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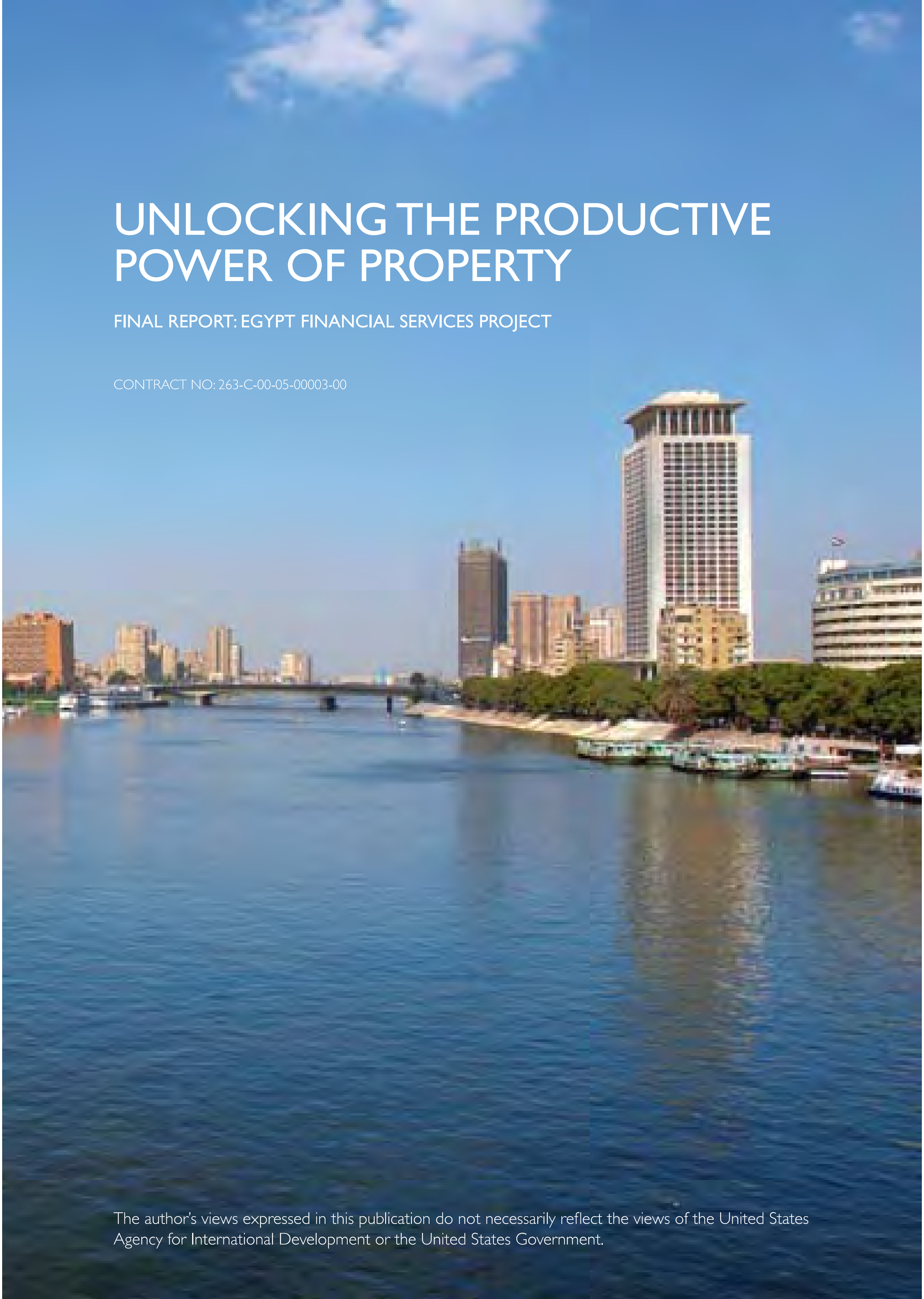
UNLOCKING THE PRODUCTIVE POWER OF PROPERTY

FINAL REPORT: EGYPT FINANCIAL SERVICES PROJECT

CONTRACT NO: 263-C-00-05-00003-00

SEPTEMBER 2010

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc.



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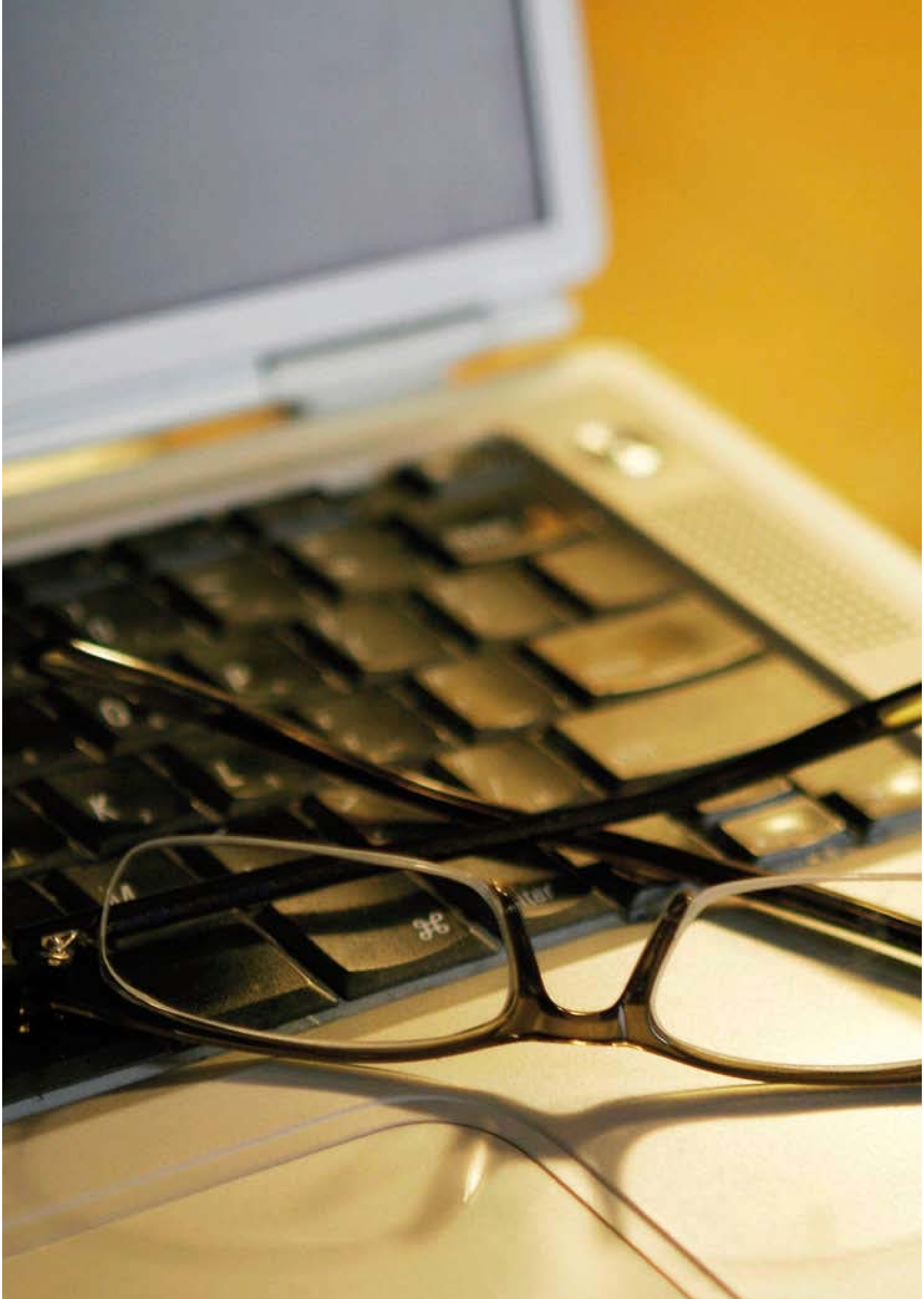

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EXECUTIVE SUMMARY

PURPOSE

The overarching goal of the USAID Egypt Financial Services (EFS) project (2004-2010) was to create the conditions to enable Egypt to legally transform real and personal property assets into resources for productive investment in the economy. To do this, EFS worked with the Government of Egypt and the private sector to achieve three primary objectives: (i) development of a primary mortgage market, (ii) enabling a secondary mortgage market, and (iii) increasing access to low-cost enterprise credit. This report highlights EFS achievements and successes, methodologies and approaches, challenges and lessons learned. It explains how progress against each objective was monitored and measured and offers recommendations for future action.

ACHIEVEMENTS

Primary mortgage market development. By creating a legal and regulatory framework, culminating in a single financial regulator for non-bank financial services, and professionalizing the real estate industry, EFS helped the Government of Egypt develop the primary mortgage market. The primary mortgage market boasts brokers, surveyors and appraisers with strengthened skills, as well as licensed, regulated mortgage finance companies, uniform foreclosure processes, and educated homebuyers.

GOVERNMENT OF EGYPT COUNTERPARTS

EFS supported the following Egyptian counterparts in undertaking key reforms::

- Central Bank of Egypt
- Capital Market Authority (now EFSA)
- Mortgage Finance Authority (MFA, now EFSA)
- Egyptian Financial Supervisory Authority (EFSA)
- Ministry of Justice (MOJ)
- Ministry of Investment (MOI)
- General Authority for Investment and Free Zones (GAFI)
- Ministry of State for Administrative Development (MSAD)
- Egyptian Survey Authority (ESA)
- Guaranty and Subsidy Fund (GSF)

PRIVATE SECTOR COOPERATING PARTNERS

EFS supported the following private sector cooperating partners in introducing new products and services:

- Mortgage Finance Association
- Egyptian Appraisers Association
- Mortgage Brokers Association
- Egyptian Stock Exchange
- Misr for Central Clearing, Depository and Registry
- Egyptian Banking Institute
- Egyptian Capital Market Association
- Egyptian Investment Management Association
- iScore
- Egyptian Mortgage Refinance Company
- Mortgage Finance Companies
- Banks

Secondary mortgage market development. To help mortgage finance companies access lower-cost, long-term funding for mortgage lending, EFS worked with the Capital Market Authority to develop a secondary mortgage market. EFS and CMA worked together to issue the first asset-backed securities, as well as to develop the regulation and functioning of mortgage-backed securities.

Access to finance. To increase access to finance for entrepreneurs, EFS, the Government of Egypt and the private sector introduced the first private credit bureau and introduced new financial instruments that attract new investment in Egypt's economy. A model registration office was developed in Mokattam—one of Cairo's steadily developing urban areas—with the support of the Government of Egypt to facilitate real property registration and replicate in other areas

IMPACT

Egypt's development of institutions, procedures, and systems for property registration and credit information sharing — with significant assistance from EFS — has brought international recognition of the country as a continually improving place to do business. In 2010 the World Bank named Egypt one of the "top ten reformers" in its annual Doing Business survey for the third consecutive year. The survey compares the relative ease or difficulty of performing the standardized transactions required to conduct business legally around the world.

