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REVIEW OF REAL ESTATE FINANCING IN ANGOLA

WITH RECOMMENDED ACTIONS FOR THE BNA TO MEET NEW CHALLENGES

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REVIEW OF REAL ESTATE FINANCING IN ANGOLA

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PREFACE

Mr. Melville Brown and Mr. Timothy Kelley, Bank Regulation Expert and Mission Leader and Real Estate Financing Expert, respectively, undertook a three week Mission in March 2010 to Luanda, Angola on behalf of the Financial Sector Program in Angola, an initiative sponsored by the United States Agency for International Development (USAID). The principal counterpart for this Mission was the Banco Nacional de Angola (BNA). The subjects of analyses for this Mission were a review of the current structure of real estate financing and the feasibility of developing a broader mortgage-based housing finance program. Particular attention was paid to researching the feasibility, legal structure and the level of regulatory oversight necessary to advance the utilization of leasing operations for real estate transactions in Angola.

The immediate product of the Mission is a review of the current issues affecting development in the real estate sector and a summation of several main points that will contribute to the development of the real estate financing (including leasing) market in Angola. To this end, the Mission focused on the most pressing issues to assist in the development of 'best practices' for real estate financing through traditional mortgage lending and leasing operations as they influence the role of the BNA as bank supervisor.

During the Mission the experts, assisted by a 'working group' from the BNA, met with the multiple banks and government ministries as an integral part of developing this report. The experts have developed a summary of major real estate issues and advice for the various courses of action the BNA might recommend to the GOA ministries and/or agencies responsible for title, registries, property rights and other subject matter areas that may fall outside BNA's legal authority but pertain to the operation of a viable real estate market. The Mission has also included a series of recommended action steps that, it is hoped, will assist the BNA to meet new challenges and lead to further operating directives and prudential regulations from the BNA for financial institutions, including but not limited to leasing, that are involved in this sector.

I. EXECUTIVE SUMMARY

The recent Cardno Mission to Angola prepared a diagnostic study and review of real estate financing practices in Angola, including recommended action steps to facilitate the inception of leasing for real estate related transactions (Leasing Imobiliário). The Mission has presented its findings on the regulation of leasing operations in this report titled: *Review of Real Estate Financing Practices in Angola*. The purpose of this paper is to provide the BNA and other interested government agencies with a summary of current practices in real estate lending and discuss the multiple issues that need be addressed in promoting and regulating mortgage lending and lease operations secured by real property (Leasing Imobiliário) in Angola.

The Mission has developed the following broad set of conclusions from its three-week consultancy with the BNA in Angola:

Real Estate Lending

- There is clear evidence of a major real estate bubble in Luanda as a consequence of the recent economic boom driven by the end of the civil war in 2002 and high revenues from the oil sector.
- The real estate bubble has been driven by speculators and is now collapsing with a major slowdown in construction and almost total halt in the sales of new residential properties.
- It has been determined that the banking sector is somewhat insulated from this market collapse, as there is limited overall exposure to real estate related credits. Real Estate exposure is estimated at less than one billion dollars out of total assets of 30 billion and total loan exposure to the private sector of approximately ten billion.
- Banks are not extending normal levels of credits into the real estate sector partially because the market is inflated and overheated, but more importantly because of the lack of a workable legal framework to ensure collateral rights, high transaction costs, an inefficient public registry, and the complications of the judicial process with no proven foreclosure process.
- To date none of the banks have extended real estate financing through lease operations. None of the banks interviewed report plans to initiate direct leasing operations although several have expressed interest in forming a leasing company subsidiary for the purpose of structuring lease purchase programs for properties.
- As a result of high levels of oil export revenue, the economy has become heavily dollarized. There is little incentive for banks to offer long-term mortgages or leases in Kwanza when their deposits are primarily short term and dollar-based. Inflation and currency risk concerns persist.
- It is the view of the Mission that wide spread use of financing as a tool for residential real estate acquisition will not occur until the private banking sector is incentivized to enter into long term (20 to 30 years) Kwanza-based mortgage lending through programs that mitigate overexposure to currency risk and provide future liquidity by matching short term deposit liabilities with illiquid long term mortgage assets.
- Additionally, the Mission has concluded that given the current structure, excessive pricing and high volatility of the real estate sector, the risk of money laundering activity occurring through real estate transactions is quite high. It is recommended that the BNA consider this issue as well in its ongoing efforts to properly regulate the sector and provide for a structured environment for normal housing finance and leasing operations.

Leasing Operations

- Despite the existence of a legal basis to do so, no commercial bank has established leasing operations on either a direct basis or through a subsidiary company in Angola.
- Leasing, as it relates to real estate financing, is primarily an alternative method of financing home ownership through a Lease to Purchase contract. It does not include the basic rental of a property.
- There appears to be the beginnings of a market interest among the larger banks in establishing leasing subsidiaries for the purpose of developing the market for lease purchase contracts as an alternative method for financing home purchases. This is also the proposed methodology for financing under the government's plan to build 1 million new 'affordable' houses in the near future.
- In order to assist in the development of the leasing industry as an alternative to source finance real estate transactions, the report recommends that the BNA establish a user friendly regulatory régime over the leasing industry under its mandate as the supervisor for all non-bank financial institutions. The Mission has strongly advised against over regulating the nascent leasing market.

The Mission report also makes the following suggestions for actions to be taken to the government in general and specifically to the BNA:

- Taxes for registration or transfer of ownership are prohibitively high (11%) and we recommend that they be completely eliminated.
- The Public Registry fees are also extremely complicated and we recommend that they be replaced with a very low fixed fee per recording, not to exceed a few hundred dollars at most.
- The registry should also develop the capacity to scan documents and make all information available electronically to all parties via the internet (free of charge) to encourage transparency and trust.

Property rights have been allocated in varying forms adding to the complications in the market.

- The current system of limited surface rights (*Direito Superfice*) should be phased out and converted to a structure that clearly allows private property with full perpetual rights of ownership and transfer.
- The Mission also recommends that a dedicated court be set up to expeditiously resolve disputes related to real estate ownership and title.

As regards the establishment of a regulatory framework for leasing operations, the Mission recommends to the BNA that:

a. The principles and level of leasing regulations as advocated by the IFC be followed;

b. The original 9 draft Avisos, as proposed by the preceding consulting team be implemented in their entirety;

c. Article 13 of the Aviso of September 2007 be amended to eliminate the application of Minimum Capital Requirements and Capital Adequacy Ratios to leasing companies—at least at the lower end of the market.

However, in the event that the BNA decides that it must implement a program of proactive supervision and regulation over leasing operations; the Mission has provided in this report a set of suggested operating ratios and accounting guidelines that can be used as the basis for the new Avisos they intend to publish.

If the BNA intends to implement such a regulatory régime, then the Mission report urges two clarifying points:

1) An exception be made to allow for micro- and small enterprises to engage in the business and only be required to meet the requirements once they reach the capital level;

2) Allow for capital invested in unencumbered (debt free) real estate to serve as the measure for meeting the established minimum capital requirements.

The report also includes broader recommendations for pro-active action by the central bank as follows:

- The BNA also has the opportunity to incentivize the industry to use standard documentation for residential financial leasing structures. This seemingly administrative issue is nonetheless important for the safe, sound and sustainable development of a housing finance program in the future.
- The BNA has the opportunity to guide the creation of a government-sponsored fund to promote residential real estate financing. This fund can take many forms and can be a driving force to bring the participation of the banking sector into the long-term residential mortgage market.

In total, this paper provides guidelines for best practices in how real estate financing (direct mortgage lending and commercial leasing programs) *ought to be developed* and supervised in Angola. It is important to note that the paper includes a number of subject-related annexes which are considered as essential to the value of the report as well as the scope of the Mission's purpose. It is recommended that the annex papers be reviewed by all parties for not only a better understanding of the concepts brought forward in this study but also by those interested in the goal of developing a dynamic and broad residential housing sector within Angola.

In summation, the consultants involved in this Mission concur with the model that it is the freedom to buy, sell, rent, improve, leverage and inherit real property that is at the core of wealth accumulation in any developed society—a concept best described by the Peruvian economist Hernan de Soto in his seminal work *Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*.

II. INTRODUCTION

A well-functioning real estate sector that includes an efficient housing finance system is integral to the development of housing markets in any emerging economy. Due to the structural weaknesses of the financial sector coupled with the current 'boom-bust' cycle of an economy especially dependent on oil revenues, the case of Angola presents some unique problems.

Banco Nacional de Angola (BNA) has identified a number of areas of concern surrounding current real estate lending practices of the commercial banks and non-bank financial institutions under their supervisory scope. The BNA is eager to adjust its supervisory policies and procedures in order to mitigate perceived increases in credit and operational risks resultant from any new or increased exposure to real estate-related credits. At the same time the BNA also desires to eliminate unnecessary constraints in the development of a long term mortgage-based market for housing finance.

The purpose of this paper is to provide the BNA with a summary of current practices in real estate lending and discuss the multiple issues that should be addressed by the BNA in promoting and regulating mortgage lending and lease operations secured by real property (*Leasing Imobiliário*) in Angola.

This paper provides guidelines for best practices in how real estate financing (direct mortgage lending and commercial leasing programs) *ought to be developed* and supervised in Angola. Finally, the report includes a set of recommended action steps that the BNA should implement to cover current (and future) bank operations as considered necessary to address and develop a working set of prudential regulations for future bank and NBFI operations in the sector.

III. SUMMARY OF ECONOMIC ENVIRONMENT

Over recent years the Angolan economy has experienced exceptional performance levels with average growth since 2004 at over 12% annually. In both 2006 and 2007 real GDP surged by around 20%, and double-digit growth rates were widely predicted for at least the next five years. It is estimated that growth in 2008 was around 15%, with strong progress in the diversification of the economic structure. Despite the oil sector continuing to contribute slightly more than 60% to GDP, notable gains have been made in the non-oil sectors of agriculture, manufacturing, and banking. The civil construction was the fastest growing nonoil sector in 2008.

Then oil prices crashed with the global recession and real economic growth came to a halt after an average rate of 18% during the previous five years. As a direct result of overdependence on oil revenues, the economy is estimated to have grown, at best, by 1.5% during 2009. The impact of the global financial and economic crisis in Angola's economy was hard and deep. Despite sharp fiscal tightening, for the first time since 2005, the budget registered a deficit and the government accumulated substantial levels of arrears with domestic suppliers.

Last year's slump in oil prices from an average of nearly $100 a barrel in 2008 to just over $50, pushed Angola's current account and budget into deficit for the first time since the war years. Despite a nominal rebound in oil prices in late 2009, the government has been forced to significantly decrease public spending (now budgeted at 37% of GDP, versus last year's 50%).

In November, the IMF approved a 27-month US$1.4 billions Stand-By Arrangement (SBA) with Angola to support further budget shortfalls. By the end of the year, imbalances were largely diminished and, overall, macroeconomic stability has been achieved. Additional economic support was received as Angola increased its sovereign debt outstandings with borrowings from Brazil, Portugal and most notably China to approximately $12 billion—pledging a significant percentage of its future oil revenues towards debt service.

Angola remains principally a mono-economy highly dependent on oil revenues and continues to finance its growth through increased production. The oil sector is projected to grow by 6.5% as oil production increases from 1.79 million barrels per day in 2009 to 1.9 million barrels per day in 2010. Angola is now sub-Saharan Africa's biggest producer after Nigeria. Oil revenues account for more than half of the country's GDP, 80% of the government's revenues and 90% of export earnings.

The end of year inflation, as measured by the CPI, reached 13.99% in 2009, the second consecutive year of increasing inflation since the 11.78% registered for 2007; this occurred despite a tight monetary policy. During 2009 the Kwanza depreciated in both the reference (from 75.17 to 89.4 Kwanzas per US dollar) and parallel (from 77 to 98.8 Kwanzas per dollar) markets. Price pressures will remain strong in 2010 even as economic growth improves, as the lag effect of the Kwanza devaluation continues in the first half of the year. The expected tight fiscal and monetary policies imposed by the BNA should help in keeping prices under control.

The private sector has not been immune to this adversity, since its activity and success is extraordinarily dependent on the public sector. In other words, the Angolan State is the main customer and source of revenue for private enterprise. Therefore, it is expected that sectors like civil construction, trade and banking may see a contraction in activity, if the crisis continues Growth of the non-oil sector should be positively impacted by the projected expansion of the oil sector, increased capital expenditures by the public sector, and some private investment in agriculture and manufacturing.

The agriculture sector-despite not having made a great contribution to GDP growth in 2008 or 2009; has undergone some positive restructuring and has received significant levels of investment that should allow important progress in the future. The diamond mining sector has been negatively affected by the fall in

demand for this precious stone in international markets. It is expected that the financial pressure that has developed on companies operating in the sector, will continue to build with recovery and a positive contribution to the GDP not expected in the near future.

In summary, the global financial-economic crisis hit the Angolan economy hard as the price of oil started a free fall trend in the second half of 2008. It was a rough economic ride in 2009, as high levels of uncertainty and rumors on the direction of macro policies resulted in investor nervousness. There were continued large imbalances in some markets such as the foreign exchange and government securities markets. Low oil prices resulted in sharp declines in oil revenues and both external and fiscal positions shifted from the large surpluses enjoyed in the recent past to destabilizing deficits.

The general consensus is that there will be a continued contraction and adjustment in some non-oil investment and spending, but the impact on the economy as a whole will be mitigated by a stabilization of oil prices in the range of $70-75 per barrel. Overall the economic scenario has improved considerably from 2009, but the old challenges remain. First, the high dependency on oil will remain a reality for some years in the near future. Second, the tight fiscal and monetary policies proposed for 2010 will not be easily implemented since there will be increasing pressures to increase public spending and to expand credit as oil prices remain at current levels. Real GDP growth rate is expected to stay between 6.5 and 7.5%, depending on the performance of the non-oil sector.

IV. OVERVIEW OF REAL ESTATE FINANCING IN EMERGING MARKETS

Lending for housing in most transition economies and many developing countries is segmented primarily between traditional lending – formal mortgage lending programs for individual home ownership, similar to that in industrialized countries, and micro-lending programs that narrowly support the incremental construction and improvement of dwellings for those in the lower economic strata. This second market segment normally represents the great majority of the populace (often as high as 97%) who either cannot access or cannot qualify for formal mortgage loans.

Because of the multiple challenges existent in emerging markets such as, nascent political systems with contradictory legal systems, limitations on necessary data, general constraints in access to finance and fragmentation within applicable regulatory frameworks; the banking sector has usually been slow to enter into formal mortgage-based lending programs except for the very high end of the market, and only then with the requirement of additional collateral of third-party guarantees. Any development in the lower end of the market has commonly been left to international development programs or generally underfunded government subsidized programs.

In emerging markets the evolution of commercial real estate sector has customarily been led by foreign contractors and investors. Typically, this market has been dominated by speculators who are driven primarily by the lure of high returns and concentrate their investment in projects that promise short term profit over long term investment returns. This paradigm has been instrumental in distorting the rational development of the sector and creating unsustainable real estate bubbles. The risk to the banking sector follows as a result of excessive credit exposure to these property developers who in turn are at risk for market corrections to the real estate bubble they have helped to create.

Experience has shown that programs for the development of a real estate market for mortgage financing have been much more strongly influenced by individual government policies regarding housing and housing finance policies than by attempts to increase financial sector depth. Surprisingly, the depth of mortgage lending is not closely related to either a country's financial depth or to its financial efficiency. This is important because it reflects the reality that mortgage market development does not simply follow broad financial market development.

In each country real estate financing is necessarily based on local economic realities and is further complicated, and often constrained, by failure to adequately address the following fundamental issues:

a) Laws and regulations governing ownership and transfer of real property;

b) Administration of property laws and regulations;

c) Public policy regarding real estate development and construction financing;

d) Planning and regulation of property development for distinct economic classes;

e) Adaptation of housing policy, legal and regulatory frameworks that meet diverse market demands for real estate development;

f) Adaptation of public and private sector financial institutions to modern practices;

g) Availability of market information;

h) Availability of borrower credit information.

As a result there has evolved a wide spectrum of housing sector policies that have been locally designed to address the extensive aspects of mortgage sector development for improving the volume and access to housing finance for a particular market segment.

Bank lending programs to the real estate sector, which are by definition highly dependent on the value of the assets (land and buildings) securing the loan, are further burdened with the particular and complicated issues of credit risk and liquidity requirements. Experience from around the world indicates that poor credit quality of real estate related loans, coupled with weak underwriting and credit management practices continue to be a dominant factor in bank failures and banking crises on a repetitive basis.

The example of the United States in the early 1990s has been repeated with devastating effect in many emerging markets where many of the credit losses suffered by banks, thrifts and insurance companies have been the result of excessive portfolio concentrations of loans in the real estate industry (residential mortgages, commercial real estate mortgages and commercial real estate loans). More specifically, US banks loaned enormous amounts of money to commercial real estate companies based on overly optimistic projections of rental income growth and increased asset values.

Investment in commercial property projects in highly speculative markets such as Angola, are characteristically 'high-risk, high-return' proposals that make commercial real estate lending hazardous to banks. Real estate development companies are by nature highly leveraged operations which use acute levels of debt in order to finance the construction of large buildings for either residential or commercial use. High gearing ratios make them sensitive to interest rate swings particularly in countries where most debt is contracted at floating (adjustable) interest rates.

In addition to the obvious credit worthiness of the obligor, the overall credit riskiness of any real estate related loan or lease transaction will be affected by the influences of risk issues such as:

- **Collateral:** Loans may be collateralized by real property, automobiles, equipment, inventories, accounts receivable, securities, savings accounts as well as mutual funds and life insurance. In the case of a borrower default, the lender would have the right to seize the collateral pledged to repay the loan.
- **Third party guarantee:** If a loan is endorsed by a third party guarantee then the third party is committed to repay the borrower's debt in case the borrower defaults.
- **Loan covenants:** Usually the credit contract between a bank and a borrower contains covenants limiting the possible actions of the borrower. These covenants might vary across countries but usually include the responsibility of the borrower to submit financial statements frequently, commitment not to issue new debt, restricted dividend payment etc.
- **Information costs:** Possibility of sharing information about the credit history of borrowers in order to reduce the unavoidable information costs inherent in the lending decision.
- **Bankruptcy legislation:** The bankruptcy process can be complex and costly. Bankruptcy legislation varies and the level of protection of the different parties involved in the bankruptcy process (workers, suppliers, shareholders, and creditors) is different from one country to another. These differences affect the value of the bank's claim on the bankrupt firm.

The central and most crucial common denominator in all real estate lending programs is obviously the ability to use land and any fixed asset placed upon it, as the principal source of security for credit. The capability to utilize real property as collateral is dependent on the rights of ownership and rights of usage of the land plot.

The following section describes the unique aspects of the Angolan land law and the impediments to the well-organized development of a mortgage-based housing finance market caused by the current inefficiencies of the property registrations system.

V. LAND LAW AND PROPERTY REGISTRATION

Property rights in Angola remain highly problematic. The national Land Laws passed in late 2004 has been met with a mixed reception. While provisions endowing individuals and communities with the right to legally register ownership of previously informally occupied land have been, for the most part positively received in rural areas; there remain a number of legal interpretations that have impeded urban development and standard real estate lending practices. There are concerns that the supporting regulations and bylaws are not entirely clear and that the three-year time limits placed on the registration process may undermine security of tenure, particularly in urban and peri-urban areas where evictions are already common.

Property rights are a central issue in developing any type of long term financing program for real estate ownership. Where these rights are secure and readily transferable, land and buildings serve as the most important form of collateral for lending. According to the Constitution, land is owned exclusively by the state and appears to be considered nontransferable.

It seems clear that the 2004 Law on Land and Urban Planning (See Annex A, attached); affirms that all land ultimately comes from the State, but permits private ownership of most urban and some non-urban land. Land is obtained for economic purposes through use rights. Property can be transferred through the *Dereito Superfice* (land use) program under long-term renewable grants from the Angolan government. These rights of usage are granted for a term of 60 years with an option to renew for an additional 30 years.

Use-rights transfers can be authorized only if an improvement or structure has been built on the land, but the authorization is highly subjective because of a lack of stipulated regulations. Urban buildings, however, can be freely transferred without prior authorization, along with the use right for underlying land. It is a clear priority for the government to ensure that the rules for authorization of property transfers be clarified and simplified, and use rights should be more freely usable as collateral.

However, registering property can take as long as 11 months, according to the World Bank's 2010 "Doing Business" Survey, with a complicated and expensive fee structure based on a vague valuation of property value. Technically new property owners must also wait five years after the initial purchase before re-selling land, and there is little empirical evidence that this restriction is being adhered to. Implementing regulations, when written, should define different forms of land use, including commercial use, traditional communal use, leasing, and terms of private ownership.

Angolan commercial banks have recently begun to offer more real estate-related financial products. However, unclear land titles and ill-defined property rights continue to complicate and lengthen the process of obtaining a straight forward mortgage loan. Banks that were interviewed by the Mission advised that virtually 100% of their individual credits for the purchase of a house or condominium were collateralized by third-party guarantees and collateral in addition to the mortgage instrument.

Like many other countries emerging from conflict, Angola has adopted a new economic model in recent years, based on encouraging private investment and a reduced emphasis on central planning. The market, rather than the state, is now regarded as the main engine of economic growth, and the concept of a 'right to private property', which was previously regarded with considerable suspicion, has been officially embraced by the authorities.

However, most land in Angola continues to be held and occupied under a 'customary title' system and people do not have documentation proving their rights of ownership. Customary land tenure is currently not recognized by Angolan law, and this creates a difficult gap between the formal legal situation and ability to develop a dynamic housing finance mechanism, and the reality facing most people living without formal tenure rights.

Many Angolans have squatted on land without official permission, often for many years. In some cases they may have bought this land in good faith from others who were illegally occupying it. Many people have lived all their lives on land which they do not have any official right to occupy, and they may have invested considerable sums of money in what they regard as their only economic asset.

The Political and Legal Framework

Land was regarded as a common resource in pre-colonial Angola, with a system of communal possession in which any member of the community had the right to cultivate parcels of land occupied by the community. Under Portuguese colonial rule, land in the north-west of the country was gradually appropriated, mainly to establish coffee plantations. Portuguese citizens were encouraged to emigrate to Angola, where planned settlements (*colonatos*) were established for them in rural areas. At the height of the colonial period, 300,000 colonial families occupied approximately half of Angola's arable land. Angola gained independence from Portugal in November 1975, prompting a massive exodus of Portuguese settlers. Thousands of plantations were abandoned, and were promptly 'nationalized' by the new government. This meant that the state became the effective owner of lands that were not already definitively considered as privately owned.

When the Portuguese left in 1975, the Commission Habitacional had authority to determine occupancy of Portuguese properties. The Commission also had to approve any leases. Ownership, however, remained with the Government. After 1975 individuals were no longer able to buy private land, but were instead granted 'surface' or 'possession' rights, which meant that they had the exclusive right to use the land, although it formally belonged to the state.

These provisions were included in Angola's Civil Code, inherited from colonial times, which remained the legal framework governing land rights until 1992, when a new constitution was adopted. The Land Law 1992 (Law 21-C/92) based itself on the former colonial cadastral record, which has not been updated since independence, and tried to restore some order to rural land relations. The law's preamble stated that local community land rights would be protected, and recognized some different forms of tenure. However, it remained heavily based on the old ideals of state central planning principles, requiring, for example, that land conceded by the government must be 'put to effective use', and retaining the right to subject production to the 'requirements of national development.'

According to the 2004 Land Law, the State can only expropriate land for specific public use, and it must declare this purpose when it does so. Anyone whose land is expropriated for public use has a right to compensation. The Land Act of 2004 was an important step towards the formalization of land title and tenure rights, but implementing regulations and required Master Plans are incomplete.

Where the state grants land concessions for urban development projects it has a legal duty to publicize this widely. These specific requirements reinforce the general principle in Angolan law that public administration must provide adequate notice to people whose rights are likely to be affected by its actions.

While these provisions, if implemented, should provide people with more procedural protection against forced evictions, a requirement that everyone must complete the official process of registering their land and securing title within three years has proven to be totally unrealistic and unworkable. The law places the onus on individual citizens to seek regularization and registration of the property within three years, and states that irregularly occupied land may be subject to forcible requisition after this period.

To date this program has been a major failure as Angola's official bureaucracy is slow and inefficient and lacks administrative capacity. Land registration requires many steps including conformity with an approved master plan and other requirements that constrain registration in informal settlements. The reader is referred to Annex B, attached for a more comprehensive discussion of the legal and regulatory perquisites for a viable property investment market.

It is reported that for the whole of Luanda only about 300 titles are registered per month. Unless the Angolan government takes deliberate steps to approve the remaining regulations and prioritize resources to ensure effective land registration for all those requiring regularization, insecurity of tenure will continue to be prevalent as the urban poor will remain vulnerable to forced evictions and any attempt to enforce the law's provisions could lead to widespread social unrest.

A previous USAID-sponsored project recommended simplified registration systems and intermediate titles of occupancy in informal settlements that can be upgraded to real rights and more formal registration over time.

