1992 to request restitution from the district court. Legal heirs are allowed to request restitution. These changes are no longer subsidized by the Ministry of Agriculture. (District Court)
- Amendment #31 to OUFLA (October 1997) allowed those people who had not formerly been required to attend a meeting of owners and who had not appealed a land division plan after the first decision was published, to file a claim within 30 days after this amendment was published. (Regional/Oblast court) These appeals are still being litigated even though the deadline passed 1.5 years ago. Land Division plans are still being altered based on successful appeals if there were *obvious factual errors*. (Obvious factual errors are described in the rules for application of OUFLA, Article 26). If the land has been sold before the claim is settled, a successful litigant will only be able to receive money or municipal land as compensation.
- Disputes over material rights of heirs when there is no contract for voluntary subdivision. (District Court)

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## Annex 3

### Bulgarian Legislation

#### I. Mortgage and Pledge

Obligations and Contracts Act, Promulgated State Gazette No. 275/22.11.1950, (November 22, 1950) (Republic of Bulgaria).

Code of Civil Procedure, Promulgated Izvestiya No. 12/08.02.1952, (February 8, 1952) (Republic of Bulgaria).

Republic of Bulgaria Law “ On Registered Pledges,” Promulgated State Gazette No. 100/22.11.1996 (November 22, 1996).

Banking Act, Promulgated State Gazette No. 52/01.07.1997, (July 1, 1997) (Republic of Bulgaria).

Draft Pass-Through Bonds and Mortgage Bonds Act, (November 30, 1998) (Republic of Bulgaria).

#### II. Registration

Republic of Bulgaria Law “On Rules for Registering,” (September 1, 1997).

Republic of Bulgaria Draft Law “On Land Registration,” (February 25, 1998).

Draft Cadastre Act, (February 1998) (Republic of Bulgaria).

#### III. Restitution

Ownership and Use of Farm Land Act, Promulgated State Gazette No. 17/01.03.1991, (March 1, 1991) (Republic of Bulgaria).

Amendment Act to the Ownership and Use of Farm Land Act, Promulgated State Gazette No. 79/17.09.1996, (September 17, 1996) (Republic of Bulgaria).

Amendment Act to the Ownership and Use of Farm Land Act, Promulgated State Gazette No. 98/28.10.1997, (October 28, 1997) (Republic of Bulgaria).

Council of Ministers Decree No. 50 “On the Adoption of Regulations on the Enforcement of Art. 10, para 10 of the Ownership of Farmlands Act,” Promulgated State Gazette No. 17/1991, (March 10, 1993) (Republic of Bulgaria).

Government Regulations of the Republic of Bulgaria “On Building-up in Farm Lands,” Promulgated State Gazette No. 47/04.06.1993, (May 20, 1993).

#### IV. Land Market

Ownership Act (often called Property Act), Promulgated State Gazette No. 92/16.11.1951, (November 11, 1951) (Republic of Bulgaria).

Council of Ministers Decree No. 118 “On Ordinance for the Adoption of Conditions and Procedure for Establishing the Current Market Price of Agricultural Land,” (May 26, 1998) (Republic of Bulgaria).

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## V. Land Lease

Republic of Bulgaria Law “On Land Lease,” Promulgated State Gazette No. 82/27.09.1996, (September 27, 1996).

## VI. Cooperatives

Cooperatives Act, Promulgated State Gazette No. 63/03.08.1991, (August 3, 1991) (Republic of Bulgaria).

## VII. Commercial Laws

Commercial Code, State Gazette No. 48/18.06.1991, (June 18, 1991) (Republic of Bulgaria).

Commerce Act, Promulgated State Gazette No. 48/18.06.1991, (June 18, 1991) (Republic of Bulgaria).

## VIII. Other Laws

Assistance of Agricultural Producers Act, Promulgated State Gazette No. 894/22.05.1998, (May 22, 1998) (Republic of Bulgaria).

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