In 2005, shortly after the start of the EFS project, it required 7 procedures, 193 days, and 6.8 percent of the total property value to legally register property in Egypt according to Doing Business. By 2010, according to Doing Business, legal registration of property in Egypt still required 7 procedures, but the number of days to complete those procedures had dropped to 72 days, and the cost of registration had been reduced to 0.9 percent of total property value. Also in 2005, Doing Business noted that the depth of Egypt's credit information was rated 2 out of a possible 6 points; the public credit information registry maintained by the Central Bank of Egypt covered only 1 percent of the adult population; and there was no private credit bureau sharing credit information. By 2010, the survey rated the depth of Egypt's credit information at 6 points, the public registry reached 2.5 percent of the adult population, and a new private-sector credit bureau included information on 8.2 percent of adults.

Importantly, with EFS assistance, Egypt has started to put its wealth of immovable property to work as productive investments in the economy. Six mortgage finance companies (MFCs) and 14 banks are now engaged in primary mortgage lending activities, and five issuers of asset-backed securities have brought 12 securitization bonds totaling LE 9.1 billion to the market.

Perhaps the most important success of the work undertaken by the Government of Egypt and the Egyptian private sector, with support and assistance from EFS, is the impact on the lives of individual Egyptians who are buying homes, registering property, starting and expanding businesses, and working in the real estate finance industry as a result of these efforts.

EFS CONTRIBUTION ACKNOWLEDGED

"There is certainly a strong positive association between the activity of the EFS project and the increase of mortgage lending and the issuance of asset-backed securities" — *2008 Midterm Evaluation of EFS, The Mitchell Group and AECOM*

CHAPTER ONE

INJECTING LIFE INTO "DEAD" ASSETS

A walk through the bustling streets and markets of Cairo reveals a combination of the ancient and the modern. Beautiful, centuries-old stone mosques are nestled between modern multistory buildings in various stages of completion. Amid the hum of economic activity and construction, Egypt has begun to unlock the potential of property assets to generate growth and investment. The change is due to a synergy of public and private sector interest and dedication, with assistance from the USAID Egypt Financial Services (EFS) project.

To understand Egypt's accomplishments, it is useful to examine the historical context of housing and its importance in modern economies. By 2000, Egypt had a glut of unfinished, partially constructed buildings throughout Cairo and in other cities —structures left behind by an apartment building boom in the 1990s that precipitated a collapse. As the majority of lenders did not offer mortgage loans to individual buyers, the housing market relied on construction contracts between buyers and builders. Buyers had to save up substantial capital and pay in installments to build a new property or add to an existing property. Since Egypt lacked a legal and regulatory framework for housing finance, builders who were paid by installment had no recourse when prospective owners failed to make payments. Builders and other financiers had no way of evaluating who to extend financing to as Egypt lacked a private, accessible credit information system. Even when money was exchanged for purchasing property, real estate ownership usually passed informally from one party to another due to the lack of an efficient property registry system. Combined, these factors hindered the emergence of a mortgage (or any other collateral-backed financial product) market.

The resultant situation is well documented in Hernando De Soto's *Mystery of Capital*. De Soto describes assets such as real estate in terms of what they can do, the economic "life" they can lead — but only if they can be formally documented and used to generate additional funds. De Soto says: "They can be used as collateral for credit. The single most important source of funds for new businesses in the United States is a mortgage on the entrepreneur's house. These assets can also provide a link to the owner's credit history, an accountable address for the creation of reliable and universal public utilities, and a foundation for the creation of securities (like mortgage-backed bonds) that can be rediscounted and sold in secondary markets." In 2000, De Soto estimated that Egypt's wealth in "dead capital" — accumulated assets lacking formal representation — included 12 million properties valued at $248 billion. The goal of the EFS project was to help Egypt unlock this wealth and enable these assets to lead what De Soto calls the "invisible, parallel life alongside their material existence."

REQUIREMENTS FOR A MORTAGE MARKET

Three processes are essential for the emergence of a primary mortgage market:

- Processes for real estate appraisal to value properties.
- Processes for authorizing mortgage brokers, who serve as intermediaries between buyers (or sellers) and mortgage lenders.
- Processes for authorizing companies to engage in mortgage finance.

At the inception of the EFS project, Egyptian policy makers had already undertaken some reforms to address these issues. In 2001, Egypt passed the Real Estate Finance Law (REFL), subsequently known as the Mortgage Finance Law (MFL), to establish industry standards and provide a regulatory framework for real estate finance, including improvements to foreclosure and recovery procedures in case of loan default. Implementation of the MFL moved slowly, however, and the World Bank identified further improvements to create an efficient real estate lending market. To facilitate registration of urban properties, the Ministry of Finance and Ministry of Justice reduced property registration fees. As required by the MFL, Egypt created the General Authority for Real Estate Finance (GARF, subsequently known as the Mortgage Finance Authority, or MFA and now merged into EFSA), and by 2003 the entity was operational. It began training, testing, and licensing mortgage brokers and appraisers and preparing processes to license mortgage finance companies. Along with commercial banks, these companies became the only institutions permitted to engage in mortgage finance. These reforms began to create the conditions for the emergence of a primary mortgage market — one in which real property can be used as collateral for credit.

To allow assets to truly take on the life that De Soto describes, however, the real estate finance companies and commercial banks

that provide financing to buyers to purchase homes must be able to secure long-term financing that has some parity with what is offered to home buyers, allowing them to free up more capital for additional lending. This secondary mortgage market fuels financial sector growth. Without it, financial institutions reach a saturation point where they have lent out all their available funds and can only conduct further lending incrementally as loans are repaid or turn repeatedly to other banks for loans. When EFS started, Egypt's Ministry of Investment had already begun studying possible secondary markets for mortgages that could draw in new, long-term funding for the real estate finance market.

Additionally, EFS worked to allow non-real estate assets (movable or personal property) to take on the parallel lives that De Soto described to expand business access to the lower-cost capital needed for start-up and growth. As De Soto notes, most U.S. small and medium enterprises access funding through mortgages. The emergence of financial instruments and institutions dedicated to providing enterprise non-banking finance (e.g. financial leasing and factoring) is turning fixed, non-real estate assets into living capital for new or expanding businesses. Enterprise lending enables individuals with a talent for jewelry-making or cooking, for example, to turn these skills into a profitable business. However, before lending to entrepreneurs, banks and other financial institutions need to be able to ensure that borrowers really own the assets they claim; that these assets have not already been pledged against other funding; that the lender can legally take possession of the assets if an entrepreneur cannot repay the loan; and that entrepreneurs seeking business funding are creditworthy and have not already defaulted on a loan from another lender.

CHAPTER TWO

DEVELOPING A PRIMARY MORTGAGE MARKET

At the start of the EFS project, Egypt had just begun to develop the laws, regulations, policies, and procedures necessary to allow for mortgage lending. There were no mortgage finance companies in operation, the Mortgage Finance Authority legally established under the Ministry of Housing was nascent, and the supporting industry of surveyors, appraisers, and mortgage brokers needed to be formalized and developed. Without sound policies and procedures for mortgage finance, regulation and supervision of mortgage lenders, and foreclosure or default recovery, the mortgage finance industry could very well have stalled Egypt's economy rather than stimulating it. Without professional surveyors and appraisers to establish the boundaries and value of properties, and without transparent and fair brokerage firms, prospective homebuyers could be deceived, while mismatches between loan and property values could disadvantage either lenders or borrowers.

Together with the Ministry of Investment (MOI), the MFA, and private mortgage finance companies, the EFS team set out to develop a legal and regulatory framework that would authorize private institutions to engage in mortgage finance, establish standards for mortgage provision, define and authorize public sector supervision of those institutions, and build their capacity to enforce standards. To support private sector engagement in mortgage finance, EFS worked with emerging private institutions, organizations, and associations to build their capacity and understanding.

CREATING A LEGAL AND REGULATORY FRAMEWORK

The Mortgage Finance Law (MFL), passed in 2001, permitted finance companies and banks to provide long-term real estate loans to individuals and called for the establishment of an authority to regulate real estate finance. Two presidential decrees created the General Authority on Real Estate Finance (GARF) as a regulatory agency under the Ministry of Housing and issued executive regulations for its operation. Although the MFL also called for a guarantee and subsidy fund, there were few details on how it would operate. By 2003, GARF was operational and began training, testing, and licensing real estate brokers and appraisers and was preparing to license mortgage finance companies. When EFS began in 2004, GARF had been renamed the Mortgage Finance Authority, or MFA, and reorganized to report to the newly formed MOI. Two mortgage finance companies (MFCs) had been established but were not yet operational, and a third company was forming.

The lynchpin of EFS's efforts was to bring the public and private sectors together in various forums to discuss and agree on the legal and regulatory framework. A Legal Working Group comprising MFA staff, MFC representatives, and EFS technical experts met regularly to draft and review regulations and procedures governing real estate finance. The Legal Working Group periodically included commercial banks in the document standardization process to kindle interest in the new mortgage finance market and to incorporate best practices.

A core task of the Legal Working Group was to review the executive regulations of the Presidential Decree that followed the REFL (renamed the MFL) of 2001 and other legislations and regulations relating to mortgage finance and identify areas for clarification in the standards and procedures for execution of these regulations. The Legal Working group examined the standards and procedures related to the execution of foreclosure laws and obstacles to the mortgage system. Reviews of the legal and regulatory provisions recommended two amendments that improved the foreclosure process, and then began to identify and address obstacles to the mortgage system.

An efficient foreclosure process. As mortgage lending grows, a small percentage of loans will not be repaid, forcing lenders to foreclose (or repossess) real estate to repay the loan. Without an efficient foreclosure process, banks and mortgage lenders must offset the risk of non-repayment or default by increasing costs to the consumer at large. The MFA stated that foreclosure rules were drafted to bring order to the foreclosure process and to protect both borrowers and lenders. As a result of working group recommendations, the foreclosure rules now have set time periods for action and procedures, per international best practice. A lender is now required to provide a borrower who has failed to make payments with a notice explaining the consequences of not bringing payments up to date by a specific deadline. To ensure that the courts responsible for enforcing foreclosure actions do so consistently, the working group developed training materials for a judges' seminar on foreclosure, and the MFA and Ministry of Justice trained legal agents to supervise foreclosure sales. Uniform enforcement of foreclosure rules in the courts reduce the perceived risk of mortgage lending, which in turn helps to increase mortgage lending and reduce costs. As a result of these improvements, Egypt conducted three successful foreclosures in 2008. The foreclosure process, which previously took five to seven years under the Civil Code, has been reduced to around six months under the MFL.

Removing legal and regulatory obstacles to the mortgage finance system. EFS worked hand in hand with the MOI, and the newly established MFA to study the regulatory structures, policies, and procedures for mortgage lending and recommend changes or refinements. In order for laws, regulatory structures, policies and procedures to have teeth, they have to become operational. An effective mortgage finance system is predicated on lending institutions being able to access long-term capital flows through secondary mortgage markets that rely on standardized lending practices that conform to international best practices. By engaging commercial banks and MFCs, and by placing an advisor in the MFA to build capacity and ensure that recommended changes had sufficient private sector buy-in, EFS helped MFA fulfill its role as regulator and brought significant standardization to the mortgage lending process.

