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Mortgage and Real Estate Advisory Services Project

By
Elaine Weiss
Everett Post
Samir Makary



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**Mortgage and Real Estate
Advisory Services Project**

Prepared by

TAPR

**Elaine Weis, Team Leader
Everett Post
Samir Makary**

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Section I

Executive Summary

MORTGAGE AND REAL ESTATE FINANCING ADVISORY SERVICES FOR THE MINISTRY OF HOUSING, UTILITIES AND URBAN COMMUNITIES (MHUUC)

SUMMARY OF FINDINGS AND RECOMMENDATIONS

I. The Egyptian Housing Market

- Reportedly, the annual increase in demand for housing units exceeds the number constructed each year and one source estimates there is a real accumulated annual demand for 750,000 units. Another official interviewed during this project estimated that the annual volume for home financing could range from LE 10 billion to LE 20 billion with an efficient housing finance system in place.
- The most recent statistics on housing production and demand are for 1999. There were at least 82,000 non-government units built in 1999 with buyers who could have qualified for loans. Excluding potential lower income and informal housing borrowers, LE 8 to 9 billion of the housing built in 1999 could have been financed.
- There is also a large potential market for financing resales of existing housing, which is currently limited by a rent control law that keeps many older units off the market. It is estimated that even with that limitation, there are 20,000 housing units resold each year that could be financed.

II. Recent Developments in the Real Estate Market

- After a boom in real estate construction during the second half of the 1990s, the real estate market has softened significantly. Developers have been left with an overhang of unsold units, particularly high priced villas and vacation homes. As real estate prices have declined, prospective buyers no longer regard housing as a good investment.
- The softening of the real estate market has forced developers use their own financial resources to finance the sale of the homes they build. In the last two years, developers have had to reduce the minimum amount a homebuyer has to pay in cash and extend the term of the installment sales contract to induce buyers to purchase.
- Most developers apply limited, if any, credit criteria when selling their units under an installment sales contract. As a result, they are experiencing relatively high delinquency and default rates, especially with people who purchased units as investments.

III. The Egyptian Real Estate Finance Market

- In Egypt, the home finance market is not well developed. Most home purchases are for cash or with 30% to 50% cash and the balance financed over 5 to 7 years, usually by the real estate developer.
- Bank lending is limited and unlikely to grow significantly because the Central Bank of Egypt (CBE) limits commercial bank real estate financing (5% of the bank's loan portfolio plus an additional 5% for real estate loans made under the Real Estate Finance Law), primarily because of the lack of long term funding.
- Banks use their limited capacity to make real estate loans to developers, for commercial real estate and as an accommodation to large customers of the bank. A relatively small amount of home loans are made to middle income individuals other than borrowers referred to the banks by the developers they are financing.
- Bank home loan financing is concentrated in the two specialized real estate banks and the Islamic banks and only part of the unsubsidized loans made by the specialized real estate banks is made to home buyers.

IV. Implementation of the Real Estate Finance Law, No. 148 or 2001

- The Real Estate Finance Law, No. 148 of 2001 was enacted on 24 June 2001 and came into force in September 2001. Presidential Decree No. 277 of 2001 establishing the Real Estate Finance Affairs Authority mandated by the Law was issued on 26 August 2001. Executive Regulations implementing some, but not all, of the provisions of the Law were issued on 9 December 2001 in Cabinet of Ministers Decree No. 1 of 2001.
- The expedited foreclosure procedures in the Law make foreclosure a practical possibility and significantly decrease the risk and, consequently, improve the effectiveness of real estate finance. However, the expedited foreclosure procedures apply only to real estate loans under the law, not to existing real estate loans, so real estate lenders have not been able to take advantage of the provisions of the Law.
- In November 2001, the Ministry responsible for the implementation of the Real Estate Finance Law, the Ministry of Economy and Foreign Trade, was dismantled and the responsibility for the Real Estate Finance Law was transferred to the Ministry of Housing, Utilities and Urban Communities (MHUUC).
- As of mid-June 2002, the Real Estate Finance Affairs Authority had not been organized. The Minister of Housing has nominated a head of the Authority, but the Prime Minister has not officially appointed him. The members of the Board of Directors of the Authority have not been appointed, although the MHUUC has drafted a decree specifying the representation on the Board of Directors. Since most of the powers and authorities to implement the Real Estate Finance Law were vested in the Authority by Presidential Decree No. 277, until the Authority is organized and its Board of Directors, Chairman, Deputy Chairman and senior management are in place, there can be little, if any progress on implementing a new housing finance system for Egypt.

- The “Real Estate Financing Activity Guarantee and Support Fund” mandated in Part IV of the Real Estate Finance Law has not been created and no budget appropriation has been made to capitalize the Fund. The MHUUC has prepared a draft of a decree to establish the Fund.
- One element of the Real Estate Finance Law, the securitization of real estate loans, is not under the jurisdiction of the MHUUC and the Authority. The Capital Market Authority (CMA) and the Ministry of Foreign Trade (MOFT) have the authority to issue the regulations for securitization. The Chairman of the CMA has made issuance of the securitization regulations one of his top priorities for the year 2002. The project team leader has had several meetings with the senior staff members of the CMA responsible for drafting the securitization regulations. They have already prepared a draft that is under review by the MOFT, but after discussing the issues involved in securitization, they intend to revise their draft regulations. Some issues involving taxation, bankruptcy and claims of employees under the Civil Code cannot be resolved by regulation. Statutory changes will be required to address these issues.

V. “Gaps” in the Legal and Regulatory Structure

- Some of the elements essential for banks to begin originating real estate loans under the Law have not been established by decree or executive regulation. In particular, the MHUUC has not yet issued the decree containing the statutory “Forms” for the real estate financing agreements that must be used for lenders to originate loans under the Law. The Ministry of Economy had drafted such forms for real estate financing agreements for 1) the purchase of real estate; 2) construction of a building on land owned by the borrower and 3) rehabilitation loans
- The proposal to “guarantee” real estate loans by covering up to three installment payments when an insured borrower defaults on his payment obligations for “serious” reasons is an invitation for all borrowers to file a claim. In addition, since installment payments may be made monthly, quarterly, semiannually or even annually, the fund could be committed to making up to three years of installment payments. The people who wrote this provision certainly did not intend this. The payment of three installments could only delay final default and execution on the surety realty, not cure default as intended. The Fund also is responsible for subsidizing loans to low income borrowers. No analysis has been done of the projected cost of such subsidies. The MHUUC should defer any action on the Fund until it has had a detailed study done of both the methods of insuring or guaranteeing real estate loans and cost effective housing finance subsidy systems.
- In the area of securitization, Parliament revised the version of the Law presented to them to require that the originators of real estate loans guarantee the mortgage-backed securities issued by the entity that purchases the real estate loans from the originator. This requirement contravenes one of the essential elements of securitization and has effectively precluded the introduction of securities backed by the real estate loans created under the Law.

VI. Institutional Capacity

- Egyptian banks do not intend to originate and hold the real estate home loans authorized by the Law. The Central Bank of Egypt (CBE) has limited a bank’s investments in all real estate

loans under the Law to 5% of the bank's total loan portfolio. Banks are more likely to fill this quota with development and commercial real estate loans than home loans. The CBE has not adopted the 50% risk weighting of residential mortgages that is standard in the U.S. and most countries that have adopted the Basle capital standards. Consequently, the banks have no incentive to undertake residential real estate lending in their own portfolios and incur the funding and interest rate risks inherent in "borrowing short and lending long".

- Banks, however, do intend to invest in real estate finance companies along with other banks and/or real estate development companies. There is strong interest by leading developers and bankers in creating real estate finance companies that will originate home loans for developer and bank clients and the general public. Most of the officials interviewed during this project see real estate finance companies, not banks, as the primary home loan originators in the new Egyptian real estate finance system. The success of the real estate finance companies will depend on their ability to sell their loans in securitizations.
- Real estate developers and banks have separately and jointly been actively studying potential investment in real estate finance companies and are prepared to establish and capitalize real estate finance companies once the Authority is organized and all of the requisite regulations, rules, forms and procedures are in place.
- Real estate developers are anxious for the Law to be implemented so that they no longer have to finance the sales of the houses they build with their own resources. The developers also would like to liquidate the real estate sales installment contracts they currently hold by securitizing the contracts, if the contracts can be sold at a reasonable discount.
- The current interest rates in Egypt of 14% to 16% are too high to make housing finance affordable to a large segment of the population. Interest rates are being kept high to defend the value of the Egyptian pound. It may be possible to structure mortgage-backed securities at a lower interest cost than the effective cost of bank deposits (including the implicit cost of sterile reserves), thereby enabling real estate lenders to charge a lower interest rate on their loans. Any reduction in the interest rates on home loans, combined with longer maturity loans, will increase the affordability of home finance.
- Egyptian life insurance companies have already designed, and the Egyptian Insurance Supervisory Authority has approved, the life insurance policies specified in the Law. These policies are being offered in the market.
- Currently Egypt has no professional standards or qualifications for real estate valuation. Real estate valuation is a very high priority with all of the officials interviewed during the project. Many view the registration of valuers and the adoption of real estate valuation standards as almost as important for the Egyptian real estate and real estate finance industries as the creation of well funded real estate finance companies and the introduction of expedited foreclosure procedures. Expert valuations are important for good loan decisions, for the confidence of investors in mortgage-backed securities, for correct accounting of corporate fixed assets, and for buying and selling real estate.
- The MHUUC and the Authority can make a significant contribution not only to the development of a sound real estate finance market, but to the valuation of real estate assets owned by companies and to more transparent financial reporting. Reliable valuations of real estate prepared by certified valuers according to standards of real estate valuation consistent

with those applied in Europe, the U.K. and the United States will facilitate foreign direct investment in Egyptian companies, privatization and the ability of Egyptian companies to issue securities in the domestic and international capital markets.

- Most of the capital market experts interviewed during this project believe that while the domestic capital market may not be able to sustain the real estate finance market, mortgage-backed securities could be sold to investors in the region. There is regional investor interest in Egyptian pound denominated securities and there would be even more interest in dollar or euro denominated securities. Apparently the CBE routinely covers the foreign exchange risk of companies that borrow in foreign currencies or sell securities to foreign investors. The CBE retains the foreign currency and provides an equivalent amount of Egyptian pounds at the official exchange rate. The Egyptian company repays the CBE in Egyptian pounds and the CBE absorbs any losses due to a fall in the value of the Egyptian pound.

VII. “Gaps” in Institutional Capacity

- The “fatal flaw” of the guarantee by the originator-seller included in the Law that may delay the introduction of securitization of real estate loans is a deterrent to some institutions. Others, however, are willing to sufficiently capitalize the real estate finance companies they plan to form to enable the institutions to originate and hold loans for a year or more. Officials of these institutions believe that if Parliament can be made to understand the adverse impact of the guarantee requirement, the Law can be amended or amendments to the Capital Market Law can be enacted to supersede the Real Estate Finance Law.
- It is recommended that the Authority adopt standards of real estate valuation practice similar to those applied in Europe, the U.K. and the United States. Until the Authority begins operations, the Minister of Housing could appoint a real estate valuation advisory board to develop the standards. When the Authority is organized, the advisory board would continue to advise the Board of Directors of the Authority on real estate valuation matters.
- There is a general consensus of opinion that there is not enough long-term capital in Egypt to sustain a viable real estate finance market with an estimated LE 10 billion to LE 20 billion annual volume of transactions. Most of the officials interviewed during this project do not believe that Egyptian life insurance companies and pension funds will invest a sufficient amount of their resources in mortgage-backed securities to support the real estate finance market. The Government of Egypt (GoE) could fill this gap by authorizing the large state pension funds to invest in mortgage-backed securities.
- Until the Egyptian pound stabilizes at a level closer to its true market value, there is little investor interest in Egyptian pound denominated securities. At that time, domestic and regional investors once again will be willing to invest in Egyptian pound denominated securities.

VIII. Recommended Policy and Regulatory Actions

Recommendations for policy and regulatory actions, including proposed executive regulations and decrees, have been made in the areas of: real estate finance companies, real estate financing

rules and real estate valuation. Specific recommendations for executive regulations that were not included in the December, 2001 executive regulations include: standardized real estate finance “forms”, assignment of rents, prepayment provisions, loan assumption, disclosure forms and financial reporting. Recommendations for revisions in the December 2001 executive regulations also have been made.

IX. Establishment of the Real Estate Finance Affairs Authority

- As previously stated, until the Real Estate Finance Affairs Authority begins operations, there will be little, if any, progress in creating a real estate finance market in Egypt.
- The MHUUC has developed an organization chart and schedule of functional descriptions that, with the incorporation of some recommended changes, can be applied as soon as the Board of Directors and Chairman of the Authority have been appointed.

X. Training Needs

- Training needs have been identified in the following areas:
- Training in real estate finance and financial regulation for the staff of the Authority in charge of licensing and supervising real estate finance companies. This can start as soon as the staff members are appointed and their experience and personal training needs are evaluated.
- Training for real estate lenders and loan brokers. This will depend on the level of expertise of staff hired by the real estate finance companies, but it is likely to be a significant need since the Egyptian Banking Institute offers no regular real estate lending training course. That Institute would be a potential candidate for conducting that training, if it opened the courses to employees of real estate finance companies and to loan brokers.
- Training for real estate valuers and the staff of the Authority in charge of the registration, certification and supervision of real estate valuers. This would be ongoing training offered by Egyptian universities, colleges and technical institutes and professional Egyptian training organizations. Training would include the standard body of knowledge of real estate valuation. Training resources in real estate valuation are available through valuation SROs and valuation training companies in Europe, the U.K. and the United States and can be accessed by Egyptian organizations.
- Public information on real estate finance. The MHUUC or the Authority could develop brochures, newsletters, fact sheets and videotapes explaining in simple language how real estate finance works and what measures have been taken to protect the public interest. Since real estate finance is new to Egypt, a public information campaign will be important to public acceptance of real estate finance.

Section II
Purpose

Section III
Background

Section IVa

The Egyptian Housing and Finance Markets

Income Groups

1. Objective and Scope of Study

The principle objective of the study (Attached as Annex __) is to estimate what various income groups can afford to pay for housing and compare this with the actual cost of housing desired by each income group. The study includes four sections:

1. A review of High, Upper Middle, Lower Middle and Low income brackets in terms of average family size, average income, consumption ratio, average growth in income, and percentage of total and urban population.
2. An estimate of standard type, size and price of housing sold for families in each bracket.
3. An analysis of the housing prices that families with various ranges of income within the brackets could afford based on assumed financing terms
4. A comparison between what families in each range can afford and the price of what is considered to be the “standard” type of house for their income bracket.

This section (IVa) summarizes the first two portions of the study. In section IVb a more conservative assessment of what level of mortgage financing different income groups can afford is presented based on currently prevailing practices in Egypt.

2. Analysis of Income Groups in Egypt

Per capita income in Egypt is LE 4,480 per annum (i.e. equivalent to US\$ 1,000 at US\$ 1= LE 4.5), or a family income of LE 20,600 (2001), on the basis of an average family size of 4.6 persons.

Income groups in Egypt are usually classified into four groups:

Group A: High income group (HI), with an annual per capita income that exceeds LE 14,000 (an average per capita income of LE 18,000 or US\$ 4,000). This group is characterized by the following:

- Average family size is 3.8 persons.
- Average family income is LE 68,400.
- Consumption ratio is 65%.
- Annual growth rate of family income is 3.4%.
- This group represents the top 8% of total population in Egypt, of which more than 75% live in the urban areas.

Group B: Upper-Middle Income Group (UMI), with an annual per capita income that ranges from LE 5,000 – LE 14,000 (an average per capita income of LE 8,000 or US\$1,780). The characteristics of this group are identified as follows:

- Average family size is 4 persons.
- Average family income is LE 32,000.

- Consumption ratio is 82%
- Annual growth rate of family income is 3.1%
- This group represents 27% of total population in Egypt, of which more than 55% live in the urban areas

Group C: Low-Middle Income Group (LMI), with an annual per capita income that ranges from LE 2,000 – LE 5,000 (an average per capita income of LE 3,000 or US\$ 670). This group is characterized by the following:

- Average family size is 4.6 persons.
- Average family income is LE 13,800.
- Consumption ratio is 94%
- Annual growth rate of family income is 2.8%
- This group represents 25% of total population in Egypt, of which more than 50% live in the urban areas

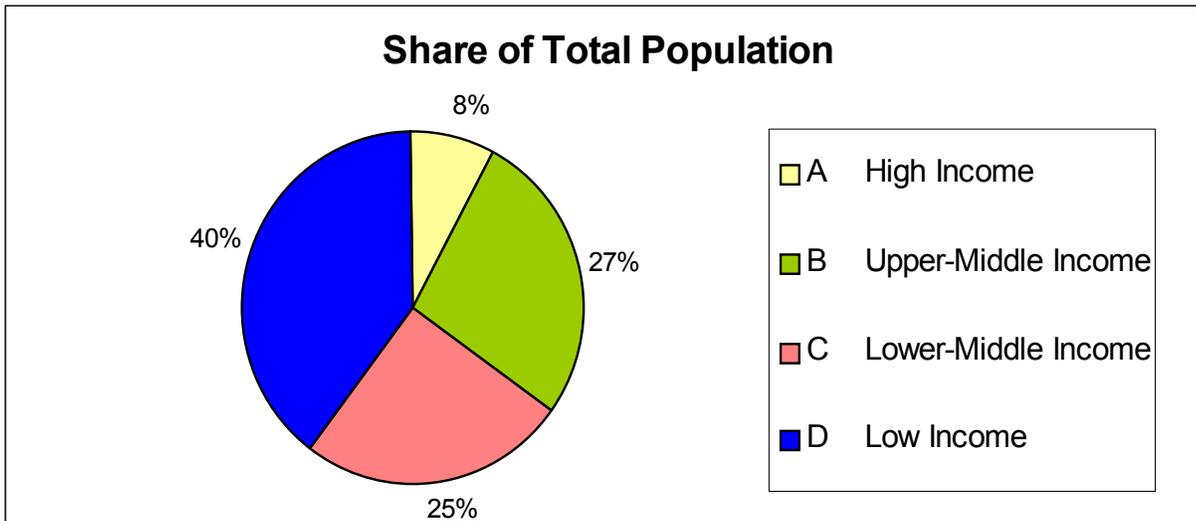
Group D: Low Income Group (LI), with an annual per capita income less than LE 2,000, with an average per capita income of LE 1,500 or US\$ 340. This group has the following characteristics:

- Average family size is 5 persons.
- Average family income is LE 7,500.
- Consumption ratio is 97%
- Annual growth rate of family income is 2.7%
- This group represents 40% of total population in Egypt, of which around 38% live in the urban areas

The following table summarizes the key features of the four income groups:

TABLE 1
Key Features of Income Groups in Egypt

Group	Average family income “LE”	Share in total population	Family size “Persons”	Consumption Ratio	% of population living in Urban areas
A High Income	68,400	8%	3.8	65%	75%
B Upper-Middle Income	32,000	27%	4.0	82%	55%
C Lower-Middle Income	13,800	25%	4.6	94%	50%
D Low Income	7,500	40%	5.0	97%	38%
Overall	20,600	100%	4.6	89%	48%



It should be noted that around 65% of the total families have annual income less than LE 20,000 (income per family). They are classified as follows:

Family Income / Year in LE	% of Total Population
18,000 less than 20,000	4%
16,000 ---	4%
14,000 ---	5%
12,000 ---	6%
10,000 ---	6%
7,500 ---	7%
6,000 ---	6%
5,000 ---	7%
Less than 5,000	20%
Less than 20,000	65%

Sources: Due to lack of accurate and detailed information on income, an approximation of income brackets is made on the basis of the data collected from various sources, including CAPMAS, Ministry of Planning. Family Budget Survey of 2000, and unpublished micro studies on income brackets and family expenditures.

3. Cost of Housing

Based on intensive interviews with contractors, civil engineers, and real estate agents, taking into consideration the common size of housing units for each income group, two values of houses (min. and max.) are identified for each income bracket. It should be noted that the level of housing is related to the level of income on the basis of the prevailing practices in the Egyptian community. The level of housing in Egyptian communities is based on the size of housing unit and level of finishing. The latter is highly correlated with the sale price of a housing unit.

TABLE 2

Prevailing Prices of Desired Housing in Egypt

Group	Level of Housing	Ranges of Unit Size	Ranges of Price/m² LE	Price of Land/m² LE	Ranges of the value of Housing Unit '000
High Income (A)	Luxury	170 – 500	1,500-3,000	300	255 -1,500
Upper-Middle Income (B)	Above Average	115 – 200	1,000-1,500	250	115 - 300
Lower-Middle Income (C)	Average	80 – 120	750-1,000	150	60 - 120
Low Income (D)	Low Cost Housing	40 – 70	600-750	100	24 - 52.5

Source: The conducted interviews with civil engineers, contractors and real estate agents.

Section IVb

The Egyptian Housing and Finance Markets

Mortgage Affordability

The primary focus of the Real Estate Finance Law is the establishment of a new system of real estate finance with financing primarily provided by a type of organization new to Egypt, non-bank, real estate finance companies. The law envisions that these companies would finance themselves primarily by packaging and selling their loans to specialized securitization companies that would, in turn, issue real estate finance bonds to investors secured by the real estate loans purchased. Real estate financing brokers, helping the companies find customers, and valuers, providing expert estimates of the value of the property being financed, would facilitate the activities of these companies. The Law provides for a Real Estate Finance Affairs Authority (the Authority) to supervise this new system, license the companies and register these experts.

The Authority, the real estate valuers, the real estate finance companies, the specialists, the rules and procedures for financing, including those for selling the loans, are all discussed in other reports of this series. The purpose of this section is to examine the probable impact of this new financing system on the affordability of housing for families purchasing their homes.

The study on “The Affordability of Housing and Accessibility of the Real Estate Finance Law” by Dr. Samir Makary, attached to this report, examines the accessibility of affordable housing as the result of financing for Egyptian families in different income brackets.

His comparison shows that many families in **most of the** income brackets can afford to buy housing that is standard housing for their bracket.

However, families in the lower ranges of the upper middle and lower middle-income brackets can only afford housing that is standard for the next lower bracket. Lower income families with annual incomes less than LE 5,000 could not afford to buy standard low-income housing even with financing.

He bases his analysis on an assumption that families in all brackets would pay 25% of the housing price in cash (a down-payment) and would finance the balance at 12% interest per year, and annual payments for 20 years. He assumes family income increases each year and uses corresponding increasing mortgage payments each year, which makes the housing purchase more affordable. He also notes that a lower interest rate, e.g. 10%, would make housing purchased with financing considerably more affordable to all families.

The Study also assumes that 30% of family income will be devoted to housing payments. He notes this is not as high as it seems because a significant part of family income is generated in the informal sector and so is, therefore, not included in official statistics. Another factor is that many families buying homes are young, often recently married. These people often get financial support for their home purchase from their families or can draw down savings to make payments.

Housing finance is most important to families in urban areas. Since about 50% of middle income and over 60% of lower income families live in rural areas, they have different affordability situations. For the low income urban families who cannot afford housing even with financing, some sort of partial subsidy will continue to be needed.

Finally, the study contends that affordability can be increased by improving the efficiency of construction, which would reduce the cost of housing by 10% to 15% and by reducing the standard size of housing units. For example, a 10% reduction in size would make a significant cost reduction.

It is important to emphasize that Dr. Makary's study finds that, without any subsidy, at least 66% of all households could afford to finance the mortgage purchase of standard housing for their income bracket. The results of his calculations also show that 50% of lower income households could afford to buy housing on this basis.

Alternative Financing Assumptions

Financing currently available in Egypt involves higher interest rates than those used in the Makary examples and annual or monthly payments are constant rather than increasing.

Housing preferences of individual families can result in affordability patterns different from those predicted by assumptions based on standard housing price ranges.

Income Assumptions

It is a widespread banking practice to take into account factors in addition to official earning in deciding whether a borrower can afford to make loan payments. These can include information such as strong evidence of sustained informal income, family assets that can be used for the payments and co-signers or guarantors who add their payment ability to that of the family borrowing to buy a home. Bank account records and payment histories also provide important verification of a family's real ability to make payments. It is also important to note that there may be several income earners in the household financing its housing. Individually, they each may have modest incomes, but together they are able to afford substantially more than might otherwise be thought.

The income sources, additional collateral and third party guarantees recommended for consideration when underwriting housing credit for Egyptian home purchasers are outlined in detail in Exhibit 17.

Housing Price Assumptions

Obviously as the family income level decreases the alternatives of buying lower priced housing than the family can afford decreases. The government probably has set certain minimum standards for basic housing. Even at the lowest income level, families do have some alternatives. Building informal housing is one of them, though it is an alternative with problems both for the families and for the government. Even at that level, financing can make a difference in housing quality. For example, in a number of countries, microloans have been used effectively to help lower-income families finance home improvements on such dwellings.

Assumptions on Financing Terms

Based on discussions with prospective participants in the housing finance and capital markets, it is likely that, at least initially, housing loans will carry an interest rate of 14% or more, will be for a maximum maturity of 10 to 12 years, will require monthly (or at least quarterly) payments and will be fully amortized by level payments, including principal and interest, over the life of the loan.

As the alternative financing models included in Exhibit (Egypt Afford.xls) show, a lower percentage of families within an income bracket will be able to afford standard housing for that income bracket with financing under current financial market conditions in Egypt than under Dr. Makary's assumptions.

Using financing at an interest rate of 14% and fixed-amount, monthly payments for 10 years, only 8% of Egyptian families can afford housing within their standard price range and only 35% can afford to buy housing in the next lower price range unless they make cash down payments of more than 25%. Under these financing terms, no low income families can afford unsubsidized housing. If the number of years to repay the loan is increased from 10 to 15 years, 15% can buy homes in their own price range and 36% can afford houses in a lower price range. Based on financing terms of 10 to 20 year monthly fixed payments equal to 30% of family income, a 25% down payment and 12% to 14% interest, the models show that it is the middle classes which benefit the most.

The following table taken from the Summary page of the model shows these variations clearly.

HOUSING AFFORDABILITY AND IMPACT OF HOUSING FINANCE

Constant, Fixed Amount Monthly Payments

Maximum % Monthly Payment to Monthly Income - except Low Income	30%
Maximum % Monthly Payment to Monthly Income - Low Income	25%
Minimum % Cash Down Payment	25%

Low Income for Families as Defined by Executive Regulations
 LE 24,000 or Less

Interest Rate	14%	14%	14%	13%	12%	12%	10%
Term in Years to Maturity	10	12	15	10	10	20	20
Percentage of Households which can Afford Housing for their Income Level	8%	12%	15%	10%	12%	22%	33%
Percentage of Households can only Afford Housing for Next Level down	35%	32%	36%	34%	32%	44%	36%
Percentage of Households which can not Afford Housing on these terms	56%	56%	49%	56%	56%	34%	31%

A fixed monthly payments structure is more commonly used by financial institutions than a graduated payment structure. As the Table shows, a very significant percentage to all Egyptian families can afford to buy housing if the financing terms are 14% interest and 20 years terms. These are terms, which may be available in the future as markets stabilize. Dr. Makary's affordability analysis is a useful demonstration of the impact on housing affordability of housing finance offered in such a more stable Egyptian financial market in which interest rates have declined and the long term bond market has been more fully developed. It may be three to five years before the Egyptian financial markets achieve this level of maturity.

Financing clearly increases the affordability of housing, especially for middle class families. Unrecorded family income, down payments higher than 25%, the increasing earning potential of young homebuyers, acceptance of housing below that customary for the family income range, lower interest rates and additional years to repay all help make housing more affordable. These factors all exist, or are possible in Egypt so increased financing as a result of the Real Estate Finance Law can indeed lead to significantly greater affordability of housing for Egyptian families.

[It should also be emphasized that the establishment of a fully functioning mortgage finance system will take a number of years. As a result, initially the number of loans that can be issued will probably be significantly less than the demand, even at these revised more conservative interest and repayment assumptions.](#)

Our conclusions on affordability of housing resulting from unsubsidized housing finance are:

- Housing for middle, moderate and even some low income families can be made more affordable without any subsidies if the purchase of the homes is financed.
- Under existing interest rates and repayment terms, many families will not be able to afford housing of the type designated as appropriate [even](#) for the next income level down from their income level unless they can increase the amount of their down payment
- Affordability will be expanded significantly if interest rates decrease from current levels or the number of years to repay can be increased as the intermediate to long term capital market in Egypt develops.

- Special loan terms, such as loans with increasing repayment amounts for families with excellent prospects of increases in their income, could increase affordability without subsidy. However, such loans are risky so it is likely few will be offered.

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Section V

Financing Housing for Low and Moderate Income Families

Introduction and Summary

We noted in the report on the Egyptian Housing Finance Markets, that, historically, much of the housing for lower and moderate-income families has been subsidized by the government. This report focuses on the impact, both with and without subsidies, of the new Law on low and moderate-income families.

The [previous section](#) of this report analyzes the affordability of housing for families of all income groups based on the unsubsidized financing, which is expected to be offered under the new law by the real estate finance companies. [This section](#) examines the potential impact of the new fund created under the law to guarantee and subsidize real estate financing. The final part is a general review of internationally accepted best practices in housing and housing finance subsidies. It presents varying approaches to subsidies and analyzes some of their problems and benefits for both low and moderate income families and governments.

Real Estate Financing Activities Guarantee and Support Fund Issues

- (BEING REVISED) *Imposing the maximum fee, listed in Article 36 of the law, directly and indirectly on buyers financing their homes will make unsubsidized housing significantly less affordable. This will be true for lower and middle-income families, even if they are exempted from paying it directly. This fee will also be unlikely to provide significant resources to the Fund for subsidies.*
- Even in the best situation, it is likely that the Fund will be able to provide few benefits unless it receives substantial funding from the State Budget.

Regarding International Best Practices

- A short review of international best practices in housing subsidies and housing finance subsidies indicates that there are a number of alternatives that the Government of Egypt could explore in detail.

The Real Estate Financing Activities Guarantee and Support Fund

The new Real Estate Finance Law requires in Articles 35 and 36 the establishment of a Real Estate Financing Activities Guarantee and Support Fund to guarantee and subsidize low-income housing finance activity. In addition, Article 5 of the new law provides for free state land and half-priced utility connections for housing for those in low-income categories.

Articles 4, 5, 6, 53, 54 and 55 of the executive regulations, issued in December 2001, implement requirements of the Law regarding the Fund and a Presidential Decree to establish the statutes of the Real Estate Financing Activities Guarantee and Support Fund has been drafted.

1. Article 35 – Defining the Role of the New Fund

This article requires the establishment of a fund to guarantee and subsidize real estate finance for the purchase of housing to those in low-income brackets. More specifically it states that the Fund will be established to assume a portion of the installments (debt service) for low-income families, providing the amount is not more than one quarter of family income.

Article 35 also provides that the statutes of the Fund will be determined by Presidential decree. In this decree, the other powers and jurisdiction of the Fund are to be determined as well. However, the relevant articles of the December 2001 executive regulations already specify some activities for the Fund.

The draft Decree sets the place of domicile of the Fund, specifies that it is to be affiliated with the Ministry of Housing, Utilities and Urban Communities and lists the composition of the Fund's Board of Directors. It also repeats the Law on the purpose and type of operations of the Fund. The most significant clarifications and additions to Article 35 made in the draft decree are that:

1. the Fund is responsible for setting general policy for guaranteeing and subsidizing real estate finance activity as defined by the Law.
2. the Fund is responsible for preparing a specialized information base for its activities.
3. the Fund will receive the free land allotted by the government for low income housing and provide half priced public utility connections.
4. the Fund will take into consideration the value of any free land and of half-price utility connections when determining subsidies.
5. the Fund will coordinate with other organizations working in the field of financing economic level housing for low-income people regarding the level of demand for such housing and the availability of resources.

Articles 4, 6, 53 and 54 of the executive regulations focus on the application process, the definition of low income, the type of documents to be used for applications to the Fund for subsidies and the timing for its approvals thereon.

Articles 5 and 55 have specific requirements for the Fund to make subsidy and guarantee payments. Article 5 says that the Fund will pay half of the cost of providing the public utility connections mentioned in Article 5 of the Law with repayment due to the Fund. This subsidy could be a major expenditure of funds, which will be offset eventually depending on the terms of repayment and the ability of the Fund to collect the payments due it.

Article 55 explicitly requires the Fund to guarantee payment of up to three installments if there is a default in repayment because of unexpected problems. It requires the by-laws of the Fund to set rules and procedures for weighing the merits of these problems and for approving the payments. It also states that the Fund shall set rules on how it will be reimbursed for making these payments

and limits any borrower/investor from benefiting from this guarantee more than once within a five year period.

2. A Review of the Fund's Role – Issues and Opportunities

The role of the Fund as a policy, data collection and coordinating organization focusing on the financing of housing for low-income people is an important one. It could produce new, more effective programs and legislative proposals making use of accurate information and information on internationally accepted best practices such as those discussed in Section C. of this report.

However, the specify requirements for the utility connection payment and the installment guarantee, need significant clarification and possibly revision to be effective.

a. Paying for 50% of Public Utility Connections and Providing Land

Article 5 of the Law, referring to the provisions in Article 35 on financing economy level, low-income housing, states that the government shall allocate certain state-owned land free of charge for erections of such housing and will subsidize 50% of the cost of public utility services to these dwellings. Article 5 of the executive regulations states that the Fund will make this 50% payment, with repayment due to it.

The wording in the translation of Law and the executive regulations is not precise. Reportedly, it means that the Fund must pay half of the cost of connecting a low-income housing site to the existing water, sewer and electricity networks. It is not clear what the terms would be for repayment of this advance. For example, would there be interest charged?

This is a form of subsidy commonly used in other countries and previously used in Egypt. Typically, the payment is for utility connections to a large site on which a developer is allowed to construct middle and upper income housing in addition to the required low-income housing on free land provided by the State. The profit the developer makes on the middle and upper income units cross subsidizes the costs for the low income ones. That profit would also be used to repay the Fund for its advance payment loan for the 50% of the utility connection cost.

It is important that the conditions be clearly stated for approving the allocation of free land and payment of half the utility connection cost. The key condition in any cross subsidy situation is that there be a certain ratio between the low-income and other housing built on the site. In the USA, the ratio of low-income to total housing on the site may be as low as 20%, but that low a percentage may not be acceptable in Egypt.

An analysis should be done, perhaps on a project-by-project basis, to determine what the ratio should be. It should cover the costs of the low-income housing and the repayment to the Fund for the utility connection and still provide the developer with enough profit to make him willing to undertake the project. Government policy on the minimum percentage of low-income housing in a project and a definition of acceptable profit to the developer are key elements in the analysis and setting the ratio. The result of the analysis should find the balance that will provide the maximum amount of lower-income housing without causing developers to lose interest in undertaking these projects.

The Fund should also make a study on what the demand is likely to be for its utility connection payments and how long it will take to receive repayment of them to aid it in preparing its budget and financial plans.

b. Paying Three Installments for Low-Income Households in Need

Article 55 states that the Fund guarantees payment of up to three installments if there is a default in repayment because of unexpected problems. It requires the by-laws of the Fund to set rules and procedures for weighing the merits of these problems and for approving the payments. It also states that the Fund shall set rules on how it will be reimbursed for making these payments and limits any borrower/investor from benefiting from this guarantee more than once within a five year period.

There are significant concerns associated with Article 55 relative to the requirement that the Fund pay these three installments. Most importantly, this form of guarantee does little either for the borrower or the lender. The low-income family whose housing is being financed is able to miss three monthly payments, but then has to repay their total to the Fund. If they were not able to pay and there was no guarantee, the financing organization usually will try and work with them to ensure continued payment and will often create a new payment schedule to make continued payment easier. Only when a number of months have passed and the financing organization is convinced that it will not get repaid will it take legal action resulting in foreclosure. So the low-income family gets little benefit from the guarantee.

The financing organization would in most cases only get a postponement of its problem in getting repaid. It may receive three more payments than it would have received without the guarantee, but three payments out of probably 120 or more payments is a small percentage of loss coverage. Usually, the financing organization will recover less from the sale of the property covered by its lien than it is owed. The extra three payments may not be sufficient additional coverage of its potential loss to make financing low-income families attractive.

Many repayment guarantee program only make payment to the financing organization when it is clearly facing a loss, and then they usually pay only a percentage of the remaining amount due after execution and sale of the property. Therefore all parties, the borrower, the financing organization and the guarantor suffer a loss, but the financing organization gets an assurance of significant coverage of its ultimate loss.

The definition of what constitutes three installments needs to be clarified because payments are made on a variety of installment bases – monthly, quarterly, semi-annually and even annually. The question has been raised as to whether Fund will pay three years of installments, if the financing contract required only one installment each year.

It is unclear whether the guarantee would pay just principal amount in the three installments or interest and fees also. The quasi-Islamic wording regarding these loans may indicate that principal and interest are indivisible in the payments and so both would be covered, but that should be clarified. It will also be important to study the potential impact of these payment guarantees would be on the securitization company buying these loans and on the ultimate holder of real estate loan back securities.

The terms need to be specified under which the Fund would be repaid, as required, for its disbursements on these three installments. Presumably the repayment would come from the buyer of the housing whose installments were paid by the Fund, but that family would have to repay the Fund in addition to what it is paying to the financing organization. The Fund would be in a weaker position than the financier in getting its payments because it would have no claim on the housing asset financed.

As the following section on subsidy best practices illustrates, there are other alternatives that may be more helpful to low-income families having trouble with the payments due on the financing for their homes. Since this requirement is written in the executive regulations, and is not mentioned in the Law itself, it can be changed relatively easily, if necessary.

If this provision is maintained, the requirement for the fund to pay should be modified to define installments as covering a period of no more than three months. If the installment, which was due, covers a period of more than three months, a claim should be made to the Fund no sooner than two or three months after the installment payment date. In that case, the financing organization would receive a partial payment from the Fund equal to no more than three months equivalent.

The regulations and the draft decree both say that rules, procedures and definitions of acceptable reasons for making the guarantee payment shall be set. It is strongly recommended that the acceptable reasons be clear, subject to easy verification, and limited to avoid unmerited claims and that an affordable, specific plan for the low-income investor to repay the Fund be included in the agreement. It would also be useful for the financing organization to have a role in assisting the low-income borrowers in making the claim. That organization has an incentive to do so because it will receive the payment from the Fund. The limit of one claim every five years will help to reduce the incidence of abuse of this guarantee procedure.

There is also a major question about how many loans there will be to lower-income families which will be covered by this three payment guarantee and about who will make them. We noted above, in the part of this report on affordability, that few lower-income families are able to afford to finance housing purchase under current lending term. It may be several years before the interest rates are low enough and term to maturity long enough to make housing finance an affordable option to a significant number of families.

There is not likely to be much interest by real estate finance companies in making these loans, because their very small profit margins will be eroded by the higher cost of these loans. It costs about the same amount to make and manage a large loan as it does a small one. Unless the financing organization can cover the increased cost per Pound of financing it makes, it will usually prefer to make larger loans. These increased costs can be covered by higher interest rates or processing and other fees, but the increased charges make the financing less affordable.

Some studies have shown that the large real estate loans to high income individuals are more risky than those to less wealthy families because the high income people can afford to walk away from a problem loan, but those who have no other option, will make extreme efforts and great sacrifices to keep the roof over their heads. If Egyptian organizations making real estate loans

become convinced that they will have fewer loan losses lending to lower income families, it might offset their concern about the higher cost of smaller loans.

3. Article 36 – Resources for the Operation of the Fund

Article 36 of the Law lists the five sources of funding for the Fund:

- a. Borrowers and lenders under the new law are each required to pay a “subscription” fee of not more than 2% of each loan payment installments to the Fund. Those borrowers/investors with limited income will be exempt from paying this fee.
- b. Gifts and donations, from both domestic and international sources, approved by the Minister of Housing.
- c. Proceeds from investments made by the Fund
- d. Proceeds of fines collected under the terms of the Real Estate Finance Law and its executive regulations.
- e. Funds allocated from the State Budget

In our opinion, four of the five sources of money listed in this provision and designed to cover the guarantee and subsidy operations and the direct operating costs of the Fund are either limited or uncertain as to their availability. The State Budget is the only truly reliable source for the Fund’s needs.

a. Funding from the subscription fee. For the reasons discussed in detail below, there will be limits on the amount of funding which will be generated from the subscription fee charged on real estate finance installments. Based on the interpretation provided, this fee is essentially a significant tax on the total entire cost of the housing purchased, including the cost of financing.

b. Funding from Gifts and Donations. The amount of gifts and donations, if any, to the Fund from donors in Egypt and abroad is highly uncertain. Unless donors have been identified who are willing to give significant funds for this purpose, this is not a reliable source of funding.

c. Funding from Investment Income. The Fund may have some investments once it has been operating for a while, but they are likely to be temporary in nature as they will most likely be needed to provide subsidy and guarantee payments. However, if the subscription fee were dedicated to the guarantee fund and managed on an actuarially sound basis or the Fund’s management decided to build a significant reserve, the result would be different. Unless the Fund builds significant reserves, the income on any such investments will add relatively little to the Fund and is likely to be insignificant in terms of what the Fund would pay in subsidies and under guarantees.

d. Funding from the Proceeds of fines. Part VIII, Articles 45 through 52, of the Law covers Penalties to be assessed for violations. While some of the individual fines, like that for unapproved mergers and liquidations where the maximum fine is LE 500,000, are

reasonably significant, others have lesser maximum amounts. In addition, while there may be some fines, the timing, amount, and ease of collection of these receipts are uncertain.. It would, therefore, be unwise to plan the operations of the Fund based on resources from fines.

e. Funds appropriated from the State Budget. That leaves the State Budget as the main source of resources for the Fund, at least for its initial capitalization. Funding from this source must be sought in the normal budgeting process and in competition with existing programs providing subsidies for low-income housing and housing finance and other critical government programs. The Fund will need to either seek an increase in total funding by the government for housing subsidies or a reallocation of existing funding to cover its needs.

4. Issues Regarding the 2% Subscription Required by Article 36 of the Law.

There are potential problems with the implementation of this provision that would result in discouraging financiers from entering the housing finance business and impact the affordability of housing finance provided under this Law. This is a serious problem because this requirement is written in the Law itself and can only be changed by parliament.

Paragraph 1. of Article 36 states that one of the Fund's resources is the subscription which the investor and the financier shall equally pay to the Fund shall not exceed 2% of the finance installment. The term "installment" has been interpreted to include the down payment and all the payments to the financier. An investor with limited income shall be exempted from paying the subscription.

For example, if a family buys a house for 100,000, paying 25,000 as a down payment and financing the balance at 14% for 10 years, their payments would include 64,740 in interest cost. The installments plus the down payment would equal 165,740. The family and the financing organization would each owe the Fund a subscription of up to 1% of 165,740, or 1,657.40.

Unless it is prohibited from doing so, the financing organization is certain to cover its costs by charging its 1,657.40 to the family being financed, either by increasing the interest rate or by charging fees. Therefore, the family will pay the whole 3,295, increasing the cost of its house by 3.3%. If this fee is spread over the life of the loan, it will add a relatively small amount to each payment, 11.64, plus a 250 subscription on the down payment, in this example.

It is not clear whether the subscription will be paid to the Fund at the time of purchase and financing or will be paid from each installment. There are good reasons why it would be better to have the full subscription paid at the beginning:

The administrative cost of handling these small amounts would be a burden for the financier and for the fund. When the loans were packaged and sold to investors, the servicing company would have to bear the cost and bother of making these subscription payments and keeping necessary

records. The financing organization, and subsequently the servicing company, should make the payments for the family being financed, and would probably charge a fee for the service.

The resources to the Fund from subscriptions would grow very slowly if paid as installments. There might even be problems in collecting them in the future. If they were paid in full up front, more significant amount will be available during the period in which the Fund is starting operations. Receipt of the subscription would be certain and so the Fund could make its plans and budget more easily.

Although the law exempts investors with undefined “limited income” from paying this fee, it does not exempt the financiers of those limited income buyers from their portion of the fee. They are unlikely to be willing to have the cost of the subscriptions reduce their profit margins and, just noted, will pass the cost on to the limited income families being financed.

If the lenders are limited, either by law or by market forces, in recovering this subscription fee costs through higher interest rates or other financing charges, it could discourage potential investors in real estate finance companies from entering the housing finance business. As noted before, their profit margins will be very thin and extra fees and high operation costs from subscription transactions could be the straw that breaks the camel’s back. If they are only restricted in passing these costs on to limited income customers, then they are likely to make few financings for those customers. Any potential savings from lower loan losses because of the Fund’s guarantee are not likely to be enough to encourage financiers not to pass on the subscription fee costs. It is doubtful whether even the Housing and Development Bank, a traditional housing lender to lower income families, would be willing to operate under this law if it could not pass on its costs or receive a government subsidy.

A subscription fee of up to 2% might not produce significant resources for the Fund at least at first. This would be especially true if the fees were collected with each installment instead of being collected up front.

There is a solution to the problem of the potential impact of the fee on financier profits and buyer affordability, that does not require parliament to act. The rate can be cut to a level at which the subscription will no long affect affordability or financier interest. This provision of the Law states only that the subscription payment shall not exceed 2% of the finance installment and does not specify a minimum percentage. The subscription rate could be set at such a low, nominal percentage that its impact will not be significant.

This solution would, of course, mean that the resources for the Fund from this source would not be significant. Therefore, the Fund should not expect much resources from the subscription fee, at least initially..

5. Financial Planning for the Fund

In order to truly assess the nature of the funding needs and the most likely scenario of funding based on the law as it now stands, it is strongly recommended that a detailed financial plan be made for the Fund. It should include a detailed study of the potential demand for housing finance

subsidies and guarantees. As the first part of this report illustrates, the size of the need for subsidies can change when interest rates and loan structuring make housing affordable to those who previously needed subsidies.

To make a financial plan for the fund, it is necessary to make some assumptions about the subsidies and guarantees that it will make. As noted in the discussion on the role of the Fund, its only specifically required task, aside from policy, data collection and coordination, is to guarantee three installments and subsidize utility costs. There has been no information available on the potential cost to the Fund of either. Other, not yet defined, subsidies likely are to be created. Such subsidies can be made in a number of ways, some of which are more cost effective than others and the Fund should carefully study which will be most effective in Egypt, based on the needs and the resources available..

The financial plan should also make a detailed study of the amount of money that the Fund can reasonably expect to receive from various sources. It would then be in a better position to design programs to maximize its assistance to low-income families and to seek funding for those programs.

Finally, since the draft Decree will require the Fund to set policy for guarantees and subsidies on real estate finance activities and to prepare a specialized information base for the Fund's activities, this would require a detailed study of alternatives and gathering of the type of data required for making a good plan. It is recommended that the MHUUC and the Board of the Fund, when that is established, seek expert help in preparing this study.

C. Best Practices in Housing and Housing Finance Subsidies

Section VI
Institutional Capacity and Constraints on Market Development
Everett Post
In progress

Section VII

Implementation of the Real Estate Finance Law No. 148/2001 and its Executive Regulations

Background and History

The enactment and implementation of a law to facilitate the development of a real estate finance system in Egypt has been a high priority of the Government of Egypt (GoE) since the late 1990s. The need for a successful mortgage finance system was intensified after 1999, when the Egyptian real estate market began to soften and developers began having difficulty selling the housing units they were constructing and repaying their development loans to the banks.

Unlike many other developing countries, Egypt has a sound foundation of law relating to real property rights, mortgages, title and lien registration, financial transactions and securities, in the Egyptian Civil Code, the Law on Real Estate Declaration and Notarization, No. 114 of 1946, the Law of Civil Procedure, the Commercial Law, No. 17 of 1999 and the Capital Market Law, No. 95 of 1992. The problem in Egypt has not been the lack of laws and regulations, but the ineffectiveness of some of the existing laws and the lengthy and costly procedures required under these laws. The most critical area requiring reform was the procedure for execution on a mortgage.

The judicial mortgage foreclosure process under the Civil Code did not give mortgage lenders assurance that they could realize on the mortgaged property in a reasonable time and at a reasonable cost. The judicial foreclosure was vulnerable to challenge by both material and frivolous claims that, in some cases, postponed final foreclosure and sale of the foreclosed real estate for years.

Other areas of concern were the length of time, complexity and cost for registration of both title to and liens on real estate and the lack of even an intermediate term capital market in Egypt.

The objectives of a new real estate finance law were to:

1. Establish a non-judicial procedure for execution on a mortgage conducted by an execution agent appointed by and under the oversight of the court of execution, that would permit the sale of the real estate pledged as security for a loan at public auction within as little as three to four months;
2. Expedite the real estate registration process for real estate financing transactions under the Law;
3. Authorize the creation of non-bank real estate finance companies and establish the regulatory framework for licensing and supervision of such companies;
4. Standardize documents and lending procedures;
5. Authorize the sale of real estate loans by bank and non-bank originators for the purpose of securitization; and
6. Authorize the issuance of real estate loan related securities, including debt instruments collateralized by real estate loans, certificates of ownership in pools of real estate loans and

shares in real estate loan investment funds, and adopt specific provisions related to the status of investors in real estate loan related securities vis á vis their rights in the cash flows generated by the real estate loans and the real estate pledged as security for the real estate loans.

~~Several drafts of a real estate finance law were prepared, but none fully addressed all of the issues involved in creating a real estate finance system. In mid-1999, the Ministry of Economy and Foreign Trade, which was the ministry responsible for the preparation of the real estate finance law, requested technical assistance from USAID to prepare a comprehensive law. After more than two years of work by the staffs of the Ministry of Economy and Foreign Trade, the Ministry of Justice and USAID sponsored Egyptian and U.S. advisors, plus advice and recommendations from the World Bank, t~~The Real Estate Finance Law, No. 148 of 2001 (the “Law”) was enacted in June, 2001. The Law became effective three months after its publication in the Official Gazette, in September 2001.

The Law requires the promulgation of a number of executive regulations by the Cabinet of Ministers (CoM) and decrees by the Ministry of Housing, Utilities and Urban Communities (“MHUUC”) or the Real Estate Finance Affairs Authority (“the Authority”). The table on the following page summarizes the requirements for and current status of the executive regulations required under the Law.

