Update on Egyptian Mortgage Lending

By Raymond J. Struyk, Head, Egypt Financial Services Project[1]
and Melvin Brown, Senior Financial Adviser, Egypt Financial Services Project

The June, 2006 issue of *Housing Finance International* included an informative article by Stephen Everhart, Berta Heybey, and Patrick Carleton that introduced recent developments in the Egyptian housing sector.[2] Since the data for that article were gathered in early 2005, this brief article provides additional information on developments in mortgage lending with respect to loan volume, terms and conditions of mortgage loans, and the regulatory environment.

Regulatory Environment

The Real Estate Finance Law of 2001 is the key piece of legislation, regulating all mortgage lending regardless of the legal status of the lender or its supervisory agency. It contains a very strict definition of the loan instrument, which is specified to be a three-party agreement among the lender, the seller and purchaser of a dwelling. The stated intention of mandating this instrument was to provide greater security to the lender as well as the purchaser in Egypt's difficult mortgage lending environment. As noted in the earlier article, difficulties arise from two primary sources: (a) the long delays probable in registering a lien, and (b) a foreclosure process for mortgagors-in-default that is still viewed as uncertain despite comparatively recent legislative changes designed to speed the process and increase certainty. But the 3-party contract has draw-backs of its own that makes it unpopular with lenders.[3]

Currently the Mortgage Finance Authority (MFA), the regulatory body for non depository mortgage lenders and the organization charged with promoting the development of the mortgage market, is conservatively interpreting and enforcing the provisions of the 2001 law, including the mandated tri-partite loan contract.[4] The Central Bank of Egypt (CBE), on the other hand, despite its issuance of a circular implementing the terms of the 2001 law, has not attempted to enforce the exclusive use of the tri-partite loan agreement for mortgage credits and has de-facto granted the banks more latitude in their loan structuring. Several of the larger and more active commercial banks are employing a variation of the tri-partite agreement or a more standard 2-party loan contract in their mortgage loan transactions.

Mortgage Finance Companies (MFCs) are specialized non-depository lending institutions. As of early September 2006, two MFCs had been operating for about two years and a third had just been granted a license. They are subject to a fairly conservative leveraging ratio of 9:1 under the terms of the real estate law of 2001. The banking sector, on the other hand, is subject to CBE interpretations of the Basle II guidelines for credit at risk and continues to function under the more liberal leverage regulations of the CBE.

The principal restriction placed on the banks for mortgage lending continues to be the CBE ruling that limits real estate related credits to 5 percent of the total the loan portfolio. This restriction is not currently a limiting factor for the banks as CBE statistics indicate that the sector as aa whole could extend approximately LE15.5 billion in total real estate related credits at current asset levels versus a maximum of LE 650 million currently extended. (The current exchange rate is about LE 5.75 = $1.) The CBE has indicated that if this limitation becomes an impediment to loan growth, it could be adjusted. Consequently, as the volume of mortgage loans continues to grow, the imbalances in the regulatory framework cited above, considered in combination with the natural funding advantages enjoyed by the deposit-taking commercial banks, could prove a long-term disadvantage to the market effectiveness of the MFCs.

March 2005 witnessed an important development with respect to property registration requirements for mortgage lending. Only about 10 percent of urban

[1] The Egypt Financial Services Project is being conducted by Chemonics International under contract with the U.S. Agency for International Development. The authors wish to thank Aser F. Obeid for help in assembling data used in the article. The views expressed are those of the authors and not necessarily those of either organization. Correspondence to: rstruyk@egyptfs.com.

[2] S. Everhart, B. Heybey, and P, Carleton, "Egypt: Overview of the Housing Sector", *Housing Finance International*, June 2006, pp. 9-13.

[3] There is interest among banks to amend this law and much of the necessary drafting has been prepared by the EFS project and others. Political acceptance may be an issue.

[4] The earlier article indicated that MFCs were not issuing mortgages (p.12). This is not the case as these loans are in fact mortgage-based transactions but the relationship among the parties (seller, buyer and lender) is somewhat complex under this agreement.

Egyptian properties are registered, in part because it is a long, complex, and (until summer 2006) an expensive undertaking.[5] A requirement for using a property as collateral under a mortgage contract has been that the property be registered. Hence, few properties qualified for mortgages without first being registered. In 2005 the implementing regulations of the Real Estate Finance Law were amended, with one provision being that a mortgage could be issued for an unregistered property if the property were deemed to qualify for registration.[6] Lenders have used this provision after due diligence on the property. The Law requires that lenders initiate the process of registering the property and mortgage. This regulatory change obviously dramatically increased the number of properties qualifying for mortgage loans. An important contextual point is that the Government of Egypt is undertaking an ambitious program of reforming and modernizing the registration system for immovable property beginning in Cairo in nine districts plus one district where the upgrade is being implemented by the USAID Egypt Financial Services Project. Hence, the utility of the able-to-be-registered provision should decline steadily over time.