In partnership with MFA, EFS developed manuals to guide the supervision and examination of MFCs, drafted regulations and procedures to govern the underwriting of mortgage loans, and prepared related documentation, all too international standards. Together, MFA and EFS designed a model organizational structure for a mortgage lending unit for use by banks wishing to enter the market. Having an onsite advisor located at the MFA full time enabled EFS to provide on-the-spot regulatory advice and review draft documents such as MFA Directives to MFCs covering topics such as licensing new MFCs and asset quality. Through on-the-job training and skills transfer, EFS assisted MFA in conducting its first two onsite portfolio examinations and operational inspections. However, adequate supervision is a continual process that requires offsite inspections as well. Through the trust developed and insight that can only be garnered through exposure to day-to-day operations, EFS guided and encouraged MFA staff to develop and test a reporting system that established data flow from MFCs to the MFA on the performance of mortgage portfolios. EFS worked with MFA on analyzing MFC data as part of its off-site inspections. With EFS guidance and assistance, the MFA successfully conducted 6 on-site inspections of MFCs and has since become a fully independent regulatory agency and market advocate.

Finally, despite clearer regulations and foreclosure processes, bankers still perceived the mortgage market as presenting a certain amount of risk. To stimulate interest in mortgage finance and encourage lending by MFCs and banks, EFS worked with the MFA to review the structure of the payment guarantee fund (eventually named the Guaranty and Subsidy Fund, or GSF) established by the MFL. EFS urged both the MFA and GSF to split the fund into two components, one to subsidize or reduce the low-income consumer cost of housing finance and another to guarantee repayment if a qualified, enrolled borrower defaulted on a loan. These measures were in line with international best practices and clarified the purpose, function, and administration of the GSF. EFS then helped restructure the GSF, provided advice on proper pricing of the guarantee, and developed the Fund's capacity to serve its two distinct functions for lenders and borrowers. Access to the loan guarantee portion of GSF reduces the risk to banks and MFCs in introducing new products like individual mortgage loans, while the subsidies lower costs of financing to consumers until competition in the market has served to lower them, at which point subsidies can continue to serve a purpose of lowering costs for specific groups that would not otherwise be able to access these loans but are creditworthy.

Single financial regulator. Even before the recent financial crisis, Egypt had begun to regulate non-bank financial services. In 2004, the newly created MOI was assigned the responsibility of supervising all non-bank financial institutions. Previously, financial services were regulated and supervised by different ministries and authorities. The Central Bank of Egypt regulates and will continue to regulate all banks. Insurance was regulated by the Egyptian Insurance Supervisory Authority (EISA), under the Ministry of Economic Planning; mortgages were regulated by the MFA under the Ministry of Housing; capital markets were regulated by the Capital Market Authority (CMA) under the Ministry of Foreign Trade; microfinance was regulated by the Ministry of Social Solidarity; and leasing and factoring were regulated by the General Authority for Investment and Free Zones (GAFI). All these supervisory agencies had to coordinate with the Central Bank of Egypt in its role as a regulator of commercial banks and ultimate authority for the effective functioning of the financial sector. To illustrate the complexity, imagine the case of a publicly traded commercial bank that offers mortgage finance. This bank would be regulated primarily by the Central Bank of Egypt (CBE), its mortgage finance portfolio would be regulated by the MFA, and the trading of its bonds to raise capital on the secondary mortgage market would be regulated by the CMA. To improve coordination and efficiency, Egypt consolidated all the functions of all of these specialized agencies regulating non-bank financial institutions under one agency, the Egyptian Financial Supervisory Authority (EFSA), under the Ministry of Investment.

To achieve this, EFS worked closely with MOI and the agencies themselves on the practical steps necessary to merge those agencies, clarify and adjust the legal and regulatory framework, and integrate staff and systems while continuing day-to-day operations during the reorganization period. EFS, the staff of the USAID Technical Assistance for Policy Reform II (TAPR II) project, and the MOI drafted a roadmap for the merger into a unified single regulatory entity, supported by two workshops in concert with the World Bank. The workshops helped create an understanding of the process and the roles of each agency and proposed amendments to the draft single financial regulator law that would help preserve the integrity and independence of the EFSA and its staff.

The workshops, led by the Minister of Investment, also helped kick off the process of implementing the merger. The EFS and TAPR II teams jointly conducted two due diligence assessments of the regulatory authorities. First, they examined administration and operations, and second, the core regulatory functions. The first assessment resulted in key recommendations on information technology (IT) infrastructure and systems, financial sustainability, accounting systems, facilities, and human resources. The due diligence report identified activities that could be consolidated, such as those carried out by each agency's legal, finance, and administrative departments that would repetitive once the

agencies merged. Based on the results, the teams developed a detailed merger plan, drafted an organizational structure for the new agency, and consolidated functions where possible and practical.

The EFSA was up and running starting July 1, 2009 as a consolidated agency. By September 2009, the new organizational structure was approved by the EFSA board and made functional on a year-long trial basis before being submitted to the Central Agency for Organization and Administration for official approval. Agency staffs were reallocated functionally and physically according to the new organizational structure and among the four premises of EFSA. The main regulatory recommendation to bring the ratio of regulatory staff to the number of regulated agencies up to international standards was implemented with the full support of the EFSA Chairman. EFSA, TAPRII, and EFS developed and implemented a plan to hire about 40 new young regulatory staff in different functional areas. The plan included for the first time in a governmental authority, a four-month orientation training and a 16-month rotation plan of the new staff among different regulatory departments of EFSA.

PROFESSIONALIZING THE REAL ESTATE INDUSTRY

With a regulatory structure in place and public sector capacity for supervision and regulation improving, the Egyptian authorities and

EFS turned to examining the private sector entities needed to effectively stimulate individual mortgage finance and home ownership. In addition to financiers, a complete real estate industry needs buyers' and sellers' agents and brokerage firms to represent and protect the interests of both during the purchasing process, as well as objective surveyors and appraisers to provide buyers, sellers, and lenders with the information needed to establish fair market values for property. Two mortgage finance companies, the state-owned banks' Al Taameer Real Estate Finance Company and the private banks' Egyptian Housing Finance Company (EHFC), were already established and registered with MFA, although these institutions had not begun to issue loans. A third company was also in the process of being formed. Brokerage firms were active in selling commercial property and providing management and rental services for Egyptian and foreign clients. Appraisal and real estate broker associations had been formed and registered and were just beginning operations. There remained a need to create awareness among the public of the new opportunities for home ownership, and among real estate and finance industry professionals of the new regulations and standards for mortgage finance.

Although many of the formal businesses that support the buying, selling, and financing of individual real estate were either nonexistent or nascent at the start of EFS, homes were being bought and sold in Egypt, supported by informal surveyors, appraisers, and agents. Through training, capacity building, and public outreach, EFS helped to formalize and professionalize the real estate industry. There are now professional associations for real estate appraisers, mortgage financers, real estate agents or brokers as well as homeowners associations, and EFS made strides toward developing a professional surveyor industry. This section highlights some key EFS accomplishments.

Egyptian Real Estate Agents Association. Although existing mortgage finance law and regulations does not regulate real estate agents, this group of professional's works at the point of origin of real estate transactions. Through their professional relationships and their desire to build a client base, agents can have a significant impact on the growth of the real estate market. Realizing their importance to the industry, EFS established a task force of key real estate salespeople who were recognized as market leaders. They eventually formed the first professional association of real estate agents in March 2006. In an excellent demonstration of what can be accomplished on the sidelines of a workshop, the group created their association during lunch breaks at an EFS strategic planning session. EFS provided support in the form of training in management, sales, and marketing. EFS also introduced internationally recognized standards and business practices such as the multiple listing system, a centralized database for all properties for sale, and proposed a certification program that could be used as a tool for self-regulation while improving current practices. Ultimately, the association chose not to pursue some of these options — for example, they may have perceived the multiple listing system as eroding the competitive advantage of individual sales agents or brokerage firms. Nonetheless, EFS helped a group of sales agents organize, professionalize, and grow the industry.

Developing a cadre of real estate market practitioners. To further develop the industry's ability to support increased real estate lending, EFS developed and implemented a training program for real estate professionals, including mortgage brokers and agents, appraisers, and foreclosure agents. The training consisted of five in-depth, specialized courses geared for each group of professionals, a separate training program for real estate appraisers, and curricula for brokers on licensing and renewal procedures.

"Own Your Home" public awareness program. Taking a lesson from the housing market collapse in the United States — which, some argue, was due to encouraging buyers to take out loans on unfavorable terms, or to borrow beyond their capacity to repay — EFS supported a public information campaign to help potential buyers make informed loan choices. EFS also encouraged the MFA to share more information about home ownership and long-term mortgage debt. Through a combination of surveys, workshops, conferences, media spots, print publications, a toolkit, and two documentaries on mortgage lending, EFS worked to educate the public to make responsible decisions about their mortgage debt, with the goal of reducing future delinquency. As a result of EFS's strategy to bring together various industry players, mortgage finance companies started to advertise their services on street signs. Radio campaigns at one point were generating more than 700 calls per day to MFCs. Many real estate developers also made it clear that their properties would be sold under the mortgage finance law, and they were aligned with MFCs to sell properties.

EFS also established the initial framework for a professional property surveyor industry. The team focused on strategies to build private sector capacity in delivering cadastral surveys and maps to help locate properties and log their unique characteristics, such as land dimensions and structures.

Support for successful mortgage lending. Mortgage finance companies, newly formed and licensed at the inception of the EFS project, lacked advanced expertise and experience in issuing credit. To help them building their capacity to make sound credit decisions, EFS conducted a needs assessment of the two existing MFCs, analyzing work processes from loan origination through initial screening, appraisal, underwriting, disbursement, and loan closing. The MFCs welcomed the EFS recommendations and incorporated them into their strategic plans. The assessments found that the credit and underwriting processes needed more attention, and that additional trained professionals were required.

To address these issues, EFS worked with the MFCs to draft a credit manual for mortgage lenders, which was then aligned with the MFA regulatory manual. The manual served both to clarify the credit analysis and underwriting process and to bring credit and underwriting policies and procedures in line with international standards and best practices. In support of the MFCs' need for more professionally trained staff, EFS brought in trainers from the Mortgage Bankers Association of America in September 2005 to give MFCs and bank staff general training on mortgage lending. The course was repeated for a total of six rounds.

Developing a model bank mortgage lending unit. Banks, seeing the emergence of a new market with high potential, were beginning to show interest in mortgage lending. Late in 2007, the MFA and Central Bank of Egypt requested EFS assistance to establish a pilot mortgage unit at Banque Misr. Working closely with the MFA and Banque Misr to develop an organizational structure, job descriptions, functional descriptions of each department, and the flow of operations for the mortgage lending process, EFS created a carefully structured unit to serve as a model that could be replicated by other banks. A range of mortgage products — including for low-income housing — as well as financial models and a draft loan review procedure were put in place for use by Banque Misr. The MFA praised the model, which met the goal of being easily adoptable by other banks.

Efforts to develop the mortgage market and professionalize the industry paid off. By September 2007, total mortgage volume at banks and MFCs reached EGP 1.9 billion, a 90% increase from December 2006 and 39% over June 2007. As reported by MOI in the Euromoney Conference in June 2010, by end of March 2010, total mortgage finance extended by banks and MFCs reached EGP 4.4 billion, a 25% quarterly growth rate during the period December 2005- March 2010.

