



**LEASING LAW IN IRAQ
AN IMPEDIMENT TO RESIDENTIAL MORTGAGES**



USAID | Iraq Economic Governance II

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TABLE OF CONTENTS

1. INTRODUCTION	2
ISSUE:.....	2
2. ANALYSIS OF THE LAW OF REAL ESTATE LEASING.....	4
BACKGROUND	4
STAKEHOLDER COMMENTS	4
SUMMARY	5
POLICY OPTIONS.....	6
3. CONCLUSION.....	9
X. APPENDIX	11
APPENDIX A – LAW OF REAL ESTATE LEASING—ENGLISH TRANSLATION.....	11

1 INTRODUCTION

1. INTRODUCTION

Issue:

- Iraq has a shortage of approximately 2,000,000 housing units. It does not have the capital to construct that many units, and needs the use of private capital. .
- Iraq lending institutions do not currently make loans for purchase of single family dwellings. In order to stimulate the construction of single family dwellings, mortgage capital must become available.
- A preliminary review of Iraqi property laws that may impact residential mortgages identified the Law of Real Estate Leasing, Law 87 of 1979, as a potential impediment to residential mortgages in Iraq.
- The impediment is the provision that a defaulting owner is allowed the right by law to become a tenant for a period of up to five years at a very low rental rate.

2 EFFECTS OF THE LEASING LAW

2. ANALYSIS OF THE LAW OF REAL ESTATE LEASING

Background

Bank mortgages for residential property in general and single family dwellings in particular are rare in Iraq. Even the mortgages that are issued are for very low loan-to-value ratios, typically 25%, and for very short term. Terms range Analysis of the Law of Real Estate Leasing from one year to a maximum of five years. One of the reasons for this is that the Law of Real Estate Leasing, Law Number 87 of 1979, includes a provision that allows a defaulting owner to declare himself a tenant and rent the property for up to five years at a rent determined by a judge. That rent is set by law at 5% of the value annually for buildings older than 1998, and judges routinely use that formula for newer buildings also.

Without the ability to exercise ownership rights for up to five years, the foreclosure sale draws few bidders. Often the bank must bid in the amount of the mortgage. Banks do not retain properties and sell them as quickly as possible for whatever the market will bring, given the ownership constraints. Banks accommodate this by making loans at very low loan-to-value ratios and for very short terms. Even if the property sells for a low price, the bank will likely recover the full mortgage because the amount is so small relative to the total value of the property.

In order to effectively stimulate the economy, lending institutions must become willing to lend at high loan-to-value (LTV) ratios and for much longer terms (20-30 years). There are currently three obstacles to these mortgages.

- Lack of capital. The banks do not have access to sufficient capital to fund large mortgages for long periods of time.
- Interest rate risk. There is no secondary market in mortgages. Banks run great risk when lending for a long term at fixed rates while borrowing at current rates. If rates rise, the loans become a serious problem.
- The foreclosure problems. The Law of Real Estate Leasing makes it very difficult to evict a defaulting owner after a foreclosure sale.

The first two problems are insurmountable for banks at this time, and they are the dominant reasons for the lack of single family dwelling mortgages at high amounts and for long terms. When capital and secondary mortgage markets are available, the third item will become the dominant issue.

Stakeholder comments

The stakeholders contacted on this issue included three government banks and two private banks. The policy analysis is based on our legal interpretations of the law and on the stakeholders' comments.

Rafidain Bank—a government bank and the largest bank in Iraq.

Agricultural Bank—a government bank making rural loans

The Real Estate Bank—A government bank whose primary business is real estate loans.

Middle East Investment Bank—a private bank

Credit Bank of Iraq—a private bank

The stakeholders indicated that while this statute is a concern, there are other reasons that prohibit making loans on single family dwellings.

- Lack of capital. Most banks do not make loans to single family dwellings because they have limited capital and commercial loans are their core business. They may take single family dwellings as collateral for a commercial loan.
- The lack of a secondary market in mortgages is a limiting factor. Banks do not like to lend for long terms, and typically only lend for 1-5 years. In order to encourage high LTV ratios and long terms, banks need a secondary mortgage market to dispose of the loans and recover their capital.
- The only bank that is making single family loans directly is the Real Estate Bank. For reasons of capital, they only make construction loans and for a period of not more than five years.
- Foreclosing is a risky process in this market. The security situation means that the person posting the notification and anybody enforcing an eviction faces the prospect of being met with deadly violence.
- Banks do not like to own real estate. The real estate leasing law can place them in a property management position for which they are not equipped. If a residence is sold at foreclosure sale, the banks do not like to bid. They avoid being in the property ownership business.