The enactment provisions of the Law required the Cabinet of Ministers to issue the executive regulations to implement the Law on the date the Law came into force (September 2001). In September 2001, Presidential Decree, No. 277 of 2001, was issued, establishing the Authority. ~~In the fall of 2001, the Ministry of Economy and Foreign Trade prepared and circulated for comment draft executive regulations and received numerous comments recommending clarification of or amendments to the regulations. The process of implementing the executive regulations was disrupted in October/November, 2001 when the Ministry of Economy and Foreign Trade was abolished and the responsibility for implementing the Law was assigned to the Ministry of Housing, Utilities and Urban Communities. Executive regulations based on the draft regulations prepared by the Ministry of Economy and Foreign Trade were issued by the MHUUC in December 2001.~~

The MHUUC also has prepared a draft Presidential Decree relating to the Real Estate Financing Activity Guarantee and Support Fund established under the Law (See the Report on Financing Low and Moderate Income Housing). In addition, the Capital Market Authority has drafted proposed executive regulations governing the securitization of real estate loans originated under the Law. These draft regulations are discussed in detail in the Report on the Securitization of Real Estate Loans.

The Executive Regulations

The executive regulations issued in December 2001 have some material deficiencies that should be addressed by the MHUUC and the Authority.

1. Some critical components required by the Law are missing, such as the standardized real estate financing contracts and the contract for the sale of real estate loans for securitization;

2. The executive regulations deal only with financing the purchase of housing units by natural persons, but the Law applies to a number of different types of real estate financing in addition to the purchase of a home and to financing to juridical as well as natural persons;
3. Some provisions, such as the qualifications for execution real estate agents, are inadvisable and should not be implemented;
4. Some provisions are vague or merely repeat the language of the Law and do not satisfy the requirements of the Law;
5. Some provisions, such as the financial criteria for real estate loans and for real estate finance companies, are inappropriate for certain real estate financing transactions authorized by the Law and/or imprudent because they would expose real estate lenders to excessive risk;
6. The jurisdictional lines between the Authority and the Central Bank of Egypt, the Egyptian Insurance Supervisory Authority and the Capital Market Authority are not clearly defined.

Although the MHUUC and the Authority would like to leave the current executive regulations in place in order to expedite the initiation of real estate lending in Egypt, it would be inadvisable to build an Egyptian real estate finance system on a shaky regulatory foundation. *Annex 2 to ¶* this report 1) analyzes the existing executive regulations and makes suggestions for amendment where indicated and 2) makes recommendations for new executive regulations in the areas not addressed by the December, 2001 executive regulations. Some of these recommendations are discussed in detail in the other reports issued as part of this project. In these cases, appropriate references are provided.

General Comments

The general comments on the executive regulations fall into four areas:

1. Overall Policy on the Extent of Regulation of Real Estate Finance Activities

There should be an overall policy decision regarding the extent to which real estate finance activities should be regulated. The MHUUC and the Authority must determine the purposes of regulation, such as: 1) to protect the public from exploitation by unscrupulous financiers and their agents; 2) to ensure that real estate finance companies are financially sound and to prevent bankruptcy of these companies; 3) to require standardization of real estate finance policies, rules and procedures to facilitate securitization of real estate financial assets; 3) to establish professional standards and codes of conduct for real estate valuers and other professionals providing essential services to the real estate finance industry. The purpose of regulation of the industry will determine the extent and type of regulation of real estate finance activities.

2. Confusion about the Meaning of Certain Provisions of the Law and Executive Regulations

After reviewing the executive regulations and the comments received by the MHUUC, there appears to be widespread confusion about some of the provisions of the Law and the regulations. For example, the “real estate agent” referred to in the Law is the person appointed by the execution judge to conduct the execution sale of the foreclosed real estate, not a real estate sales agent. Similarly, the brokers (intermediaries) that are the subject of Article 38 of the Law are

financing brokers, not real estate sales brokers. Where needed, the executive regulations should provide clear definitions of the terms used in the Law.

3. Inadequate Level of Detail

The executive regulations do not completely satisfy the requirements of the Law. In some cases, no executive regulation has been issued and in others there needs to be additional detail to define terms and clarify the meaning of the Law. Since real estate financing is a new business activity in Egypt, it cannot be assumed that real estate lenders and professionals, and the general public, will have an understanding of the rights, procedures and practices involved in real estate lending. These should be specified in the executive regulations. However, such comprehensive executive regulations will be voluminous.

4. Overlapping Jurisdictions

There are areas where the jurisdiction of the Authority overlaps with the jurisdiction of other regulatory agencies. For example, Article 3 of the Law exempts banks registered with the Central Bank of Egypt (“CBE”) only from registration with the Authority and from the provisions of clause 2 of Article 4 of the Law, dealing with financing rules and credit underwriting standards, and of Part 7 – Control. Banks will be subject to all other provisions of the Law and its executive regulations. The joint jurisdiction of the Authority and the CBE over real estate financing activities by banks will require an agreement between the two regulatory authorities regarding the responsibilities of each authority and the information sharing necessary for effective enforcement.

There also is some overlap of jurisdiction between the Authority and the Egyptian Insurance Supervisory Authority (“EISA”). Article 37 of the Law gives the financier the right to require the investor to purchase insurance against the risks of non-payment of the amount due to the financier due to the investor’s death or disability. Article 37 further states that the Executive Regulations “shall determine the rules and conditions of such insurance.” The rules and conditions of insurance offered by insurance companies operating in Egypt are under the jurisdiction of EISA. EISA also will specify any restrictions on tying arrangements between the financier and the insurance companies. EISA is in the process of finalizing an anti-tying regulation that would apply to real estate finance activities and institutions.

Securitization is the area where there is the greatest overlap of regulatory authority. Article 11 of the Law specifies that the Capital Market Authority (“CMA”) will issue the executive regulations for securitization. There should be close coordination between the CMA, the Authority and the CBE on the requirements for the real estate financial assets to be securitized.

Detailed Analysis of the Law and the Executive Regulations

Following is a detailed analysis of the specific provisions of the Law that require executive regulations or decrees to be issued *is provided in Annex 2*. Where an executive regulation or decree has been issued, its sufficiency is discussed and recommendations for amendment are made. In those cases where no executive regulation or decree has been issued, the MHUUC and/or the Authority provide a draft executive regulation or model forms for consideration-

. *The following table summarizes the conclusions of this annex.*

**Executive Regulations and Decrees Required
Under the Real Estate Finance Law No. 148 of 2001**

Article/Paragraph of the Law	Regulation or Decree	To Be Issued By	Subject	Status	Priority
Art 1, Par. 1	Exec. Reg.	CoM	Other security for real estate loans	Issued, revision recommended	Low
Article 2	Decree	President	Establish regulatory authority	Issued	N/A
Article 4, Par. 2	Exec. Reg.	CoM	Financing rules & procedures	Issued, revision required	High
Article 4, Par. 2	Exec. Reg.	CoM	Qualification and registration of real estate valuers	Issued, revision required	High
Article 5, Par 2	Exec. Reg.	CoM	Criteria and rules for low-income borrowers	Issued, revision required	Medium
Article 6, Par. 3	Decree	MHUUC	Forms for financing agreements	Not issued	High
Article 7, Par. 5	Exec. Reg.	CoM.	Disposition or encumbrance of real estate	Issued, revision required	Medium
Article 9, Par. 2	Exec. Reg.	CoM	Prepayment of the loan	Issued, revision required	High
Article 10, Par. 1	Exec. Reg.	CoM	Registration of real estate security	Issued, review required	Medium
Article 11, Par. 1	Exec. Reg.	CoM	Agreement for sale of loans for securitization	Not issued	High
Article 11, Par. 1	Exec. Reg.	CMA/MoFT	Securitization regulations	Draft under review	High
Article 16, Par. 2	Exec. Reg.	CoM	Qualification and registration of real estate agents	Issued, requires revision	High
Article 18, Par. 2	Exec. Reg.	CoM	Amount of bid bond	Issued, may require revision	Low
Article 29	Exec. Reg.	CoM	Licensing real estate finance companies	Issued, revision recommended	High
Article 29	Forms	Authority	Application forms for real estate finance companies	Not issued	High
Article 32, Par. 1	Exec. Reg.	CoM	Financial criteria for real estate finance companies	Issued, revisions required	High
Article 33, Par. 2	Exec. Reg.	CoM	Financing reporting of real estate finance companies	Issued, revision required	Medium
Article 34, Par. 1	Exec. Reg.	CoM	Dissolution, merger & liquidation of real estate finance companies	Issued, revision recommended	Low
Article 35, Par. 2	Decree	President	Establish guarantee & support fund	Draft prepared	High
Article 37, Par. 2	Exec. Reg.	CoM	Rules of insurance	Issued, revision recommended	High
Article 38, Par. 2	Exec. Reg.	CoM	Qualification and registration of real estate finance brokers	Issued, revision required	High
Article 39	Forms	Authority	Disclosure of terms and conditions of real estate finance	Not Issued	High
Article 40, Par. 2	Exec. Reg.	CoM	Loan statements	Issued, revision recommended	High
Article 41	Exec. Reg.	CoM	Processing complaints	Not issued, procedures proposed	Medium
Article 43, Par. 1	Exec. Reg.	CoM	Fees for obtaining copies of documents of the Authority	Issued, revision recommended	Low
Article 44, Par. 1	Decree	Min. of Justice & MHUUC	Designating officers of the Authority with status of law officers	Not issued	Medium

~~THE REAL ESTATE FINANCE LAW AND ITS EXECUTIVE REGULATIONS~~

~~Part I—General Provisions~~

~~ARTICLE 1—APPLICABILITY OF THE LAW~~

~~Provisions of the Law~~

~~Article 1 of the Real Estate Finance Law, No. 148 of 2001 (“the Law”) defines the types of real estate financing activities covered by the Law and the terms used in the Law. It also exempts real estate security pledged as collateral for real estate loans from all duties and expenses. Article 1 also provides that executive regulations can be issued to permit collateral for real estate loans other than the real estate being financed.~~

~~Provisions of the Executive Regulations~~

~~Chapter One, Articles (1) and (2) of the executive regulations address the provisions of Article 1 of the Law.~~

~~Chapter One General Provisions~~

~~Article (1)~~

~~Real estate financing shall be effected in accordance with the provisions of the law for investment in purchasing, building, restoration or improving residential, administrative, service buildings and those designed for commercial activity purposes.~~

~~Article (2)~~

~~If the financed property is not registered under the name of the seller, the financier may accept, as a guarantee for providing finance, mortgage of real estate assets that are owned by the investor or any other person, personal guarantee, securities at the full amount of accrued installments, or acceptance on the part of the investor to deduct from the financing installments from the salary or income thereof. The financier, in the above-cited cases, may require the investor to register the property under the investor’s name and then mortgage it to the benefit of the financier for a term mutually agreed upon.~~

~~If the property for which finance is offered is a building or a unit within a building which is built on a plot of land allocated to the investor by the government or any public artificial person, the financier may accept assignment thereof to its benefit as collateral for financing, provided approval of the allocating authority for such assignment is obtained.~~

Analysis of the Executive Regulations

Articles (1) and (2) of the executive regulations are acceptable as written. They would benefit from the following revisions, but these changes are not a high priority.

1. Define the “investor” in a real estate finance transaction to include both natural and juridical persons;
2. Define “investment in purchasing, building, restoration or improving” to include: a) development of residential, commercial and mixed use projects, b) completion of partially constructed units, c) refinancing of existing mortgage loans, installment sales contracts or construction loans secured by the subject real estate, and d) borrowing for any purpose (i.e. a real estate equity loan) against the security of real estate that is owned by the borrower free and clear of any mortgage or other debt. Enabling homeowners to borrow against the equity in their homes would tap into a large pool of illiquid capital that could be used to finance small businesses and entrepreneurial enterprises.
3. Clarify the apparent inconsistency between the provision in the first paragraph of Article 2 that, “The financier, in the above cited cases, may require the investor to register the property under the investor’s name and then mortgage it to the benefit of the financier” and item (E) of Article 6 of the Law that requires the financing agreement to include “The seller’s commitment to register the realty in the name of the buyer, clear of any real right (in rem) of third parties.”
4. Provide greater flexibility in authorizing eligible collateral other than the real estate being financed by adding a clause that says “and any other type of collateral described in the financing rules as eligible collateral.”

ARTICLE 4—CRITERIA FOR REAL ESTATE FINANCING

Provisions of the Law

Article 4 of the Law states that executive regulations shall be issued specifying the criteria for real estate financing by institutions under the jurisdiction of the Authority, i.e. public juridical persons engaged in real estate financing activities and real estate finance companies.

Provisions of the Executive Regulations

Chapter One, Article (3) sets out the financing rules and procedures for real estate loans under the Law:

Article (3)

III. Practicing Real Estate Financing Activity shall be in accordance with the following Criteria

- A) Financing procedures shall be clear and definite in such a manner that guarantees the investor’s knowledge of all rights and obligations that appertain thereto. The financing documents shall include—sine qua non—acknowledgment by the investor of having received and familiarized himself with a copy of the form containing the key conditions to be prepared by the Authority prior to signing the financing agreement.

- ~~B) Financing should not exceed 90% of the value of the property.~~
- ~~C) A valuer listed in the roster to be prepared by the Authority shall determine the value of the property, provided that that value shall not be an affiliate to the investor or the financier.~~
- ~~D) It is prohibited for a financier to provide one or more finances at an amount exceeding 10% of the capital thereof for one individual investor, the spouse, and relatives thereof to the fourth degree; or to other corporate persons in whose capital the financier contribution exceeds 10%.~~
- ~~E) In the cases where the amount of finance is related to the investor's income, proof of the income shall be by virtue of tax certificate issued by the Tax Department stating the income taken as the basis for taxation over the last three years preceding the financing agreement. In case financing shall be given against deduction from the investor's salary, proving the salary shall be by virtue of authenticated certificate by the employer thereof.~~
- ~~F) Finance repayment installment should not exceed 40% of the total investor's income, other than low income investors stated under Article (6) herein.~~

Analysis of the Executive Regulations

~~The financing rules and procedures set out in Article (3) of the executive regulations require substantial revision. The shortcomings of the current article and recommendations for revised or new provisions are discussed in detail in the Report: Financing Rules. Revising the financing criteria has a high priority because some of the criteria in the current article would expose real estate lenders to excessive risk. In addition, the current financing rules are highly inappropriate for loans to juridical persons and for real estate development and commercial real estate loans.~~

ARTICLE 5 — PROVISION OF LAND AND UTILITIES FOR LOW INCOME HOUSING DEVELOPMENT

Provisions of the Law

~~Article 5 provides that the GoE will allocate state owned land, free of charge, and provide public utility services at 50% of their actual cost for the construction of "economy level" housing. The executive regulations are to define the criteria for low income persons eligible to purchase such housing and the rules and procedures for financing the purchase of the houses built.~~

Provisions of the Executive Regulations

~~Chapter One, Articles (4), (5) and (6) address the provisions of Article 5 of the Law.~~

Article (4)

~~The institutions that desire to implement low cost residential projects to be sold to low income people as defined in Article (6) below in accordance with real estate financing scheme and providing the advantages stipulated by law in that regard, may apply to the Guarantee and Support Real Estate Financing Fund and enclose with the application comprehensive study of the project including the number of units, areas, the estimated prices thereof, and other elements related to the project.~~

~~The fund shall conclude agreement with the institution that desires to implement the project and the investors accepted thereby to provide finance. Such agreement shall detail all the provisions regulating performance of the project, the method of selling the residential units and financing thereof, together with identifying the percentage of subsidy provided by the fund.~~

~~Article (5)~~

~~Plots allocated by the Government for low income residential projects to be implemented through real estate financing shall be handed over to the fund, which shall only pay 50% of the cost of providing utilities to the administrative authority. Repayment to the fund shall be according to the provisions of article (4) herein above.~~

~~Article (6)~~

~~Low income persons, for the purposes of applying the provisions of the law and these executive regulations, shall be deemed to mean any persons whose total annual income does not exceed LE 9000 or LE 12,000 if married or having dependents.~~

~~Priority of providing finance to obtain low cost house shall be given to the investors of lower incomes; when incomes are equal preference shall be to the investor having larger family.~~

Analysis of the Executive Regulations

~~The executive regulations relating to the provision of land and reduced cost utilities installation should be amended. These revisions should not be made until the Real Estate Activity Guarantee and Support Fund (the "Fund") is established and becomes operational because the Fund will be responsible for establishing the policies and procedures for the provision of free government land and reduced cost infrastructure for affordable housing development. Revision of the current executive regulations or repeal the current regulations and enactment of new regulations should be the first priority of the Board of Directors of the Fund.~~

~~The executive regulations should provide more detail on the criteria that must be met for a residential development project to be eligible for the free land and reduced cost utilities installation provided for in Article 5 of the Law. At a minimum, the regulations should specify:~~

- ~~1.the maximum selling price for the homes to be constructed based on an analysis of the affordability of the homes to the target low and moderate income market. The maximum selling price should be adjusted annually to account for increases or decreases in family income, inflation and development costs;~~
- ~~2.the maximum payment to income ratios for low and moderate income home buyers, since they are exempted from the general financing rules. Based on existing law and regulation, the general consensus is that the maximum payment to income ratio should be 25%;~~
- ~~3.the loan to value ratios to be applied to the purchase of affordable housing units. The MHUUC and/or the Fund should consider whether a higher loan to value (i.e. lower cash deposit) should be allowed for low and moderate income home purchasers. A higher loan to value ratio will expand the market for home purchase, but will increase the risk of default. Since all of the low and moderate income housing loans made under the provisions of the Law will be insured (or guaranteed) by the Fund, an analysis of the~~

~~potential costs to the Fund relative to its financial resources should be conducted before higher loan-to-value loans are permitted.~~

~~4.the parties and procedures involved in obtaining approval of residential development projects for free land and subsidized infrastructure. Article 4 refers to the “institutions that desire to implement low cost residential projects.” Typically government provides low cost or free land and infrastructure to developers, not lending institutions. If the residential development project meets the criteria established under the Fund’s low and moderate income housing program and is approved by the Fund, the developer would then obtain financing from a private sector lending institution. The real estate lending institution should not be required to review the applications and projects for compliance with the rules and procedures established by the Fund.~~

~~5.the criteria, rules and procedures for both the construction and marketing of the project and financing the purchase of affordable housing by low and moderate income home buyers. The current regulations say that these criteria, rules and procedures will be contained in the agreement between the Fund and the “institution.” Even if the contractual provisions of these agreements are standardized and the forms of the agreements are issued by decree or regulation so that they are available to the public, it will be difficult for developers, lending institutions and the prospective home buyers to understand all of the terms and conditions related to the development and financing of affordable housing projects. Therefore, it would be more appropriate and more transparent for these criteria, rules and procedures to be issued by the Fund as executive regulations so that developers and lending institutions can evaluate the business and financial feasibility of engaging in the development and financing of affordable housing.~~

~~6.the actions the Fund will take to facilitate securitization of affordable housing loans. A critical issue for lending institutions will be the ability to securitize affordable housing loans because private sector real estate lenders will not have the financial and managerial resources to carry and manage a portfolio of affordable housing loans. It is not reasonable to expect a real estate lender and third party guarantors to guarantee the performance of securities backed by affordable housing loans because of the risks associated with such loans. The GoE and the MHUUC should consider providing a government guarantee of real estate loan related securities collateralized by affordable housing loans similar to the Government National Mortgage Association (“GNMA”) guarantees offered in the United States.~~

~~Article (5) requires the Fund to pay 50% of the cost of providing utilities to an affordable housing project. These costs should be included in the development costs of the project and paid by the developer out of his own funds or out of the initial disbursement of loan proceeds on the development loan. There is no reason for the Fund to tie up its limited financial resources by paying infrastructure costs up front. It is strongly recommended that Article (5) be deleted in its entirety or replaced with a new Article (5) that clearly places the responsibility for payment of all costs of the development project, other than the land, on the developer. The role of the Fund should be limited to establishing, applying and enforcing the criteria, rules and procedures for approval of affordable housing projects to receive free land and reduced cost utilities.~~

~~Article (6) sets the maximum income limits for low income persons to be eligible for financing at LE 9,000 for single persons and LE 12,000 for married persons and persons with dependents.~~

~~The Report on Financing Low and Moderate Income Housing discusses in detail the income ranges in Egypt that are considered low and moderate income and the affordability of housing for these segments of the market. Based on the affordability analysis presented in the report, it is recommended that the MHUUC reconsider the LE 9,000 and LE 12,000 income limits to better reflect the income distribution by family size in Egypt and differences in income levels between urban and rural areas.~~

~~The current regulation does give preference to larger families, but this provision is too ambiguous. A schedule of maximum income limits by geographic area and family size should be issued. The maximum income limit for larger families should be higher than the maximum income limit for a married couple. It is also recommended that the executive regulations require the Fund to issue annual schedules of maximum income rather than setting the income limits in the regulations themselves so that the regulations do not have to be amended every year to reflect changes in family income.~~

~~Part II—Finance Agreement~~

~~ARTICLE 6—TERMS AND CONDITIONS OF STANDARDIZED AGREEMENTS~~

~~Provisions of the Law~~

~~Article 6 of the Law specifies the terms and conditions of a uniform real estate purchase agreement and requires the Minister of MHUUC to “issue a decree concerning the ‘Forms’ to be used in the agreements” for all types of real estate finance transactions authorized by the Law.~~

~~Provisions of the Executive Regulations~~

~~The current executive regulations do not include the “Forms” required by Article 6 of the Law. Without the standardized financing agreements, real estate lenders cannot begin making real estate loans under the Law. Therefore, the preparation of these agreements and the issuance of the decree by the Minister of MHUUC specifying the “Forms” of the agreements should have the highest priority.~~

~~Prior to its dissolution, the Ministry of Economy and Foreign Trade prepared draft financing agreements for purchase, construction on the investor’s own land and rehabilitation financing transactions. English translations of these agreements are included in Exhibit 1 of this report. These agreements omit certain key provisions, such as a guarantor as a signatory of the agreement, and should be reviewed and revised, as needed, by competent legal counsel. Exhibit 1 also includes a standard Murabaha financing agreement used by the Faisal Islamic Bank. This agreement includes some of the terms and conditions that are missing in the draft financing agreements. The statutory forms of the financing agreements should conform to the extent practicable within the limits of the Law to the financing agreements currently used by banks in Egypt for real estate secured loans. There are several essential terms of a real estate loan that should be standardized, at least for home loans, in the statutory forms of real estate financing agreements. Exhibit 2 of this report discusses some of the terms and conditions that should be considered in preparing the statutory real estate financing agreements.~~

Providing for a Return on the Financing

The most important and most problematic condition of the real estate financing contract is to provide the lender with a return on the funds advanced for the loan. Standard real estate financing agreements used around the world specify the interest rate the lender is charging the borrower on the loan. However, because of religious and cultural considerations in Egypt, the real estate loans under the Law cannot include an explicit interest rate and the draft financing agreements do not provide for a return on the loan. Obviously, no bank or real estate finance company is going to provide real estate financing if it cannot earn a market rate of return. Some method acceptable under Shari'a Law must be found to provide the real estate lender with a market rate of return on the funds advanced in a real estate financing transaction. This should be the highest priority for the MHUUC.

The current practice for financing real estate in Egypt varies depending on the entity providing the financing. The real estate banks do charge an explicit interest rate on the real estate loans they offer. Developers financing the sale of their units increase the price of the real estate being sold to provide a return. The Faisal Islamic Bank may resell the real estate to the buyer at a higher price than the purchase price paid to the seller to achieve a return on its investment and does assess a charge based on the return on its other investments in the case of delinquency.

Setting a price for the real estate above the cash price if financing is provided is not practicable for long term real estate loans because the financed price would be so much higher than the cash price that buyers would not be willing to accept the financing. An additional drawback of this method of providing a return on a loan is the distortion it would introduce into the market. The selling prices of real estate that will be used as the basis for real estate valuation would not be reliable measures of market value because of differences in the financing terms between otherwise comparable properties.

A method of Islamic real estate financing used in the United States and accepted by the government secondary mortgage market agencies is based on the computation of the return on a loan as implicit rent. The theory is that the lender's lien on the real estate being financed gives it rights to the benefits of the real estate in proportion to the ratio of the amount of the outstanding balance on the loan to the original purchase price of the real estate (i.e. loan-to-value ratio). Since the lender does not have possession of its share of the real estate, the borrower owes the lender compensation for his use of the lender's share of the property. The compensation agreed upon in the financing agreement is based on rents for comparable units in the locale in which the real estate being financed is located. The market rent is recomputed each year and the payment is adjusted accordingly. The implicit rent paid to the lender is equivalent to the prevailing interest rate on similar real estate loans. An amortization schedule is generated incorporating the implicit rent to arrive at the total monthly payment the borrower must make on the loan. As the buyer pays the principal installments on the loan, the lender's share of the rights in the property decline proportionately, the amount of the monthly payment allocated to payment of the implicit rent decreases and the amount allocated to repayment of principal increases. The result is full amortization equivalent to the amortization of a loan on which an explicit interest rate is charged.

Method of Computing the Payment of the Installments and the Return

Once a method has been adopted for providing a return to the real estate lender, the MHUUC must also specify a method (or methods) of calculating the installments of principal and the return on the loan. In the U.S. and most western countries, real estate loans are fully amortizing, level

~~payment loans. The equal payments are computed using a present value formula. However, in Egypt many real estate loans are level principal reduction loans in which the installment is constant, but the return is different for each payment or for each year's payment. The schedules shown in Exhibit 3 show the difference between a standard amortization schedule and the level principal reduction repayment schedule used by some Egyptian financial institutions.~~

~~The method of computing the payment schedule commonly used in Egypt results in an effective interest rate on the loan that is higher than the nominal interest rate. This is because the computation employs what is referred to as "add-on interest". Each year the interest for the year is computed based on the outstanding balance as of the end of the prior year. The annual interest is then divided by 12 months (or by 360 or 365 days) and the monthly interest thus computed is added to the level monthly principal installment. Since the outstanding balance on the loan is being reduced with each installment payment during a year, this method of interest calculation results in the borrower paying more interest on the loan than is actually due.~~

~~Payment Frequency~~

~~The frequency of payments also should be established in the statutory forms of the real estate financing agreements. Real estate financing agreements currently in use in Egypt employ different payment schedules – monthly, quarterly, semiannual or annual. The statutory real estate financing agreement for home loans should require monthly payments. The repayment provisions on commercial and development loans should permit repayment schedules to match the cash flows from the real estate being financed.~~

~~ARTICLE 7 – DISPOSING AND ENCUMBRANCE OF THE SECURITY REALTY~~

~~Provisions of the Law~~

~~Article 7 of the Law permits the borrower to dispose of the real estate pledged as security for a real estate loan by sale, gift or other means and to encumber the real estate with "any real right thereon" only if the lender gives prior approval to such disposition or encumbrance and, in the case where a new buyer plans to assume the original borrower's obligations under the real estate financing agreement, approves the assumption of the loan. Article 7 also gives the lender the right of prior approval and the right to require an assignment of rents and leases if the borrower leases the security realty to third parties.~~

~~Article 7 limits the basis for a lender's refusal to approve the sale or transfer of the security realty, the assumption of the real estate loan by the new buyer and the leasing out of the security realty to "serious reasons that would expose his (the lender's) interest and rights to risk."~~

~~The executive regulations are to establish the rules and procedures to be followed in each of the transactions listed in Article 7 of the Law.~~

~~Provisions of the Executive Regulations~~

~~Chapter Two, Articles (7) through (10) of the executive regulations deal with the transactions discussed in Article 7 of the Law.~~

Chapter Two: Disposal of the Collateral Property and Leasing Thereof, and Prepayment

~~Article (7)~~

~~The investor who desires to dispose with the collateral property, attach any encumbrances thereupon, lease thereof, or permit any person to solely occupy it shall have to obtain written financier's approval before effecting any disposal or conveyance or encumbrances of the collateral property. This shall be done by virtue of a written request addressed to the financier at least thirty days before taking any of the above actions.~~

~~Article (8)~~

~~Attached to the request for approval of disposal or attaching encumbrances shall be written declaration by the assignee or the person having title to the encumbrance to the effect of accepting subrogation on behalf of the investor with regard to all liabilities arising from the financing agreement. The financier may require the investor to lodge an undertaking to the effect of being jointly liable with the assignee to fulfill those obligations.~~

~~Article (9)~~

~~The financier may require the investor, in order to approve the investor's leasing the property or allowing occupation thereof by third party, to provide written declaration assigning interests in rent or consideration of occupancy to the financier, together with informing the lessee or the occupant with that assignment. This is in order to discharge the investor's dues to the financier according to the real estate financing agreement.~~

~~Article (10)~~

~~The financier shall not reject the request referred to in Article (7) above except for serious reasons that may endanger the financier's interests and rights. The financier shall communicate the reasons for rejection to the investor via registered mail with acknowledgment of receipt within thirty days from receiving the investor's request. Failure to respond shall be construed as approval on the financier's part of the request.~~

Analysis of the Executive Regulations

Articles (7) and (8) deal with disposition and encumbrance of the security realty and the assumption of the real estate loan by a third party. The only rules and procedures these articles establish that are not already in the Law are:

1. The financier's (lender's) prior approval must be in writing;

- ~~2. The investor (the borrower) must submit a written request to the lender to approve the disposition, assumption, encumbrance or lease of the security real estate at least thirty days before any such transaction can be effected;~~
- ~~3. The person assuming the real estate loan or the person to whom an encumbrance is granted must submit a written agreement attached to the written request of the investor “to the effect of accepting subrogation on behalf of the investor with regard to all liabilities arising from the financing agreement.”~~

~~These rules and procedures are not sufficient because they do not establish uniform terms and conditions and standard language for the required requests and agreements. Consequently, each lender could have its own form of agreement, or even a different agreement for every individual loan, with different terms and conditions. It is essential for the securitization of real estate loans that there be uniform terms and conditions for all agreements relating to the security realty so that there is no question about the rights of the parties in individual real estate financing transactions. As Article 7 of the Law requires, the executive regulations should specify the rules and procedures, not make general statements. Exhibit 4 of this report contains draft executive regulations that are specific in terms of the procedures to be followed for the disposition or encumbrance of the security real estate.~~

~~The executive regulations regarding assumption of a real estate loan must provide specific details about the procedures the parties must follow. For example, any person who wants to assume a loan should be required to meet the credit granting criteria established in the financing rules and the lender’s internal credit policies. The proposed new owner should be required to submit a loan application and all supporting documents as if he were a new borrower. The lender should be required to have the assumption of the real estate loan annotated on the inscription of the mortgage at the Real Estate Registration Office.~~

~~Article (9) merely repeats the language of the second paragraph of Article 7 of the Law. The only procedures established by the executive regulations are to authorize the financier to require a written assignment of the investor’s interests in the rents and lease payments generated by the security real estate and to require the investor to provide a written declaration that the tenants or lessees have been informed of the assignment. The executive regulations should set out the specific procedures and documents for an assignment of rents. Exhibit 6 of this report presents a draft executive regulation dealing with assignment of rents.~~

~~Article (10) of the executive regulations does not provide any more detail about the reasons for denial of a request for assumption of a loan, encumbrance of the security realty or leasing of the premises than is included in the third paragraph of Article 7 of the Law. The only procedure specified in Article (10) is that the written notice of the rejection of the request be delivered “via registered mail with acknowledgment of receipt thereof.” The executive regulations should spell out the conditions under which a lender can refuse a request from the borrower for approval of the transactions enumerated in Article 7 of the Law so that the lender cannot be arbitrary and capricious in its decision to approve or deny the request. The current executive regulations give little protection and no recourse to the borrower if his application is denied. His only recourse would be to bring a lawsuit against the lender in which he would try to prove that the approval of his request would not “endanger the financier’s interest and rights.”~~

~~The executive regulations relating to Article 7 of the Law also should require that the lender make full disclosure in plain language to every borrower at time of settlement of the loan of the~~

~~limitations on the borrower's rights to dispose of, encumber or lease the security realty. Each borrower should be required to sign a declaration that he has read, understood, and agrees to the terms and conditions for disposition, encumbrance and leasing of the security real estate.~~

~~ARTICLE 9—PREPAYMENT OF THE REAL ESTATE LOAN~~

~~Provisions of the Law~~

~~Article 9 of the Law permits the borrower to prepay all or any part of the real estate loan according to the rules to be determined by the executive regulations. The rules and procedures for prepayment of a loan are governed by the Civil Code for loans to individuals, and the Commercial Code for loans to juridical persons or individuals that are considered “commercial papers” under the Commercial Code.~~

~~Provisions of the Executive Regulations~~

~~Article (11) of the executive regulations deals with prepayment of a loan.~~

~~Article (11)~~

~~In the event of the investor's desire to effect prepayment in full or in part, the investor shall inform the financier three months at least before effecting prepayment. Due installments shall be discounted in accordance with the discounting table attached to the financing agreement specifying the discounted value paid according to the date thereof against the years of repayment of financing installments.~~

~~Analysis of the Executive Regulations~~

~~The executive regulations issued under the Law cannot supersede the rules for prepayment of debts contained in the Civil Code, the Commercial Code or any other Egyptian law. For example, Article 343 of the Civil Code states that the money paid by the debtor shall be applied first to pay expenses, then to pay interest due and last to the original debt, unless otherwise agreed upon by the debtor and the creditor. Unless the statutory real estate financing agreement provides otherwise, prepayments must be applied according to the Civil Code.~~

~~It is not reasonable to require a borrower to give three month's notice of his intent to make a partial prepayment of a loan if the amount of the prepayment is a relatively small percentage of the outstanding loan balance. The most common form of prepayment is where the borrower makes additional principal payments on the loan in addition to his scheduled installment payment. These additional principal payments usually would be nominal, perhaps several hundred Egyptian pounds.~~

~~The executive regulations should permit the borrower to make partial prepayment of the real estate loan up to a specified percentage, say 10% to 20%, without prior notice to the lender. There should be some prior notice requirement for larger partial or full prepayments, but three months seems excessive. One or two months notice should be more than adequate. The regulations also should require that the borrower is obligated to continue to make his regularly scheduled loan payments after he has given notice to the lender of his intent to prepay the loan. A proposed draft for an executive regulation dealing with the issues of prepayment is presented in Exhibit 7.~~

~~Article 11 requires that the loan payoff amount be computed as the discounted value of the remaining installments as of the date of payoff. This computation would apply only to a full prepayment of the loan. If the payments of the installment and the return on the loan are computed using a standard amortization formula, there would be no need to discount the remaining installments. The loan payoff amount would be the outstanding balance on the loan as of the last payment date before the loan payoff date plus the daily interest for the number of days from the last payment date to the loan payoff date. The computation specified in the regulations would not be applicable at all to a partial prepayment.~~

~~Part III : Registration of the Real Estate Security and Transference of Rights Resulting from the Finance Agreement~~

~~ARTICLE 10—REGISTRATION OF THE REAL ESTATE SECURITY~~

~~Provisions of the Law~~

~~Article 10 of the Real Estate Finance Law exempts registration of real estate rights under the Law from registration fees, specifies the time limits for processing an application for registration at the Real Estate Registration Office and requires written notification by registered mail of the Real Estate Registration Office’s decision regarding the application for registration. These provisions supersede conflicting provisions of the Law on Declaration and Notarization of Real Property Interests, No. 114 of 1946. However, the other rules and procedures contained in the Law on Declaration and Notarization of Real Property Interests remain in effect and cannot be superseded by the executive regulations issued under the Real Estate Finance Law.~~

~~The Law on Declaration and Notarization of Real Property Interests governs the registration of real estate and interests in real estate. Article 1054 of the Civil Code stipulates that the provisions of the Law No. 114/ 1946 regulating the Real Estate Registration Office applies to effecting, renewing, deleting and canceling the inscription of a mortgage interest. The procedures to register both title and mortgages or other lien rights in real estate involve a number of steps:~~

- ~~a. An application for the declaration of the contract including the identity and authority of the persons executing the document, the terms of the contract and the physical description of the property is submitted to the Real Estate Registration Office. The parties to the transaction must appear before a notary to validate their signatures to the contract. Since the real estate financing agreement may involve three or more parties, all signatories of the financing agreement will have to appear before the notary.~~
- ~~b. After accepting the application, the Real Estate Registration Office sends the application to the survey office to verify the property description. The survey office will actually survey the property and will issue a statement containing the legal description of the property, which is returned to the Real Estate Registration Office. This step is considered one of the main sources of delay in the real estate registration process. The one week time limit for approval or denial of an application for registration of real estate interests specified in the second paragraph of Article 10 of the Real Estate Finance Law begins “after ascertaining the accurate limits of the realty as described in the application and the~~

title deed.” Therefore, the time required to survey the security realty has not been shortened by the provisions of Article 10.

e. The application is returned to the Real Estate Registration Office where the notary will draw up the official declaration and all supporting documents and enter an inscription in the registry that the declaration has been accepted.

d. The declaration is then stamped and signed by the parties and the signatures verified by the notary, the declaration is entered into the Real Estate Registry and an official number is issued.

Article 10 states that executive regulations will be issued that will specify the information to be included in the application to be filed with the Real Estate Registration Office to register the official mortgage or other lien rights of the lender in the security realty. Article 10 does not address the case where collateral other than real estate has been pledged as security for a real estate loan.

Provisions of the Executive Regulations

Chapter Three, Articles (12) and (13) of the executive regulations sets out the information to be included in an application for registration of the real estate security at the Real Estate Registration Office and the procedures to be followed to register the real estate security.

Article (12)

The application for registering the real estate security shall be filed by the financier or the investor in accordance with the provisions of law to the Real Estate Registration Office within jurisdiction of which the property is located. The application shall include the following information:

A) Names and data pertinent to investor and financier.

B) The value of installments and guaranteed rights.

C) The expiry date for repayment of the price or financing installments.

Attached to the referenced application shall be the real estate financing agreement and the deed of title of the property in the name of the investor, or the financing collateral in the name of the financier.

Article (13)

The competent real estate registry shall verify the correctness of the property's boundaries and specifications as shown in the application for registration, together with the deed of title attached thereto. The registry may require the applicant to complete thereof in not less than three days.

Deciding upon the application or directing completion thereof should not exceed one week from the date of lodging thereof.

The only reason for rejection of the application for registration is the submittal of incomplete documents.

In all cases, the applicant shall be informed via registered mail with acknowledgement of receipt in accordance with the law, of accepting the application, direction to complete documents, or reasoned rejection.

Analysis of the Executive Regulations

~~Real estate loans secured by an assignment of an allocation certificate on land allocated to the borrower by the government or public authority may not be eligible for registration at the Real Estate Registration Office. If not, the MHUUC must ascertain how the lender's rights in the allocated land can be registered. If there is no existing law governing the creditor's rights in allocated land, the MHUUC must issue executive regulations stipulating the procedures to be followed in registering such rights.~~

~~Similarly, real estate loans secured solely by collateral other than real estate may not be eligible for registration at the Real Estate Registration Office since the lender does not have any right or interest in the real estate being financed. Since there is no system in Egypt for registration of lien interests in other collateral similar to the U.C.C. in the United States, the lender that accepts collateral other than real estate to secure a real estate loan must include provisions in the real estate financing agreement to protect its interest in the collateral pledged. The Real Estate Finance Law is silent on the requirements to register rights in other collateral, so the existing provisions of other laws will govern such transactions.~~

~~Article (12) states that the financier or the investor shall register the real estate security, in accordance with the provisions of law, but does not cite which law(s). Article 6 of the Real Estate Finance Law, item (F), says that the agreement between the lender and the buyer will stipulate that the buyer is required to record the lien on the security realty, but is silent on the duties of the investor and the financier in this regard for real estate financing agreements for other purposes.~~

~~The information specified in Article (12) to be included in the application for registration may not conform to the information requirements of the Law on Declaration and Notarization of Real Property Interests. In particular, there is no requirement for the application to include a legal and physical description of the security real estate. This information will be included in the real estate financing agreement and the deed of title attached to the application, but the application itself should include all of the basic information relating to the transaction:~~

- ~~a. The name and address of the financier and the name, surname and title of the person signing the application.~~
- ~~b. If the investor is a natural person the application shall also give his full name, profession and place of residence. If the investor is a juridical person, the application shall give the name and address of the juridical person. If the security realty being pledged as collateral for the real estate loan is owned by a person other than the investor, the full name, profession and place of residence of that person, if an individual, or the name and address, if a juridical person.~~
- ~~c. The date of the real estate financing agreement and the place of issuance.~~
- ~~d. The source, full amount and maturity date of the debt secured by the real estate.~~
- ~~e. An accurate description of the security realty.~~

~~Article (13) sets requirements for processing the application for registration that conflict with the provisions of Article 10 of the Law. The Law states that the Real Estate Registration Office may require the applicant to file all necessary information and documents "within a week from the date~~

of submitting the request.” Article (13) requires the applicant to complete the application “in not less than three days.” While three days is within one week, the intent of the Law to give the applicant up to one week to submit complete documents seems clear.

The second paragraph of Article (13) says that the decision on a complete application must be made within one week of filing of the application, but second paragraph of Article 10 of the Law states that the one week time limit will not begin until “after ascertaining the accurate limits of the realty as described in the application and the title deed.”

The third paragraph of Article (13) states that the only reason for rejection of the application for registration is the submission of incomplete documents, but Article 10 of the Law does not give the Cabinet of Ministers the authority to limit the reasons for refusing the request in an executive regulation. The Law states that “The decision refusing the request shall be substantiated.”

~~ARTICLE 11 — ASSIGNMENT OF RIGHTS IN REAL ESTATE FINANCING AGREEMENTS FOR SECURITIZATION; GUARANTEE OF SECURITIES; SERVICING OF REAL ESTATE LOANS; DISCLOSURE OF INFORMATION REGARDING THE REAL ESTATE FINANCING AGREEMENTS ASSIGNED~~

Article 11 of the Law addresses the issues involved in the securitization of real estate loans. The first paragraph states that the Ministry of Foreign Trade will issue the securitization regulations. The Report on Securitization of Real Estate Loans discusses the draft securitization regulations in detail. Paragraph one also requires the Minister of MHUUC, as the successor to the Minister of Economy and Foreign Trade, to issue a decree specifying the form of the purchase and sale agreement for securitization transactions.

Article 11 also requires the originator seller of the securitized real estate loans to guarantee the timely payment of interest and principal on the securities backed by the real estate loans sold. The executive regulations of the Law are to establish the rules for securing third party guarantees in addition to the guarantee of the originator seller.

The final paragraph of Article 11 provides that the originator seller can disclose information about the real estate loans being sold to the purchaser of the loans without obtaining the prior approval of the borrowers on the sold loans. The executive regulations will determine what information can be disclosed.

~~Provisions of the Executive Regulations~~

Articles (14) through (16) of the executive regulations address the issues raised in Article 11 of the Law.