CHAPTER THREE

DEVELOPING A SECONDARY MORTGAGE MARKET

A primary mortgage market generates a steady stream of installment payments against home loans and ensures lenders can take possession of the property in the unlikely event of default. However, banks and mortgage finance companies active in the primary mortgage market have limited funds to lend to their customers, and monthly payments do not provide sufficient cash flow to enable lenders to expand their operations. Once banks and MFCs have lent out their initial funds, they must look beyond incremental repayments for additional funds to meet the growing demand for mortgages. They can borrow from commercial or wholesale banks, but most bank loans have much shorter repayment terms than mortgages. This creates a funding mismatch that increases the cost of capital for both lenders and borrowers. For the real estate finance market to continue to grow and for rates to be competitive, banks and mortgage finance companies must be able to sell their portfolios on the capital market to raise the cash they need to provide new loans. This is the secondary mortgage market.

UNDERSTANDING CAPITAL MARKETS

A capital market enables companies or governments to raise long-term funds by providing money for more than a year. Money is raised through the selling of either debt securities (such as bonds) or equity securities (such as stocks). A stock or bond is born through a risk assessment process called underwriting, much as loans are originated. Stocks and bonds are then bought and sold by brokers, bond dealers, and custodians. The capital market is overseen by a financial regulator that, among other duties, protects the purchasers of stocks and bonds from fraud.

EFS set out to support the development of a secondary mortgage market by working with the Capital Market Authority (CMA) to develop a regulatory and supervisory infrastructure for this new market. The CMA, which was eventually consolidated into the EFSA (see Chapter 2), regulated financial transactions and markets that allow businesses and financial institutions to raise capital. Sources of funds used in the secondary mortgage market typically include mortgage

bonds. More generally, this type of financial market is called an asset-backed securities market and includes not only mortgages as the assets guaranteeing the bond issued to raise the funds, but also a variety of other loan assets, including credit card payments and car loans. These assets are then purchased and grouped or "bundled" by a separate financial institution that divides them into sellable pieces (usually a bond) that represent a portion of the total bundle of assets. The bonds are secured by the loan assets in the bundle. These types of securities generally mature over the medium to long term at a fairly steady rate, similarly to the assets securing them.

Building on work carried out under the USAID Capital Markets Development (CMD) program, the EFS team worked with the CMA to develop a legal and regulatory structure, designed instruments appropriate to the Egyptian context, and built the CMA's regulatory capacity. In parallel, EFS worked to facilitate the establishment and development of the non-bank financial institutions that would issue these securities.

Developing a regulated asset-backed securities market with the CMA and MFA. EFS supported the CMA and MFA in laying the groundwork for introducing mortgage-backed securities as a mid- to long-term financing tool for lenders to finance mortgage portfolios with long maturities at relatively lower costs than would be available from banks.

Beginning in 2004, EFS, CMA, and MFA reviewed the executive regulations on asset-backed securities. Together, they proposed and drafted amendments to the rules and regulations that facilitate and regulate asset-backed securities (ABS) in general, as well as the new mortgage-backed securities (MBS). EFS then trained CMA and MFA staff on the regulatory requirements for a sound MBS market and the interrelations between the primary and secondary mortgage markets, underscoring the need for standardization of mortgage documents that was already underway.

To ensure that the mortgage-backed securities were underwritten appropriately and priced adequately, EFS followed up with training in MBS market operations for securities underwriters, investment banks, the credit rating agency, and stock exchange and clearinghouse staff. Together, CMA, MFA, and EFS sought out and trained mortgage lenders and potential issuers of MBS in the uses, advantages, disadvantages, formation, and structure of MBS. Training of regulators was essential to enable them to identify the potential risks to public investors associated with MBS or ABS and to protect the public investors by, among other things, improving disclosure of: types and conditions of assets in a securitization portfolio; forecasts of future cash flows from the portfolio and to the bondholders; risks associated with the portfolio including credit/default risk, market risk, legal risk, early repayment risk, etc; as well as the credit rating of the securitization portfolio and the credit rating of the bond itself. EFS worked with the CMA to establish and issue the first pilot asset-backed securities. Once the CMA had drafted the rules to issue securitized bonds, EFS provided on-the-job training for the CMA and two pilot securitized bond issuers in 2005.

Establishing the Egyptian Mortgage Refinance Company (EMRC). To further support the development of a robust mortgage market, EFS worked to introduce mortgage refinancing. Refinancing allows borrowers to replace an original mortgage and its terms with new terms. When interest rates fall, most borrowers want to take advantage of lower rates either to reduce their monthly payments or to pay off their loans faster. To enable Egyptian home buyers to take advantage of the falling interest rates that occur as the mortgage market grows, EFS provided legal support for the creation of a mortgage refinance company. Called the Egyptian Mortgage Refinance Company (EMRC), Egypt's first mortgage refinance company was incorporated in 2006 with paid-in capital of 217 million Egyptian pounds. At its incorporation, it boasted 23 shareholders included the Central Bank of Egypt, the GSF, 18 banks, and 3 mortgage companies.

NO NEED TO BORROW FROM BANKS

"We're planning on repeatedly going back to the market to continuously finance our operation. We're not dependent on banks for expansion — we're dependent on the capital market." — *Hazem Moussa, General Manager, Contact Securitization Company, Cairo, Egypt*

At the end of the EFS program, 12 asset-backed securities were issued by 5 issuers for a total value of LE 9.1 billion. Most importantly, strengthening of capital markets through the introduction of mortgage-backed securities, and more broadly, asset-backed securities, allows financiers and businesses to access lower-cost funds to use for additional lending. This not only increases access to mortgages and other productive assets through lending, but, helps to lower the costs of financing. These costs are then passed to homebuyers in the form of lower interest rates.

CHAPTER FOUR

INCREASING ACCESS TO ENTERPRISE FINANCING

In the 1980s and 1990s, most Egyptian home buyers had to save the full price of a property or the bulk of construction costs due to the lack of a real estate finance system. Similarly, without a system for registering movable and immovable property, without a credit information sharing system such as a credit bureau, and without capital market instruments offering alternative, less costly sources of financing, the financial sector focused on businesses that could afford to repay the full amount of their debt. By creating a private credit bureau, building the foundation for property registries (for both immovable property like real estate and movable property like machinery or receivables), and introducing new financial instruments, EFS helped to improve the options available for enterprise finance and to attract new investment in the productive sector. Together with the development of the real estate finance industry, these innovations encouraged a cultural shift toward collateral-based lending and the more informed credit risk analysis offered by a functioning credit bureau.

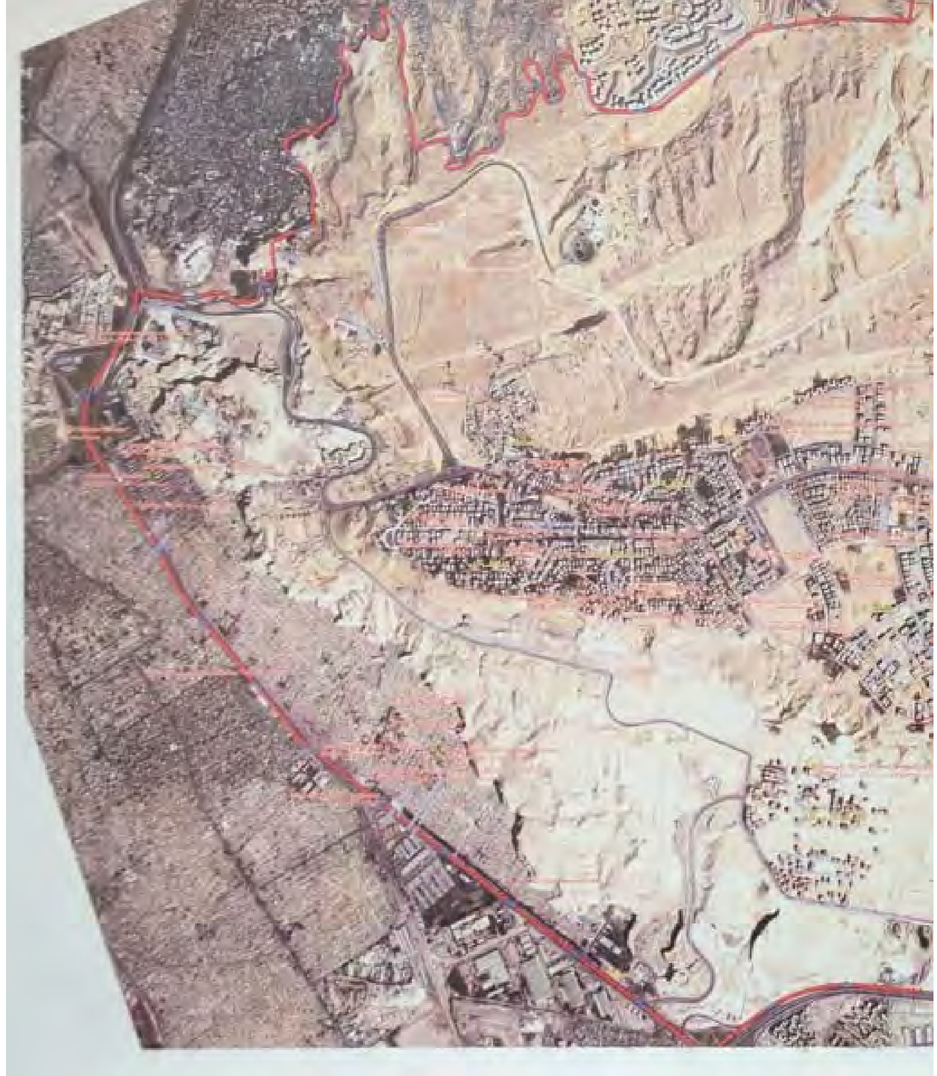
EGYPT'S FIRST PRIVATE CREDIT BUREAU, ISCORE

At EFS's inception, Egypt had a public credit bureau that was operated and used by the CBE. While this helped the CBE administer and regulate the inter-bank market, this system did not enable individual credit risk assessment, which meant that banks had a limited and/or

THE FIVE "CS" OF CREDIT

Best practices in sound enterprise lending are governed by an evaluation of five "Cs":

- *Character*. The borrower demonstrates responsibility with respect to debt repayment.
- *Cash flow*. The borrower demonstrates adequate



cash flow to repay the loan.

- *Collateral.* The lender can recover some or all losses by repossessing the borrower's collateral (assets, movable or immovable).
- *Conditions.* The loan conditions are structured to offset risks arising from an imbalance of the criteria above.
- *Capital.* Total capital (either from the loan or paid-in) is sufficient to fund the enterprise.

Checking character, cash flow, and loan conditions greatly rely upon a comprehensive credit bureau. A credit record or report will show a borrower's debts and demonstrated history of repayment. Repayment history goes a long way toward establishing good credit character, while debt obligations compared with earnings demonstrate whether a borrower's cash flow is sufficient to take on another debt. Risks associated with either character or cash flow can influence the terms or conditions of the loan: better character and good cash flow means less risk and more favorable terms, while the opposite means that banks may still be able to lend, but will offset the risks with more stringent terms that help them recover the debt in case of default.

subjective basis on which to determine who was a "good" or a "bad" borrower, or to assign interest rates and other favorable terms accordingly. A private credit bureau, serving the entire financial market, would enable institutions to make these determinations. EFS worked with the CBE on enabling legislation and regulations to provide for the creation and oversight of a private credit information system, and to ensure that consumers' rights would be adequately protected in the system's use. With the framework in place, EFS worked to develop the CBE's capacity to oversee the private credit bureau, and to establish and operate a private credit bureau, iScore.