VI. STATUS OF THE REAL ESTATE MARKET IN ANGOLA

Property plays a critical role in the social and economic challenges facing Angola. Following the peace agreement that ended a long period of civil war, Angola has experienced a surge of construction driven by increased investment and significant oil-based revenues. The problems of the common two-tiered structure for real estate markets in emerging markets, as described above, has been further exacerbated in the case of Angola. While the war caused massive migration into urban centers, the economic development of large oil reserves has created a "boomtown" atmosphere in Luanda, which is driving prices and rents to unrealistic levels simultaneously with severe economic and social distortions.

The economy of Angola continues in its transition from a socialist-oriented command economy mired in civil war to a market based system that respects individual ownership of property and enterprise. Culturally, the vast majority of society still lives with only minimal inclination toward entrepreneurship or the belief in the values of home ownership in the dwelling that they inhabit. Part of this is likely the residual effect of 30 years of war causing a pervading feeling of fear that deters people from demanding a more responsive government. However, the pervasive reality is that the bureaucracy is intimidating with multiple steps in any process through a complex set of government offices. Dealing with the judicial system, public notary system, fiscal authorities and the total registry costs are very complicated and few people have either the knowledge, time, patience, nor money to register their de facto ownership of the land they occupy. This actuality limits the growth of the market for available or potential mortgages to less than a minute fraction of the population; with no bank willing to take on additional risk to truly test the market in any substantial way

Economic distortions in the real estate sector are particularly acute in Angola where it is reported that 70% of the population nationwide and 10% in Luanda subsists on $1 per day, while at the other end, western style homes and apartment for expatriates are commanding as much as $25-30,000 per month, often paid two years in advance. Virtually 100% of housing construction and finance programs has been concentrated at this high profit extreme of the market while broader government housing policies and programs that would impact the low-end and affordable real estate market have not yet been designed or implemented.

Demand at the high-end of the market, has attracted foreign developers and speculators. However, the needs and markets for more moderate and affordable communities have gone largely unmet. As a result of migration driven both by employment demands and past civil unrest, Luanda has been surrounded by massive unplanned informal settlements with poor infrastructure and services.

Continued legal uncertainties in the key areas of property title, registration and the complexities of land use approvals are major impediments to regular property development, although these issues have often been bypassed by special regulations which greatly favor the building of luxury housing and the establishment of new 'high end' development areas.

There are also reports of land expropriation within Luanda and its surrounding areas with little regard for any transparent system of redress for individuals. The Mission heard reports that recently the poor occupying valuable land in areas near the port are being forced to move, justified by their lack of property registration, while the multiple housing developments located in Luanda Sul were 'authorized' on the basis of special legislation approved through Presidential Decree that allows concession and registration of surface rights.

Moreover, development at the high end, while very profitable for the time being is raising systemic risk issues in the banking sector and may not be sustainable for much longer. Demand for first class properties (the majority of which are being purchased by speculators for rental income) and expatriate housing is finite, the financing structures currently employed are flawed, and there are signs of over-building.

The Mission conducted several interviews with local banks to gain greater insight on the structure and status of the local real estate market. The following list highlights some of the more interesting findings:

- The new Land Act was passed in 2004, but implementing rules for real estate transactions involving the transfer of land use rights (surface rights) are still not clearly defined or understood.
- There is a central registry system for land titles but it is inefficient. A 'clean' mortgage instrument cannot be structured if the property is not registered.
- Expansion in the real estate market and demand for western style housing began in earnest after the end of the civil war as oil companies and other multinationals (including embassies) started looking for homes for their employees.
- There is a growing middle class of Angolans but most of the local sales of property is being driven by a elite class of persons who have profited from the oil boom.
- Much of the real property market is being driven by speculators who are attracted to the high rental incomes available.
- New rentals in Luanda now reaching the $18-25,000 per month range—often payable two years in advance.
- At least 50 % of the new sales are not to owner-occupants.
- The largest planned residential development in Angola is the Luanda Sul development which was approved under special government legislation that enabled sale and registration of surface rights. The entire area is supposed to be developed under a master plan which includes the building of the Belas Business and Residential Park (two residential towers and two business towers), covering some 48 thousand square meters of area) and the Belas Shopping Center.
- The Mission visited Luanda Sul area one afternoon and met with one of the developers of a new condominium complex to discuss unit pricing and sales terms. This development is being built and sold by an offshore company affiliated with the Banco Espiritu Santo Group from Portugal. There is no direct or indirect credit exposure of the locally-incorporated commercial bank to this project.
- Portuguese construction firms such as Soares da Costa and Techeira Duarte have remained in Angola over the years since independence and are now the leaders for development and construction of a majority of local real estate projects.
- The developer of the Belas Park complex is the Odebrecht Group from Brazil, one of the largest engineering and construction companies in Latin America. It is reported that Odebrecht has employed up to 30,000 workers at one time, making it the second largest private sector employer.
- The Mission was advised that sales in Luanda Sul, and other residential properties under construction downtown, have come to a virtual halt since the decline in oil prices at the end of 2008. However, there is no indication as yet of any reduction in the pricing of new units or any notable decrease in prices in rentals.
- The commercial banks report minimum exposure to the housing sales in Luanda Sul as virtually all purchases are either on a cash basis or are financed on a short-term basis directly by the developers.

The Government of Angola has demonstrated a strong interest in normalizing the exigent conditions of the local real estate market. It is well understood that the current market structure is unsustainable and that fundamental changes will have to be made across the full spectrum of real estate financing fundamentals. To achieve progress in this area the government will need bringing to bear the necessary legal, regulatory and financial resources required to allow the market open and free movement. Of immediate concern should be the development of programs that would address the following issues:

- Adaptation of policy, legal and regulatory frameworks that meet market demand for real estate development;
- Advancement and implementation of land ownership and property registrations laws (see attached Annex C);
- Adaptation of public and private sector institutions to changing needs and modern practices;
- Development of real estate professionals with the qualifications and experience needed for sound investments and efficient transactions;
- Create the operational environment for banks and other financial institutions extending real estate related finance to create the mortgage market primarily in local currency, avoiding the complex issues of foreign exchange risk when financing local assets.

To date the government has advanced to the stage of drafting legislation which will address some of the above issues. For example, the new *Lei de Medicao Imobiliário* will require, among other matters, that real estate brokers be licensed by the Instituto de Habitacao Nacional (National Housing Institute) and will require verification that the individual prove their knowledge of the industry through training classes (definition of time requirements and subject matter not clear) and continuing education programs. A preliminary limit on real estate commissions charged to sellers has been set at a maximum of 10%.

It was beyond the scope of this Mission to thoroughly evaluate this legislation but a preliminary review indicates that, when enacted, it should begin the process of raising the professional standards and bringing the operations of the real estate market closer to international best practices.

Government Sponsored Housing Programs

The Mission has also been informed of the Government's planned program to build one million new urban residences through a series of newly formed integrated town sites, over the next four years. At this point nearly 700,000 of these units are contemplated to be completed through a (yet to be finalized) program of credits and grants to individuals to build their own homes involving the use of government funds through an investment fund. This fund will cover costs for infrastructure development, housing construction, and home purchase. It appears that another 150,000 units are reserved for government employees with the remaining 150,000 units to be built and financed entirely by the private sector. Apparently this latter sub-program is to incentivize the private sector to build affordable housing units as well as the more profitable high end of the market.

Again, due to short timeframe of this Mission, it was not possible to thoroughly analyze the details and structure of this ambitious plan. However, a brief review of the proposed Decreto Promocao e Acesso a Habitacao Social (a master plan type document), raises a number of questions, including:

- It is envisioned that all new homes in this project must be built within the new town sites planned by the government. This raises concerns about the housing needs in and around Luanda as well as the apparent plans for a forced relocation of the population.
- There will be a considerable need for investment in the cost of a significant level of infrastructure development to allow for access to basic utilities, water, sewer and electricity.
- Land acquisition costs are presumably covered by the government but this issue is not clear. If land costs are imputed into the total project costs, this will raise the price of housing to the end user appreciably.
- It is proposed that nearly 700,000 units will include land use allocation and that individuals will be able to build their own homes using tax-exempt construction materials. This program raises a number of logistical and financing questions.

- Appears that the program sets a limit on access by individuals who are participating through rent contracts (actual contract terms undefined) to people with a minimum work history of three years and annual earnings of at least 24 times the minimum salary set by the government.
- The current minimum salary is set at approximately the equivalent of $100 dollars a month. This means that the annual income required to enter into a rental contract for "social housing" is a total of $28,800 per year for three years.
- Likewise, the minimum salary level required to enter into a financial leasing agreement is set between 48 and 144 times the minimum salary. Presumably this wide range is related to the price of the property to be purchased.
- It is calculated therefore that the minimum annual income required for a lease purchase (*arrendamento resoluvel*) contract is USD $57,600 per year.

Based solely on a preliminary review of this program structure, but reinforced by a number of years of experience in international housing finance programs; the Mission concludes that there are a number of structural flaws with this new government housing program. It is the opinion of the Mission that the government has approached its plan to build one million new housing units in newly created town sites from the reverse of normal practices.

It seems obvious that this program has been designed to target the narrow market of the upper echelons of the formal working class and does not address the broader base of the lower income population and their need for affordable housing. A quick calculation of the qualification criteria set for participation in this program shows that as currently structured it is reasonable to assume that a person who qualifies for this housing purchase program:

- Would earn the minimum annual salary of approximately $58,000 (48 times the Minimum Salary);
- Would be able to purchase
    - assuming a normal 30-year fixed rate mortgage at 10 % and
    - applying an average debt to income ratio (DTI) requirement of 30-40%:
- A home priced in the $125,000 to $165,000 range.
- This would require a monthly mortgage payment of $1,400.

It is highly questionable just how many people earn this level of income in Angola.

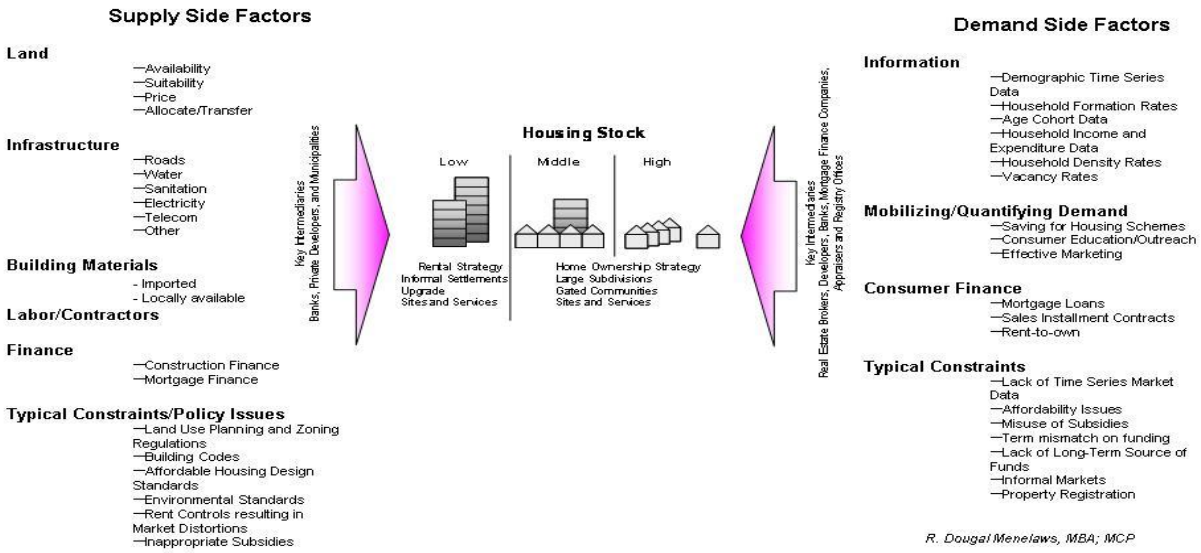
Before setting these high pre-qualification standards for participation and then allowing for developers to build high-end and expensive units that are unaffordable to the majority, the Mission recommends that the government conduct a comprehensive market-based Affordability Study in order to determine the proper pricing levels of the housing inventory to be built. The single most important obstacle to producing more housing is getting market players to truly understand affordability.

To properly serve the Angolan market developers must be required to introduce and apply innovative site layout and house design standards that increase density, lower prices and still return profit to investors. International experience shows that with a proper public/private partnership, such as developed in India, South Africa and Indonesia, that successful developers can deliver a sufficient volume of core 'starter' homes priced as low as USD $8,500 utilizing proven design standards.

In redesigning this housing program the government should readdress its position regarding the use of government funds and/or subsidies as regards wealth transfers and direct financial intermediation. The degree to which the government is willing to provide for the free transfer of land title and reduce its income from import duties and fee generating transaction charges; will be a determining factor in creating a truly dynamic and affordable housing market which incentivizes active participation from the banking sector.

It is further recommended that the government readdress the overall structure of this program taking into account the fundamental principles of supply and demand as illustrated in the following chart.

Diagram 1: Housing Production – Supply and Demand



VII. DISCUSSION OF FACTORS AFFECTING HOUSING DEVELOPMENT

The following section provides a brief description of the myriad of issues and factors that are in play in the development of a dynamic and sustainable real estate market. It is easy to infer that the current state of housing development and real estate finance in Angola requires that the government be aware of the concepts discussed below. The BNA should assist other government agencies in this effort and advocate financial controls that encourage appropriate public and private sector actions as necessary to change the market structure from its current 'boom-bust' cycle to one that takes full advantage of the funds available in the Angolan economy.

Supply Side Factors

Supply side inputs include land, infrastructure, building materials, labor, finance and entrepreneurial skills. Housing production costs depend largely on the cost and availability of inputs such as land, labor, building materials, construction equipment, public infrastructure, construction finance, as well as professional and entrepreneurial resources.

However, it is important to note that productivity among housing suppliers can differ substantially even when unit input costs among different projects are relatively the same. The single most important factor in production efficiency is the entrepreneurial skill set of the real estate developer or the builder/owner.

Factors that inhibit efficient production and restrict supply of affordable housing include high land prices, overly complex planning controls, building standards and land development codes. Restrictions on the supply of land and the density of residential development greatly affect land costs.

Often design standards are set to accommodate the upper income tier of the market and inhibit the design and delivery of housing affordable to middle and lower income households. In particular design standards that control density by requiring minimum lot size, setbacks, building to plot coverage ratios, building height, vehicular access and off street parking prevent innovative design and introduction of affordable low cost housing.

The timing and provision of infrastructure affects the spatial pattern of development and land values. Because infrastructure is a complementary input to the production of housing, the amount, type, and price of infrastructure will influence the demand for complementary housing inputs, which will in turn affect the type of housing supplied in different locations, residential densities, and land and housing prices. These, in turn, may be reflected in commuting times, wages, the costs of goods and services, and the productivity of enterprises.

Government intervention in the provision of serviced land should be encouraged as policy. In fact, without government intervention critical public facilities such as parks, open spaces, major infrastructure and urban services, which the private sector cannot profitably produce and sell, will not be provided. These services are essentially "public goods" in that they are indivisible, difficult to price and users often cannot be excluded.

Therefore setting the structure for future urban development by building key infrastructure is the most effective public policy tool for promoting sound urban development. Finding the appropriate balance and division of labor between the public and private sector is the solution to effective and productive urban land development management.

The single greatest factor in reducing the price of housing is the provision of serviced land and major infrastructure. Simply stated if you build a road, provide access to water, electricity and sanitation in the right location, housing will follow.

The building materials industry is another important contributor. In some countries staple building materials are not produced locally and have to be imported. Key imported materials such as concrete, steel, plywood, sheet rock, copper piping and electrical wiring introduce currency exchange and supply risk into the production cost equation for developers. In countries that have no prior experience in producing housing at scale additional investment in local building material companies is required to increase capacity and quality of production.

Another major impediment to producing housing at scale is lack of construction finance. Without access to financing, owner/builders utilize savings and current income to build housing in what becomes an informal market. Construction often occurs incrementally as funds become available over time. This can result in a proliferation of partially completed buildings and urban blight. Such building patterns are often found in developing countries and reflect and demonstrate the lack of an efficient housing finance system.

When construction finance is available, however, ready capital transforms the construction process. Professional developers become more efficient, project building cycles are shortened and more housing is produced at lower cost.

Rent controls uniformly inhibit production of housing. International experience suggests that rent control, in conjunction with legal frameworks that are favorable to tenants against landlords, will result in the decease of supply of rental housing by the private sector. Rent controls lower costs for sitting tenants but they have the unintended consequence of reducing the value of the housing stock and deter further investment in rental housing.

Existing units suffer from lack of maintenance, since landlords have no incentive to invest in maintenance and due to difficulties in evicting bad tenants; landlords prefer to keep units vacant rather than re-renting them under rent control.

Demand Side Factors

Demand for housing is driven by demographics, particularly new household formation rates, and household income and employment levels. Palestine for example has a young population and household rate formation is very high.

Stable employment and household income underpins demand for mortgage finance. Typically we find tiered markets in developing countries where only the top 5% to 10% of the market are housed through the formal sector, where:

- Units are professionally designed and built;
- Building permits are issued;
- Property is registered;
- Most of the units are mortgaged.

Developers and owner/builders serve this market first due to lower perceived risk and higher profit margins.

The next tier is often un-served households in the 50^{th} to 90^{th} income percentile range that can qualify for finance but require an affordable product range to be built first by developers. This requires developers to build units with appropriate design standards that can be afforded by households in this income range. Without this, these households will continue to access housing supplied through informal markets in which consumer protection and legal safeguards are often lacking.

However, the single most important obstacle to producing more housing is getting market players to truly understand affordability. To serve this large market and next tier developers are required to introduce and

apply innovative site layout and house design standards that increase density, lower prices and return profit to investors.

Not every household can qualify for home ownership and indeed the rental market serves an important complementary function in housing markets. Homeowners in waiting and young households need access to rental housing as they save to qualify for home ownership.

Finally, lower income groups typically cannot be served by the private sector without the provision of government subsidies. Programs that target and benefit the very poor require careful design of subsidies that do not distort markets. Typically such schemes involve the provision of upgraded infrastructure services such as water, sanitation and electricity to high density low income neighborhoods and rental assistance vouchers.

The Importance of Mortgage Finance

Housing is the principal asset of the household and housing finance has a major impact on the financial or non-financial form these savings may take. When introducing mortgage finance for the first time as financial products nothing is more important than educating households on the benefits derived from a mortgage loan. Extensive mass consumer education and outreach campaigns allow the public to learn and understand what the new financial product offers to include full disclosure of their benefits and risks.

The establishment of a primary mortgage market is a critical factor in generating demand. Because a housing unit normally costs a multiple of annual household income, mortgage financing is essential in making the purchase of a home affordable. Yet mortgage financing in developing countries is often limited. Home purchases financed by the formal financial sector in many countries typically account for less than 15% of the annual value of housing investment. Home purchases as a result are usually financed by a combination of household cash savings, current income, loans from relatives and loans from moneylenders.

It is important to understand that the makeup of available financing determines the pattern of investment as well as the type and quality of housing that is built. Informal methods of financing housing predate the development of the formal financial sector. Because informal financing is lumpy, irregular and risky, incremental housing is often the result and the lack of regular housing finance programs often create large inventories of unfinished construction.

Housing finance also encourages the growth of the financial services sector, which studies have also shown to be a key factor in economic development. If consumers begin to save for down payments this increases both the assets available to the financial services sector, and the demand for more financial services. Additionally, financial markets and intermediaries act as a lubricant in well functioning economies. They perform the crucial task of mitigating information and transactions costs and provide a needed bridge and filter between economic agents of information that otherwise would not be shared. This enables firms to allocate their resources more effectively and increase their productivity, resulting in greater overall economic growth.

Where housing is produced informally it is not uncommon for end purchasers to enter into private sales purchase agreements with independent property developers. Typical terms are 10% to 30% down with the balance due over five to seven years. Under this arrangement the end purchaser essentially leases to own and if the property is registered, it is in the name of the owner/builder until such time the note is fully paid. In highly speculative markets developers tend to concentrate only on the very high end of the market and prices and purchase terms can be even more onerous.

Mortgage loans have utility because they allow households to distribute patterns of saving, investment, and consumption in a more efficient way. Housing finance can also contribute to the deepening of the formal financial sector and a decrease in the size of informal markets. In countries where financially

sound mortgage finance systems are in place, demand for mortgage loans often is so high that mortgage lending becomes the most rapidly growing segment in the financial portfolios of lending institutions.

In countries with large informal employment markets, mortgage finance not only assists qualified low and middle income households to become homeowners but also enables these households to transform accumulated housing equity into a source for financing small business activities.

The following chart lists the key components and prerequisites for developing a dynamic and sustainable housing finance system:

Key Prerequisites for an Effectual and Robust Housing Finance System

- Macroeconomic stability which enhances housing affordability through lower and more stable mortgage interest rates, the adoption of consumer friendly mortgage instruments and a choice of fixed or adjustable interest rate mortgages. The national macroeconomic environment must include transparent government policies for the control of inflation, stable exchange rates, equitable taxation and private ownership of property.
- Adequate laws, titling systems, and judicial processes that allow households to establish ownership and pledge property as collateral. The enforceability of the lender's security interest is a major determinant of the attractiveness of mortgage lending. If liens are not enforceable, there is little to distinguish mortgage loans from unsecured debt. Lack of enforceability causes mortgage lending to be perceived as a high risk and unprofitable area for lending in many developing countries.
- Robust and dynamic markets for the sale and resale of new and existing housing. The presence of numerous buyers and sellers, transparent and accurate information on prices and sales characteristics, an accurate and timely title registration system and the lack of discriminatory or onerous taxes (e.g., stamp duties, high property taxes) are all necessary to foster growth in housing markets and make houses safer collateral for finance.
- Sufficient supply levels of housing units, both in volume and in price range, consistent with the national distribution of household income. Such supply characteristics implies having an efficient production process capable of generating property sales with infrastructure and services, quick license and permit approval mechanisms, short production cycles and easy access to ample acquisition finance. Formal market-based credit facilities should be predominant with government subsidy programs implemented only when necessary to stimulate participation from certain low income sectors of society.
- Competitive and efficient primary mortgage markets represented by a wide range of mortgage finance programs. Competition stimulates innovation and the adoption of cost-saving processes and technology. As markets expand and deepen, greater efficiencies in lending can offset the higher costs of small loan size for affordable housing. The ability to price for risk and the development of risk-sharing mechanisms like mortgage insurance can expand the supply of credit to low and moderate income households.
- Mortgage products that meet the needs of borrowers and lenders. A robust housing finance system generates a wide range of products to meet consumer needs and protects consumers against rogue lenders or products incompatible with their ability to repay. In addition finance must be available for housing construction and renovation, increasing the efficiency of the building process.
- An infrastructure for information for assessing collateral and credit risk. This is particularly important to address the complexities of underwriting and servicing small loans to individuals with typically undocumented and potentially unstable sources of income. The lack of, or high cost of, obtaining information, vetting it for credibility, and fitting it into established financial forms and delivery channels is a substantial impediment to mortgage-based housing finance.
- Adequate levels of household domestic savings relative to the size of the economy providing a pool of resources that can support the credit needs of households. Household savings should supply a core deposits base in the banking system.

VIII. BANK LENDING IN REAL ESTATE—CURRENT SITUATION IN ANGOLA

The Mission was able to perform a rough analysis of the consolidated financial statements for the banking sector in an attempt to gain insight as to the overall exposure of commercial banks to the real estate sector. This was not the normal simple task as the chart of accounts used by the BNA does not provide a breakdown of loans by sector or industry[1]. Therefore the analysis level sought was achieved through a process of deduction.

Based on the statistics available for year-end 2009[2]; the total assets of the banking sector were the approximate equivalent of $34 billion. The total capital of the banking sector was reported to be approximately $3.4 billion or approximately 10% of total assets. Total loans outstanding as of year-end were reported at $10.8 billion (31.2% of total assets), with total deposits mobilized (both Kwanza and foreign currency) of $27 billion. The overall credit exposure of the Angolan bank outstandings to the private sector (due from) totals only $5.8 billion and is equal to approximately 54% of total loan assets. As the majority of bank credits to the private sector are known to be short-term (one year or less); it is imputed therefore that banking sector exposure to the national real estate market (construction loans and property purchase credits) is less than 10% of total loan assets outstanding—approximately $1 billion.

System-wide the commercial banks exhibit a relatively low lending rate of $\leq$ 51% of deposits. This implies that there is sufficient liquidity in the system to support new credits to the real estate sector, particularly for smaller individual mortgage loans. The banks are notably reluctant to lend in this area Rationale for this risk adverse position can be attributed to a number of systemic issues such as:

- Demand for collateral by banks in an environment without mechanisms for perfecting liens;
- Uncertainty in the legal basis for land ownership and titling instruments;
- A weak judicial system with little or no legal precedence for debt resolutions through the bankruptcy process;
- The lack of an efficient central registry or credit bureau operation;
- Caution in relation to an inflated market.