~~Article (14)~~

~~The agreement of assignment of rights ensuing from the real estate financing agreement to the entity licensed to practice securitization activity, model of which shall be issued by virtue of a decision of the competent minister in charge of economic affairs, shall include the following:~~

- ~~A) Acceptance of the financier of assigning the interests thereof ensuing from the real estate financing agreement to the assignee.~~
- ~~B) The consideration assumed by the assignee in return of the assignment and discharging conditions.~~

- ~~C) Detailed statement of the assigned rights, including the relevant installments of each financing transaction and its collateral property, conditions of guarantee, and the information appertaining to the debtor.~~
- ~~D) The financier's obligation to collect the assigned installments in the capacity of an agent of the assignee in return for collection commission to be determined by the agreement.~~

~~Article (15)~~

~~Without prejudice to the financier's guarantee for discharging the rights ensuing from the securities, agreement may be made for third party guarantee of the rights ensuing from the securities issued by the securitization entity, provided that the credit rating thereof shall not be less than the rating specified by the Capital Market Authority, and that the guarantee shall cover all due installments and not to be qualified by whatever condition.~~

~~Article (16)~~

~~The financier shall disclose to the assignee of the debiting investors of the assigned rights, collateral provided, installments paid, dates of such payments, and instances of rejection to pay; obtaining the approval of those investors of disclosure is not necessary.~~

~~Analysis of the Executive Regulations~~

~~Article (14) states that the Minister of Foreign Trade will issue the decree specifying the form of the assignment agreement in a securitization transaction. However, it is the Minister of MHUUC who is the responsible minister.~~

~~Purchase and sale agreements for securitizations are quite complex documents. The simple provisions specified in Article (14) are not sufficient to cover all of the duties, warranties and representations required for the sale of loans for securitization. The MHUUC should try to obtain copies of purchase and sale agreements used in other countries to use as models for the assignment agreement.~~

~~Article (15) authorizes the use of third party guarantors for securitization transactions. The third party guarantees can be senior to the guarantee by the originator seller, putting the originator seller in a second or third loss position. However, Article (15) also requires that the third party guarantee "shall cover all due installments and not to be qualified by whatever condition." The Law does not require that the originator seller or third parties guarantee the timely payment of interest and principal on the underlying real estate loans, but, rather, on the securities backed by the real estate loans.~~

~~As discussed in detail in the Report on Securitization of Real Estate Loans, the credit enhancements commonly used in securitization transactions do not provide a 100% guarantee because the securities issued are backed by financial assets that generate cash flow and by real estate collateral. There is no need for each guarantor to provide a full guarantee. Credit enhancements in securitizations are usually layered, with different entities covering different risks. It is recommended that the last clause of Article (15) either be deleted or replaced with language that says that the third party guarantees can~~

~~cover a portion of the risk of loss. If necessary legally, the regulation could require that the total of all guarantee coverage by the originator seller and all third party guarantors equal 100% of the interest and principal repayment on the securities issued.~~

~~Article (16) should be more inclusive in the information that can be disclosed to a prospective purchaser of real estate loans in a securitization. All information about the borrower, any guarantors of the loan, the security realty, any additional collateral, the performance of the loan, delinquency and default rates and any other information relating to the real estate loans to be sold should be authorized for disclosure to a prospective purchaser of the loans without prior consent of the borrowers.~~

Part IV Execution on the Realty

Provisions of the Law

~~Articles 12 through 27 of the Law set out the procedures for execution on the security realty. There is no requirement that executive regulations be issued except in Article 16, relating to the qualifications and registration of execution real estate agents and their remuneration and Article 18, relating to determining the rules for computing the bid bond. If no special provision is prescribed in the Law, the provisions of the Civil and Commercial Procedure Law shall apply.~~

Provisions of the Executive Regulations

~~Chapter Four, Articles (17) through (26) deal with execution on the realty. There may be some question whether there is any statutory authority for most of these regulations and whether any of them conflict with the applicable provisions of the Civil and Commercial Procedure Law.~~

Article (17)

~~Foreclosure on the part of the financier against the collateral property shall not be entertained without officially notifying the investor or providing sufficient guarantee, as the case may be. The notice shall include:~~

- ~~A) Instructing the debtor either to discharge or provide sufficient collateral~~
- ~~B) Statement of the due installments or the collateral acceptable to the financier~~
- ~~C) Specifying a term for the investor to discharge or to submit sufficient collateral, provided that such term shall not be less than 60 days from the date of notification.~~
- ~~D) The investor shall be warned that non-response on his part throughout the term specified in the notice renders due all unpaid installments in accordance with the provisions of the real estate financing agreement.~~
- ~~E) Specifying chosen domicile of the financier.~~

Article (18)

~~Execution shall be initiated by notifying the investor, the assignee, the owner of the rights in rem, the lessee and the possessor of the property of the real estate financing agreement after inscribing the execution formula thereupon, together with summoning the investor to discharge. The notification shall include the following:~~

- A) ~~Statement of the date and place of inscribing the execution formula on the real estate agreement.~~
- B) ~~Summoning discharge of the outstanding amounts in full according to the provisions of the real estate financing agreement within a minimum of thirty days of the date of the notice summoning discharge.~~
- C) ~~Description of the property indicating the location, area, and boundaries thereof.~~

~~Article (19)~~

~~The financier shall notify the real estate registry under whose jurisdiction the property subject to execution falls of the real estate financing agreement after inscribing the execution formula thereupon and summoning the investor to discharge for the purpose of annotation on the book of entries of reality guarantees within a week of the date of notification. The financier shall inform all creditors having registered interests in the property and the possessor thereof of the agreement after inscribing the execution formula and summoning discharge. Failure to so doing shall render the summoning non-operative vis-à-vis those creditors and the possessor.~~

~~Article (20)~~

~~Annotation by the real estate registry on the writ of execution serves as registration of the warning of appropriation, and thus the property shall be deemed under attachment as of the date of such annotation.~~

~~Article (21)~~

~~The execution judge shall nominate a real estate agent from amongst those enrolled in the roster maintained by the authority for that purpose to proceed with the public auction, in accordance of Chapter Six herein. That agent shall have no direct or indirect interest in the sale, or with the financier or the investor.~~

~~The judge shall include in the order to proceed with the sale instructing the applicant for execution to deposit a bid bond for the account of the execution. Fixing that amount is the discretion of the judge.~~

~~Article (22)~~

~~The basic sale price of the property subject to execution shall be determined by two valuers listed in the roster of the Authority upon the request of the real estate agent. Valuation shall be subject to the following criteria:~~

- A) ~~The value of the property upon purchase.~~
- B) ~~The improvements incorporated after purchase of the property.~~
- C) ~~The effect of inflation rates on real estate market.~~
- D) ~~The current market value of similar properties within the same district or similar districts.~~

~~Article (23)~~

~~The real estate agent shall set, within fifteen days of the date of annotation of the execution writ on the registry book, the list of conditions of sale, which shall include the following:~~

- ~~A) Specifications of the property subject to execution, including area, location, boundaries thereof, and other relevant information that best describes it.~~
- ~~B) The date and place of inscribing the execution formula on the real estate financing agreement.~~
- ~~C) The date and place of annotation of the execution writ at the reality registry office.~~
- ~~D) Date, hour, and place of conducting sale auction.~~
- ~~E) Division of the property into multiple sale transactions, as the case may be, and stating the basic price of each~~
- ~~F) The deposit securing participation in the auction shall not be less than 1% of the basic sale price of the property and not exceeding 5% thereof.~~

~~Article (24)~~

~~The real estate agent shall, prior to proceeding with auction, ensure notifying all concerned parties within the time limits specified under Article (19) of the law of the list of conditions of sale and order of the offers and communicating same to the attendees.~~

~~Article (25)~~

~~The agent shall deposit the proceeds of sale at the court's treasury within three days of the issuance of the sale decision by the court.~~

~~Article (26)~~

~~The execution judge shall determine the fees of the agent based on the effort exerted thereby to complete sale procedures and the time consumed. Fees shall not exceed 3% of the auction sale price.~~

~~Analysis of the Executive Regulations~~

~~There is some question as to why the MHUUC determined that these executive regulations were necessary, since the Law sets out the procedures to be followed in an execution on the security realty. There may not be statutory authority for these regulations. Executive regulations relating to execution on the realty may be needed where the provisions of the Law are ambiguous or confusing or to define terms used in the Law. However, some of these regulations paraphrase the Law and add nothing to the provisions in the Law while others appear to diverge from the procedures established by the Law.~~

~~It is recommended that the provisions of the executive regulations dealing with execution on the realty be reviewed and revised, as necessary, by a lawyer with expertise in civil and commercial procedure law relating to execution on collateral.~~

~~Articles (21) and (26) attempt to satisfy the requirements for executive regulations in Articles 16 and 18 of the Law. The qualifications and registration procedures for execution real estate agents are discussed in detail in the Report on Real Estate Finance Companies, Real Estate Finance~~

~~Brokers and Execution Real Estate Agents.—It is appropriate for the regulations relating to execution on the realty to require that the agent have no direct or indirect interest in the sale, the financier or the investor.—Article (26) sets a maximum of 3% of the auction sale price for the remuneration of the execution real estate agent.—Within this limit, the amount of remuneration paid to the agent is at the discretion of the execution judge.~~

~~Article 18 of the law requires that the executive regulations determine the rules for computing the bid bond for bidders at the real estate auction.—However, Article (21) of the regulations leaves the computation of the bid bond to the discretion of the execution judge.—This provision does not seem to fully satisfy the requirement of the Law.~~

~~Article (22) should be revised to be consistent with the executive regulations on real estate valuation.—The criteria specified in Article (22) for computing the basic price of the real estate to be auctioned are not consistent with real estate valuation standards in effect in other countries.~~

~~Articles (23) and (24) should be reviewed carefully for consistency with the procedures set out in the Civil and Commercial Procedures Law.—In addition to the items listed, the conditions of sale should specify what evidence a bidder must submit to prove that he has the financial capacity to complete the purchase if he is the winning bidder.—Typically, a bidder has to provide a commitment letter from a bank or other financial institution to advance funds for the purchase of the real estate being auctioned.—It is not clear whether item (F) relating to the amount of the “deposit securing participation in the auction” refers to the bid bond mentioned in Article 18 of the Law or the minimum deposit a successful bidder must pay at the conclusion of the auction.—If this deposit is the bid bond, item (F) of Article (23) conflicts with Article (21).~~

~~Article (25) requires full payment and deposit of the auction sale price within three days of the judge’s ruling approving the sale.—Depending on the time between the date of the auction and the date ruling is handed down, three days may be an unreasonably short time for the purchaser at the auction to secure financing, especially if the real estate purchased is a commercial property or a real estate development.—The successful bidder should be allowed at least one, and probably two, weeks to secure the financing needed to complete the purchase.~~

Part V Real Estate Finance Companies

Provisions of the Law

~~Articles 28 through 34 of the Law deal with the licensing, financial criteria, reporting requirements and supervision of real estate finance companies.~~

Provisions of the Executive Regulations

~~Articles (27) through (37) of the executive regulations set out the specific criteria, rules and procedures for real estate finance companies.—Articles (27) through (35) of the executive regulations are discussed in detail in the Report on Real Estate Finance Companies, Real Estate Finance Brokers and Execution Real Estate Agents.—Articles (36) and (37) address the criteria and procedures for applications for the dissolution, sale of all or part of the assets and merger of real estate finance companies.—The provisions of Articles (36) and (37) are adequate and require no comment or analysis.~~

Real Estate Finance Guarantees

~~ARTICLES 35 AND 36 — THE REAL ESTATE ACTIVITY GUARANTEE AND SUPPORT FUND~~

Provisions of the Law

~~Article 35 authorizes the establishment of the Real Estate Activity Guarantee and Support Fund by Presidential Decree. The MHUUC has prepared a draft of the Presidential Decree. Article 36 enumerates the financial resources available to the Fund.~~

Provisions of the Executive Regulations

~~Chapter Seven, Articles (53) through (55) of the executive regulations and the draft decree establishing the Real Estate Activity Guarantee and Support Fund address insurance of real estate loans and real estate finance subsidies.~~

~~Article (53)~~

~~Low-income persons who would like to receive subsidy to buy a house should apply to one of the offices of the real estate financing guarantee and subsidy fund. This application should use the form designed for that purpose and should include the following:~~

- ~~(a) Description of the property and location thereof~~
- ~~(b) Letter from the seller of the property expressing approval of the sale~~
- ~~(c) Certificate from real estate valuers approving the offered price~~
- ~~(d) Certificate substantiating the annual income of the applicant~~
- ~~(e) Any other documents the fund may require~~

~~Article (54)~~

~~The fund shall study the application and shall decide thereupon within 30 days of receiving the application. The decision shall include, in the case of approval, specification of the subsidy percentage to be provided by the fund and the procedures and timing for concluding the contract with the objective to ensure provision of subsidy within a period not to exceed fifteen days from the date of accepting the application.~~

~~Article (55)~~

~~The fund guarantees discharge of installment payments that are in default because of unexpected reasons up to three installments as a maximum. The bylaws of the fund shall set the rules and procedures for proving and weighing of these reasons. Also the rules shall establish the ways by which the fund shall be reimbursed for the installments advanced.~~

~~The fund shall not replace any one investor in discharging the defaulted payments before the lapse of 5 years.~~

Analysis of the Executive Regulations

~~The issues of credit insurance and subsidizing low income housing loans are discussed in detail in the Report on Financing Low and Moderate Income Housing. The current executive regulations should not be implemented until the Fund has been established and capitalized and the Board of Directors of the Fund has had the opportunity to consider and adopt its policies and procedures for both insuring real estate loans and providing real estate finance subsidies.~~

~~The method of covering losses on insured loans by paying up to three delinquent installments on any given loan within a five year period is inherently flawed. This system provides perverse incentives to borrowers who will perceive that they have paid for the right to receive a government subsidy of three installment payments. As a senior officer of a large Egyptian insurance company stated, there is a 100% probability that all insured borrowers will default on three installments to take advantage of the loan insurance benefits provided by the Fund.~~

~~Mortgage and other forms of credit insurance are widespread and models with a history of default and loss experience are readily available. It is unwise for Egypt to experiment with an unproven method of insuring lenders against loss on the loans they originate. The real estate loan insurance offered in Egypt should be the standard form of insurance or guarantee, with the guarantee fund covering a specified percentage or all of the outstanding amount of a loan in the event of default or covering all or part of the loss the lender sustains on the sale of the real estate in an execution procedure.~~

~~The issues of loan guarantees and subsidies require substantial research and analysis. To rush into poorly structured guarantee or subsidy programs could lead to disaster.~~

ARTICLE 37—LIFE INSURANCE

Provisions of the Law

~~Article 37 gives the lender the right to require that the borrower obtain insurance against death or disability with the lender named as beneficiary on the policy (ies).~~

Provisions of the Executive Regulations

~~Article (56) of the executive regulations set out the conditions relating to the life and disability insurance policies authorized in Article 37 of the Law:~~

~~Article (56)~~

~~In the event that the financier requires the investor to hold insurance with the benefit accruing to the financier at the value of its rights in accordance with the real estate financing agreement against the risks of death or disability, this insurance shall be concluded with an Egyptian insurance company according to the following provisions:~~

- ~~1. The insurance company shall pay the amount of insurance to the beneficiary based on a certificate of death of the investor or a medical certificate substantiating full or not less than 50% disability. This certificate should be issued by one of the~~

medical institutions that are specified by the insurance company in agreement with the authority.

2. The investor shall be under obligation to pay the premiums and provide proof of payment thereof.

Analysis of the Executive Regulations

The Egyptian Insurance Supervisory Authority (EISA) has already approved two forms of the life insurance authorized by Article 37 of the Law. One policy will pay off the total outstanding balance of a real estate loan, up to the policy limit and the other will take over the payments on the loan upon the death of the insured borrower. The insurance companies are not willing to write disability insurance because of past poor experience with such policies. Therefore, although the Law authorizes a lender to require the borrower to obtain disability coverage, no Egyptian insurance company currently is offering such coverage. Given this situation, the executive regulations should say that a lender may only require the borrower to obtain disability insurance if such insurance is generally offered by Egyptian insurance companies at a “reasonable and customary” cost. In other words, the lender cannot require that a borrower purchase a policy that is not available or is available only at an excessive premium rate.

Article (56) of the executive regulations establishes some of the conditions of insurance. The issuance of regulations under the Real Estate Finance Law governing insurance creates a potential conflict of jurisdiction between the Real Estate Finance Affairs Authority and EISA. Conditions of insurance by Egyptian insurance companies are clearly within the supervisory jurisdiction of EISA. The only conditions that should be imposed by regulations issued under the Real Estate Finance Law are those relating to the relationship between the lender and the insured borrower.

Another issue is the ability of the lender to assign its interest as the beneficiary in life insurance policies to a purchaser of real estate loans in a securitization. The insurance laws and regulations must authorize assignment of the lender’s rights without the insured borrower having to name a new beneficiary.

Because of these issues, it is recommended that Article (56) of the executive regulations be deleted in its entirety and replaced with a new Article 56, a draft of which is presented in Exhibit 5 of this report. The insurance regulation that is adopted should be reviewed by EISA and any conflicts with the insurance laws and regulations should be resolved before the final regulation is issued.

ARTICLE 38—REAL ESTATE FINANCE BROKERS

Provisions of the Law

Article 38 requires that any person acting as an intermediary between a prospective borrower and a lender must be registered with the Real Estate Finance Affairs Authority. Executive regulations shall establish the qualifications, rules and procedures for registration with the Authority.

Provisions of the Executive Regulations

Chapter Six, Articles (39) through (43) set out the qualification criteria for real estate finance brokers and the procedures for registration with the Authority. These are discussed in detail in the Report on Real Estate Finance Companies, Real Estate Finance Brokers and Execution Real

~~Estate Agents. Articles (49) through (52) of the executive regulations address the practices of real estate finance brokers.~~

~~Article (49)~~

~~The broker shall hand the applicant for financing a copy of the form set by the authority showing all the key conditions of the financing agreement and should explain all the terms and the risks associated therewith. The investor should sign a statement that he has received a copy of the agreement and has read it before signing the agreement; this statement shall be enclosed with the real estate financing agreement.~~

~~Article (50)~~

~~The financier will fix the fees of real estate financing broker, provided that the fees should not exceed the limit set by the board of directors of the authority.~~

~~Article (51)~~

~~It is prohibited for the broker to receive any payment, commission or any interest that is related to his work except from the financier who commissioned him to endeavor to have a contract concluded.~~

~~Article (52)~~

~~The broker has to make entries in his books of all transactions performed thereby and shall maintain relevant documents and provide the parties to the agreement and the authority certified copies thereof.~~

Analysis of the Executive Regulations

~~The qualifications set for real estate finance brokers in the executive regulations are too low and the registration procedures do not require the applicant to demonstrate any knowledge of the law, regulations and real estate financing practices. Recommendations have been made for more appropriate qualifications and procedures in the applicable section of the Report on Real Estate Finance Companies, Real Estate Finance Brokers and Execution Real Estate Agents.~~

~~Article (49) of the executive regulations is in error because it only applies to real estate finance brokers. All real estate lenders, not just real estate finance brokers, must provide the borrower with a form setting out the terms and conditions of the real estate loan.~~

~~Article (50) requires the board of directors of the Authority to set maximum fees for real estate finance brokers. There is some question as to why the Authority should be setting fees for private contractual relationships, although this practice is common in Egypt. Article (51) is a standard condition for real estate finance brokers, although some laws and regulations permit the broker to accept payment from other parties if such payments are fully disclosed. The main questions raised by Article (52) dealing with record keeping by the broker are which parties should hold the original executed copies of the documents and why the Authority should maintain a file of copies of all of the documents relating to real estate financing transactions.~~

~~ARTICLE 39 — DISCLOSURE OF TERMS AND CONDITIONS OF REAL ESTATE LOANS~~

Provisions of the Law

~~Article 39 requires the Authority to prepare a consumer disclosure form explaining in plain language all of the terms, conditions and obligations of the borrower in a real estate financing transaction. All banks and real estate finance companies engaged in real estate lending and all real estate finance brokers must give each applicant a copy of this disclosure form. The borrower must sign a declaration that he has read and understands the terms, conditions and obligations explained in the disclosure form. A copy of that declaration must be attached to the real estate financing agreement.~~

Provisions of the Executive Regulations

~~Article (49) should be corrected to include all real estate lenders, not just real estate finance brokers. This article merely restates the provisions of Article 39 of the Law. It does not include the disclosure form required by the Law. Preparation of the disclosure form is the responsibility of the Authority, not the MHUUC.~~

~~ARTICLE 40 — MONTHLY LOAN STATEMENTS~~

Provisions of the Law

~~Article 40 requires the lender to provide monthly loan statements to the borrower. Monthly statements are appropriate only for loans where the payments are made on a monthly basis. The executive regulations are to specify the contents of the loan statements.~~

Provisions of the Executive Regulations

~~Article (57) of the executive regulations sets out the content of the monthly loan statements.~~

~~Article (57)~~

~~The financier shall inform the investor of the following on a monthly basis:~~

- ~~A)The value of the original principal financing plus the total costs due for this principal from the beginning of financing through the full repayment.~~
- ~~B)The value of installment payments made to the financier and the costs thereof through the statement date.~~
- ~~C)The value of the installments and costs of financing outstanding~~
- ~~D)Any charges, expenses or costs that have been deducted from the account of the investor even though it is for the performance of an agreement condition, a court judgment or in accordance with the law.~~
- ~~E)Any change in the address of the financier where the investors payments should be made~~
- ~~F)Any change in the costs of financing.~~
- ~~G)Any other information that came to the knowledge of the financier that may affect the real estate guarantee thereof.~~

Analysis of the Executive Regulations

~~The regulation should state that the lender or servicer will mail the loan statement to the borrower within a specified number of days after the end of each calendar month and that the lender or servicer shall not charge the borrower any fee for preparation and delivery of the monthly loan statement. If the borrower requests the lender to provide him with loan statements more frequently than monthly, or if the borrower requests a replacement or duplicate loan statement or a loan statement certified by an officer of the lender or servicer, the lender or servicer should be able to charge a commercially reasonable fee for these services.~~

~~In addition to the items listed in Article (57), the monthly loan statement should show the loan number or other means of identifying the loan, the statement date, the date the last payment was received, any delinquent payments and any partial prepayments of the principal due on the loan. The loan statement also should include a statement informing the borrower that if he thinks there is an error in his loan statement, he must notify the lender or servicer in writing within a specified period of time after the statement date and giving the name of the individual or the department and the address where the borrower must send his notice of an error in the statement and a telephone number where the borrower can ask questions about his statement.~~

~~ARTICLE 41—COMPLAINT DEPARTMENT~~

Provisions of the Law

~~Article 41 requires that a department be established within the Authority to receive and process complaints. In the Report on the Real Estate Finance Affairs Authority, it was recommended that complaint departments be established within the real estate finance department and the valuation department because the laws and regulations governing these two areas of supervision and the technical expertise required to process a complaint are different. If such a structure would not be in compliance with Article 41, a single complaint department with divisions for real estate finance, valuation and other complaints should be established.~~

Provisions of the Executive Regulations

~~Articles (58) through (60) of the executive regulations address the procedures for filing and processing complaints:~~

~~Article (58)~~

~~The authority shall establish a department to receive complaints and study these complaints against those who deal with real estate financing and this office shall have a sufficient number of officers.~~

~~Article (59)~~

~~The complaint should be filed in writing by the concerned party or its agent and shall be recorded in a special log designed for that purpose against a receipt that shows the date of entry and the number thereof in the log.~~

~~Article (60)~~

~~The office shall notify the complainant of the results of the study of the complaint and the procedures taken within fifteen days of submittal thereof.~~

~~The office shall prepare a semiannual report to be submitted to the board of directors of the authority including the number and topics of complaint and decisions taken and the office's remarks and recommendations.~~

Analysis of the Executive Regulations

~~In Article (58) it should be made clear that “those who deal with real estate financing” includes real estate valuers. The procedures for filing and processing complaints against real estate valuers are discussed in detail in the Report on Real Estate Valuation. Complaint forms for the different classes of individuals and institutions supervised by the Authority should be prepared and provided to persons wishing to file a complaint. The complaint procedure should provide for an administrative hearing and appeal to the Board of Directors of the Authority.~~

Part VI Control

ARTICLE 43—ACCESS TO RECORDS

Provisions of the Law

~~Article 43 of the law authorized any interested party to have access to the registers, reports, documents and other papers of the Authority relating to real estate financing activity by paying a fee to the Authority. The Authority, however, may not provide access to records and documents that would violate the laws on the confidentiality of information.~~

Provisions of the Executive Regulations

~~Article (61) of the executive regulations specifies the fees the Authority will charge for copies of records and documents.~~

~~Article (61)~~

~~Any concerned person has the right of access at the authority to the files, documents and reports and all other documents relevant to the business of real estate financing and also to receive official extracts therefrom, in accordance with article 43 of the law, against a charge of LE 50 for viewing and LE 10 for each page of the official extracts of the documents with a maximum total charge of LE 100.~~

Analysis of the Executive Regulations

~~The executive regulations do not make any reference to the confidentiality of information or to the circumstances in which disclosure of information would be “likely to impair the real estate finance activity or encroach on the public interest.” There is some information that should not be made available to the public. For example, enforcement actions and criminal investigations frequently are not public records. Documents that contain confidential personal and financial information about borrowers, registered professionals and officers and directors of real estate finance companies also should not be disclosed to the public. The Board of Directors of the Authority should consider what information should not be made public and issue an executive regulation listing such confidential information.~~

Section VIII

Real Estate Finance Affairs Authority

Introduction

The Real Estate Finance Law, No. 148 of 2001 mandated the establishment of the Real Estate Finance Affairs Authority to control and supervise real estate finance companies, real estate valuers, real estate financing brokers and execution real estate agents and to further the development of an efficient real estate finance system in Egypt.

Presidential Decree No. 277 of 2001 delegated to the Authority most of the power to establish policies and procedures relating to real estate finance that had been vested in the Ministry under the Real Estate Finance Law.

As of mid-June, 2002, the Chairman and most of the members of the Board of Directors of the Real Estate Finance Affairs Authority have been appointed, but the Authority has not begun operations.

Since only the Chairman-designate and the representatives of the Central Bank of Egypt and the Capital Market Authority on the proposed Board of Directors of the Authority will have expertise in business, financial institutions and financing activities, the Minister of Housing should appoint experts in banking, and especially real estate lending, to fill the open positions on the Board of Directors.

Depending on the number of real estate finance companies, valuers, loan brokers and real estate execution agents registered with the Authority, the Authority could be financially self-sufficient. The organizational structure and function descriptions proposed by the Ministry are sound. Several changes have been recommended to incorporate the proposed expanded activities of the Authority in the area of real estate valuation and to eliminate and combine several functions. Because of the specialized technical knowledge involved in real estate valuation and the importance of real estate valuation not only to real estate finance, but to the Egyptian economy as a whole, it is recommended that a Real Estate Valuation Advisory Board be established to advise the Board of Directors of the Authority on matters relating to real estate valuation standards, qualification of real estate valuers and certification examinations.

Establishment of the Authority

The Real Estate Finance Law, No. 148 of 2001, Article 2, mandated that:

An authority concerned with real estate finance affairs shall be established and attached to the Minister of Economy and Foreign Trade. A decree of the President of the Republic shall be issued concerning its formation and determining its powers.

In September 2001, Presidential Decree No. 277 of 2001 was issued setting out the purpose, powers and duties of the “Real Estate Finance Affairs Authority”. The purpose of the Authority is:

To control real estate finance affairs, supervise the proper implementation of its law, monitor its activity and control, work on its development and take the procedures and measures ensuring the efficiency of its marketing and maintenance of dealers' rights. (Article 2)

Powers of the Authority

Presidential Decree No. 277 of 2001 delegated to the Authority most of the power to establish policies and procedures relating to real estate finance that had been vested in the Ministry of Economy and Foreign Trade, and its successor, the Ministry of Housing, Utilities and Urban Communities, under the Real Estate Finance Law.

Article 3. The Authority, toward achieving its purposes, shall be concerned with the following:

Drawing the general policies to be applied as required in directing the real estate finance activity, in light of the provisions of the Real Estate Finance Law.

Preparing and holding tables wherein shall be recorded the names of the valuation experts referred to in the said law, and supervising their activity.

Preparing and holding a register wherein shall be recorded the names of the real estate agents prescribed in the said Law, and supervising their activity.

Preparing and holding a table wherein shall be recorded the names of the real estate brokers prescribed in the same law, and supervising their activities.

Issuing permits for real estate companies to exercise their activity, monitoring their works, and exercising their control thereof.

Issuing final resolutions in requests for merger of real estate companies, discontinuing their works, or liquidating the whole or the largest portion of their assets.

Preparing models of the real estate finance basic conditions

Enabling all concerned parties to access and review the registers, reports, documents and other papers available with the Authority and connected with the real estate finance activity or obtaining official excerpts thereof, subject to the provisions of laws re-organizing the confidentiality of information and according to the rules and procedures to be determined in the executive regulations of the foregoing law, and against the duty to be determined in these regulations.

Providing and publishing adequate information and data on the real estate finance activity.

Current Status

~~In November 2001, the Ministry of Economy and Foreign Trade was dismantled and the powers and responsibilities for implementing the provisions of the Real Estate Finance Law and Presidential Decree No. 277 were transferred to the Ministry of Housing, Utilities and Urban Communities ("MHUUC").~~

~~As of mid June, 2002, the Chairman and most of the members of the Board of Directors of the Real Estate Finance Affairs Authority have been appointed, but the Authority has not begun operations.~~

The MHUUC has prepared a draft amendment to Presidential Decree No. 277 specifying up to sixteen members of the Board of Directors of the Authority. These are:

1. Chairman of the Authority (Chairman of the Board)
2. Deputy Chairman of the Authority
3. New Housing Societies Organization representative
4. Housing and Utilities representative at the MHUUC
5. General Organization for Building and Housing Cooperatives representative
6. Central Bank of Egypt representative
7. Ministry of Justice representative
8. Real Estate Activity Guaranty and Support Fund representative
9. Ministry of Planning representative
10. Ministry of Finance representative
11. Capital Market Authority representative
12. State Council representative
13. Maximum of four experts to be appointed by the decree of the Minister of Housing, Utilities and Urban Communities

Only the Chairman-designate and the representatives of the Central Bank of Egypt and the Capital Market Authority will have expertise in business, financial institutions and financing activities. It is recommended that the Minister of Housing appoint experts in banking, and especially real estate lending, to the Board of Directors. The Board also should retain experts to advise it in specific technical areas such as accounting, securities and financial analysis. In the report on valuation, the ~~project consultant~~ team recommends the establishment of a Real Estate Valuation Advisory Board to provide the Board of Directors with the required expertise in real estate valuation

Funding the Authority

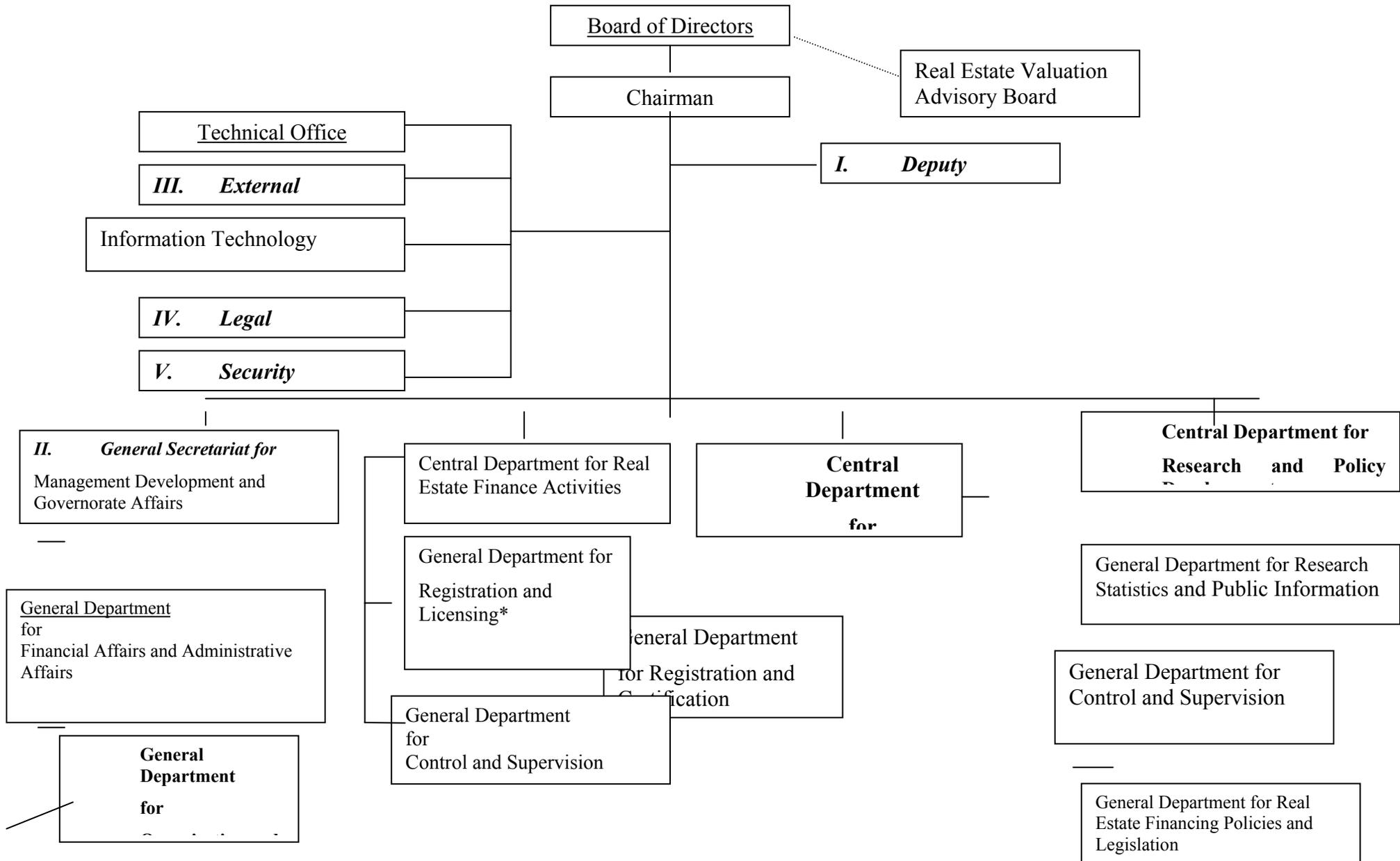
The Authority will be funded from several sources, a State budget appropriation, registration and enforcement fees, charges for the services provided by the Authority, loans and grants from Egyptian and foreign donors and income earned on investment of the Authority's funds. Depending on the number of real estate finance companies, valuers, loan brokers and real estate execution agents registered with the Authority, the Authority could be financially self-sufficient. Many financial institution and real estate supervisory authorities in other countries are self-funding.

Most officials interviewed during this project expect there to be only a few real estate finance companies, perhaps ten or fewer. Based on the experience of other countries that have real estate valuer professional certification requirements, and the proposed qualification criteria for Egyptian real estate valuers, Egypt can anticipate that during the first few years, about 1,800 to 2,000 people will qualify and register with the Authority as real estate valuers. There is no way to estimate the number of loan brokers who will register with the Authority. However, since there will be few real estate finance companies and most of those that are created will be affiliated with Egyptian banks and/or developers who will refer prospective borrowers to the real estate finance companies, there may be only 1,000 or fewer people who register with the Authority as loan brokers. There should be even fewer real estate execution agents registered with the Authority since the only business of a real estate execution agent is to conduct real estate execution proceedings.

Organization of the Authority

The MHUUC prepared a proposed organization chart and schedule of functional descriptions and asked the project team to review and comment on both. The organizational structure and function descriptions proposed by the Ministry are sound. Several changes have been proposed by the project team to incorporate the proposed expanded activities of the Authority in the area of real estate valuation and to eliminate and combine several functions. The organization chart *follows* and functional descriptions recommended by the project team are presented ~~on the following pages~~ *in Annex 3*. No changes were made in the structure of the administrative functions because the team assumed that this structure was typical for Egyptian public authorities. The most significant change made by the team was the addition of a Real Estate Valuation Advisory Board.

Real Estate Finance Affairs Authority



Function Descriptions of the Real Estate Finance Affairs Authority

Board of Directors

The affairs of the Authority will be directed by its Board of Directors: “the Board of the Authority shall be deemed as the supreme power dominating its affairs, the disposition of its matters and the proposition of the general policies applied thereto.” The executive regulations specify that the Board of Directors also perform several specific duties:

1. Approval or denial of applications for licensing as a real estate finance company (Article 32);
2. Setting the rules for estimation of the fees real estate valuers may charge their clients (Article 48);
3. Setting a maximum limit for the fees a real estate lender can pay a real estate financing broker (Article 50).

It may be advisable to have the Chairman of the Authority approve or deny applications for licensing and for dissolution, merger or sale of all or the majority of the assets of real estate financing companies so that an applicant whose application has been denied can appeal the decision to the Board of Directors, whose decision would be final. If the Board denies an application, the appeal process would have to be an arbitration or administrative law procedure.

The Real Estate Valuation Advisory Board

Because of the specialized technical knowledge involved in real estate valuation and the importance of real estate valuation not only to real estate finance, but to the Egyptian economy, it is recommended that a Real Estate Valuation Advisory Board be established. The purpose of the Real Estate Advisory Board is to advise the Board of Directors on matters relating to real estate valuation standards, qualification of real estate valuers and certification examinations. The Board of Directors of the Authority or the Minister of Housing should give serious consideration to setting up the Advisory Board before the Authority is fully operational so that work could begin on designing Egyptian professional standards for real estate valuation. The introduction of Egyptian professional standards for real estate valuation is one of the most important contributions the Ministry of Housing, Utilities and Urban Communities could make to the development of a sound real estate finance system.

Chairman of the Authority

The Chairman of the Authority will be responsible for managing the affairs of the Authority and for implementing the provisions of the Real Estate Finance Law, No. 148 of 2001, and its executive regulations and decrees, Presidential Decree No. 277 and the policies, procedures and directives approved by the Board of Directors. With the exception of the Deputy Chairman, who will be appointed by the Minister of Housing, Utilities and Urban Communities, the Chairman will appoint the heads of each department of the Authority. He will also represent the Authority before the Court and with third parties. The Chairman should approve or deny all applications for licensing as a real estate finance company or for dissolution, merger or sale of all or the majority of the assets of a real estate finance company.

Deputy Chairman

~~The Deputy Chairman will be appointed by the Minister of Housing, Utilities and Urban Planning and shall serve as the Chairman of the Authority in the absence of the Chairman. The Deputy Chairman will assume such duties and responsibilities as the Chairman may delegate to him.~~

Offices Reporting to the Chairman

~~Five offices will report directly to the Chairman: technical office, external relations, information technology, legal and security.~~

General Secretariat for Management Development and Governorate Affairs

~~The General Secretariat is responsible for the administrative functions of the Authority, included budget, financial management, human resources, coordination of the activities of any branches of the Authority the governorates and training and management development of the Authority's personnel.~~

Central Department for Real Estate Finance Activities

~~The Central Department for Real Estate Activities has two principal functions: 1) registration and licensing of real estate finance companies, loan brokers and execution real estate agents; and 2) the control and supervision of real estate finance companies, loan brokers and execution real estate agents. The Department will be responsible for implementing the policies and procedures approved by the Board of Directors relating to the activities of the entities and persons under its jurisdiction. The Central Department will consult with the General Department for Real Estate Financing Policies and Legislation with respect to the Authority's policies, procedures, reporting requirements and other matters related to the entities under the jurisdiction of the Central Department.~~

~~The Head of the Central Department will be responsible for making recommendations to the Chairman for approval or denial of applications for licensing, dissolution or merger of real estate finance companies or the sale of all or a majority of a real estate company's assets. The Head of the Central Department will take all necessary actions related to the enforcement of the Real Estate Finance Law and shall make recommendations for disciplinary actions and/or penalties to the Chairman and the Board of Directors.~~

General Department for Registration and Licensing

~~The General Department for Registration and Licensing will receive and process applications for a license as a real estate finance company and registration as a loan broker or execution real estate agent. The head of the department will make recommendations to the head of the Central Department regarding approval or denial of applications. The General Department will receive, process and make recommendations for approval or denial of applications for changes in the authorized activities of and the merger, closure or sale of all or significant part of the assets of real estate finance companies. The General Department will maintain current lists of all entities registered with it and shall make such lists and other information available to the public, and provide officially stamped copies thereof, in accordance with the policies and rules adopted by the Board of Directors~~

General Department for Control and Supervision

~~The General Department for Control and Supervision will supervise the activities of real estate finance companies, loan brokers and execution real estate agents. The Department will review the financial statements of real estate finance companies for compliance with the financial criteria established by the executive regulations and the Board of Directors and will make on-site inspections of such companies as needed. The General Department will receive and investigate complaints against the entities under the jurisdiction of the Department. The Department will recommend such disciplinary actions as it determines are appropriate to the Head of the Central Department.~~

Central Department for Real Estate Valuation

~~The duties of the Central Department for Real Estate Valuation are discussed in detail in the report on real estate valuation. The Central Department for Real Estate Valuation will be responsible for the registration, certification and supervision of real estate valuers. The Department also will receive and investigate complaints from the public about real estate valuers and make recommendations to the Chairman and the Board of Directors of the Authority for disciplinary action. The Department will provide valuers, users of valuations and the public with information about real estate valuation standards, qualification of real estate valuers, the code of ethics and complaint processing and adjudication procedures. The Department also will provide technical support and staff in the area of real estate valuation to the Chairman and the Board of Directors of the Authority and the Real Estate Valuation Advisory Board.~~

General Department for Registration and Certification

~~The General Department for Registration and Certification will receive and process applications for registration and certification of real estate valuers according to the procedures established by the executive regulations or approved by the Board of Directors, oversee the administration of certification examinations, maintain a list of the names and addresses of people registered or certified as real estate valuers, retain records and all application materials filed with it and make such lists, records, materials and other information available to the public, and provide officially-stamped copies thereof, in accordance with the policies and rules adopted by the Board of Directors.~~

General Department for Control and Supervision

~~The General Department for Control and Supervision will be responsible for enforcement of the rules relating to real estate valuers established by the executive regulations and the Board of Directors. The General Department will provide for expert review valuers to evaluate disputed valuations. The General Department will establish administrative procedures for receiving and processing complaints from the public against real estate valuers. The Department will provide information to the public about real estate valuation standards and valuation review and complaint procedures~~

Central Department for Research and Policy Development

~~The Central Department for Research and Policy Development will prepare studies and research relating to real estate finance and valuation and will collect the statistics and other data required for such studies and research. The Central Department will make recommendations to the Chairman and the Board of Directors about the policies, procedures and standards to be adopted~~

by the Authority. The Central Department will review such policies, procedures and standards to ensure consistency with overall Egyptian economic policy. The Central Department will develop informational materials for the public relating to real estate finance, real estate valuation and the rules, regulations and procedures administered by the Authority.

General Department for Research, Statistics and Public Information

The General Department for Research, Statistics and Public Information will collect, analyze and disseminate data, statistics and information on the activities of the Authority and will conduct studies and research based on such data, statistics and information, including periodical statistical reports and newsletters. The Department will document, classify and index all data, information, statistics and documents in a manner that permits easy retrieval, access and usage thereof. The Department will prepare and publish information for the public relating to the activities, rules and procedures of the Authority relating to real estate finance and real estate valuation.

General Department for Real Estate Financing Policies and Legislation

The General Department for Real Estate Financing Policies and Legislation will develop policies and procedures for approval by the Chairman and the Board of Directors relating to real estate financing activities, the financial and other criteria for real estate finance companies, the basic conditions of real estate finance, the standardized forms to be used in real estate finance and other issues as directed by the Chairman or the Board of Directors. The Department will prepare any proposed legislation and executive regulations or amendments to legislation and executive regulations necessary for the performance of the duties of the Authority or to reflect changes in the Egyptian economy, the real estate and real estate finance markets and related laws and regulations.

Section IX

Real Estate Valuation

Introduction

Real estate valuation is essential to the development of a sound real estate finance market, to privatization and to more transparent financial reporting in Egypt. Real estate valuation standards should be correctly applied and supervised. This can be accomplished in Egypt by the establishment of: 1) professional standards of valuation and valuation methodology; 2) qualification criteria for real estate valuers in terms of education, technical knowledge and skills; 3) a code of ethics; and 4) effective supervision of the real estate valuation profession.

The provisions of the executive regulations issued by the Ministry of Housing, Utilities and Urban Communities (“MHUUC”) in December, 2001, relating to real estate valuation are not sufficient and do not conform to standards of real estate valuation and real estate valuer qualification requirements in use around the world.

In order to fully implement the intent of the Real Estate Finance Law, the Real Estate Finance Affairs Authority (“the Authority”) should issue new executive regulations setting out: 1) more stringent qualification criteria for real estate valuers; 2) requirements for the examination of applicants to ensure that registered or certified valuers have the technical knowledge required to prepare reliable real estate valuations; and 3) standards for real estate valuation, including a code of ethics, that are consistent with well established professional real estate valuation practices. Proposals for revised executive regulations for real estate valuation are presented in this report.

The Authority should evaluate the different real estate valuation standards in use in other countries and incorporate those principles and practices of real estate valuation most suitable for the Egyptian market into standards of valuation practice for Egypt. This task will require technical expertise in accounting, the real estate market for residential and commercial properties, real estate valuation practices in other countries, current real estate valuation practices in Egypt and the sources, availability and reliability of real estate market data. The Authority should seek assistance from one or more of its valuation supervisory counterparts in other countries and from international real estate valuation SROs.

The principal impediment to the implementation of Egyptian Valuation Standards is the lack of reliable information on the selling prices, terms and conditions of real estate sales. The Authority could provide a valuable service to the Egyptian real estate market if it could collect data on real estate sales and make the data available to real estate valuers and real estate lending institutions.

It may be necessary for the Authority to issue temporary certifications of real estate valuers until the professional education and examination requirements have been implemented.

It is recommended that the registration, certification, control and supervision of real estate valuers will be under the jurisdiction of the Central Department for Real Estate Valuation. The Head of the Central Department will report directly to the Chairman of the Authority. The Central Department will have two divisions: the General Department for Registration and Certification and the General Department for Control and Supervision.

Because real estate valuation involves a high degree of specialized knowledge and skills, it is recommended that the Minister of Housing or the Board of Directors of the Real Estate Finance Affairs Authority appoint a Real Estate Valuation Advisory Board to advise the Board of Directors and the Central Department for Real Estate Valuation on matters relating to real estate valuation standards, qualification of real estate valuers and certification examinations.

Detailed information and recommendations regarding real estate valuation requirements in Egypt are presented in Annex 4.

The Importance of Reliable Real Estate Valuation

Real estate valuation is essential to the development of a sound real estate finance market, to privatization and to more transparent financial reporting in Egypt. Reliable valuations of real estate prepared by certified valuers according to standards of real estate valuation consistent with those applied in Europe, the U.K. and the United States can reduce the risk involved in real estate transactions by assigning credible market values to real estate. All participants in the market should be able to understand the methodology applied and have an assurance of consistency in valuation. Real estate valuation standards should be correctly applied and supervised. This can be accomplished in Egypt by the establishment of: 1) professional standards of valuation and valuation methodology; 2) qualification criteria for real estate valuers in terms of education, technical knowledge and skills; 3) a code of ethics; and 4) effective supervision of the real estate valuation profession.

International Development of Professional Standards for Real Estate Valuation

Real estate valuation principles and techniques have been practiced around the world for many years, primarily for valuing real estate collateral for bank loans, valuing real estate assets in estates and establishing real estate sales prices. However, the development of real estate valuation as a profession is a more recent phenomenon, arising out of the recognition that competent, objective and professionally prepared real estate valuations are required for sound real estate lending, reliable financial reporting and corporate valuation and a variety of other business activities.

The real impetus for the development of professional standards of real estate valuation and educational and experience qualification criteria for valuers was the series of financial crises in a number of countries in the 1980s and 1990s. The United States, Japan, Thailand and Malaysia experienced periods when real estate prices escalated to unsustainable levels and then collapsed. The savings and loan crisis in the United States in the early 1980s was largely due to lending based on unrealistically high, and frequently fraudulent, real estate values. The Japanese real estate market has yet to recover from the excesses of the 1980s. In 1997, the over-inflated real estate bubbles in Malaysia and Thailand burst, contributing to the financial crises in those countries.

One response to these financial crises has been the establishment of real estate valuation standards and educational and professional qualification criteria for real estate valuers enforced by government agencies or self-regulating organizations (“SROs”). In the United States, the government passed a law that real estate valuations relating to lending transactions by any federally insured financial institution must be prepared in accordance with the Uniform Standards

of Professional Appraisal Practice (“USPAP”). These real estate valuations have to be prepared by valuers licensed or certified by one or more of the fifty state real estate appraiser certification boards. In order to be licensed or certified, a real estate valuer must satisfy specific educational, experience and continuing education requirements.

Other countries have adopted valuation standards and codes of ethics for professional valuation practice. In some countries these standards and codes were written into law or regulation while in others, SROs were created to adopt and enforce valuation standards. The largest and most important of these real estate valuation SROs are the Royal Institution of Chartered Surveyors (“RICS”) in the UK, whose valuation standards have been codified in its *Appraisal and Valuation Manual* (the RICS “Red Book”) and The European Group of Valuers’ Associations (“TEGoVA”), consisting of the national real estate valuation associations of several European countries, whose real estate valuation standards are set out in its *Approved European Property Standards* (the “Blue Book”). Real estate valuer professional associations in Canada, Australia and Latin America also have adopted uniform standards of valuation practice. In 1981, The International Valuation Standards Committee (“IVSC”) was established to harmonize the different real estate valuation standards being applied around the world. The IVSC published standards in 1985 and in the years 1994 through 1997. These standards were revised and supplemented as part of the IVS 2000 project and the first edition of the IVSC’s *International Valuation Standards* (“IVS” or the “white Book”) was published in 2000.

Real Estate Valuation in Egypt

Prior to the enactment of the Real Estate Finance Law, No. 148 of 2001, there were no requirements in Egyptian law or financial institution regulations that real estate valuations be performed according to standard procedures or that the people preparing the real estate valuations meet any qualification criteria. Real estate valuations have been performed by a number of professionals, including engineers, university professors and the valuation staffs of the commercial banks. The recent decline in the real estate market has revealed the weakness of a system without standards. All of the public and private sector officials interviewed during this project emphasized the need for Egypt to establish real estate valuation and qualification standards for real estate secured lending.

The Real Estate Finance Law requires that real estate valuations be performed by real estate valuers registered with the Real Estate Finance Affairs Authority (the “Authority”). The Authority is to establish the valuation standards and qualification criteria for registered real estate valuers. The executive regulations issued by the Ministry of Housing, Utilities and Urban Communities (“MHUUC”) in December, 2001, set general education and experience criteria for registration with the Authority as a real estate valuer but did not establish any requirement that real estate valuers demonstrate knowledge of and expertise in real estate valuation principles and practices. The regulations established some general requirements for real estate valuation practice, including valuation criteria (Article 45), conflict of interest (Article 46), review valuation in the case of dispute (Article 47) and valuation fees (Article 48). The valuation criteria established by the regulations are not sufficient and do not conform to standards of real estate valuation in use around the world.

Article (45). The valuers shall, upon conducting valuation of the property, comply with the criteria provided for in Article (22).

~~Article (22). Valuation shall be subject to the following criteria:~~

- ~~The value of the property upon purchase.~~
- ~~The improvements incorporated after purchase of the property~~
- ~~The effect of inflation on the real estate market~~
- ~~The current market value of similar properties within the same district or similar districts~~

~~In order to fully implement the intent of the Real Estate Finance Law, new executive regulations should be issued setting out: 1) more stringent qualification criteria for real estate valuers; 2) requirements for the examination of applicants to ensure that registered or certified valuers have the technical knowledge required to prepare reliable real estate valuations; and 3) standards for real estate valuation, including a code of ethics, that are consistent with well established professional real estate valuation practices.~~

Real Estate Valuation Standards for Egypt

Appropriateness of Models from Other Countries

~~Existing international real estate valuation standards can serve as models for an Egyptian standard of professional real estate valuation practice. However, the characteristics of real estate markets, valuation practice and valuation concepts, terminology and methodology vary from country to country. For example:~~

- ~~1. Differences in the availability and quality of market data;~~
- ~~2. Use of real estate valuations in financial accounting. In the UK real estate valuers work closely with accountants and auditors on financial reporting, whereas in the U.S. and Canada, real estate valuation and accounting are totally separate procedures;~~
- ~~3. Definition of market value. In some countries, the valuer establishes a “market value” based on the actual facts of the transaction, while in others, including the United States, the valuer establishes a “fair market value” that disregards transaction-specific factors~~
- ~~4. Valuation concepts. In some countries market value means “market value under existing use”, while in other countries market value means “market value under highest and best use.”~~

~~The Authority should evaluate the different real estate valuation standards in use in other countries and incorporate those principles and practices of real estate valuation most suitable for the Egyptian market into standards of valuation practice for Egypt. This task will require technical expertise in accounting, the real estate market for residential and commercial properties, real estate valuation practices in other countries, current real estate valuation practices in Egypt and the sources, availability and reliability of real estate market data. The Authority should seek assistance from one or more of its valuation supervisory counterparts in the other countries and from international real estate valuation SROs.~~

~~It also is important for the real estate valuation standards adopted by the Authority to be consistent with Egyptian Accounting Standards and, where applicable, International Accounting Standards (“IAS”). The Authority should have Egyptian accounting experts review the valuation standards it proposes before the standards are issued.~~

Fundamental Real Estate Valuation Standards

Real estate valuation standards address several issues: 1) the definition of market value; 2) valuation methodology; 3) the content of valuation reports; and 4) a code of ethics and professional practice for real estate valuers.

1. Definition of Market Value for Valuation Purposes

Egyptian real estate valuation standards should be based on the fundamental principles of real estate valuation. The first step is to define “market value” for purposes of the valuation.

a. “Market Value” or “Fair Market Value”

The accounting concept of “fair value” and the valuation concept of “market value” are similar, but not identical concepts. In many cases, the fair value of the real estate may be equivalent to the market value, but in some situations, it is not, because the market value may be influenced by the specific circumstances of the transaction for which the valuation is being prepared. For example, the selling prices of real estate may differ due to the availability of financing, sales concessions or other terms and conditions of the sale. The selling price of a house or flat in a cash purchase usually is less than the selling price of the same house or flat if the seller is financing the purchase. In the case of valuing new construction, the question is whether the market value should be based on the building that is actually being built, even if it contains “over improvements” desired by the owner or purchaser for which the general market would not pay full cost, or on standard construction. For income producing real estate, the fair market value also incorporates projections of future cash flow based on assumptions of “stabilized occupancy,” not the current occupancy.

U.S. valuation standards are based on the “fair market value” of the real estate, which is defined as:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of ownership from seller to buyer under conditions whereby the buyer and seller are typically motivated to consummate the sale, both parties are well informed or well advised and acting in what they consider their own best interest, a reasonable time is allowed for the offer of the real estate on the open market, payment is made in terms of cash or customary financial arrangements and the selling price of the real estate is not affected by special financing or sales concession granted by anyone associated with the sale

b. Value Under Existing Use or “Highest and Best Use”

The value of real estate can be based on “market value under existing use” or the “market value under highest and best use”. The market value under existing use is a relatively simple concept, the value of the real estate as it is currently being used, even if that use is not the best use of the real estate. The concept of highest and best use involves assumptions by the valuer about which use of the subject real estate, “from among reasonably probable and adequately supported

alternative uses is legally permissible, physically possible, financially feasible and maximizes the utility” of the real estate.

Land value is usually valued based on the highest and best use of the property as if vacant and ready for development. Improvements are valued according to how their existing uses contribute or detract from the value of the land. For example, under highest and best use, the market value of a single family home built on a parcel of land in a prime urban location would be estimated as the sum of the value of the land as if it were developed for a higher use, such as an office building, plus the value of the house (or minus the cost of removal of the house). If the land were valued under its current use as a single family residence, the valuation would understate the price a buyer would be willing to pay for the land if he could develop it as a commercial property. However, if the house located on the land is an historic building that could not be demolished, the real estate would have to be valued under its existing use because its highest and best use is not legally permissible.

Valuation Methodology

The next element of valuation standards is uniform valuation methodology. The valuation of real estate involves three methods of valuation: 1) the Comparable Market Value (CMV) [sales comparison] method; 2) the cost method; and 3) the income method. The CMV method compares the subject real estate to similar, recently sold properties; the cost method computes the market value of the land on which a building is situated and adds to it the cost of the building; the income method applies a rent multiplier or discounts the projected future cash flows from the subject real estate to arrive at a market value. The three valuation methods are explained in detail in the various real estate valuation manuals and texts that are generally available. A list of sources for valuation standards information is provided in Exhibit 8.