Volume of Mortgage Lending

The variation in the type of loan agreements being used by lenders creates confusion in the reporting of mortgage lending by financial institutions. The confusion arises as to whether *only* 3-party mortgages should be reported as a mortgage. The figures cited below are inclusive of all types of mortgage contracts.

The two MFCs report their lending to the MFA as mortgage loans. Both are building their portfolios by originating loans and by taking over installment loans originated by developers.[7] At the mid-September 2006, according to MFA data, the MFCs had a stock of 972 mortgage loans with a combined value at origination of LE 227 million. This compares with a June 2005 figure of about LE 16 million or $2.7 million.

Mortgage lending by commercial banks is reported to the CBE as a separate type of asset. However, there is some uncertainty as to whether 2-party home purchase mortgages are being reported as mortgages, but it appears to be the case. At the end of June 2006, commercial banks had an outstanding balance of LE 300 million of home purchase mortgages.[8] Conversations with commercial banks indicate that they are beginning to see home purchase mortgage lending as an interesting new type of consumer lending.

Using the figure just cited for commercial banks, the stock of outstanding home purchase mortgages in total was about LE 520 million in summer 2006 and the portfolio consisted of around 2,300 loans.[9] (Note that the LE 520 is for residential mortgages whereas the LE 650 ($133 million) cited earlier was for all real estate lending.)

The foregoing makes two points evident. First, this type of lending is growing very rapidly but from a very small base indeed. Two thousand loans in a country of around 13 million households is indeed a drop in the ocean. Second, loan amounts are large—an average of LE 232,000 or about $38,700 for loans made by MFCs. Obviously, in Egypt where average household income is about $6,875,[10] loans are going to very high income households.[11] If one assumes that loans finance 40 percent of the purchase price on average, then the ratio of the average house price *for these transactions* to average country-wide household income is 14.[12] Other analysts put the overall media price-median income ratio for Cairo at 6-7.

Loan Terms

As the competitive market for mortgage lending begins to develop in earnest, it is interesting to plot the data on loan terms and conditions being offered in the market. The market is now beginning to show greater elasticity in the structure of the mortgage-based credits being offered. Table 1 provides information on loan terms for the two MFCs and three of the main commercial banks with active mortgage lending programs.

Information in the table is based on official

5 Egypt Financial Services Project, *Property and Registration Law in Egypt: Current Operation and Practice*, June 2005. Over the past few years registration fees have been gradually reduced. Finally in summer 2006, they were lowered to quite moderate amounts, with the fee, varying in four brackets depending on the size of the unit. The lowest fee is LE500 for a unit under 100 square meters, and the highest is LE2000 for units over 300 square meters.

6 Prime Minister's Decree No. 465 of the Year 2005 Amending Certain Provisions of the Executive Statutes of the Real Estate Finance Law, March 20, 2005.

7 In principle, these loans are recast as true mortgages; but the information on this point differs among sources.

8 Unpublished information provided by MFA.

9 Calculated by applying the average loan amount for MFCs to the commercial banks' loan volume.

10 Various World Bank web pages report the average per capita GDP in Egypt (Atlas method) in 2004 as $1,250 and an average household size of about 5.5.

11 According to World Bank data published on its web site, income inequality in Egypt is moderate. Using data for 2000, the Gini coefficient of 29 is reported. The richest 20 percent of the population received 39 percent of total income, and the poorest, 9.8 percent.

12 A ratio of median free market dwelling price to median household income for 1992 of 7 for Cairo is reported in Table 2 of S.N. Erbas and F.E. Nothaft, "Mortgage Markets in Middle East and North African Countries: Market Development, Poverty Reduction, and Growth," *Journal of Housing Economics*, vol. 14, 2005, pp. 212-41. S. Aziz, H. Kamal, M.S. Kamal, K. Selim, H. Serageldin, and D. Sims report a similar value for Cairo but are not clear as to the date for which this value applies; see *Housing Demand Study for the Arab Republic of Egypt* (Cairo: Report to USAID by the project Technical Assistance for Policy Reform II, 2006, p.36).