The CBE and EFS first examined the Banking Law and laws regarding privacy rights and information exchange, then drafted changes to permit the establishment of private sector credit bureaus, mandate the CBE as their licensor and regulator, and enable the exchange of credit information between the CBE, bank and non-bank financial institutions, and credit bureaus. They then drafted rules and regulations for private sector credit bureau operations, including provisions to protect consumers' right to obtain copies of their credit reports and to

lodge a complaint should the information contained therein be misreported. To ensure widespread use of the credit bureau — essential to ensure its value and utility to the financial sector as a whole — the CBE agreed to share partial data with iScore and issued a regulation making it mandatory for banks and non-bank financial institutions to report to and use private credit bureaus.

Concurrently, iScore was established in 2005. EFS worked with the CBE to draft a membership agreement in conformity with the rules and regulations for private credit bureau operations. EFS sponsored a workshop on U.S. best practices for credit bureaus with broad participation by the CBE, iScore, banks, the property registry, and representatives of the U.S. Federal Deposit Insurance Corporation, the U.S. Federal Trade Commission, and a U.S. data aggregation company, ChoicePoint. The workshop addressed compliance and regulatory issues related to the use of credit information. As a result, the CBE developed three regulatory models, one to oversee credit bureaus, one to oversee non-bank members of the credit bureau, and a third to oversee member banks. Importantly, the workshop underscored

"CUSTOMER HABITS HAVE CHANGED"

"The Egyptian Credit Bureau is an integral part of a sound credit cycle. … Customer habits have changed. Credit has now become an integral part of our economic cycle." — *Mohamed Kafafi, Chairman, iScore, Emerging Egypt 2008 (AmCham)* the need for CBE to be flexible in its examination processes, and to review the work procedures, manuals, systems, and internal controls of banks and iScore before inspecting individual transactions. This enabled a review and analysis of transactions to diagnose the need for better policies, procedures, and systems.

TITLE SYSTEM VS. DEEDS SYSTEM

Although either a title-based or a deeds-based system serves the function of documenting ownership, each employs a different approach.

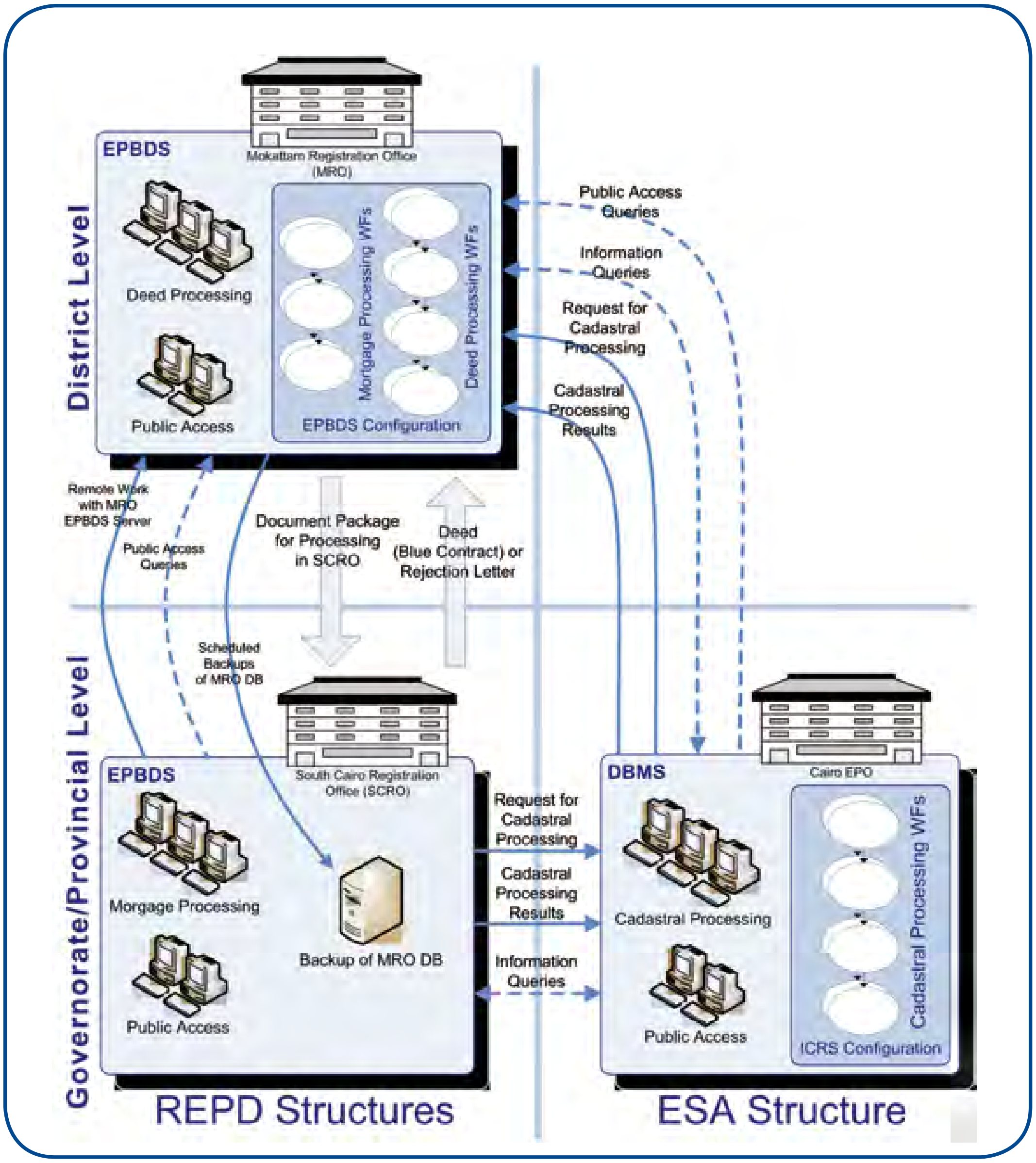
- Title-based systems operate on the principle of "title by registration," meaning that through the process of registering the title document, the government bestows ownership rights. A single common land registry in the form of a "master" book reflects changes to land ownership, which are registered and represented in a physical title. Only legal changes are entered.
- Deeds-based systems "register" any document or instrument related to land. A property may have several instruments or documents registered that relate to ownership, division of property, or restrictions, but this does not attest to the legality of any of the documents. Under a deeds-based system, litigation is required to resolve land claims even when deeds are registered.

With any information-sharing system, issues of information quality, security, format, and standardization determine its utility. To ensure that credit information is linked to the correct borrower, the CBE required banks to provide personal information on borrowers to iScore with each borrower's national identification number issued by Ministry if Interior. Although the banks were adhering to their own internal verification processes and best practices, some of the information they provided fell short of iScore's requirements or the CBE's governing regulations, and iScore had to reject these records. iScore worked closely with these banks to clarify data requirements, use of the Dun & Bradstreet software that extracts and validates information before it is sent by banks, and provided training to 48 banks to improve their understanding of the information required for credit reports. EFS also sponsored U.S.-based training for the CBE's IT department on securing information flows. After the training, the CBE issued detailed IT regulations governing the exchange of information between public and private entities using credit bureaus.

Perhaps most importantly, the introduction of a private sector credit bureau enables banks to make sound credit decisions, and to structure loan terms and conditions to meet the individual profile of the borrower. Systematized, standardized, and regulated information sharing allows banks to understand and meet the needs of individual clients, while individuals, armed with an objective record of their credit history, are better able to gain access to banking services and favorable terms. The stories of the two borrowers (see page X) are typical of the businesses that have benefited from expanded enterprise lending that relies on information from Egypt's first private credit bureau.

DEVELOPING A MODERN, EFFICIENT REAL PROPERTY REGISTRATION OFFICE

To further enable the development of mortgage finance, USAID and the Government of Egypt identified the need for a streamlined, modern, efficient, safe, and secure immovable property (real estate)



registration system as critical for expanding mortgage lending and increasing levels of home ownership. At the start of the EFS project, 90 percent of urban land and real estate was not formally registered, and the registration process was time-consuming and costly, taking up to 193 days and costing an average of approximately 7 percent of the total value of the property. Previously, the government had made efforts to lower the costs of registration: in 2003, the ministers of finance and justice reduced fees to 4.5 percent in an effort to facilitate mass urban property registration. Despite these efforts, the World Bank's 2004 *Doing Business* survey found that the cost of property registration remained at around 7 percent. Beginning in 2004, EFS reviewed property registration laws, operational processes and practices, the institutional environment, and the use of technology in the registration process to identify key constraints to a more efficient, inclusive property registration process. EFS recommended business process reengineering to clarify and simplify procedures, then developed a model registration office (MRO) in Mokattam, one of Cairo's prime areas for new housing.

The property registration process is governed by two laws: Siguel Al-Shaksi, Law 114/1946, governs the registration of deeds, and Siguel Al-Ainee, Law 142/1964, governs title registration. In practice, Siguel Al-Shaksi, or deed registration law, is applied in urban areas, while Siguel Al-Ainee, or title registration law, has been applied in more than 85 percent of the rural areas across the country over the last 30 years. EFS's review of the legal and regulatory environment revealed that ad hoc interpretations of legislation and regulations had led to a convergence of the two systems, with neither law being applied in full. EFS proposed merging the two processes into one Siguel Al-Ainee, or title registration law, but in light of time and resource constraints, the government preferred to focus on improving Siguel Al-Ainee for introduction in new urban areas. It was initially determined in 2006 that a model registration office would be established in a new urban area (Mokattam) to introduce Siguel Al-Ainee.

An underlying issue related to effective and timely property registration was the time required for initial adjudication activities, such as researching existing documentation, ownership status, and other rights and restrictions affecting ownership. With fewer than 10 percent of all properties registered, determining this basic information was difficult. To address this issue, EFS developed an operations manual for adjudication. Another challenge was linking spatial information about the property and its installations (cadastral information) with ownership records. To simplify the process, EFS worked with the Egyptian Survey Authority (ESA) on a new linkage process. The scheme was adopted for the Mokattam MRO and was intended for use in a national title registration campaign. After some debate, it was decided that before rolling out the title-based system, EFS would work on improving the deeds-based system (Siguel Al-Shaksi) as a prerequisite.

DEEP REFORMS

"Egypt's reforms went deep. … Fees for registering property were reduced from 3 percent of the property value to a low fixed fee. With more properties registered and less evasion, revenue from title registrations jumped by 39 percent in the 6 months after the reform … [and] the first private credit bureau was established." — *World Bank, Doing Business in Egypt 2008.*

Given the overlapping nature of the deeds-based and title-based systems as each was applied in Egypt, several related processes had to be improved to enable accurate documentation of real property ownership. Typically, land titles or deeds were filed and indexed by owner name and year, which unnecessarily complicated the research process. EFS recommended using a parcel-based index where property would be identified by location and ownership records associated with that location would be linked. As in many rapidly growing urban areas, it was difficult to determine Mokattam's boundaries. Using high-resolution satellite imagery combined with field surveys, ESA, the Ministry of Justice's Real Estate Publicity Department, and the Cairo Governorate formally delineated the area that would be served by the Mokattam MRO and that would be mapped. Supervised by ESA and EFS, a private survey firm was engaged to carry out parcel index mapping to identify properties in half of Mokattam.