Selection of the most appropriate valuation method to apply depends on the type of real estate being valued and the market conditions for the subject real estate. In some cases, all three methods should be applied to arrive at separate estimates of market value. The valuer would then arrive at a final estimate of market value based on the three separate value estimates. For non-income producing real estate, the valuer may use only the CMV method or both the CMV and cost methods. The income method is less meaningful for non-income producing real estate because the valuer would have to impute the income generating capacity of the real estate in order to compute a market value using the income method. Proposed standard forms applying the CMV and cost methods of valuation for use in real estate valuation in Egypt have been developed as part of the project. These forms are included in Exhibit 9.

Valuation of Non-income Producing Private Residences

For non-income producing private residences, the market value should be established by the residential Comparable Market Value (CMV) [sales comparison] method. The CMV method computes a market value for the subject real estate by comparing it to similar units that have been sold recently. The market prices for comparable units are the actual sales prices of similar residential units in the same or proximate location as the subject real estate. The valuation should be based on at least three (3) sales of comparable units sold within not more than the prior twelve (12) months. In an active real estate sales market, the comparable sales should have occurred within the most recent three (3) months. Additional comparable sales may be considered if they

~~contribute significantly to understanding the real estate valuer's final determination of the fair market value of the subject real estate.~~

~~As a general rule, the real estate valuer uses the actual sales price of the comparable unit in the valuation. If the real estate valuer is unable to obtain information on the actual sales price of a comparable unit, but has knowledge of the asking price and the actual completion of the sale, the asking price may be used in the valuation and adjusted for market conditions accordingly.~~

~~The valuer should make adjustments to the sales prices of the comparable units to reflect the differences between the comparable units and the subject real estate. Adjustments are also made to reflect financing and sales concessions. If the subject real estate is superior to the comparable, the sales price of the comparable should be adjusted upwards and if the subject real estate is inferior to the comparable, the sales price of the comparable should be adjusted downward. The following adjustments are usually made to the sales prices of the comparable units:~~

- ~~1) Location: If the subject real estate is a unit in a multi-unit structure or project, at least one of the comparable sales should be situated outside the structure or project that contains the subject real estate. The sales comparables for units outside the structure or project in which the subject real estate is located should be within 5 blocks (and not more than 1 kilometer) of the subject real estate. If the comparables are located within one block of the subject real estate, no adjustment for location would be required.~~
- ~~2) Site and View: Adjustments should be based on their influence on the sales price, due to the appeal of the site, view, lot size, floor in a multistory building and topography of the subject real estate relative to the comparable.~~
- ~~3) Construction Quality: Adjustments should be based on differences in the quality of construction between the subject real estate and the comparables, including the quality of construction of the structures in which the subject real estate and the comparables are situated and the interior finishing quality of the individual units. Construction quality includes the types of materials and construction methods used as reflected by the cost less accrued depreciation, adjusted for market acceptance.~~
- ~~4) Age: Adjustments should be based on the effective age of the subject real estate and the comparables, which may also be considered as part of the condition adjustment.~~
- ~~5) Condition: If the subject real estate is new construction, condition adjustments should be based on information contained in the listings of the comparables, inspection of the comparables, interviews with knowledgeable parties and other data sources. If the subject real estate is not new construction, adjustments should be made for remodeling, upgrading, including electrical and plumbing systems, and other maintenance items that effectively improve the overall condition of the real estate. The estimated cost to cure deficiencies should be the basis for adjustments for inferior condition. Market studies and depreciated costs should be the basis for adjusting for superior condition.~~
- ~~6) Market Trends: Adjustments should be made for temporary speculative market trends that have inflated real estate prices to levels that are not sustainable.~~
- ~~7) Sales or financing concessions: Adjustments should be made for any costs usually paid by the buyer that the seller agrees to pay, any discount offered by the seller or any financing costs paid by the seller to reflect the effect on the sales price as indicated by~~

the market. Adjustments should also be made if the buyer is assuming the seller's real estate loan or is refinancing an existing loan or sales contract.

Most of the adjustments are based on the real estate valuer's judgment and experience, not statistical data. As a result, two qualified real estate valuers are unlikely to arrive at the same market value for a given piece of real estate. As the real estate valuation profession develops in Egypt, there should be more consistency in the value adjustments made. The Authority could make a significant contribution to the regularization of value adjustments by collecting sales data and conducting statistical analyses of those data to arrive at reasonable ranges for the different adjustment factors.

The valuer uses the adjusted selling prices of the comparable sales to arrive at a market value for the subject real estate. The valuer does not simply average the adjusted comparable selling prices, but weights each comparable according to his judgment about which comparable is most similar to the subject real estate.

b. Valuation of Small Investment Real Estate

For small investment rental real estate, that is, small residential, commercial or mixed-use real estate affordable to individual investors, the valuer must analyze at least three investment real estate comparables. The investment real estate comparables should be similar to the subject real estate in terms of the use of the property: residential, commercial or mixed use. They should be located within 5 kilometers of, the subject real estate and should accurately represent the market for the units in the subject real estate. The valuer should include a schedule of the subject real estate's actual current rents and estimated market rents. The valuer should reconcile the adjusted sales prices of the comparable sales according to the manner in which such investment properties sell in the market area. The valuer also should indicate what factors typical investors in the market area consider when purchasing similar investment real estate.

Valuation of Investment Real Estate

If the subject real estate is larger income-producing real estate, whether residential, commercial or mixed-use, the income method of valuation should be used in addition to the CMV method. Valuation by the income method can be by discounted cash flow (DCF) or comparable rent multiplier (CRM). The value of the subject real estate using the CMV method should be used primarily to support the valuer's final determination of the market value of the real estate, but should not be weighted as heavily as the market value determined by the income method in the final estimate of value.

The discounted cash flow (DCF) method is based on the expected net income (the rental income less maintenance and administrative expenses) of the subject real estate discounted over a specified time period or over the expected economic life of the real estate. The time period over which the cash flows will be discounted will depend on the intended holding period of the entity purchasing or constructing the improvements on the real estate. If the real estate will be held for a limited period and then sold, the valuer must calculate a residual value of the real estate at the end of that period. The discount rate used in the DCF method should be based on a market interest rate. In Egypt, the interest rate on longer-term bank deposits is the most appropriate discount rate. The discounted cash flow method is appropriate for all types of investment real estate.

The comparable rent multiplier (CRM) method applies the ratio of the selling price of comparable investment real estate to the gross revenues from the comparables expressed as a multiple to the projected gross revenue of the subject real estate to estimate the market value of the subject real estate. This method is appropriate only for residential investment real estate and should not be used for mixed-use or commercial real estate.

d. Valuation of New Construction and Special Purpose or Unique Real Estate

The valuation of new construction and real estate that is unique because of its use, style or construction method may utilize the cost method of valuation. The cost method should not be used as the principal valuation method for other types of real estate. The cost method must include proper adjustments to the construction cost for physical depreciation of the structure and/or the individual unit. A valuation report that relies solely on the cost method should not be acceptable for determining the market value for the purpose of real estate lending.

Impediments to Implementation of Egyptian Valuation Standards

The principal impediment to the implementation of Egyptian Valuation Standards is the lack of reliable information on the selling prices, terms and conditions of real estate sales. In other countries, valuers obtain real estate sales data from their professional associations, real estate sales professional associations and public records, in jurisdictions where the sales price of the real estate must be registered in the real estate registration records. The Authority could provide a valuable service to the Egyptian real estate market if it could collect data on real estate sales and make the data available to real estate valuers and real estate lending institutions. Information about the parties to the transactions would have to be kept confidential, but data could be coded to protect the privacy of the parties and still disclose the relevant information needed to prepare reliable real estate valuations.

The Real Estate Valuation Report

In addition to valuation methodology standards, the Real Estate Financial Affairs Authority should specify the form and content of Valuation Reports.

Form of the Valuation Report

Real estate valuation reports should be prepared on the valuation forms specified by the Authority. A real estate valuation report should be dated not more than 60 days prior to the date of the real estate financing agreement for which the valuation report is being prepared. The valuer must certify that the information in the report is accurate, internally consistent, fully supported and sufficiently documented.

Information to be Provided by the Parties

The parties to the real estate transaction should be required to provide the following information on the subject property, as applicable, to the real estate valuer:

- a. An accurate survey or other acceptable legal description of the property
- b. The complete real estate financing agreement

- e. Income and expense statements, property leases and a list of any movable property items that are included in the transaction, and
- d. Any other information that may materially affect the value or marketability of the property.

Description of the subject real estate

The real estate valuer should be required to inspect the exterior and interior areas of the subject real estate and provide a complete description of the subject real estate and the immediate neighborhood. Model forms for recording property inspection data for homes and commercial or residential investment real estate prepared for use in Egypt are included in Exhibit 9. The real estate valuation report should include, as appropriate, surveys, architectural plans, a sketch or plan of the layout of the subject real estate, including the dimensions and estimates of the gross area of the unit(s) being financed, the gross area of the building in which the unit(s) are located and the number and types of rooms contained in each unit within the subject real estate. Photographs of the subject real are recommended.

Real estate valuation reports for development projects, construction of buildings on land owned by the borrower and on real estate that requires repair, alteration or completion, should include the plans and specifications for such development, construction, repairs or alterations.

Contents of the Valuation Report

The real estate valuation report must be sufficiently descriptive to enable the reader to ascertain the estimated market value of the subject real estate and the rationale for the estimate and provide sufficient detail and depth of analysis to reflect the complexity of the real estate being valued. The valuation report should contain supporting documentation with all pertinent information reported so that the valuer's logic, reasoning, judgment and analysis in arriving at his value conclusion indicate to the reader the reasonableness of the market value reported. Any personal property, fixtures or intangible items that are movable property but are considered in the valuation should be listed, described and appropriately valued.

A Uniform Residential Valuation Report and a Residential Comparable Rent Analysis form for small residential income real estate that have been designed for use in Egypt are included in Exhibit 9. As the proposed Uniform Residential Valuation Report demonstrates, the real estate valuation report should include the following sections:

Description of Subject Property

This section of the report should clearly identify the subject real estate by providing a complete address and legal description. The sales price, contract date and loan charges paid by or sales concession made by the seller must be stated as set out in the real estate financing agreement.

Neighborhood Section

This section should contain an accurate description of the subject neighborhood and the factors that influence the market value and marketability of real estate located in the neighborhood. The information presented in the neighborhood section must be consistent with and support the conclusions reached by the valuer. Unfavorable factors presented in

~~the neighborhood section require the valuer to address the impact of those factors on the value and marketability of the subject real estate.~~

Site Section

~~This section must accurately describe the physical characteristics of the site and the specific unit(s) being financed. The valuer should address the quality of construction of the structure, the floor plan(s) of the individual unit(s), amenities, availability of parking and any other features of the building or project that would materially affect the selling price or marketability of the subject real estate.~~

Comments Section

~~The comment section should include any other information the valuer believes would have a material effect on the selling price or marketability of the subject real estate.~~

Estimate of Value

~~The market value of the subject real estate as estimated by one or more of the three valuation methods discussed in this chapter.~~

Reconciliation

~~If the valuer has used more than one of the three valuation methods to estimate the market value of the subject real estate, the valuer must reconcile the estimates computed to determine a final market value estimate. The reconciliation must contain the conditions and assumptions of the valuation on which the final estimate of market value is based.~~

Final Estimate of Market Value

~~The valuer must arrive at a final estimate of the market value of the subject real estate, state the effective date of the value estimate, sign the valuation report and provide his registration number.~~

Unacceptable Real Estate Valuation Practices

The following should be considered unacceptable real estate valuation practices:

- ~~a. Inclusion of inaccurate or incomplete data about the subject real estate, the neighborhood or any comparable sale used in the valuation.~~
- ~~b. Failure to report and/or consider any factor that has a material adverse effect on the value and/or the marketability of the subject real estate.~~
- ~~c. Reliance on comparable sales data provided by interested parties to the transaction, without independent verification.~~
- ~~d. The use of adjustments for differences between the subject real estate and the comparable sales that do not reflect the appropriate market reaction to such differences or the failure to make proper adjustments when they are clearly necessary.~~

Deficient Real Estate Valuation Reports

Real estate valuers must be responsible for any deficiencies in their reports. A deficient report should be returned to the valuer for correction. Changes to a real estate valuation's estimate of value should be permitted only as a result of a review conducted by an appropriately qualified registered review real estate valuer with a class of certification equal to or higher than that of the valuer who prepared the valuation.

Code of Ethics and Professional Practice

Real estate valuers not only have to follow standard valuation methodologies in performing real estate valuations; they must conform to the highest standards of ethics and professionalism. All real estate valuation standards include a code of ethics to ensure the integrity of real estate valuations. A proposed code of ethics for Egypt is presented in Exhibit 10.

Registration and Certification of Real Estate Valuers

The Need for Professional Qualifications

A well-functioning real estate market requires a base of professional valuation skills. Training, examination and certification programs can ensure the professional expertise, integrity and responsibility of real estate valuers. In Egypt, the Real Estate Finance Affairs Authority has the responsibility for ensuring that real estate valuers are well qualified and properly supervised.

International Experience

There is no consistent international treatment for the registration of real estate valuers. The table on the following page shows the number and number per million of population of real estate valuation professionals in selected developed and emerging markets.

— THE REAL ESTATE VALUATION PROFESSION IN SELECTED COUNTRIES

COUNTRY	NUMBER OF VALUERS	NUMBER OF VALUERS PER MILLION POPULATION
BRAZIL	5,000	29.39
CZECH REPUBLIC	5,500	535.37
FRANCE	1,750	29.74
GERMANY	8,000	97.38
HONG KONG	1,084	159.46
KOREA	1,724	36.47
MALAYSIA	500	21.50
MEXICO	3,000	30.62
SINGAPORE	519	129.71

UNITED KINGDOM	20,000	334.79
UNITED STATES	80,000	284.14

SOURCE: INTERNATIONAL VALUATION STANDARDS COMMITTEE

Qualification Criteria for Egyptian Real Estate Valuers

The Egyptian government has recognized the importance of having qualified professionals perform real estate valuations. The Real Estate Finance Law, No. 148 of 2001 requires that all real estate valuers be registered with the Real Estate Finance Affairs Authority and that executive regulations be issued to establish the criteria for such registration. Section One of Chapter 6 (articles 38 through 43) of the executive regulations issued by the Ministry of Housing, Utilities and Urban Communities in December, 2001, dealt with the qualification criteria and registration procedures for real estate valuers. A number of comments were made by private and public sector entities about these criteria. Most of the commenters believed the qualification criteria were too liberal. Some stated that there should be technical expertise requirements in addition to the general education requirements. These comments and the recommendations of the project team have been incorporated into the proposed revised Section One of Chapter 6 of the executive regulations presented in Exhibit 4.

Classes of Certification

The proposed executive regulation establishes four classes of real estate valuers, registered assistant valuers and classes "A", "B" and "C" certified valuers, based on different qualification criteria. The registered assistant valuer class is included to permit recent university graduates in the eligible fields of study to gain the professional experience needed to become certified real estate valuers. The classes of certified valuers are based on an escalating scale of technical expertise to be demonstrated by passing examinations for certification and recertification. Class C certified valuers would be authorized to value only individual residential units. Class B certified valuers would be authorized to value individual residential units and small (under LE 5 million) development projects and investment real estate. Class A certified valuers would be authorized to value any type of real estate.

The Department shall provide for the registration or certification of natural persons in four classes of real estate valuers:

"Class A Certified Valuer"—a person registered with the Department who is certified as qualified to issue valuation reports for any type of real estate

"Class B Certified Valuer"—a person registered with the Department who is certified as qualified to issue valuation reports only for residential, commercial or mixed-use real estate having a value of less than LE 5,000,000

~~“Class C Certified Valuer”—a person registered with the Department who is certified to issue valuation reports only for individual dwelling units having a value of less than LE 1 million~~

~~“Registered Assistant Valuer”—a person registered with the Department who is authorized to perform valuation services only under the supervision of a certified valuer.~~

~~No person may use the title “certified real estate valuer” or any abbreviation or words to that effect, or issue a valuation report in connection with any real estate transaction under the Real Estate Finance Law No. 148 of 2001, unless such person is certified for the applicable class of certification by the Department. However, the work upon which a valuation report is based may be performed by a registered assistant valuer if the report is approved and signed by a certified valuer.~~

Educational Requirements

~~All applicants for registration as real estate valuers with the Real Estate Finance Affairs Authority should be required to have a university degree in a field of study relevant to real estate valuation.~~

~~Any person desiring to act as a registered assistant valuer or as a certified valuer must make application in writing to the Department in such form and detail, as the Department shall prescribe. Each applicant must be at least 21 years of age and hold a university degree in one of the following academic fields:~~

~~For All Classes of Certification:~~

- ~~Urban Planning~~
- ~~Civil Engineering~~
- ~~Mechanical Engineering~~
- ~~Construction Engineering~~
- ~~Architectural Engineering~~
- ~~Planning and Development~~

~~For Class “B”, “C” and “Registered Assistant Valuer” certification only, unless additional specified technical courses have been successfully completed:~~

- ~~Architectural Design~~
- ~~Business Administration~~
- ~~Economics~~
- ~~Accounting~~

Professional Valuation Education

~~Initially, all applicants for registration and/or certification should be required to successfully complete at least 60 classroom hours of professional education on real estate valuation principles and practices, ethics and Egyptian real estate valuation standards.~~

~~In addition to the academic education requirements for registration and certification, each applicant must have successfully completed, prior to the filing of his application, at least 60 classroom hours, inclusive of examination, of instruction in the principles of real estate valuation. The required curriculum to be included in such instruction shall be specified by a decree issued by the Authority. The required instruction shall be offered by a recognized Egyptian or foreign valuation organization, university, college, technical school, training institute or a governmental entity. Successful completion means certification by the institution providing the instruction of the applicant's completion of 60 classroom hours of instruction and receipt of a passing grade on an examination. The Valuer Examination Committee of the Valuation Advisory Board shall recommend what constitutes a passing grade on an examination.~~

~~Upon the recommendation of the Real Estate Valuation Advisory Board, the Authority may, by decree, establish continuing profession education and examination requirements for renewal of registrations or certifications and for certification of the different classes of valuers.~~

~~The project team is not recommending minimum hours for continuing professional education or experience. The Authority may want to adopt continuing education requirements in the future when Egyptian institutions of higher education and technical training institutes add real estate valuation courses to their curricula. These continuing education criteria may be satisfied by existing classes offered for degree programs. Applicants should be required to submit an official transcript from the institution of higher education or other evidence of successful completion of classes that satisfy the continuing education requirements the Authority may establish.~~

Examination for Certification and Recertification

~~In Egypt, qualification for professional certification is by examination. Qualification procedures for real estate valuers should be consistent with the qualification procedures for other professions. Every applicant for certification, including applicants to become registered assistant valuers, will be required to pass an examination testing his knowledge of the technical skills required for performing the real estate valuations authorized by the class of certification for which he is applying. In addition, every five years real estate valuers will have to pass a recertification examination in order to be recertified.~~

~~To be registered or certified as a valuer, or to renew a registration or certification, the applicant must demonstrate, by passing a written examination, at a minimum, that he or she possesses:~~

- ~~(1) A knowledge of technical terms commonly used in real estate valuation.~~

- ~~(2) An understanding of the principles of land economics, real estate valuation processes, reliable sources of valuation data, and problems likely to be encountered in the gathering, interpreting, and processing of data in carrying out valuation disciplines.~~
- ~~(3) An understanding of the standards for the development and communication of real estate valuations as provided in this executive regulation~~
- ~~(4) An understanding of the types of misconduct for which disciplinary proceedings may be initiated against a certified valuer, as set forth in this executive regulation~~
- ~~(5) Knowledge of the theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate valuation that are appropriate for the class of certification for which application is made.~~

~~There shall be different examinations for each class of certification offered by the Department.~~

Experience Requirements

~~Real estate valuations are being performed in Egypt, so some applicants for certification will already have valuation experience. Other applicants may have experience related to real estate valuation, such as civil engineering, architectural engineering, real estate development and real estate lending. Therefore, it is appropriate to require valuation or related experience for qualification as a certified real estate valuer even at the introduction of certification. People applying to become registered assistant valuers will not be required to have employment experience related to real estate valuation. The Authority also may want to consider minimum years of real estate valuation experience for certification and recertification after sufficient time has passed for applicants to satisfy such requirements.~~

~~In addition to the educational requirements specified in this Article, applicants desiring to be certified valuers must present evidence satisfactory to the Department that he or she meets the experience requirements specified below. Acceptable valuation or related experience includes employment as a real estate valuer, preparation of feasibility studies for real estate projects, evaluation of plans and specifications for real estate projects, real estate development, real estate lending, real estate sales and such other activities as the Valuation Board may authorize by rule. There is no experience requirement for registration as a registered assistant valuer.~~

~~Class A Certified Valuer — at least 10 years of valuation or related experience involving large and complex residential and commercial real estate~~

~~Class B Certified Valuer — at least 8 years of valuation or related experience involving both residential and commercial real estate~~

~~Class C Certified Valuer — at least 5 years of valuation or related experience involving residential and/or commercial real estate~~

~~Moral Character~~

~~Applicants for registration or certification with the Real Estate Finance Affairs Authority also should have a good moral character and reputation and should not have been:~~

- ~~1. declared bankrupt, unless he has been rehabilitated; sentenced for a felony, or a crime of fraud or dishonesty unless he has been rehabilitated;~~
- ~~2. denied registration or certification or been disbarred, or had his registration, license, or certificate to practice or conduct any regulated profession, business, or vocation revoked or suspended because of any conduct or practices, unless, because of lapse of time and subsequent good conduct and reputation, or other reason deemed sufficient, the interest of the public is not likely to be endangered~~
- ~~3. dismissed from his position of employment or stricken from the register of a profession for matters affecting honesty and honor within the previous five (5) years.~~

~~Temporary Certification~~

~~It may be necessary for the Authority to issue temporary certifications of real estate valuers until the professional education and examination requirements have been implemented. In order to receive a temporary certification, an applicant must meet all other certification requirements. It is recommended that a temporary certification be for a period of not more than six (6) months. During that time, the holder of a temporary certificate must complete the professional education requirement and pass the appropriate examination.~~

~~Administration and Supervision of Real Estate Valuers~~

~~The project team has made recommendations for the organization of the real estate valuation supervisory function. These recommendations are shown in the proposed organization chart of the Real Estate Finance Affairs Authority and function descriptions presented in the report on the organization structure of the Authority and are discussed in greater detail below.~~

~~Central Department for Real Estate Valuation~~

~~The Central Department for Real Estate Valuation within the Real Estate Finance Affairs Authority will be responsible for the registration, certification and supervision of real estate valuers. The department also will receive and investigate complaints from the public about real estate valuers and make recommendations to the Board of Directors of the Authority for disciplinary action. The department will provide valuers, users of valuations and the public with information about real estate valuation standards, qualification of real estate valuers, the Code of Ethics and complaint adjudication procedures.~~

~~The Central Department of Real Estate Valuation (the “Valuation Department”) is established within the Real Estate Finance Affairs Authority (the “Authority”) to register and certify real estate valuers and administer the provisions of this executive regulation. The Valuation Department shall be managed by its Director who shall be appointed by the Chairman of the Authority~~

~~The Director of the Department shall:~~

~~Receive applications for registration and certification of real estate valuers.
Establish and administer the procedures for processing applications for registration and certification.~~

~~Maintain a registry of the names and addresses of people registered or certified under this executive regulation.~~

~~Retain records and all application materials submitted to the Department~~

~~Establish administrative procedures for receiving and processing complaints from the public against real estate valuers~~

~~Establish administrative procedures for disciplinary proceedings conducted pursuant to the procedures established by the executive regulations and the Board of Directors~~

~~Provide information to the public about real estate valuation, registration and certification of valuers, standards of real estate valuation and complaint procedures~~

~~Establish administrative procedures for making the records of the Department available to the public for inspection in accordance with this executive regulation.~~

~~Investigate complaints received from the public against real estate valuers and potential violations as set out in this executive regulation and recommend to the Board of Directors of the Authority appropriate disciplinary actions against registered or certified valuers who have been found to have violated the executive regulations.~~

~~Provide technical support and staff in the area of real estate valuation to the Chairman and the Board of Directors of the Authority and the Real Estate Valuation Advisory Board established by this executive regulation.~~

~~Real Estate Valuation Advisory Board~~

~~Because real estate valuation involves a high degree of specialized knowledge and skills, it is recommended that the Minister of Housing or the Board of Directors of the Real Estate Finance Affairs Authority appoint a Real Estate Valuation Advisory Board to advise the Board of Directors and the Central Department for Real Estate Valuation on matters relating to real estate valuation standards, qualification of real estate valuers and certification examinations. Members of the Real Estate Valuation Advisory Board would represent the Ministry of Housing, Utilities and Urban Communities, the Real Estate Finance Affairs Authority, the Ministry of Higher Education, the Central Bank of Egypt, the real estate valuation profession, real estate developers, the public interest, banks and real estate finance companies. It is also recommended that a Valuation Examination Committee of the advisory board be created to design certification examinations and examination administration procedures and set the minimum passing grade(s). These standards and procedures would be submitted to the Board of Directors of the Authority for approval. The Central Department for Real Estate Valuation, along with the Ministry of Higher Education, would administer the certification examinations.~~

~~A Real Estate Valuation Advisory Board (the “Valuation Advisory Board”) is established to provide the Board of Directors of the Authority with technical expertise in the field of real estate valuation. The Valuation Advisory Board is composed of eleven members, consisting of:~~

~~The Deputy Chairman of the Authority, who shall be the Chairman of the Valuation Advisory Board~~

~~One member representing the Ministry of Housing, Utilities and Urban Communities~~

~~One member representing Central Bank of Egypt~~

~~One member representing the Ministry of Higher Education~~

~~Two members appointed by the Chairman of the Authority who are certified valuers under the provisions of the executive regulations, one of whom is a certified general valuer and one of whom is a certified residential valuer~~

~~Two public members appointed by the Minister of Housing, Utilities and Urban Communities who are not related within the third degree of consanguinity or affinity to any real estate valuer or any official or employee of the Real Estate Finance Affairs Authority. At least one of the public members shall be a member of the faculty of one of the fields related to valuation, as specified in this executive regulation, at a university registered with the Ministry of Higher Education.~~

~~One member appointed by the Minister of Housing, Utilities and Urban Communities who is a real estate developer with experience in residential and commercial real estate development.~~

~~One member, appointed by the Governor of the Central Bank of Egypt, who is not a certified valuer who is employed by a bank that purchases or makes use of commercial and residential valuations and whose position of employment relates to the use of valuations by that institution.~~

~~One member, appointed by the Chairman of the Authority, who is not a certified valuer who is employed by a real estate finance company that purchases or makes use of either commercial or residential valuations and whose position of employment relates to the use of valuations by that institution.~~

~~A Valuer Examination Committee of the Valuation Advisory Board is established consisting of the representative of the Ministry of Higher Education, who shall serve as the chairman of the committee, the Chairman of the Authority, the representative of the Ministry of Housing, Utilities and Urban Communities, one of the certified valuer members and the public member of the Board who is a member of the faculty of one of the fields related to valuation, as specified in this executive regulation, at an Egyptian university. The Valuer Examination Committee shall recommend to the Valuation Advisory Board the examination specifications for registered and certified valuers, the procedures to provide appropriate examination questions and answers and to administer and grade examinations.~~

~~The duties and responsibilities of the Real Estate Valuation Advisory Board would be to:~~

~~Recommend to the Board of Directors of the Authority standards of real estate valuation practice.~~

~~Recommend to the Board of Directors of the Authority appropriate and reasonable continuing profession educational requirements for the renewal of registrations and certifications and certification of the different classes of certifications established by this executive regulation.~~

~~Establish the examination specifications for registered and certified valuers, provide or procure appropriate examination questions and answers, administer examinations and establish procedures for grading examinations.~~

~~Advise the Board of Directors of the Authority on matters relating to valuers and valuation standards and the executive regulations and decrees necessary for the Valuation Board and the Director of the Department to carry out their duties.~~

~~Perform such other functions and duties as the Board of Directors of the Authority may be deemed necessary to carry out this executive regulation.~~

Fees

~~The Board of Directors of the Real Estate Finance Supervisory Board will adopt a schedule of fees for the registration and certification of real estate valuers. These fees should be consistent with the fees charged for certification of other technical professionals in Egypt. For example, Exhibit 12 shows the fee schedules for Civil Engineers. The fee income generated by the Central Department of Real Estate Valuation should be sufficient to pay all direct costs of the Department and the Real Estate Valuation Advisory Board and the Department's and Advisory Board's share of the administrative costs of the Real Estate Finance Affairs Authority.~~

Dispute and Complaint Resolution

~~The Authority should provide a means of resolving disputes involving real estate valuations and/or valuers and complaints filed against valuers. Disputes involving real estate valuations, should be resolved by a review of the disputed valuation by a qualified review valuer. The review valuer should be certified in a class of certification at least as high as the class of certification of the valuer whose valuation is being disputed. The review valuer should be retained by the Authority and should file his report to the Head of the Central Department for Real Estate Valuation. If the review valuer determines that the valuation was not prepared in a manner consistent with real estate valuation standards, the Authority should require that the original valuer prepare a new valuation in full compliance with the standards, at no cost to the person who retained the valuer. A valuer whose valuation is disputed has the right to appeal the decision of the review valuer and/or the Head of the Central Department for Real Estate Valuation to the Board of Directors of the Authority.~~

~~Complaints from users of real estate valuations or from the public may be filed with the General Department for Control and Supervision of the Central Department for Real Estate Valuation on the forms provided for that purpose. A model complaint form is provided in Exhibit 13. The recommended complaint process is as follows:~~

~~**Step 1: Screening the Complaint.** Upon receipt of a complaint against a registered or certified real estate valuer or a person performing real estate valuations or claiming to be a registered or certified real estate valuer, the General Department for Control and Supervision will first make a determination of whether the Authority has jurisdiction over the subject matter of the complaint and the individuals involved in the complaint. If the General Department determines that it has jurisdiction over both the subject matter and at least one of the parties to the complaint, it will then determine if there is reason to believe a violation of law, regulation or rule may have been committed. If so, the complaint is accepted for investigation and the complaining party is notified in writing of the acceptance of his complaint for investigation. If no, the file is closed without action and the complaining party is notified in writing of the reasons for rejection of the complaint.~~

~~**Step 2: Investigation.** The person who is the subject of the complaint is given a copy of the complaint and has the obligation to file a written response to the complaint with the General Department within five (5) days of receipt of the complaint. The General Department will evaluate the response and conduct whatever additional inquiries it determines are necessary to determine whether there is sufficient evidence that the respondent has violated one or more laws or regulations or rules administered by the Authority. If the determination is that there is insufficient evidence of a violation, the case is closed without action and both the complainant and the valuer are so notified in writing. If the General Department believes it can prove that the valuer violated law, regulation or rule, the head of the General Department will make a recommendation for resolution to the Head of the Central Department for Real Estate Valuation, who will determine the appropriate resolution of the complaint. If the case cannot be resolved by agreement of the parties, the Head of the Central Department will refer the case to the Legal Office of the Authority. If the case cannot be resolved by formal settlement negotiations, it will proceed to an administrative hearing.~~

~~**Step 3: Administrative Hearing Process.** The administrative hearing will be held before a three member panel consisting of the Chairman of the Authority and two members of the Board of Directors who have been appointed by the Board. The Central Department for Real Estate Valuation has the burden of proving by competent evidence that a violation of law, regulation or rule was committed. If the administrative hearing process results in a finding that a violation was committed, the administrative hearing panel may impose the appropriate sanction(s) provided for in the Real Estate Finance Law and its executive regulations. If the burden of proof is not met, the case will be dismissed.~~

~~**Step 4: Right of Appeal.** In those cases resulting in a sanction, the respondent has the right to appeal the decision to the full Board of Directors of the Authority. The decision of a majority of the Board of Directors shall be final. The respondent has all rights provided him by the Laws of the Republic of Egypt to appeal the decision of the Board to a court of competent jurisdiction.~~

Section X

Real Estate Finance Companies

Introduction

Most of the officials interviewed during this project see real estate finance companies, not banks, as the primary home loan originators in the new Egyptian real estate finance system.

Banks are not expected to utilize the additional real estate lending authority recently granted by the Central Bank of Egypt (5% of total loans) to originate and hold the home loans authorized by the Law. Banks, however, do intend to invest in real estate finance companies. There is strong interest by leading developers and bankers in creating real estate finance companies that will originate home loans for developer and bank clients and the general public.

The Board of Directors of the Real Estate Finance Affairs Authority should establish policies and issue executive regulations relating to: 1) whether an existing company can be licensed as a real estate finance company; 2) the relationship between a licensed real estate finance company and its parent and/or affiliates; and 3) the types of activities in which real estate finance companies will be allowed to engage.

The real estate financing activities set out in Article 1 of the Real Estate Finance Law should be the primary activities of a real estate finance company. However, the Authority must balance its mandate to license companies that engage in real estate finance activities with the need to authorize a sufficiently broad range of permitted activities to maximize a real estate finance company's probability of successful operation. The Authority should authorize real estate finance companies to engage in non-lending financial activities, such as purchasing real estate loans and real estate installment contracts from other real estate loan originators, developers and Islamic banks for the purpose of investment or for accumulating pools of loans to be sold to a securitization company; originating and/or servicing real estate loans as the agent of one or more originators; issuing letters of credit; accepting deposits relating to its real estate finance activities; and limited direct real estate investment and investment in joint-ventures and the shares of other companies.

Obtaining and maintaining reliable sources of short and long term funding will be critical to the establishment and growth of real estate finance companies. Securitization of real estate finance company loans is the linchpin of the entire real estate finance system created by the Real Estate Finance Law. Every official interviewed during this project stated that the creation of a viable, financially feasible means of securitization of real estate loans by the Capital Market Authority (CMA) was a condition precedent to any investment in real estate finance companies. The proposed CMA regulations for real estate securitization companies do not appear to establish a financially sound system for securitization.

An initial LE 50 million capital requirement seems excessive and the short time to pay up 100% of the required capital does not seem reasonable in light of the initial capital requirement for other non-bank financial institutions. Instead of imposing a minimum capital requirement in an amount so high it will be a barrier to entry for legitimate investors, the Authority should develop a

schedule of basic minimum capital requirements based on the activities in which a real estate finance company intends to engage and its projected growth in assets for the first three years of operations.

The December, 2001, executive regulations set out the procedures for licensing real estate finance companies, but do not include the application form to be completed by an applicant for a license. In addition to the documents and certifications listed in the executive regulations, the incorporators of real estate finance companies should be required to provide: 1) a business plan for the company, including financial projections for the first three (3) years of operation; 2) a written commitment from a bank to provide the company with a line of credit; 3) copies of any agreements the company may have negotiated with a) developers to provide real estate loans for home buyers, b) developers, banks or other real estate finance companies to purchase real estate loans and/or real estate sales installment contracts, and c) securitization companies to sell the loans originated by the company; and 4) a surety bond from an Egyptian insurance company in the amount of at least LE 500,000.

The executive regulations state that the Board of Directors of the Authority will approve or deny an application for a license as a real estate finance company. It may be advisable to have the Chairman of the Authority, or a special committee of the Board, approve or deny applications so that the applicant can appeal an adverse decision to the full Board of Directors. The Chairman, or a special committee of the Board, also should be given the authority to approve or deny applications for the merger or sale of all or substantially all of the assets of a real estate finance company. Decisions on applications to suspend activities as a real estate finance company or to liquidate the company probably should be made by the full Board of Directors of the Authority.

The financial criteria for real estate finance companies set out in the December 2001, executive regulations should be revised to better measure the financial performance of a non-bank financial institution.

The Authority should issue prudential guidelines for the management of a real estate finance company instead of leaving management policies solely to the discretion of the board of directors of each company.

The Authority should require financial reporting in addition to the semiannual audited financial statements required by the Law so that the control and supervision department of the Authority can monitor the performance of licensed real estate finance companies. The Authority also should determine the circumstances under which on-site examinations of the books and records of a real estate finance company are warranted.

Real Estate Financing Brokers

The qualification criteria for real estate financing brokers set out in the executive regulations, relate only to a natural person. In Egypt, registration generally applies only to individuals, not juridical persons. However, for real estate financing brokerage activities, the Authority should consider registration of juridical persons.

The qualification criteria set out in the executive regulations are too lax. The regulations state that a person with only a high school certificate and five years of experience who has not been

convicted of a crime or an offense involving moral turpitude or breach of trust or declared insolvent qualifies for registration as a real estate financing broker. The qualification criteria for real estate financing brokers should be more stringent than those set out in the executive regulations. In addition, applicants for registration as a real estate financing broker should be required to pass an examination to demonstrate their knowledge of the law, regulations and real estate financing practices.

Execution Real Estate Agents

There is a high degree of confusion about the nature of the real estate agents mentioned in the Real Estate Finance Law. Real estate agents under the Real Estate Finance Law are not real estate sales agents engaged in representing sellers and buyers of real estate. In the context of the Law (Article 16), a real estate agent is the person appointed by the justice of execution to conduct the public auction of security realty subject to an execution proceeding. The justice of execution may only appoint a real estate agent registered with the Real Estate Finance Affairs Authority.

An execution real estate agent must be familiar not only with the relevant provisions of the Real Estate Finance Law and its executive regulations, but with the provisions of the Civil Code and the Civil and Commercial Procedures Law because the provisions of these laws will apply where no special provision is made in the Real Estate Finance Law. Few people other than lawyers will be knowledgeable about the provisions of the Civil Code and the Civil and Commercial Procedures Law applicable to the execution on real estate.

There may be other professionals besides lawyers who possess the knowledge and experience required to be an execution real estate agent. These may include employees of banks engaged in loan collection, workout, restructuring and execution on collateral, bank investment services departments engaged in real estate management for clients, persons registered as bankruptcy trustees, estate executors and other people with legal training who are not practicing lawyers.

Applicants for registration and renewal of registration as an execution real estate agent should be required to pass an examination to demonstrate their knowledge of the requirements for the conduct of a public auction set out in the Real Estate Finance Law and its executive regulations and the applicable sections of the Civil Code and the Civil and Commercial Procedures Law, ethical standards and real estate valuation principles.

Detailed information and recommendations concerning real estate finance companies and the specialized personnel required are contained in Annex 5.

Real Estate Finance Companies

Definition of a Real Estate Finance Company

The Real Estate Finance Law, No. 148 of 2001 created a new form of Egyptian non-bank financial institution—the real estate finance company. A real estate finance company is an Egyptian joint stock company that engages in real estate financing activities. Real estate financing activities under the Law (Article 1) include virtually every form of real estate financing in which the lender takes a security interest in the real estate subject to the financing. In order to operate as a real estate finance company, a company must be registered with the Real Estate Finance Affairs Authority (the “Authority”). The Authority will establish the minimum capital requirement and other financial criteria for real estate finance companies and will supervise their activities.

The Central Role of Real Estate Finance Companies

Most of the officials interviewed during this project see real estate finance companies, not banks, as the primary home loan originators in the new Egyptian real estate finance system. Currently only the two specialized real estate banks, the Egyptian Arab Land Bank and the Housing Development Bank, and the Faisal Islamic Bank provide any significant amount of financing to individuals for home purchase. Commercial banks are the principal source of financing for both residential and commercial real estate development and the purchase of commercial real estate, but make few home loans. The home loans made by banks are primarily to borrowers referred to them by the developers they are financing, to their own employees and as an accommodation to large customers.

Real estate lending by commercial banks for all purposes has been limited by Central Bank of Egypt (CBE) regulations to 5% of the bank’s loan portfolio. Recently the CBE issued a new directive permitting banks to hold an additional 5% of total loans for real estate loans made under the Real Estate Finance Law. The CBE has restricted commercial bank real estate lending because of the interest rate and funding risks of “borrowing short and lending long”. Since the primary sources of funds for banks are current accounts and short term time deposits with an average maturity of less than 90 days, a concentration in intermediate and longer term real estate loans would expose the banks to the risks inherent in a maturity mismatch between their assets and their liabilities. Before the enactment of the Real Estate Finance Law, real estate secured loans also represented a significant credit risk because of the lengthy and costly execution process in effect at the time.

Banks use their limited real estate lending capacity to make shorter term development and commercial real estate loans and are not expected to utilize their expanded real estate lending authority to originate and hold the home loans authorized by the Law. Since the CBE has not adopted the 50% risk weighting of residential mortgages that is standard in the U.S. and most countries that have adopted the Basle capital standards, the banks have no incentive to undertake residential real estate lending to individuals for their own loan portfolios.

Banks, however, do intend to invest in real estate finance companies along with other banks and/or real estate development companies. There is strong interest by leading developers and bankers in creating real estate finance companies that will originate home loans for developer and bank clients and the general public. The insurance company and pension fund officials

interviewed during this project indicated that their companies would consider investing in real estate finance companies if such investment appears prudent and promises a market return. Real estate developers and banks have separately and jointly been actively studying potential investment in real estate finance companies and are prepared to establish and capitalize real estate finance companies once all of the requisite regulations, rules, forms and procedures are in place.

Ownership Structure and Activities of Real Estate Finance Companies

In order to be classified as a real estate finance company, a company must originate real estate loans that meet the criteria set out in the Real Estate Finance Law. Although the intent of the Law was to create a financial institution, the Law itself does not limit the activities of a company that is licensed as a real estate finance company, so long as one of its activities is originating real estate loans. For example, under the current law and its regulations, a manufacturer of bathroom fixtures could be licensed as a real estate finance company if it decides to make home improvement loans to homeowners who purchase the company's products. While it may be clear that the Authority would not want to license non-financial companies whose primary activities are not directly related to real estate finance as real estate finance companies, the issue of licensing real estate sales brokerage companies (e.g. Caldwell Banker) or real estate developers as real estate finance companies is less well defined.

The Board of Directors of the Real Estate Finance Affairs Authority should establish policies and issue executive regulations relating to: 1) whether an existing company can be licensed as a real estate finance company; 2) the relationship between a licensed real estate finance company and its parent and/or affiliates; and 3) the breadth of activities in which real estate finance companies will be allowed to engage.

Require a Separate Company.

It is recommended that a company wishing to obtain a license as a real estate finance company be required to form a separate subsidiary joint stock company to conduct its real estate financing activities. This will facilitate the Authority's control and supervision of real estate financing activities.

Require Portfolio Diversification and Market-Based Lending.

A related issue is whether the Authority should place any restrictions on "captive" real estate finance companies that are wholly or majority (51% or more) owned subsidiaries of other companies. A captive real estate finance company is likely to provide financing only for clients of its parent and affiliate companies, which could result in an excessive concentration of credit that exposes the real estate finance company to undue risk. For example, the real estate financing subsidiary of a real estate development company would provide loans only to the purchasers of homes in its parent company's projects. Another concern is whether the captive real estate finance company would apply prudent credit underwriting criteria to clients referred by its parent or affiliated companies. For example, a real estate finance company owned by a real estate sales brokerage company could be under pressure to approve loans to clients of its parent that it would not approve on an arms-length basis.

~~The Authority should require real estate finance companies that are subsidiaries or affiliates of other companies to adopt measures to maintain the independence of their credit granting procedures from the control or undue influence of their parents and/or affiliates. These measures include requiring that: 1) a majority or the Board of Directors of the real estate finance company not be officers, directors, principal shareholders or employees of its parent and/or affiliates; 2) the Board of Directors of the real estate finance company adopt a portfolio diversification policy that will prevent undue concentrations of credit in any one real estate development project; and 3) the Board of Directors adopt an affiliate transactions policy that clearly establishes the independence of the real estate finance company's credit decision-making process. The Authority should require that the founders of a real estate finance company implement these measures and provide documentation to the Authority before a license is granted.~~

~~Specify the Activities in Which a Real Estate Finance Company May Engage~~

~~The real estate financing activities set out in Article 1 of the Real Estate Finance Law should be the primary activities of a real estate finance company. However, the Authority must balance its mandate to license companies that engage in real estate financing activities with the need to authorize a sufficiently broad range of permitted activities to maximize a real estate finance company's probability of successful operation.~~

~~In countries where the laws and regulations governing specialized real estate finance companies restrict their activities to originating and servicing real estate loans, these companies have been granted preferential treatment in terms of taxation, capital requirements and powers. This is not the case in Egypt. Therefore, the Authority should be careful to avoid a situation where the restrictions it places on the activities of real estate finance companies actually increase the financial risks of their operations.~~

~~Egyptian banking laws and regulations prevent real estate finance companies from engaging in lending activities other than those specified in Article 1 of the Real Estate Finance Law. However, the Authority could authorize real estate finance companies to engage in non-lending financial activities, such as purchasing real estate loans and real estate installment contracts from other real estate loan originators, developers and Islamic banks for the purpose of investment or for accumulating pools of loans to be sold to a securitization company; originating and/or servicing real estate loans as the agent of one or more originators; issuing letters of credit; accepting deposits relating to its real estate finance activities; direct real estate investment, real estate development and investment in joint ventures and the shares of other companies.~~

~~Purchase (Discounting) of Real Estate Installment Sales Contracts~~

~~Purchasing real estate installment sales contracts from developers and Islamic banks would enable real estate finance companies to build a portfolio of short term performing financial assets quickly. If developers could sell the performing installment sales contracts they currently hold to real estate finance companies, they could improve their liquidity and profitability. However, in order to purchase these contracts, the real estate finance company would either have to buy out the seller's equity position in the real estate subject to the contract or the seller would have to subordinate its interest in the real estate to the rights of the real estate finance company. The real estate finance company would have to underwrite the borrowers under the real estate installment sales contracts in the same manner as it would underwrite the loans it originates and would have~~

to discount the contracts to a price that would provide a market rate of return for the real estate finance company.

Originating and/or Servicing Loans for Third Parties

Real estate loan origination and servicing requires a substantial investment in technology and human resources. In its early years, a real estate finance company may not originate and/or service a sufficient volume of its own loans to cover its origination and servicing costs. A company could generate fee income by originating and/or servicing loans as an agent for another financial institution or a real estate securitization company. Loan origination and servicing for third parties is merely an extension of the real estate finance company's principal business and a means to cover its cost of operations. The Real Estate Finance Law requires that the originator of a real estate loan (the "financier") service the loans it originates. However, it does not appear that the Law precludes the financier from entering into a servicing agreement with a third party to service its loans, so long as the third party servicer is the original servicer.

Providing Letters of Credit

It is unlikely that, at least during the first few years of operation, any real estate finance companies, even those owned by large Egyptian banks, will be considered sufficiently creditworthy for its letters of credit to be accepted by the financial market. However, the Real Estate Finance Law requires that a real estate finance company that sells its loans to a real estate securitization company which, in turn, issues debt securities backed by the loans sold, guarantee the payment of interest and principal on the securities issued. A stand-by or performance letter of credit is the most common method of providing such a guarantee. Therefore, it is essential that the Authority authorize real estate finance companies to issue letters of credit for this purpose. The Authority also should consider authorizing real estate finance companies to issue letters of credit on behalf of its clients. The contingent liability of letters of credit should be supported by capital in addition to the capital required to support the assets shown on a real estate finance company's balance sheet. The capital requirement should be the same as that for banks issuing letters of credit.

Accepting Deposits Related to Real Estate Finance Activities

Real estate finance companies are prohibited from soliciting and holding money deposits, since only banks have the authority to accept deposits from the public. However, in the normal course of its real estate lending activities, a real estate finance company will receive money from its clients and other parties for down payments, reserve accounts and other purposes. These purposes will be specified in the terms and conditions of the real estate financing agreements between the real estate finance company and its clients. A real estate finance company should be authorized to accept and hold for the benefit of its clients, the deposit of money in relation to its real estate lending or servicing activities, so long as all such moneys are placed in a segregated deposit account at an Egyptian bank and are not commingled with the real estate finance company's own funds.

Direct Real Estate Investment

Direct real estate investment in income producing real estate would provide a real estate finance company with an additional source of income and, potentially, capital gains. However, such investments would require the commitment of a significant proportion of the company's equity capital and access to long term funding that is not currently available in the Egyptian financial market. Direct real estate investment also would expose the company to additional risk. If the Authority permits real estate finance companies to own real estate for investment, the amount of the company's resources that can be invested should be limited to a specified percent, say 20% to 25%, of the company's capital. If a real estate finance company chooses to engage in direct real estate investment, its owners will have to invest additional equity capital to support this activity.

Real Estate Development

Authorizing real estate finance companies to engage in real estate development raises policy as well as operational issues. One of the primary reasons for the establishment of real estate finance companies was to provide a means of financing the sale of units built by real estate developers. If the real estate finance company is itself a developer, it will be in competition with existing real estate developers and will concentrate its real estate lending on its own developments. The Housing Development Bank is an example of a specialized real estate financial institution that, until the CBE prohibited real estate investment by banks, has provided financing primarily for its own projects, not the general public. Engaging in real estate development also would expose the real estate finance company to additional financial risks. It is recommended that the Authority prohibit real estate finance companies from engaging in real estate development activities.

Investment in Joint Ventures and Corporate Equities

Investment in joint ventures and the shares of other companies would diversify a real estate finance company's assets, but would also expose the company to additional risk and potential conflict of interest. In Egypt, banks are permitted to invest in the shares of a joint stock company in an amount not to exceed 40% of the company's issued capital. The aggregate of all extensions of credit to the company and the bank's ownership of its shares cannot exceed 30% of the bank's capital. It is reasonable to grant real estate finance companies the authority to invest in the shares of a joint stock company in an amount not to exceed 40% of the company's issued capital, provided that the sum of all extensions of credit to the company and the real estate finance company's ownership of the company's shares does not exceed the loan to one borrower limit, which is recommended at 15% of capital.