Since the end of the civil war in 2002, the banks have concentrated their activities and earned their profits primarily from transaction in short-term trade financing, and investments in high-interest government bonds. The banks have supported the real estate construction boom only marginally, financing only certain mid-level phases of a construction project on a short-term basis. In many cases these credits have been further supported by the corporate guarantees of the major offshore construction companies. It is reported that even this minimal level of lending is winding down as the impact of the end of the construction bubble begins to take effect.

The record shows that the majority of the real estate development in Angola has taken place in and around Luanda and has been dominated by speculative transactions targeted at the high end of the market only. While this has proven to be very profitable approach in the recent past, it has also created an unsustainable pricing bubble that is already showing signs of a collapse.

The Mission is somewhat concerned that several banks have already launched off-shore real estate investment companies that are operating as joint ventures. In this respect the line between traditional risks in bank construction financing and equity participation in funds depending on sales to return investment is

[1] This shortfall is to be corrected with the new chart of accounts currently being developed for the BNA by a group of consultants from the Central Bank of Brasil

[2] See Annex D, attached for a schedule of the consolidated loans outstanding for the Angolan banks as of 12/31/09

becoming blurred at the risk of loss to the banks should projects not perform. There is need for a more careful analysis of supply and demand within the real estate market; taking into account the need for a market which serves the more moderate income levels and provides affordable financing for the development of new communities.

Risk of Money Laundering Activity in the Real Estate Sector

The real estate sector provides numerous opportunities for criminal abuse. The amount of money to be made in both residential and commercial real estate creates temptations for fraud and money laundering. It is clear that the Angolan economy is not immune to exploitation of weaknesses in money laundering oversight.

The best defense against money laundering activities has proven to be a strong anti money laundering (AML) policy, supported by the government and implemented through the banking system and its reporting requirements on large cash and suspicious transactions. In most countries the central bank, or a separate Financial Intelligence Unit (FIU) act as an overseer of the process of gathering and analyzing financial data that may allow for the detection of money laundering activities. As money laundering is usually a cross-border activity, an international network of cooperating FIUs has been established as shared information has proven to be an effective AML tool.

It should be noted that money laundering activities can easily occur outside formal banking channels, it is necessary to implement policies and procedures which will institute elements of anti-money laundering (AML) compliance to the real estate sector. These elements can be directed toward those with knowledge or, or involvement by, those professions who serve as "gatekeepers", i.e. attorneys, real estate brokers, building contractors, developers, notaries, registrars, building inspectors, moneychangers, owner/builders and similar professions/entities, who although may or may not handle funds per se, are closely involved in the process to the extent that they can be obligated to report on unusual or suspicious activity**.**

It is not within the scope of this Mission to review or comment on the efficacy of AML policies or programs in Angola. However, the Mission was disappointed to learn that to date no formal AML program for the commercial banking sector has been created nor has an FIU been established. The Mission learned that Angola is not a member of the internationally recognized Financial Action Task Force (FATF) and is in fact listed in the annual US State Department report to Congress as a 'Jurisdiction of Concern'.

Given the structure, excessive pricing and high volatility of the real estate sector noted by the Mission, it is concluded that the risk of money laundering activity occurring through real estate transactions is quite high and it is recommended that the BNA consider this issue as well in its ongoing efforts to provide a structured environment for normal housing finance and leasing operations.

Précis of Bank Lending to the Angolan Real Estate Sector

The Mission met with the management of several of the larger commercial banks operating in Angola and queried regarding their approach to and total credit exposure to the local real estate sector. Responses basically confirmed the conclusion that currently there are no publicly offered mortgage programs by any bank in Angola. While there are a hand full of individual loans extended for the purpose of purchasing property being offered by three banks, in particular, BancoBIC, BESA and BFA; these have been structured only with multiple forms of guarantee in addition to any mortgage instrument.

These credit enhancements include corporate guarantees, individual co-obligors and alternative cash assets deposited with the bank. There is empirical evidence that in only a small percentage of cases has a recorded lien on the property been filed with the public registry. By some accounts as little as 10% of the buyers of the housing and condominium units being financed are planning to live in the units--thus

making non-owner occupied (i.e. speculators) property as much as 90% of the market. The common consensus is that buyers have been attracted to this market primarily for the perceived profits to be gained from the extremely high levels of rental income that have been charged since early 2004.

The formal housing market in a few select areas of Luanda (such as the major development if Luanda Sul) has experienced a remarkable increase in demand that has led to overbuilding and a noticeable pricing bubble in high-end real estate that is extreme. Sales prices for new condominium apartments still under construction have reached as high as $5,000 to $6,000/m2. This bubble has pushed the prices of mediocre condo and single family housing to totally unsustainable levels as the past influx of foreign capital from oil companies and other related industries has begun to dry up. International companies are reportedly paying rentals as high as $25,000/month to house expatriate employees.

The reality is that the vast majority of the real estate sales in the local market have been the result of developer financing schemes and the banks, not traditional housing finance loans from the banks. For all practical purposes there is no bank-led mortgage market nor is any bank planning to build one until they are more comfortable that clear title is available and prices readjust to more normal levels.

Total residential financing exposure to banks for construction financing and "mortgages" is less than $1 billion for probably no more than a few thousand mortgage-backed loans. It is estimated that the average size of these loans is approximately $200,000 which effectively excludes all but the very elite within the Angolan economy.

BancoBIC appears to have one of the larger "mortgage" portfolios reported by bank management at more than USD$100 million. They state that to date, they have not had a single default nor have they initiated any formal foreclosure proceedings. It is believed that this is more a reflection of the immaturity of the market (no long term history of loan repayments as yet), and the impact of the additional collateral being held, than any true reflection of the quality of these loans. It is feared that the near term effect of collapse of this market will lead to a significant rise in loan arrears and possibly an abandonment of some unfinished construction projects.

There is a high level of new construction in both high rise mixed use buildings that is scheduled to be delivered over the next 18 months to 2 years which could increase supply by several thousand residential units along with mixed use shopping and office product. However, the delivery of these units, coupled with the recent increase in efficiencies and lower prices for raw material imports, will likely accelerate the collapse of the current real estate bubble. There will be a notable readjustment in demand as desperate renters abandon older high rental agreements for new more competitive units. This will subsequently cause speculators to move out of the market further, causing a further increase in supply as speculators try to sell their properties. The Mission estimates that this type of correction could cause prices to cascade by 30% or 40% of their current levels.

There are currently no operating programs offered by the government or any third party funding group that we can determine that can fund or redirect the construction programs and subsequent purchase of any housing for the low income sector. The government plan for building one million homes over the next four years, as discussed above should be recognized as overly ambitious and considered to be in the early planning stages only. Unless some action is taken to eliminate the structural impediments and incentivize commercial banks to enter the formal (and more traditional housing finance market; there will be no significant private housing development in Angola for the foreseeable future.

Finally, it is well known that bank excessive exposure to the real estate sector has caused significant losses in recent years. The methods that banks use to account for credit losses in their loan portfolios greatly impacts the institution's financial success. Annex E, attached, offers an interesting research paper, assembled from a 2005 World Bank survey, that provides an in-depth review and discussion of Bank Loan Provisioning in Emerging Markets, The Mission recommends that this paper become required reading for the on-site and off-site examiners in the BNA Bank Supervision Department.

Creating a Sustainable Mortgage Market

The following section outlines the multiple issues and impediments affecting the development of a sustainable mortgage market in Angola as well as some of the action steps considered necessary to create a residential mortgage market which serves the larger Angolan population.

Private Ownership of Land: After 30 years of civil war and a strong socialist influence the current status of land ownership in Angola remains largely in the hands of the government. There are varying degrees of private control over certain parcels of land through temporary land use grants or other de facto land controls. The Mission's meeting with the director of the Institute for Housing indicated that it is their intention to have people become true owners of their homes and he referred to the constitution which says that everyone has a right to a home. Many people have taken possession of land with an official recognition of their rights of use in the form of a "Derieto de Superfice".

Property Title Process: The process of registering private property is cumbersome and complicated; the vast majority of people appears to not want to bother to register their property or simply can't afford to do so. Included in the following is a description of some of the procedures that seem to be required to take form title to private property. It is not a complete list and a detailed study to document the actuality would be needed, however it identifies several impediments that the Mission recognizes and makes the recommendation to diminish their negative impact.

Judicial order: For an individual to take title to their property it seems that first they are required to have the appropriate certifications for the construction and use permits in addition to a document that declares that they can transition the property to Private property from surface rights. The time and money needed to do this is unknown.

Notary Public: The role of the Notario Publico is needed to document any land transaction including a mortgage. The time it takes depends on the Notario and the fees charged by Notaries are unknown.

Taxes and fees to be paid: The Ministry of Finance out lined the taxes that are to be paid for the transfer of property between parties. The taxes are as follows:

1. 10% of the total value being transferred;
2. 8% of the 10% tax charged above.

Total fees to be paid are in fact nearly 11% which makes Angola one of the most expensive countries to buy and sell real estate. The mission recommends that this transfer tax be changed to a minor fixed fee or eliminated all together so as to encourage individuals and businesses at all levels to formally register their property. The goal is to have an inclusive society with the vast majority of people participating in the formal economy and adding value to their properties for their own gain.

Registration process and fees: The public registry has an extremely complicated and expensive registration process. First they do not scan documents they simply accept original forms and manually record the information. While this information may be accurate without the original form scanned in and readily available in electronic format it will lend itself to a less then transparent public registry. Second and most importantly the cost and complexity of calculating the fees is not a public process and in fact the fees are calculated by hand with no automated transparent matrix. (See Annex C, attached for a more comprehensive set of action plans to establish a workable property registration system.)

At this point it is impossible for any individual or business to know their cost based on a simple calculation. The following is a sample of the registration fee for a USD $ 10,000 piece of land. This calculation was performed in the offices of the Public Registry with the staff personnel in charge of the fee calculation. There is a 7 to 12 step process with extremely complicated calculations. The end result is that the fees to be paid are a total of USD $1,386. This fee includes a 30% tax on the base fees charged

by the registry to be paid to the Ministry of Justice. Once the fee is calculated the payment must be made at a local bank branch. The registry does not accept money.

In the case of purchasing the property from the government which is the case most of the time, then a purchase must be made and the government assigns an appraiser to value the transaction. In the case of most residential transaction there seems to be a relative fee dictated by the government somewhere between USD $8 and USD $30 per m2.

Total Estimated Fees for Ownership Transfer of a 100m2 Plot of Land-Valued at $10,000

Concept	Price
1) Permits to convert land and "purchase" from the government $15/m2 (estimated average between range USD $8 to USD $30/m2)	$1,500
2) Transfer Tax 10% + (8%of 10%)	$1,080
3) Registration fee (tabela)	$1,386
Total	**$3,416**

The equivalent of 34% of the value of the property, which in most cases the individual is already occupying but does not have ownership rights, is prohibitive. This high cost is a significant impediment to the creation of a formal housing finance market and, if not corrected, will result in a growing market for informal housing finance that will not be eligible for any mortgage finance.

View of private property as a guarantee by banks: The general consensus of all of the banks with whom the Mission had discussions concerning the prospects of mortgage lending and financial leasing; is that the property registry is the first and principal impediment to real estate related financing. The process is costly and complicated. The value of the registry is not yet tested nor do they maintain clear records through a digital registry of scanned documents.

Foreclosure: A key factor that is also untested is that the process of foreclosure has not yet been executed. Not one bank has had to use the court system for a foreclosure and some anecdotal estimations put the time needed to execute a normal foreclosure at five years. This should be reduced to no more than 2 years.

Banking Incentives to Enter Long Term Mortgage Market: First and foremost there must be a clear distinction between wealth transfer (housing grants or public housing) and direct financial intermediation. Private banks have their own internal funding base to consider when developing a long term lending program of any nature as the majority of their funding is from short-term sources. However, this issue (particularly in a market of low loan to deposit ratios and excess liquidity) should not prevent the private sector financial institutions from participating in and playing a leading role in assisting a government program or a hybrid program. It is not uncommon for a government fund to be used by banks as a form of insurance and/or subsidy for all or part of their funding participation.

It is the view of the Mission that wide spread use of financing as a tool for residential real estate acquisition will not occur until the above mentioned impediments are reduced or eliminated. That being said, the Mission is of the opinion that private banks will only enter into long term (20 to 30 years) Kwanza-based mortgage lending if there is a way to mitigate the bank's exposure to currency risk and assist them in matching short term deposit liabilities with illiquid long term mortgage assets.

Real Estate Financing—Minimum Underwriting Standards

During the Mission's meeting with the Director of the Institute of Housing he indicated that the federal government was creating a fund to assist in the financing of housing. It is not clear what structure this fund will take but serious consideration must be given to the creation of such a vehicle and its ability to incentivize local banks to participate in this financing in some capacity as well.

A key regulatory suggestion is that the entities involved in the act of lending money or offering financial leases on residential property do so within a common framework of loan documentation.

The Mission recommends the following as a set of minimum acceptable standards:

- Appraisals should be uniform and done by qualified professionals;
- Transaction documents should be uniform and standardized across the market for both mortgages and lease purchase contracts. This includes:
  - Property sales contracts;
  - Standardized promissory note with built-in mortgage lien;
  - Industry approved format for Lease Agreements.
- Disclosures for both transactions should be standardized clearly informing the buyer / lessee of the risks and obligations;
- Income documentation should be standardized to include:
  - Bank account records over time-- 12months, 24 months etc.;
  - Verification of Employment ;
  - Employment pay stubs;
  - Tax Returns.
- Expense / Debt Documentation:
  - Credit Report (increase usage of the Angolan Buro de Crédito)
    - Where no credit history is available direct banking relationship inquiries must be made to investigate if any formal debt exists that could impede the borrower's ability to make the monthly payment.
  - Borrower Disclosure of monthly debt payments and total liability.
- Debt to Income ratios at the monthly level should be calculated and recorded in a common format so that all loans and leases can be viewed in a common risk analysis of the entire loan / lease portfolio;
- A commonly accepted ratio of total monthly Debt Payments to Monthly Income (DTI) in mortgage or lessee payments is between 25% and 40%.

These are considered common underwriting standards and it is critical to the future growth of the industry that they be adopted as generally accepted best practices by all groups offering real estate financing. It does not necessarily mean that all loans must meet these criteria but if the government is going to offer any guarantees or subsidies to banks or leasing companies in this segment it should only do so as it relates to loans or leases that meet the specified criteria[3].

[3] The current proposed legislation for the promotion of urban housing mentions using a multiple of the minimum wage as qualifying criteria. It is the Mission's opinion that the appropriate criteria should rightly be a Debt to Income (DTI) ratio and not a minimum income which could easily miss the reality of a borrower's ability to meet a monthly payment schedule.

While there is currently great potential for developing a residential mortgage market in Angola, there remain a number of political, demographic, organizational and legal issues that must be addressed before a dynamic real estate sector with both commercial and individual home ownership components can be established. In particular, substantial policy, regulatory, and institutional advances must be made if mortgage finance is to successfully stimulate the supply and financing of affordable housing.

A major objective of the Government of Angola's financial sector reform program is the development of a program to stimulate the expansion of access to credit. Banco Nacional de Angola (BNA), as the country's central bank; considers the provision of regulatory oversight and supervision for real estate finance and real estate services to be an important step in this development process.

IX. OVERVIEW OF LEASING AS A FINANCIAL AGENT

Throughout the world leasing companies are usually treated as nonbank financial institutions (NBFIs), which are differentiated from and subject to less stringent regulations than banks. This allows most leasing companies to operate a normal companies and operate within a broader range of operating norms—such as the ability to:

- Leverage more resources (higher debt/equity ratios);
- Be exempted from restrictive capital adequacy ratios and credit allocation requirements;
- Use market-based rates of interest.

Because of their specialization, leasing companies are also considered to have a more complete set of technical and financial skills required for leasing. Leasing officers are better informed than bank officers about new equipment on the market, and have better skills in assessing value of used equipment and potential residual values.

The transaction of a lease is generally an asset-renting transaction, that is, the separation of legal ownership from economic use. The distinguishing factor between a lease and a loan is that in the latter money is lent out, while in a lease it is the asset itself that is lent out. This fact alone significantly changes the risk profile of leasing operations.

Basically, a lease can be defined as a contract where a party being the owner (lessor) of an asset (leased asset) provides the asset for use by the lessee for consideration (rentals) that are either fixed or dependent on certain variables, for a certain period (fixed or flexible lease period). At the end of the lease period, subject to the embedded options of the lease contract, the asset may either be returned to the lessor, purchased at a discounted price by the lessee, or disposed of per the lessor's instructions.

As leasing is based on the proposition that profits are earned through the use of assets, rather than from their ownership; it focuses on the lessee's ability to generate cash flow from business operations to service the lease payment, rather than on the balance sheet or past credit history of the borrower (lessee). This is why leasing is particularly advantageous for new, small and medium-size businesses that do not have a lengthy credit history or a significant asset base for collateral. Furthermore, the lack of additional collateral requirements intrinsic in most leasing transactions offers an important advantage in countries with weak business environments, particularly those with weak creditors' rights and collateral laws and registries, for instance, in countries where secured lenders do not have priority in the case of default.

Both lessor and lessee (as well as the supplier in the three-party structures) can be legal entities as well as individuals (sole proprietors).There should not be restrictions allowing only leasing companies or other financial institutions to operate as lessors. Depending on local legislation, there will be at least two parties to a lease—the owner and the user (called the lessor and the lessee).

Legal Framework

At the inception of this section, the Mission wishes to state that it is in full agreement with the conclusions and recommendations set forth by the previous EMG Mission on the establishment of a legal framework for Leasing in Factoring in 2008. In particular, and as further stated in this report, the Mission endorses the recommended Avisos, nos. 1-9, as set forth in this report and strongly recommends that they be implemented along with the prudential regulations now recommended for real estate related leasing operations (Leasing Imobiliário) An abbreviated copy of Avisos 1-9 as previously presented is attached as Annex F.

In most countries, the civil code provides the legal basis for leasing. Some countries such as United States, France, Argentina, Brazil, Russia, Korea, Indonesia, Morocco, and Ghana have specific leasing laws. Tajikistan, Uzbekistan, and Kyrgyz Republic have recently enacted leasing laws with support from IFC.

Whether provided by a specific leasing law or by the general civil code, the effectiveness of the legal framework will depend on the following key elements:

- **Clarity in defining a lease contract, leased assets, and responsibilities and rights of parties to a lease contract:** The legal framework should define what constitutes a lease transaction, a leased asset, and the responsibilities and rights of the lessor and lessee. For example, it clarifies whether or not the lessor can use a leased asset as collateral to leverage further funding for the financial institution or company.
- **Liability:** Clarifying responsibility for liability of third-party losses arising out of the operation of leased assets is especially important because ownership and use of an asset is separated in leasing. This is particularly relevant in the case of assets such as vehicles because the risk of causing third-party losses is significant.
- **Priority of lessor's claim over leased asset:** This provides the basis for the advantage of leasing over lending under conditions of lessee bankruptcy. As the equipment owner, the lessor's claim to the asset should be superior to any claim creditors may have on the lessee.
- **Repossession:** Easy and fast repossession of leased assets is one of the main advantages the lessor has compared with the lender. The legal framework should permit non-court repossession, so that lessors can repossess leased assets without going to court as long as the lessee does not contest the repossession. When repossession is legally and judicially easy, lessors can lend to riskier businesses and price their leases with a lower risk premium, making leasing available more cheaply.

In financial leases, it is common to differentiate between the primary lease period and the secondary lease period. The former is the period over which the lessor intends to recover its investment, while the latter is intended to allow the lessee to exhaust a substantial part of the remaining asset value. Alternatively, many jurisdictions stipulate that the disposal of the leased asset (either by sale, transfer to the lessee, or return to the lessor) must be specified in the lease contract.

The primary period of a lease is normally non-cancelable, while a secondary lease period is normally cancelable. Many jurisdictions restrict the minimum lease period; therefore this must be checked in each specific jurisdiction. The minimum lease period is often related to the normal amortization period for a given asset, but in some cases it is stated as a specific time period.

Lease rentals represent the consideration (usually monetary) for the lease transaction, that is, this is what the lessee pays to the lessor. If the lease is a financial lease transaction, the rentals will usually be the recovery of the lessor's principal and a certain rate of return on the outstanding principal. In other words, the rentals can be seen as bundled principal repayments and interest. In many cases, financial lease payments may include other costs such as insurance, regular maintenance and certain taxes (such as property tax).These payments may be on a "pass-through" basis or otherwise structured.

If the lease is an operating lease transaction, the rentals might include several elements depending upon the costs and risks borne by the lessor, such as:

- Interest on the lessor's investment;
- Charges for certain costs borne by the lessor such as repairs, insurance, maintenance or operational costs;
- Depreciation of the asset;

- Servicing or packaging charges for providing a package of the above service.

Residual value is generally defined as market value (at the end of the lease). But in some contexts it may mean amortized (or balance sheet) value, value for tax purposes, or carry other definitions. These values may differ significantly, and these differences may have important implications. Residual value risk is another important term used in leasing and refers to the risk that the actual (realizable) value of the leased asset at the end of the leased term will differ substantially from the estimated residual value at the inception of the lease.

Residual value becomes important when discussing operating leases, where the cost of the operating lease depends to a large extent on the value of the asset at the end of the lease period—the higher the residual value, the less the amount to finance and hence the cheaper to lease the asset.

Residual values are important to consider during the underwriting process. If a lessee is leasing an asset with a fast depreciation rate with the asset only achieving a low residual value after the lease period, or if in the event of a default the lessor is forced to repossess the asset during the lease, the lessor faces the risk of not being able to recover sufficient capital value from the sale or disposal of the asset. Even though this may be a recoverable expense from the lessee (or in some cases from the supplier), it may also require lengthy legal procedures to recover the shortfall.

Residual value financial leasing has become an important aspect of leasing in the United States, but most emerging economies and many European countries still fully amortize such leases.

The options allowed to the lessee at the end of the primary lease period are called end-of-term options. Essentially, one or more of the following options will be given to the lessee at the end of the lease term:

- Option to buy (buyout option) at a bargain price or nominal value (typical in a hire-purchase transaction), called bargain buyout option;
- Option to buy at a fair market value or substantial fixed value;
- Option to renew the lease at nominal rentals, called bargain renewal option;
- Option to renew the lease at fair market rentals or substantial rentals;
- Option to return the equipment.

Alternatively, the lease could be completely paid out and amortized to zero, at which point the equipment is automatically transferred to the lessee. This is typically the case in developing countries or new leasing markets. In any lease the suitable option depends on the nature of the lease transaction, as well as the applicable regulations. For example, in a full payout financial lease the whole, or substantially the whole, of the lessor's investment would be recovered during the primary lease period.

Therefore, it is quite natural that the lessee should be allowed to exhaust the whole of the remaining value of the equipment. Regulation permitting, the lessor provides the lessee with a bargain purchase option to allow the lessee to complete the purchase of the equipment.

A buyout option may characterize the lease as hire-purchase. However, in many jurisdictions it is the existence of such a buyout option that distinguishes leases from hire-purchase transactions. If the lessor is interested in structuring the lease as a lease and not a hire-purchase, the lessor would be advised not to provide any buyout option but to allow the lessee to renew the lease and continue using the asset.

In essence, a renewal option achieves the same purpose as a purchase, but the lessor retains is ownership as well as his reversionary interest in the equipment. Fair market value options, either for purchase of equipment or for its renewal, are typical of operating leases. But this mechanism does no more than assure the lessee continued use of the equipment. If equipment has to be bought at its prevailing market value, it can be purchased directly from the market rather than from the lessor. Therefore, the higher the fair market value, the less the value of the option for the lessee.

Registration of Lease Assets

Many countries have followed the approach of a central registry for lodging liens (not solely for registering leased assets within country) with an efficient process available for checking if assets have a lien against them. Furthermore, it is not important whether a private owner or state owns the registry, but it is important that the registry has sufficient legal status to provide such assurance. This should be accompanied by legislation that provides a mechanism for the properly documented lien holder to recover the asset from an unsecured party.

With a centralized registry office, anyone purchasing an asset can check that the asset is not owned by another party. If someone buys an asset without consulting the registry, they are presumed not to have purchased the asset in good faith, and thus their title to the asset is at risk. They are, therefore, obligated to check the registry prior to purchase.

Registries also enable leasing companies to protect their assets in instances where lessees are subject to judicial action aimed at recovering assets. It may be that the leasing development project has to become involved in improving or even creating such a registry. Experience has shown, however, that although asset registration may be available, it should not necessarily be obligatory for owners to register their assets.

As with any monopoly, if only a single registry exists, the costs of registration and lien verification should be regulated; the ultimate goal is to ensure that the cost of registration and lien verification is as low as possible (while still covering costs, of course) so as to encourage use of the registry.

Obligatory registration of lease agreements may not be necessary, as this could lead to administrative barriers, higher costs, and indirect regulation of the industry. If institutions prefer to register agreements, this option should be available.

Asset Repossession

Repossession is a key element of leasing, enabling credit providers to efficiently secure their asset and realize funds from the asset disposal. Without such ability, leasing is little different from other forms of unsecured finance.