Initial business process mapping and reengineering led to internal streamlining of the land registry services for secondary transactions. EFS helped the Ministry of Justice prepare policy notes comparing the existing transaction fee structure (established as a percentage of property value) with a flat fee structure that would make transaction fees more straightforward and objective, removing subjective and costly property valuation criteria. This change significantly streamlined internal registration processes, as the flat fee scheme could be applied immediately. The flat fee scheme was introduced in 2006, too late to be covered in the 2007 World Bank's *Doing Business* survey, but by the 2008 survey reported that this improvement, combined with the iScore private credit bureau, helped Egypt earn recognition as the top reformer worldwide.

To identify further bottlenecks and constraints to land registration, and at the direct request of the Assistant to the Minister of Justice for real estate affairs, EFS established a stakeholder group of representatives from government and private sector property lawyers. Given the length of time required to amend laws and the lack of a clear preference for a deed-based versus a title-based system, the group focused on measures that could be taken with no change in the legal and regulatory structure. They identified 35 core recommendations to streamline and strengthen Siguel Al-Shaksi, the deeds-based system. However, given the interrelatedness of the two systems, the recommendations improved both systems and set the stage for conversion or integration in the future. All these changes were adopted in the form of revised REPD technical instructions and circulars during 2007 and 2008.

In preparation for the establishment of a fully operational MRO in Mokattam, EFS provided capacity building assistance. Approximately

140 REPD and ESA staff received training through EFS support. Courses included customer service and IT skills, while selected staff were trained extensively on using registry and cadastre software applications configured with EFS assistance. Core courses on concepts of registration, mortgage registration, and property registration were delivered to MRO staff. This training can be used to support the establishment of further MROs in any of the other 120 registration offices serving other urban districts.

To further streamline and strengthen the deeds registration system through consistent application of registry business processes, data integration, and security of ownership information, EFS supported the introduction of modern IT systems in REPD and ESA. The Enhanced Parcel-Based Deeds System (EPBDS) software was configured according to specifications developed with and approved by REPD. ESA cadastral maps and processes were also automated through configuration of the Cadastral Data Management System (CDMS) according to specifications developed with and approved by ESA. The two systems exchange data electronically, which means the public is no longer required to visit multiple offices to obtain registration. EPBDS and CDMS are also installed in the South Cairo Registration Office (SCRO) and the ESA Provincial Office (EPO) in Cairo, respectively. These four offices were refurbished and fitted with modern IT hardware with EFS assistance. Exhibit X shows the exchange of information between the various entities.

Technical assistance delivered through EFS helped establish a demand-driven property registration environment in Mokattam. The MRO showcases a modern one-stop shop for the property registration services of REPD, ESA, and the Notary Public. The application of IT in a newly designed space has also permitted the establishment of a dedicated customer service area and separate back-office for transaction processing, which limits client access to back-office operations, reducing opportunities for fraud and corruption.

In September 2008, the Ministry of Justice granted the MRO full legal and operational status, and it was officially inaugurated in November 2008. By then, the MRO had processed more than 1,000 transactions. Citizens enjoy improved access to registry data and cadastral maps, and the EPBDS includes a Web feature that permits the public to search transaction status and view property records on a computer in the MRO. A further step that was planned, but not implemented by EFS, is to connect MRO and EPO via a VPN to exchange data in real-time. This was not implemented because of lack of land lines in Mokattam. In addition to establishing MRO, MOJ has re-engineered registration processes in other registry offices. As a result, by 2009, without reducing the number of procedures necessary for property registration, Egypt had reduced the number of days required to register property from 193 in 2008 to 72 in2009. This achievement helped Egypt make the World Bank's list of top reformers worldwide.

MODEST BEGINNINGS FOR A COLLATERAL REGISTRY

To expand enterprise lending, EFS engaged the MOI as a counterpart to unlock the capital invested in personal property by businesses and individuals for use as loan collateral. The MOI agreed to sponsor a proposal and draft legislation to establish a moveable collateral property registry. In support of this initiative, EFS trained officials from MOI and the General Authority for Investment and Free Zones (GAFI) in crafting an overall strategy, establishing a legal framework, identifying the regulator and operator, developing the system, training staff to use it, and conducting a public awareness campaign. Meanwhile, EFS supported the MFA in developing a transitional registry for recording EMRC interests in mortgage portfolios that secured loans to mortgage lenders. The draft law and regulations are ready to be adopted, and at the close of EFS, Egypt was moving toward implementation of a movable collateral registry.

NEW INSTRUMENTS TO SUPPORT A ROBUST FINANCIAL SERVICES SECTOR

To attract investment in Egypt and make more capital available to Egyptian enterprises, EFS supported the introduction of new financial instruments. Working closely with the public and private sector, EFS supported real estate investment funds, leasing, factoring, commodities futures and derivatives, and other financial instruments.

Investment fund reform. To increase market sustainability and reduce trade vulnerability associated with the dominance of retail investors, the CMA and EFS revisited the legal framework for investment funds, including real estate investment funds. EFS identified a dozen major regulatory issues hindering the growth of investment funds. To address these issues, the CMA leveled the playing field for banks and non-bank fund sponsors, enhanced governance and investor protection, expanded marketing and selling channels for investment fund certificates, established qualifications for professional investment fund managers, diversified risk, and improved disclosure and transparency. A comprehensive set of regulations was presented to the CMA in 2009.

Enabling leasing as an alternative to loans. In support of MOI initiatives to ease access to finance for small and medium enterprises (SMEs), and to promote alternative sources of midterm and short-term finance, EFS worked with the MOI and GAFI to review financial leasing law and regulations. Together, they recommended changes to establish standards for operating leasing, consumer leasing, securing the interests of lessors in leased assets, adoption of international accounting and taxation standards for leasing contracts, and securitization of lease receivables. EFS, MOI and GAFI then worked to draft regulations for consumer protection in leasing contracts. To support implementation of the new laws and regulations, EFS trained GAFI and government policy makers in international best practices in the regulation, operation, accounting, and taxation of leasing transactions. EFS procured IT hardware and developed specifications for development of an electronic leasing registry that could be integrated into the emerging collateral registry in the future. Finally, to promote new alternatives to lending, EFS produced brochures and other marketing materials on leasing and sponsored an awareness workshop for GAFI and the Alexandria Businessmen Association.

Setting rules for the commodity futures and financial derivatives markets. Another way to unlock assets as capital and advance the market economy is through the commodity futures or financial derivatives markets. In less sophisticated times, all commodities were brought to market to be bought or sold. Distributors and traders could predict trends in pricing for crops or livestock, buying them at low prices and strategically selling them at higher prices. The contemporary version of these transactions is the derivatives market. A derivative is a financial contract with a value linked to the expected future price movements of the “asset” it is linked to, such as a share, currency, or nonperishable good, known as the underlying asset.

There are many kinds of derivatives, the most notable being swaps, futures, and options. However, since a derivative can be placed on any

sort of "underlying asset," the scope of derivatives is nearly endless. Thus, the real definition of a derivative is an agreement between two parties that is contingent on a future outcome of the "underlying asset." These instruments derive their value from the expected future price of the underlying asset. Some more commonplace derivatives, such as swaps, futures, and options, are frequently traded on open markets before their expiration date as if they were assets. Investment in derivatives, and particularly in commodities futures, can be risky —expected values can differ greatly from actual values. Therefore, proper functioning of this kind of a market hinges on a legal framework that improves the quality and transparency of price discovery and enables risk management by hedging (where an investment in one market is buttressed by taking an opposite position in another market). Financial hedging is much the same as one would hedge a bet for, say, a "dark horse" in a race that offers a higher payoff, but with a smaller perceived chance of winning, with a proportional bet on a favored horse that has a higher perceived chance of winning, but at a lower payoff.

To enable risk management and hedging, and to improve price discovery and transparency of commodities, MOI worked to establish a legal framework for the commodity futures and financial derivatives markets. Supporting this initiative, EFS finalized draft regulations under the existing Capital Market Law, adapted them to the Egyptian context and published them for comment, and assessed the CMA's organizational capacity as a regulator.

Introducing Sukuks as another way of injecting financial life into assets. EFS supported an MOI initiative to introduce sukuks as a mid-term or long-term financing tool for businesses. Sukuks are bonds, financial notes, or securities issued pursuant to a contract arising from a sale, lease, or participation in asset ownership. They incorporate elements of profit or loss sharing as returns or yields. With the World Bank, EFS sponsored a workshop on sukuks for key government and industry representatives. Subsequently, EFS drafted regulations on structuring, registration, issuance and trading of sukuks, which were presented to the CMA and MOI for adoption. EFS also trained CMA and market institutions in structuring, trading, and regulating *sukuks*.

Among other milestones in developing new financial instrument for investors, EFS helped CMA draft and approve a master repurchase agreement for bonds and to develop capital adequacy standards for brokers, bond dealers, and custodians.

Progress in short selling. In short selling, a party borrows and sells an investment security (a share or a bond) it does not own with the intention of buying that identical investment security later at a lower price in time to meet its obligation to deliver the security to the lender. In this way, the seller hopes to profit from a decline in the price of the assets between the time of sale and time of purchase. The security lender would earn interest of cash collateral provided by the security borrower (the short seller). The risk is that the short seller may lose money if the price rises instead of falling in the interval. Building on previous efforts, the CMA and Misr for Central Clearing, Depository and Registry (MCDR) approved the securities lending and borrowing system to enable short selling of government bonds and other securities. This would improve risk management, increase market liquidity, and pricing.

CHAPTER FIVE

BY THE NUMBERS

Although EFS focused on establishing the legal framework and infrastructure necessary for introducing a comprehensive mortgage finance industry, a notable effect was to strengthen the entire financial sector. EFS succeeded in making financing more accessible at lower cost, not only for housing, but also for businesses. Lenders are more willing to lend because loans are fully and firmly guaranteed and collateralized by assets. In fact, enabling the use of assets to back financing is the key success of the EFS project. Real estate, machinery and equipment can be used as collateral for loans through the introduction of movable and immovable property registries. Assets can also be used otherwise to secure financing, as in factoring, or as new products to benefit entrepreneurs, like leasing. Banks and non-bank financial institutions, through the use of the credit bureau can now identify borrowers with a track record of paying their debts and better manage their credit risk. To address the key constraint of “dead capital,” EFS formalized assets in an official registry and worked with government to ensure that lenders can verify that borrowers really own their assets, have not previously pledged them to a third party, and that the asset can be repossessed and sold to pay off the debt if the borrower defaults. Finally, EFS introduced financial instruments that opened up new avenues for productive investment and allowed the full spectrum of assets to be used to acquire financing. Below, we present the measures of these successes.