Recommended Permitted Activities for Real Estate Finance Companies

In summary, the activities of real estate finance companies should be limited to:

1. Originating and purchasing real estate loans for the purpose of investment or for accumulating pools of real estate loans for sale to securitization companies and servicing, or contracting with a third party for servicing, such loans; and

- ~~2. Purchasing real estate installment sales contracts for the purpose of investment or for accumulating pools of real estate installment sales contracts for sale to securitization companies and servicing, or contracting with the originator-seller or a third party for servicing, such contracts;~~
- ~~3. Originating and settling real estate loans in its own name and simultaneously transferring the loans to an investor or a real estate securitization company (“table funding”);~~
- ~~4. Originating real estate loans for a fee, as an agent for another financial institution, an investor or a real estate securitization company;~~
- ~~5. Servicing real estate loans for a fee, as an agent for another financial institution, an investor or a real estate securitization company;~~
- ~~6. Issuing stand-by or performance letters of credit to guarantee debt securities backed by loans sold by the company and for other purposes;~~
- ~~7. Accepting and holding for the benefit of its clients, the deposit of money in relation to its real estate lending or servicing activities, so long as such moneys are not commingled with the real estate finance company’s own funds.~~
- ~~8. Investing temporary cash balances in bank deposits, Egyptian government treasury bills and bonds and readily marketable investment grade corporate bonds;~~
- ~~9. Investing in joint ventures and the shares of Egyptian companies, to the extent permitted by the executive regulations;~~
- ~~10. Owning real estate used in the conduct of its business (“company premises”) and real estate taken in satisfaction of debts previously contracted (“other real estate owned”);~~
- ~~11. Owning real estate for investment in an aggregate amount not to exceed 25% of the company’s capital.~~

Funding Real Estate Finance Companies

~~Obtaining and maintaining sources of short and long term funding will be critical to the establishment and growth of real estate finance companies. Without a constant and reliable supply of cash, the real estate finance company cannot sustain itself. Since a real estate finance company will not be allowed to solicit or accept money deposits and the Central Bank of Egypt will not function as a lender of last resort for the real estate finance company industry, the only sources of funds for real estate finance companies will be equity investment by its shareholders, bank lines of credit, operating income, principal repayments on its loans and the proceeds from the sale of the loans it originates to real estate securitization companies.~~

~~Securitization of real estate finance company loans is the linchpin of the entire real estate finance system created by the Real Estate Finance Law. Every official interviewed during this project stated that the creation of a viable, financially feasible means of securitization of real estate loans~~

~~by the Capital Market Authority (CMA) was a condition precedent to any investment in real estate finance companies. The proposed CMA regulations for real estate securitization companies do not appear to establish a financially sound system for securitization. A detailed discussion of the issues of securitization and possible solutions is presented in the report on securitization.~~

~~Assuming that a viable system of securitization of real estate loans can be designed and implemented, real estate finance companies also will need a dependable source of short term financing to fund the real estate loans they are accumulating for sale to securitization companies. A bank line of credit ("warehouse line of credit") is the only source of such liquidity, in the absence of a commercial paper market. In order to be licensed, the incorporators of a real estate finance company should be required to have a written commitment from a bank for a line of credit of at least LE 2 million. On an ongoing basis, a real estate finance company should have unused lines of credit in an amount at least equal to its unfunded loan commitments.~~

~~Registration and Licensing of Real Estate Finance Companies~~

~~Articles 27 through 33 of Chapter Five of the Executive Regulations issued in December 2001 deal with the requirements and procedures for registration with and licensing by the Real Estate Finance Affairs Authority.~~

~~Chapter Five: Companies of Real Estate Financing~~

~~Article (27)~~

~~The company licensed to practice real estate financing activity shall be an Egyptian Joint stock company with a minimum issued capital of LE fifty million, the minimum paid upon incorporation is 25% and the balance to be paid within a maximum of one year from registration in the commercial registry.~~

~~Article (28)~~

~~The application for licensing of real estate finance companies shall be on the form designed by the Authority, and shall include the following:~~

- ~~A)The Company's preliminary contract of incorporation and by laws~~
- ~~B)The Company's commercial registry~~
- ~~C)Qualifications and experiences of the Company's directors and branch managers~~
- ~~D)Declaration of incorporators and directors of not being subject to declaration of bankruptcy over the last five years, or provision of certificate of rehabilitation.~~
- ~~E)Declaration of incorporators and directors of not being subject to felony or misdemeanor penalty for honor and honesty marring crimes over the last five years, or provision of certificate of rehabilitation.~~
- ~~F)Certificate by Authority enrolled auditors accepting auditing of the company's accounts.~~
- ~~G)Receipt in substantiation of payment of licensing fees.~~

~~Article (29)~~

~~Licensing fees shall be LE 5,000 for 50,000,000 capital companies, and 10,000 for companies having higher capital.~~

~~Article (30)~~

~~Following are prerequisites for licensing:~~

- ~~A) Submit complete the documents referred to in Article 28 above~~
- ~~B) The executive director shall have a minimum of ten years practical banking or financial experience after obtaining university degree in the same field~~
- ~~C) Directors of finance, legal, and engineering departments and branch managers shall have a minimum of ten years practical banking, financial, or legal experience after obtaining university degree in the same field~~

~~Article (31)~~

~~The authority shall give the applicant a certificate indicating receipt of the application and the attachments thereto. Within ten days from lodging the application, the authority shall require the applicant by virtue of a statement handed thereto, to complete whatever documents that may be required within the following three month period, otherwise said application shall be deemed null.~~

~~The authority shall decide upon the application for licensing and communicate its decision via registered mail with acknowledgement of receipt to the applicant, within thirty days from the date the required documents shall have been completed.~~

~~Article (32)~~

~~License shall be granted by a resolution issued by the board of directors of the authority. The application for licensing shall not be rejected except with a reasoned decision only in such cases cited by Article (31) of the law.~~

~~Article (33)~~

~~The companies licensed to practice real estate financing business shall be listed in the register of corporate persons and companies designed by the authority for that purpose. Such listing shall include the data that appertain to each company, the capital thereof, branch addresses, names of the members of the boards of directors, directors, and financial auditors.~~

~~Minimum Initial Capital Requirement for Real Estate Finance Companies~~

~~Article 27 sets the minimum issued capital for licensing as a real estate finance company at LE fifty (50) million, of which 25% must be paid on incorporation and the balance to be paid within one year. The entire amount of the initial capital must be paid in cash.~~

~~An initial LE 50 million capital requirement seems excessive and the short time to pay up 100% of the required capital does not seem reasonable in light of the initial capital requirements for other non-bank financial institutions. The table on the following page shows the minimum capital requirements for other non-bank financial services companies in Egypt.~~

~~Instead of imposing a minimum capital requirement in an amount so high it will be a barrier to entry for legitimate investors, the Authority should develop a schedule of basic minimum capital requirements. The basic minimum capital requirement should be paid up in full in cash before the company begins operations. The cash paid up by the shareholders should be deposited in an account at an Egyptian bank. The cash must remain in the custody of the bank and no withdrawal of the cash can be allowed until the legal representative of the real estate finance company having power of attorney submits evidence of the registration of the company with the Authority.~~

~~Like the companies licensed by the Capital Market Authority, the minimum initial capital for a real estate finance company should depend on the activities in which the real estate finance company intends to engage. For example, if a real estate finance company's sole activity is to originate home loans for sale to a securitization company or other investor, it does not require a large amount of capital. However, a real estate finance company whose primary activity will be originating and holding large real estate development and commercial real estate loans in its own portfolio will require more capital to support its lending activities.~~

Minimum Initial Capital Requirements of Non-Bank Financial Institutions

Class of Institution	Minimum Initial Capital (LE in millions)	% Paid-up
Real Estate Finance Company	50	25%; balance within 1 year
Insurance Company (life and non-life)	30	50%; balance within 5 years
Financial Lease Company	0.50	100%
Securities Brokerage Company	0.25	25%
Securities Underwriting and Promotion Company	3	50%
Companies that Issue Securities or Share in their Capital Increase	3	50%
Securities Clearance and Settlement Companies	3	50%
Companies Engaged in the Formation and Management of Securities Portfolios	3	50%
Investment Funds	5	100%
Venture Capital Companies	10	100%

~~In determining an appropriate initial minimum capital requirement, consideration should be given to the purposes of capital for a real estate finance company. Capital will:~~

- ~~1. be a principal source of long term funding for real estate loans held for investment;~~
- ~~2. provide financial resources to cover start-up operating expenses during the first few years of operation;~~
- ~~3. absorb operating losses during the start-up period and ongoing losses that may be incurred in the real estate finance company's loan and investment portfolio;~~

4. determine the largest loan the real estate finance company can make to any one borrower; if the company intends to make large development and commercial real estate loans it must have sufficient capital to permit it to engage in those activities; and
5. be one of the primary determinants of the company's financial strength for the banks that provide lines of credit, rating agencies and capital market investors.

The initial capital requirement for a real estate finance company should be the amount of capital sufficient to absorb all losses during the first three years of operation, support the projected asset growth of the company and meet, at all times, the minimum leverage ratio of 10% of assets. For example, a real estate finance company that expects to have LE 200 million in assets at the end of its third year of operations and projects total net losses of LE 2 million during its first three years of operation would require minimum initial capital of LE 22 million, LE 20 million to meet the 10% leverage ratio requirement for LE 200 million in assets and LE 2 million to absorb losses. Of course, the Authority would require an additional capital cushion in case the company's losses and/or asset growth exceed their projections, and would probably set the minimum initial capital requirement at about LE 25 million.

The following proposed minimum capital schedule should be applied. In each case the minimum capital would be the greater of the amount shown or the amount of capital required to meet the 10% leverage capital requirement at the end of the third year of operations. The minimum capital would have to be paid up in cash before the real estate finance company could begin operations.

Real estate finance companies that limit their activities to originating loans for sale	LE 5 million
Real estate finance companies that limit their activities to originating loans for investment and for sale	LE 10 million
Real estate finance companies that intend to engage in all permitted activities (including direct real estate investment)	LE 20 million

Additional Contributed Capital

The incorporators of a real estate finance company may wish to contribute assets to the company to provide additional capital. Such assets may be in the form of marketable debt securities, shares, real estate loans, real estate installment sales contracts or real estate to be used as the premises of the real estate finance company for carrying out its business. The debt securities and shares contributed should be assigned to the real estate finance company and kept in a safekeeping (custodial) account with the same bank that holds the company's deposit. The contribution of real estate loans and real estate sales installment contracts should be evidenced by a purchase and sale agreement between the party contributing the assets and the real estate finance company. The contribution of real estate should be evidenced by a deed conveying the real estate to the company. The conveyance of the real estate must be registered at the Real Estate Registration Office.

The values of the non-cash assets contributed as additional capital should be established as follows:

- ~~1. Marketable (traded) securities (debentures, finance bonds or shares) should be valued at their closing bid or quoted price as of the date immediately preceding the date of contribution;~~
- ~~2. Real estate loans or real estate sales installment contracts should be valued in accordance with Egyptian accounting standards relating to the valuation of financial assets, less any allowance for losses required by the executive regulations;~~
- ~~3. Real estate should be valued at its market value, as established by a valuation conducted by a certified real estate valuer according to the executive regulations on real estate valuation.~~

~~Application for a License~~

~~Articles 28 through 33 of Chapter Five of the executive regulations set out the procedures for licensing real estate finance companies. The executive regulations do not include the application form to be completed by an applicant for licensing as a real estate finance company. A real estate finance company application form must be developed before any applications for a license can be filed with the Authority.~~

~~In addition to the documents and certifications listed in Article 28, the incorporators of real estate finance companies should be required to submit a business plan for the company, including financial projections for the first three (3) years of operation. The business plan should state the real estate financing activities in which the company intends to engage, its sources of funding, including a commitment from a bank to provide the company with a line of credit, and any agreements the company may have negotiated with 1) developers to provide real estate loans for home buyers; 2) developers, banks or other real estate finance companies to purchase real estate loans and/or real estate sales installment contracts; and 3) securitization companies to sell the loans originated by the company.~~

~~Real estate finance companies also should be required to obtain and maintain a surety bond from an Egyptian insurance company in the amount of at least LE 500,000, naming as beneficiaries, the Authority and any person who has a claim against the surety on the bond based on any default or violation of any duty or obligation of the licensed real estate finance company.~~

~~Article 32 of the executive regulations states that the Board of Directors of the Authority will approve or deny an application for a license as a real estate finance company. It may be advisable to have the Chairman of the Authority approve or deny applications so that the applicant can appeal an adverse decision to the Board of Directors. Alternatively, the Board of Directors could appoint a committee of the Board to decide on applications for licensing, with the right of appeal to the full Board.~~

~~Financial Reporting to the Authority~~

~~The Real Estate Finance Law (Article 33) and the executive regulations (Article 34) require that real estate finance companies submit semiannual reports to the Authority. There is a problem with Article 34 of the executive regulations because it says that financial reports will be filed within “one month from the expiry of the six month period stipulated in the second paragraph of article (33) of the law.” However, the second paragraph of Article 33 of the Law states: “the company~~

~~shall submit its financial statements to the administrative authority every six months at the date to be determined in the executive regulations.” The financial reporting dates should correspond to the most common fiscal year for Egyptian companies. The Authority should also consider establishing a standard fiscal year, e.g. June 30 or December 31, for all real estate finance companies.~~

~~Semiannual financial reports may not be frequent enough for effective supervision and control of real estate finance companies. However, the regulations cannot require more frequent financial reporting because the Law specifies “every six months”. If possible legally, the executive regulations should require quarterly supplementary financial or statistical reports in addition to the statutory semiannual financial reports.~~

~~Financial reporting for real estate finance companies will be similar to the financial reporting for banks. The primary difference will be the accounting for “Loans Held for Sale”. These are the loans the real estate finance company is accumulating for sale to a securitization company. Unlike “Loans Held for Investment,” Loans Held for Sale are reported at the lower of cost or market for accounting purposes rather than at historical cost, less an allowance for loan losses. An Allowance for Loan Loss can be established for Loans Held for Sale or the estimated future credit losses can be charged against income in the income statement. Exhibit 14 shows a representative balance sheet and income statement for a real estate finance company.~~

Financial Criteria for Real Estate Financing Companies

~~The Real Estate Finance Law, Article 32, requires that executive regulations be issued to “define the financial criteria to which the company shall be committed.” Article 35 of the Executive Regulations lists the following financial criteria for real estate finance companies.~~

Article (35)

~~The licensed company shall comply with the following:~~

- ~~A)The assets of the company should be evaluated in accordance with Egyptian standards of Accounting and Egyptian auditing standards specified by the ministerial decrees issued in that regard~~
- ~~B)The sufficiency of the capital should not be less than ten percent (10%) of the total assets of the company~~
- ~~C)The current assets of the company should not exceed 25% of the current (circulating or floating) liabilities thereof~~
- ~~D)The total loans obtained by the company should not exceed 10 times its capital.~~
- ~~E)Setting the regulations necessary for good performance in accordance with paragraph 4 of Article 32 of the Law.~~

Valuation of Assets

~~Item (A) of Article 35 requires that Egyptian accounting and auditing standards be applied in evaluating the assets of a real estate finance company. If Egyptian accounting and auditing standards do not require real estate finance companies to establish appropriate valuation~~

~~allowances and/or an allowance for loan loss on their balance sheets and to provision for projected loan losses in their income statements, the executive regulations should impose such requirements. Real estate finance companies that sell loans with servicing retained also will have to account for the value of the retained servicing rights.~~

~~**a.Allowance for Loan Losses**~~

~~A real estate finance company should be required to establish and maintain an allowance for loan losses ("ALL") at a level that is adequate to absorb the estimated credit losses associated with its loan portfolio (including all binding commitments to extend credit). To the extent not provided for in a separate liability or capital account, the ALL should also be sufficient to absorb estimated credit losses associated with off-balance sheet credit instruments.~~

~~The term "estimated credit losses" means an estimate of the current amount of the loan portfolio (net of unearned income) that is not likely to be collected; that is, net chargeoffs that are likely to be realized for a loan or pool of loans. The estimated credit losses should meet the criteria for accrual of a loss contingency (i.e., a provision to the ALL) set forth in the executive regulations. When available information confirms specific loans, or portions thereof, to be uncollectible, these amounts should be promptly charged off against the ALL.~~

~~Estimated credit losses should reflect consideration of all significant factors that affect repayment as of the evaluation date. Estimated losses on loan pools should reflect historical net chargeoff levels for similar loans, adjusted for changes in current conditions or other relevant factors. Calculation of historical chargeoff rates can range from a simple average of net chargeoffs over a relevant period, to more complex techniques, such as migration analysis.~~

~~Portions of the ALL can be attributed to, or based upon, the risks associated with, individual loans or groups of loans. However, the ALL would be available to absorb credit losses that arise from the entire portfolio. It would not be segregated for any particular loan, or group of loans.~~

~~For purposes of a real estate lending company's financial reports an adequate ALL should, after deduction of all assets classified loss, be no less than the sum of the following items:~~

- ~~1.For loans paid current, that is, within 30 days, whether analyzed and provided for individually or as part of pools, 1 percent of the total outstanding balance(s) of the loan(s)~~
- ~~2.For loans past due over 30 days up to 90 days, whether analyzed and provided for individually or as part of pools, 10 percent of the total outstanding balance(s) of the loan(s)~~
- ~~3.For loans past due over 90 days up to 180 days, whether analyzed and provided for individually or as part of pools, 20 percent of the total outstanding balance(s) of the loan(s)~~
- ~~4.For loans past due over 180 days up to 360 days, whether analyzed and provided for individually or as part of pools, 50 percent of the total outstanding balance(s) of the loan(s)~~
- ~~5.For loans past due over 360 days, whether analyzed and provided for individually or as part of pools, 100 percent of the total outstanding balance(s) of the loan(s)~~

~~Furthermore, management's analysis of an adequate ALL level should be conservative to reflect a margin for the imprecision inherent in most estimates of expected credit losses. This additional~~

~~margin might be incorporated through amounts attributed to individual loans or groups of loans, or in an unallocated portion of the ALL.~~

~~Estimated credit losses should reflect consideration of all significant factors that affect collectibility of the portfolio as of the evaluation date. While historical loss experience provides a reasonable starting point, historical losses, or even recent trends in losses, are not by themselves, a sufficient basis to determine an adequate level. Management should also consider any factors that are likely to cause estimated losses to differ from historical loss experience, including but not limited to:~~

- ~~1.Changes in lending policies and procedures, including underwriting, collection, chargeoff, and recovery practices.~~
- ~~2.Changes in local and national economic and business conditions.~~
- ~~3.Changes in the volume or type of credit extended.~~
- ~~4.Changes in the experience, ability, and depth of lending management.~~
- ~~5.Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans.~~
- ~~6.Changes in the quality of an institution's loan review system or the degree of oversight by the board of directors.~~
- ~~7.The existence of, or changes in the level of, any concentrations of credit.~~

~~b. Accounting for Servicing Rights~~

~~Servicing of loans includes collecting installment and interest payments from the borrowers; monitoring delinquencies, executing on the security realty, if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, agent banks and others providing services; and accounting for and remitting installment and interest payments to the holders of beneficial interests in the loans, i.e. the investors in the securities issued when the loans are securitized. Servicers typically receive fees for servicing loans sold for securitization and bear the costs of servicing.~~

~~Servicing becomes a distinct and separate asset or liability (“servicing rights”) when the servicing function is contractually separated from the underlying loans by sale or securitization of the loans with servicing retained by the originator-seller or by a separate purchase or assumption of the servicing. When an originator sells loans for securitization and retains the servicing, which it is required to do under the Real Estate Finance Law, the originator has to recognize a servicing asset or liability on its balance sheet. The value of the servicing asset will depend on the revenue generated by servicing fees, the price at which the loans were sold and the risk of loss of servicing revenue.~~

~~Leverage Capital Ratio~~

~~A 10% leverage capital ratio (item B) is appropriate for a real estate finance company and is consistent with the leverage ratio for Egyptian commercial banks that will come into effect in December, 2002. For purposes of computing the leverage ratio, capital should be defined as the sum of its paid-up capital (including surplus) contributed capital and retained earnings. The~~

~~Authority may want to consider imposing a risk-based capital ratio in addition to the leverage capital ratio. However, since the activities of real estate finance companies will be limited to only a few classes of assets, a risk-based capital requirement may not be warranted.~~

~~Article 32 of the Real Estate Finance Law also requires the executive regulations to determine a ratio of capital to liabilities. Since the leverage ratio is 10%, the maximum capital to liabilities ratio would be 1:9, or 11.11%. The ratio commonly used to measure a company's debt burden is the total debt to capital ratio, expressed as a multiple. With a 10% leverage capital ratio, the maximum total debt to capital multiple would be 9x.~~

Liquidity

~~Item C) of Article 35 establishes a maximum current ratio. Generally, regulations set a minimum current ratio to ensure that a company has sufficient cash and liquid assets to pay its current obligations as they come due. Perhaps the intent of setting a maximum current ratio was to force real estate lending companies to invest their financial resources in real estate loans.~~

~~Liquidity is important for any financial institution, not only as a source of cash to pay the institution's current liabilities, such as payroll, other operating expenses and the current interest and principal due on borrowed funds, but as the means used to disburse funds on the loans originated by the institution. Banks obtain these funds primarily from deposits and insurance companies from the premiums paid by its clients. For non-depository real estate finance companies, the major sources of cash to fund its operations are:~~

- ~~1. Cash investment by its shareholders;~~
- ~~2. Interest and dividends earned and collected on its investment and real estate loan portfolios;~~
- ~~3. Fees and charges collected for originating and servicing real estate loans, for issuing letters of credit and for providing other services to third parties;~~
- ~~4. Repayment of principal on its loans and investments;~~
- ~~5. Proceeds from the sale of loans, securities and other assets;~~
- ~~6. Net income from investment real estate, if the company is engaged in direct real estate investment;~~
- ~~7. Borrowed money, primarily lines of credit from banks.~~

~~The current ratio is not an appropriate measure of liquidity for a financial institution. Instead of the current ratio specified in item C) of the executive regulations, the Authority should establish ratios that are in common use to measure the liquidity position of a financial institution. The liquidity position of a real estate finance company should be measured by two ratios: 1) the Liquidity Ratio; and 2) the Interest Coverage Ratio~~

a. Liquidity Ratio

~~The Liquidity Ratio is the ratio of the monthly average balance of short-term liquid assets, including cash, current accounts at Egyptian banks, term deposit accounts at Egyptian banks that mature in 30 days or less, Treasury bills or bonds of the Egyptian Government and marketable investment grade corporate bonds that mature in 90 days or less and other receivables that mature~~

~~in 30 days or less, to the prior month's average balance of short term liabilities. Short term liabilities include accounts payable and all interest and any portion of the principal amount of any borrowing that is payable on demand or within 30 days. A real estate finance company should maintain a Liquidity Ratio of not less than 20% or 25%.~~

~~**b. Interest Coverage Ratio**~~

~~The interest coverage ratio is the ratio of the company's income available to pay the interest expense on its debt and is calculated as:~~

~~*Interest, fee and other income before interest expense, taxes, depreciation and amortization*~~

~~*Divided by*~~

~~*Gross interest expense incurred*~~

~~Real estate finance companies should maintain an interest coverage ratio of at least 1:1.~~

~~**Capital to Support Lending Operations**~~

~~Item D) of Article 35 of the executive regulations establishes a 10:1 ratio of total loans to capital. A real estate finance company could never reach this ratio and still comply with the minimum leverage capital ratio of 10% since the company would always have assets on its balance sheet in addition to loans. Perhaps a better measure to ensure that a real estate finance company has sufficient capital to support its loan origination volume when it is selling a significant portion of its loans is to require additional capital to support the volume of loans it sells during a specific financial reporting period.~~

~~If a real estate finance company has full recourse liability for loans that have been sold, accounting principles would require that the sale transaction be recorded on the books of the originator-seller as a financing, not a sale. In other words, the sold assets would remain on the books of the real estate finance company and it would record a debt liability. Since the assets would remain on the company's books, the company would have to maintain the 10% leverage capital to support the assets sold.~~

~~However, if the real estate company has less than full recourse on the loans it sells, accounting principles will require the company to either establish a recourse reserve as a liability account on its books or treat the recourse liability as a contingent liability. Since a contingent liability is not on the company's balance sheet, the Authority should require that the company maintain additional capital against these off-balance sheet liabilities. The amount of capital that the company will have to hold will depend on the terms of its recourse obligation.~~

~~Even if a real estate lending company has no recourse liability on the loans it sells, it should maintain capital sufficient to cover the risks involved in originating and servicing loans sold for securitization. The following amounts of capital are recommended:~~

~~If the company will service the securitized loans it sells:~~

~~3% of the first LE 100 million in loans sold~~

~~plus, 2% of the next LE 100 million~~

~~plus, 1% for each LE 1 million in transactions in excess of LE 200 million~~

~~If the company will not service the securitized loans itself, but will have the loans serviced by an agent of the company:~~

~~3% of the first LE 200 million in loans sold
plus, 2% of the next LE 200 million
plus, 0.5% for each LE 1 million in transactions in excess of LE 400 million~~

~~Policies and Procedures for Safe and Sound Operation~~

~~Item E) of Article 35 of the executive regulations requires real estate finance companies to have policies and procedures for “good performance in accordance with paragraph 4 of Article 32 of the law.” Article 32 basically states the same thing. The executive regulations should provide guidelines for what constitutes “good performance”. Exhibit 15 of the report on financing rules provides several models for policies and procedures for loan underwriting. The executive regulations should provide similar guidelines for other areas of the company’s operations, including, but not limited to: liquidity management, risk management, loan classification, affiliate transactions, insider dealing and dividend policy.~~

~~Supervision of Real Estate Finance Companies~~

~~The Central Department for Real Estate Finance Activities within the Real Estate Finance Affairs Authority will have the responsibility for supervising real estate finance companies. The General Department for Registration and Licensing will receive and process applications and make recommendations to the Head of the Central Department on the approval or denial of license applications and applications for changes in the authorized activities of and the merger, closure or sale of all or a significant part of the assets of real estate finance companies. The Head of the Central Department will have prepared a summary of the reasons for approval or denial of any application received by the department and submit the summary to the Board of Directors (or the Chairman of the Authority, if the executive regulations are amended).~~

~~The General Department for Control and Supervision will have the responsibility for ongoing oversight of licensed real estate finance companies. Oversight will be conducted primarily through off-site surveillance of the companies. The Central Department will analyze the semiannual financial reports and any supplementary financial or statistical reports the Authority may require real estate finance companies to submit to determine if the company meets all of the financial criteria established by the executive regulations and is being operated in a safe and sound manner. The General Department for Control and Supervision may conduct on-site examinations of the books and records of a real estate finance company at any time. The Authority may determine that such on-site examinations should be on a regularly scheduled basis, or only when the General Department for Control and Supervision has determined, based on its analysis of the financial statements and reports submitted by a real estate finance company, that an on-site examination is warranted. Banking regulations call for biannual on-site examinations and more frequent examination as needed. There is no reason for real estate finance companies to be examined on-site more frequently than banks.~~

~~Fees~~

~~Article 29 of the Real Estate Finance Law and Article 29 of the executive regulations establish a maximum licensing fee of LE 10,000. The executive regulations relate the amount of the licensing fee to the initial capital requirement~~

~~Article 29~~

~~Licensing fee shall be LE 5,000 for 50,000,000 capital companies and LE 10,000 for companies having higher capital.~~

~~There is little logic in relating the licensing fee to a real estate finance company's initial capital, other than that incorporators who can afford to invest more capital can afford a higher fee. If a scale of licensing fees is applied, it should relate to the activities in which a real estate finance company intends to engage. The licensing fees for companies engaged in securities activities are based on the types of business in which the securities companies will engage. However, it seems needlessly complicated to have a scale of licensing fees for real estate finance companies. The licensing fee should be set at LE 10,000 for all real estate finance companies.~~

~~The licensing fee is paid only on the issuance of the license. The executive regulations are silent on recurring fees to be paid to the Authority to cover the cost of control and supervision. The Authority should consider assessing an annual fee based on total assets and the annual volume of loan originations. However, Article 29 of the Law may prohibit such annual assessments.~~

~~REAL ESTATE FINANCE BROKERS~~

~~Regulation of Financing Brokerage Activities~~

~~Article 38 of the Real Estate Finance Law, No. 148 of 2001 requires that “none but the intermediaries whose names are recorded in a table provided by the administrative quarter for the purpose, may exercise mediation works between the financier and the investor in the finance agreement” and that “the executive regulations shall determine the rules, conditions and procedures for recording in such table.” Real estate financing brokerage activities are commercial activities under the Commercial Law, No. 17 of 1999 and would be subject to the provisions of that Law as well as the Real Estate Finance Law. Sections One and Three of Chapter 6 of the Executive Regulations issued in December 2001 specify the qualification criteria for registration as and the duties of a real estate financing broker.~~

~~Definition of Real Estate Financing Brokerage~~

~~A real estate financing broker is a person who, for compensation, acts on behalf of one or more of the entities authorized to exercise the activity of real estate lending to: 1) solicit real estate loans; 2) accept and process applications for real estate loans; 3) negotiate between a borrower and a lender; 4) settle real estate loans; or 5) purchase or sell real estate loans. Such activities are called “financing brokerage activities”. An employee of a lender who engages in any of these activities for his employer would not be considered a real estate financing broker.~~

~~The authority should determine whether to include a “loan correspondent” within the definition of “real estate financing broker”. A loan correspondent is a person who, in the regular course of business, directly or indirectly originates and settles loans in his own name utilizing funds provided by a lender and simultaneously assigns the loans originated to that lender. Since the real~~

estate financing system envisioned under the real estate finance law includes institutions that will accumulate real estate loans for securitization, the authority may want to consider requiring registration of loan correspondents that are not banks, public juridical authorities or real estate finance companies, or employees of such institutions, as real estate financing brokers.

Qualification Criteria for Registration with the Authority

The qualification criteria for real estate financing brokers set out in Section One of Chapter 6 of the Executive Regulations, relate only to a natural person. In Egypt, registration generally applies only to individuals, not juridical persons. However, for real estate financing brokerage activities, the Authority should consider registration of juridical persons.

The executive regulations state that a person with only a high school certificate and five years of experience who has not been convicted of a crime or an offense involving moral turpitude or breach of trust or declared insolvent qualifies for registration as a real estate financing broker. Egyptian government authorities, associations and other institutions made a number of comments about these requirements, primarily that they were too lax.

While the duties and responsibilities of a real estate financing broker do not call for the level of knowledge and expertise required for real estate valuers or execution real estate agents, the qualification criteria for real estate financing brokers should be more stringent than those set out in the executive regulations. Frequently the real estate financing broker will be the only person with whom the borrower has contact in a real estate financing transaction. The broker will be responsible for informing the borrower about his financing options, explaining the terms and conditions of the financing and evaluating the borrower's eligibility for financing.

The recommended qualification criteria for an individual who wants to be registered as a real estate financing broker are:

1. Be a citizen of the Republic of Egypt
2. Be at least 21 years of age
3. Have a degree or certificate from a university, college or technical institute registered with the Ministry of Higher Education
4. Have been employed for at least five (5) years, at least three (3) of which have been in a position involving lending, real estate financing, real estate sales, real estate development, accounting, law or such other fields as the authority may authorize by decree;
5. Not have been convicted in a crime, or in an offense involving moral turpitude or breach of trust or been declared bankrupt or insolvent unless rehabilitated.
6. Have a good moral character and reputation and not have been dismissed from his position of employment or stricken from the register of a profession for matters affecting honesty and honor within the previous five (5) years

Examination

~~It is essential that the real estate financing broker possess the technical knowledge to carry out his functions. As is the case with the registration of real estate valuers and execution real estate agents, it is recommended that applicants for registration and renewal of registration as a real estate financing broker be required to take and pass an examination to demonstrate their knowledge of applicable laws and regulations relating to real estate financing and real estate financing practices.~~

~~Supervision of Real Estate Financing Brokers~~

~~Section Three of Chapter 6 (Articles 49 through 52) of the Executive Regulations sets out some of the duties of real estate financing brokers.~~

~~Section Three~~

~~Real Estate Financing Brokers~~

~~Article (49)~~

~~The broker shall hand the applicant for financing a copy of the form set by the Authority showing all the key conditions of the financing agreement and should explain all the terms and the risks associated therewith. The investor should sign a statement that he has received a copy of the agreement and has read it before signing the agreement; this statement shall be enclosed with the real estate financing agreement.~~

~~Article (50)~~

~~The fees of the real estate financing broker will be fixed by the financier, provided that the fees should not exceed the limit set by the Board of Directors of the Authority.~~

~~Article (51)~~

~~It is prohibited for the broker to receive any payment, commission or any interest that is related to his work except from the financier which commissioned him to endeavor to have a contract concluded.~~

~~Article (52)~~

~~The broker has to make entries in his books of all transactions performed thereby and shall maintain relevant documents and provide the parties to the agreement and the Authority certified copies thereof.~~

~~The duties specified in these articles are appropriate for real estate financing brokers. In Article (49) the real estate financing broker should also be required to give each applicant a statement that the broker is the agent of the lender, not the applicant. This statement should explain the duties and responsibilities of the broker, any limitations on his authority to approve or process the loan application and the right of the applicant to file a complaint against the broker with the Authority.~~

~~The requirement that the real estate financing broker file copies of the financing documents with the Authority is somewhat questionable. There is no reason why the Authority should maintain a file of copies of the real estate financing agreements arranged by registered brokers. In fact, disclosing the information about the financing transactions could raise issues of the confidentiality of financial records. It is recommended that Article 52 be revised to read:~~

~~The broker has to make entries in his books of all transactions performed thereby. The broker shall have all documents executed in triplicate and shall retain one copy of all relevant documents in his files for at least five (5) years. One copy of the executed original documents shall be turned over to the financier by which the broker was retained and the third to the borrower under the agreement. Certified copies of all documents shall be provided to all other parties to the agreement. Every month the broker shall file a statistical report to the Authority, on the forms provided by the Authority, reporting the volume of loans arranged in that month and such other information as the Authority shall require as specified in a decree issued by the Authority.~~

Prohibited Conduct

~~The Authority should issue an executive regulation or decree that describes what conduct on the part of the real estate financing broker is prohibited and could lead to disciplinary action or the imposition of the penalties under Chapter VIII of the Real Estate Finance Law.~~

~~A person registered as a real estate financing broker should not:~~

- ~~1. Make a false statement or representation for purposes of inducing a lender to extend credit for a real estate loan or for purposes of inducing a person to request or accept a real estate loan from a specific lender or lenders.~~
- ~~2. Make a false statement or representation about his ability to secure a real estate loan for a prospective borrower.~~
- ~~3. Make a false statement or representation about the return rate, amount of loan or other terms and conditions of real estate loans offered through the real estate financing broker or a prospective borrower's ability to satisfy the credit criteria of a lender.~~
- ~~4. Solicit or accept a fee from a prospective borrower to secure a real estate loan from a lender on behalf of the borrower. The real estate financing broker may only receive compensation from the lender(s) he represents.~~
- ~~5. Fail to disclose, or make a false statement or representation about, the relationship between the real estate financing broker and the lender(s) with which he has a contract of representation.~~
- ~~6. Fail to disclose, or make a false statement or representation, about the availability of real estate loans from lenders other than those with which he has a contract of representation.~~
- ~~7. Give compensation to a person to refer borrowers to him, without disclosing to the borrower that the referral was in return for such compensation.~~
- ~~8. Give or receive compensation or anything of value to influence the independent judgment of a real estate valuer in determining the value of the real estate relating to a real estate loan.~~

EXECUTION REAL ESTATE AGENTS

Purpose of the Execution Real Estate Agent

The Real Estate Finance Law, No. 148 of 2001 establishes a non-judicial real estate execution procedure for real estate loans under the Law in which the security realty is sold at a public auction conducted by a “real estate agent” appointed by the justice of execution within whose jurisdiction the security realty is located. The execution on the security realty is “under the hand” of the justice of execution, but not conducted by him. The procedures for the execution on the real estate, including annotation of the writ of execution at the Real Estate Registration Office, notice to all interested parties, establishment of the basic price and other terms and conditions of the sale and the conduct of the execution sale are to be carried out by the appointed real estate agent. The justice of execution may only appoint a real estate agent registered with the Real Estate Finance Affairs Authority.

Qualifications for Registration as an Execution Real Estate Agent

The execution real estate agent must be familiar not only with the relevant provisions of the Real Estate Finance Law and its executive regulations, but with the provisions of the Civil Code and the Civil and Commercial Procedures Law because the provisions of these laws will apply where no special provision is made in the Real Estate Finance Law. Few people other than lawyers will be knowledgeable about the provisions of the Civil Code and the Civil and Commercial Procedures Law applicable to the execution on real estate. Therefore, it may be advisable for the Authority to require that an applicant must be a lawyer to be eligible for registration as an execution real estate agent. In the United States, the government sponsored secondary mortgage market agencies, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, designate specific law firms to act as their agents in non-judicial real estate foreclosures.

There may be other professionals besides lawyers who possess the knowledge and experience required to be an execution real estate agent. These may include employees of banks engaged in loan collection, workout, restructuring and execution on collateral, bank investment services departments engaged in real estate management for clients, persons registered as bankruptcy trustees, estate executors and other people with legal training who are not practicing lawyers.

It is recommended that the following qualification criteria be adopted for registration of execution real estate agents:

1. A juridical person may not register with the Authority as an execution real estate agent.
2. A natural person may apply to the Authority, on the forms to be provided by the Authority, for registration as an execution real estate agent if he satisfies the following qualification criteria:
 - a. Be a citizen of the Arab Republic of Egypt.
 - b. Be at least 21 years of age
 - c. Be a lawyer or hold at least a university degree in the field of law, business administration or economics from a university registered with the Ministry of Higher Education

d. Have at least 10 years of experience in one or a combination of the following areas:

- 1) Law practice with a practice area in bankruptcy, banking, real estate or civil procedure;
- 2) University professor of law, civil procedure, real estate, bankruptcy or related fields;
- 3) Employment with an Egyptian bank with responsibility for real estate lending, loan workouts, loan restructuring or execution on collateral;
- 4) Employment with the investment services department of an Egyptian bank with responsibility for real estate management and/or sales;
- 5) Bankruptcy trustee registered with the Ministry of Justice;
- 6) Executor of estates.

Examination Required

All applicants for registration as an execution real estate agent should be required to pass an examination to demonstrate their knowledge of the execution provisions of the Real Estate Finance Law and its executive regulations, the applicable provisions of the Civil Code and the Civil and Commercial Procedures Law, the ethical standards applicable to execution real estate agents and the principles of real estate valuation. The examination should be prepared jointly by the Authority and the Ministry of Justice.

Moral Character

All applicants must have the honesty and integrity required to conduct a real estate execution proceeding. An application for registration with the Authority should be denied if the Authority determines that the applicant:

1. Has paid money or other valuable consideration, except the required fees, to any member or employee of the Authority for approval of his application for registration or to any person responsible for the preparation, administration or grading of examinations in order to obtain a passing grade on the examination.
2. Has attempted to obtain approval of his application for registration by means of knowingly making a false statement, submitting false information, refusing to provide complete information in response to an application question, or engaging in fraud, misrepresentation, or concealment.
3. Has been disbarred, or has had his or her registration, license, or certificate to practice or conduct any regulated profession, business, or vocation revoked or suspended by any Egyptian governmental authority or has had an application for such registration, licensure, or certification to practice or conduct any regulated profession, business, or vocation denied by any Egyptian governmental authority.

~~4. Has been convicted or found guilty of, or entered a plea of nolo contendere to, regardless of adjudication, a crime in any jurisdiction which involves moral turpitude or fraudulent or dishonest conduct. The record of a conviction certified or authenticated in such form as admissible in evidence under the laws of Egypt or other nation shall be admissible as prima facie evidence of such guilt.~~

~~5. Is confined in any jail, postadjudication; is confined in any prison or mental institution; or, through mental disease or deterioration, can not entrusted to carry out the duties of an execution real estate agent.~~

~~Code of Ethics~~

~~It is critical to the integrity of the execution proceeding that the execution real estate agent adheres to the highest ethical standards. The Authority should adopt a Code of Ethics for execution an real estate agent that specifies his personal obligations and responsibilities. As a condition of registration, each registered execution real estate agent should sign a statement that he will comply with these standards and that he understands that a violation of the Code of Ethics will be grounds for suspension or revocation of his registration or other disciplinary action.~~

~~1. An execution real estate agent shall maintain knowledge of and comply with all applicable laws and executive regulations governing the execution on security realty and shall not knowingly participate or assist in any violation of such laws or regulations.~~

~~2. An execution real estate agent shall not accept appointment by a justice of execution if he has any rights to or interest in the security realty that is the subject of execution or if any of the parties involved in the execution proceeding is related to him to the third degree of consanguinity.~~

~~3. An execution real estate agent shall perform his duties honestly, impartially, objectively and independently, without accommodation of personal interests.~~

~~4. An execution real estate agent shall not engage in criminal conduct or any conduct involving dishonesty, fraud, deceit or misrepresentation or commit any act that reflects adversely on his honesty, trustworthiness or professional competence.~~

~~5. It is a violation of this Code of Ethics for an execution real estate agent to accept the payment of undisclosed fees, commissions, or things of value in connection with the execution proceeding for which the execution real estate agent was appointed.~~

~~Administrative Procedures Applicable to Real estate Financing Brokers and Execution Real Estate Agents~~

~~Registration and Renewal Procedures~~

~~Articles 41 through 43 of the executive regulations set out the procedures for the registration and renewal of licenses for real estate financing brokers and execution real estate agents. Article 43 should be amended to make it clear that renewal of registration is not automatic, but will require~~

~~1) recertification by passing an examination to test the knowledge and expertise of the applicant and 2) the payment of a renewal fee.~~

~~The authority is required to maintain a current list of registered real estate financing brokers and execution real estate agents that will be made available to the public. The authority also should maintain a list of brokers and agents who have been subject to disciplinary actions.~~

~~The Authority will establish a schedule of fees for the registration of real estate financing brokers and execution real estate agents. These fees should be consistent with the fees charged for certification of valuers and other technical professionals in Egypt. The Authority should not approve an application for registration or renewal of a registration until all applicable fees have been paid. An applicant should not be allowed to sit for an examination unless he has paid the examination or reexamination fee.~~

~~Fees should be charged for the following:~~

- ~~1. An application fee for registration~~
- ~~2. An examination fee~~
- ~~3. A reexamination fee~~
- ~~4. A fee for renewal of a registration~~
- ~~5. A delinquent renewal fee in addition to the renewal fee~~
- ~~6. A fee for an extension to renew a registration of not more than six months~~

~~Revocation or Suspension of Registration~~

~~The Board of Directors of the Authority should be empowered to revoke or suspend, for a period not to exceed 10 years, the registration of a real estate financing broker or an execution real estate agent, place any such real estate financing broker or execution real estate agent on probation, or apply the penalties set out in Part VIII of the Real Estate Finance Law, No. 148 of 2001, if it finds that the registered real estate financing broker or execution real estate agent:~~

- ~~1. Has violated any provisions of the Real Estate Finance Law No. 148 of 2001 or its executive regulations, any Code of Ethics, any lawful decree, order or rule of the Authority which is binding upon him or her or, if an execution real estate agent, any order or instruction of a justice of execution in an execution proceeding conducted by the execution real estate agent.~~
- ~~2. Has made a false affidavit or affirmation intended for use as evidence by or before a justice of execution, the Authority or any member thereof.~~
- ~~3. Has accepted money or other valuable consideration, except the fees to which he is entitled by law or regulation.~~
- ~~4. Has been guilty of fraud, misrepresentation, concealment, false promises, false pretenses, dishonest conduct, culpable negligence, or breach of trust or has aided,~~

~~assisted, or conspired with any other person engaged in any such misconduct and in furtherance thereof; or has formed an intent, design, or scheme to engage in such misconduct and committed an overt act in furtherance of such intent, design, or scheme. It is immaterial to the guilt of the registered real estate financing broker or execution real estate agent that the victim or intended victim of the misconduct has sustained no damage or loss or that the damage or loss has been settled and paid after discovery of the misconduct.~~

- ~~5. Has been convicted or found guilty of, or entered a plea of nolo contendere to, regardless of adjudication, a crime in any jurisdiction which directly relates to the activities of a registered real estate financing broker or execution real estate agent, as applicable, or which involves moral turpitude or fraudulent or dishonest conduct. The record of a conviction certified or authenticated in such form as admissible in evidence under the laws of Egypt or other nation shall be admissible as prima facie evidence of such guilt.~~
- ~~6. Has become temporarily incapacitated from acting as a real estate financing broker or an execution real estate agent because of drunkenness, use of drugs, or temporary mental derangement; however, suspension of a registration in such cases shall only be for the period of such incapacity.~~
- ~~7. Is confined in any jail, postadjudication; is confined in any prison or mental institution; or, through mental disease or deterioration, can no longer safely be entrusted to conduct the activities of a real estate financing broker or execution real estate agent, as applicable.~~
- ~~8. Has failed to inform the Authority in writing within 30 days after pleading guilty or nolo contendere to, or being convicted or found guilty of, any felony.~~
- ~~9. Has been found guilty, for a second time, of any misconduct that warrants disciplinary action, or has been found guilty of a course of conduct or practice which shows that he or she is incompetent, negligent, dishonest, or untruthful.~~
- ~~10. Has made or filed a report or record, either written or oral, which the registered real estate financing broker or execution real estate agent knows to be false; has willfully failed to file a report or record required by law or regulation; has willfully impeded or obstructed such filing, or has induced another person to impede or obstruct such filing. However, such reports or records shall include only those which are signed or presented in the capacity of a registered real estate financing broker or execution real estate agent, as applicable.~~
- ~~11. Has obtained a registration by means of knowingly making a false statement, submitting false information, refusing to provide complete information in response to an application question, or engaging in fraud, misrepresentation, or concealment.~~

- ~~12. Has paid money or other valuable consideration, except the required fees, to any member or employee of the Authority to obtain a registration.~~
- ~~13. Has failed or refused to appear at the time and place designated in a subpoena issued with respect to a violation of applicable law or regulation, unless such failure to appear is the result of facts or circumstances that are sufficient to excuse appearance in response to a subpoena from the circuit court; nor shall a person who is present before the Board of the Authority or a member thereof or one of its authorized representatives refuse to be sworn or to affirm or fail or refuse to answer fully any question propounded by the Board, the member, or such representative.~~
- ~~14. Has obstructed or hindered in any manner the enforcement of the Real Estate Finance Law, No.148 of 2001 or its executive regulations or the performance of any lawful duty by any person acting under the authority of the Real Estate Finance Law, No.148 of 2001 or its executive regulations, or interfered with, intimidated, or offered a bribe to any member of the Board or any employees of the Authority or any person who is, or is expected to be, a witness in any investigation or proceeding.~~

Section XI

Real Estate Financing Rules and Procedures

Introduction

The Real Estate Finance Law, No. 148 of 2001 (the “Law”) created a new class of non-bank financial institution, the real estate finance company, to be supervised by a new supervisory authority, the Real Estate Finance Affairs Authority. In order to ensure that real estate finance companies are operated in a safe and sound manner and originate high quality loans for sale in securitizations or to hold in their portfolios, the Law also mandates in Article 4 of the Law that executive regulations be issued to establish prudential real estate financing rules.

The Ministry of Housing, Utilities and Urban Communities (“MHUUC”) issued executive regulations in December 2001 to implement the requirements of the Law. Article 3 of these executive regulations was intended to satisfy the requirements of the Real Estate Finance Law to establish real estate financing rules. Article 3 does not fulfill the requirements of the second paragraph of Article 4 of the Law because it does not: (1) provide financing rules applicable to borrowers who are not natural persons, i.e. companies or other business entities; (2) address the financing criteria for commercial, development, construction or rehabilitation lending; or (3) determine the procedures for real estate financing. The provisions of the executive regulations currently in force relating to financing rules either should be replaced in their entirety or significantly revised. Proposals for revised financing rules are provided in this report.

One of the primary purposes for establishing financing rules is to facilitate the securitization of real estate loans originated by real estate finance companies. The securitization of loans, especially comparatively small real estate loans to individuals, requires a high degree of standardization of loan underwriting criteria, loan documentation and lending procedures.

It is recommended that general guidelines for lending procedures and loan documentation and specific financing procedures for loans to landowners to build house (“build-on-own-land”) loans, rehabilitation loans, development loans and investment real estate loans be issued. Proposed financing rules are included in Exhibit 15.

The provisions of Article 3 of the December 2001 executive regulations relating to the maximum loan-to-value ratio, loan-to-one-borrower limits and payment-to-income ratio provisions should be revised to better incorporate the intent of the Law. The proposed revised ratios are presented in ~~this report~~ *Annex 6*.

It is recommended that the Real Estate Finance Affairs Authority adopt a uniform residential financing application for individuals applying for a loan to purchase a home. A proposed application form is shown in Exhibit 4.

Perhaps the most significant omission from the financing rules established in Article 3 of the executive regulations is the lack of any procedures for real estate valuation. Every official interviewed during this project cited the need for uniform standards for real estate valuation and professional qualifications for real estate valuers as the highest priority issue that must be addressed by the executive regulations. The procedures a real estate lender must follow in obtaining a valuation report on the surety realty for a real estate loan are included in the General

Financing Rules presented in Exhibit 15. Detailed proposals for the establishment of real estate valuation standards and criteria for professional certification and valuer professional education are presented in Report on Real Estate Valuation.

Background

The Real Estate Finance Law, No. 148 of 2001 (the “Law”) created a new class of non-bank financial institution, the real estate finance company, to be supervised by a new supervisory authority, the Real Estate Finance Affairs Authority. In order to ensure that real estate finance companies are operated in a safe and sound manner and originate high quality loans for sale in securitizations or to hold in their portfolios, the Law also mandates in Article 4 of the Law that executive regulations be issued to establish prudential real estate financing standards and procedures.

The second paragraph of Article 4 of the Law requires that executive regulations “determine the finance rules and procedures, its credit limits and the ratio of finance to the value of the realty” for real estate loans originated by real estate finance companies and public authorities under the Law. The financing rules and procedures established by the executive regulations do not apply to banks because banks are specifically exempted from the provisions of the second paragraph of Article 4.