To encourage the development of an efficient and fair repossession system, many countries have adopted the following: within the legislation, in the event of a default by the lessee, there should be scope to allow the lessee to voluntarily return the leased asset to the lessor without penalty.

Where the lessor tries to repossess the asset and the lessee disputes its grounds for repossession, the lessee should have access to the courts to challenge the repossession order. To encourage efficiency in repossession, a non-judicial process should be available either through a court order (an order issued by a judge outside of court proceedings and processed within a short time period, for example, ten days) or a notary writ (a writ issued by a notary which serves as a legal basis for repossession).

Non-judicial mechanisms for repossession can be used in those cases where the lessee admits the default but does not voluntarily return the asset. Where a lessor has already repossessed an asset but the lessee can demonstrate having fulfilled its obligations under the lease, the lessee will be entitled to go to court to claim damages.

Rights in Case of Default

Lastly, the multiple issues surrounding the rights and obligations of the parties in the case of a default of lease terms must be considered. Fundamentally, *w*here the lessee defaults on lease terms or is deemed to be bankrupt, the lessor has the right to repossess the asset. The general norms of bankruptcy law should

apply, with the insolvent pool of assets consisting only of those that are owned by the insolvent company. What does not belong to the insolvent company should be returned to the owner (that is, the lessor).

Note that in cases where the bankrupt lessee's liabilities are assumed by another party (there is no default on the lease agreement) the "successor" may retain the lessee's rights under the lease agreement. This may happen where temporary administration or wholesale purchase of a bankrupt lessee occurs, particularly where the leased asset is essential to the viability of the (former) lessee as a going concern.

Where the lessor is deemed bankrupt, this should have no effect on the lessee. The lessee, if perfectly solvent, retains the right to the use of the asset. It is important to clarify in law or regulation the procedure for asserting the right to receive lease payments in case of dispute, that is, the party to whom the lessee must make payments to avoid facing accusations of default when payments are made in good faith.

The party that acquires the lessor's assets as a result of the latter's default is able to enforce the rights of the original lessor only under the lease, that is, the receipt of lease payments. The new owners are not able to take possession of the asset for all cases in which the lessee is still meeting its obligations under the lease. The obligations and rights are simply assigned from the original lessor (in default) to a new party. This has to be supported by legislation which provides that the transfer of ownership does not lead to termination of the agreement and cannot be considered grounds for such termination.

Lease vs. Lend: The Lessor's Perspective of Leasing

From a provider's perspective, leasing has significant advantages over lending. These include:

- **Stronger security position:** This is perhaps the most important advantage in developing countries, where unclear property rights, poorly functioning asset registries, and weak laws of secured transaction constrain lending. In case of default, legal ownership of the equipment allows a lessor to repossess equipment more easily than it is for a lender to take possession of collateral (in case of loan repayment defaults). The nature of asset ownership in a lease transaction also has an advantage if the lessee declares bankruptcy.
- **Bankruptcy***:* Under most bankruptcy jurisdictions, lease payments have priority over loan payments and typically, the lessee is allowed to continue making lease payments. Furthermore, even if the lessee is not permitted to make the lease payments, the lessor can always repossess the equipment (unlike lenders who have to wait for the decision of a bankruptcy court before they can take possession of the collateral).
- **Lower transaction costs:** Anecdotal evidence suggests that transaction costs of contracting a lease is likely to be lower than that of executing a loan contract since the cost of creating, perfecting, and enforcing security for loans is avoided. In most developing countries, asset registries are not computerized and are fragmented geographically or by type of asset. This makes security perfection a long and costly process. Similarly, enforcing security is typically a cumbersome process and costly process. In contrast, repossession of leased equipment is usually faster and cheaper. It is reported that in Bolivia and Ecuador leased goods are recovered typically in one to two months while it takes a year or more to recover loan collateral.
- **Lighter regulation:** In most countries, leasing companies are not subject to prudential regulation, and to other restrictions such as interest rate caps and sector-specific credit allocation common in several developing countries. This allows them more leverage in raising funds and flexibility to charge market interest rates, thereby reaching client segments that might be too risky and costly for banks to reach.
- **Tax benefits:** In a typical tax-treatment of leasing, lessors benefit from being able to take capital allowances on the leased equipment. However, the availability of tax benefits depends on whether the

typical tax treatment of leases is available to all leases or are restricted to some leases. Also, the net impact of taxes on leasing depends on other applicable taxes (value-added tax, capital gains tax, property tax, etc), whether the lessor and lessee are tax-paying entities, and on the length of lease terms

- **Credit risk:** The risks vary significantly depending on whether the lease is a finance lease or an operating lease. The risks for finance leases are not significantly larger than that that for loans because residual value risk is rarely involved and because the liability and litigation risk is offset by the lesser portfolio risk.
- **Portfolio risk:** This is the risk of lessees not making the lease payments as scheduled. However, the stronger security position of the lessor (compared to a lender) makes this risk likely to be less costly than that to a lender. Lessors use credit/lease history of the client to estimate this risk, and compensate for high risk associated with a lessee by requiring additional collateral or higher equity (security depositor down-payment) or charging a higher lease payment.
- **Perfection of Security Rights:** Security creation is the process by which an asset owned by the borrower is converted into collateral for a loan. Security perfection involves making the existence of the security interest public, for example, through registration with an asset registry and establishing its priority. Enforcement of a security interest involves taking possession and recovering the loan receivables through sale of a collateral when the borrower fails to repay.
- **Residual value risk:** This is the risk in wrongly estimating the value of equipment at the end of lease period. If the lessee maintains the equipment poorly, the equipment may be worth less than the expected residual value. This risk is less relevant for finance leases because they amortize all or most of the equipment cost, unlike in operating leases where lessors recover their costs through multiple leases.
- **Liability and litigation risk:** Since the lessor is the owner of a leased asset, the lessor is often liable for third-party losses arising out of the operation of leased assets. This risk is particularly important in the case of assets such as vehicles. Leasing also tends to have higher litigation risk since the difference in ownership and use rights makes it more complex than a loan. This makes the potential for legal disputes greater for leases than for loans.
- **Changes in tax regulations:** This is the risk that if the tax-regulations change during the course of the lease period, and the expected tax-saving is not realized. This risk is relevant if the lessors depend significantly on the tax benefits typically available in leasing.

X. FRAMEWORK FOR LEASING OPERATIONS IN ANGOLA

Despite passing the basic laws necessary to create a leasing industry, it should be stated clearly that the leasing market in Angola has yet to begin meaningful operations. There have been some leasing operations for 'big ticket' items, such as airplanes, but these transactions have been conducted by off-shore leasing companies which are affiliated with, but not owned by local banks. Leasing for real estate transactions (*Leasing Imobiliário*), sale/ lease back transactions or real estate secured financial leasing transactions at either the commercial and residential level have not materialized as would normally be expected for a market with the level of investment and financial activity experienced in Angola.

The principal impediments or constraints to developing a general leasing operation cited by persons interviewed during this Mission, as well as some review of existing laws and regulations include:

- The BNA has not yet issued the long-awaited regulatory framework and set of operational directives necessary to allow commercial banks to begin leasing operations in earnest.
- High customs duties are charged on all imported goods that would be used in lease finance operations.
- Private ownership of real property, as set forth under the Land Law of 2004 remains unclear and subject to interpretation.
- There are deep-seated impediments in the ability to obtain or produce legal title to real property.
- The operations of the public registry are cumbersome and overly expensive.
- The process of transfer of government granted land use certificates to subsequent asset purchasers is uncertain.
- Accounting principles for the tax treatment of lease income, depreciation of fixed assets and capital gains are irregularly applied and are in the case of smaller companies overly burdensome.

Differences between Finance and Operating Leases

At the inception of this discussion it is important to understand the various types of lease structures that constitute these financial operations. The two principal lease types are:

1. *Financial*, which includes lease purchase contracts, and
2. *Operational,* including leases which are often considered to be closer to a straight rental agreement.

The structure of the primary lease operations in the real estate sector (*Lease Imobiliario*) can in fact fall into either category.

Financial leasing, the most common form for this type of credit, is a contractual arrangement that allows one party (the lessee) to use an asset owned by the leasing company (the lessor) in exchange for specified periodic payments. Critical to this arrangement, legal ownership (retained by the leasing company) is separated from economic use of the asset (held by the lessee).

The leasing company focuses on the lessee's ability to generate cash flow to service the lease payments, rather than relying on its credit history, assets or capital base. This arrangement particularly suits new, small- or medium-sized enterprises (SMEs) without a long history of financial statements.

A key element of this type of lease is that the lessor retains full ownership of the leased asset during the life of the lease and the principal security for the transaction is provided by the asset itself.

- The lease transfers ownership of the asset to the lessee by the end of the lease term.

- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair market value at the date the option becomes exercisable, and at the inception of the lease, it is reasonably certain that the option will be exercised.
- The lease term is for a majority of the useful life of the asset and where the title to ownership may or may not eventually be transferred.
- The present value of the minimum lease payments at the inception of the lease is greater than or equal to the fair value of the leased asset.
- The leased assets are of such a specialized nature that only the lessee can use them without major modifications.

Leases that do not have any of these characteristics are considered to be operating leases. International Financial Reporting Standards state that a lease is a financial lease if it contains at least one of the features in this list—if not it is considered to be an operating lease.

As a leader in developing leasing companies in emerging markets, the IFC has published the following list of 'lessons learned' from their experience:

- Technical partners should have a substantial equity stake (20%-40%). Although foreign technical partners have played an important role in the majority of the leasing companies that IFC has sponsored, they have not always proven effective, for various reasons, including unfamiliarity with the market, cultural differences, and lack of interest. Technical partners with a substantial investment are more likely to contribute effectively.
- Careful portfolio management pays. Many of the problems that arose in IFC-sponsored leasing companies resulted from overly concentrated portfolios by client or sector.
- Leasing companies are vulnerable to adverse macroeconomic changes. A worsening of the macroeconomic climate usually affects small- and medium-sized firms quickly. Such firms often form a high percentage of leasing customers. Furthermore, if credit is tightened, leasing companies may suffer from financing constraints or term mismatches.
- Leasing companies benefit from foreign exchange convertibility and reduced tariffs on imported machinery and equipment. Leasing companies in developing countries often require foreign exchange to purchase imported equipment, but prefer to denominate their leases in local currency (because of their SME client base). Without foreign exchange convertibility leasing companies write mostly foreign currency leases to match their loans to finance imported equipment, which restricts their market to exporters.
- Stand-alone leasing firms compete more vigorously for markets and focus on their portfolios. For this reason IFC usually prefers to finance stand-alone companies, although such firms can be at a disadvantage when competing with leasing subsidiaries of commercial banks, which can tap low-cost depositors' funding from their parents.
- Difficulties in mobilizing domestic financing are often one of the most serious constraints to expansion. This is one of the key roles that local partners can bring to a new leasing company, as well as knowledge of local markets.

The following table presents a view of the difference between finance and operating leases.

Financial Leases vs. Operational Leases

Finance Leases (or Full Payout Leases)	Operating Leases
• Risks and rewards of ownership are transferred to, and borne by, the lessee. This includes the risks of accidental ruin or damage of the asset (although these risks may be insured or otherwise assigned). Thus damage that renders an asset unusable does not exempt the lessee from financial liabilities before the lessor. • The goal of the lessee is either to acquire the asset or at least use the asset for most of its economic life. As such, the lessee will aim to cover all or most of the full cost of the asset during the lease term. • It is expected that the lease will assume the title for the asset at the end of the lease term. The lessee may gain the title for the asset earlier, but not before the full cost of the asset has been paid off. • The lessor retains legal ownership for the duration of the lease term, though the lessee may or may not buy out the leased asset at the end of the lease, with the lessor charging only a nominal fee for the transfer of asset to the lessee. • The lessee chooses the supplier of the asset and applies to the lessor for funding. The leasing company that funds the transaction should not be liable for the asset quality, technical characteristics, and completeness, even though it retains the legal ownership of the asset. • The lessee will also generally retain some rights with respect to the supplier, as if it had purchased the asset directly	• Economic ownership with all of the corresponding rights and responsibilities are borne by the lessor. The lessor buys insurance and undertakes responsibility for maintenance. • The goal of the lessee is usage of the leased asset for a specific temporary need, and hence the operating lease contract covers only the short-term use of the asset. Further, the duration of an operating lease is usually much shorter than the useful life of the asset. • It is not the lessee's intention to acquire the asset, and lease payments are determined accordingly. In addition, an asset under an operating lease may subsequently be rented out. • The present value of all lease payments is significantly less than the full asset price.

Source: IFC Leasing Report 2008

The IFC's experience also suggests that six factors are fundamental to the financial success of leasing companies

- **Management**. A high standard of cashflow-based credit analysis and supervision of clients, complemented by follow-up and equipment insurance procedures are critical.
- **Competent partners**. In many markets where leasing is being introduced, it is important to have an active, committed and competent foreign technical partner. The technical partner, which should have enough equity to ensure active participation, should: establish and monitor standards and procedures; train local staff; advise on lease pricing, marketing and administration; and perhaps second the first general manager.
- **Funding**. The single biggest obstacle to the growth of IFC's investee leasing companies is access to term local currency funds. Access to term deposits from insurance companies or pension funds or to a local bond market helps overcome this problem.
- **Asset-liability matching (ALM).** Leasing companies must match fixed-rate leases with fixed-rate term funding, or if only floating rates are available (locally or internationally), it needs a regulatory framework that allows periodic adjustments of lease rates.

- **Attractiveness to lenders**. Given their high debt-equity ratios, leasing companies must remain attractive to lenders. Security sharing agreements that establish equal rights to a pool of collateral for senior lenders are often used in IFC agreements. Also, IFC gives guarantees or direct loans, particularly to new companies that have not yet established credit histories that allow them to borrow locally.
- **Regulatory framework**. Leasing companies need a regulatory, legal and fiscal environment that at least provides equal treatment compared with other sources of capital investment financing. Clear, simple and effective legal procedures are important to reclaim assets if the terms of the lease agreement are breached.

XI. REGULATION AND SUPERVISION OF LEASING OPERATIONS

Financial market practitioners and economists alike define prudential regulation as the form of regulation involved in counteracting asymmetric information problems in financial markets. Information asymmetry arises where products or services are sufficiently complex that other forms of regulation are insufficient. The general practice is to subject institutions that obtain public deposits to prudential regulation because of the information asymmetry problems faced by the large number depositors in monitoring the use of their deposits. By this rationale, lessors that do not obtain public deposits (leasing companies in most countries, equipment sellers, NGOs,) should not be subject to prudential regulation.

The advantages and disadvantages of having prudential regulation for the leasing sector have been debated in numerous cases. It is general accepted that the advantages include:

- Providing an element of credibility that can be useful during the initial stages of the development of the leasing industry; and
- Preventing loss of public confidence on the industry that might result from large scale failure of leasing firms.

Noted disadvantages include:

- Stifling growth of the industry, especially when prudential norms are too strict (for example, by preventing entry of firms because of high capital requirements or causing inefficient use of funds because of the high levels of reserves required and low leverage ratios).
- Hampering the evolution of the industry from just being a simple substitute for loans to a specialized service serving a natural market for such services.
- Inadequate knowledge and capacity of the supervisors in charge of regulation.
- Dissuading lessors from taking the risks needed to reach clients perceived as high-risk – SMEs and microenterprises. This is especially important because high risk clients do not have adequate access to bank finance.

Two key issues are whether leasing warrants prudential regulation, and whether institutions subject to prudential regulation (particularly banks) should be permitted to provide direct leasing services. The World bank Group, though its affiliate the IFC, advises against prudential regulation of leasing companies that do not obtain public deposits.

Rationale for Prudential Regulations

In several countries with developed leasing markets, such as the U.S., U.K., Germany, and certain emerging markets such as South Korea and Thailand, leasing companies are not subject to any prudential regulation. However, in other countries with less developed financial markets, leasing companies are usually included under the category of Nonbanking Financial Institutions (NBFIs) and, while they are required to adhere to some prudential requirements, they are not usually supervised on an ongoing basis to the level that the banking sector is.

Regulatory measures used in prudential regulation usually include:

- entry requirements;
- capital requirements;
- balance sheet restrictions, including:
    - maximum leverage ratios,

- single client exposure,
- insider transaction limitations, and
- provisioning requirements;

- associations among institutions;
- liquidity requirements;
- accountability requirements; and
- insurance / support schemes.

The relevant question related to permitting banks and other lenders to undertake leasing) is whether leasing is more risky than lending. It has been repeatedly shown and rightly argued that financial leasing (unlike operational leasing) is rarely riskier than lending because of the stronger security position of lessor. It is therefore generally recommended that all financial institutions that are permitted to lend should also be permitted to provide finance leases. However, to further insure the safety of the national financial sector, in most countries, banks can provide leasing services only through subsidiary corporations, with the normal prudential restrictions on related party credit risk.

The IFC, which has a long-standing track record of investment in new leasing companies throughout the world, has noted several key structural issues related to the involvement of commercial banks in leasing operations.

IFC's evaluation of leasing investments: three key lessons.

- To be sustainable, leasing companies need access to local currency funding at a competitive cost;
- Stand-alone leasing companies are vulnerable to competition especially from banks entering the leasing market, as banks have major funding, pricing power and operational advantages;
- As leasing project sponsors, banks have strong advantages over other sponsor types, and are more likely to assist or even absorb an affiliated leasing company should competition become fierce.

The IFC, in their Leasing Report of 2008, has also identified several market-based beneficial impacts of leasing companies operating in developing markets. The most significant include:

- **Access to finance and increase in capital investment:** This is perhaps the most significant development impact. Lessors are often willing to lease to entities that cannot access bank credit. Legal ownership of leased assets allows the lessor to require lesser equity than demanded by lenders and less or no additional collateral. Small and medium enterprises (SMEs) are the most notable beneficiaries from the development of leasing. Finance for SMEs has been called the 'missing middle' of finance since banks mostly address the needs of large enterprises and microfinance organizations are increasingly addressing the needs of microenterprises. Since leasing supports acquisition of equipment it enhances capital investment in an economy.
- **Increase in capital base and capital market development:** Growth of leasing sector requires that leasing companies have access to capital. This leads to increased borrowing from banks as well as from the capital market, thereby increasing the gross capital base of a country. Leasing companies raise capital from pension funds and insurance companies, innovative bond offerings, securitizing of their lease receivables, and listing in the equity market. These activities in turn, contribute to capital market development.
- **Competition in the financial market:** As an additional source of investment financing, leasing competes with bank financing. This provides incentive for both banks and lessors to become more efficient and innovative, leading to better products, and lower spreads in interest rates.

With only minor differences in opinion related to specific circumstances, the Mission subscribes to the position of the IFC that regulatory supervision of leasing institutions should not be structured in such a fashion as to impede the ability of the business to grow normally subject to open market forces. Leasing companies should be held responsible for the consequences of their own risk management and investment decisions. Formal regulatory supervision of leasing institutions should be necessary only under special circumstances such as when their operations influence the health of the financial sector systemically or there is a general lack of knowledge in the industry and the protection of the public is at stake.

Where leasing is at an early stage of its development, such as in the case of Angola, with a limited level of understanding as to its impact, it can be argued that there is a need for certain levels of regulation and management in the areas of licensing and approval leasing activities of the banks or their subsidiaries. It is not recommended however, that this level of regulation or supervision extend into the area of minimal capital requirements (MQR) or operating ratio restrictions.

The need for a proactive regimen of regulation of leasing activities should be balanced by an understanding that the regulation or supervision of lessors, where previously imposed in other countries, has been in some cases counter-productive. Regulation can give external institutions the opportunity to interfere in, and could adversely affect the activities of others directly involved in the sector.

While regulation and supervision may provide institutions with weak corporate governance the opportunity to profit from the development of the leasing sector; to the greatest extent possible, the market itself should act as the regulator for lessors. If regulation and supervision are not executed in the proper manner, this could adversely affect the competitive nature of a domestic leasing industry and in some cases introduce artificial barriers to the development of the leasing sector. Companies with poor corporate governance and weak internal controls will have limited ability to raise new equity capital in the market, and so their development and ability to do business will be restricted. In the long run, effective and profitable companies will survive and prosper while ineffective companies that don't adapt will inevitably be put out of business by market forces.

Regulation is considered to be a reasonable business model where lessors are deposit-takers (that is, where leasing companies are affiliated with or effectively acting as "banks"). Regulation would also be prudent in situations where lessors are able to take receipt of deposits. There are several key tests for public regulation by which these recommendations are guided:

- Regulations should be implemented only where there is a clear public interest. Deposit-taking institutions (generally, banking institutions) provide the most obvious example of this case.
- Non-bank, non-deposit-taking leasing institutions normally do not require the same level of stringent regulations as deposit-taking commercial banks, and in some cases, no specific regulation may be necessary.
- The necessity for and level of regulatory intervention should be assessed on a case-by-case basis and depend on a variety of factors, including the overall legal and regulatory framework, and the competitive environment. Restrictive levels of regulation may affect the availability of financing or pricing of financing to a leasing company versus a commercial bank which is able to mobilize local deposits.
- Regulate the activity only to an appropriate level. In the case of leasing companies issuing tradable securities, it is not the leasing activity that generates the need for regulation, but the act of issuing publically traded securities.

Licensing of Leasing Operations

In a number of countries, leasing operations have not typically required specific licensing from the authorities for the following reasons:

- Usually, formal business licensing through a regulatory entity is necessary only for those activities that can cause considerable public loss, are detrimental to public safety, or cannot be regulated by any other method. Leasing companies are not deposit-taking institutions, and their bankruptcy would not influence the economy in the same way bankruptcy of a bank would. The Mission views that the Angolan public would be best served if leasing operations in general, remains an unlicensed activity except has it pertains to the use of Financial Leasing as an alternative to Residential Mortgage Financing and then only at a level above $10 million in lease assets outstanding.
- In case of the lessor's default, there is no risk for the lessees. The lessees can continue the existing lease agreement with the new owner of an asset, and legislation can provide for the protection of their rights in these cases. Only the lessor's shareholders suffer the loss, but their loss is no different from any other company. This is an entrepreneurial risk that is mitigated through the mechanisms of corporate and shareholder control and applies equally to any other corporate entity. As for the lessor's creditors, employees and other stakeholders, their position is also no different from that of any other enterprise.
- Experience has shown that licensing of leasing to be an administrative barrier could be an impediment for the development of this market. Burdensome licensing requirements could limit not only the possibilities for local enterprises but also investments by non-resident lessors who find it easier to lease in those countries that do not license leasing.
- If there is pressure to introduce licensing of leasing because of potential abuse of the possible tax privileges (the stated reason for licensing), it should be sufficient to set clear parameters and classifications on a lease transaction for the tax authority and other regulating bodies to have sufficient definition to classify and reject non-conforming leases that exist only to capture tax advantages. Licensing of leasing typically does not create a shield against potential tax abuses.
- Issuance of a leasing license for a specific period can potentially create problems for lessors. If the law provides that the license is issued for five years, then what would the framework of operations be for a lessor whose license is due to expire prior to the expiration of the lease agreement? The legality of these agreements can thus be put in question.
- It is not clear whether a sub-lessor is entitled to transfer the leased asset in a sublease without a license. Taking into account that in most jurisdictions the legal status of the sub-lessor equates with that of the lessor (all provisions of the law envisaged for the lessor also extend to the sub-lessor), the former may be obliged to obtain a license prior to the transfer of a leased asset to a sub-lease.
- In those jurisdictions that impose the restriction that a lessor operate exclusively in the leasing business (or set exact proportions on the income from leasing activities that a leasing company may earn), leasing companies face the challenge of flexibly adapting to the changing market situation or otherwise fall into a non-competitive position.
- A leasing license usually does not contain as many requirements that a license for securities or banking operations contains and therefore, in most cases, it is nothing but some type of "registration procedure."

Many developed countries only require non-deposit-taking lending institutions to file annual audited statements as good disclosure/transparency requirements

Impact of Minimum Capital Requirements (MCR)

The imposition of MCR for NBFIs means that companies, if they are further required to count this capital in the calculation of minimum capital adequacy and solvency ratios, and/or are required to retain a proportion of their assets as liquid to satisfy any immediate demands placed upon their business, is by definition proscribed and limited to lending only a proportion of their net asset value. The obligation of MCR for non-bank (non-deposit taking) leasing companies acts as a form of operational regulation and leads to further supervision of the companies affected.[4]

Clear distinction has to be made between the activity of the lessors and banks, insurance companies, pension funds and capital market participants, versus the necessity of imposing MCR for most NBFI operations. Establishing MCR is a necessary prerequisite for the deposit-taking institutions to meet their liabilities in case of default within the framework of the Basel accords on issues such as capital adequacy ratios. For such institutions, it is important that liabilities are met to avoid any negative implications for depositors. Leasing companies on the other hand, conduct ordinary entrepreneurial activity and are not deposit taking institutions. Their default is harmful only to their stakeholders. In this respect, lessors are in the same position as any other company, with banks financing lessors in the same manner any other borrower regardless of their level of capital.

The establishment of MCR, depending on the fiscal amount of capital investment required, could affect the development of the certain leasing services such as micro-leases. In the case of social development oriented microcredit programs, serious consideration should be given to waiving any specific MCR and allowing market forces to control the sustainability of the leasing operation.