Primary mortgage market: Increasing individual mortgages. Licensed mortgage finance companies, which were just emerging at the inception of EFS, numbered 11 and had issued more than 12,000 mortgages valued at 1.8 billion Egyptian pounds by March 2010. Commercial banks dramatically increased mortgage lending as a result of EFS assistance. In 2005, banks loaned only 121 million Egyptian pounds annually. By March 2010, banks have lent 2.7 billion Egyptian pounds in mortgages. As a testament to the effects of the secondary mortgage market taking hold and MFCs' newfound ability to access longer term financing, MFCs began offering longer loan maturities. By March 2010, the average MFC mortgage loan matured in 16 years, as opposed to 6 years in 2005.

Secondary mortgage market: Longer loan maturities and better interest rates. In 2005, asset-backed securities were almost nonexistent. Over the life of the EFS project, 12 asset-backed securities were issued using assets such as real estate receivables, vehicle loans, or financial leasing receivables as the underlying asset. The trading value of government bonds increased from 9 billion Egyptian pounds in 2005 to 41 billion Egyptian pounds in 2009. The proof of how these securities are improving the market is visible in the trends for loan maturities of primary mortgages, which have increased from 6 to 16 years over the life EFS, bringing them much closer to the average mortgage loan maturity in developed countries. Importantly, the price spread between treasury bonds and median mortgage loan interest rates fell from 4.8 percent in 2007 to 3.62 percent in 2009. This shows a closer relationship between mortgage rates and the treasury bonds as a benchmark or a yield curve that provide mortgage lenders with longer term financing. This trend, if it continues, means that mortgage loan interest rates are getting lower as the market becomes more accustomed to turning to capital markets rather than banks for long-term financing.

Increasing access to enterprise finance: Building a better place to invest and do business. Egypt's achievements in introducing a private sector credit bureau and a modern property registration system have been well documented as helping Egypt become a better place to do business, according to the World Bank's Doing Business reports. Perhaps equally important is the fact that new financial instruments introduced by EFS are attracting new investment, enabling more lending to small and medium businesses in the form of factoring, leasing, and financial derivatives. New financial instruments mobilized more than 5 billion Egyptian pounds in 2009 alone, attracting a total of 3,000 investors.

CHAPTER SIX

THE WAY FORWARD

The joint efforts of the Government of Egypt and EFS to inject life into assets have attracted new investment and generated new capital for businesses and lending. The introduction of an inclusive, reliable credit bureau enables Egyptian financiers to make better credit decisions and offer more favorable terms to qualified borrowers. An improved immovable property registry — the Model Registration Office (MRO) — enables real estate financing and protects property rights. New financial instruments offer an array of options for enterprises that need financing to start up or expand. Progress made with the help of EFS has created new opportunities for Egypt to strengthen its economy by transforming "dead" assets into the market as living, productive capital.

CAPTURING THE POWER OF A SINGLE FINANCIAL REGULATOR

The consolidation of non-bank financial regulators into a single regulator allows Egypt to consolidate efforts, eliminate duplication, and simplify coordination with the Central Bank of Egypt. With regulation and supervision consolidated in the EFSA and the CBE, regulators are able to manage the interrelated components and workings of the financial markets. The understanding gained through day-to-day operations and cross-training of staff in different departments can

lead to further reform and enhancements in non-bank financial services. This comprehensive vision of the financial sector could also serve as a catalyst for expansion of non-bank financial services—either down into the microfinance market, or further up into expanded capital markets in emerging areas such as asset-based financial instruments that were initially introduced with assistance by EFS. Properly regulated by EFSA, and supported by a functioning credit bureau and property registries, capital markets offer seemingly endless potential to attract investment and generate productive capital. Financial derivatives can be developed using almost any underlying asset that can be adequately regulated, standardized, and priced.

An additional area of opportunity that could be explored by EFSA is consumer financing regulation. EFSA, developed as a single financial regulator created from the individual regulatory agencies supervising capital markets, mortgage finance, insurance and pension funds, microfinance, and leasing and factoring. Some consumer finance services offered by non-bank institutions currently lack supervision. For example, Egyptian stores offer installment sales, in-house credit cards, and other forms of consumer financing that do not fall under a supervisory regime. Unregulated, any institution offering consumer finance may defraud public consumers by manipulating credit conditions and interest rates disclosed to attract customers. EFSA could be the regulator protecting the rights of both consumers and creditors.

REPLICATING THE MODEL REGISTRY OFFICE ACHIEVEMENTS THROUGHOUT EGYPT

The strides made in immovable property registration through the development of the MRO in Mokattam could be replicated throughout the hundreds of real property registration offices operating in Egypt. Specifically, the introduction of improved IT infrastructure, parcel-based indexing for property records, and cadastral maps would help to improve property registration and further expansion of real estate finance. Additionally, it is recommended that the Government of Egypt consider legal and regulatory reform regarding property registration to clarify and consolidate duplicative deeds-based and title-based systems.

FURTHER SUPPORT FOR SMALL AND MEDIUM ENTERPRISE FINANCE

Although the “heart” of EFS was mortgage finance, new financial instruments and the introduction of a credit bureau and collateral registry went a long way toward laying the foundation for a robust small and medium enterprise (SME) finance sector. SMEs abound in the streets of Egypt’s cities, but these enterprises are largely informal and lack access to finance. Informality and lack of access to credit typically go hand in hand, as most lenders require formal proof of business registration before extending credit. Similarly, formalization often presents disincentives in the form of taxation, and enterprises are forced to weigh the costs of formalization against the benefits of increased access to credit. As SME credit is not widely available, the costs of formalization outweigh the perceived benefits. Any effort to promote SME finance in Egypt should address formalization.

Countries that have successfully formalized enterprises of all sizes have done so utilizing a multi-pronged approach: public outreach and education; streamlining and simplifying regulations affecting SMEs; and providing tax incentives. Tax incentives can either be reductions in tax obligations for specific types or sizes of businesses, or they

can be less complicated tax reporting and assessment. Egypt ranked fairly low, 140th out of 183 economies, in paying taxes under the World Bank's 2010 *Doing Business* survey. According to the Bank's methodology, a medium enterprise has to pay 43 percent of its profit in tax obligations and make 29 tax payments per year, which would consume an estimated 480 hours annually (or 60 8-hour workdays). Tax reform would likely go a long way toward removing a major constraint to formalization of SMEs.

A traditional approach to increasing access to SME finance is one that typically involves institutional capacity building at the bank level; development of funds specifically for SMEs; and business training and development for SMEs. Banks' attention to SMEs can be encouraged by building their capacity to originate loans for SMEs, which have different credit risk profiles, cash flow, and assets than large businesses do. Governments can encourage SME access to credit by establishing funds specifically for SMEs. Typically, these funds are provided to banks for on-lending or are used as a guarantee fund for banks while they become accustomed to the risks of an unfamiliar market. Finally, SMEs, even very successful ones, do not always have the knowledge or experience to present the formal business documentation needed for credit applications. Training in developing strategic or business plans, accounting and financial recordkeeping, corporate governance, and marketing all serve to facilitate credit applications and credit underwriting.

Housing construction is booming on the outskirts of Cairo, as real estate developers and mortgage lenders work together to provide affordable homes and mortgages to middle and lower income families.

SUCCESS STORY

MORTGAGE LENDING GROWING IN EGYPT

A RISE IN HOUSING PRICES AND THE IMPLEMENTATION OF A REGULATORY SYSTEM BY THE MORTGAGE FINANCE AUTHORITY IS CREATING INCENTIVES FOR EGYPTIANS TO OPT FOR MODERN LENDING.

In a society where a credit-based lending system is a not a customary practice, Egyptians' desire to purchase homes and utilize savings is shifting perceptions about the Egyptian mortgage system. Together with the government's priority of strengthening the infrastructure of the regulatory system and expand the existing mortgage lending system, Egypt is meeting the growing needs of the sector and its people.

With assistance from USAID through its Egypt Financial Services (EFS) project, the Mortgage Finance Authority (MFA) cleared several major obstacles that have hindered the mortgage lending process over the past few years and established a strong and stable system. The MFA recently began to see results with the creation of an effective foreclosure system and the expansion of licensed lending institutions.

The impact of a foreclosure system has been significant for lenders and banks as the sense of security and confidence in the system has increased their willingness to lend using mortgages. Some mortgage finance companies in Egypt are reaching their maximum leverage levels allowed by law and have concluded agreements with the newly established refinance company to lend them against their loan portfolios in order to allocate additional housing loans. Also, due in part to developing the appropriate regulatory environment, introducing specialized professional training and expanding public outreach activities through technical assistance from USAID, mortgage finance companies have expanded throughout Egypt. In 2006, Egypt had only two mortgage finance companies and by the end of 2008 there are nine licensed companies.

With increased competition among lenders to attract new customers, Egypt has seen a steady decline in mortgage rates. Mr. Osama Saleh, the MFA chairman, noted, "The [lending] interest rate did not reflect the real interest rate situation of the country. The risk taken was incorporated into the interest rate the banks and [mortgage finance] companies were charging…When competition intensifies further, we will start seeing interest rates fall again."

The impact of MFA's successes is already translating directly to the Egyptian people. Mortgage lenders are teaming with housing firms to not only attract high-end investment but attract middle- and low-income families with affordable mortgages and quality housing.

Government entities are also working to extend the benefits of these trends by reducing property taxes and registration fees. In July, 2008 the Guarantee and Subsidy Fund (GSF) reformed the pricing premium of its loan guarantee component, in light of the recommendations introduced by the USAID. The Ministry of Investment announced the removal of the fixed flat rate, which to many was excessively high and replaced it with a loan to value rate which in turn creates yet another incentive for Egyptians to take part in the growing mortgage market.

Mortgage lending and regulatory systems in Egypt are emerging with notable growth and success. A rise in housing prices and the implementation of the MFA's regulatory function are creating incentives for Egyptians to opt for modern lending. According to the Ministry of Investment, the value of outstanding mortgages has reached nearly 3 billion Egyptian pounds and hopes to reach 4 billion by mid-2009. It is clear that Egypt's potential in the mortgage sector is just beginning.

Housing construction is booming on the outskirts of Cairo, as real estate developers and mortgage lenders work together to provide affordable homes and mortgages to middle and lower income families.

Top: RAMIC employee, Sherif Abdel Hady works on maintinging a car engine; Owner Mohamed Rizk Marzouk (right) displays samples of Al Safa Misr for Garments products to Banque due Caire Branch Manager Sharaf El Din Ahmed.

SUCCESS STORY

SMALL, GOOD BORROWERS BENEFIT FROM CREDIT BUREAU

Creation of a legal and regulatory structure facilitates SME loans for Egyptian small and medium enterprises.

Limited access to finance constrains economic growth in developing countries. This is truest so for micro, small and medium enterprises. Prior to the private credit bureau, only large borrowers were likely to have their credit information reported to Central Banks, which enables greater access to the formal banking sector whereas small borrowers often suffer. Though they are contributors to GDP, their credit information is not reported to the Central Bank which normally has a minimum threshold for reporting and monitoring credit information.

Egypt is no exception. However, Egyptian policy makers have recognized the importance of expanding credit to small and medium enterprises and many banks are establishing new departments to lend to micro and/or small enterprises. The Egyptian Credit Bureau launched its operations in July 2008 and introduced credit scoring in January 2010. It now collects and disseminates information on small and medium borrowers.