Banks are primarily portfolio lenders who utilize their deposit resources to originate and hold loans. The most important source of income for a bank is net interest income, i.e. the difference between the bank’s cost of deposits and other borrowed funds and the interest income it earns on its investments in debt securities and loans. Within the limits of prudential regulation, the Board of Directors and management of banks have the authority to adopt the lending criteria and procedures best suited to the degree of risk they are willing to accept, the expertise of their management and staff and the needs of their clients. The Central Bank of Egypt (CBE), as the supervisory authority for banks, evaluates the policies and procedures adopted by a bank’s Board of Directors in light of the institution’s capital adequacy, asset quality, management capability, earnings, liquidity and risk management and makes a determination about whether the institution is being managed in a safe and sound manner. The CBE has issued basic prudential regulations addressing capital adequacy, liquidity and risk diversification, but has not established standards or guidelines for lending procedures.

Current Status

The Ministry of Housing, Utilities and Urban Communities (“MHUUC”) issued executive regulations in December 2001 to implement the requirements of the Law. Article 3 of these executive regulations was intended to satisfy the requirements of the second paragraph of Article 4 of the Law. Article 3 states:

Article (3)

**Practicing Real Estate Financing Activity shall be in accordance with the following
Criteria**

- A. Financing procedures shall be clear and definite in such a manner that guarantees the investor's knowledge of all rights and obligations that appertain thereto. The financing documents shall include – sine qua non - acknowledgment by the investor of having received and familiarized himself with a copy of the form containing the key conditions to be prepared by the Authority prior to signing the financing agreement.
- B. Financing should not exceed 90% of the value of the property.
- C. A valuer listed in the roster to be prepared by the Authority shall determine the value of the property, provided that that value shall not be an affiliate to the investor or the financier.
- D. It is prohibited for a financier to provide one or more finances at an amount exceeding 10% of the capital thereof for one individual investor, the spouse, and relatives thereof to the fourth degree; or to other corporate persons in whose capital the financier contribution exceeds 10%.
- E. In the cases where the amount of finance is related to the investor's income, proof of the income shall be by virtue of tax certificate issued by the Tax Department stating the income taken as the basis for taxation over the last three years preceding the financing agreement. In case financing shall be given against deduction from the investor's salary, proving the salary shall be by virtue of authenticated certificate by the employer thereof.
- F. Finance repayment installment should not exceed 40% of the total investor's income, other than low-income investors stated under Article (6) herein.

Article 3 does not appear to completely fulfill the requirements of the second paragraph of Article 4 of the Law because it does not: (1) provide financing rules applicable to borrowers who are not natural persons, i.e. companies or other business entities; (2) address the financing criteria for commercial, development, construction or rehabilitation lending; or (3) determine the procedures for real estate financing. The policies and procedures adopted by real estate lending institutions should be subject to at least some prudential guidelines.

The Need for Standardization of Financing Procedures

The intent of the requirement for regulatory financing rules and procedures was primarily to facilitate the securitization of real estate loans originated by real estate finance companies. Although real estate finance companies may hold some loans in their portfolios, such as nonconforming home loans and developer and commercial real estate loans, the framers of the Law intended real estate finance companies to function as the principal originator-sellers in the securitization transactions authorized by the Capital Market Authority. The officials interviewed as part of this project clearly perceive the real estate finance companies as "American-style" mortgage bankers that originate home loans for sale. Therefore, the financing rules applicable to the loans held for sale by real estate finance companies must be designed to mitigate the risk of inconsistent lending practices within a pool of loans supporting a securitization.

The securitization of loans, especially comparatively small real estate loans to individuals, requires a high degree of standardization of loan underwriting criteria, loan documentation and lending and loan servicing procedures. Real Estate Securitization Companies (“RESC”) and other purchasers of loans, rating agencies, securities regulators and institutions providing guarantees for real estate loan-backed securities (“REBS”) are not going to perform a due diligence on every loan in a pool of mortgages being securitized to determine the risk factors in individual loans. Pools of home loans will consist of several hundred to over a thousand separate loans. Assuming an average loan amount of LE 100,000, the loan pool supporting an LE 50,000,000 issue of real estate loan-backed securities would contain at least 500 individual loans. In addition, it would be difficult for attorneys to issue the required legal opinions if the underlying loans differ in terms of legal terms and conditions.

The various institutions involved in securitization transactions must rely on the assumption that each loan has been underwritten by the originator(s) using consistent credit underwriting standards and procedures and standard loan documents.

In the United States, the two government sponsored secondary mortgage market agencies, the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”), dictate virtually every term, condition, form, contract and procedure used in originating and servicing the mortgage loans they purchase. Without uniform standards, the secondary mortgage market agencies and mortgage insurers and guarantors could not assess their risk exposure.

In countries where mortgage-backed securities (“MBS”) are issued primarily by the private sector rather than by government agencies, the rating agencies have the primary responsibility for evaluating the risk factors inherent in the pool of mortgages being securitized. For single originator-seller MBS, the rating agency will evaluate the credit underwriting policies and procedures of that originator-seller in making its risk assessment. However, in MBS where there are a number of originators selling loans into the pool to be securitized (“multi-seller MBS”), the rating agency would have difficulty assessing the risks of the loan pool due to differences in loan underwriting, lending procedures and loan documentation. In most multi-seller financing structures, the securitization entity establishes the uniform loan underwriting standards, lending procedures and loan documentation it requires for each loan it purchases.

Detailed recommendations regarding needed strengthening the regulations are presented in Annex 6.

~~Recommendations for the Executive Regulations on Underwriting Criteria~~

~~IV. Most of the financing rules set out in Article 3 of the executive regulations apply to real estate loans made to individuals for the purchase of a home. The other forms of real estate lending authorized by the Law are not addressed.~~

~~V. Financing Procedures~~

~~Clause (A) of Article 3 of the December, 2001 Executive Regulations does not establish standard procedures for real estate financing. It merely states that “the financing procedures shall be clear and definite.” This is not sufficient to ensure consistency among individual loans to be sold in a securitization or to manage the risks inherent in loans held for investment. It is recommended that~~

~~new executive regulations be issued, or Article 3 of the existing regulations be amended, to establish guidelines for lending procedures and loan documentation.~~

~~A) The Board of Directors of the financier shall adopt financing policies and procedures that shall conform to the financing rules set out in the Annexes to this regulation and incorporated herein by reference.~~

~~Proposed general financing guidelines setting out standards applicable to all real estate loans and the required content of real estate lending policies and procedures and specific financing procedures for loans to land owners to build a house (“build on own land”) loans, rehabilitation loans, development loans and investment real estate loans are included in Exhibit 15 of this report.~~

Prudential Risk Ratios for Real Estate Financing

~~Clauses (B), (D) and (F) of Article 3 of the December, 2001 executive regulations set out the standard risk ratios used in residential real estate lending to individuals. All of these provisions should be revised to better incorporate the intent of the Law.~~

Loan-to-Value Ratio

~~The loan to value (“LTV”) ratio establishes the maximum amount of a loan that can be granted relative to the value of the real estate being financed. Clause (B) of Article 3 sets the maximum LTV at 90%. Even for a low risk single-unit, moderately priced, owner-occupied principal residence, a 90% LTV is too high for Egypt, considering the lack of expertise in real estate valuation, the unreliability of the data on which real estate valuations are based and the uncertainty about the funding and coverage to be provided by the proposed Guaranty Fund. For developer and investment real estate loans, a 90% LTV would expose the lender to excessive risk. A scale of LTVs based on the type of real estate being financed and the purpose of the loan be adopted. The proposed scale of LTV limits where the only security for the loan is the security realty is shown in table on the following page and a proposed loan to value rule providing for exceptions to the maximum LTV limits is included as Exhibit 16.~~

Risk Diversification

~~Clause (D) of Article 3 of the executive regulations establishes a loan to one borrower maximum of 10% of the capital of the lender. Loan to one borrower limitations are appropriate only for loans the lender intends to hold in its loan portfolio. Loans originated for sale in securitizations need not be subject to the loan to one borrower limitation if the lender is originating the loan as the agent for the real estate securitization company (“RESC) or other loan purchaser. Loans originated for a securitization would be subject to the loan concentration limits set by the RESC or other purchaser of the loans.~~

~~The 10% loan to one borrower limit is more restrictive than the loan to one borrower limitation for banks. Banks are prohibited from having aggregate extensions of credit to and investments in any one borrower in excess of 30% of the bank’s capital base. The argument for a more stringent loan to one borrower limit for non-bank real estate lenders especially newly organized real estate finance companies is that the capital is lower than that of banks and that banks have a greater ability to raise new capital. In addition, the Central Bank of Egypt will not provide capital support for a non-bank lender as it does for banks. The lack of availability of CBE intervention to prop up a real estate finance company if a large borrower defaults is a legitimate argument. However, since all of a real estate finance company’s loans will be secured by real estate whereas~~

~~many of a bank's loans are unsecured commercial credits, the argument also could be made that the loan to one borrower limit for real estate finance companies should be the same as that for banks. It is questionable whether the loan to one borrower limitation for governmental entities (i.e. "public juridical persons") should be the same as that for banks or real estate finance companies or if one should be imposed at all.~~

~~PROPOSED MAXIMUM LOAN-TO-VALUE RATIOS~~

MAXIMUM LOAN-TO-VALUE RATIO OF 75%

Loans to individuals secured by real estate with a value of LE 250,000 or less for the purchase, construction on own land, completion, rehabilitation, repair or expansion of an owner-occupied individual dwelling unit that is the principal residence of the borrower

MAXIMUM LOAN-TO-VALUE RATIO OF 70%

Loans to individuals secured by real estate with a value greater than LE 250,000 but not more than LE 500,000 for the purchase, construction on own land, completion, rehabilitation, repair or expansion of an owner-occupied individual dwelling unit that is the principal residence of the borrower

Loans to individuals secured by real estate with a value of LE 500,000 or less for the purchase, construction on own land, completion, rehabilitation or expansion of residential investment real estate where the borrower will occupy one of the dwelling units

MAXIMUM LOAN-TO-VALUE RATIO OF 65%

Loans to individuals secured by real estate with a value greater than LE 500,000 for the purchase, construction on own land, completion, rehabilitation, repair or expansion of an owner-occupied individual dwelling unit that is the principal residence of the borrower

Loans to individuals secured by real estate with a value greater than LE 500,000 but not more than LE 1 million for the purchase, construction on own land, completion, rehabilitation or expansion of residential investment real estate where the borrower will occupy one of the dwelling units

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~~Clause (D) of Article 3 relates only to borrowers who are natural persons “one individual investor, the spouse, and relatives thereof to the fourth degree” or to companies in which the lender owns more than 10% of the company’s shares “or to other corporate persons in whose capital the financier contribution exceeds 10%”. The regulation does not aggregate loans to an individual borrower with loans to companies owned or controlled by the individual borrower. The regulation also does not establish a loan to one borrower limit for borrowers that are juridical persons, such as developers or investors in commercial real estate. The risk exposure to the lender of large development and commercial real estate loans is much greater than that of loans to an individual and his relatives.~~

~~It is recommended that Clause (D) of Article 3 of the Executive Regulations be revised to increase the loan to one borrower limit to 15% of the lender’s capital and to include loans to borrowers other than individuals.~~

~~It is prohibited for a real estate lender to have an aggregate of all extensions of credit to plus all equity investments in any one person in excess of 15% of the lender’s capital base. For purposes of this regulation the lender’s capital base is its total shareholders equity (net worth). Extensions of credit include loans, whether or not all of the proceeds of the loan have been fully disbursed, investment in bonds or other debt securities, guarantees, letters of credit and unused commitments.~~

~~Extensions of credit to and equity investments in any one natural person include extensions of credit to the borrower, his immediate family, to any partnership or joint venture in which the borrower or a member of his immediate family is a partner or principal and to any company in which the borrower, any member of the borrower’s immediate family or the borrower together with one or more members of his immediate family owns more than 20% of the issued voting shares or which the borrower, any member of his immediate family or the borrower together with one or more members of his immediate family otherwise controls, directly or indirectly. Immediate family means the spouse and minor children.~~

~~Extensions of credit to and equity investments in any one juridical person include extensions of credit to or equity investments in the borrower, any company or joint venture in which the borrower owns more than 20% of the voting shares of the company or has more than a 20% interest in the joint venture or otherwise controls the company or joint venture. For purposes of this regulation, an extension of credit to a sole proprietorship shall be considered an extension of credit to a natural person.~~

~~In addition to the restriction on loans to one borrower, there should be restrictions on the loans a real estate finance company can make to its officers and directors, including the families and related interests of such officers and directors. The proposed rules would permit a real estate finance company to make loans to its officers and directors up to the loan to one borrower limit~~

~~only for the purchase, construction or rehabilitation of a principal residence occupied by the officer or director.~~

~~Payment to Income Ratio~~

~~Clause (F) of Article 3 establishes a 40% maximum payment-to-income ratio. Payment-to-income ratios are appropriate only for individual borrowers. For corporate borrowers, measures of the ability to service debt are based on the ratio of income available for debt service to debt service, called coverage ratios.~~

~~Individual Borrowers~~

~~Applying a 40% payment-to-income ratio to qualify individual borrowers where income is based on a tax certificate issued by the Tax Department or, if the loan payments are to be made as a payroll deduction, certification by the employer, as specified in clause (E) of Article 3, may result in many creditworthy home loan applicants being denied real estate credit. It is widely recognized that a person's income from all sources may not be reported on his tax return. It is unlikely that prospective borrowers will report all of their income to the tax authorities for two years in order to obtain a real estate loan.~~

~~It is standard credit underwriting practice for a lender to include stable income from all sources in evaluating a loan applicant's ability to pay. Income includes wages and salaries, interest and dividend income, income from a business owned by the borrower, bonus and fee income, remittances from abroad and the income from all co-borrowers. If after investigation and verification, the lender determines that the borrower's income from any and all sources is expected to continue in the future, the lender usually includes that income when computing the maximum loan payment the borrower can afford.~~

~~For individuals, it is recommended that the payment-to-income ratio be based on the total stable income of the borrower. Definitions of the types of income to be included in calculating the ratios and reasons for exceptions to the ratios are presented in Exhibit 17. The proposed payment-to-income ratios for loans to natural persons are:~~

~~1. Monthly Housing Expense to Income Ratio~~

~~The monthly housing expense is the total payment the borrower is required to make according to the financing agreement. In general, where the borrower is a natural person, the subject property is the borrower's primary residence and there is no non-occupying co-borrower or guarantor, the monthly housing expense-to-income ratio should not be greater than 30 percent of the borrower's monthly income. If the subject property is investment property and/or there is a non-occupying co-borrower or guarantor, the occupant's monthly housing expense-to-income ratio should not exceed 40 percent of the borrower's monthly income.~~

~~2. Monthly Debt Payment to Income Ratio~~

~~The monthly debt payment is the sum of the monthly charges for the following:~~

~~a. Monthly housing expense~~

- ~~b. Monthly payments on all installment debts with more than 10 months of payments remaining~~
- ~~c. Monthly payments on credit card and other revolving or open-end accounts. In the absence of a stated payment, 5 percent of the outstanding balance will be considered to be the required monthly payment.~~
- ~~d. Car lease payments, regardless of the number of payments remaining~~
- ~~e. Monthly fixed obligations, such as education expense~~
- ~~f. Aggregate monthly negative net rental income (i.e. net loss) from all investment properties owned~~
- ~~g. Monthly payments on installment debts secured by financial assets in which repayment may be obtained by liquidating the asset may be excluded from the monthly debt payment to income ratio for qualifying purposes regardless of the payment amount or number of payments remaining. If the payments due on a debt are made less frequently than monthly, the lending institution will apply the appropriate factor to convert the payment to a monthly payment.~~

~~If the borrower is a co-borrower or guarantor on a debt for another person, the lender must determine who actually makes the payments on the debt when deciding whether the contingent liability should be included as a debt payment~~

~~In general, the monthly debt payment to income ratio should not be greater than 35 percent of the borrower's stable monthly income. If the subject property is investment property and/or there is a non-occupying co-borrower or guarantor, the occupant's monthly debt payment to income ratio should not exceed 45 percent of the borrower's monthly income.~~

~~Borrowers Other Than Individuals~~

~~A determination of the sufficiency of a juridical person's income to support additional debt service requires a more sophisticated analysis. Since a corporate borrower usually will be seeking a real estate loan for an income producing purpose, the lender should look first to the ability of the development project or investment real estate being financed to generate sufficient cash flow to cover the debt service, based the valuation report and a feasibility study of the development project or investment real estate.~~

~~If the loan is for the purchase of investment real estate, such as an office building, hotel or shopping mall, the income generated by rental or sale of the commercial units is the primary source of repayment of the loan. If the lender makes a real estate loan to a developer to build a housing project, the primary source of repayment will be the proceeds from the sale of the homes or the conversion of the development loan to home purchase loans to the individual home buyers. The projected cash flow from the real estate being financed should be at least 1.25 times the required debt service on the loan.~~

~~Uniform Residential Financing Application~~

~~The Authority should adopt a uniform residential financing application for individuals applying for a loan to purchase a home. A proposed application form is shown in Exhibit D.~~

Real Estate Valuation Standards

Perhaps the most significant omission from the financing rules established in Article 3 of the executive regulations is the lack of any procedures for real estate valuation. Every official interviewed during this project cited the need for uniform standards for real estate valuation and professional qualifications for real estate valuers as the highest priority issue that must be addressed by the executive regulations. The procedures a real estate lender must follow in obtaining a valuation report on the surety realty for a real estate loan are included in the General Financing Rules presented in Exhibit 16. Detailed proposals for the establishment of real estate valuation standards and criteria for professional certification and valuer professional education are presented in Report on Real Estate Valuation.

Section XII

Securitization and Real Estate Loans

Introduction

Securitization of the real estate loans authorized under the Real Estate Finance Law, No. 148 of 2001 is the linchpin of the new real estate finance system for Egypt. All of the public and private sector officials interviewed during this project stated that the ability to securitize real estate loans is a condition precedent to the development of a well-functioning Egyptian housing finance system. Securitization of real estate loans, particularly home loans, is the only viable source of the long-term financial resources needed to sustain an active housing finance market.

The Capital Market Authority (“CMA”) will play a critical role in the development of the Egyptian real estate finance system because the CMA is the authority responsible for securitization. The Real Estate Finance Affairs Authority and the Capital Market Authority should work together to design and implement regulations to ensure the successful securitization of real estate loans under the Law.

A provision of the Real Estate Finance Law could prevent the securitization of real estate loans. Parliament added a requirement that originators of real estate loans guarantee the real estate loan-backed securities issued by the securitization companies to which they sell their loans. This requirement contravenes one of the essential elements of securitization. Legal and accounting experts must determine whether there are conditions under which loans sold with such a guarantee can be treated as “true sales”. The Capital Market Authority must make a final determination, in consultation with the Ministry of Justice and the Central Accounting Authority, of the legal and accounting treatment of real estate loans sold for securitization under the current language of the Real Estate Finance Law.

There are issues of taxation and claims of employees and trade creditors of a securitization company that must be clarified before securitizations can take place. There should be consultations with the Ministry of Finance to obtain a ruling on the tax treatment of each of the entities involved in a securitization transaction. The priority of claims of employees and trade creditors of securitization companies can be resolved by requiring securitization companies to maintain adequate capital and liquidity.

It probably will be one year or more before there is a sufficient volume of real estate loans originated under the Real Estate Finance Law to permit securitization. It is unlikely that banks that are in the process of establishing affiliated real estate finance companies will begin originating real estate loans on their own balance sheets. It is possible that foreign banks that have experience in originating real estate loans in other countries will begin originating real estate loans for securitization through their Egyptian subsidiaries or affiliates.

Real estate financial assets other than real estate loans originated under the Real Estate Finance Law could be securitized if authorized by the Capital Market Authority’s securitization regulations. The specialized real estate banks, the Islamic banks, and perhaps some of the large banks, have portfolios of real estate loans that could be securitized and real estate developers are carrying large portfolios of real estate sales installment contracts. Real estate developers, and the

banks that finance them, could improve their liquidity and profitability if the developers could securitize the real estate sales installment contracts they currently carry on their books. Banks, and especially the real estate banks, would free up capital and improve their liquidity by securitizing the estate loans currently on their books.

Most of the capital market experts interviewed during this project believe that while the domestic capital market may not be able to sustain the projected LE 10 to LE 20 billion in annual real estate lending, real estate loan-backed securities could be sold to investors in the Gulf region.

The CMA and the Ministry of Foreign Trade (“MOFT”) have prepared draft securitization regulations. An unedited English translation of these regulations is included as Exhibit 19 of this report. The proposed regulations require revision to make them more consistent with the securitization laws and regulations of other countries that have successfully introduced securitization in their capital markets and to deal with issues of securitization not addressed in the proposed regulations.

The securitization bonds conceived under the Real Estate Finance Law and the draft securitization regulations are apparently a hybrid between a traditional corporate bond and an asset-backed security. Unlike a traditional corporate bond, the securitization bond is not a general obligation of the real estate securitization company with real estate loans pledged as collateral. Neither is it any standard form of asset-backed security in which the securitization bond would represent either a pro rata share of the underlying real estate loans or an ownership interest in specified cash flows arising from the securitized real estate loans. The CMA should clarify the nature of the securitization bonds authorized by the Law and the securitization regulations and clearly define exactly what rights are conveyed to the investors in these bonds. The CMA also should consider the implications of the different financing structures commonly used in securitizations to determine which ones are most appropriate structures for the new Egyptian real estate loan securitization market.

Background

From its earliest drafts, the Real Estate Finance Law has been designed to facilitate the securitization of real estate secured financial assets, and home loans in particular. The ~~Minister of Economy and Foreign Trade~~ *Government* recognized that sources of funding for longer term real estate loans would have to be found outside the commercial banks that dominate the financial system in Egypt because short term bank deposits are not appropriate to fund long term real estate loans. The sources of funds for real estate finance can be accessed only through the capital market. Traditional providers of long term funding, such as life insurance companies, pension funds and high net worth investors, would not originate real estate loans themselves, but would invest in fixed income securities collateralized by real estate loans.

~~The 1999 USAID sponsored report on the housing finance system in Egypt discussed the alternatives for tapping these long term sources of funds.~~ Several *financial* models were presented to the ~~Minister of Economy and Foreign Trade for consideration~~ *considered by the Government*. These were a government sponsored central liquidity facility like the institution established in Jordan, mortgage bonds, such as those issued by mortgage banks in Finland, Latvia and some other countries and real estate loan-backed securities. After consideration of these options, the ~~Minister~~ *Government* determined that real estate loan-backed securities were the most appropriate capital market instruments for Egypt.

Most of the officials interviewed during this project recognize that the ability to raise funds in the capital markets through securitization is essential to the development of the Egyptian real estate finance market. Other than the specialized real estate banks, banks do not intend to carry on their residential mortgage financing activities at the bank level. The CBE has limited a bank's investment in real estate lending to 5% of its loan portfolio and has issued a directive authorizing an additional 5% of total loans for real estate loans under the Law. Banks are expected to continue to use their limited capacity to make real estate loans to finance developers and commercial real estate.

If a bank decides to participate in residential real estate financing, it will do so through an affiliated real estate finance company. The model several people have described is one in which several banks, or one or more banks along with a real estate developer, will establish and capitalize a real estate finance company. These real estate finance companies could be portfolio lenders originating real estate loans to hold in their loan portfolios, but because the funding sources are limited for these institutions, most will be organized to originate and sell loans for securitization. Real estate finance companies must have the ability to securitize their loans to raise funds to sustain ongoing lending activities.

Securitization Under the Real Estate Finance Law

Article 11 of the Real Estate Finance Law, No. 148 of 2001 authorizes lending institutions to assign their real estate loans to “one of the quarters exercising the activity of securitization” authorized by the Capital Market Authority (“CMA”). The Ministry of Housing, Utilities and Urban Communities (“MHUUC”) has no authority over securitization activities other than to issue a decree specifying the form of the purchase and sale agreement by which real estate loans will be assigned to real estate securitization companies. After the dissolution of the Ministry of Economy, the Ministry of Foreign Trade remained the responsible Ministry for the Capital Market Authority and, hence, for securitization.

It is critical for the Real Estate Finance Affairs Authority to work closely with the CMA on securitization of real estate loans because it is the issuer of real estate loan-backed securities and its regulator who will dictate the terms and conditions of the loans to be securitized, the documents required, loan underwriting standards and procedures and loan servicing. The rating agencies that will rate the securities will also play a role because the characteristics of the underlying pool of mortgages in a securitization will determine in large part the extent of credit enhancement required to obtain an investment grade rating. Although the Real Estate Finance Law gives the Authority the power to establish standardized loan documents, loan underwriting criteria and financing rules, these documents, criteria and rules must meet the requirements of the CMA, the rating agencies, third-party providers of credit enhancement and capital market investors.

The project team leader has met with the Chairman of the CMA and the staff responsible for preparing the executive regulations to permit securitization of real estate loans. The CMA has already drafted proposed regulations to implement securitization. However, after several meetings discussing the issues outlined in the matrix of securitization issues and alternative solutions included as Exhibit 20 of this report, it became clear that the regulations require further work. The issues involved in securitization are complex and involve legal, accounting, taxation, financial structuring, supervision, operational, financial reporting and disclosure considerations.

The CMA staff recognizes their need for specialized expert advice on accounting, underwriting, taxation, disclosure, settlement and financial reporting for asset-backed securities.

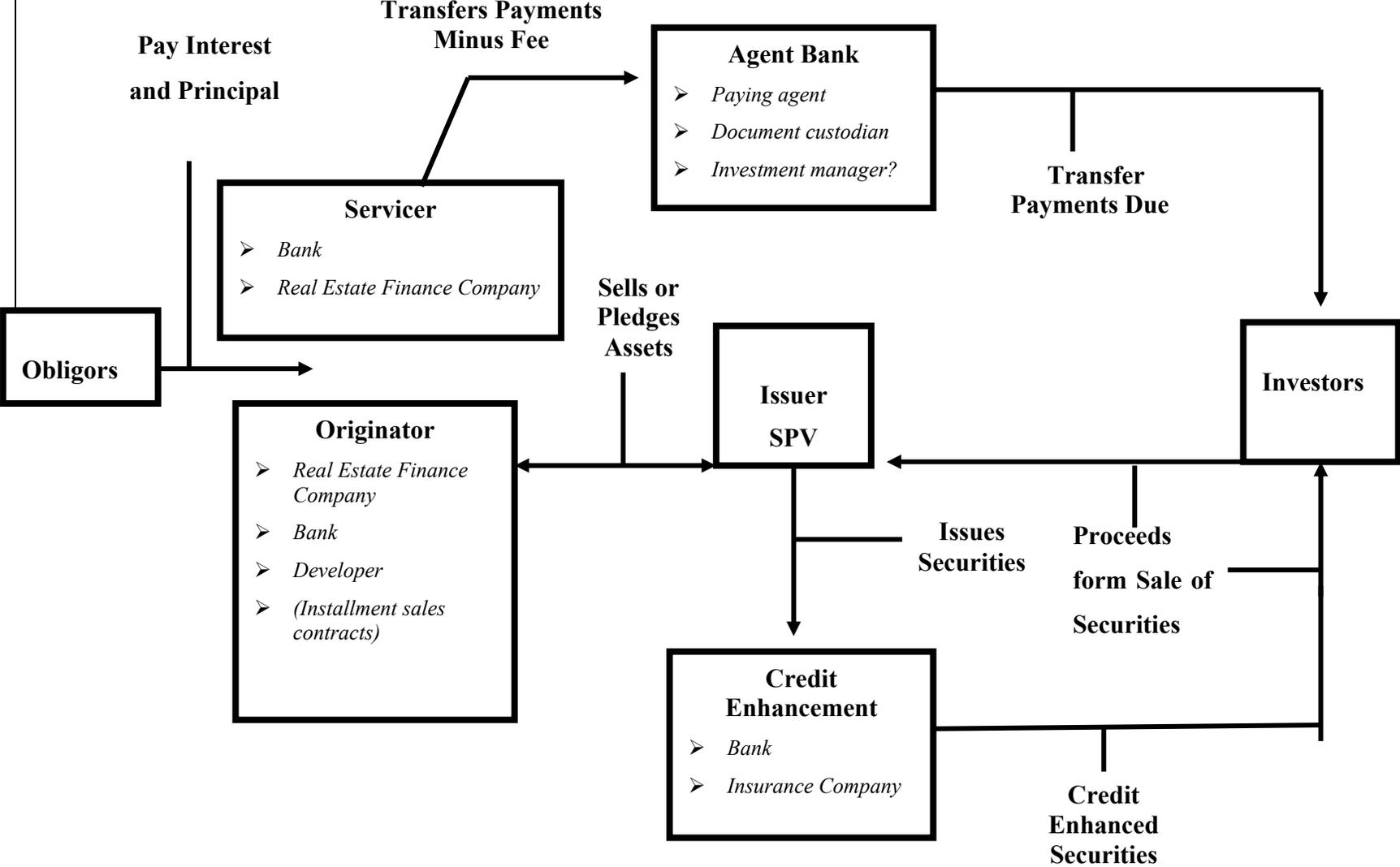
A detailed discussion of the issues associated with securitization is presented in Annex 7.

Issues of Securitization

What is Securitization?

~~Securitization is the process by which loans or other financial assets are sold to a third party that issue debt securities backed directly or indirectly by the loans or other financial assets purchased. A chart of a representative securitization transaction is shown on the following page. The obligations on the securities are primarily serviced by the cash flows of the discrete pool of loans or other financial assets that, by their terms, convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the holders of the securities. The securities issued are called “asset-backed securities” or “ABS”. Securities backed by pools of mortgages are called “mortgage-backed securities” or “MBS”. Under the Real Estate Finance Law, real estate loans will back the debt securities issued, so the securities can be referred to as “real estate loan-backed securities” or “RELBS”.~~

Securitization Process for an Asset-Backed Security



~~The draft securitization regulations define securitization as follows:~~

~~Article (289)~~

~~Real Estate Securitization activity shall be deemed to mean the transactions of assigning the portfolios of financial rights and sureties annexed thereto arising from real estate financing agreements executed in accordance with the provisions of Real Estate Finance Law promulgated by law no. 148 for the year 2001 to the companies licensed to practice the business of securitization of financial rights. Those companies shall issue bonds whose principal and the yield thereupon shall be paid from the proceeds of the assigned portfolio of rights.~~

~~**What Entity Will Purchase the Real Estate Loans and Issue the Real Estate Loan-Backed Securities?**~~

~~Normally, a Special Purpose Entity (“SPE”) is established to purchase the securitized assets. In other countries, the SPE may be a company, a trust or take either form. Exhibit 21 presents excerpts from the laws and regulations of several countries relating to the permitted legal forms of SPEs. Regardless of its legal form, the SPE is a passive, bankruptcy remote entity created for the limited purpose of acquiring financial assets and issuing securities. Unlike traditional issuers of corporate debt obligations that are operating companies with ongoing business operations, SPEs have no activities other than purchasing pools of financial assets and issuing securities backed by those pools of assets, have few, if any, employees and have agents that perform the issuer’s necessary day-to-day functions.~~

~~The draft securitization regulations specify that in Egypt, the SPE will be a joint stock company to be called a “Real Estate Securitization Company” whose purpose is “confined only to practicing the business of securitization.” In addition, “mutual investment funds taking the form of joint stock companies may practice the securitization business” if they obtain a license for this activity from the CMA. A Real Estate Securitization Company may not issue any bonds or financing instruments other than “Securitization Bonds”, but will be authorized to issue more than one Securitization Bond, so long as it maintains a separate account for each securitization transaction.~~

~~**What is the Form and Structure of a Securitization Bond?**~~

~~The draft securitization regulations refer only to Securitization Bonds without defining what financial structures these bonds may take. Securitization bonds are not general obligations of the real estate securitization company credit enhanced through the pledging of specific real estate loans as collateral because the second paragraph of Article 11 of the Real Estate Finance Law and the second paragraph of Article 302 of the draft securitization regulations explicitly state that the source of payment of the interest and repayment of principal on the bonds will be only the proceeds from the securitization portfolio.~~

~~Real Estate Finance Law, Article 11, Paragraph 2:~~

~~The assignee quarter shall settle the rights resulting from the securities issued thereby on their maturity dates out of the proceeds of the assigned rights.~~

~~Draft Securitization Regulations, Article 302, Paragraph 2:~~

~~In all cases, the obligation on the part of the real estate securitization company shall be confined only to the fulfillment of such obligations ensuing from the~~

~~securitization bonds on the proceeds of the rights included in the portfolio, after deducting the commissions and fees.~~

~~However, unlike asset-backed securities in other countries, the securitization bonds do not represent an ownership interest in either the underlying real estate loans or in specified cash flows arising from the underlying securitization portfolio. Under the Capital Market Law, only investment companies are permitted to sell shares that represent undivided interests in a pool of assets. Therefore, the CMA has determined that Securitization Bonds should not represent undivided interests in either the securitization portfolio itself (Pass-Through Securities) or in specific cash flows generated by the securitization portfolio (Collateralized Real Estate Loan Obligations). What apparently has been conceived is a hybrid between a traditional corporate bond and an asset-backed security. The CMA should clarify the nature of the securitization bonds authorized by the Law and the securitization regulations and clearly define exactly what rights are conveyed to the investors in these bonds. The CMA also should consider the implications of the different financing structures commonly used in securitizations to determine the most appropriate structures for the new Egyptian real estate loan securitization market.~~

~~What Financing Structures Should be Considered for Securitization Bonds?~~

~~The structure of securitization bonds is important because of the potential difference in timing between the cash inflows from the underlying loans and the scheduled payments of interest and principal on the bonds. The real estate loans under the Real Estate Finance Law will be amortizing loans, generally with monthly payments of interest and principal. If the interest and principal repayment dates on the Securitization Bonds differ significantly from those of the underlying pool of loans, the issuer must assume substantial reinvestment risk that could threaten the financial soundness of the bonds. The risk would be the greatest with a traditional bond structure in which interest is paid annually, semiannually or quarterly during the life of the bond and the principal is repaid in full at maturity. For example, if securitization bonds with a 13% interest rate, interest payable semiannually, and the principal amount of the bond payable at maturity are collateralized by fully amortizing real estate loans with monthly payments of interest and principal, the issuer will have to reinvest the monthly cash flows from the loans until the interest payment dates and the final maturity date. If the reinvestment rate is 11%, the reinvested cash flows from the real estate loans probably will not generate sufficient income to pay the interest on the bonds. Such a structure is inherently financially unsound and should not be permitted under the securitization regulations.~~

~~Pass-Through Certificates~~

~~To avoid excessive reinvestment risk, the timing of interest and principal payments on asset-backed securities usually tracks the timing of interest and principal payments on the underlying loans or receivables. As securitization has become more sophisticated, the financial structures of asset-backed securities have become quite complex, with multiple classes of bonds having different payment schedules and different maturities. However, at the initial stage of development of securitization, it would not be prudent to allow the issuance of complicated collateralized securities. These securities involve significant risks that could be magnified in a market where there has been no experience with either securitization or with the underlying real estate loans themselves.~~

~~The most basic form of asset-backed security is the pass-through certificate. The pass-through structure has usually been the first form of securitization introduced in most countries. A pass-~~

through certificate provides its owner with a pro rata ownership interest in a pool of loans or receivables. An issuer of pass-through certificates primarily acts as a conduit for the investors by collecting and proportionally distributing the cash flows generated by the homeowners making payments, usually monthly, on their real estate loans, net of servicing and other fees. Because home real estate loans are fully amortizing assets, a holder of a pass-through certificate receives some return of principal at each payment date. Complete return of principal and the final maturity of the pass-through do not occur until the final real estate loan in the pool is paid in full, although most pass-through structures permit a “clean-up call” on the certificates when the loan pool is reduced to a specified level. The pass-through of the cash flows received from the underlying loan results in a great deal of uncertainty about the timing of principal repayment on the securities.

Pay-Through Bonds

The simplest bond structure for securitization bonds that would reduce, but not eliminate the uncertainty about principal repayment on the securities is the pay-through financing structure. Unlike a pass-through certificate, a pay-through bond represents a claim on the cash flows generated by the underlying real estate loans, not an ownership interest in the real estate loans themselves. Although the payment terms of a pay-through bond may not exactly match the payment terms of the underlying loans, the relationship between them usually is close. In most cases, the payments of interest and principal on the underlying loans, and interest from the short term reinvestment of payments on the loans, are expected to be the sole funding sources for payments on the bonds. Interest on the bonds is paid on the same schedule as the underlying loans, i.e. monthly, quarterly, semiannually or annually. Scheduled principal repayment and prepayments are “paid through” in whole or in part to the bondholders in the form of mandatory calls on the bonds. Because the pay-through bond still involves uncertainty about the amount and timing of principal repayment, investors who want a specific return on an investment over a definite time period may not find the pay-through bond structure attractive or may demand a higher premium to compensate for the risk of the mandatory calls.

Collateralized Real Estate Loan Obligation

A collateralized real estate loan obligation (a collateralized mortgage obligation or “CMO” in other countries) is a type of pay-through bond that is divided into classes having different payment priorities. They are similar to pay-through bonds in that the source of payment of interest and principal on the bonds is the cash flow from the underlying loans, but they differ from the simpler form of bond structure in that they convey ownership claims only on the cash flows assigned to specific classes of securities (called “tranches”) based on specified principal distribution rules. Because the underlying loans are amortizing, collateralized obligations are usually divided into “fast-pay” and “slow-pay” classes that have different priorities as to the payment of principal. The final maturity of each class is based on the scheduled amortization of the underlying loans and, if there are reliable statistical data on prepayment experience, assumed prepayments. All principal repayments, including prepayments, are made first to the class having the earliest maturity date until it is retired and then to the class with the next earliest maturity date until it is retired, and so on until the principal is repaid in full on all of the classes.

~~Structured collateralized bonds involve significant risks in markets such as Egypt, where there is little, if any, historical statistical data on the performance and prepayment experience of the underlying loans. Potential shortfalls in cash flow and miscalculations of the amount of principal repayment would have to be covered by guarantees, cash reserves, liquidity facilities or other forms of credit enhancement.~~

~~Impediments to the Implementation of Securitization of Real Estate Loans~~

~~The Sale of Real Estate Loans Must be a “True Sale” to a “Bankruptcy Remote” Entity~~

~~The greatest impediments to the securitization of real estate loans under the Real Estate Finance Law are the questions about 1) whether the real estate securitization company is “bankruptcy remote” from the originator-seller of the loans and 2) whether the sale of the real estate loans by the originator (the “financier”) of the loans to the real estate securitization company satisfies the legal requirements for a “true sale” of the loans. This issue has arisen because of the requirement in the third paragraph of Article 11 of the Law that:~~

~~The financier shall guarantee settling the rights resulting from the aforementioned securities. Agreement may also be reached on a third party’s guarantee for settling these rights according to the rules to be determined in the executive regulations of the present law.~~

~~In an attempt to ensure that investors in the real estate loan-backed securities authorized in the Real Estate Finance Law would have confidence in the creditworthiness of the issuers of securities, Parliament added this paragraph to the Law. The requirement that the originator-seller of real estate loans (the financier) guarantee the payment of interest and principal to the purchasers of securities seems to contravene the fundamental requirements for securitization—a true sale of the assets and the bankruptcy remoteness of the issuer. As a result, the Law may have prevented the development of the very securitization market it was intended to foster.~~

~~What is “Bankruptcy Remoteness?”~~

~~An issuer is bankruptcy remote if the insolvency of the originator-seller of the underlying real estate loans would not result in an interruption of the cash flows from the originator-seller to the holders of the securitization bonds or in any other way affect the pool of underlying loans backing the securities. Provisions designed to ensure that the issuer is bankruptcy remote have been included in the draft securitization regulations:~~

- ~~1. Limiting the activities of the real estate securitization company to securitization transactions (Article 291);~~
- ~~2. Prohibiting the financier from having representation on the board of directors of the real estate securitization company (Article 292); and~~
- ~~3. Prohibiting the real estate securitization company from incurring any other debt (Article 300).~~

~~However, simply requiring that the real estate securitization company be structured to be bankruptcy remote does not ensure that the assets held by the real estate securitization company~~

will be protected from the claims of the creditors of the originator-seller in the event that the originator-seller becomes subject to a bankruptcy proceeding.

Importance of a True Sale in Securitization Transactions

The transfer of the real estate loans to the real estate securitization company must be in the contractual form of an absolute assignment. Courts refer to such a structure as a true sale. Theoretically, a "bankruptcy remote" entity has purchased real estate loans that have effectively been placed beyond the reach of creditors of the originator-seller in a subsequent bankruptcy of the originator-seller. The holders of the securitization bonds collateralized by the real estate loans purchased have a first priority claim on the real estate loans that are held for their benefit by the securitization company through a trustee or an agent bank.

Generally, recourse to the originator-seller of the real estate loans will be the most important factor in determining whether the transfer of real estate loans from the originator-seller to the real estate securitization company is a sale or merely a pledge of collateral by the originator-seller. If the guarantee provision of Article 11 of the Real Estate Finance Law is interpreted to mean that the originator-seller is selling the loans with full recourse, the credit risk of the real estate loans has not been transferred to the real estate securitization company, but has been retained by the originator-seller. The economic nature of the transaction, regardless of the actual terms of the contract of sale, is a secured financing. IAS and US accounting standards, and banking regulations, will require the originator-seller of a loan with a performance guarantee or full recourse to retain the sold loans on its books and record a debt liability.

The treatment of a loan sale as a secured borrowing creates serious concerns for the issuer of the real estate loan-backed securities and the investors who purchase these securities. If a bankruptcy judge determines that, regardless of terms of the purchase and sale agreement (PSA) transferring the loans to the real estate securitization company, the transaction was not a true sale, but a loan, the real estate loans that were sold would be treated as part of the bankruptcy estate of a bankrupt originator-seller. In addition, the re-characterization of a sale of loans as a collateralized borrowing effectively annuls the securitization transaction, frustrating investor expectations. To maintain the viability of this financing mechanism, the purchasers of the securitization bonds must be able to rely on the apparent form of the transaction. Uncertainty about how courts may view the transaction will reduce, if not eliminate, the market for these securities.

Possible Solutions to the Problem

There may be no solution to the problem created by the third paragraph of Article 11 of the Law except amendment of the Law or the enactment of a provision in an amendment of the Capital Market Law that would supersede the Real Estate Finance Law. Amendment of the Real Estate Finance Law to remove the guarantee requirement is unlikely unless the Parliament can be made to clearly understand that the provision it added to the Law precludes securitization of real estate loans. As a result, no real estate finance companies will be formed, no real estate loans will be sold for securitization and the intent of the Law will be frustrated.

It is possible that a securitization of real estate loans could be treated as a true sale, despite the guarantee mandated by the Law, if a legal ruling can be obtained that the guarantee is a separate and distinct transaction from the sale of the real estate loans and is not full recourse. Legal

~~experts at the Ministry of Justice, the CMA and the Real Estate Finance Affairs Authority could make a formal determination that if a securitization of real estate loans meets specific criteria, the courts should construe the transaction as a true sale and the sold assets should not be included in the originator-seller's bankruptcy estate.~~

~~There are minimum requirements that would have to be in place for a finding to be made that the sale of real estate loans under the current law could be treated as a true sale. The first requirement is for the parties to execute a purchase and sale agreement (PSA) memorializing the sale of the real estate loans. The PSA must clearly state that the parties intend the transaction to be a sale of the loans, not a secured borrowing and that the originator-seller retains no control over the loans sold to the real estate securitization company. The contract must also clearly state that all risk of loss on the loans is transferred to the real estate securitization company, regardless of any guarantee the originator-seller may provide to the investors in the securitization bonds issued by the real estate securitization company.~~

~~The next requirement is to have the guarantee agreement required by Article 11 of the Law be a separate agreement between the originator-seller and the real estate securitization company.~~

~~The third requirement is to construct the real estate securitization company as a completely separate entity over which the originator-seller has no direct or indirect control in order to avoid possible substantive consolidation in a bankruptcy proceeding. Deficiencies in structural or operational separation can result in the substantive consolidation of the transferred loans held by the real estate securitization company with the bankruptcy estate of the originator-seller. There may be some question about whether the 20% ownership of the real estate securitization company by an originator-seller permitted under Article 297 of the draft securitization regulations would be considered direct or indirect control of the real estate securitization company by the originator-seller.~~

~~The fourth requirement is for the transaction between the originator-seller and the real estate securitization company to be an "arm's length" transaction in which the real estate securitization company pays the market price for the loans it purchases and for the collection on and administration of the securitized loans ("loan servicing") by the financier.~~

~~The final requirement is that a third-party provider of credit enhancement for the securitization bonds can assume all or part of the liability of the originator-seller for the required guarantee. The investors in the securitization bonds would have a claim against the provider of the credit enhancement rather than the originator-seller. Since most of the originator-sellers will be newly organized real estate finance companies without any record of performance, the guarantee of the originator-seller will not be highly regarded by either the rating agencies or investors. Article 302 of the draft securitization regulations permits the real estate securitization company to secure additional guarantees for the securitization bonds, which could be senior to the guarantee of the originator-seller.~~

Article (302)

~~Without prejudice to the financier's obligation to guarantee fulfillment of the payments due for the securitization bonds issued by the real estate securitization company against the securitization portfolio assigned thereby, the company may obtain additional guarantees in the interest of the bond holders including insurance~~

~~policies, in person or in kind guarantees, or any other forms of guarantee deemed suitable thereby.~~

~~The problem with this solution is that every expert and official consulted on this issue as part of this project said that the specific word used for guarantee in the Law meant a 100% guarantee and the draft securitization regulations do not interpret the guarantee to be less than 100%. Credit enhancement for asset-backed securities usually covers only a percent of the total amount of an issue because the underlying loans or receivables collateralize the securities. It is highly unlikely that a portfolio of 500 or more well diversified real estate loans to individuals for home purchase would suffer catastrophic defaults and losses on default simultaneously. Therefore, it is not necessary to provide a 100% default guarantee. Unless the guarantee requirement in the Law could be interpreted to mean less than a 100% guarantee of the securitization bonds, the costs of the guarantees may make securitization less financially feasible. Since these costs will be passed down to the borrowers on the underlying loans, real estate loans will become less affordable for Egyptian homebuyers.~~

~~Another problem is the breadth of interpretation of what constitutes a guarantee. The credit enhancements commonly used for asset-backed securities include a number of other structures besides a guarantee. The guarantee requirement should be broadly interpreted to include the range of credit enhancements used for securitizations. A list of standard credit enhancements is provided in Exhibit 4.~~

Conclusion

~~Until the legal issue of a true sale of real estate loans under the provisions of Article 11 of the Real Estate Finance Law is resolved, there will be no securitization of the real estate loans originated under the Law. Without the ability to remove real estate loans sold from their books, banks will not originate real estate loans. It is unlikely that banks and other prospective organizers of real estate finance companies will invest their funds in institutions that have a limited ability to fund real estate loans. The real estate finance system in Egypt will not develop and the status quo will be maintained.~~

Lack of Securitizable Loans

~~It will be some time before there is a sufficient volume of real estate loans originated under the Real Estate Finance Law to permit securitization. The Real Estate Finance Affairs Authority was only recently established and is not yet fully operational. A number of the regulations, rules and forms necessary for real estate finance companies to begin operations have not yet been issued. Optimistically, it will be a year or more before real estate finance companies will begin to reach their potential.~~

~~It is unlikely that banks that are in the process of establishing affiliated real estate finance companies would begin originating real estate loans on their own balance sheets. It is possible that foreign banks that have experience in originating real estate loans in other countries will begin originating real estate loans for securitization through their Egyptian subsidiaries or affiliates.~~

~~Real estate related assets other than real estate loans originated under the Real Estate Finance Law could be securitized if authorized by the Capital Market Authority's securitization regulations. However, the current draft regulations limit real estate securitization activity to "portfolios of~~

financial rights and sureties annexed thereto arising from real estate financing agreements executed in accordance with the provisions of Real Estate Finance Law, No. 148 for the year 2001”.

The Capital Market Authority should give serious consideration to expanding the types of real estate related financial assets that can be securitized. The specialized real estate banks, and perhaps some of the large banks, have portfolios of real estate loans that could be securitized. However, the foreclosure provisions of the Real Estate Finance Law were not retroactive. Therefore, all existing mortgage loans remain subject to the unwieldy foreclosure procedures of the Civil Code. Performance guarantees would be required for these loans to be securitized.

The installment sales contracts currently held by many real estate developers and Islamic banks and commercial real estate loans currently on the balance sheets of Egyptian banks also could be securitized. The installment sales contracts are relatively short term and have a performance history, which will make them easier to securitize. The securitization of these real estate financial assets could relieve some of the pressure on the banks' liquidity and capital and the developers' liquidity and profitability.

Limited Capacity of the Egyptian Capital Market

All of the capital market experts interviewed during this project did not believe that the Egyptian capital market could support the estimated LE 10 billion to LE 20 billion annual volume of real estate loan transactions. Initially, issue size would have to be relatively small, LE 30 million to LE 50 million. Interest rates on the securitization bonds would have to be at least 13% and probably higher. When all of the costs and fees associated with the securitization transaction are taken into account, the interest rate that would have to be charged on the underlying real estate loans would probably be over 15%. At a 15% interest rate, real estate loans would not be affordable to many middle income Egyptian families. Higher income people could decide that with deposit interest rates at 11% to 12%, they would prefer to pay cash for their home purchases rather than finance at a rate of 15% or more.

Most of the experts interviewed felt that interest rates in Egypt were being kept artificially high to defend the Egyptian pound, but that this situation could not go on indefinitely. Once the pound is devalued or allowed to float at market exchange rates, domestic interest rates are expected to decline to levels where real estate finance would be affordable.

There has traditionally been strong regional interest in Egyptian securities. The marketing director of a major Egyptian investment bank estimated that about 70% of all of the shares listed on the stock exchange were owned by non-Egyptians. There was a consensus that Gulf region investors would be receptive to real estate loan-backed securities. Many of these investors would be familiar with asset-backed securities from other countries and would not view Egyptian real estate loan-backed securities with as much skepticism as domestic investors. However, the expectation that the Egyptian pound will be devalued has dried up the stream of foreign investment in Egyptian pound-denominated securities. When the pound has stabilized, foreign, and particularly Gulf region, investment is expected to resume at its historical, or even higher, levels.