In Angola there is a distinct need for the development of a truly sustainable real estate finance sector that meets both the needs of the market[5] and the demands of the economy. Eliminating the MCR requirement for leasing in general, but most specifically for the residential real estate leasing sector, will allow for entrepreneurs to freely develop an affordable housing market and enter into structured lease purchase contracts with the majority of the populace.

As these businesses grow from the micro level to an extent which represents a significant level of capital accumulation and subsequent impact on the housing market (exact amount to be determined); then it is to the benefit of the general market that they report to the financial authorities and adopt the use of standardized contracts and credit criteria for their lessees. This will facilitate the creation of homogeneous financial instruments in the market, which can be further monetized and regulated efficiently.

For the BNA to require compliance with the current level of MCR (50 million Kwanzas) as set in the 2005 *Lei des Intituiicoes Financieras* (Financial Institutions Law) for residential real estate leasing companies that operate at the high end of the market is not likely to be relevant given the large capital requirements needed to purchase real estate assets in the first place. Any use of leverage through borrowing from local banks will be disclosed in the reporting of these banks—already under the purview of the BNA.

Furthermore, any additional reporting by leasing companies may or may not be required to serve as a cross check in the market. Banks that do not disclose their loans or equity investments appropriately would be operating fraudulently. If leasing companies were simply required to report their sources and levels of financing from local banks to the BNA then it could add to the administrative burden and business complexity.

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[4] See Annex G for a more complete explanation of the relationship of capital requirements and asset growth in banking operations

[5] The "market" in this case refers to the level of the economy which, to date has been excluded from any viable banking or leasing credits. In particular the target market should be defined as the broadest base of demand for housing finance

Government Funding and Subsidies for Leasing Operations

Experience has shown that direct subsidization of leasing companies has been harmful to the development of the leasing industry. In many countries, it is perceived that providing lease finance to certain sectors (for example, real estate development) will provide a means to overcome the difficulties these sectors face. This is rarely effective, and may actually even negatively affect both the (market-based) leasing sector and the subsidized sector—bad money chases away good and distorts the market. Disguising the approach as "by means of leasing" does not reduce or change the inherent costs, risks, or problems. Instead, it often distorts and hides the problem.

The Mission recommends that the Supervision Department of the BNA abstain from assuming a position of active or overly invasive supervision over the daily operations of independent leasing companies operating in Angola, with the exception of the process of Residential Financial Leasing companies at a threshold of over $25 million of portfolio at risk. Building supervisory capacity does not mean that all NBFIs need to be supervised, and when they do, they usually do not require the same level of supervision and resources as banks. The BNA must establish its priorities for the allocation of limited supervisory resources and capacity. There appears to be little benefit in establishing an extensive on-site examination régime for the nascent leasing operations currently present and which will present negligible risk to the system.

The BNA should require regular submission of financial reports from any leasing company with transactions that meet the following circumstances:

- The leasing company is a wholly-owned or majority-owned subsidiary of a locally licensed commercial bank. Leasing companies that are subsidiaries of Non-Angolan bank holding companies which also control a local bank will be considered as independent from the local bank. However, any credit arrangement between the local bank and the independent leasing company should be disclosed in the financial statements submitted to BNA.
- A particular leasing company includes an equity or credit position from a local bank which mobilizes deposits or has other liabilities raised from the Angolan market.
- To the extent that a leasing company is operating as an affiliated business of a locally incorporated commercial bank, the level of investment accepted from and total credit exposure to the affiliated entity shall be limited to a maximum of 25% of the capital of the lending bank.

XII. LEASING OPERATIONS IN ANGOLA

The Angolan Government passed a Law no. 13/05 in September, 2005 allowing for leasing activity in Angola. This law states that leasing operations can be carried out either by commercial banks or independent leasing companies. The BNA, through its Aviso no. 04/07, further classified stand-alone leasing companies as NBFIs and therefore subject to BNA prudential regulations and supervision.

This Aviso stipulates that all independent leasing companies must maintain a minimum paid-up capital position of 50 million Kwanzas (approx. US$ 500 thousand). While this low level of capital was principally meant to be a simple cost of licensing for leasing operations, it fuels the debate as to the role (and necessity or desirability) of extensive government regulation and government oversight.

The Mission believes that, under ideal circumstances, independent financial leasing companies operating in Angola should be considered as standard commercial business entities able to accept normal risks and operate without excessive government oversight.

In reality the minimum capital required (Kz 50 million) to open a leasing operation in Angola is well below the threshold of funding that will be necessary to operate any leasing business that would be significant in a commercial or industrial real estate market. However, it must be noted that the entry level housing market will likely be created at a much lower amount and therefore this limit could restrict access by the small to medium size entrepreneur who may own one or more homes and offer lease purchase options to the market.

The operating expenses that will be incurred in the purchase (and importation) of any 'leasable' asset in a commercial/industrial market (i.e. construction equipment, manufacturing machinery or building materials) will require an investment far greater than the minimum levels set to obtain a license. The very nature of the leasing business requires a liquid funding base to purchase assets to be leased and the company's ability to obtain outside funding for its operations should not be a particular matter for regulation or supervisory intervention by the BNA.

Leasing of Real Estate—*Leasing Imobiliário*

Superficially, there appears to be a vibrant commercial real estate market in Angola. There is ample visible evidence of an on-going construction boom in new high rise office and residential buildings in Luanda. It is estimated that the total investment in recently completed buildings in the downtown area is in excess of $1 billion over the last two to three years. However, there is also strong evidence that this market is collapsing and residential sales have effectively ceased.

As a direct result of the slowdown in construction and virtual halt in demand in pre-construction sales for high-end residential and office space (that has that has occurred since late 2008); it appears that existing developers are seeking the possible use of leasing as an alternative to the direct purchasing system they have enjoyed in the past. As the sales of new residential units appears to be slowing if not already stopped, the need for banks and developers to have alternatives such as lease purchase option contracts becomes more acute—to either promote a more rational financing program to potential buyers or as a useful workout tool for disposing of existing stock.

The Mission understands that many of the leasing agreements in Luanda today are established prior to actual completion of construction, sometimes as far as two years before expected delivery. Construction loans have specific risks in their own right which are not a subject of this paper. For the purposes of this analysis it will be assumed that physical delivery and cash flow from leasing agreements can be calculated and are in effect.

Based on conversations with BNA officials as well as meetings with private banks it appears there are two opposite points on the spectrum of ownership vs. lender that the BNA must address to mitigate excessive bank risk:

I. *The building is owned by the Bank and is leased to tenants directly*. This is not common in most markets because the activity of leasing is typically the purview of dedicated Real Estate Investment Companies or Leasing Companies.

However the following points should be taken into consideration:

   a. If banks directly own buildings for rent this exposure must not exceed the recommended ratios.
   b. If the bank holds equity in the project or building directly it must do so with prudential regulations limits on its own capital base and not with depositor funds.

II. *The Bank loans funds to a Leasing Company which in turn leases property to tenants*. This is a standard model in which the lender provides a loan for the Leasing company to finance its purchase of the building.

In Case I above, the bank would have the building listed as a real estate asset on its balance sheet and would be subject to existing regulations limiting the level of real estate investment by the bank. The BNA already has a supervisory role in the monitoring of this ratio. In Case II, the BNA still retains monitoring control though it's supervision over the lending bank in the areas of legal lending limits and concentrations of credit to any one borrower or business sector.

The lending bank is required to maintain normal underwriting standards, capital adequacy ratios and prudential reserve requirements for this credit extension. The BNA, if it finds this to be a particularly risky or problem loan during its periodic examination could reclassify the loan and require further reserves. In Case II the BNA need not assume a supervisory role or be overly concerned about the performance of the lease portfolio, except to the extend that it may impair the solvability of the lending bank.

The basic business activity of commercial or industrial real estate leasing, in the opinion the Mission does not require active BNA supervision nor the imposition of a Minimum Capital Requirement (MCR), so long as the funds for the equity capital raised by the leasing company (to be used in its business of purchasing the real estate) are from sources other than a direct investment by a local bank. We are of the opinion that an overzealous interpretation of the 2005 Financial Institutions Law could result in a negative impact on the development the leasing market.

The current leasing legislation (Artigo 13) mandates that all leasing companies are regulated by the BNA and required to maintain MCR of KZ 50,000. The Mission is concerned that such a requirement likely to inhibit investment in new leasing operations; particularly for SME and micro credit operations.

Particular attention needs to be given to the use of Financial Leasing as a needed financial alternative in the local low income market. The regulation should apply with the primary purpose of guiding the Financial Leasing Market in low income housing (*Arrendamento Resoluvel*) to a standardized form of qualification of the Lessees so that at some time in the future they can convert their lease to a mortgage with ownership rights. By qualifying the Lessees with proof of income, credit history and other standard mortgage qualifying criteria the documentation of the pool of financial leases can be monetized and leveraged to increase liquidity in the housing development sector.

It is also critical that individual owners of real estate be allowed to develop their individually-owned residential properties and offer lease purchases options to the market and not be regulated or required to report as a licensed BNA entity. It is precisely that kind of activity that is currently part of the informal market and should be encouraged to be part of the formal market. It is the individual entrepreneur who will utilize his skills to acquire land rights and build a home and lease it out.

A prudent scope of regulation would be to allow the individuals (sole proprietorships) or small business to conduct the business of owning and leasing residential real estate up to the proposed financial capital level of (to be determined) Kwanza or other reasonable threshold that would incentivize companies owning real estate and offering Financial Leases to meet certain reporting requirements to BNA and more importantly adopt the prescribed standardized documentation of Lessees to allow for a standardized market within the asset class of Residential Financial Leases.

In relation to regulatory activity by the BNA over leasing, the Mission repeats it position that it is in full agreement with the recommendations of the prior report from USAID/Cardno consultants, "*Leasing and Factoring: Analysis of Angolan Legislative Framework and Draft Regulations"* dated, August 12, 2008. We concur that the BNA should issue the recommended Avisos 1 through 9 as these provide an important framework relating to the definitions and structure of allowed leasing activities. It is envisioned that these 9 Avisos, when published, will greatly assist the BNA in its efforts to build confidence in the financial sector necessary for the development a viable leasing sector.

During the course of the Mission's review the bank supervision staff of the BNA expressed their opinion that they have the right and obligation to incorporate and require that all leasing company operations comply with the set of minimum capital requirements and operating ratios set forth in the Financial Institutions Law of 2005 (lei 13/05) including the application of the subsequent Avisos establishing operational ratios.

The Case of Financial Institutions Providing Housing Finance

In the housing sector, banks and other specialized financial institutions such as thrifts, mortgage societies, primary mortgage institutions, or mortgage banks often offer the same products. Those institutions face similar risks, including credit risk exposure to the borrowers, liquidity risk from the possible loss of short-term funding, and market risk at the time of maturity.

The conditions under which deposits can be withdrawn from those institutions are often mentioned as differentiating factors between banks and specialized housing finance institutions and are viewed as justification to impose different prudential rules (such as MCR). The general rule, however, is that when specialized housing finance institutions solicit deposits directly from the public and when those institutions' deposits are guaranteed implicitly or explicitly by the government, those institutions must be regulated at least to the standards of banks.

Given that the risks of specialized housing finance institutions are sometimes greater than those of banks, which have more diversified balance sheets, there is a case for stricter regulation of those institutions. The concentration of lease assets deriving their cash flows wholly from in housing and real estate finance means that their risks may be highly concentrated, and a large overconcentration can be the source of systemic failures.

However, with the direct or implied support of the government (including the central bank) towards the development of a viable housing finance program, understanding of this hazard can be improved and measures taken to mitigate the risk of systemic failure. Eventually, the availability of a mortgage-backed securities market may help lending institutions manage their risk profile and minimize the concentration of exposures.

In some countries, building societies—which are very similar to banks in terms of the range of financial services offered—are grouped together with other nonbank financial institutions (NBFIs) and are supervised separately, even though they need to be regulated with standards similar to those of banks.

The purpose of proposing standardized documentation and lessee criteria for residential financial leasing is to allow for increased liquidity in the housing market. The BNA or a designated Fund of the government or even a specialized NGO operation can use the standardization to facilitate investments into

the housing sector. There is a certain caution in using a mandate of documentation to be used rather than an incentive to leasing and mortgage companies. The preference should be toward an incentive rather than a mandate as an order to finance only specific types of borrowers based on general criteria such as Debt to Income (DTI) ratios and employment and payment history. The BNA can act as the primary driver and coordinator for the promotion of a standardized documentation régime through a series of Avisos to the financial institutions that it supervises.

XIII. SPECIFIC RECOMMENDATIONS

The following section provides specific recommendations to the BNA and other related government entities to facilitate investment into the housing sector:

- Implement the Avisos as prescribed by the earlier USAID team. Each Aviso serves to define and regulate the way in which parties to leasing agreements interact.
- Eliminate the transfer tax of 10% + (8% of 10%).
- The "Registro Publico" fees should be reduced to one fee per recording and not based on an inverse graduated scale. The public registry is for the transparency and protection of all parties involved and should encourage individuals and entities at all levels to participate. The costs of recording to not vary by the value of what is being recorded.
- The government should actively promote the benefits to the community to register their properties as private property and encourage the transition from "dereito de superfice" or rights of use.
- Current legislation requires Leasing Companies to have a minimum of USD $500,000 approximately (Kwa$5 million) but this requirement should be specified to exempt NGOs, SME operations and individuals who choose to own homes and utilize a lease purchase contract as effective sales tool. These entities would be required to be more closely regulated only when they dedicate more than 75% of their business activity to leasing and reach the level of paid-in capital required by law.

Suggested Limitations on Finance Leasing Business—*Regulation Light*

The following general guidelines on leasing operations are recommended by the Mission no matter what level of further specific prudential regulations the BNA may decide upon:

- The total value of property leased to one person or company, including a subsidiary or related company, by a finance leasing company shall not exceed 25% of the total paid-in-capital of the leasing company. However, the BNA may grant exceptions to this rule depending on the circumstances—for example, a smaller leasing company with only one or two lease contracts.
- The maximum value of property leased by a finance leasing company to one shareholder shall not in individual cases exceed 10% of the shareholder's equity in the finance leasing company.
- The total value of property leased to shareholders, members of the board of directors, executive director, chief executive officer or officers of the leasing company cumulatively shall not exceed 25% of the total paid-in-capital of the company.
- Property leased to above mentioned persons shall not be on terms and conditions other than those generally applicable to the public at large nor should these persons be permitted to serve in any officer capacity in the company if the lease payments (or any other debt amounts) due from them to the leasing company remains in arrears and unpaid for more than three months.
- A finance leasing company shall not solicit, receive or accept short-term deposits from the public. This restriction shall not apply to term deposits of more than one year from unaffiliated institutions and/or companies when funds are received for the purposes of providing working capital to the leasing company.

Leasing Companies—examples of regulatory requirements and operating ratios

During the course of the Mission's review the bank supervision staff of the BNA expressed their opinion that they have the right and obligation to incorporate and require that all leasing company operations comply with the set of minimum capital requirements and operating ratios set forth in the Financial Institutions Law of 2005 (lei 13/05) including the application of the subsequent Avisos establishing operational ratios. The Mission has doubts regarding the efficacy of this opinion and disagrees with this position.

After considerable discussion between Mission consultants and members of the BNA working group, the Mission has decided to leave intact its principal findings and recommendations regarding the need to require a minimal capital investment for leasing companies across the board, or to include a set of operating norms and performance ratios for leasing operations. The Mission has articulated its position regarding the appropriate regulatory system for leasing operations in Angola and continues to agree with the overall principles recommended by the IFC, as discussed in this report. A principal concern of the Mission is the negative effect on the development of a leasing market in the case that capital requirements and entry costs are prohibitive and act to effectively deny access to local entrepreneurs or smaller investment groups.

However, in recognition of the fact that BNA management may very well proceed with its current goal of extending its regulatory authority, as set forth the Financial Institutions law of 2005, beyond the set of the nine framework Avisos; the Mission provides the following suggested structure for prudential regulations that has been assembled from the regulations and operative norms found in several representative jurisdictions.[6] It is important to note that the recommended regulatory environment presented below does not take effect until a critical level of assets under lease is achieved. This allows for the free entry to the market of new and smaller leasing companies.

Financial leasing company supervisory indicators:

- **Formation of Capital** The value of property or assets to be leased which are owned free and clear (no debt-related liens) may be counted towards the company's tier one capital base.
- **Capital adequacy ratio** The net capital of the financial leasing company shall be no less than 8% of the risk-weighted assets.
- **Limit on the concentration of financing** The financing balance to a single lessee of the financial leasing company shall be no more than 30% of its net capital. The guaranty fund provided by the lessee can be deducted from the financing balance.
- **The connected level of a single customer**. The financing balance to a connected party of the financial leasing company shall be no more than 30% of its net capital.
- **The connected level of group customers**. The financing balance to all connected parties of the financial leasing company shall be no more than 50% of its net capital.

[6] The regulations researched and drawn upon for this suggested framework include: The People's Republic of China, Pakistan, Brazil, US, Ukraine and Kyrgyzstan

Accounting standards and policies

Financial leasing companies operating in Angola will be subject to the following minimal accounting standards once its total lease portfolio exceeds the equivalent of $10 million.

- The minimum paid-in-capital of a finance leasing company must be achieved within six months of the granting of an operating license by the BNA
- The ratio of capital to risk weighted assets of a finance leasing company shall be maintained at a minimum of 8%. For the purposes of assigning weights to lease assets, internationally accepted methodology shall be followed.
- A finance leasing company licensed under these regulations may raise working capital funding through the issuance of promissory notes, private placement bonds, private investments, and long-term deposits from financial institutions and companies and through loans and overdrafts from persons, banks, insurance companies and other savings institutions located in Angola or abroad.
- The total debt of a finance leasing company shall not be an amount greater than ten times its capital. The BNA shall have the option of providing temporary waivers to this ratio on a case-by-case basis, after consultation with the affected leasing company and its creditors.
- A financial leasing company shall comply with the risk asset classification system currently in place for commercial banks in Angola.
- A financial leasing company shall establish bad debt provisioning system and promptly set aside adequate provisions for bad debts equal to at least 3 months debt service requirements. It shall not make any profit distribution before the provisions are adequately funded.
- A financial leasing company shall submit to the BNA its internally prepared (unaudited) balance sheet, the income statement and other financial schedules as may be required by the BNA, on a semi-annual basis during its first two years of operation. After a two year period or the level of total lease assets under its control reaches the equivalent of $25 million (whichever occurs first), the company shall submit an Annual Report with its financial statements prepared and audited by a certified public accounting firm approved by the BNA.
- A financial leasing company shall submit the BNA a schedule of all sources of capital investments and third party on a quarterly basis for comparison with similar reports received from other local financial institutions,
- A financial leasing company shall submit to the BNA a Connected Transaction Report on a quarterly basis. This report shall include: the details of any parties or companies connected to the leasing company by way of direct or indirect capital investment, the type of transactions, the amount and the object of each transaction, the transaction price and the pricing approach, the profit and loss of transactions, the nature and the proportion of the connected party's rights and interests in the transaction.
- In the case that a financial leasing company is found in violation of relevant provisions of these standards, the BNA may order it to make corrections within a prescribed time limit; and if no corrections are made upon the expiration of the time limit, or the company's activities seriously endanger its sound operations, or harms the legal rights and interests of customers, the BNA may, depending on different circumstances, take supervisory actions such as suspending businesses, making restrictions on shareholders' rights, etc. in accordance with the Law Financial Institutions of 2005 and other applicable laws and regulations.

- In the case that a financial leasing company has already been or will possibly be in credit crisis, which seriously affects the legal rights and interests of customers, the BNA may assume management control of the company and or require its corporate reorganization.

XIV. LIST OF CONTACTS AND PERSONS VISITED

Banco Nacional de Angola (BNA)-Administration and Mission 'working group'

Laura M.P. de Alcântara Monteiro—Vice Governor

Dra. Beatriz Ferreira de Andrade dos Santos, General Manager, Bank Supervision

Pedro Ntima, Bank Examiner

Domingos Major, Bank Examiner

Maria ___. Bank Examiner

Falvio Antonio Garrido, Auditor, Banco do Brasil

João Alberto Magro, Consultant/Auditor, Banco do Brasil

USAID/ US EMBASSY

Randall Peterson, USAID Mission Director

Vic Duarte, USAID Supervisory General Development Officer

Domingos Menezes, USAID Development Officer

Jeffery Izzo, Chief of Political Economic Section, US Embassy

Central Registry Office -Registro Predial

Dra. Beatriz Soarez, General Manager

Ministry of Finance

Abilio Costa, Head of Normas Tributarias (Taxes)

Ministry of Housing and Urbanism-National Institute of Housing

Eugénio da C. Alexandre Correia – General Manager

BancoBIC

Graça Pereira – Administradora

José Carlos Silva – Director Central

Banco Espírito Santo Angola

Antonio de Silva Inácio, Executive Administrator--Credit

Banco de Poupança e Credito (BPC) – State-owned Savings Bank

Antonino da Silva Inácio – Executive Director

Joao Handanga, Director General Real Estate Lending

Filipe Gonçalves, Senior Consultant

Associação de Bancos de Angola

João Fonseca Administrador Executivo and President of the Association

José Carlos CA. Marques – Director Executivo

Present in meeting were representatives from:

Banco Totta, BFA, BCA, BancoBIC, BAE and Banco Keve

ESCOM Imobiliária—Subsidiary of Banco Espirito Santo and principal developer of a 150 Condominium Development in Luanda Sul

Jorge Gonçalves – Supervising Sales Manager

Associação dos Profissionais Imobiliários de Angola (APIMA)

Branca Neto do Espírito Santo - Presidente de Direcção

World Bank Group

Ricardo Gazel, Senior Economist, Angola

ANNEX A: 2004 LAND LAW ENGLISH TRANSLATION

(*Lei da Terrs de Angola, Lei 09/04, de 9 de Novembro*)

PREAMBLE

Considering the fact that the land problem in general, and in particular the judicial framework of the land problem has not yet been the object of the multidisciplinary treatment that it deserves. Considering that the land problem in its judicial dimension must be treated in integrated form and in accordance with its multiple uses, to wit:

- support of shelter or habitation for the population residing in the territory, which implies an adequate urban regime;

- protection of natural riches whose use and exploitation involve law with respect to mining, agriculture, forests, and territorial organization;

- support for the exercise of economic, agrarian and industrial activities, and the provision of services.

- support in relation to all effects resulting from disorderly or degrading human actions which have negative impact on the ecological equilibrium and concern environmental law.

Taking into account, on one hand, that current law, especially Law 21-c/92, did not deal with the land problem in all those dimensions and, on the other hand, that an integrated and multidisciplinary vision was lacking on the part of the legislator of current Lands Law that could lead to an affirmation according to which the current Law is an Agrarian Law. The economic, social and urbanistic goals were not taken into account, and in general, the overlap between the land question and territorial organization.

Agreeing to approve the general bases of the judicial land regimes, as well as the rights that may obtain on the lands and the general regime of concession and establishment of land rights.

In these terms and under the contents of line b) of article 88 of the Constitutional Law, the National Assembly approves the following:

CHAPTER I

Provisions and General Principles

Section I

General Provisions

Article 1.

Definitions

With respect to the present law, it is understood by:

a) "Urban agglomerations": territorial zones with urban infra-structures, namely, networks for the supply of water electricity and basic hygiene, if their expansion is processed according to urban planning or, lacking it, under urban administrative instruments approved by the relevant authority.

b) "City": the urban agglomeration thus classified by territorial organizational norms, to which legal administration has been designated, and with the minimum number of inhabitants as defined by law;

c) "Rural Communities": communities of neighboring or cohabiting families that, in rural areas, have collective rights to possession, administration, use and fulfillment of the means of community production, namely, of the rural community lands occupied by them and worked in a useful and effective manner according to the principles of self administration and governance, whether for their habitation, for the

exercise of their activities, or even for the effecting of other ends recognized by custom and by the present document or its regulations.

d) "Public domain": a set of things that the State or local authorities use to effect their business, using powers of authority, that is, through the Public Law, including, namely, things destined to the use of all, things utilized by public services or over which the their authority extends, and things that satisfy the purposes of a collective public person.

e) "Private domain": a set of things not comprising part of the public domain and which are not State or local authority property.

f) "Title (*Foral*)": a title approved by Government document, under which the State delimits the area of integrated lands in the public domain pertaining to the State And by it conceded to local authorities for autonomous administration;

g) "Land rights": rights that apply to land integrated into the private domain of the State and that are of which the titleholders are individual persons or collective persons under public or private law;

h) "Soil": superficial layer of earth over which original state proprietorship obtains, destined for useful exploitation, rural or urban, by means of diverse types of land rights foreseen in the present law;

i) "Subsoil": layer of earth immediately under the soil.

j) "Land": same as lot.

k) "Lot": a delimited part of the soil, including the subsoil, and constructions existent on it that do not have economic autonomy, to which corresponds or could correspond its own number in the respective building matrix in the building registry.

