TACKLING THE SHELTER CHALLENGE: Developing the Mortgage Market in Egypt

Sahar Nasr and Laila Abdelkader

Introduction: The Egyptian revolution has brought to the forefront the need to focus on job opportunities; transparency and accountability; a fair and competitive environment; as well as equal access to finance, land, and housing—especially for underserved segments of society. Although the government of Egypt embarked on a macroeconomic and structural reform program in 2004, economic and social progress could not keep pace with the aspirations of many Egyptians, and spatial welfare disparities remained unchanged—contributing to the social discontent leading to the revolution.

The housing sector tends to be a large part of the economy in most countries; it is a major factor in creating stable societies and a key indicator for social well-being. This is why governments intervene in the housing market through a range of policies, including subsidies. Note also that housing and construction create significant job opportunities.

Egypt’s Housing Dilemma: There has been a persistent gap in Egypt between incomes and the cost of new housing even at the middle income level. It is estimated that around 200,000 new housing units are needed annually to keep pace with household formation, but only the top 10 to 20 percent of the income distribution can afford to acquire a formally recognized house. To help improve access to formal home ownership by low and middle income households, the government has in the past provided a range of subsidies, through numerous special programs. Many of these public housing schemes involved large government subsidies.

Prior to reforms, Egypt suffered from a severely undeveloped housing finance system. The banking sector offered very little formal housing finance to households although a few commercial banks have made a limited amount of loans to homebuyers, mostly as part of their retail activities or of their lending to developers, by using collateral other than mortgage pledges. A few developers have also been providing term financing under a system of deferred installment sale contracts, but these have not offered secure or favorable conditions for borrowers. Housing affordability was not improved because loan maturities were too short. Banks were reluctant to extend mortgage loans for two main reasons: (i) the maturity mismatch between their short term deposits and long term mortgage loans; and (ii) the lack of registered titles. At the non-banking front, only two mortgage companies were created who engaged in small amounts of lending due to lack of long term funds.

Building Blocks for Developing a Mortgage Market: To address the constraints, the government worked on developing an enabling environment for a modern residential mortgage market that would allow most of the burden of housing finance to be shifted away from the government budget and onto the financial markets and the private sector. A number of major reforms have been undertaken, starting with the issuance of the real estate finance law, which set the legal and regulatory framework. The enabling environment also included policies, institutions and systems to facilitate the emergence.
of an efficient, low risk residential mortgage finance system in which mortgage lenders compete on a market basis to make housing finance available to Egyptian households on economically attractive terms and conditions. The building blocks for housing finance which were put into place, with the assistance of the World Bank, included:

- Strengthening the legal and institutional framework for mortgage securities through amendments to the capital market law to facilitate the issuance of alternative forms of financial instruments, such as mortgage bonds and eventual securitization.
- A new regulatory institution for real estate activities, the Mortgage Finance Authority (MFA) creating a secure and strong regulatory environment to protect the interest of lenders and consumers.\(^5\)
- Establishment of the Guarantee and Subsidy Fund (GSF)\(^6\) to provide a temporary social safety for borrowers who experience adverse life events, such as a loss of employment that lead to payment defaults.
- Collateral enforcement and foreclosure processes were strengthened through the establishment of specialized economic courts. The ability to enforce the collateral is essential to lenders if they are to give value to the collateral in a secured loan.
- Creation of a private credit bureau (iScore) for the first time in Egypt, whereby non-bank financial institutions, such as mortgage companies would have access to timely credit-worthiness information, improving the underwriting process and lowering credit risk for lenders.
- Enhancing consumer protection and financial literacy was a priority, through setting minimum disclosure standards pertaining to loan information, and familiarizing consumers with the new financial products.
- Formation of the first liquidity facility in Egypt for mortgage finance, the Egyptian Mortgage Refinance Company (EMRC) enabled qualified mortgage lenders to access long-term refinancing for their mortgage loans and to better manage the risks of mortgage lending.

\(^5\) In 2010, all non-bank financial institutions became regulated by a single regulator, namely the Egyptian Financial Supervisory Authority (EFSA), under which MFA came.

\(^6\) Currently renamed to become the Mortgage Finance Fund (MFF).

- Improvements in streamlining of property registration, including the fast track registration system for new houses, through the nationwide mapping and titling program, and the drastic reduction in registration fees (Figure 1).

**Figure 1: Procedures for Streamlining and Cutting Cost of Property Registration**

<table>
<thead>
<tr>
<th>12% of property value</th>
<th>6% of property value</th>
<th>3% of property value</th>
<th>Maximum flat fee of LE 2000</th>
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The above building blocks have helped Egypt gradually develop its mortgage sector, attracting foreign capital into the sector and a steady growth of mortgage loans both in number and geographic spread around the country.