The result is that there are few single-family dwelling loans. The current leasing law provision is only one aspect of the problem, and because of the other problems it is not currently the most limiting factor. Security and lack of capital and lack of a secondary mortgage market are more significant at this time. However, when the security situation improves and if capital becomes more available, the other restrictions will disappear and this will then be the limiting factor. As a result, the law should be addressed before it becomes the dominant restriction.

Summary

A strong residential single-family construction market that produces a large number of housing units will have to be funded through debt (mortgages). Individual Iraqi's do not typically have the resources to fund construction of a single family home. Money for single family dwelling purchase is currently obtained from friends and family and sellers. A policy is needed that will encourage lending institutions to make more construction loans for single-family homes at high loan-to-value ratios and for long periods. One of the impediments is the Law of Real Estate Leasing. The law was enacted by the Revolutionary Command Council under socialist policies that shifted the balance of economic power in situations of nonpayment of the debt away from the capital sector (mortgagee) and entirely in favor of the individual (mortgagor). This policy and the resulting law have discouraged the use of limited capital for residential construction. The development of alternative policies and laws is focused on an effort to strike a different balance between the rights of the mortgagor and mortgagee in the case of default with the policy goal of eliminating one of the obstacles to single family residential construction mortgages.

Policy Options

There are several policy alternatives available at different balance points between the purely capitalist (mortgagee rights prevail) end of the spectrum and the purely individual (mortgagor rights prevail) end of the spectrum. Each alternative will be evaluated in terms of three policy considerations:

- Effect on mortgage lending for single family homes.
- Possible Social Policy implications
- Economic implications

Alternative 1. At the purely individual (mortgagor) end of the spectrum, the existing law remains intact. The owner can only exercise limited ownership rights restricted to collecting a small rent for up to five years. This means the present value of the property is reduced.

Effect on mortgage lending. This alternative will not encourage the expansion of mortgage capital to finance single family dwelling construction. It would have the most negative effect of all the alternatives.

Social Policy implications. This alternative has the least negative (most positive) impact on social policy. Persons are not displaced because of defaulting on mortgages. It drives residential construction toward multifamily structures rather than single family dwellings.

Economic implications. This alternative will have the most negative/least positive effect on the economy. The economy will not have the benefit of expanded single family construction funded with mortgage capital, including the employment gains in that sector. The value of properties sold by foreclosure sale is low because of the reduced ability to exercise ownership rights.

Alternative 2. At the other end of the spectrum, the defaulting owner can be evicted immediately after sale of the property. This alternative gives the new owner the right to start exercising his ownership rights immediately. It provides the highest present value of the property.

Effect on mortgage lending. This alternative would have the strongest positive effect on mortgage lending. Owners would have the ability to exercise their ownership rights immediately. It would make for a very competitive bidding process at foreclosure sales and reduce banks' fear of having to become property managers.

Social Policy implications. This alternative has the most negative impact on social policy. Persons would be immediately displaced because of defaulting on mortgages. With no time to find alternative housing, they would become a homeless issue for at least a period of time necessary to find alternative housing. With the shortage of housing, this could be a period of months.

Economic implications. The resulting housing construction with the use of mortgage financing would be most positive under this alternative.

Alternative 3. Intermediate solutions strike some balance between the two extremes. The solution should provide the owner with the ability to exercise ownership rights in a reasonable time, while providing the defaulting owner a reasonable time to find alternative housing. In a normal housing market, this would be up to 30 days. In the current Iraqi market it should be longer—probably in the range of 90-120 days. An intermediate alternative would balance between the new owner's need to exercise ownership rights in a reasonable time and the tenant's need to have a reasonable amount of time to find alternative housing.

Document Body

It would also apply only to mortgages initiated after the effective date of the statute. No existing mortgagors who expected a level of security would be affected. All new mortgagors would be advised that they are subject to new foreclosure rules. These would be known in advance so there would be no abrogation of assumed rights.

Effect on mortgage lending. This would have a very positive effect on mortgage lending compared to alternative one. Owners would have the ability to exercise their ownership rights in a reasonable period of time. This would make for a competitive bidding process at foreclosures and reduce banks' fear of having to become property managers and reduce an impediment to single family mortgages.

Social Policy implications. This would have a slight negative impact on social policy. Persons would not be immediately displaced because of defaulting on mortgages. With a reasonable amount of time to find alternative housing, they would rarely become a homeless issue. It would encourage a balance between single family and multifamily construction.