I) "Passageways": lands or rural roads in the public domain of the State or of local authorities, whether in the private domain of the State or of individuals, are placed under a regime of service as passageways or integrated into community lands, according to customary right.

Article 2.

Object

The present law establishes the general bases of the judicial regime for lands integrated into property originating with the State, the land rights over which the general regime of transference, establishment, exercise, and extinction of these rights may fall.

Article 3.

Area of application

1. The present law applies to those rural and urban lands over which the State establishes some of the land rights contemplated in it for the benefit of individual persons or collective persons under public or private right, purposely designated with a view to the execution of purposes oriented toward agricultural production or animal husbandry, forest, mineral, industrial, commercial, or habitational uses, urban or rural edification, territorial organization, environmental protection and combat against soil erosion.

2. Excluded from the area of application of this law are lands that cannot be the object of private rights, such as lands in the public domain or those that, by their nature, are not susceptible to individual appropriation.

Section II

Fundamental Principles

Subsection I

Land Structure

Article 4.

Fundamental Principles

The transfer, establishment and exercise of land laws pertaining to concedable State lands are subject to the following fundamental principles:

a) principle of original proprietorship of land by the State;

b) principle of the transference of lands integrated into the private domain of the State;

c) principle of useful and effective exploitation of the land;

d) principle of ultimate authority.

e) principle of respect for the land rights of rural communities;

f) principle of natural resource proprietorship by the State;

g) principle of the no reversibility of nationalizations and confiscations.

Article 5.

Property origin

Land constitutes property originating in the State, integrated into its private domain or into its public domain.

Article 6.

Transmissibility

1. Without detriment to the matter dealt with in article 35, the State can transfer or place onus on the ownership of lands integrated into its private domain.

2. Accords dealing with transfer or onus referred to in the preceding number, which violate norms of public order, are null and void.

3. The nullification mentioned in the preceding number are evocable in general terms.

4. No rights over lands integrated into the private domain of the State and in the domain of rural communities can be acquired through squattership.

Article 7.

Useful and effective usage

1. The transfer of property rights and the establishment of limited land rights over lands integrated into the private property of the State can only take place with the objective of guaranteeing their useful and effective usage.

2. The indexes of useful and effective usage of lands will be fixed by means of territorial administrative instruments, clearly taking into account the objective to which the land is destined, the type of cultivation practiced there and the construction index.

3. The area of the lands to be conceded cannot exceed a third of the surface corresponding to the work capacity of the direct user and his family.

4. Land rights that are acquired, transferred or established under the terms of the present law are extinguished if not utilized or if the useful and effective usage indexes are not observed for three consecutive or six interpolated years, regardless of the reason.

Article 8.

Ultimate Authority

1. Establishment on the integrated private domain lands of the State, of land rights different from those foreseen in the present law, is not permitted.

2. Accords by which land rights not foreseen in this law are established are null.

3. The nullification foreseen in the preceding number is evocable in general terms.

Article 9.

Rural Communities

1. The State respects and protects the land rights of which rural communities are titleholders, including those founded in use or custom.

2. Lands belonging to rural communities may be expropriated by public utility or be the object of requisition by way of just indemnification.

Article 10.

Natural Resources

1. Natural resources are property of the State, integrated with the public domain.

2. State property rights over natural resources are not transferable.

3. Without detriment to the matter dealt with in the previous number, the State may construct, to the advantage of individual or collective persons, rights to the exploitation of natural resources, under the terms of the respective legislation.

4. The transfer of property rights or the establishment of limited land rights on lands in the private domain of the State, or under the provision of the present law, do not imply the acquisition, by accession or other mode of acquisition, of any right over other natural resources.

Article 11.

Nationalizations and Confiscations

Without detriment to specific legislative provisions regarding reprivatizations, all acquisitions of property rights by the State by dint of nationalization or of confiscations realized under the terms of the respective legislation, are considered valid and irreversible.

Article 12.

Expropriation by public utility

1. No one can be deprived, all or in part, of his property rights or of his limited land rights, unless in cases established in the law.

2. The State and local authorities may expropriate lands if they are to be utilized for a specific purpose of public utility.

3. The expropriation eliminates land rights established on lands and determines its definitive transfer to State patrimony or to the local authorities, it being the responsibility of the latter to pay the holder of the nullified rights a just indemnity.

Article 13.

Public domain

The State may subject lands covered in the area of application of the present law to the judicial regime of goods in the public domain, in cases and in terms foreseen in it.

Subsection II

Land Intervention

Article 14.

Objectives

The state intervenes in the administration and in the concession of lands to which the present document applies, in harmony with the following objectives:

a) adequate organization of territory and the correct formation, organizing and function of urban agglomerations;

b) protection of the environment and economically efficient and sustainable utilization of the lands;

c) priority of public interest and of economic and social development

d) respect of the principles foreseen in the present law.

Article 15.

Territorial organization and

urban planning

The establishment or transfer of land rights over lands and their occupation, use and usufruct is governed by the norms of the instruments of territorial organization and of urban planning, namely in those provisions that touch on the objectives contemplated in them.

Article 16.

Environmental protection and land use

1. The occupation, use and usufruct of lands are subject to the norms regarding environmental protection, namely to those that deal with the protection of the landscape and of the species of flora and fauna, to the preservation of ecological equilibrium and to the right of citizens to a healthy and unpolluted environment.

2. The occupation, use and usufruct of lands must be exercised in a manner that does not compromise the regenerative capacity of tillable lands and the maintenance of the respective productive capacity.

STRENGTHENING LAND TENURE AND PROPERTY RIGHTS IN ANGOLA: LAND LAW AND POLICY B-9

Article 17.

Public interest and economic and social development

The establishment and transfer by the State of property rights on the land obey the priority of public interest and the economic and social development of the Country.

Article 18.

Limits on the exercise of property rights

1. The exercise of property rights on lands by their titleholders is subordinate to the economic and social purpose that justified their establishment.

2. Material on the abuse of rights as treated in the Civil Code is applicable to the exercise of rights contemplated in the present law.

CHAPTER II

On Lands and Rights

Section I

On Lands

Article 19.

Land classification

1. Lands are classified as a function of the objectives on which they are established and to which they are subject under the terms of the law.

2. State lands are classified as conferrable and not conferrable.

3. With regards to its usage by individual or collective persons, conferrable property is classified as urban land or rural land.

4. It is understood that urban land refers to the rustic building situated in an area delimited by a jurisdiction (foral) or in an area delimited by an urban agglomeration and that is destined to urban edification.

5. Rural land is that rustic building situated outside the area delimited by a jurisdiction (foral) of the area of an urban agglomeration and that is designated to purposes of agricultural, animal husbandry, forest and mining activity.

6. The classification of conferrable property, urban or rural, is made in the general plans of territorial organization or, in its lack or insufficiency, by decision of relevant authorities under the terms of the present document.

7. Properties integrated into the State's public domain and community property are unconferrable properties.

Article 20.

Conferrable properties

1. Conferrable properties are properties of which the State is the original proprietor, if they have not definitely entered into the private ownership of others.

2. The domain of conferrable properties and the limited land rights established over these are subject to the judicial regime of the private domain of the State or of local authorities, to the rules appearing in the present document and to the matters contained in article 1304 of the Civil Code.

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3. State land rights do not become obsolete.

4. Without detriment to the content of article 35, the State can transfer the right of property over conferrable lands or confer on them the land rights foreseen in the present law in benefit of individual or collective persons.

5. The state can also transfer their land rights over lands to be conceded to the local authorities through the concession of title or of an equivalent legal title.

Article 21.

Urban Lots

1. Urban lots are classified as a function of the urban objective in urbanized lands, construction lots and lots that can be urbanized.

2. Lots for which concrete purpose is defined by urbanistic plans or as such classified by the decision of relevant authorities are urbanized, as long as urbanization infrastructure is implemented in them.

3. Urbanized lots are considered construction lots when they are included by a duly approved operation to divide land into lots, are destined for building construction, and as long as they have been licensed by the relevant local authority.

4. Lots are urbanizable which, in spite of being included in the area defended by title or in the equivalent urban perimeter, have been classified by urbanistic plan or equivalent plan as an urban reserve for expansion.

Article 22.

Rural Lands

1. Rural lands are classified in function of the for purpose which they are destined and of the judicial regime to which they are subject, in rural community lands, agricultural lands, forest lands, installation lands and road lands.

2. Rural community lands are lands occupied by families from the local rural communities for inhabitation, exercising of activity or for other purposes recognized by custom or by the present document and respective regulations.

3. Considered as agricultural lands are lands appropriate for cultivation, designated for the exercise of agriculture and animal husbandry, under the terms of establishment or transfer of land rights of the judicial regime described in the current law.

4. Forest lands are lands which are appropriate for the exercise of forest activity, designated for the rational exploration and utilization of natural or artificial forests, under the terms of the rural organization plan and of the respective special legislation.

5. Installation lands are those destined for the introduction of industrial or agro-industrial mining installations, in the terms of the present law and of the respective legislation applicable to the exercise of mining and oil-producing activities and to industrial parks.

6. Considered as road lands are lands affected by the implantation of land communication lines, of water supply and electricity supply chains, and of pluvial drainage and sewers.

Article 23.

Rural community lands

1. Rural community lands are lands utilized by a rural community according to the customs related to land use, including, depending on the case, the complementary areas for itinerant agriculture, the cattle passageways for cattle access to sources of water and pastures and crossings, subject or not to the regime of service, utilized for accessing water or roads or access paths to urban centers.

STRENGTHENING LAND TENURE AND PROPERTY RIGHTS IN ANGOLA: LAND LAW AND POLICY B-11

2. The delimitation of rural community lands is preceded by auditions with families that integrate rural communities and with the institutions of traditional power existing in the place of the situation of those lands.

Article 24.

Agricultural lands

1. Agricultural lands are classified by the relevant entity, through proper regulation, in function of the type of predominant cultivation, in lands for irrigation, trees and plant cultivation, and dry lands.

2. The type of cultivation, referred to in the previous number, is that which is considered by the relevant entity as more adequate to the aptitude of the lands, to the conservation of these and to the preservation of its capacity for regeneration.

3. The transfer and establishment by the State of land rights over conferrable lands and the exploitation of these depend always on the observance of the criteria stated in the previous number.

4. The state promotes building remodeling operations destined to describe not only the fragmentation but also the dispersion of rustic buildings belonging to the same titleholder, with the intention for improving the technical and economic use of the agricultural, wild and animal husbandry exploration.

5. The parceling, that is referred to in the previous number, may imply a joining of lands over those which already belong to private property or the useful domain of the direct user.

Article 25.

Installation lands

1. Without detriment to that which is determined in the instruments of territory organization, the classification of the lands as installation lands depends on the proximity of these to mines, raw material or road axis that recommend the implantation of a mining or industrial installation.

2. The classification of a lot as a mining and oil-producing installation lot, falls to the organ that protects territory organization and the environment, by means of proposal or appearance before the entities that superintend the respective area.

3. The classification of a lot as an industrial installation lot falls to the organ that protects territory organization and the environment, by means of proposal or appearance before the entity that protects the respective area.

4. The organ that protects territory organization and the environment should send copies of the lot classification dispatches to the registration services, containing the respective documentation.

Article 26.

Road lands

1. Without detriment to the regime established in the Statute of National Roads and in the National Road Plan, the classification, by the relevant entity, of a lot as a road lot depends on previous consultation to the organisms that superintend public works areas for supplying water and electricity and to the Provincial Governments in whose territorial constituency the road network will be integrated.

2. The jurisdiction over the State's private domain road lands on the public domain, when destined for public roads, falls to the organs which superintend the areas of public works and transportation.

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3. That which is determined in number 4 of article 25 is applicable to road lands, with the necessary adaptations.

Article 27.

Reserved lands

1. Considered as reserved lands or reserves, are those lands excluded from the general occupation regime, use or fruition by individual persons or collectives, in function of their jurisdiction, total or partial, to the realization of special objectives that determine their establishment.

2. Without detriment to that which is determined in article 14, number 5, of the Basic Environmental Law, the establishment of the reserves is of the competency of the government, which in them will be able to include from the State's public or private domain or from the local authorities, as lands that have already entered definitively in the private property of others.

3. The reserves can be total or partial.

4. In total reserves no form of occupation or use is permitted, except that which is necessary for its own conservation or management, bearing in mind the effecting of the objectives of public interest described in the respective establishment document.

5. The establishment of total reserves aims, among other objectives, to the protection of the environment, national defense and security, the preservation of monuments of or historic sites and the promotion of population or repopulation.

6. In partial reserves all forms of occupation or use are permitted which do not contradict the objectives described in the respective establishment document

7. Partial reserves are comprised of, namely:

a) interior waters, of the territorial sea and the exclusive economic zone;

b) the continental platform;

c) the strip seafront and of island contour, bays and estuaries, measured from the maximum high tide level, maintaining a protection strip for the interior of the territory;

d) the protection strip adjoining nascent waters;

e) the strip of land protection around dams and lagoons;

f) lands occupied by public interest iron lines and respective stations, maintaining a protection strip adjoining each axis of the line;

g) lands occupied by auto-roads, by four lane roads and by electricity, water, telecommunications, petroleum and gas installations and conductors with an adjoining strip of thirty meters on each side;

h) lands occupied by provincial roads with an adjoining strip of thirty meters and by secondary, municipal roads with a fifteen meter adjoining strip;

i) the strip of land of two kilometers along the land frontier;

j) lands occupied by airports and airfields with an adjoining strip of one hundred meters;

k) the one hundred meter strip of land adjoining military installations and other State defense and security installations.

8. The authority that has established the reserve can determine the exclusion of one or more lands from its scope, as long as it is for a justifiable motive.

STRENGTHENING LAND TENURE AND PROPERTY RIGHTS IN ANGOLA: LAND LAW AND POLICY B-13

9. Buildings that don't belong to the state can be included in the reserves by means of expropriation by public utility or by the establishment of administrative services..

10. When expropriation by public utility or restrictions in the terms of this law takes place, just indemnification is always due to the proprietors and to the titleholders of other affected real rights, without detriment to the possibility of opting for the subscription of the social capital of the commercial societies that come to establish themselves for the exploration of activities related to the reserved land.

Section II

Regarding Rights over Lands

Subsection I

State Domains

Article 28.

State Domains

The State and local authorities, by force of the fundamental principles consecrated in articles 4 and 12, can be titleholders of land rights, in harmony with the following regimes:

a) public domain, being, in this case, namely applicable the norms described in articles 10 number 3, 9 numbers 1, 13 and 29;

b) private domain, being, in this case, namely applicable that which was established in articles 5, 6, 7 numbers 1 and 2, 8, 20 and 25 and in the norms of subsection II of the present section.

Article 29.

The State's Public Domain

1. Integrated in the State's public domain are:

a) the interior waters, the territorial sea, a continental platform, an exclusive economic zone, the adjoining sea depths, including resources alive and not alive which exist in them;

b) the national air space;

c) the mineral resources;

d) the public highways and roads, the bridges and public iron lines;

e) the beaches and coastal seafront, in a strip fixed by title or by Government document, whether integrated or not in urban perimeters;

f) the territorial zones reserved for the defense of the environment;

g) the territorial zones reserved for the ports and airports;

h) the territorial zones reserved for military defense objectives;

i) the monuments and buildings of national interest, as long as they have been thus classified and have been integrated into the public domain;

j) other items affected, by law or by administrative act, to the public domain.

2. The goods of the public domain are property of the State and, as such, are inalienable, perpetual, and not subject to seizure.

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Article 30.

Public Domain Exploration Rights

The concession of rights for research, exploration and production of mineral resources and other natural resources of the public domain is regulated by special legislation applicable to the type of natural resource in cause.

Article 31.

Classification and unaffectedness

1. The classification or the unaffectedness of public domain goods is, according to each case, declared by Government document or by a document that approves general plans of territory organization.

2. The classification that is referred to in the previous number counts as a declaration of public utility for effecting the process of expropriation by public utility.

Article 32.

Sovereign regime of public domain

1. The State can, by Government document or by title, transfer goods integrated in its public domain to local authorities, with the objective to decentralize management.

2. The regime of the public domain of the State is applicable, with the necessary adaptations, to the public domain of the local authorities, without detriment to the applicable regulatory provisions.

Article 33.

Reserved lands and rural communities' rights

1. The State ensures the families that make up the rural communities residing in the perimeters of the reserved lands:

a) the well-timed execution of territory organization policies, with aim toward well being, toward their economic and social development and to the preservation of the areas in which traditional ways of using the land are adopted;

b) the concession of other lands or, that not being possible, adequate compensation that is due to them, in case of establishment of new reserves that have affected the lands possessed or utilized by them;

c) the right of preference of their members, in equal conditions, in the providing of charges and functions created in the reserved lands;

d) the jurisdiction to expenses, that are seen to promote the well-being of rural communities, of a certain percentage of taxes charged by the access to parks and by hunting, fishing or tourist activities developed there.

2. The percentage of the taxes, that are referred to in line d of the previous number, will be fixed in the General Regulation of Land Concession.

STRENGTHENING LAND TENURE AND PROPERTY RIGHTS IN ANGOLA: LAND LAW AND POLICY B-15

Subsection II

Land Rights

Article 34.

Types and regime

1. The following are the land rights that the State can transfer or establish over the conferrable lands integrated in the private domain for benefit of individual or collective persons:

a) property rights;

b) useful customary domain;

c) useful civic domain;

d) surface rights;

e) precarious occupation rights;

2. The provisions of the present law and of its regulations are applied to the transfer and the establishment of the land rights determined in the previous number.

Article 35.

Private property Rights

1. Besides special provisions contained in the present document and in its regulations, that which is established in articles 1302 to 1384 Civil Code is applied to property rights

2. The State can transfer to individual persons of Angolan nationality, property rights over conferrable urban lands integrated in its private domain.

3. The state cannot transfer to individual persons or collective persons of private right the property rights over rural lands integrated either in its public domain or in its private domain.

Article 36.

Property rights over urban lands

1. The transfer of property rights over urban lands integrated in the State's private domain or the local authority's private domain is admissible as long as such lands are included in the scope of an urbanization plan or of legally equivalent instrument and the respective land division has been approved.

2. The right that is referred to in the previous number, can be acquired by contract, public auction or redemption of the title, according to the transfer process regulated by regulatory provisions of the present law.

3. The transference of property rights for urban lands that have already entered in the private property regime is allowed, providing, in this case, that what has been established in number two of the previous article is observed.

4. The exercise of the powers of use and transformation of urban lands integrated in private property of individual or collective persons is, namely, subject to the restrictions contained in the urbanistic plans and the restrictions that derive from the urbanistic objective to which such lands are destined.

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Article 37.

Useful customary domain

1. Recognized to the families that make up rural communities are, the occupation, the possession and the rights of use and fruition of rural community lands occupied by them and employed in a useful and effective way according to custom.

2. The recognition of the rights that are referred to in the previous number, is done in title emitted by the

relevant authority in terms of the regulatory provisions of this document.

3. Rural community lands, while integrated in useful customary domain, cannot be the object of concession.

4. Traditional Power institutions having been heard, the unaffectedness of rural community lands and its concession can, however, be determined without detriment to the concession of other lands to the titleholders of the useful customary domain or, that not being possible, without detriment to the adequate compensation that is due to them.

5. Only rural community lands freely vacated by their titleholders in harmony with the customary laws of provisional ownership organization or, exceptionally, in terms of the regulatory provisions can be an object of unaffectedness.

6. The exercise of useful customary domain is free, their titleholders are exempt from the payment of title fees or installments of any kind.

7. The useful customary domain does not become obsolete, but can be extinguished by lack of use and by free vacating in the terms of the customary norms.

8. The useful customary domain can only be mortgaged in cases mentioned in number 4 of article 63 in order to guarantee the payment of bank loans.

9. If questions related to useful customary domain cannot be resolved by direct customs, they will be regulated by the norms included in articles 1491 to 1523 of the Civil Code, except regarding payment of title fees, the State being considered as a titleholder of the direct domain and the families as titleholders of the useful domain.

Article 38.

Useful civil domain

1. The useful civil domain is integrated by the combination of powers that article 1501 of the Civil Code recognizes to the tenant.

2. Besides special provisions contained in the present document and in its regulations applied to the useful civil domain, that which is specified in articles 1491 to 1523 of the Civil Code also applies.

3. The lands over which the useful civil domain can regulate can be rural or urban.

4. The useful civil domain can be established by concession contract between the State or the local authorities and the concessionaire.

5. The amount of the title fee is fixed in the respective contract, being calculated in harmony with the criteria established by regulatory provision of the present document, namely, with the classification of the land and with a degree of development of each zone or region.

6. The title fee is paid in cash in the Treasury of Public Finance at the end of each year, counted from the date of establishment of the useful civil domain.

7. The right to redeem of the title fee is conferred to the tenant, when the period has twenty years of duration, not being legal to elevate this period.

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8. The exercise of the right to redeem the title fee depends on the proof, by the tenant, that the effective use of the lands, object of the useful civil code, together with other eventually possessed in property or tenancy, is not inferior to two thirds of the total surface of those lands.

9. The price of redeeming, paid in cash, is equal to ten title fees

10. When the capacity of redeeming is exercised and tenancy has been abolished, that which is established in article 61 is applicable, with the necessary adaptations.

11. The useful civil domain can be mortgaged in the terms of line b of number 1 of article 688 of the Civil Code.

Article 39.

Surface rights

1. Establishment of surface rights over rural or urban lands integrated in their private domain is admissible by the State or by the local authorities, in favor of individual persons, nationals or foreigners or of collective persons with effective headquarters in the Country or abroad.

2. Besides special provisions contained in the present document and in its regulations, that which is determined in articles 1524 to 1542 of the Civil Code is applied to surface rights.

3. The person with surface rights pays only one installment or a certain annual installment in cash, fixed to title of price in the respective contract, the amount being calculated in harmony with the criteria established by regulatory provision of the present document, namely, with the classification of the land and with the degree of development of each territorial outline.

4. The surface right can be mortgaged in the terms of line c of number 1 of article 688 of the Civil Code.

5. The person with surface rights enjoys the right of preference, in last place, in the sale or granting in compliance of the soil.

6. That which is established in articles 416 to 418 and 1410 of the Civil Code is applicable to the preference right.

Article 40.

Precarious occupation rights

1. Establishment by the State or by the local authorities over rural and urban lands integrated in their private domain is admissible through lease contract celebrated by determined time, of a precarious occupation right for the construction of installations not definitely destined, namely, to support:

a) the construction of buildings of definitive character;

b) short duration mining prospect activities;

c) scientific investigation activities;

d) activities for the study of nature and its protection;

e) other activities listed in the regulations of authorities.

2. The lease contract referred to in the previous number will fix the area and location of the land subject to the precarious occupation right.

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3. It is equally admissible to establish, by lease contract, the right of use and precarious occupation of land goods integrated in the public domain, as long as the nature of these permits it.

4. The construction of installations referred to in the present article is subject to the general regime of the useful improvements listed in article 1273 of the Civil Code, being, in consequence, recognized the following rights:

a) the right to raise the installations implanted in the land, as long as it can be done without detriment to it;

b) when, to avoid detriment to the land, the occupant cannot raise those installations, they will receive from the State or the local authorities, depending on the case, an indemnification calculated according to the rules of enrichment without cause;

c) in cases in which not raising the installations elevated by the occupant causes damage, namely of the environment's nature, to the occupied land, the occupant should restore the land to the situation in which it was found before the edification, not having in this case the right to any indemnification.

5. The occupant pays an installment, only one or periodic, in cash, as determined by the respective contract, its amount being calculated in harmony with the criteria established by regulatory provision of the present document, namely, with the area and the classification of the land and with the period through which the precarious occupation right has been established.

CHAPTER III

Concession of land rights

Section I

General provisions

Article 41.

Urban infrastructures

1. The establishment of land rights over urbanizable lands depends on the observance of that which is determined in the urbanistic plans or in equivalent instruments and on the execution of the corresponding urbanization works.

2. The recipes that the State or local authorities receive, as compensation of the establishment of land rights over urbanizable or urbanized lands, can only be applied in the acquisition of property.

Article 42.

Titleholders

Without detriment to that which is determined in article 35, land rights over conferrable lands integrated in the private domain of the State or local authorities can be acquired:

a) the individual persons, of Angolan nationality;

b) the collective persons of public right with main headquarters in the Country, as long as they have capacity of acquisition of rights over real estate;

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c) the collective persons of private right with main headquarters in the Country, namely the institutions that follow the realization of cultural, religious and social solidarity objectives, as long as they have capacity of acquisition of rights over real estate;

d) the public Angolan enterprises and the commercial societies with main headquarters in the Country;

e) the individual persons of foreign nationality and the collective persons with their main headquarters in abroad, without detriment to the restrictions established in the Constitutional Law and in the present law;

t) the foreign entities of public right that have capacity for acquisition of rights over real estate, recognized in international accords, as long as, in the respective countries, equal treatment to equivalent Angolan entities is given;

g) the collective international persons that, in the terms of the respective statutes, are endowed with capacity for acquisition of rights over real estate.

Article 43.