Table 1. Mortgage Loan Terms and Conditions for Selected Egyptian Lenders – Summer 2006

	Mortgage Finance Companies		Commercial Banks		
	Egypt Housing Finance Co.	Taamir	Egyptian Arab Land Bank[a]	Nat'l Societies General Bank	Commercial International Bank
Maximum LTV – %	75	80	75	80	70
Maximum PTI – %	35	40	40	30	40
Maximum loan term	10 yrs[b] 5 for Egyptians living abroad	20 yrs[b] 10 for Egyptians living abroad	10 and 20 yrs[c,d]	10[c]	15[c]
Interest rate – %	13	13	13.5 on 10 yr 14.0 on 20 yr	11.6	Fixed for 3 years at 13, then variable
Insurance required: – life – property	Yes Yes	Yes Yes	Yes Yes	Yes Yes	Yes Yes

Source: Egypt Financial Services project.

a. Government-owned bank
b. Actual term is around 7-8 years.
c. Actual loan period is not known
d. Longer loans are subject to more stringent underwriting

lender statements. Actual lending practices can differ from these general terms, often depending on the actual ability of the borrowers to meet the maximum payment to income criteria as set by regulations, management decisions concerning business intangibles and customer relationship factors. We know, for example, that in practice the average loan period offered through the MFCs is shorter than the maximums stated – actual averages are 7 and 8.5 years, respectively, for the Egypt Housing Finance Company (EHFC) and Taamir.[13] These loans are funded by a combination of equity and terms loans. The MFCs are looking to the recently created Egyptian Mortgage Refinance Company, a liquidity facility following the Malaysian Cagamas model, for liquidity in the future.

Loan periods for mortgages from the Egyptian-Arab Land Bank (operating cooperatively with the Housing Development Bank[14]) are 10-20 years. As established government-owned institutions reporting to the Ministry of Housing, they are heavily involved with the national program to provide low cost housing on loan terms that includes a subsidy (non-repayable) for a portion of the required down payment. The great majority of the mortgage credits extended by these banks are structured with borrower participation in the subsidy program administered by the Guarantee and Subsidy Fund (GSF).[15] The banks' government affiliation and mission apparently make them willing to accept greater interest rate risk than some other lenders. But, as the table shows, unadjusted for possible risk differences, their interest rates are the same as others in the market.

The Commercial International Bank (CIB), which has only recently expanded its mortgage lending programs beyond its own staff and favored corporate clients, may also be making 10-15 year loans. CIB is currently the only lender offering a loan repricing option – now set three years after loan issuance. The initial interest rate is not

[13] We do not have parallel information from the commercial bank statistics but anecdotal evidence indicates that the average loan term is still well below 10 years.

[14] There are plans to merge these banks within a year, which could lead to positive advancements in the overall development of the national housing finance program for Egypt.

[15] The GSF is an independent agency under the MOI but its programs fall under the supervision of the MFA. MFA management is also on the Board of the GSF.

indexed; rather the new rate will be whatever the bank's interest rate for this product is at the time of repricing.

In addition to the loan terms and conditions presented above, all lenders currently require borrowers to carry both life and property insurance during the life of their loan. Private sector lenders also require significant up-front fees for loan origination. Pre-payment penalties, typically 2 percent of the prepaid amount, are common.

Interest rates are high but not at such punishing levels as in some developing nations. The typical rate is 13 percent. Rates have, however, edged downward in the past year. Based on various indicators, it appears that spreads are relatively modest. Among banks, 90 percent of deposits are time deposits; in 2006, the 3-month deposit interest rate was 6.2 percent and certificates of deposit paid 9.5 percent.[16] Inflation at the same time is running about 5 percent. The World Bank reported for 2004 a 5.7 percentage point interest rate spread and only a 3.5 percentage point risk premium on lending in Egypt (defined as the difference between the lending rate to the private sector and the "risk free" treasury bill rate).[17] Together these facts suggest that interest rates may be difficult to bring down very much in the near term. Possibilities for reducing mortgage interest rates are further complicated by the fact that lenders are not rigorously calculating (or simulating) the price of the various risks they face; when they do, they may discover that they have been implicitly under pricing them.

Prospects

In many ways the situation in Egypt exhibits the potential for creating the type of dynamic housing finance market as that experienced by a number of countries in Eastern Europe and the Commonwealth of Independent States in the past 15 years: once the basic conditions to control credit and other risks were either in place or were being put in place, prices were stable and economic growth sustained, then mortgage loan volume grew sharply and eventually stabilized at the higher levels in response to the strong latent demand for better housing. While several of these countries employed deep subsidies to ignite their mortgage markets into periods of sustained growth (eg, Hungary), others did not – including Poland and Armenia.

The Egyptian mortgage market now appears poised for rapid and sustained growth, assuming the macroeconomic environment remains positive and that the Government of Prime Minister Ahmed Nazif continues on its strong reform path. The gains to date were based on continued progress in strengthening the legal basis for mortgage lending, substantial improvements in the regulatory environment, and, most importantly, the increased public awareness in the benefits of mortgage-based homeownership.

Based on the experience of other countries, the growing interest of commercial banks in this form of consumer lending, and the expected continued forward movement on the part of the Egyptian authorities in learning from others, sharp growth in mortgage lending can be expected in the years immediately ahead.

[16] Central Bank of Egypt 2004-2005 Annual Report and the Ministry of Finance, The Financial Monthly, vol .1, no .9, July 2006.

[17] World Development Indicators, 2006, Table 5.5.