Economic implications The resulting housing construction with the use of mortgage financing would be very positive under this proposal.

Ranking of effects of the three alternatives on each of the policy considerations.

Alt. No.	Mortgage Lending	Social Policy	Economic Impact
1	Most Negative Alternative	Most Positive Alternative	Most Negative Alternative
2	Most Positive Alternative	Most Negative Alternative	Most Positive Alternative
3	Very Positive effect	Slight negative effect	Very Positive effect

Conclusion

3 CONCLUSION

3. CONCLUSION

The first and second alternatives reflect the extreme ends of the property rights spectrum and have disadvantages of either long-term tenancy or immediate eviction. The third alternative is a policy that avoids both immediate eviction and long-term tenancy. It provides the balance needed to encourage lending to meet the need for housing financed with mortgage capital, while minimizing the immediate effects of foreclosure on the defaulting owner.

The policy should also provide for application only to mortgages enacted after the effective date of the law. This prospective application means that the changed provisions would not any affect existing mortgagors. No existing persons would have reason to object to these provisions, and the prospective application maximizes the likelihood of passage.

The implementation would amend Article 15 of the Law of Real Estate Leasing, Law 87 of 1979, by providing a limit to the length of time that a tenant can remain in the property while looking for an alternative residence. The length of time should strike a balance between the needs of the new owner to exercise his ownership rights and the needs of the defaulting owner to have sufficient time to locate alternative living quarters.

Appendices

X APPENDICES

X. APPENDIX

Appendix A – Law of Real Estate Leasing—English Translation

LAW OF REAL ESTATE LEASING NO (87) 1979 AS AMENDED *

* The code was published in the Iraqi Gazette. Issue 2719 on 30/6/1979.

** The first article was nullified and substituted by the present text according to Law no 56 in 2000, the sixth amendment code.

*** The third article was nullified and substituted by the present text according to Law no 56 in 2000, the sixth amendment code.

**** The fourth article was nullified and substituted by the present text according to code no 56 in 2000, the sixth amendment code. The judgment stipulated in item 4 of the fourth article of law is executed after the lapse of 3 three years from the date of expiring of this code (valuation of the total value of the real estate). This resulted from the currency valuation changes.

Article 1

1- A - The provisions of this code are valid on real estate rented for residence for Iraqis within the borders of Baghdad municipality and other municipalities.

B-The Palestinian, resident in Iraq since 1948 and his offspring, are treated like Iraqi for the purpose of this law.

2-The following real estates are excluded from the provisions of item 1 from this article. They are subject to provisions of civil law and other laws concerned, with leasing: -

A- Real estates prepared for residence rented by the state, public institutions and companies for its workers.

B-real estates prepared for residence, rented by the state, public institutions and companies for its workers, excluded by the statement of finance minister.

C-Real estate rented for non-Iraqis individuals and boards. **

Article 2

The period of leases is set in the contract. When it is not set the contract, it is regarded as a period of one year from the date of the contract, if there is no date in the contract; it starts from the date submitting the vacant real estate to the lessee.

Article 3

1. The leasing contract is extended after expiration as long as the lessee is residing in the real estate and continuing to pay the rent according to the provision of this law and observing the provisions of paragraph (14) of article 17. ***

2. The newly built residencies real estates, which were finished on or after 1/1/1998 , are excluded from the rule of paragraph (1) of this article. The period of expiring the leasing contract in it is according to the agreement of two parties.

Article 4

1. The annual rent of real estate included in this rule of law is no more than the following percentages:-

A. 5% five percent of the total value of real estate and apartments rented for this purpose.

B. 7% seven percent of the total value of real estates and apartments rented as residential rooms. (rooming houses)

Appendices

2. The ministers' council may increase the two percentages stated in paragraph (1) of this article whenever it is necessary.
3. The newly built residential property finished on or after 1/1/1998 are excluded from the rule of paragraph (1) of this article.
4. The total value of the real estate for the purpose of law is meant the total value of land and construction in the time of valuation by the financial authority in execution of this law.
5. The lessee and lesser may ask to evaluate the rented real estate total value once every five years. The rent is amended according to the new evaluation within the two percentages stated in paragraph (1) of this article. ****

Article 5

1. The lessee has the choice to rent the residential real estate furnished or unfurnished. If he agrees to rent it furnished 20% of the furniture value is added to the annual rent.
2. The apartments owners have the right to rent them furnished, observing the stated rule in the previous article.

Article 6

The real estate owner can increase the rent if he expanded the rented building on the lessee approval, if the expansion increased the building value and benefit. The increase in rent should not exceed the percentage stated in sections A, B, C of paragraph (1) of the fourth article from the value of expansion.