Area limits

1. The area of the rural lands, object of the concession contract, cannot exceed:

a) in urban areas, two hectares;

b) in suburban areas, five hectares.

2. The area of the rural lands, object of the concession contract, cannot be smaller than two hectares or greater than ten thousand hectares

3. The counsel of Ministers can, however, authorize the transfer or an establishment of land rights over rural lands of area greater than the maximum limit indicated in the previous number.

Article 44.

Accumulation of rights

The transfer or the establishment of land rights in favor of an individual or collective person, to whom the State or local authorities have previously attributed some of the land rights listed in this law, depends on the proof of useful employment of the conceded lands.

Article 45.

Principle of adequate capacity

1. Singular and collective persons, that require the transfer or establishment of land rights listed in the present document, need to show proof of their capacity to guarantee the useful and effective employment of the lands to be conceded.

2. The area of the lands to be conceded to each direct user depends on their capacity to guarantee the useful and effective employment of the same.

3. Excepted from that which is established in the previous numbers, are projects relating to agriculture, animal husbandry, or forest use of agricultural or forest lands with an area that does not exceed ten percent of the minimum surface corresponding to the unit of cultivation fixed for each of the Country's zones, being that the case, there is no need for proof of adequate capacity

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4. The area of unit of cultivation is fixed by regulatory document of the present law in function of the Country's zones and the type of land.

5. With respect to that which is outlined in the previous number, agricultural lands can be:

a) irrigation lands, tree or plant lands;

b) dry lands.

Article 46.

Judicial concession business

1. The following are the judicial business by which any of the land rights outlined in this law can be transferred or established:

a) purchase and sale contract;

b) forced acquisition of the direct domain by the tenant, operating that coercive transference through the agreement of the parties or of judicial sale by way of the exercise of the authority right of the title (foro) integrated by judicial decision;

c) establishing title contract for the establishment of the useful civil domain;

d) special concession contract for the establishment of the surface rights;

e) special lease contract for the concession of precarious occupation rights.

2. Applicable to the judicial concession business are the special provisions of the present law and of its regulations and, secondarily, the provisions of the Civil Code.

3. Without detriment to that which is determined in the previous number, the local authorities, can, by proper document, discipline the content of the judicial concession business that deal with lands integrated in their private domain.

Article 47.

Onus of concessions

1. The transfer or establishment of land rights included in the present law can only take place by onerous title.

2. Exempt from what is stated in the previous number:

a) the establishment of useful domain, that is not established through concession, but by simple recognition;

b) a establishment of land rights included in the present law to benefit persons who show proof of insufficient funds, within the terms established in regulatory provisions.

3. The title fees or other installments, unique or periodic, are paid in cash or its amount is halved in accordance to the criteria described in previous articles with respect to each type of land right described in them.

4. The price of urban lands in the private domain of local authorities is fixed by public tender, which will have a basic value determined by price indexes fixed by the rules of the market and by the municipal rules effective in the province or urban center in which those buildings are situated.

5. In the case described in the previous number, the result of the bid is documented, in which the highest bid of each bidder will be registered, the right being adjudicated to the highest bidder.

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Article 48.

Purchase and sale

1. The sale of lands, in accordance to that which is described in line a of number 1 of article 46 or of number 4 of the previous article, is made by way of public auction.

2. Once the price is deposited and the tax paid, if it is owed, the state or the local authority will give to the auctioneer the corresponding auction title which identifies the land, certifies the payment of the price and tax, and declares the date of the transfer which will coincide with that of the auction.

3. The purchase and sale contract can be resolved by the State or by they local authorities, if the indexes of useful and effective exploitation of the land are not observed during three consecutive years or six interpolated years, regardless of the reason.

4. When the contract under the terms of the previous number is resolved, the acquirer can demand the restitution of the price paid, without any actualization, but does not have the right to be indemnified from the improvements that were made, which will be reverted to the State or to the local authority, according to each case.

5. The property right referred to in line a of number 1 of article 34, can only be transferred by the acquirer by previous authorization of the conceding authority and after a period of five years of useful and effective exploitation of the land, counted from the date of its concession or the date of its last transfer.

6. Lands over which surface rights have been established or that have been contracted, and that have been the object of useful and effective exploitation during the legally fixed period, can be sold, without public auction, to the titleholders of those limited land rights.

7. The statements of the following article are applicable, with the necessary adaptations, to the purchase and sale contract.

Article 49.

Concession

1. The concession contracts mentioned in article 46, number 1, lines c, d, and e, are only valid if they are celebrated by written document in which are present, besides the essential elements, the rights and duties of the concessionaires, the applicable sanctions in case of non-compliance of these, and the causes of extinguishment of land rights.

2. The concession contract celebrated in the terms of the previous article includes the concession title, in the terms of the regulatory provisions.

Article 50.

Free concessions

The State and local authorities can transfer or establish land rights, to guaranteed title, over lands integrated in their private domain, for the benefit of:

a) persons who show proof or insufficient financial means and that wish to integrate population projects in less developed areas of the country;

b) recognized public utility institutions, that continue the realization of goals related to social solidarity, culture, religion or sports.

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Article 51.

Limits on community lands

1. The delimitation of areas of the rural communities and the definition of good use of community lands, by the relevant authority, must obey what is described in the corresponding instruments of land organization and in the regulatory provisions of the present law.

2. In accordance to what is described in the previous number, the relevant authority should hear the administrative authorities, the institutions of Traditional Power, and the affected families of the rural community.

Article 52.

Limits on urban lands

The limits on urban lands are fixed by titles, by urbanistic plans, and by the land division operations that have been approved.

Article 53.

Title (Foral)

1. The government, under the Governor's substantiated proposal of the respective province, can provide titles to the urban centers, as long as the following conditions are cumulatively verified:

a) the existence of a duly approved general urbanization plan;

b) the existence of official registry of municipalities;

c) the existence of supply networks for water and for providing electric energy, and of basic sanitation networks.

2. The titles delimit the area of the lands integrated in the public domain of the State and by the State conceded to the local authorities for autonomous administration.

3. The titles are approved by Government document.

Article 54.

Land division

1. Constituting a land division operation is an action that has by objective or by effect the division of urbanizable lands in one or more destined lands, immediate or subsequently, to urban edification, in harmony with what is sated in the urbanization plans, or in its lack or insufficiency, with the decisions of the relevant authority organs.

2. A lot is understood as the autonomized unit of land resulting from the land division operation.

3. The land division operations of the lands integrated in the private domain of the authority takes place by initiative of the respective municipal district.

4. In cases not discussed in the previous number, the land division is approved by permit issued by the local authority, through previous formal petition by the interested parties.

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Article 55.

Duration of the concessions

1. The land rights mentioned in the present law are transferred or established:

a) perpetually, in the case of property rights, without detriment to the provision in article 48 regarding the resolution of the purchase and sale contract;

b) perpetually, in the case of customary useful domain without detriment to its extinguishment by non-use and by being freely vacated under the terms of the customary norms;

c) perpetually, in the case of civil useful domain, without detriment to the right of de redeeming;

d) by period not greater than seventy years, in the case of surface rights;

e) by period not greater than one year, in the case of precarious occupation.

2. In the cases described in lines d and e of the previous number, when the period is over, the contract is renewed in the succeeding periods, if none of the parties has denounced it during that time and by a manner agreed upon, or if no cause of extinguishment described in the law has occurred.

Article 56.

Duties of the acquirer

These are the obligations of the acquirer of the land rights:

a) pay in a timely matter the title fees and other installments to which, depending on the case, the acquirer is obligated;

b) effect the useful and effective exploitation of the conceded land in accordance to the fixed indexes;

d) not apply the land to a use different from that which it is destined for;

e) not violate the rules of territory organization and of the urbanistic plans;

f) utilize the land in order to protect the capacity of regeneration of the same and of the natural resources existing in it;

g) respect the norms of protection of the environment;

h) not exceed the limits imposed in article 1;

i) respect the land rights of the rural communities, namely, the passages that fall over the land;

j) afford to the relevant authorities all the information solicited by them about the useful and effective exploitation of the land;

k) observe that which is described in the present law and in its regulations.

Article 57.

Installments

1. The titleholders of land rights are subject to the payment, according to price or rent, in one single installment or of a certain annual installment.

2. The annual installment can be progressive or regressive, according to the type and the amount of the investment that was realized.

3. The installments are paid in cash and are fixed in the respective contract, their amount being calculated based on the situation and classification of the land, on the area and on what it is destined for.

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Article 58.

Concession process

1. The process of concession is initiated with the presentation of the requirement by the interested party and consists of the phases of provisional demarcation, of appreciation, of approval and definite demarcation.

2. General Regulation of Land Concession will settle the legal regime applicable to the process of concession.

Article 59.

Concession Title

The relevant authority produces a concession title, according to the legally fixed model, in which are identified the nature of the conceded land, the type of land right transferred or established, the date of the transfer or establishment, the period of the concession contract, the identification of the conceding authority, and, if it is the case, the price and tax that have been paid.

Article 60.

Predial cadastral registry

1. The Government will approve the norms that guarantee the harmonization of the acts practiced by the conceding authority with those which must be practiced by the services of the cadastral and predial register.

2. Subject to enrollment in the predial register are the legal facts that determine establishment or recognition, acquisition, modification and extinguishment of land rights described in this law.

3. The facts referred to in the previous number only produce effects against others after the date of the respective register, but, even not registered, they can be invoked among the parties or their heirs.

4. The preserver must refuse the petition of the register if the presenter does not exhibit the respective concession title and, being that the case, photocopy, authenticated by notary, of the dispatch of previous authorization of the transfer pronounced by the conceding authority.

5. That which is described in the current law, in its regulations and in the Predial Register Code is applied to the registration process.

6. The conceding authority should officiously remit certification of the contract, the corresponding documentation and the requirement of the definitive register to the conservatory of the relevant predial register, where they will be filed, and the acquirer should pre-pay the respective fees and expenses.

7. The conceding authority should file a copy of the documents relative to the transfer or establishment of the land rights over conferrable lands, in such a way as to guarantee the reform of any process of concession that is destroyed or disappears.

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Section II

Transfer and extinguishment of land rights

Article 61.

Transfer

1. Without detriment to what is established in previous articles and the restrictions established in them, land rights are transferred in life and by death.

2. The transfer of land rights by statute among living persons is done by way of declaration of the parties in the concession title, with recognition done in the presence of the signing of the alienator, and is subject to register in general terms.

3. If the transfer is for an onerous title, its value must be indicated.

4. Transfer by death is subject to inscription in the concession title, and the signature of the successor must be recognized in person, after presentation to the notary, for filing, a certificate of proof.

5. Transfer of land rights implies the cessation of the rights and obligations of the respective titleholder in the view of the State or local authorities.

6. Transfer or rights in life, whether guaranteed or onerous title, can only be realized by its titleholder under penalty of nullification, via previous authorization from the conceding authority and after a period of five years of useful and effective exploitation of the land, counted from the date of its concession or the date of the last transfer.

7. The authority referred to in the previous number expires in the period of one year counted from the date of notification to the petitioner of the respective dispatch.

8. In the case of transfer of land rights by action among living persons, the notary cannot recognize the signature of the alienator if the authorization dispatch is not presented for filing.

9. The state enjoys the right of preference and has first place among the legal parties in the case of sale, granting in compliance or establishing title (foro) of the conceded lands.

10. That which is described in articles 416 to 418 and 1410 of the Civil Code is applicable to the right of preference described in the previous number.

Article 62.

Alteration of the concession

1. The modifiable or extinguishable facts of the land rights, namely, the result of judicial execution, fragmentation or parceling of the conceded lands, are subject to inscription in the concession title and in the predial register.

2. The courts cannot pronounce sentences from which result the transfer of land rights over conceded lands, without its having been previously authorized by the conceding authority, being, in this case, applicable with the necessary adaptations, or stated in the previous article.

Article 63.

Incapacity to transfer free concessions

1. Land rights that the State or local authorities have transferred or established, as free title, to benefit those persons and institutions referred to in lines a and b of article 50 cannot be transferred.

2. The conceding authority can, however, authorize the transfer, as long as it is realized in favor of the person or institution that meets the requirements enunciated in lines a and b of article 50.

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3. Without detriment to the regime of unaffectedness that is referred to in article 37 and without detriment to customary rights, the titleholder of the customary useful domain cannot transfer the right in life or by death.

4. The customary useful domain is unseizable, except in cases in which it has been mortgaged to guarantee payment of bank loans acquired by its titleholder with intentions for useful and effective exploitation of the conceded land.

Article 64.

Causes of extinguishment

Land rights are extinguished, namely:

a) by the end of the period, being established for a certain time, if the concession contract is not renewed;

b) by non-exercise of by inobservance of the indexes of useful and effective exploitation during three consecutive years or six interpolated years, regardless of the reason;

c) by using the land for a uses different from that for which it was destined;

d) by exercising land rights in infraction of that which is stated in article 18;

e) by expropriation by public utility;

f) by the disappearance or non-use of the land.

Article 65.

Sanctions

Titleholders of land rights who violate the provisions of the present law, are subject to the application of sanctions established in the regulatory provisions.

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Section III

Competency for concessions

Article 66.

Council of ministers

1. The following falls to the Council of Ministers:

a) authorize the concession of occupation, use and fruition of the territorial waters, of the continental platform and the exclusive economic zone;

b) authorize the concession of occupation, use and fruition of other land goods integrated in the public domain of the State;

c) authorize the transfer or establishment of land rights over rural lands larger than ten thousand hectares, under the terms of number 3 of article 43.

d) authorize the transfer of public domain lands to the State's private domain;

e) authorize the transfer of rights over lands integrated in the public and private domain of the State to local authorities;

f) authorize the concession of titles to urban centers.

2. The jurisdictions described in lines b, d, e, t, and g of the previous number can be delegated, according to the type of lands, in the entity charged with superintendency of the official register.

3. Authorization of transfer or establishment of land rights over rural lands larger than one thousand and equal or smaller than ten thousand hectares, is under the jurisdiction of the entity supervising the official register, through an appraisal linked to the entity responsible for the respective area.

Article 67.

Central organ for technical land management

The following falls to the Central organ for technical land management:

a) organize and conserve the archive in order to permit the identification of each parcel of land, not only regarding situation, but also regarding legal facts subject to records regarding it;

b) organize and execute technical jobs relating to the demarcation of lands and reserves;

c) organize, execute and maintain updated geometric records;

d) prepare general programming of the Country's cartography, submit respective approval to the relevant authority and maintain it updated;

e) execute the directives contained in territory organization plans, in rural areas.

Article 68.

Provincial governments

1. The following falls to Provincial Governments, relative to the lands integrated within their territory's boundaries:

a) authorize the transfer or establishment of land rights over lands which are rural, agricultural, or forest, of an area equal to or smaller than one thousand hectares;

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b) authorize the transfer or establishment of land rights over urban lands, in accordance with the urbanistic plans and with approved land division;

c) celebrate lease contracts through which precarious occupation rights are established for the State's public and private domain lands, under the terms to be defined by regulation;

d) submit transfer proposals of public domain lands to the state's private domain to the Council of Ministers;

e) submit proposals for concession of titles to urban centers, which fulfill legal requirements, to the Council of Ministers;

t) administer the State's public and private land domain;

g) supervise compliance of that which is stated in the present law and in its regulations.

2. The capacities of Municipal and communal administrators are described in regulation

CHAPTER IV

Procedural dispositions

Section I

Nullification action

Article 69.

Declaration of nullification

The decisions of the conceding authority contrary to the law are null.

Article 70.

Active legitimacy

1. Without detriment to that which is stated in article 286 of the Civil Code, the nullification action can be effected:

a) by associations of representing environmental protection agencies, within the scope described in the respective legislation;

b) by associations of legally established economic interests, acting within the scope of its attributes.

c) by rural communities, to defend their collective rights.

2. The entities referred to in the previous number act responsibly in their own name, though they may act in favor of a collective right of persons who may be affected by the nullified decisions.

3. The judicial personhood and capacity of rural communities is recognized.

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Article 71.

Passive legitimacy

1. The action referred to in the previous article may be effected against the conceding authority that has pronounced the decision contrary to the law or its regulations.

2. The conceding authority is represented by the Public Ministry.

Article 72.

Relevant tribunal

1. Nullification action falls to the Provincial Tribunal Civil and Administrative Hall of the place in which the conceding authority has its headquarters

2. Individual or collective foreign persons should, at the moment of the establishment of land rights in the litigation referring to it, expressly declare that they are subject to the jurisdiction of the national tribunals.

Article 73.

Format of the process

1. Nullification action follows the terms of the summary legal declaration and is exempted from preparations and costs

2. The action referred to in the previous number always admits recourse for the Civil and Administrative Chamber of the Supreme Tribunal, independent of the value of the cause.

3. The interposed appeal of the sentence that decrees nullification does not suspend the execution of the same.

Article 74.

Nature of the process

The processes to which the present section refers, as well as those independent to it, do not have an urgent character, without detriment to acts relative to adjudication of property, of a limited land right or of the possessions and its notification to the interested having to be practiced even during judicial holidays.

Article 75.

Communication of judicial decisions via registry

The tribunals should forward, within the thirty day period from the beginning of the judgment, to the respective Conservatory of Predial Registry, a copy of the decision that decrees the extinguishment of any of the land rights described in this law or that have decreed the nullification or voiding of a registry or of its cancellation.

Article 76.

Scope of this section

The norms of the present section apply, with necessary adaptations, to the remaining nullities described in this document or in its regulations.

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Section II

Mediation and conciliation

Article 77.

Mediation and conciliation attempt

1. The litigations relative to land rights are compulsorily submitted to an attempt at mediation and conciliation before the legal proposal of the action in the relevant tribunal.

2. Excepted from that which is stated in the previous number the nullification action, to which the previous section refers, that can be immediately proposed by the interested party in the relevant Provincial Tribunal Civil and Administrative Hall.

Article 78.

Organ for mediation and conciliation and procedure administration

1. The composition of the organ for mediation and conciliation and procedure administration described in this section will be settled in the General Regulation of Land Concession.

2. The procedure for mediation and conciliation should obey the principles of impartiality, celerity and gratuitousness.

3. When the litigation pertains to individual interests, homogeneous or collective, the entities referred to in article 70, number 1, can take the initiative of the procedure for mediation and conciliation and participate in it, as principals or accessories.

4. The mediation organ can attempt conciliation or propose to the parties the solution that seems most appropriate.

5. The mediation's resulting accord will be registered and have the nature of extrajudicial transaction.

Section III

Arbitration

Article 79.

Resolution of litigation

Without detriment to that which is stated in the previous sections, the eventual litigations that can emerge over the transfer or establishment of land rights must be submitted to arbitration.

Article 80.

Arbitration tribunal and designation of arbiters

1. The arbitration tribunal will be comprised of three members, two being nominated by each of the parties, and the third, which will perform the functions of president-arbiter, chosen by common accord by the arbiters that the parties have designated.

2. The arbitration tribunal is considered established on the date on which the third arbiter accepts nomination and communicates this to the parties.

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3. The arbitration tribunal will function in the headquarters of the Provincial Government to which the lands or of most of their extension belong, and will utilize the Portuguese language.

4. The arbitration tribunal will judge in accordance with Angolan law.

5. The decisions of the arbitration tribunal must be pronounced during a period of a maximum of six months after the date of its establishment.

6. An arbitration decision will establish those who must bear the costs of the arbitration and in what proportion

Article 81.

Applicable norms

The arbitration regulates itself by the present document and, on that which is not in opposition with this, by the general regime of voluntary arbitration in accordance with Law number 16/03, of the 25th of July.

Section IV

Community justice

Article 82.

Litigations in the interior of rural communities

1. Those litigations relative to collective rights of possessions, of management, of use and fruition, and of common useful domain of rural community lands will be decided in the interior of rural communities, in harmony with the respective community's effective customs.

2. If one of the parties does not agree with the resolution of the litigation under the terms stated in the previous number, the same will be decided by the tribunals, being applicable, in this case, that which is stated in section II of the present chapter.

CHAPTER V

Final and transitory provisions

Article 83.

Transitory situations

1. The surface rights established under Law number 21-C/92 and 28 of August, of its Regulation of Concessions approved by Decree number 32/95 of the 8th of December, and 46-A/92, 9th of September, and of the remaining local or special regulations, are subject to the regime of surface rights stated in the present law.

2. To the land rights established under the terms of the effective legislation before the appearance in force of the documents referred to in the previous number, the regime of surface rights stated in the present law are applied, as long as:

a) the lands under jurisdiction of those rights have not been nationalized or confiscated;

b) the respective titleholders have proceeded to the respective regularization under the terms and periods stated in Law il 21C/92 of August, and in number 2 of article 66 of the Regulation of Concessions approved by Decree number 32/95, 8th of December, and 46/92, 9th of September.

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3. Under the terms of the corresponding legislation, the lands to which the previous number refers will be confiscated if the situation of unjustifiable abandonment or non-regularization persists.

4. Relative to concession processes are found to be pending, the petitioners should, by the period of one year counted from the publication of the applicable general or special regulation, alter the concession petition, in harmony with the provisions in the present law, namely in what applies to the types of land rights described in it.

5. While local authorities are not established, their attributions and capacities will be exercised by the State's local organs.

Article 84.

Occupation titles

1. Without detriment to that which is stated in article 6 numbers 5 and 6, individual and collective persons that occupy lands belonging to the States or the local authorities without a title, must, within a period of three years counting from the publication of applicable general or special regulation require a concession title.

2. The non-observance of that which is stated in the previous number implies no acquisition of any land right by the occupant, by virtue of inexistence of title.

3. The state and local authorities can use against the occupant the means conceded to the possessor in articles 1276 and following of the Civil Code.

4. In the cases referred to in the previous numbers, the furnishing of a concession title depends on the fulfillment of requirements stated in the present law, in its regulations, in urbanistic plans, or in its lack or insufficiency, in the instruments of urbanistic administration approved by the relevant authority.

Article 85.

Regulation

The Government will approve the General Regulation of Land Concessions, in a period of six months counting from the date of present law's entrance in force.

Article 86.

Alterations to the Civil Code

Articles 1524 and 1525, number 2 of the Civil Code have the following composition:

Article 1524.

Notion

Surface rights consist of the capacity to construct or maintain, perpetually or temporarily, a project in buildings owned by others, or on it to make or maintain plantations. "

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Article 1525.

Object

1. [...]

2. Surface rights may have the object of construction or maintenance of a building project on soil belonging to others."

Article 87.

Revocatory Norm

All legislation that contradicts that which is stated in the present law and in its respective regulations, namely Law number 21-C/92, of 28th of August, and the Regulation of Concessions approved by decree number 32/95, 8th of December and 46/92, 9th of September, is revoked.

Article 88.

Entrance in force

The present law enters in force ninety days from the date of its publication.

THE PRESIDENT OF THE NATIONAL ASSEMBLY

ROBERTO ANTÓNIO VICTOR FRANCISCO DE ALMEIDA

Proclaimed on ..... of .....of 2004

To publish

THE PRESIDENT OF THE REPUBLIC

JOSÉ EDUARDO DOS SANTOS

ANNEX B: LEGAL AND REGULATORY ESSENTIALS FOR REAL PROPERTY INVESTMENT

Introduction

The development of a private real property market requires the development of laws and regulations which will:

1) Provide for security of tenure;
2) Permit ready transferability of interests in real property; and
3) Promote affordability of real property ownership.

To the extent that the law does not protect and promote the security of tenure, transferability and affordability, responsible long term real property investment will be discouraged and responsible investors in real property will be replaced by speculators and exploiters.

Security of tenure and transferability are particularly important to foreign investors. By their very nature, real property investments present certain risks to foreign investors that are not shared, at least in the same degree, by other types of foreign investment. Thus, real property is usually purchased as a "long term" investment involving significant commitments, not merely in terms of initial expenditure, but also, and more importantly, in terms of development, maintenance and management. Likewise, real property investments are significantly less liquid than other forms of investments making them significantly more vulnerable to changes in political, social, economic and legal environment of the country and community in which they are located.

Further, real property, real property investors and real property transactions represent especially visible, and hence vulnerable, targets for taxation, fees, currency restrictions, and other governmental impositions and requirements which are difficult to escape. Finally, real property, being a unique and non-fungible national asset, is uniquely liable to governmental "takings" or "restrictions" which purport to be justified "in the public interest."

Of course, and in addition, foreign investment in real property presents all of the complexities and problems of other forms of foreign investment, i.e. remote management, difference in business and investment philosophy and culture, popular resentment of foreign control and complexities of communication.

For all of these reasons and conditions, the development of an active, efficient and effective private real property market will depend on, and at least in the first instance, be significantly influenced by the state of development of the laws and regulations as well as the judicial and administrative processes which support security of land tenure, transferability and affordability.

It cannot be emphasized too strongly or too often that real property exists only as a "creature of the law." Real property constitutes nothing more nor less than the "aggregate of rights in land (and in whatever is erected on, grown upon or affixed to it) which are guaranteed and protected by the government." Since real property exists as a "legal construct," its nature, extent, size, shape, utility, cost and character are matters which are fundamentally determined by law and must be the subject of continuous review.