Another alternative that had widespread support is to issue US dollar-denominated real estate loan-backed securities. Apparently, the Central Bank of Egypt routinely covers the foreign exchange risk for foreign currency-denominated securities and loans. If real estate securitization

~~companies could issue securitization bonds at current US dollar interest rates and not be exposed to foreign exchange risk, they could pass through the low US dollar interest rates available today to the borrowers of real estate loans. Loan interest rates could be 8% to 9% or even lower, making housing finance affordable to many middle income families.~~

~~**The Capital Market Authority Draft Securitization Regulations**~~

~~The draft securitization regulations require some modification to better incorporate the legal and operational characteristics of securitization. The staff of the Capital Market Authority was provided with the securitization regulations and laws of several countries that have introduced securitization in the last ten years or so. These can provide useful insight into the requirements for comprehensive securitization regulations.~~

~~There are some issues that cannot be dealt with by regulation, such as taxation, the priority of claims of employees and creditors and the bankruptcy treatment of assets held for the benefit of securitization bonds holders by originator sellers and loan servicers. These issues should be resolved through the structure of the securitization transaction and securitization companies themselves and/or by obtaining a ruling from the relevant ministry.~~

~~A detailed analysis of the draft securitization regulations is beyond the scope of this project, but the following list of issues and questions points out some of the areas of concern.~~

~~**Chapter One—General Provisions**~~

~~Article 289~~

~~The definition of real estate securitization activity could be broadened to include real estate financial assets other than real estate loans under the Law.~~

~~The sources of funds to pay interest and principal on the bonds should include cash reserves, payments by guarantors or insurers, earnings on temporary investments by the real estate securitization company and the capital of the real estate securitization company.~~

~~**Chapter Two—Licensing**~~

~~Article 291~~

~~Under this article, real estate securitization companies appear to be going concerns that will issue a number of securitization bonds collateralized by different pools of loans. It is more common for a real estate securitization company to be established for a single bond issue and then to terminate when the bond issue is paid off in full. Managing and accounting for multiple issues of securitization bonds to ensure that there is no commingling of separate bondholders' funds and rights will require more than the separate accounting required in Chapter Five of the regulations.~~

~~Five million in capital, only half of which must to be paid in cash, may be sufficient for a limited volume of issuance (up to LE 100 to LE 150 million), but could prove inadequate to support a larger volume of issuance. A real estate securitization company should be required to maintain capital at a specified percentage of the aggregate outstanding balance of all securitization bonds issued.~~

~~It is not clear whether mutual investment funds taking the form of joint stock companies would have to infuse an additional five million in capital (LE 2.5 million in cash) to be licensed as a real estate securitization company, although the Capital Market Law and its regulations require additional capital for each activity in which a securities company engages.~~

~~Article 292~~

~~This article is intended to ensure the independence of the board of directors of the real estate securitization company by prohibiting representatives of any financier selling loans to the company and any credit rating agency that rates its bonds from sitting on the board of directors of the company. When a real estate securitization company is established, the financiers from whom it will purchase loans may not be known. It is possible that a director of the company who is independent when he is elected to the board may lose that independence in the future if the institution with which he is affiliated begins to sell loans to the real estate securitization company. This article is silent on whether representatives of companies owning financiers are eligible to sit on the board of a real estate securitization company.~~

~~This article should include a requirement that the real estate securitization company may not use a name that the same as or so similar to the name of any one of its shareholders or any financier from whom it intends to purchase loans as to imply that the financial strength of the shareholder or financier stands behind the real estate securitization company.~~

~~The name of the real estate securitization company shall not include the name of any financier or any of its associated companies, or imply any association with any financier or any of such companies;~~

~~Article 293~~

~~This article should be expanded, or a new article added, to address the management of the real estate securitization company. It is recommended that the regulations require that, like an investment fund, a real estate securitization company be required to “contract the management of its activities to a specialized entity.” By outsourcing its management activities, the company can avoid any question of the priority of claims of employees.~~

~~Article 294~~

~~In addition to the organizational documents required by this article and Article 135 of the Capital Market Executive Regulations, a company seeking a license as a real estate securitization company should submit documents establishing its bankruptcy remoteness. These would include a resolution of the board of directors of the company in organization that it may not declare bankruptcy, voluntarily enter into insolvency proceedings or make material changes to its organizational documents without the unanimous vote of all directors. In addition, the organizational documents should mandate that the real estate securitization company will: 1) maintain its office separate and distinct from the offices of any originator seller or its affiliates; 2) conduct business solely in its own name; 3) have a managing director, other officer or agent charged with day-to-day management; and 4) pay its own expenses. The organizational documents also should include all contracts for services to be provided to the real estate finance company by third parties.~~

Chapter Three—Assignment of the Securitization Portfolio

Article 295

~~A second paragraph should be added to this article, or a new article added, to include the criteria for a true sale of the securitization portfolio to the real estate securitization company. The following are representative true sale provisions:~~

~~The securitization portfolio must be isolated to the extent possible from the financier(s) from which the real estate securitization company has purchased securitized real estate loans. The financier must effectively transfer all rights and obligations in the securitization portfolio to the real estate securitization company and not retain any residual interest in the securitization portfolio. The real estate securitization company shall have the exclusive right to pledge or exchange its interest in the securitization portfolio. The ongoing duties and responsibilities of the financier are limited to those specified in the first paragraph of this article. The assignment of the securitization portfolio shall be subject to the following conditions:~~

- ~~1.the transfer must be such as to totally divest the financier and all of its associated companies of all rights and obligations originating from the securitization portfolio and all risks in connection with the real estate loans assigned;~~
- ~~2.the real estate securitization company shall have no right of recourse against the financier or any of its associated companies for any loss sustained in connection with the securitization portfolio after the transfer thereof, except for a guarantee of the securitization bonds or other form of credit enhancement provided by the financier under separate agreement with the real estate securitization company;~~
- ~~3.the financier, at its own discretion, may enter into agreement to 1) repurchase or substitute a real estate loan if there has been a breach of any of the terms, conditions representations or warranties of the assignment agreement or 2) repurchase fully from the real estate securitization company all of the securitized real estate loans remaining when the outstanding amount of the securitization portfolio has declined to a level that makes the securitization bond uneconomical to carry on to full repayment or settlement;~~
- ~~4.under the terms of the assignment agreement, the financier shall be under no obligation to provide additional real estate loans to the real estate securitization company to maintain a “coverage ratio” of collateral to outstanding securitization bonds. A financier may enter into a separate agreement with the real estate securitization company to provide this form of credit enhancement.~~
- ~~5.the services provided by the financier specified in the first paragraph of this article as the “servicing agent” of the real estate securitization company must be provided on an arm’s length basis on market terms and conditions;~~
- ~~6.as servicing agent, the financier has no obligation to remit funds to the real estate securitization company or a paying agent designated by the real estate securitization company unless and until the funds have been received by the financier from the obligor(s) on the underlying real estate loans;~~

~~7.all expenses incidental to underwriting, conveyance of the securitization portfolio including expenses for credit enhancement may be paid by the financier or a related company of the financier, but neither the financier nor any of its related companies shall bear any recurring expenses for the securitization transaction after the securitization portfolio has been assigned to the real estate securitization company.~~

~~Article 296~~

~~The Capital Market Authority will need more detailed information about the securitized real estate loans and the structure of the securitization bonds that the real estate securitization company intends to issue. This information includes, but is not limited to, the following:~~

~~A detailed description of the structure of the securitization bonds and all significant agreements relative to that structure;~~

~~Corporate profiles of all parties involved, including guarantors, providers of credit enhancement or liquidity facilities, custodians and paying agents;~~

~~A detailed description of the securitized real estate loans, including the cash flow profile and, if available, historic levels of delinquency, default and loss on default for similar portfolios of real estate loans; and~~

~~An explanation of how the cash flows from the real estate loans are expected to meet the real estate securitization company's obligations to holders of the securitization bonds.~~

~~Article 297~~

~~The Capital Market Authority should confirm with the Central Bank of Egypt (CBE) that a real estate securitization company in which a bank registered with the CBE holds a 20% ownership position will not be construed as an affiliate of the bank.~~

Chapter Four—Issuance of Securitization Bonds

~~Article 298~~

~~This article states that the provisions of the Capital Market Law (and presumably its executive regulations) shall apply to the issuance of securitization bonds. The provisions of the Capital Market Executive Regulations relating to bonds and financial notes (Articles 34 through 38) do not accommodate the financial structures employed in securitization transactions. These provisions relate to bonds issued by operating companies, not a specialized securities company whose sole purpose is the issuance of bonds.~~

~~Article 34 of the Capital Market Executive Regulations limits the value of issued debt securities to the net asset value of the company, in other words, a debt to equity ratio of 1:1. Obviously a real estate securitization company will be much more highly leveraged. The Capital Market Authority can grant permission to exceed this limit, but the securitization regulations should state that the maximum amount of issued securitization bonds will be a specified multiple of the capital of the real estate securitization company. For example, if the Capital Market Authority determines that a real estate securitization company should maintain capital at 3% of its total assets (LE 3 for every LE 100 in~~

~~assets), the company could issue up to 97% of its total assets in securitization bonds (LE 97 for every LE 100 in assets), for a debt to equity multiple of 32.33X.~~

~~Article 35 requires approval of the bond issue by the general assembly of the shareholders of the company. For real estate securitization companies, the board of directors should be empowered to make the decision to issue securitization bonds. Convening a general assembly of the shareholders every time the company plans to issue a securitization bond is unwarranted since the sole business of the company is to issue bonds.~~

~~Article 37 requires that “bonds or financial notes of the same issue entitle their holders to equal rights vis-à-vis the Company.” Securitization bonds give the investors rights to the cash flows from the underlying securities, not claims on the assets of the real estate securitization company, except to the extent that those assets are pledged against a specific bond issue. Additionally, real estate securitization companies must be authorized to issue different classes of securities within the same bond issue with different rights to the cash flows from the underlying securities, not “equal rights” as required in Article 37. The securitization regulations should include provisions regarding the interests of holders of securitization bonds that supersede the provisions of Article 37.~~

~~Article 38 requires that bonds have coupons. Asset backed securities generally do not carry coupons because the payment of interest and principal vary from interest payment date to interest payment date. The amount of interest and principal received will depend on the cash flow received on the underlying real estate loans. Holders of asset backed securities do not submit a coupon to receive the interest and principal due. The paying agent of the real estate securitization company maintains a schedule of payments due to bond holders, makes the appropriate payments when due and prepares financial reports to that effect.~~

~~Article 39 states that the rules and provisions relating to shares are applicable to bonds. The rules and provisions relating to shares should be carefully analyzed to determine whether any are not appropriate for securitization bonds. If so, provisions must be included in the securitization regulations to supersede the conflicting provisions of the Capital Market Executive Regulations.~~

~~Article 299~~

~~A prospectus for a securitization bond must provide detailed information about the underlying financial assets, the classes of bonds being issued and the rights of holders of each class of bond. The information required under Article 299 and Articles 37 and 42 of the Capital Market Executive regulations might not be sufficient for full disclosure for securitization bonds. The staff of the Capital Market Authority should evaluate the prospectus requirements in other countries to determine whether the provisions of the existing and proposed regulations are adequate.~~

~~Article 300~~

~~The third paragraph of Article 300 limits the value of securitization bonds outstanding to the value of the underlying pool of loans collateralizing the bonds. Asset backed securities~~

typically have some amount of overcollateralization, but not enough to cover all contingencies. The provisions of Article 300 may be problematic as the underlying loans pay down and temporary cash balances are held until an interest and/or principal payment date. The article does not specify what a real estate securitization company must do if the value of the bonds should fall below the value of the underlying pool of real estate loans.

Article 301

This article addresses the use of proceeds from the securitization portfolio. The second paragraph says that the “real estate securitization company shall keep the surplus of the above proceeds in an independent account whose deposits shall be utilized for limited risk investment, provided that the balance of such account shall be reimbursed in full to the financier on the final maturity date of the bonds and after being fully amortized.” This paragraph should be deleted in its entirety and replaced with a provision that states that any surplus shall be used as additional security for the securitization bonds and can be paid out to bond holders if the proceeds from the underlying real estate loans are not sufficient to meet the payment obligations to bond holders and can cover losses on the underlying real estate loan portfolio. Any surplus remaining after retirement of the securitization bonds in full should not be “reimbursed to the financier” because the financier has no rights in the surplus. Paying out the surplus to the financier would violate the principles of a true sale of the real estate loans. The real estate securitization company should retain any surplus.

Chapter Five—Management of Securitization Transactions

The provisions of Chapter Five (Articles 304 through 307) totally ignore the role of third parties in securitization transactions. The regulations should specify the nature and qualifications of third parties usually involved in securitizations, such as the paying agent, document custodian and investment manager. Segregation of accounts for each securitization transaction alone does not constitute management of real estate loan backed securities. The provisions of the Capital Market Executive Regulations relating to investment managers for investment funds can serve as a guide for the regulations that should be issued for third parties providing services to a real estate securitization company, although the powers of such third parties will not be as broad as those of an investment manager.

Article 305 requires that the financier deposit the amounts collected on the real estate loans on behalf of the real estate securitization company to an account of the company. Usually the financier, or financiers in a multi-seller securitization, pays the amounts collected from the obligors on the underlying loans to the paying agent of the issuer, not directly to the issuer. By this method, there can be no commingling of funds with the funds of the real estate securitization company or between different securitization bond issues. It is also customary for a document custodian of the real estate securitization company to hold the original documents of the underlying real estate loans.

Article 306 calls for a quarterly evaluation of the securitization portfolio. This is not frequent enough to monitor the condition of the portfolio. At a minimum, the securitization portfolio should be evaluated monthly. The accounting systems used by the real estate securitization company or its agents should be capable of producing a daily trial balance.

The evaluation report should include, at a minimum, delinquency statistics on the real estate loan pool and earnings on temporary cash balances in addition to the items specified. Post-issuance financial reporting is becoming more detailed to provide better information about the securitized loans to the issuer, its auditors, the rating agencies and investors.

Section XIII

Training Needs and Resource Assessment

Training needs resulting from the passage of the Real Estate Financing Law are difficult to assess definitively at this time because the Real Estate Finance Affairs Authority is not fully operational. Training needs of its staff will vary based on the expertise and experience of those hired. Similarly, until REFAA's staff has set its training requirements for registering real estate finance companies, real estate financing brokers, Execution Real Estate Agents and Real Estate Valuers, it is difficult to completely plan their training.

However, the positions, which these potential trainees will hold, are listed in this report. The type of training that they will need for those positions is clear. This section examines the type of training needed by the staff of REFAA, the real estate finance companies, the real estate financing brokers, the execution real estate agents and the real estate valuers. It suggests ways that this training could be provided and the timing for its start based on the likely timing of implementation for the various activities that the law mandates.

Article 38 A—Training for the Staff and Board of the Real Estate Finance Affairs Authority

General Training Issues and Rationale: It will be important to tailor training for the senior staff of REFAA to their individual needs. Once they are hired, the skills and experience of each can be evaluated, personalized training programs can be designed to focus on needed skills.

REFAA will be a small regulatory agency, so there is likely to be considerable interaction between departments, just as there is between the organizations and specialists they oversee. All managerial and professional personnel should have a basic understanding of all the markets and the functions recommended for the senior managers, even if those are outside their direct area of responsibility.

The managerial and professional staff, should be thoroughly familiar with the Real Estate Finance Law and its decrees and regulations. They must have a clear understanding of their own duties, methods of supervision, handling of complaints, enforcement activities, reporting requirements, analyzing reports, etc.

Proposed Start to Training: It would be useful to have a workshop, seminar or retreat lasting several days for REFAA managers soon after they are all in place. This would give them an overview of REFAA's activities and responsibilities and of the basic training topics discussed above. The seminar could also be designed to help identify areas of particular need for additional training for key individuals or managers from the same department. That need could in turn be met by having foreign experts come to Cairo or by sending the individual or group to special foreign or Egyptian programs. Training experts could work with REFAA's General Department for Organization and Training to devise the most effective, on-going staff training programs.

A 1. Board of Directors

Training Issues and Rationale: This report recommends in its section on the Real Estate Finance Affairs Authority that the Board retain experts to advise it in technical areas such as accounting, securities, and financial analysis. The Board members represent different organizations and may not be familiar with some of the activities of REFAA on which they will have the ultimate decision. It is possible that members of the Board of REFAA may also wish to participate in the initial seminar and in some of the training programs, or have a program designed for their needs.

As these reports show, especially in the Report: Real Estate Financing Rules and Procedures and the Report: Securitization of Real Estate Loans, there are major issues to be resolved regarding the provisions of Law 148 of 2001 and its related Presidential Decrees and regulations. The Board, with the help of the senior managers of REFAA and in coordination with the Ministry of Housing, Utilities and Urban Communities and other interested parties, will need to take the lead in resolving these issues so that the Law can be fully implemented.

Proposed Training or Advice: In addition to providing for possible participation by Board Members in programs designed for REFAA's senior management, it would be useful for training experts to consult directly with the Board to ascertain what training or advice would be most useful to it.

Advice on alternatives for resolving the conflicts and issues in the Law, decrees and regulations would be especially useful to the Board and the senior managers.

Article 38 A-2. Senior Managers of REFAA

Training Issues and Rationale: Senior Managers (the Chairman, Deputy Chairman, and Department heads) will need a strong understanding of real estate and real estate finance markets, of loan securitization issues, of the activities of real estate finance companies and of real estate valuation concepts and applications. They also must be thoroughly familiar with the functions of the three major groups of specialists REFAA supervises: the real estate financing brokers, the execution real estate agents and the real estate valuers.

They will also need to effectively manage REFAA, to advise the Board of Directors on policy issues and, with the help of the staff responsible for regulating real estate finance companies. They would also coordinate closely with the Ministry of Justice, the Capital Markets Authority and the Central Bank of Egypt on matters of mutual interest and with the Ministry of Higher Education on education requirements and examinations for each of the three groups of specialists.

Senior management will also need to create a clear and targeted information campaign. Most of REFAA's activities, e.g. valuation and home finance, have not previously been managed by a government agency and there is widespread confusion about them. Good information to those it serves will be key to REFAA's effective operations.

Proposed Training: Specially designed training programs are needed because REFAA is completely new, responsible for new functions and will have a very small professional and

managerial staff. Senior managers are likely to have differing levels of experience and expertise, so programs could include personalized advice and training to compensate for any lack of knowledge or experience by these managers in the various fields of specialization of the experts whom they manage.

These reports and the proposed initial workshop will provide a good base for informed, senior management decisions. Advice, beyond what is included in these reports, on the establishment, structure and management procedures for REFAA may also be useful. It would be especially useful for them to meet with managers of similar organizations in other counties.

Senior managers would benefit from advice and training on

- Managing a non-bank, financial regulatory organization
- Real estate and real estate finance markets and policies
- Securitization issues
- Real estate valuation issues and applications
- Effective public information campaigns
- Resolving issues and conflicts in the Law, its decrees and regulations

A. 3. Central Department for Real Estate Financing Activities

*Article 38 A-*3. A. Staff Responsible for Registering Real Estate Finance Companies and Real Estate Financing Brokers

Training Issues and Rationale: There will be a small number of employees of REFAA who will be responsible for registering and regulating real estate finance companies and real estate financing brokers. These employees will need to advise the Chairman and the Deputy Chairman and to implement efficiently their decisions and those of REFAA's Board. They will also maintain liaison with the Capital Markets Authority on issues related to the securitization of loans originated by the real estate finance companies and with the Central Bank on financial policy issues.

Therefore, these employees need a high level of expertise in finance and regulation of non-bank financial institutions, with specialization in commercial and retail real estate lending and in the management and regulation of real estate finance companies. The activities of real estate financing brokers are closely related to those of lenders so a person with the expertise to regulate real estate finance companies, would also have the experience to oversee brokers.

REFAA may be able to hire experts, with extensive experience in real estate lending at banks or with supervision experience at the Central Bank of Egypt. However, it may be difficult to find experts who have training and experience in all the fields related to registering and regulating real estate finance companies, real estate financing brokers. This is especially true because the banks do little retail home loan business and because real estate finance companies do not yet exist in Egypt.

Securitization is also a new activity in Egypt. Without securitization, there will be limited funding for loans made by real estate finance companies and very few if any loans will be made.

For reasons discussed in the section titled Report: Securitization of Real Estate Loans, the requirements for securitization will determine what procedures and loan documents are used by the real estate finance companies. Because the CMA, not REFAA, will determine the regulations setting requirements for securitization, the staff of the Central Department for Real Estate Finance Activities will need to understand the issues the CMA will manage and coordinate closely with the CMA.

Proposed Training: Personalized training programs tailored to build on the experience and knowledge of the personnel hired. This could be in the form of on-the-job training by short term experts hired to help in an area in which the staff lacks experience, or short term programs for staff members conducted at Egyptian or foreign institutions. It would be helpful if some members of this department could attend training programs on securitization, organized for CMA staff. Some examples of types of training that may be needed by REFAA managers responsible for registering real estate finance companies and real estate financing brokers are:

- Housing Finance Policy, Lessons learned from other countries
- Housing Finance Markets, Products and Loan Affordability
- Regulation of Non-bank Financial Institutions
- Securitization, Requirements for Real Estate Finance Practices and Documents
- Real Estate Loan Servicing and Securitization
- Registration Eligibility Criteria
- Financial Institution Quality Control and Risk Management,
- Financial Accounting, Audits and Systems
- Asset – Liability Management
- Real Estate, Housing and Financial Market Trends and Policies
- Basic issues in valuation and foreclosure
- Origination, analysis/Underwriting Process

| *Article 38 A-3. B. Staff Responsible for Registering Execution Real Estate Agents*

Training Issues and Rationale: The decision of a justice of execution, for the sale of mortgaged real estate to generate funds to repay a seriously past due loan and the execution of this decision, is sometimes called foreclosure. This is a specialized field, with requires legal knowledge not only of the Real Estate Finance Law, but also of relevant parts of the Civil Code and the Civil and Commercial Procedures Law.

As a result, most foreclosure experts are lawyers.

Because these REFAA officials must set the requirements for registering the Execution Real Estate Agents, who are eligible to be appointed by the justice of execution to implement his decision, it would be desirable have detailed knowledge of foreclosure procedures and related issues. The Ministry of Justice should have an important role in setting the requirements for registration and for the training of these Agents.

Staff members, or external advisors, who are lawyers, have legal training, and have extensive experience in the foreclosure process in Egypt would be valuable to REFAA in the setting and updating registration requirements for Execution Real Estate Agents. Senior REFAA managers,

who supervise such experts, should also have a strong knowledge of the procedures and issues in foreclosure.

Proposed Training: Since foreclosure procedures are primarily a matter of Egyptian law and practices, specialized legal and problem loan training would be helpful to REFAA managers responsible for registering Execution Real Estate Agents. Such training might well be conducted by the Ministry of Justice or by experts working with that Ministry. Training topics that could be useful to those managers include:

- Problem loans, restructuring and workouts
- Legal analysis in foreclosure and the eviction process
- Lessons learned and issues on foreclosure from other countries
- Qualification and certification issues and procedures.

Training for managers responsible for registering these Agents should be discussed with appropriate officials at the Ministry of Justice as soon as possible and started as soon as the staff is hired. The foreclosure procedures in the Real Estate Finance Law are new and greatly improved over the previous procedures. They have been in effect since the Law was approved in 2001 but there will be no list of registered Execution Real Estate Agents until the REFAA staff issues registration criteria and starts registering the Agents. Therefore, assistance and training for these staff members should have high priority.

Article 38 A-4. Staff of the Central Department for Real Estate Valuation and the Real Estate Valuation Advisory Board

Training Issues and Rationale: Valuation is a completely separate field from finance, lending and foreclosure. Its focus is on analyzing large amounts of data on costs and market value of properties. Real estate valuers play important roles in transactions unrelated to real estate finance so there is very strong interest among banks, developers, accountants, businessmen and others in the establishment of a clear and definitive list of registered valuers.

Depending on the type of property being appraised, Real Estate Valuers use a variety of sophisticated analytical techniques and require a high degree of specialized knowledge and skills.

Because of highly specialized knowledge required for real estate valuation, the Report: Real Estate Valuation recommends that the Ministry of Housing or the Board of Directors of REFAA appoint a Real Estate Valuation Advisory Board to advise the Board and the Central Department for Real Estate Valuation. This Board would provide advice on real estate valuation policy, recommend valuation standards for Egypt, a code of conduct for valuers, requirements for the registration of qualified valuers and policies for settlement of valuation disputes.

Valuation as a profession exists in Egypt, but without generally accepted, written standards or defined qualifications for determining levels of expertise and specialization. If Egyptian valuations are to be recognized internationally, valuers must be demonstratively qualified and perform in accord with internationally accepted standards. Therefore, our Real Estate Valuation report proposes that REFAA and the Advisory Board evaluate the different valuation standards in

use in other countries and incorporate those principles and practices of real estate valuation most suitable for the Egyptian market into standards of valuation for Egypt.

To provide staff support, implement the recommendations of the Advisory Board and manage the Central Department for Real Estate Valuation, REFAA will need expert Real Estate Valuers who have strong experience in accounting and the current real estate valuation process in Egypt and who also understand the real estate markets for residential and commercial properties and the sources, availability and reliability of real estate market data.

Proposed Advice and Training: The Real Estate Valuation Advisory Board and the Central Department for Real Estate Valuation should seek expert advice as soon as possible starting with help in the evaluation of real estate valuation standards in use elsewhere and other policy issues that it faces. The Real Estate Finance Affairs Authority should seek such assistance from one or more of its valuation supervisory counterparts in other countries and from the international real estate valuation Self Regulatory Organizations such as the Royal Institution of Chartered Surveyors or The European Group of Valuers' Associations.

The staff of the Central Department for Real Estate Valuation should benefit from individualized advice and training on a variety of topics including:

- Detailed study of the international appraisal standards and their application to the Egyptian markets.
- Advanced topics in market-based property valuation
- Setting training and experience requirements for Real Estate Valuers to remain registered.
- Setting qualification, experience and training requirements for Real Estate Valuers to achieve higher levels of registration authorizing them to value different types of properties and ones that are increasingly complex.
- The impact of property valuation on lending, real estate sales, accounting, etc.
- Establishment of Review Valuation procedures.

Training and advice should be provided to the staff of this department as soon as they are hired to help the Advisory Board and REFAA to develop registration policies and procedures and implement them as quickly as possible. There are no issues or conflicts in the Law, decrees and regulations concerning real estate valuation or the registration of valuers strong interest by the many parties that use valuers in setting standards and registering valuers as soon as possible. Therefore, there is no reason to delay and strong reasons to act quickly helping to initiate this key REFAA responsibility.

| *Article 38 A-5.* Staff of the Central Department for Research and Policy Development

The responsibilities of this department are implied rather than mandated through the Real Estate Finance Law. Its two arms the General Department for Research, Statistics and Public Information and the General Department for Real Estate Financing Policies and Legislation will perform vital new functions.

A. 5. A. Research Statistics and Public Information Staff

Training Issues and Rationale: As the Real Estate Valuation report notes, the principal impediment to the implementation of Egyptian Valuation Standards is the lack of reliable information on selling prices and on terms and conditions of real estate sales. If the Research, Statistic and Public Information department could facilitate the collection and dissemination of this information, it would greatly improve the quality of valuations and help improve the efficiency of the real estate market.

Collection and public dissemination of statistics and studies on real estate and real estate finance markets and on the housing market is limited currently. Data will also be needed by each operating department to track trends in the businesses the companies and specialists it supervises. Such data will not only be essential to good decision making by REFAA, but it will also be very important in helping the public and interest groups to better understand the issues and responsibilities facing the Authority.

As noted under the section on training and advice for the senior management of REFAA, clear and effective public information is essential to correct misunderstandings that now exist and to promote acceptance and use of the services that the Authority will regulate.

There is a great deal of misperception about housing finance in Egypt since there has been a limited amount of unsubsidized loans available to home buyers. Most of those who should benefit from financing as a result of the Real Estate Finance Law have paid cash for their homes and been financed under installment sales contracts. As a result, few have experience with borrowing to finance the purchase of their home. A public information campaign will be important to gain public acceptance of home financing.

Proposed Training: Different types of training and advice are needed for the specialists in the different functions of this department.

- Data collection and management is one specialty. Presumably REFAA will hire experts in this field. They would benefit from training and advice from experts who have established this type of system elsewhere, especially on possible establishment of a system to collect information real estate sales.
- Managing research and studies is one area in which the staff may not need much training, although some training on research methods may be useful.
- Public Information dissemination is a key specialty and one for which good training programs and advice may be particularly useful. Training and assistance to the MHUUC or the Authority in developing brochures, newsletters, fact sheets and videotapes would be helpful. These would explain in simple language how real estate finance works and what measures have been taken to protect the public interest. Training and assistance in developing these materials and in conducting an educational campaign is available from a number of organizations experienced in producing them.

A. 5. B. Real Estate Policies and Legislation Staff

Training Issues and Rationale: As noted in this report and others in our package, there are some significant issues and contradictions that must be resolved in implementing some of the provisions of the Real Estate Finance Law and related decrees and regulations. This is a high priority issue and should be the first for the new staff of this department.

Even after they are resolved, there will be new laws which will affect REFAA's activities and changes if the market and the economy. The staff of this department is likely to be composed of legal and policy experts.

Proposed Training: Advice and training from experts in the law would be useful.

B. Training for Real Estate Lenders and Real Estate Financing Brokers

Training Issues and Rationale: The Executive Regulations approved in December 2001 state that executive directors, directors of the finance, legal, engineering departments and branch managers of real estate finance companies must have ten years practical banking experience after receiving a university degree in the same field. Most real estate finance companies will probably include banks as important founding owners. It is therefore likely that trained bankers with real estate lending experience will be hired, either directly or on the basis of a contract, from one of these banks.

Their training needs will depend on their expertise and experience, but the need may be significant for training in housing finance, which is not a major focus of business for the banks. There is likely to be a small number of real estate finance companies, so there will not be a demand for training a large number of lenders. REFAA might not issue training requirement beyond the qualifications set in the regulations, but the companies should be still be interested in training to develop their employees' skills.

Real estate financing brokers will have similar but less extensive needs because they will only need to prequalify potential borrowers. As key elements of the loan marketing process, working closely with real estate developers and sales companies, the brokers should also have a good understanding of the housing market and the potential demand for home financing.

Proposed Training: There is time to do a careful study of the training needs and requirements for the staff of real estate finance companies and loan brokers. The issues that must be resolved including the Laws guarantee requirement and its conflict with the needs and requirements for securitization will take considerable time to resolve. Until they are resolved, viable operations by real estate finance companies will be difficult or impossible. So it is unlikely that any will start operating soon, and therefore their staff and brokers will not need training.

Training for lenders and brokers should be offered on a continuing basis by established Egyptian organizations that provide similar types of training. Such institutions can get help in creating and developing the necessary courses from a wide variety of experts and organizations around the world. Some of the real estate finance companies may decide to arrange their own specialized training for their lenders, possibly in organizations outside Egypt. Courses could include among others:

- Real Estate Loan Origination, Underwriting and Pricing
- Real Estate Valuation and Collateral Issues
- Housing Finance and the Retail Market
- Credit MIS, audits and accounting issues
- Funding, Asset/Liability Management and Securitization
- Real Estate Loan Servicing and Securitization

Egyptian Banking Institute and Other Training Organizations: One such established Egyptian organization is the Egyptian Banking Institute, which was inaugurated by the Central Bank of Egypt in 1991 as the center to build the skills of bank employees to ensure that they are equipped to fulfill their roles. It is a membership organization funded by the banks to train their staff. It also provides training on a contract basis to other organizations. The lack of attention by the banks to real estate finance is evidenced by the fact that the Banking Institute offers no regular real estate training course among its many training subjects, other than a three-day senior bankers program taught by a foreign expert.

That Institute is interested in expanding its services to include real estate and housing finance and would be one potential candidate for conducting that training, if it opened the courses to employees of real estate finance companies and real estate financing brokers.

In addition to Egyptian organizations, excellent regional ones such as the Arab Academy of Finance and Banking and the Kuwait Institute of Finance would be good sources for this type of training.

C. Training for Execution Real Estate Agents

As noted above, there will be a limited need for training of these agents because their tasks are prescribed by Egyptian law and practice. The Executive Regulations require that they have at least university certificates and five years of experience. REFAA, in cooperation with the Ministry of Justice, may specify the type of university certificate, presumably a legal one, and the type of experience that these experts will need in order to be registered. Training might be conducted by the Ministry of Justice or by legal and judicial reform program working with that ministry.

Proposed Training: Presumably training in foreclosure procedures can be incorporated in law school and other legal training programs. Some training in lending issues would also help these agents to understand lending, problem loan and workout procedures that precede foreclosure action. Training topics would include:

- Problem loans, restructuring and workouts
- Legal analysis in foreclosure and the eviction process

D. Training for Real Estate Valuers

Training Issues and Rationale: The Executive Regulations only require Real Estate Valuers to have a high school certificate and five years experience in order to be registered, but our Report: Real Estate Valuation, recommends much more stringent requirements. However, there will be a

need for ongoing training in real estate valuation. REFAA should require such training to keep the Real Estate Valuers' skills current and to qualify them for higher level licenses that would allow them to undertake more complicated jobs.

Proposed Training: Egyptian universities, colleges, technical institutes and professional Egyptian training organizations could offer this type of training. Egyptian organizations can easily access training resources for their programs through valuations SROs and valuation training organizations in Europe, the U.K. and the United States. Based on experience elsewhere, a significant number of courses will need to be offered to cover a number of different valuation subjects. Some examples include:

- Basic Valuation Principles
- Basic Valuation Procedures
- Valuation Standards
- Apartment Valuation
- Income Valuation of Mixed Use Properties
- Cost Valuation of Mixed Use Properties
- Sales Comparisons for Mixed Use Properties

E. Summary and Timelines on Training Needs

Summary

The initial focus of training and advice should be the new staff and board members of the Real Estate Financing Affairs Authority. That will in turn help them to establish the training criteria for the valuers, execution real estate agents, real estate financing brokers and the staff of real estate finance companies.

For REFAA staff, training needs will be highly personalized and determined only after its staff is hired. The Chairman of the Authority and most of its Board were appointed in mid June and its core staff should be hired within the next two or three months. Advice for the Board and for the senior management of the Authority could prove useful during that period.

In September, when most of the staff should be in place, the initial seminar or workshop should take place. Training needs for the staff should be assessed at that time and training plans could then be established.

Training and advice REFAA staff responsible for registering Execution Real Estate Agents and for REFAA's valuation experts, and the Real Estate Valuation Advisory Board, should take precedence over training for staff registering real estate finance companies and real estate financing brokers because it is likely that legal and operational issues will delay the creation of real estate finance companies and the start of lending by them until the end of 2002 or into 2003.

Any training for Execution Real Estate Agents could start as soon as REFAA has specified training requirements, because the new foreclosure procedures enacted in the Real Estate Finance Law are already in existence.

Training for real estate property Real Estate Valuers would be offered by Egyptian organizations on and can also start as soon as REFAA defines its requirements for registering different levels of Real Estate Valuers.

For lenders at the real estate finance companies and real estate financing brokers, training should be offered by Egyptian organizations that can easily access appropriate training material. Training could start as soon as local organizations were prepared to offer courses, but that is unlikely to occur until it is clear that real estate finance companies are being created and are preparing to start operations.

Timeline

June 2002

Chairman of REFAA and most of the Board of Directors is appointed

July and August 2002

Appointment of additional Board Directors and hiring of staff for the Authority.

Possible expert advisor(s) for the Board and/or Chairman and Deputy Chairman

September 2002

Initial multi-day team building seminar or workshop overview of REFAA's roles and responsibilities for the managers and professional staff of REFAA.

Assessment to the training needs of REFAA staff by training expert working with the Authority's General Department for Organization and Training.

Start of advice and training for Central Department for Real Estate Activities staff responsible for registering Execution Real Estate Agents

Start of advice and training for staff of Central Department for Real Estate Valuation

Real Estate Valuation Advisory Board should be formed.

September/October 2002

Advice to real estate valuation staff and the Advisory Board on valuation standards in other countries. Possible workshop on valuation standards for Egypt.

Training and assistance on real estate sales data collection and management

Advice on legislation and regulations to staff and Board

October/November 2002

Registration of first Execution Real Estate Agents, probably on a temporary or preliminary basis.

Registration of the first Valuers, probably on a temporary or preliminary basis.

November/December 2002

Initial training requirements for valuers and for Execution Real Estate Agents established.

January/February 2003

First training programs organized for valuers

First training programs organized for Execution Real Estate

Annex 2

***THE REAL ESTATE FINANCE LAW
AND ITS EXECUTIVE REGULATIONS***

Part I – General Provisions

ARTICLE 1 – APPLICABILITY OF THE LAW

Provisions of the Law

Article 1 of the Real Estate Finance Law, No. 148 of 2001 (“the Law”) defines the types of real estate financing activities covered by the Law and the terms used in the Law. It also exempts real estate security pledged as collateral for real estate loans from all duties and expenses. Article 1 also provides that executive regulations can be issued to permit collateral for real estate loans other than the real estate being financed.

Provisions of the Executive Regulations

Chapter One, Articles (1) and (2) of the executive regulations address the provisions of Article 1 of the Law.

*Chapter One
General Provisions*

Article (1)

Real estate financing shall be effected in accordance with the provisions of the law for investment in purchasing, building, restoration or improving residential, administrative, service buildings and those designed for commercial activity purposes.

Article (2)

If the financed property is not registered under the name of the seller, the financier may accept, as a guarantee for providing finance, mortgage of real estate assets that are owned by the investor or any other person, personal guarantee, securities at the full amount of accrued installments, or acceptance on the part of the investor to deduct from the financing installments from the salary or income thereof. The financier, in the above-cited cases, may require the investor to register the property under the investor’s name and then mortgage it to the benefit of the financier for a term mutually agreed upon.

If the property for which finance is offered is a building or a unit within a building which is built on a plot of land allocated to the investor by the government or any public artificial person, the financier may accept assignment thereof to its benefit as collateral for financing, provided approval of the allocating authority for such assignment is obtained.

Analysis of the Executive Regulations

Articles (1) and (2) of the executive regulations are acceptable as written. They would benefit from the following revisions, but these changes are not a high priority.

1. Define the “investor” in a real estate finance transaction to include both natural and juridical persons;
2. Define “investment in purchasing, building, restoration or improving” to include: a) development of residential, commercial and mixed-use projects, b) completion of partially constructed units, c) refinancing of existing mortgage loans, installment sales contracts or construction loans secured by the subject real estate, and d) borrowing for any purpose (i.e. a real estate equity loan) against the security of real estate that is owned by the borrower free and clear of any mortgage or other debt. Enabling homeowners to borrow against the equity in their homes would tap into a large pool of illiquid capital that could be used to finance small businesses and entrepreneurial enterprises.
3. Clarify the apparent inconsistency between the provision in the first paragraph of Article 2 that, “The financier, in the above cited cases, may require the investor to register the property under the investor’s name and then mortgage it to the benefit of the financier” and item (E) of Article 6 of the Law that requires the financing agreement to include “The seller’s commitment to register the realty in the name of the buyer, clear of any real right (in rem) of third parties.”
4. Provide greater flexibility in authorizing eligible collateral other than the real estate being financed by adding a clause that says “and any other type of collateral described in the financing rules as eligible collateral.”

ARTICLE 4 – CRITERIA FOR REAL ESTATE FINANCING

Provisions of the Law

Article 4 of the Law states that executive regulations shall be issued specifying the criteria for real estate financing by institutions under the jurisdiction of the Authority, i.e. public juridical persons engaged in real estate financing activities and real estate finance companies.

Provisions of the Executive Regulations

Chapter One, Article (3) sets out the financing rules and procedures for real estate loans under the Law.

Article (3)

- III. *Practicing Real Estate Financing Activity shall be in accordance with the following Criteria*
 - A) *Financing procedures shall be clear and definite in such a manner that guarantees the investor’s knowledge of all rights and obligations that appertain thereto. The financing documents shall include – sine qua non – acknowledgment by the investor of having received and familiarized himself with a copy of the form*

containing the key conditions to be prepared by the Authority prior to signing the financing agreement.

- B) Financing should not exceed 90% of the value of the property.*
- C) A valuer listed in the roster to be prepared by the Authority shall determine the value of the property, provided that that value shall not be an affiliate to the investor or the financier.*
- D) It is prohibited for a financier to provide one or more finances at an amount exceeding 10% of the capital thereof for one individual investor, the spouse, and relatives thereof to the fourth degree; or to other corporate persons in whose capital the financier contribution exceeds 10%.*
- E) In the cases where the amount of finance is related to the investor's income, proof of the income shall be by virtue of tax certificate issued by the Tax Department stating the income taken as the basis for taxation over the last three years preceding the financing agreement. In case financing shall be given against deduction from the investor's salary, proving the salary shall be by virtue of authenticated certificate by the employer thereof.*
- F) Finance repayment installment should not exceed 40% of the total investor's income, other than low-income investors stated under Article (6) herein.*

Analysis of the Executive Regulations

The financing rules and procedures set out in Article (3) of the executive regulations require substantial revision. The shortcomings of the current article and recommendations for revised or new provisions are discussed in detail in the Report: Financing Rules. Revising the financing criteria has a high priority because some of the criteria in the current article would expose real estate lenders to excessive risk. In addition, the current financing rules are highly inappropriate for loans to juridical persons and for real estate development and commercial real estate loans.

ARTICLE 5 – PROVISION OF LAND AND UTILITIES FOR LOW INCOME HOUSING DEVELOPMENT

Provisions of the Law

Article 5 provides that the GoE will allocate state-owned land, free of charge, and provide public utility services at 50% of their actual cost for the construction of "economy-level" housing. The executive regulations are to define the criteria for low-income persons eligible to purchase such housing and the rules and procedures for financing the purchase of the houses built.

Provisions of the Executive Regulations

Chapter One, Articles (4), (5) and (6) address the provisions of Article 5 of the Law.

Article (4)

The institutions that desire to implement low cost residential projects to be sold to low income people as defined in Article (6) below in accordance with real estate financing scheme and providing the advantages stipulated by law in that regard, may apply to the Guarantee and Support Real Estate Financing Fund and enclose with the application

comprehensive study of the project including the number of units, areas, the estimated prices thereof, and other elements related to the project.

The fund shall conclude agreement with the institution that desires to implement the project and the investors accepted thereby to provide finance. Such agreement shall detail all the provisions regulating performance of the project, the method of selling the residential units and financing thereof, together with identifying the percentage of subsidy provided by the fund.

Article (5)

Plots allocated by the Government for low income residential projects to be implemented through real estate financing shall be handed over to the fund, which shall only pay 50% of the cost of providing utilities to the administrative authority. Repayment to the fund shall be according to the provisions of article (4) herein above.

Article (6)

Low income persons, for the purposes of applying the provisions of the law and these executive regulations, shall be deemed to mean any persons whose total annual income does not exceed LE 9000 or LE 12,000 if married or having dependents.

Priority of providing finance to obtain low cost house shall be given to the investors of lower incomes; when incomes are equal preference shall be to the investor having larger family.

Analysis of the Executive Regulations

The executive regulations relating to the provision of land and reduced cost utilities installation should be amended. These revisions should not be made until the Real Estate Activity Guarantee and Support Fund (the "Fund") is established and becomes operational because the Fund will be responsible for establishing the policies and procedures for the provision of free government land and reduced cost infrastructure for affordable housing development. Revision of the current executive regulations or repeal the current regulations and enactment of new regulations should be the first priority of the Board of Directors of the Fund.

The executive regulations should provide more detail on the criteria that must be met for a residential development project to be eligible for the free land and reduced cost utilities installation provided for in Article 5 of the Law. At a minimum, the regulations should specify:

- 1. the maximum selling price for the homes to be constructed based on an analysis of the affordability of the homes to the target low and moderate-income market. The maximum selling price should be adjusted annually to account for increases or decreases in family income, inflation and development costs;*
- 2. the maximum payment-to-income ratios for low and moderate income home buyers, since they are exempted from the general financing rules. Based on existing law and regulation, the general consensus is that the maximum payment-to-income ratio should be 25%;*
- 3. the loan-to-value ratios to be applied to the purchase of affordable housing units. The MHUUC and/or the Fund should consider whether a higher loan-to-value (i.e. lower cash deposit) should be allowed for low and moderate-income home purchasers. A higher*

loan-to-value ratio will expand the market for home purchase, but will increase the risk of default. Since all of the low and moderate income housing loans made under the provisions of the Law will be insured (or guaranteed) by the Fund, an analysis of the potential costs to the Fund relative to its financial resources should be conducted before higher loan-to-value loans are permitted.

- 4. the parties and procedures involved in obtaining approval of residential development projects for free land and subsidized infrastructure. Article 4 refers to the “institutions that desire to implement low cost residential projects.” Typically government provides low cost or free land and infrastructure to developers, not lending institutions. If the residential development project meets the criteria established under the Fund’s low and moderate income housing program and is approved by the Fund, the developer would then obtain financing from a private sector lending institution. The real estate lending institution should not be required to review the applications and projects for compliance with the rules and procedures established by the Fund.*
- 5. the criteria, rules and procedures for both the construction and marketing of the project and financing the purchase of affordable housing by low and moderate income home buyers. The current regulations say that these criteria, rules and procedures will be contained in the agreement between the Fund and the “institution.” Even if the contractual provisions of these agreements are standardized and the forms of the agreements are issued by decree or regulation so that they are available to the public, it will be difficult for developers, lending institutions and the prospective home buyers to understand all of the terms and conditions related to the development and financing of affordable housing projects. Therefore, it would be more appropriate and more transparent for these criteria, rules and procedures to be issued by the Fund as executive regulations so that developers and lending institutions can evaluate the business and financial feasibility of engaging in the development and financing of affordable housing.*
- 6. the actions the Fund will take to facilitate securitization of affordable housing loans. A critical issue for lending institutions will be the ability to securitize affordable housing loans because private sector real estate lenders will not have the financial and managerial resources to carry and manage a portfolio of affordable housing loans. It is not reasonable to expect a real estate lender and third-party guarantors to guarantee the performance of securities backed by affordable housing loans because of the risks associated with such loans. The GoE and the MHUUC should consider providing a government guarantee of real estate loan related securities collateralized by affordable housing loans similar to the Government National Mortgage Association (“GNMA”) guarantees offered in the United States.*

Article (5) requires the Fund to pay 50% of the cost of providing utilities to an affordable housing project. These costs should be included in the development costs of the project and paid by the developer out of his own funds or out of the initial disbursement of loan proceeds on the development loan. There is no reason for the Fund to tie up its limited financial resources by paying infrastructure costs up front. It is strongly recommended that Article (5) be deleted in its entirety or replaced with a new Article (5) that clearly places the responsibility for payment of all costs of the development project, other than the land, on the developer. The role of the Fund should be limited to establishing, applying and enforcing the criteria, rules and procedures for approval of affordable housing projects to receive free land and reduced cost utilities.

Article (6) sets the maximum income limits for low-income persons to be eligible for financing at LE 9,000 for single persons and LE 12,000 for married persons and persons with dependents. The Report on Financing Low and Moderate Income Housing discusses in detail the income ranges in Egypt that are considered low and moderate income and the affordability of housing for these segments of the market. Based on the affordability analysis presented in the report, it is recommended that the MHUUC reconsider the LE 9,000 and LE 12,000 income limits to better reflect the income distribution by family size in Egypt and differences in income levels between urban and rural areas.

The current regulation does give preference to larger families, but this provision is too ambiguous. A schedule of maximum income limits by geographic area and family size should be issued. The maximum income limit for larger families should be higher than the maximum income limit for a married couple. It is also recommended that the executive regulations require the Fund to issue annual schedules of maximum income rather than setting the income limits in the regulations themselves so that the regulations do not have to be amended every year to reflect changes in family income.

Part II – Finance Agreement

ARTICLE 6 – TERMS AND CONDITIONS OF STANDARDIZED AGREEMENTS

Provisions of the Law

Article 6 of the Law specifies the terms and conditions of a uniform real estate purchase agreement and requires the Minister of MHUUC to “issue a decree concerning the ‘Forms’ to be used in the agreements” for all types of real estate finance transactions authorized by the Law.

Provisions of the Executive Regulations

The current executive regulations do not include the “Forms” required by Article 6 of the Law. Without the standardized financing agreements, real estate lenders cannot begin making real estate loans under the Law. Therefore, the preparation of these agreements and the issuance of the decree by the Minister of MHUUC specifying the “Forms” of the agreements should have the highest priority.

Prior to its dissolution, the Ministry of Economy and Foreign Trade prepared draft financing agreements for purchase, construction on the investor’s own land and rehabilitation financing transactions. English translations of these agreements are included in Exhibit 1 of this report. These agreements omit certain key provisions, such as a guarantor as a signatory of the agreement, and should be reviewed and revised, as needed, by competent legal counsel. Exhibit 1 also includes a standard Murabaha financing agreement used by the Faisal Islamic Bank. This agreement includes some of the terms and conditions that are missing in the draft financing agreements. The statutory forms of the financing agreements should conform to the extent practicable within the limits of the Law to the financing agreements currently used by banks in Egypt for real estate secured loans. There are several essential terms of a real estate loan that should be standardized, at least for home loans, in the statutory forms of real estate financing agreements. Exhibit 2 of this report discusses some of the terms and conditions that should be considered in preparing the statutory real estate financing agreements.

Providing for a Return on the Financing

The most important and most problematic condition of the real estate financing contract is to provide the lender with a return on the funds advanced for the loan. Standard real estate financing agreements used around the world specify the interest rate the lender is charging the borrower on the loan. However, because of religious and cultural considerations in Egypt, the real estate loans under the Law cannot include an explicit interest rate and the draft financing agreements do not provide for a return on the loan. Obviously, no bank or real estate finance company is going to provide real estate financing if it cannot earn a market rate of return. Some method acceptable under Shari'a Law must be found to provide the real estate lender with a market rate of return on the funds advanced in a real estate financing transaction. This should be the highest priority for the MHUUC.