Article 7

1. The property taxes offices upon the request of one of contract parties shall handle the estimation of the value of the properties included at this code in addition to the furniture value in case of furnished lease.
2. The decision of the estimation committees shall be determine the valuation of the property, fixing the amount of the leasing tax starting from the date of the contract.
3. The tenant shall have the right of rejection mentioned at the law of property taxes about the decision of estimation committees.
4.
 - A. The lessor and the tenant should write a lease contract and file a copy with the property taxes office, information office and police stations within (30)days from the day of agreement.
 - B. If the lease contract was not written and the copy is not put according to paragraph (A) after one year of agreement and the tenant occupation of the property without disagreement of the lessor. the tenant can prove the contract by any means mentioned in the code of proof.

Article 8

The lessor should hand the property to the tenant at a condition suitable for use, according to the contract.

Article 9

The estate owner has the right to add any extension at a floor or more of the property if there is enough space without violating the building regulations and not violating the tenants' use of property but if contrary the tenant can ask for decreasing the rent, in conformity with the reduce of the usage.

Article 10

1. The rent of the properties included in this law shall be paid as monthly payments without consideration of the period of the contract, and any agreement contrary to this is void. If the lessor was the government or public fiction personality, the tenant is allowed to pay rent monthly or on one payment.
2. The rent can be paid according to the above paragraph to a notary public office, or by mail or banking assignment to the benefit of the lessor.
3. If the lessor refused to receive the rent, the tenant can pay at the notary public office at the city where the property is located within (15) days and the lessor shall bear the expense of warning and deposit that shall be decreased from the deposited payment.
4. Cancelled.

Appendices

Article 11

No Sub lease nor partial nor complete assignment of the lease is allowed unless by written agreement.

Article 12

Cancelled

Article 13

- 1- Lessee shall not house others except those who are mentioned in the contract unless by the written approval of the lesser.
- 2- Excluded from the rule of the paragraph mentioned above: lessee's origins and offspring and single brothers or sisters or widows or divorced women and any person that law or customs or social traditions requests the lessee to support or to house, on conditions that the rented house should contain them and no one of them own an estate in the city where the rented house exists.

Article 14

- 1- The new owner of the estate shall subrogate in place of the past owner in rights and obligations according to this law.
- 2- Within thirty days of transferring the ownership of the property, the new owner shall inform the lessee by a notification issued by notary public enclosed with the deed of the real estate.

Article 15

- 1- The owner or the partner shall not be compelled to abandon property if it was sold by order of court, but he shall be informed if he wishes to stay as a lessee.
- 2- The party who occupies the property shall be informed fifteen days before selling by the court that he may stay as a lessee.
- 3- If the occupier of estate stipulated in Paragraph (1) of this article is not a lessee by a standing lease contract, the court will estimate the rent as of the date of estimation according to the provisions of law.

Article 16

An employee of the government or any public legal personality assigned to work at another city may occupy the house that his precedent was occupying at the same contractual conditions, according to the terms of this law .

Article 17

The lesser shall not request ask lessee to abandon property, unless, otherwise for the following reasons:-

- 1- If lessee has not paid amount of rent for seven days, and after notifying the lessee by notary public from the date. It must be paid within (8) days of notification of the warning and the expenses of this warning shall be on the tenant. The tenant shall not make use of this protection more than once a year starting from the last warning. After that the lesser can request the eviction of the property if the tenant dose not pays the rent within fifteen days.
- 2- If the tenant rented the property or give up rent as a whole or in part without written permission of the lesser, or inhabited with him persons other than those mentioned at article 13 of this law.
- 3- If the tenant caused big damage to the property on purpose.
- 4- If the tenant made fundamental changes to the property without a written permission from the lessor.
- 5- If the tenant used the property for a purpose other than the purpose mentioned at the lease contract.
- 6- If the use of the property by the tenant harmed the reputation of the lessor.
- 7- If the rented property was not occupied for a period more than forty five days without a legal excuse.
- 8- If the tenant or his wife or one of his minor sons built a house within their living city.
- 9- If the tenant or his wife or one of his minor sons owned a property suitable for living within the boarder of their home city evicted legally or leased after eviction
- 10- If the owner wants to flatten the property to rebuilt it to make two or more housing units according to the original design of the area.
- 11- If the owner wants to add new floors to the existed building and the eviction of the building was necessary.