With assistance from USAID through the Egypt Financial Services (EFS) project, project staff supported the creation of a legal and regulatory structure which facilitates exchange of information between banks and microfinance institutions/NGOs on borrowers of all sizes.

Banque du Caire was one of the first banks to join and comply with the requirements of the Egyptian Credit Bureau, and is one of the major lenders in the microfinance sector.

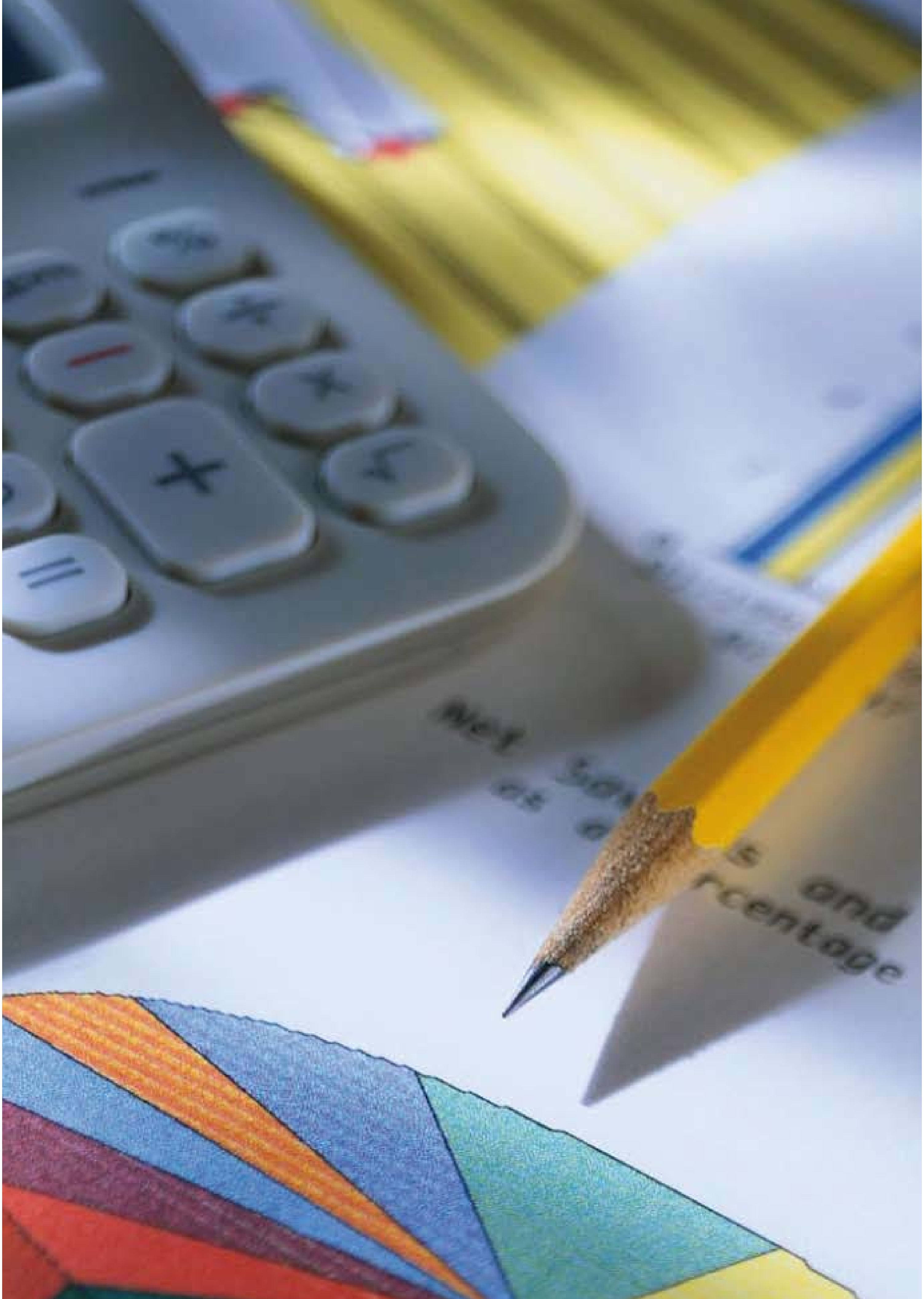
Ramic and Al Safa Misr for Garments are two such examples of small but good borrowers that are accessing financial services that would not have been available previously.

Ramic is a family-owned business that specializes in supply, installation and maintenance of air conditioners for cars. The company serves large clients such as the government ministries, and hotel chains.

"We started by taking a loan for L.E 3000. This was repaid as agreed. Now our loan has reached L.E 25,000 which we repay over monthly installments," explains Engineer Ahmed Ramy Nassif, who has his two sons and wife as partners. " The finance we get from the bank enables us to have in hand a stock of spare parts which is necessary for our business. "

Al Safa Misr for Garments is another excellent example for the success of a small business. It manufactures underwear for men, women and children, started its operations in 1993 and has units for production, quality control, supply, storage, etc. Its fabric remnants are even sold in the local market, recycled, and used in furniture manufacturing. The company has obtained ISO 9001 and other local quality certificates.

"Micro and small loans are useful and help people. A small amount can support a growing business," says Mr. Mohamed Risk. Mr. Mohamed continues, "We employ 100 females in the factory and they are all the main bread winners for their families."



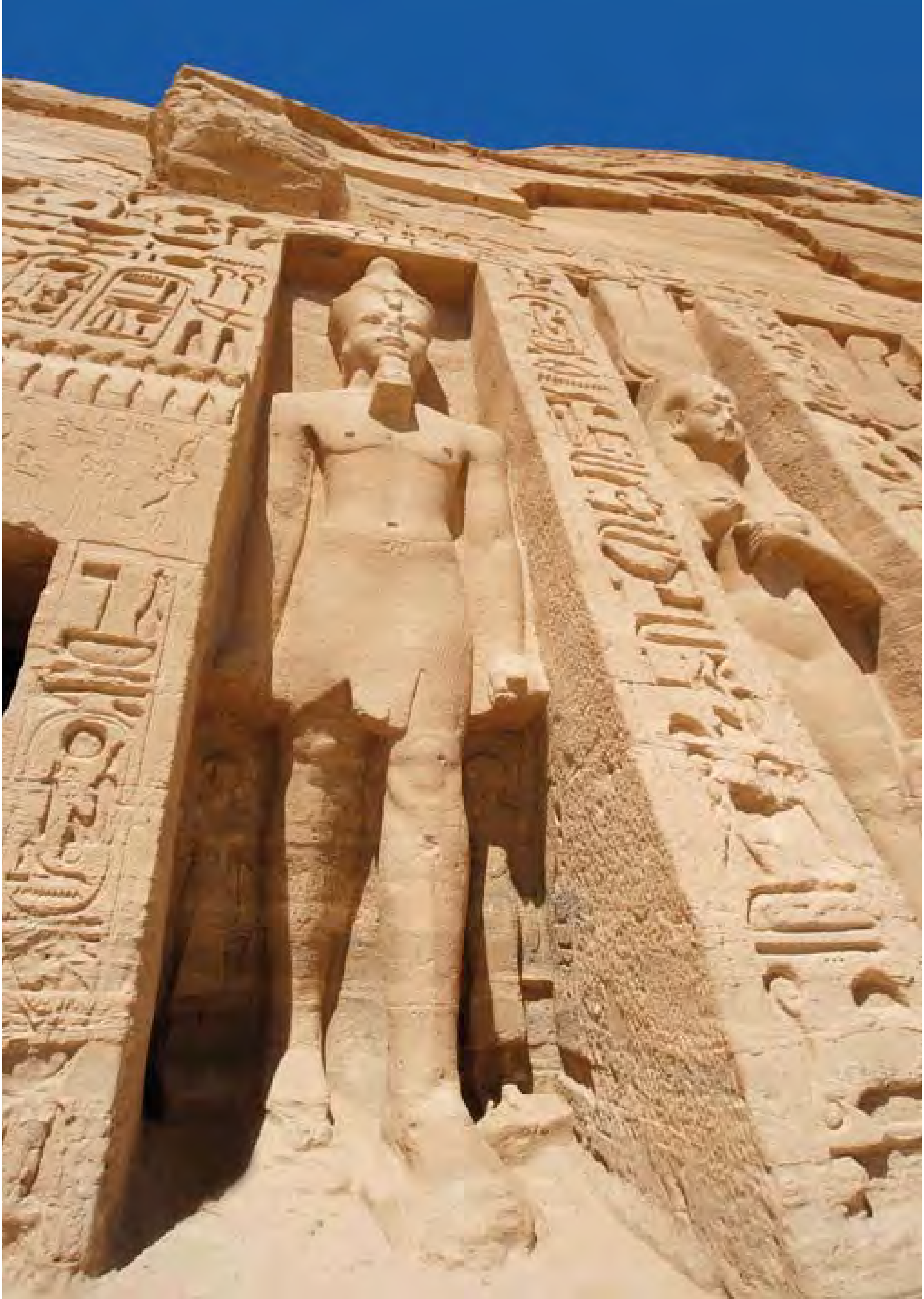
REAL ESTATE REFORM ENABLES EGYPTIANS TO OWN HOMES

CAIRO, Egypt—A new real estate office in one of Cairo's poorest slums is enabling more residents to buy homes and protect their property rights.

In Mokattam, a district that is home to tens of thousands of zabaleen, or garbage collectors, the state-of-the-art office is processing property registration quicker and more accurately than ever before. Given the district's high number of planned and already existing residential developments and the high concentration of lower-income residents, USAID and the government of Egypt selected Mokattam to be the flagship registry office.

Through a USAID project, international land registration experts created a fully-automated, operational model registry office in Mokattam. The registry streamlined file and document management and uses electronic signatures on paper documents. Specific documents require manual signatures, such as final deeds, but are also scanned into the registry database for record keeping.

A decade ago, 90 percent of urban real estate and land was not formally registered in Egypt. On average, 93 days were required to register a



simple transfer of property, and registration costs were equivalent to 7 percent of the property's value.

The first major step in modernizing mortgage finance infrastructure in Egypt was to create an electronic records system. This made records dramatically easier for prospective buyers and mortgage lenders to search and determine the right owner.

Egyptian Financial Services (EFS) re-engineered its business process to decrease registration time and then began training their staff. EFS established a Training Development Center and developed a five-week training program. With USAID support, about 140 staff members were trained in the core curriculum, customer service, and information technology.

"The training was excellent," said Mona Masry, a senior technical investigator in the real estate publicity department. "It's fantastic to have all information available on one screen and not have to search through stacks of paper records. It makes our work quicker and easier, and this will mean better services for the public."

The technical assistance has created a demand-driven property registration environment in Mokattam. Also, the incidence of errors has been significantly reduced, while protection of property records and ownership information has increased markedly.

The World Bank's Doing Business 2008 report, comparing regulation of 178 countries' economies between April 2006 and June 2007, named Egypt the top economic reformer in the region and the world, highlighting property registration as a key factor.

According to the report, simplification of administrative procedures for property registration ensured Egypt's spot among the top 10 reformers around the world. The average number of days to register property in Egypt dropped from 193 in 2007 to 74 in 2008.

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CONTRACT NO: 263-C-00-05-00003-00

AUGUST 2010

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc.

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