Real Property Associations and Legal/Regulatory Development

Associations of persons engaged in businesses involving real property, whether related to valuation, management, development, brokerage, or finance, represent the constituency which can make the most significant and intelligent contribution to the development of clear, comprehensive, equitable, efficient and economical laws and regulations governing the ownership of real property and the conduct of the real

property marketplace. The importance of the active participation of the real property professions and professionals in the development of a legal and regulatory infrastructure for real property cannot be overstated.

Real estate professionals, when properly organized, can not only identify legal regulatory needs and priorities, but also, and more importantly, can monitor, on a continuing basis, the fairness, effect and efficiency of the laws and regulations which are enacted and implemented. Associations of real property professionals have the capacity to provide legislators and administrators with invaluable assistance and support in three important areas of activity.

I. Identifying Legal and Regulatory Requirements and Priorities

By collecting and synthesizing the experience of their members, Associations have the capacity to identify, on the basis of direct, empirical knowledge, the legal and regulatory needs of the real property marketplace and the people and organizations it serves. Associations can effectively develop and support forms of legislation and regulation which will improve efficiency and reduce transactions and administrative costs. Moreover, by reason of associations' contacts with other associations representing real property markets in other communities and in other countries, it has access to international and comprehensive advisory resources as well as to historical and statistical information relevant to legislative and regulatory objectives and processes. Further, associations can readily identify, on the basis of their members' "hands on" experience with real property owners, investors, financiers and users, the legal and regulatory concerns which are most urgent and demand the highest priority.

II. Providing Legal and Regulatory Oversight

The collective experience of association members can represent the most effective form of **"reality check"** on the performance and consequences of laws and regulations. This reality check is particularly important where, as is the case in the countries of Eastern Europe, Russia and the Newly Independent States, most, if not all, of the laws and regulations will be original creations or derived from experience in other countries with different cultures, economies, legal traditions, and political environments. Associations can provide early warning required to permit the correction of failed of failing legislative or regulatory initiatives and the avoidance of damage to land investor, owners and users as well as to the credibility and viability of the free market in real property.

III. Providing Legal and Regulatory Education, Training and Information to Real Property Professionals and the Public

The Real Property associations represent the most accessible, convenient and effective mechanism for the delivery of information concerning real property law and regulation to the mass of the public as well as the real property investors, owners and users with whom they transact business and by whom they are employed. Through the associations' educational programs, the implications and applications of laws and regulations, as well as changes in and interpretations of them, can be rapidly transmitted to association members who, in turn, can disseminate them throughout their organizations and staff, incorporate them into their transactional policies, procedures and practices, and publish them to the public through their promotions. Association publications, seminars training courses and model forms and checklists are only a few of the innumerable methods and means by which legal and regulatory requirements can be widely disseminated with minimal expense and delay and optimum accuracy.

Legal and Regulatory Essentials

It would be quite impossible here to attempt to detail the substance of the laws and regulations required to assure the degree of security of tenure, transferability and affordability of real property required by investors, both foreign and domestic. However, based on the American legal infrastructure relating to real

property and the private real property market, it is possible to identify twelve (12) areas[7] which require legislative and regulatory consideration. It would be convenient if these areas were discrete and independent of each other. Unfortunately, such is not the case. The areas are interdependent, intimately related, complementary as well as supplementary. While they can be treated in separate legislative or regulatory enactments, their application must be reconciled with each other in terms of purpose and process to be meaningful and effective.

AREA 1: Laws and Regulations Governing the Nature and Extent of Real Property Ownership and Evidence of Ownership

This area involves fundamental land policy. In the United States, the national land policy, which was established even before its Constitution was adopted, provided that real property would be owned in "fee simple;" that it would not be subject to the restrictions of "primogeniture" and "entail"; and that its transfer could not be constrained by any limitations extending beyond specified "lives in being plus 21 years." United States land policy also authorized the separate sale or disposition of surface rights from subsurface rights and air rights.

While this land policy has been adopted, in whole or part, by other nations, there are alternative land policies which provide for property to be limited to a term of years or for life; or which provide for other forms of reversion to the state or restrictions on the capacity to sell or transfer. The national land policy, in large measure, defines the basic "bundle of legal rights" which constitutes real property and hence is one of the most critical subjects of legislative concern for the community of real property professionals. Regardless of what land policy is ultimately determined to be, however, it is imperative that the legal infrastructure establish a clear and detailed process whereby the ownership of the land and any interest in it, can be evidenced and documented authoritatively.

AREA 2: Laws and Regulations Governing the Conveyance or Transfer of Ownership Interest in Real Property

A free private property market contemplates that interests in real property can and will be bought, sold or otherwise transferred or acquired. It also contemplates that real property is

an asset that can be used as collateral for borrowing and to support a security interest in it.

Moreover, it is imperative for the state as well as owners and investors to know, at all times, the ownership of all property within its jurisdiction and the conditions and limitations of such ownership.

To achieve these objectives it is essential that an effective, economical and comprehensive system be established whereby all properties can be accurately surveyed and described in consistent language and form. It is also essential that a cadastral or recordation system be established which will identify the owner and liens, easement, security interest and other rights and interests in the property which could affect its use, value, or transferability. There are various systems for recordation available and in use; some public and some private. Likewise, recordation can be definitive of ownership rights and interest or it may be informational. But whatever the system, it must establish the basis for title insurance and other guarantees sufficient to protect against fraud or misrepresentation of ownership rights.

Developments in surveying by space satellite and in computer-driven recordation cadastral systems have been significant in recent years and offer significant opportunities for the establishment of comprehensive systems at minimal cost. In this connection, cost and efficiency are critical considerations in the

[7] The organization of the real property legal and regulatory infrastructure into twelve areas is entirely arbitrary and intended merely to provide a manageable "checklist" to assist in organizing and focusing the legislative and regulatory concerns and efforts of the organized real property profession.

establishment and operation of recordation or cadastral systems. Excessive cost or delay will discourage their utilization.

AREA 3: Laws and Regulations Governing the Relationship and Rights of Owners of Real Property and Their Lessees.

Laws and regulations should be established defining the relationship and rights of owners of real property and those to whom they rent or lease. The law of real property must be concerned to assure that persons who lease are properly protected in their expectation of habitable and safe premises. At the same time, it must assure property owners that their tenants will not commit waste or otherwise jeopardize the security or value of the property leased to them. Laws and regulations should establish the terms and conditions under which leases may be terminated and tenants evicted and in the manner and timing of such eviction minimize tenant hardship; similarly, they should provide for warranties and protections as are required to prevent tenants from exploitation and harassment. Provision might also be considered for expedited processing of landlord/tenant disputes as well as punitive and injunctive remedies for tenant and landlord misconduct.

AREA 4: Laws and Regulations Governing Takings by the Government

In every nation the government reserves to itself the power of "eminent domain;" that is, the right to acquire private real property without the permission or consent of the owner. It is important that the circumstances under which the right of "eminent domain" can be exercised be clearly defined and limited. It is equally important that provision be made for the payment of reasonable compensation and that a procedure be established which will permit the offer of compensation to be challenged if it does not, in the owner's opinion, reflect the fair market value of the property. Such challenge should authorize judicial review and allow the use of non-governmental appraisers to present testimony and evidence.

Powers of eminent domain are particularly susceptible to abuse unless carefully defined and limited. In this connection, it is important that any "taking" be for "essential public purposes" only and that provision be made whereby the claim that the property is "essential" to a public purpose may be challenged by the owner.

AREA 5: Laws and Regulations Establishing and Governing Restrictions on Land Use and Development

Among the areas of law and regulation involving real property, those establishing and governing restrictions on land use and development are, beyond question, the most complex, controversial, political and far-reaching in their impact. Proper laws and regulations governing land use and development can significantly enhance and preserve the value of real property while at the same assuring its protection and preservation for future generations. However, such laws and regulations can, if excessive or abusive, constitute an effective taking of property without compensation and can easily and instantly convert real property from an "asset" to a "liability."

Land use and development laws and regulations can generally be classified into the following categories:

a) Zoning - laws and regulations restricting land by its proposed use: i.e. residential, commercial, agricultural, industrial, mixed, recreational, public, etc.;
b) Environmental - laws and regulations restricting land use by its environmental impact: i.e. air quality, water quality, wetlands and coastal areas, endangered species and habitat, etc.;
c) Building - laws and regulations prescribing or limiting the form, construction, size, materials and placement of buildings and improvements, etc.;
d) Health and Safety - laws and regulations limiting occupancy, prescribing plumbing ventilating and heating facilities, specifying fire prevention materials, alarms, sprinklers and exits, etc.;
e) Subdivision Platting - laws and regulations requiring approval of subdivision development to assure that its impact on the utility infrastructure (roads, water, sewer, etc), the social

infrastructure (schools, parks, police, fire, etc.), and on the character and quality of the community (population density, property values, aesthetics, etc.) is acceptable;

f) Developer Dedications - laws and regulations requiring, as a condition for approval of development, the owner/developer to "dedicate" some portion of his property to the community for roads, schools, recreational facilities, or other uses.

The ownership of real property inherently involves a type of "trusteeship," and requires that the effort to identify its "highest and best used for the owner" also accommodate such use to the needs and interest of the community in which it is located. At the same time, the community as represented by the legislators and regulators must recognize that private property cannot exist unless it is secure from inverse condemnation and other restraints which, operating retroactively, defeat the reasonable expectations of the owner as to its permitted use.

AREA 6: Laws and Regulations Governing Security Interest in Real Property

Real property constitutes a valuable asset. As such it is essential that the laws and regulations permit it to be used as security/collateral. Unless real property can be made collateral for the security of its purchase and unless its value can be converted, at least in part, into cash without the necessity of its sale, the number of persons an investors able to become real property owners will be extremely limited and the private real property market will be seriously, if not fatally, impaired.

Accordingly, comprehensive laws and regulations must be established which provide for and clearly define the nature and extent of permissible security interest in real property and the rights and remedies of borrowers and lenders who use real property as collateral. In this connection, laws and regulations governing the mortgaging of property should be adopted which make provision of their assignment, for their foreclosure and for rights of redemption as well as for their proper recordation. Any legal rights of prepayment or acceleration beyond those to which the lender and borrower have agreed should be defined. Provision should also be made for the priority and enforcement of second mortgages. In addition, the laws and regulations should provide for a process for foreclosure and redemption which is economical,

Equitable, and which will not result in the impairment of title to the property for a protracted period.

The laws and regulations governing security interest in real property should be so designed as to ultimately permit mortgages to "packaged"; and sold as real estate securities. Such packaging significantly improves the liquidity of real estate investment, renders real property ownership more convenient and affordable, and permits real property lenders to lend. Laws and regulations should encourage uniformity in the terms, conditions and in qualifying requirements of security interests.

AREA 7: Laws and Regulations Governing the Forms of Ownership and Interest in Real Property

The laws and regulations governing real property should clearly define the permissible forms in which such property may be owned. In this regard, real estate laws in the United States recognize not only "sole ownership" but also ownership in "joint tenancy," ownership as "tenants in common" and ownership in the form of "tenancy by the entireties." As earlier indicated, ownership can also be subject to the limits of primogeniture and entail depending on the national land policy on the right of alienation.

All of these ownership arrangements involve different consequences in the event of the death of one or another of the owners and it is important that distinctions between them be sharply defined. Further, each of these arrangements involves different requirements in the event of sale or other disposition prior to death.

In addition to the foregoing forms of property ownership created by its purchaser(s), there are other ownership interests which the law and regulations may recognize. These include:

a) Dower interests which the right of the widow to defined ownership interest (in the United States, usually one-third) in real property owned by the deceased husband at death;

b) Courtesy interests provided that the widower has a life estate in real property owned by his wife at her death; courtesy is in lieu of any dower interest but under some laws, dower interests are substituted for courtesy;

c) Community property interests which contemplate that a husband and wife own all property acquired in the course of their marriage equally and such property cannot be alienated without the consent of each;

d) Property interests created by the death of the owner intestate under the laws of descent;

e) Homestead interests which limit the right to evict the owner and the right of creditors to assert their claims against the property.

The laws and regulations should determine what interest in land will be created in real property by operation of laws (such as dower, courtesy, community property, homestead, descent), should clearly define the nature and extent of those interests which are created, should specify the manner and form in which such interests must be recorded or validated and should identify the manner in which they can be released, waived or otherwise eliminated if the property is transferred or sold.

AREA 8: Laws and Regulations Governing the Creation and Application of Liens on Real Property

In the United States, certain classes of creditors have the right to have their debts paid out of a debtor's real property. Persons and businesses who furnish labor and materials (and in some instances, construction machinery) in the construction of improvements on real property have been allowed to place a lien against the real property for the amount owed for such labor and materials and to recover the amount owed them from the proceeds of the sale of the property. Such liens recognize the special vulnerability of those tradesmen engaged in the improvement of real property and their unique and identifiable contribution to its value. In addition, the law recognizes liens against real property established:

a) to enforce a legal judgment [judgment liens];
b) to collect unpaid taxes (including, in addition to taxes on the real property itself, income, state, inheritance, gift and corporate taxes) [tax liens]; and
c) to prevent the disposition of real property required to satisfy a judgment while litigation which might lead to such judgment is pending [attachment liens].

If statutory liens are created, it is essential that legal and regulatory provision be made to definitely establish:

1) The procedure by which, and the form in which, they are created;

2) The place and manner in which they must be recorded or published and the nature, form and extent of the notice required to be given;

3) The date and lien becomes effective and its priority vis-à-vis other liens and claims against the property, including contractual liens (i.e. mortgages) and equitable liens;

4) The need for and nature of proof that the work was done and the materials were provided with the consent of the property owner and that the work was properly completed as authorized;

5) Convenient and economical procedures for the waiver and release of mechanics and Materialmen's liens;

6) Procedures for the enforcement of judgment liens and attachments with appropriate creditor protections and rights of redemption;

7) Procedures and requirements for the conduct of an execution sale of the property with notice requirements and other safeguards to assure that the true value of the property is realized;

8) The form of title received upon an execution sale and the objections to which it is vulnerable; and

9) The duration of a judgment lien, the form that a satisfaction of the judgment should require, and the place where it should be filed.

AREA 9: Laws and regulations Governing the Creation of Easements

An easement is defined as a right acquired by the owner of one parcel of property to use the land of another "for special purpose." Easements, in contrast to licenses, run with the land, that is, they follow the ownership of the land, whereas a license is a personal right which cannot be sold. An easement cannot be revoked whereas a license is revocable.

Easements can be created:

a) By express grant or reservation;
b) By agreement or contract;
c) By implied grant or reservation;
d) By implication from a common plan or development;
e) By implication on the basis of necessity;
f) By prescription (adverse use) for a statutory period of time;
g) By condemnation for public purposes (as for a street, telephone or power line, water and sewer line, railroad right of way, scenic preservation, etc.);
h) By reference to a subdivision plat; and
i) By estoppel (owner objections to use constituting easement foreclosed by owner conduct).

The laws and regulations relating to the creation of easements should not only decide what easements will be recognized but also how their existence will be recorded or identified, how they may be terminated and what obligations they impose on the owner and the holder or the user as regards maintenance and repair.

AREA 10: Laws and Regulations Governing the Ownership of Condominiums Planned Unit Developments and Cooperatives

Increasingly, residential real property is being developed in the form of cooperative condominium or planned unit development (PUD) in urban and more densely populated areas. These forms of development offer an opportunity for real property ownership to persons and families who would otherwise be compelled to rent. Cooperative, PUD and condominium ownership avoids the problems arising in "landlord/tenant" relationships, provides security against arbitrary rent increases and evictions, assures owners greater control over their living conditions, and, generally assures that residents have an economic stake in the space they occupy, the facilities they use and the community in which they live.

However, cooperative, PUD and condominium ownership present special risks and problems of acquisition, governance and operation which do not exist in other forms of property ownership or in the usual landlord/tenant relationship. The interdependence of owners of cooperative, PUD or condominium units is such as to require comprehensive legal and regulatory safeguards relating to the

a) Use and maintenance of common elements;
b) Organization, powers and operation of the owner's association;
c) Financing insurance applicable to the unit; and
d) Control of occupancy and use.

AREA 11: Laws and Regulations Governing Agents Involved with Providing Real Property

The purchase, sale, rental, management and valuation of real property is generally found to be sufficiently complex and important to require the use of agents. This means that a well developed "law of agency" is important to the proper operation of a private real property marketplace. In the United States, the development and application of the general law of agency to the needs of real property management, brokerage, appraisal and rental has been significantly influenced, if not, substantially defined by the National Association of Realtors and its constituent member institutes, societies and councils. Its Code of Ethics has been influential in defining the nature and scope of the responsibilities, rights and liabilities of real property agents.

Moreover, the obligations of agency have been further validated and reinforced by incorporation into the rules and regulations governing the licensing and conduct of persons licensed to engage in the real property business. Generally, agencies involving real property are required to be in writing and to define the nature and scope of the authority to be exercised as well as the terms and conditions of compensation.

AREA 12: Laws and Regulations Governing the Taxation of Real Property

The affordability of real property is significantly influenced by the laws and regulations governing its taxation and the assessments and fees which are imposed on it. Lack of clarity or consistency in assessment practice or arbitrary or unreasonable rate escalation can erode the value of real estate as an investment and render its ownership and use unaffordable. Affordability is also affected by the manner in which mortgage interest and real estate taxes are treated in computing applicable personal and corporate income taxes. Finally, affordability of real property is impacted by its vulnerability to special assessments and governmental impact fees incident to its development or improvement.

Real property associations in the United States have devoted a significant portion of their legislative and regulatory interest and energy to the effort to assure that real estate is not overburdened with taxes and that tax incentives are created to encourage home ownership and real property investment.

CONCLUSION AND RECOMMENDATIONS

The nature, extent, value, utility, transferability and essentially every other quality of real property is defined, in the first instance, by the laws and regulations applicable to it. For this reason, every person involved in a business involving the marketing, valuation, development, financing or management of real property has a vested interest in assuring that the laws and regulations applicable to real property:

a) support the "highest and best use of the land";

b) promote an efficient and honest real estate marketplace;

c) encourage and protect home ownership and investment in real property; and

e) establish safeguards against exploitation and abuse of the land and its ownership.

To advance these interests, associations of real property professionals and practitioners

are well advised to establish the following Four Part Program.

Program Part I: Legal and Regulatory Audit

Part I of the Program involves the conduct of a comprehensive **Legal and Regulatory Audit**. This is a major undertaking and one that can be accomplished only on a collective and cooperative basis. In this connection, the cooperation should involve not only the members of the association but also, and equally important, any other associations of persons connected with real property including, but not limited to, associations of valuers, brokers, property managers, homebuilders, insurance companies, accountants, developers and attorneys.

The Audit should identify, on a local, regional and national basis, the state of law and regulation applicable to real property in each of the twelve primary areas of concern identified herein. In this connection, the objective should be to determine:

a) Those areas of law or regulation which have been adequately addressed; and
b) Those areas of law or regulation which are inconsistent, inadequate or counterproductive either in substance or process.

In connection with the Audit, assignments of responsibility might be made in accordance with legal and regulatory areas of particular expertise and concern. Thus, valuers might undertake the audit of Areas # 4, 5 and 9; while real property financiers might examine Areas #2, 6 and 8. Notwithstanding such assignments, however, the interrelationship of real property law and regulation will not permit "tunnel vision" in analysis or exclusive delegations of audit responsibility. Multi-disciplinary task forces would be useful organizational structure for conducting the audit as would joint or liaison committees where multiple association are engaged.

The result of the Audit should be compilation and correlation of relevant laws and regulations, organized geographically and by legislative and regulatory authority, which can be used to develop legislative and regulatory recommendations. In this connection, it is essential that the Audit be maintained and updated on a continuing basis with a standing committee of the association charged with that responsibility.

Program Part II: Legislative and Regulatory Recommendations

Using the results of the Audit, it is then necessary to develop legislative and regulatory recommendations. This effort involves three phases:

1) Using the Audit to develop a comprehensive list of laws and regulations which require enactment or adoption, or which require supplementation, or which require repeal or revision;
2) Arranging the list that is developed into an order which reflects priority, not only in terms of importance but also in terms of feasibility and available resources;
3) Developing legislative and regulatory proposals and initiatives which are coherent, consistent, and effective.

The effort to develop legislative and regulatory recommendations will require significant consultation, debate and compromise since it will involve a variety of vested interests both within the association and outside of it. The same is true when legislative and regulatory recommendations need to be given their priorities.

In establishing priorities, consideration should be given, not merely to importance but also to the political environment, the time and effort required, the nature and extent of the probably opposition, the degree of internal consensus that the recommendation enjoys and the capacity it requires for implementation to name only a few considerations.

The effort to develop legislative and regulatory recommendations should also involve extensive research. Model laws and regulations of other jurisdictions and nations should be examined; academics and consultants should be utilized; discussion with relevant committees of attorneys should be invited; interviews with potential domestic and foreign investors should be arranged. The objective of such research is to identify arguments, pro and con, co-opt potential opposition, and assure that the best legislative or regulatory solution is identified and proposed.

It should also be understood that legislative and regulatory flexibility is imperative since "politics" is defined as the "art of compromise." In the preparation of legislative and regulatory proposals, a clear and

comprehensive range of options should be identified so that accommodations can be made in the process of enactment without frustrating the primary objectives of the effort.

Program Part III: Legislative and Regulatory Initiatives

When the audit has been completed and the legal and regulatory reform proposals have been developed, the next step is to cause those proposals to be introduced to the appropriate legislative or regulatory authority. In this connection, it is essential that the campaign in support of the proposal be carefully and fully developed in advance. This usually includes at least three steps.

The first step is to assure that the association rank and file members understand the proposal and are prepared to support it. Nothing is more destructive to a legislative or regulatory initiative that active opposition from members of the association supporting it. The association will need to enlist the active participation of the members through:

a) Letters of endorsement;
b) Attendance at and participation in hearings which might be held;
c) Personal contacts with legislators or regulators with whom they have a special relationship; and
d) Efforts to gain support of those members of the public and the media to whom they have access.

The second step is to identify legislators or regulators (or candidates) who have evidenced a special interest in real property issues, including foreign investment and homeownership, or who have a background which might incline them to support such issues. Legal and regulatory initiatives require sponsors and it is essential that every effort be made to attract those who are most influential. It is also desirable to have the initiative seen as a "bipartisan or non-partisan" issue. Therefore, sponsorship by representatives of all parties is most desirable, if not always possible. It is also desirable to persuade the primary political parties to include the broad principles upon which association reform initiatives are premised (i.e. homeownership, attracting investment, private property, security of tenure, etc.) in their platforms or statement of principles.

The third step is to create support coalitions, particularly including coalitions involving organizations and associations purporting to represent the public interest. Private property initiatives must not be allowed to appear in conflict with the public interest, if at all possible. Similarly, involvement of lawyer groups, accounting groups and others with a legislative or regulatory agenda might permit mutual cooperation and reciprocal support.

Political effectiveness requires sustained effort and a continual monitoring of the status of legislative or regulatory proposals. Opportunities for testimony must be identified, witnesses briefed, amendments obtained and evaluated and supporters canvassed. Good laws are the product of hard work and careful preparation more than they are the product of a "good idea."

Program Part IV: Legal and Regulatory Education and "Self-Help"

At best, the development, initiation and enactment of the type and number of laws and regulations required for an infrastructure which will promote and protect private real property ownership and investment and a free marketplace will take several years. During this period, it is necessary to maintain momentum in the development of the private real property market and the promotion of private ownership and investment. To maintain this momentum, it is essential for associations of real estate professional to:

a) Establish real estate practices, procedures, forms, checklists to govern and guide their members where the practices and procedures prescribed by law or regulation are non-existent, inadequate or confusing;

b) Establish and enforce ethical standards which can compensate for deficiencies or ambiguities in the law related to agency, landlord/tenant relations, valuations or any of the other Areas of the law as they apply to real property marketing and representation;
c) Establish training and pre-licensing education courses which indoctrinate those entering any aspect of the real estate business in their responsibilities to their customers and clients as well as to their fellow professionals;
d) Prepare educational and informational materials which will inform real property buyers, sellers, landlords, tenants and investors of
    - their rights and responsibilities
    - the procedures they should follow to preserve and protect their property interests, and
    - the range of financing, valuation, brokerage, management and development of resources available to them;
e) Enlist the support and assistance of the media to identify legal and regulatory failures and inadequacies, to support association proposals and to encourage the use of real property professionals in real property transactions,
f) Provide training and education which will assure strict compliance with laws and regulations to assure that responsibility and liability for its inadequacy cannot be shifted to the professional through ignorance or inadvertence.

If the experience of the organized real property profession in the United States is any measure, association leadership, initiative and vision can compensate for a great deal of legislative and regulatory inadequacy and ambiguity. The standards of practice in brokerage, valuation, land management and other phases of real property activity and transactions were developed in the absence of law and regulation and, in fact, ultimately became, in large measure, their substance.

With the power of collective resources, the vision of collective expertise, the perspective of membership diversity and the moral force of collective responsibility, then every Real Property Association, local, regional or national has the potential to create a legal and regulatory environment of success.