The World Bank supported the establishment of the first liquidity facility through the Egypt Mortgage Finance Project, amounting to LE 214.2 million (US$ 37.1 million equivalent). EMRC, which is designed to help financial intermediaries (banks and non-bank lenders) in the primary market to provide long-term, market-based, mortgage loans for residential housing, focuses more on low-income households. The project played a key role in setting up the legal, regulatory and institutional infrastructure for the development of the mortgage market in Egypt, as well as streamlining property registration—a key challenge. The project became more critical after the January 25th revolution in playing a key role in refinancing low-income housing—a major popular demand.
The liquidity facility model was chosen in Egypt rather than other types of funding mechanisms for several reasons. The liquidity facility can contribute to the growth of the mortgage market growth and its down-market expansion. A mortgage liquidity facility is the first step in developing a secondary mortgage market. There are several advantages to such a structure:

- It acts as a way to mutualize the banking sector’s access to the capital market allowing banks to access rates that none of them could obtain individually.
- Avoids the pitfalls of securitization with the misalignment of incentives because of the way the refinancing works, the mortgage assets stay on the balance sheet of the bank.
- Addresses directly the main obstacle to the development of mortgages which is the maturity mismatch between the mortgage asset and available funding.

Such reforms led to the development of a mortgage market that will contribute to improving access to affordable housing. The volume of market-based mortgage loans extended by primary lenders reached LE 4.5 billion in 2012, compared to LE 300 million in 2006 (Figure 2). The average mortgage loan’s term to maturity reached 16 years in 2012, as opposed to 7 in 2006 (Figure 3). This has helped in increasing the number of primary lenders extending mortgage loans to 12 (Figure 4). The volume of participating mortgage lenders (PML) with outstanding borrowings from EMRC has reached LE 450 million in 2012 from zero when the project started.

EMRC has improved affordability of housing finance and played a key role in the refinancing of subsidized mortgage loans. More than 98 percent of the refinance loans and 78 percent in terms of volume were allocated to low-income households (Figure 5). This has set the foundation for the Affordable Mortgage Finance Program, which moved the housing subsidies from supply-side to a more efficient and well targeted demand-side subsidy to the beneficiaries.

The project also improved geographical distribution, where 15 Governorates benefited from these mortgage loans, including those in Upper Egypt with high incidence of poverty and a large housing gap. EMRC had a positive impact on the National Housing Program that provides loans to low-income households on a fixed rate basis. This gives a special importance to EMRC since lenders would otherwise have no way to hedge such lending, which is a major contribution to low-income housing together with the lengthening of maturities. Overall, this project has benefited low-income, underserved groups.

A South-South Learning Resource: The project was referred to as an example of innovative and good practice in the IBRD Strategy for Engagement with Middle Income Countries Report. In the context of south-south partnership, there are cross-regional benefits generated by the project as well, in particular its influence on the design of the Tanzanian liquidity facility model. There is also strong interest in a number of other sub-Saharan African countries to follow a similar development route for their mortgage markets—starting with Nigeria.

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7 Defined as mortgage loans up to LE 100,000.
Moving Forward: As Egypt moves towards a new vision offering more equitable opportunities and active participation by citizens in their governance, it also faces challenges. Yet, the current environment is open to new ways of doing things, including creating a more inclusive housing finance system. Despite strides, the basis for a comprehensive, well-functioning mortgage finance system is not yet fully in place. Key issues to be addressed are below:

1) Formulate a strategic roadmap for the mortgage market, and prepare a housing strategy focusing on low-income housing.

2) Develop EMRC into a functional, financially sustainable, market-based institution able to secure a stable source of funding to the mortgage sector.

3) Create an environment enabling mortgage lenders to provide greater access to housing finance, as well as going down-market by strengthening the regulatory and institutional framework for the mortgage market, including amendments to the real estate finance law.

4) Increase formal housing by private participation in the new affordable housing program.

5) Move forward with the implementation of the Affordable Housing Program, scale-up MFF, and assist low-income households via mortgage linked subsidies enhancing affordability.

6) Ensure that housing subsidies are transparent and well targeted for new housing programs.

7) Resolve the huge problem of old housing stock, vacancy, and frozen rents.

8) Resolve the deadlock between the New Urban Communities Authority (NUCA), and private developers.

9) Strengthen the Non Bank Financial Institutions’ (NBFI) regulatory framework.

10) Improve consumer protection, and regulate developer installment loans, as consumer credit.

11) Develop new and innovative products and expand the Islamic housing finance portfolio.

It is also critical to mitigate the risk of the reversal of reforms. The interim government is not in a position to make long-term strategic decisions, and is being pressured towards unsustainable populist policies. The hostility towards those previously benefitting from privilege and corruption should not lead to a universal condemnation of market mechanisms and private-sector led financial sector reforms.

Contact MNA K&L:
Laura Tuck, Director, Strategy and Operations.
MENA Region, The World Bank
Regional Quick Notes Team:
Omer Karasapan, and Roby Fields
Tel #: (202) 473 8177
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8 EMRC has not issued a bond yet, and for the mortgage market and the affordable housing program to scale up, EMRC has to be able to provide fixed rate long term liquidity to lenders through use of bonds as its major funding strategy. This will be a challenging task in the short term in view of the current interest rate environment.

9 Almost 3.7 million urban housing units are unused, either vacant or closed and an estimated 42% of the housing stock is frozen under rent control.

10 This affects some 200,000 units under construction or planned in the next 18 months by the private sector under NHP and another 70,000 developed by governorates.