Appendices

- 12- If a status of necessity occurred after signing the contract forcing the owner or one of his married sons to occupy the rented property, and neither his wife nor his minor sons has a house that he can live in within the border of the city. The following are considered status of necessity :-
- A- If the owner was working for the government or for social sector offices inside or out side Iraq and transferred to the city where his property located upon the public interest or his service was terminated for any reason.
 - B- If the lessor was one of those mentioned at item (a) of this article and finished his study or training out side Iraq and back to the city where his property is located.
 - C- If the lessor was an employee and his service was lent out side Iraq or studying out side Iraq under the permission of official Iraqi office and returned to the city where his property is located after the termination of his mission or study.
 - D- If the tenant was once of the employee of Government office or the socialist sector and being notified from an authorized side to evacuate the house or the apartment belongs to government which he lives in.
 - E- If the tenant have been traited with a final judgment against him to evacuate the house which be lives in as a tenant an condition that the cause of evacuation is not for his refusal or doing something.
 - F- If a prisoner or missed in action returned to city when the rented house is, whether the house was registered in his name, wife name or one of his little kids.

13 If the rented building is about to fall .

14 If 12 years have been passed since the rent contract.

(12)many amendments have been done on text No,17, the last one was law no.56 for the year 2000 /the sixth amendment law ,which canceled the original text and put the present text instead.

In article No. 15 of the amendment law we read :

The provision of text No.14 of the seventeenth article of the law is to be operative on all rent contracts made after the effective date of this law and operative (effective) for rent contracts made before its validity and as follow:

After 3 three months of the validity of this law if 12 twelve years have been passed on the date of rent contract or more .

After four years of the validity date of this law if eight years but not to 12 have been passed on the date of rent contract .

Article eighteen: Deleted by (13)

Article 19

1.In order to implement two texts (10, 11)of the seventeenth article of the law ,the owner must send a warning to the tenant attached with certified copy of building license before 90 ninety days from the date of evacuation request on condition to demolish and rebuild within a period does not exceed 90days from the date of the real evacuation .

2.If the tenant of the real property who have evacuated for the reason in text No .12 of the seventeenth article of the law within 90 days or he lived inside it then deserted it before three continuous living years from the date of evacuation according to texts No-10,11,13of the seventeenth article without legal apologize the lessee has the right to oblige the tenant with the previous terms mentioned in rent contract or maybe request for reparation to harms made to him by evacuation (14)

j. After passing (5) five years from the passage of this law and if a period does not exceed (8) eight years have passed for the date of rent contract .

13. The article No.18 have been deleted by the law No.56 for the year/2000. sixth amendment law .

14. The nineteenth article have been deleted and substituted by the present text according to law no 56 for the year ,2000.The sixth amendment law .

Article (20)

The property owner who has a real (property) ready for rent for living purposes must inform the taxes office or police station (if there was no office) of vacancy within (15) days from the date of its evacuation, or in a period

Appendices

not exceeding (90) days from the date of its construction or evacuation. If its owner refused to rent it within the mentioned period the financial authority has to rent it to other according to provision of this law

(15) The twentieth article was deleted and substituted by the present text according to law no .56 for the year 2000/The sixth amendment law.

Article 21

It is not allowed to the lessor, lessee or any other person to get any amount of money or interest out of the frame of rent contract according to the authorized broker

Article 22

1-All cases made by implementing provision of this law to be considered of urgent cases and it is not allowed to contest against it by reforming cascation resolution .

2-The implementing sides must give the sentenced to evacuation a period does not exceed 90 days from the of implementing the sentence. cascation contest does not effect this period .

Article 23

1-To be punished with severe imprisonment for not less than (6) six months and not exceeds (3) three years and with a fine (50,000) fifty thousand Dinars or one of these two punishments, both the lesser and the lessee, if they agreed to rent a housing property in an annual hire exceeds the maximum level decided according to law .

2-To be punished with imprisonment for a period not less than (3)three months and not exceeds (6)months with a fine (10,000)one hundred thousands Dinar or one of these two punishments any one of the two contracting sides if they refused to comply or to submit its copy to real estate taxes office ,information office or police station in case if the office is not available within period mentioned in text no(4)of the seventh article of the law .If one of then submit a copy , the other one wont be obliged to do so .

3-To be punished with severe imprisonment for a period not less than two years and not to exceed (5)five years with a fine of (50,000) fifty thousand Dinnars, who violate provisions of text no.2 of the nineteenth article of law .

4- To be punished with imprisonment for a period not less than (3) three months and not exceeding two years with a fine (25,000) twenty five thousands Dinnars, or one of those two punishments, any one who violate provisions of the twentieth and twenty first articles of the law.