The current practice for financing real estate in Egypt varies depending on the entity providing the financing. The real estate banks do charge an explicit interest rate on the real estate loans they offer. Developers financing the sale of their units increase the price of the real estate being sold to provide a return. The Faisal Islamic Bank may resell the real estate to the buyer at a higher price than the purchase price paid to the seller to achieve a return on its investment and does assess a charge based on the return on its other investments in the case of delinquency.

Setting a price for the real estate above the cash price if financing is provided is not practicable for long term real estate loans because the financed price would be so much higher than the cash price that buyers would not be willing to accept the financing. An additional drawback of this method of providing a return on a loan is the distortion it would introduce into the market. The selling prices of real estate that will be used as the basis for real estate valuation would not be reliable measures of market value because of differences in the financing terms between otherwise comparable properties.

A method of Islamic real estate financing used in the United States and accepted by the government secondary mortgage market agencies is based on the computation of the return on a loan as implicit rent. The theory is that the lender's lien on the real estate being financed gives it rights to the benefits of the real estate in proportion to the ratio of the amount of the outstanding balance on the loan to the original purchase price of the real estate (i.e. loan-to-value ratio). Since the lender does not have possession of its share of the real estate, the borrower owes the lender compensation for his use of the lender's share of the property. The compensation agreed upon in the financing agreement is based on rents for comparable units in the locale in which the real estate being financed is located. The market rent is recomputed each year and the payment is adjusted accordingly. The implicit rent paid to the lender is equivalent to the prevailing interest rate on similar real estate loans. An amortization schedule is generated incorporating the implicit rent to arrive at the total monthly payment the borrower must make on the loan. As the buyer pays the principal installments on the loan, the lender's share of the rights in the property decline proportionately, the amount of the monthly payment allocated to payment of the implicit rent decreases and the amount allocated to repayment of principal increases. The result is full amortization equivalent to the amortization of a loan on which an explicit interest rate is charged.

Method of Computing the Payment of the Installments and the Return

Once a method has been adopted for providing a return to the real estate lender, the MHUUC must also specify a method (or methods) of calculating the installments of principal and the return on the loan. In the U.S. and most western countries, real estate loans are fully amortizing, level payment loans. The equal payments are computed using a present value formula. However, in Egypt many real estate loans are level principal reduction loans in which the installment is constant, but the return is different for each payment or for each year's payment. The schedules shown in Exhibit 3 show the difference between a standard amortization schedule and the level principal reduction repayment schedule used by some Egyptian financial institutions.

The method of computing the payment schedule commonly used in Egypt results in an effective interest rate on the loan that is higher than the nominal interest rate. This is because the computation employs what is referred to as "add-on interest". Each year the interest for the year is computed based on the outstanding balance as of the end of the prior year. The annual interest is then divided by 12 months (or by 360 or 365 days) and the monthly interest thus computed is added to the level monthly principal installment. Since the outstanding balance on the loan is being reduced with each installment payment during a year, this method of interest calculation results in the borrower paying more interest on the loan than is actually due.

Payment Frequency

The frequency of payments also should be established in the statutory forms of the real estate financing agreements. Real estate financing agreements currently in use in Egypt employ different payment schedules – monthly, quarterly, semiannual or annual. The statutory real estate financing agreement for home loans should require monthly payments. The repayment provisions on commercial and development loans should permit repayment schedules to match the cash flows from the real estate being financed.

ARTICLE 7 – DISPOSING AND ENCUMBRANCE OF THE SECURITY REALTY

Provisions of the Law

Article 7 of the Law permits the borrower to dispose of the real estate pledged as security for a real estate loan by sale, gift or other means and to encumber the real estate with "any real right thereon" only if the lender gives prior approval to such disposition or encumbrance and, in the case where a new buyer plans to assume the original borrower's obligations under the real estate financing agreement, approves the assumption of the loan. Article 7 also gives the lender the right of prior approval and the right to require an assignment of rents and leases if the borrower leases the security realty to third parties.

Article 7 limits the basis for a lender's refusal to approve the sale or transfer of the security realty, the assumption of the real estate loan by the new buyer and the leasing out of the security realty to "serious reasons that would expose his (the lender's) interest and rights to risk."

The executive regulations are to establish the rules and procedures to be followed in each of the transactions listed in Article 7 of the Law.

Provisions of the Executive Regulations

Chapter Two, Articles (7) through (10) of the executive regulations deal with the transactions discussed in Article 7 of the Law.

Chapter Two: Disposal of the Collateral Property and Leasing Thereof, and Prepayment

Article (7)

The investor who desires to dispose with the collateral property, attach any encumbrances thereupon, lease thereof, or permit any person to solely occupy it shall have to obtain written financier's approval before effecting any disposal or conveyance or encumbrances of the collateral property. This shall be done by virtue of a written request addressed to the financier at least thirty days before taking any of the above actions.

Article (8)

Attached to the request for approval of disposal or attaching encumbrances shall be written declaration by the assignee or the person having title to the encumbrance to the effect of accepting subrogation on behalf of the investor with regard to all liabilities arising from the financing agreement. The financier may require the investor to lodge an undertaking to the effect of being jointly liable with the assignee to fulfill those obligations.

Article (9)

The financier may require the investor, in order to approve the investor's leasing the property or allowing occupation thereof by third party, to provide written declaration assigning interests in rent or consideration of occupancy to the financier, together with informing the lessee or the occupant with that assignment. This is in order to discharge the investor's dues to the financier according to the real estate financing agreement.

Article (10)

The financier shall not reject the request referred to in Article (7) above except for serious reasons that may endanger the financier's interests and rights. The financier shall communicate the reasons for rejection to the investor via registered mail with acknowledgment of receipt within thirty days from receiving the investor's request. Failure to respond shall be construed as approval on the financier's part of the request.

Analysis of the Executive Regulations

Articles (7) and (8) deal with disposition and encumbrance of the security realty and the assumption of the real estate loan by a third party. The only rules and procedures these articles establish that are not already in the Law are:

- 1. The financier's (lender's) prior approval must be in writing;*

2. *The investor (the borrower) must submit a written request to the lender to approve the disposition, assumption, encumbrance or lease of the security real estate at least thirty days before any such transaction can be effected;*
3. *The person assuming the real estate loan or the person to whom an encumbrance is granted must submit a written agreement attached to the written request of the investor “to the effect of accepting subrogation on behalf of the investor with regard to all liabilities arising from the financing agreement.”*

These rules and procedures are not sufficient because they do not establish uniform terms and conditions and standard language for the required requests and agreements. Consequently, each lender could have its own form of agreement, or even a different agreement for every individual loan, with different terms and conditions. It is essential for the securitization of real estate loans that there be uniform terms and conditions for all agreements relating to the security realty so that there is no question about the rights of the parties in individual real estate financing transactions. As Article 7 of the Law requires, the executive regulations should specify the rules and procedures, not make general statements. Exhibit 4 of this report contains draft executive regulations that are specific in terms of the procedures to be followed for the disposition or encumbrance of the security real estate.

The executive regulations regarding assumption of a real estate loan must provide specific details about the procedures the parties must follow. For example, any person who wants to assume a loan should be required to meet the credit granting criteria established in the financing rules and the lender’s internal credit policies. The proposed new owner should be required to submit a loan application and all supporting documents as if he were a new borrower. The lender should be required to have the assumption of the real estate loan annotated on the inscription of the mortgage at the Real Estate Registration Office.

Article (9) merely repeats the language of the second paragraph of Article 7 of the Law. The only procedures established by the executive regulations are to authorize the financier to require a written assignment of the investor’s interests in the rents and lease payments generated by the security real estate and to require the investor to provide a written declaration that the tenants or lessees have been informed of the assignment. The executive regulations should set out the specific procedures and documents for an assignment of rents. Exhibit 6 of this report presents a draft executive regulation dealing with assignment of rents.

Article (10) of the executive regulations does not provide any more detail about the reasons for denial of a request for assumption of a loan, encumbrance of the security realty or leasing of the premises than is included in the third paragraph of Article 7 of the Law. The only procedure specified in Article (10) is that the written notice of the rejection of the request be delivered “via registered mail with acknowledgment of receipt thereof.” The executive regulations should spell out the conditions under which a lender can refuse a request from the borrower for approval of the transactions enumerated in Article 7 of the Law so that the lender cannot be arbitrary and capricious in its decision to approve or deny the request. The current executive regulations give little protection and no recourse to the borrower if his application is denied. His only recourse would be to bring a lawsuit against the lender in which he would try to prove that the approval of his request would not “endanger the financier’s interest and rights.”

The executive regulations relating to Article 7 of the Law also should require that the lender make full disclosure in plain language to every borrower at time of settlement of the loan of the

limitations on the borrower's rights to dispose of, encumber or lease the security realty. Each borrower should be required to sign a declaration that he has read, understood, and agrees to the terms and conditions for disposition, encumbrance and leasing of the security real estate.

ARTICLE 9 – PREPAYMENT OF THE REAL ESTATE LOAN

Provisions of the Law

Article 9 of the Law permits the borrower to prepay all or any part of the real estate loan according to the rules to be determined by the executive regulations. The rules and procedures for prepayment of a loan are governed by the Civil Code for loans to individuals, and the Commercial Code for loans to juridical persons or individuals that are considered “commercial papers” under the Commercial Code.

Provisions of the Executive Regulations

Article (11) of the executive regulations deals with prepayment of a loan.

Article (11)

In the event of the investor's desire to effect prepayment in full or in part, the investor shall inform the financier three months at least before effecting prepayment. Due installments shall be discounted in accordance with the discounting table attached to the financing agreement specifying the discounted value paid according to the date thereof against the years of repayment of financing installments.

Analysis of the Executive Regulations

The executive regulations issued under the Law cannot supersede the rules for prepayment of debts contained in the Civil Code, the Commercial Code or any other Egyptian law. For example, Article 343 of the Civil Code states that the money paid by the debtor shall be applied first to pay expenses, then to pay interest due and last to the original debt, unless otherwise agreed upon by the debtor and the creditor. Unless the statutory real estate financing agreement provides otherwise, prepayments must be applied according to the Civil Code.

It is not reasonable to require a borrower to give three month's notice of his intent to make a partial prepayment of a loan if the amount of the prepayment is a relatively small percentage of the outstanding loan balance. The most common form of prepayment is where the borrower makes additional principal payments on the loan in addition to his scheduled installment payment. These additional principal payments usually would be nominal, perhaps several hundred Egyptian pounds.

The executive regulations should permit the borrower to make partial prepayment of the real estate loan up to a specified percentage, say 10% to 20%, without prior notice to the lender. There should be some prior notice requirement for larger partial or full prepayments, but three months seems excessive. One or two months notice should be more than adequate. The regulations also should require that the borrower is obligated to continue to make his regularly scheduled loan payments after he has given notice to the lender of his intent to prepay the loan. A proposed draft for an executive regulation dealing with the issues of prepayment is presented in Exhibit 7.

Article 11 requires that the loan payoff amount be computed as the discounted value of the remaining installments as of the date of payoff. This computation would apply only to a full prepayment of the loan. If the payments of the installment and the return on the loan are computed using a standard amortization formula, there would be no need to discount the remaining installments. The loan payoff amount would be the outstanding balance on the loan as of the last payment date before the loan payoff date plus the daily interest for the number of days from the last payment date to the loan payoff date. The computation specified in the regulations would not be applicable at all to a partial prepayment.

Part III : Registration of the Real Estate Security and Transference of Rights Resulting from the Finance Agreement

ARTICLE 10 – REGISTRATION OF THE REAL ESTATE SECURITY

Provisions of the Law

Article 10 of the Real Estate Finance Law exempts registration of real estate rights under the Law from registration fees, specifies the time limits for processing an application for registration at the Real Estate Registration Office and requires written notification by registered mail of the Real Estate Registration Office’s decision regarding the application for registration. These provisions supersede conflicting provisions of the Law on Declaration and Notarization of Real Property Interests, No. 114 of 1946. However, the other rules and procedures contained in the Law on Declaration and Notarization of Real Property Interests remain in effect and cannot be superseded by the executive regulations issued under the Real Estate Finance Law.

The Law on Declaration and Notarization of Real Property Interests governs the registration of real estate and interests in real estate. Article 1054 of the Civil Code stipulates that the provisions of the Law No. 114/ 1946 regulating the Real Estate Registration Office applies to effecting, renewing, deleting and canceling the inscription of a mortgage interest. The procedures to register both title and mortgages or other lien rights in real estate involve a number of steps:

- a. An application for the declaration of the contract including the identity and authority of the persons executing the document, the terms of the contract and the physical description of the property is submitted to the Real Estate Registration Office. The parties to the transaction must appear before a notary to validate their signatures to the contract. Since the real estate financing agreement may involve three or more parties, all signatories of the financing agreement will have to appear before the notary.*
- b. After accepting the application, the Real Estate Registration Office sends the application to the survey office to verify the property description. The survey office will actually survey the property and will issue a statement containing the legal description of the property, which is returned to the Real Estate Registration Office. This step is considered one of the main sources of delay in the real estate registration process. The one-week time limit for approval or denial of an application for registration of real estate interests specified in the second paragraph of Article 10 of the Real Estate Finance Law begins “after ascertaining the accurate limits of the realty as described in the application and the*

title deed.” Therefore, the time required to survey the security realty has not been shortened by the provisions of Article 10.

- c. The application is returned to the Real Estate Registration Office where the notary will draw up the official declaration and all supporting documents and enter an inscription in the registry that the declaration has been accepted.
- d. The declaration is then stamped and signed by the parties and the signatures verified by the notary, the declaration is entered into the Real Estate Registry and an official number is issued.

Article 10 states that executive regulations will be issued that will specify the information to be included in the application to be filed with the Real Estate Registration Office to register the official mortgage or other lien rights of the lender in the security realty. Article 10 does not address the case where collateral other than real estate has been pledged as security for a real estate loan.

Provisions of the Executive Regulations

Chapter Three, Articles (12) and (13) of the executive regulations sets out the information to be included in an application for registration of the real estate security at the Real Estate Registration Office and the procedures to be followed to register the real estate security.

Article (12)

The application for registering the real estate security shall be filed by the financier or the investor in accordance with the provisions of law to the Real Estate Registration Office within jurisdiction of which the property is located. The application shall include the following information:

- A) Names and data pertinent to investor and financier.
- B) The value of installments and guaranteed rights.
- C) The expiry date for repayment of the price or financing installments.

Attached to the referenced application shall be the real estate financing agreement and the deed of title of the property in the name of the investor, or the financing collateral in the name of the financier.

Article (13)

The competent real estate registry shall verify the correctness of the property's boundaries and specifications as shown in the application for registration, together with the deed of title attached thereto. The registry may require the applicant to complete thereof in not less than three days.

Deciding upon the application or directing completion thereof should not exceed one week from the date of lodging thereof.

The only reason for rejection of the application for registration is the submittal of incomplete documents.

In all cases, the applicant shall be informed via registered mail with acknowledgement of receipt in accordance with the law, of accepting the application, direction to complete documents, or reasoned rejection.

Analysis of the Executive Regulations

Real estate loans secured by an assignment of an allocation certificate on land allocated to the borrower by the government or public authority may not be eligible for registration at the Real Estate Registration Office. If not, the MHUUC must ascertain how the lender's rights in the allocated land can be registered. If there is no existing law governing the creditor's rights in allocated land, the MHUUC must issue executive regulations stipulating the procedures to be followed in registering such rights.

Similarly, real estate loans secured solely by collateral other than real estate may not be eligible for registration at the Real Estate Registration Office since the lender does not have any right or interest in the real estate being financed. Since there is no system in Egypt for registration of lien interests in other collateral similar to the U.C.C. in the United States, the lender that accepts collateral other than real estate to secure a real estate loan must include provisions in the real estate financing agreement to protect its interest in the collateral pledged. The Real Estate Finance Law is silent on the requirements to register rights in other collateral, so the existing provisions of other laws will govern such transactions.

Article (12) states that the financier or the investor shall register the real estate security, in accordance with the provisions of law, but does not cite which law(s). Article 6 of the Real Estate Finance Law, item (F), says that the agreement between the lender and the buyer will stipulate that the buyer is required to record the lien on the security realty, but is silent on the duties of the investor and the financier in this regard for real estate financing agreements for other purposes.

The information specified in Article (12) to be included in the application for registration may not conform to the information requirements of the Law on Declaration and Notarization of Real Property Interests. In particular, there is no requirement for the application to include a legal and physical description of the security real estate. This information will be included in the real estate financing agreement and the deed of title attached to the application, but the application itself should include all of the basic information relating to the transaction:

Article 38 The name and address of the financier and the name, surname and title of the person signing the application.

- b. If the investor is a natural person the application shall also give his full name, profession and place of residence. If the investor is a juridical person, the application shall give the name and address of the juridical person. If the security realty being pledged as collateral for the real estate loan is owned by a person other than the investor, the full name, profession and place of residence of that person, if an individual, or the name and address, if a juridical person.*
- c. The date of the real estate financing agreement and the place of issuance.*

Article 38 The source, full amount and maturity date of the debt secured by the real estate.

Article 38 An accurate description of the security realty.

Article (13) sets requirements for processing the application for registration that conflict with the provisions of Article 10 of the Law. The Law states that the Real Estate Registration Office may require the applicant to file all necessary information and documents "within a week from the

date of submitting the request.” Article (13) requires the applicant to complete the application “in not less than three days.” While three days is within one week, the intent of the Law to give the applicant up to one week to submit complete documents seems clear.

The second paragraph of Article (13) says that the decision on a complete application must be made within one week of filing of the application, but second paragraph of Article 10 of the Law states that the one week time limit will not begin until “after ascertaining the accurate limits of the realty as described in the application and the title deed.”

The third paragraph of Article (13) states that the only reason for rejection of the application for registration is the submission of incomplete documents, but Article 10 of the Law does not give the Cabinet of Ministers the authority to limit the reasons for refusing the request in an executive regulation. The Law states that “The decision refusing the request shall be substantiated.”

ARTICLE 11 – ASSIGNMENT OF RIGHTS IN REAL ESTATE FINANCING AGREEMENTS FOR SECURITIZATION; GUARANTEE OF SECURITIES; SERVICING OF REAL ESTATE LOANS; DISCLOSURE OF INFORMATION REGARDING THE REAL ESTATE FINANCING AGREEMENTS ASSIGNED

Article 11 of the Law addresses the issues involved in the securitization of real estate loans. The first paragraph states that the Ministry of Foreign Trade will issue the securitization regulations. The Report on Securitization of Real Estate Loans discusses the draft securitization regulations in detail. Paragraph one also requires the Minister of MHUUC, as the successor to the Minister of Economy and Foreign Trade, to issue a decree specifying the form of the purchase and sale agreement for securitization transactions.

Article 11 also requires the originator-seller of the securitized real estate loans to guarantee the timely payment of interest and principal on the securities backed by the real estate loans sold. The executive regulations of the Law are to establish the rules for securing third party guarantees in addition to the guarantee of the originator-seller.

The final paragraph of Article 11 provides that the originator-seller can disclose information about the real estate loans being sold to the purchaser of the loans without obtaining the prior approval of the borrowers on the sold loans. The executive regulations will determine what information can be disclosed.

Provisions of the Executive Regulations

Articles (14) through (16) of the executive regulations address the issues raised in Article 11 of the Law.

Article (14)

The agreement of assignment of rights ensuing from the real estate financing agreement to the entity licensed to practice securitization activity, model of which shall be issued by virtue of a decision of the competent minister in charge of economic affairs, shall include the following:

- A) *Acceptance of the financier of assigning the interests thereof ensuing from the real estate financing agreement to the assignee.*
- B) *The consideration assumed by the assignee in return of the assignment and discharging conditions.*

- C) *Detailed statement of the assigned rights, including the relevant installments of each financing transaction and its collateral property, conditions of guarantee, and the information appertaining to the debtor.*
- D) *The financier's obligation to collect the assigned installments in the capacity of an agent of the assignee in return for collection commission to be determined by the agreement.*

Article (15)

Without prejudice to the financier's guarantee for discharging the rights ensuing from the securities, agreement may be made for third party guarantee of the rights ensuing from the securities issued by the securitization entity, provided that the credit rating thereof shall not be less than the rating specified by the Capital Market Authority, and that the guarantee shall cover all due installments and not to be qualified by whatever condition.

Article (16)

The financier shall disclose to the assignee of the debiting investors of the assigned rights, collateral provided, installments paid, dates of such payments, and instances of rejection to pay; obtaining the approval of those investors of disclosure is not necessary.

Analysis of the Executive Regulations

Article (14) states that the Minister of Foreign Trade will issue the decree specifying the form of the assignment agreement in a securitization transaction. However, it is the Minister of MHUUC who is the responsible minister.

Purchase and sale agreements for securitizations are quite complex documents. The simple provisions specified in Article (14) are not sufficient to cover all of the duties, warranties and representations required for the sale of loans for securitization. The MHUUC should try to obtain copies of purchase and sale agreements used in other countries to use as models for the assignment agreement.

Article (15) authorizes the use of third party guarantors for securitization transactions. The third party guarantees can be senior to the guarantee by the originator-seller, putting the originator-seller in a second or third loss position. However, Article (15) also requires that the third party guarantee "shall cover all due installments and not to be qualified by whatever condition." The Law does not require that the originator-seller or third parties guarantee the timely payment of interest and principal on the underlying real estate loans, but, rather, on the securities backed by the real estate loans.

As discussed in detail in the Report on Securitization of Real Estate Loans, the credit enhancements commonly used in securitization transactions do not provide a 100% guarantee because the securities issued are backed by financial assets that generate cash flow and by real estate collateral. There is no need for each guarantor to provide a full guarantee. Credit enhancements in securitizations are usually layered, with different entities covering different risks. It is recommended that the last clause of Article (15) either be deleted or replaced with language that says that the third party guarantees can

cover a portion of the risk of loss. If necessary legally, the regulation could require that the total of all guarantee coverage by the originator-seller and all third party guarantors equal 100% of the interest and principal repayment on the securities issued.

Article (16) should be more inclusive in the information that can be disclosed to a prospective purchaser of real estate loans in a securitization. All information about the borrower, any guarantors of the loan, the security realty, any additional collateral, the performance of the loan, delinquency and default rates and any other information relating to the real estate loans to be sold should be authorized for disclosure to a prospective purchaser of the loans without prior consent of the borrowers.

Part IV Execution on the Realty

Provisions of the Law

Articles 12 through 27 of the Law set out the procedures for execution on the security realty. There is no requirement that executive regulations be issued except in Article 16, relating to the qualifications and registration of execution real estate agents and their remuneration and Article 18, relating to determining the rules for computing the bid bond. If no special provision is prescribed in the Law, the provisions of the Civil and Commercial Procedure Law shall apply.

Provisions of the Executive Regulations

Chapter Four, Articles (17) through (26) deal with execution on the realty. There may be some question whether there is any statutory authority for most of these regulations and whether any of them conflict with the applicable provisions of the Civil and Commercial Procedure Law.

Article (17)

Foreclosure on the part of the financier against the collateral property shall not be entertained without officially notifying the investor or providing sufficient guarantee, as the case may be. The notice shall include:

- A) Instructing the debtor either to discharge or provide sufficient collateral*
- B) Statement of the due installments or the collateral acceptable to the financier*
- C) Specifying a term for the investor to discharge or to submit sufficient collateral, provided that such term shall not be less than 60 days from the date of notification.*
- D) The investor shall be warned that non-response on his part throughout the term specified in the notice renders due all unpaid installments in accordance with the provisions of the real estate financing agreement.*
- E) Specifying chosen domicile of the financier.*

Article (18)

Execution shall be initiated by notifying the investor, the assignee, the owner of the rights in rem, the lessee and the possessor of the property of the real estate financing agreement after inscribing the execution formula thereupon, together with summoning the investor to discharge. The notification shall include the following:

- A) *Statement of the date and place of inscribing the execution formula on the real estate agreement.*
- B) *Summoning discharge of the outstanding amounts in full according to the provisions of the real estate financing agreement within a minimum of thirty days of the date of the notice summoning discharge.*
- C) *Description of the property indicating the location, area, and boundaries thereof.*

Article (19)

The financier shall notify the real estate registry under whose jurisdiction the property subject to execution falls of the real estate financing agreement after inscribing the execution formula thereupon and summoning the investor to discharge for the purpose of annotation on the book of entries of reality guarantees within a week of the date of notification. The financier shall inform all creditors having registered interests in the property and the possessor thereof of the agreement after inscribing the execution formula and summoning discharge. Failure to so doing shall render the summoning non-operative vis-à-vis those creditors and the possessor.

Article (20)

Annotation by the real estate registry on the writ of execution serves as registration of the warning of appropriation, and thus the property shall be deemed under attachment as of the date of such annotation.

Article (21)

The execution judge shall nominate a real estate agent from amongst those enrolled in the roster maintained by the authority for that purpose to proceed with the public auction, in accordance of Chapter Six herein. That agent shall have no direct or indirect interest in the sale, or with the financier or the investor.

The judge shall include in the order to proceed with the sale instructing the applicant for execution to deposit a bid bond for the account of the execution. Fixing that amount is the discretion of the judge.

Article (22)

The basic sale price of the property subject to execution shall be determined by two valuers listed in the roster of the Authority upon the request of the real estate agent. Valuation shall be subject to the following criteria:

- A) *The value of the property upon purchase.*
- B) *The improvements incorporated after purchase of the property.*
- C) *The effect of inflation rates on real estate market.*
- D) *The current market value of similar properties within the same district or similar districts.*

Article (23)

The real estate agent shall set, within fifteen days of the date of annotation of the execution writ on the registry book, the list of conditions of sale, which shall include the following:

- A) Specifications of the property subject to execution, including area, location, boundaries thereof, and other relevant information that best describes it.*
- B) The date and place of inscribing the execution formula on the real estate financing agreement.*
- C) The date and place of annotation of the execution writ at the reality registry office.*
- D) Date, hour, and place of conducting sale auction.*
- E) Division of the property into multiple sale transactions, as the case may be, and stating the basic price of each*
- F) The deposit securing participation in the auction shall not be less than 1% of the basic sale price of the property and not exceeding 5% thereof.*

Article (24)

The real estate agent shall, prior to proceeding with auction, ensure notifying all concerned parties within the time limits specified under Article (19) of the law of the list of conditions of sale and order of the offers and communicating same to the attendees.

Article (25)

The agent shall deposit the proceeds of sale at the court's treasury within three days of the issuance of the sale decision by the court.

Article (26)

The execution judge shall determine the fees of the agent based on the effort exerted thereby to complete sale procedures and the time consumed. Fees shall not exceed 3% of the auction sale price.

Analysis of the Executive Regulations

There is some question as to why the MHUUC determined that these executive regulations were necessary, since the Law sets out the procedures to be followed in an execution on the security realty. There may not be statutory authority for these regulations. Executive regulations relating to execution on the realty may be needed where the provisions of the Law are ambiguous or confusing or to define terms used in the Law. However, some of these regulations paraphrase the Law and add nothing to the provisions in the Law while others appear to diverge from the procedures established by the Law.

It is recommended that the provisions of the executive regulations dealing with execution on the realty be reviewed and revised, as necessary, by a lawyer with expertise in civil and commercial procedure law relating to execution on collateral.

Articles (21) and (26) attempt to satisfy the requirements for executive regulations in Articles 16 and 18 of the Law. The qualifications and registration procedures for execution real estate agents are discussed in detail in the Report on Real Estate Finance Companies, Real Estate Finance

Brokers and Execution Real Estate Agents. It is appropriate for the regulations relating to execution on the realty to require that the agent have no direct or indirect interest in the sale, the financier or the investor. Article (26) sets a maximum of 3% of the auction sale price for the remuneration of the execution real estate agent. Within this limit, the amount of remuneration paid to the agent is at the discretion of the execution judge.

Article 18 of the law requires that the executive regulations determine the rules for computing the bid bond for bidders at the real estate auction. However, Article (21) of the regulations leaves the computation of the bid bond to the discretion of the execution judge. This provision does not seem to fully satisfy the requirement of the Law.

Article (22) should be revised to be consistent with the executive regulations on real estate valuation. The criteria specified in Article (22) for computing the basic price of the real estate to be auctioned are not consistent with real estate valuation standards in effect in other countries.

Articles (23) and (24) should be reviewed carefully for consistency with the procedures set out in the Civil and Commercial Procedures Law. In addition to the items listed, the conditions of sale should specify what evidence a bidder must submit to prove that he has the financial capacity to complete the purchase if he is the winning bidder. Typically, a bidder has to provide a commitment letter from a bank or other financial institution to advance funds for the purchase of the real estate being auctioned. It is not clear whether item (F) relating to the amount of the “deposit securing participation in the auction” refers to the bid bond mentioned in Article 18 of the Law or the minimum deposit a successful bidder must pay at the conclusion of the auction. If this deposit is the bid bond, item (F) of Article (23) conflicts with Article (21).

Article (25) requires full payment and deposit of the auction sale price within three days of the judge’s ruling approving the sale. Depending on the time between the date of the auction and the date ruling is handed down, three days may be an unreasonably short time for the purchaser at the auction to secure financing, especially if the real estate purchased is a commercial property or a real estate development. The successful bidder should be allowed at least one, and probably two, weeks to secure the financing needed to complete the purchase.

Part V Real Estate Finance Companies

Provisions of the Law

Articles 28 through 34 of the Law deal with the licensing, financial criteria, reporting requirements and supervision of real estate finance companies.

Provisions of the Executive Regulations

Articles (27) through (37) of the executive regulations set out the specific criteria, rules and procedures for real estate finance companies. Articles (27) through (35) of the executive regulations are discussed in detail in the Report on Real Estate Finance Companies, Real Estate Finance Brokers and Execution Real Estate Agents. Articles (36) and (37) address the criteria and procedures for applications for the dissolution, sale of all or part of the assets and merger of real estate finance companies. The provisions of Articles (36) and (37) are adequate and require no comment or analysis.

Real Estate Finance Guarantees

ARTICLES 35 AND 36 – THE REAL ESTATE ACTIVITY GUARANTEE AND SUPPORT FUND

Provisions of the Law

Article 35 authorizes the establishment of the Real Estate Activity Guarantee and Support Fund by Presidential Decree. The MHUUC has prepared a draft of the Presidential Decree. Article 36 enumerates the financial resources available to the Fund.

Provisions of the Executive Regulations

Chapter Seven, Articles (53) through (55) of the executive regulations and the draft decree establishing the Real Estate Activity Guarantee and Support Fund address insurance of real estate loans and real estate finance subsidies.

Article (53)

Low-income persons who would like to receive subsidy to buy a house should apply to one of the offices of the real estate financing guarantee and subsidy fund. This application should use the form designed for that purpose and should include the following:

- (a) Description of the property and location thereof*
- (b) Letter from the seller of the property expressing approval of the sale*
- (c) Certificate from real estate valuers approving the offered price*
- (d) Certificate substantiating the annual income of the applicant*
- (e) Any other documents the fund may require*

Article (54)

The fund shall study the application and shall decide thereupon within 30 days of receiving the application. The decision shall include, in the case of approval, specification of the subsidy percentage to be provided by the fund and the procedures and timing for concluding the contract with the objective to ensure provision of subsidy within a period not to exceed fifteen days from the date of accepting the application.

Article (55)

The fund guarantees discharge of installment payments that are in default because of unexpected reasons up to three installments as a maximum. The bylaws of the fund shall set the rules and procedures for proving and weighing of these reasons. Also the rules shall establish the ways by which the fund shall be reimbursed for the installments advanced.

The fund shall not replace any one investor in discharging the defaulted payments before the lapse of 5 years.

Analysis of the Executive Regulations

The issues of credit insurance and subsidizing low income housing loans are discussed in detail in the Report on Financing Low and Moderate Income Housing. The current executive regulations should not be implemented until the Fund has been established and capitalized and the Board of Directors of the Fund has had the opportunity to consider and adopt its policies and procedures for both insuring real estate loans and providing real estate finance subsidies.

The method of covering losses on insured loans by paying up to three delinquent installments on any given loan within a five-year period is inherently flawed. This system provides perverse incentives to borrowers who will perceive that they have paid for the right to receive a government subsidy of three installment payments. As a senior officer of a large Egyptian insurance company stated, there is a 100% probability that all insured borrowers will default on three installments to take advantage of the loan insurance benefits provided by the Fund.

Mortgage and other forms of credit insurance are widespread and models with a history of default and loss experience are readily available. It is unwise for Egypt to experiment with an unproven method of insuring lenders against loss on the loans they originate. The real estate loan insurance offered in Egypt should be the standard form of insurance or guarantee, with the guarantee fund covering a specified percentage or all of the outstanding amount of a loan in the event of default or covering all or part of the loss the lender sustains on the sale of the real estate in an execution procedure.

The issues of loan guarantees and subsidies require substantial research and analysis. To rush into poorly structured guarantee or subsidy programs could lead to disaster.

ARTICLE 37 – LIFE INSURANCE

Provisions of the Law

Article 37 gives the lender the right to require that the borrower obtain insurance against death or disability with the lender named as beneficiary on the policy (ies).

Provisions of the Executive Regulations

Article (56) of the executive regulations set out the conditions relating to the life and disability insurance policies authorized in Article 37 of the Law.

Article (56)

In the event that the financier requires the investor to hold insurance with the benefit accruing to the financier at the value of its rights in accordance with the real estate financing agreement against the risks of death or disability, this insurance shall be concluded with an Egyptian insurance company according to the following provisions:

- 1. The insurance company shall pay the amount of insurance to the beneficiary based on a certificate of death of the investor or a medical certificate substantiating full or not less than 50% disability. This certificate should be issued by one of the*

medical institutions that are specified by the insurance company in agreement with the authority.

- 2. The investor shall be under obligation to pay the premiums and provide proof of payment thereof.*

Analysis of the Executive Regulations

The Egyptian Insurance Supervisory Authority (EISA) has already approved two forms of the life insurance authorized by Article 37 of the Law. One policy will pay off the total outstanding balance of a real estate loan, up to the policy limit and the other will take over the payments on the loan upon the death of the insured borrower. The insurance companies are not willing to write disability insurance because of past poor experience with such policies. Therefore, although the Law authorizes a lender to require the borrower to obtain disability coverage, no Egyptian insurance company currently is offering such coverage. Given this situation, the executive regulations should say that a lender may only require the borrower to obtain disability insurance if such insurance is generally offered by Egyptian insurance companies at a “reasonable and customary” cost. In other words, the lender cannot require that a borrower purchase a policy that is not available or is available only at an excessive premium rate.

Article (56) of the executive regulations establishes some of the conditions of insurance. The issuance of regulations under the Real Estate Finance Law governing insurance creates a potential conflict of jurisdiction between the Real Estate Finance Affairs Authority and EISA. Conditions of insurance by Egyptian insurance companies are clearly within the supervisory jurisdiction of EISA. The only conditions that should be imposed by regulations issued under the Real Estate Finance Law are those relating to the relationship between the lender and the insured borrower.

Another issue is the ability of the lender to assign its interest as the beneficiary in life insurance policies to a purchaser of real estate loans in a securitization. The insurance laws and regulations must authorize assignment of the lender’s rights without the insured borrower having to name a new beneficiary.

Because of these issues, it is recommended that Article (56) of the executive regulations be deleted in its entirety and replaced with a new Article 56, a draft of which is presented in Exhibit 5 of this report. The insurance regulation that is adopted should be reviewed by EISA and any conflicts with the insurance laws and regulations should be resolved before the final regulation is issued.

ARTICLE 38 – REAL ESTATE FINANCE BROKERS

Provisions of the Law

Article 38 requires that any person acting as an intermediary between a prospective borrower and a lender must be registered with the Real Estate Finance Affairs Authority. Executive regulations shall establish the qualifications, rules and procedures for registration with the Authority.

Provisions of the Executive Regulations

Chapter Six, Articles (39) through (43) set out the qualification criteria for real estate finance brokers and the procedures for registration with the Authority. These are discussed in detail in the Report on Real Estate Finance Companies, Real Estate Finance Brokers and Execution Real

Estate Agents. Articles (49) through (52) of the executive regulations address the practices of real estate finance brokers.

Article (49)

The broker shall hand the applicant for financing a copy of the form set by the authority showing all the key conditions of the financing agreement and should explain all the terms and the risks associated therewith. The investor should sign a statement that he has received a copy of the agreement and has read it before signing the agreement; this statement shall be enclosed with the real estate financing agreement.

Article (50)

The financier will fix the fees of real estate financing broker, provided that the fees should not exceed the limit set by the board of directors of the authority.

Article (51)

It is prohibited for the broker to receive any payment, commission or any interest that is related to his work except from the financier who commissioned him to endeavor to have a contract concluded.

Article (52)

The broker has to make entries in his books of all transactions performed thereby and shall maintain relevant documents and provide the parties to the agreement and the authority certified copies thereof.

Analysis of the Executive Regulations

The qualifications set for real estate finance brokers in the executive regulations are too low and the registration procedures do not require the applicant to demonstrate any knowledge of the law, regulations and real estate financing practices. Recommendations have been made for more appropriate qualifications and procedures in the applicable section of the Report on Real Estate Finance Companies, Real Estate Finance Brokers and Execution Real Estate Agents.

Article (49) of the executive regulations is in error because it only applies to real estate finance brokers. All real estate lenders, not just real estate finance brokers, must provide the borrower with a form setting out the terms and conditions of the real estate loan.

Article (50) requires the board of directors of the Authority to set maximum fees for real estate finance brokers. There is some question as to why the Authority should be setting fees for private contractual relationships, although this practice is common in Egypt. Article (51) is a standard condition for real estate finance brokers, although some laws and regulations permit the broker to accept payment from other parties if such payments are fully disclosed. The main questions raised by Article (52) dealing with record keeping by the broker are which parties should hold the original executed copies of the documents and why the Authority should maintain a file of copies of all of the documents relating to real estate financing transactions.

ARTICLE 39 – DISCLOSURE OF TERMS AND CONDITIONS OF REAL ESTATE LOANS

Provisions of the Law

Article 39 requires the Authority to prepare a consumer disclosure form explaining in plain language all of the terms, conditions and obligations of the borrower in a real estate financing transaction. All banks and real estate finance companies engaged in real estate lending and all real estate finance brokers must give each applicant a copy of this disclosure form. The borrower must sign a declaration that he has read and understands the terms, conditions and obligations explained in the disclosure form. A copy of that declaration must be attached to the real estate financing agreement.

Provisions of the Executive Regulations

Article (49) should be corrected to include all real estate lenders, not just real estate finance brokers. This article merely restates the provisions of Article 39 of the Law. It does not include the disclosure form required by the Law. Preparation of the disclosure form is the responsibility of the Authority, not the MHUUC.

ARTICLE 40 – MONTHLY LOAN STATEMENTS

Provisions of the Law

Article 40 requires the lender to provide monthly loan statements to the borrower. Monthly statements are appropriate only for loans where the payments are made on a monthly basis. The executive regulations are to specify the contents of the loan statements.

Provisions of the Executive Regulations

Article (57) of the executive regulations sets out the content of the monthly loan statements.

Article (57)

The financier shall inform the investor of the following on a monthly basis:

- A) The value of the original principal financing plus the total costs due for this principal from the beginning of financing through the full repayment.*
- B) The value of installment payments made to the financier and the costs thereof through the statement date.*
- C) The value of the installments and costs of financing outstanding*
- D) Any charges, expenses or costs that have been deducted from the account of the investor even though it is for the performance of an agreement condition, a court judgment or in accordance with the law.*
- E) Any change in the address of the financier where the investors payments should be made*
- F) Any change in the costs of financing.*
- G) Any other information that came to the knowledge of the financier that may affect the real estate guarantee thereof.*

Analysis of the Executive Regulations

The regulation should state that the lender or servicer will mail the loan statement to the borrower within a specified number of days after the end of each calendar month and that the lender or servicer shall not charge the borrower any fee for preparation and delivery of the monthly loan statement. If the borrower requests the lender to provide him with loan statements more frequently than monthly, or if the borrower requests a replacement or duplicate loan statement or a loan statement certified by an officer of the lender or servicer, the lender or servicer should be able to charge a commercially reasonable fee for these services.

In addition to the items listed in Article (57), the monthly loan statement should show the loan number or other means of identifying the loan, the statement date, the date the last payment was received, any delinquent payments and any partial prepayments of the principal due on the loan. The loan statement also should include a statement informing the borrower that if he thinks there is an error in his loan statement, he must notify the lender or servicer in writing within a specified period of time after the statement date and giving the name of the individual or the department and the address where the borrower must send his notice of an error in the statement and a telephone number where the borrower can ask questions about his statement.

ARTICLE 41 – COMPLAINT DEPARTMENT

Provisions of the Law

Article 41 requires that a department be established within the Authority to receive and process complaints. In the Report on the Real Estate Finance Affairs Authority, it was recommended that complaint departments be established within the real estate finance department and the valuation department because the laws and regulations governing these two areas of supervision and the technical expertise required to process a complaint are different. If such a structure would not be in compliance with Article 41, a single complaint department with divisions for real estate finance, valuation and other complaints should be established.

Provisions of the Executive Regulations

Articles (58) through (60) of the executive regulations address the procedures for filing and processing complaints.

Article (58)

The authority shall establish a department to receive complaints and study these complaints against those who deal with real estate financing and this office shall have a sufficient number of officers.

Article (59)

The complaint should be filed in writing by the concerned party or its agent and shall be recorded in a special log designed for that purpose against a receipt that shows the date of entry and the number thereof in the log.

Article (60)

The office shall notify the complainant of the results of the study of the complaint and the procedures taken within fifteen days of submittal thereof.

The office shall prepare a semiannual report to be submitted to the board of directors of the authority including the number and topics of complaint and decisions taken and the office's remarks and recommendations.

Analysis of the Executive Regulations

In Article (58) it should be made clear that "those who deal with real estate financing" includes real estate valuers. The procedures for filing and processing complaints against real estate valuers are discussed in detail in the Report on Real Estate Valuation. Complaint forms for the different classes of individuals and institutions supervised by the Authority should be prepared and provided to persons wishing to file a complaint. The complaint procedure should provide for an administrative hearing and appeal to the Board of Directors of the Authority.

Part VI Control

ARTICLE 43 – ACCESS TO RECORDS

Provisions of the Law

Article 43 of the law authorized any interested party to have access to the registers, reports, documents and other papers of the Authority relating to real estate financing activity by paying a fee to the Authority. The Authority, however, may not provide access to records and documents that would violate the laws on the confidentiality of information.

Provisions of the Executive Regulations

Article (61) of the executive regulations specifies the fees the Authority will charge for copies of records and documents.

Article (61)

Any concerned person has the right of access at the authority to the files, documents and reports and all other documents relevant to the business of real estate financing and also to receive official extracts therefrom, in accordance with article 43 of the law, against a charge of LE 50 for viewing and LE 10 for each page of the official extracts of the documents with a maximum total charge of LE 100.

Analysis of the Executive Regulations

The executive regulations do not make any reference to the confidentiality of information or to the circumstances in which disclosure of information would be "likely to impair the real estate finance activity or encroach on the public interest." There is some information that should not be made available to the public. For example, enforcement actions and criminal investigations frequently are not public records. Documents that contain confidential personal and financial information about borrowers, registered professionals and officers and directors of real estate finance companies also should not be disclosed to the public. The Board of Directors of the Authority should consider what information should not be made public and issue an executive regulation listing such confidential information.

Annex 3

Function Descriptions of the Real Estate Finance Affairs Authority

Board of Directors

The affairs of the Authority will be directed by its Board of Directors: “the Board of the Authority shall be deemed as the supreme power dominating its affairs, the disposition of its matters and the proposition of the general policies applied thereto.” The executive regulations specify that the Board of Directors also perform several specific duties:

- 1. Approval or denial of applications for licensing as a real estate finance company (Article 32);*
- 2. Setting the rules for estimation of the fees real estate valuers may charge their clients (Article 48);*
- 3. Setting a maximum limit for the fees a real estate lender can pay a real estate financing broker (Article 50).*

It may be advisable to have the Chairman of the Authority approve or deny applications for licensing and for dissolution, merger or sale of all or the majority of the assets of real estate financing companies so that an applicant whose application has been denied can appeal the decision to the Board of Directors, whose decision would be final. If the Board denies an application, the appeal process would have to be an arbitration or administrative law procedure.

The Real Estate Valuation Advisory Board

Because of the specialized technical knowledge involved in real estate valuation and the importance of real estate valuation not only to real estate finance, but to the Egyptian economy, it is recommended that a Real Estate Valuation Advisory Board be established. The purpose of the Real Estate Advisory Board is to advise the Board of Directors on matters relating to real estate valuation standards, qualification of real estate valuers and certification examinations. The Board of Directors of the Authority or the Minister of Housing should give serious consideration to setting up the Advisory Board before the Authority is fully operational so that work could begin on designing Egyptian professional standards for real estate valuation. The introduction of Egyptian professional standards for real estate valuation is one of the most important contributions the Ministry of Housing, Utilities and Urban Communities could make to the development of a sound real estate finance system.

Chairman of the Authority

The Chairman of the Authority will be responsible for managing the affairs of the Authority and for implementing the provisions of the Real Estate Finance Law, No. 148 of 2001, and its executive regulations and decrees, Presidential Decree No. 277 and the policies, procedures and directives approved by the Board of Directors. With the exception of the Deputy Chairman, who will be appointed by the Minister of Housing, Utilities and Urban Communities, the Chairman will appoint the heads of each department of the Authority. He will also represent the Authority before the Court and with third parties. The Chairman should approve or deny all applications

for licensing as a real estate finance company or for dissolution, merger or sale of all or the majority of the assets of a real estate finance company.

Deputy Chairman

The Deputy Chairman will be appointed by the Minister of Housing, Utilities and Urban Planning and shall serve as the Chairman of the Authority in the absence of the Chairman. The Deputy Chairman will assume such duties and responsibilities as the Chairman may delegate to him.

Offices Reporting to the Chairman

Five offices will report directly to the Chairman: technical office, external relations, information technology, legal and security.

General Secretariat for Management Development and Governorate Affairs

The General Secretariat is responsible for the administrative functions of the Authority, included budget, financial management, human resources, coordination of the activities of any branches of the Authority the governorates and training and management development of the Authority's personnel.

Central Department for Real Estate Finance Activities

The Central Department for Real Estate Activities has two principal functions: 1) registration and licensing of real estate finance companies, loan brokers and execution real estate agents; and 2) the control and supervision of real estate finance companies, loan brokers and execution real estate agents. The Department will be responsible for implementing the policies and procedures approved by the Board of Directors relating to the activities of the entities and persons under its jurisdiction. The Central Department will consult with the General Department for Real Estate Financing Policies and Legislation with respect to the Authority's policies, procedures, reporting requirements and other matters related to the entities under the jurisdiction of the Central Department.

The Head of the Central Department will be responsible for making recommendations to the Chairman for approval or denial of applications for licensing, dissolution or merger of real estate finance companies or the sale of all or a majority of a real estate company's assets. The Head of the Central Department will take all necessary actions related to the enforcement of the Real Estate Finance Law and shall make recommendations for disciplinary actions and/or penalties to the Chairman and the Board of Directors.

General Department for Registration and Licensing

The General Department for Registration and Licensing will receive and process applications for a license as a real estate finance company and registration as a loan broker or execution real estate agent. The head of the department will make recommendations to the head of the Central Department regarding approval or denial of applications. The General Department will receive, process and make recommendations for approval or denial of applications for changes in the authorized activities of and the merger, closure or sale of all or significant part of the assets of real estate finance companies. The General Department will maintain current lists of all entities registered with it and shall make such lists and other information available to the public, and provide officially-stamped copies thereof, in accordance with the policies and rules adopted by the Board of Directors.

General Department for Control and Supervision

The General Department for Control and Supervision will supervise the activities of real estate finance companies, loan brokers and execution real estate agents. The Department will review the financial statements of real estate finance companies for compliance with the financial criteria established by the executive regulations and the Board of Directors and will make on-site inspections of such companies as needed. The General Department will receive and investigate complaints against the entities under the jurisdiction of the Department. The Department will recommend such disciplinary actions as it determines are appropriate to the Head of the Central Department.

Central Department for Real Estate Valuation

The duties of the Central Department for Real Estate Valuation are discussed in detail in the report on real estate valuation. The Central Department for Real Estate Valuation will be responsible for the registration, certification and supervision of real estate valuers. The Department also will receive and investigate complaints from the public about real estate valuers and make recommendations to the Chairman and the Board of Directors of the Authority for disciplinary action. The Department will provide valuers, users of valuations and the public with information about real estate valuation standards, qualification of real estate valuers, the code of ethics and complaint processing and adjudication procedures. The Department also will provide technical support and staff in the area of real estate valuation to the Chairman and the Board of Directors of the Authority and the Real Estate Valuation Advisory Board.

General Department for Registration and Certification

The General Department for Registration and Certification will receive and process applications for registration and certification of real estate valuers according to the procedures established by the executive regulations or approved by the Board of Directors, oversee the administration of certification examinations, maintain a list of the names and addresses of people registered or certified as real estate valuers, retain records and all application materials filed with it and make such lists, records, materials and other information available to the public, and provide officially-stamped copies thereof, in accordance with the policies and rules adopted by the Board of Directors.

General Department for Control and Supervision

The General Department for Control and Supervision will be responsible for enforcement of the rules relating to real estate valuers established by the executive regulations and the Board of Directors. The General Department will provide for expert review valuers to evaluate disputed valuations. The General Department will establish administrative procedures for receiving and processing complaints from the public against real estate valuers. The Department will provide information to the public about real estate valuation standards and valuation review and complaint procedures

Central Department for Research and Policy Development

The Central Department for Research and Policy Development will prepare studies and research relating to real estate finance and valuation and will collect the statistics and other data required for such studies and research. The Central Department will make recommendations to the Chairman and the Board of Directors about the policies, procedures and standards to be adopted

by the Authority. The Central Department will review such policies, procedures and standards to ensure consistency with overall Egyptian economic policy. The Central Department will develop informational materials for the public relating to real estate finance, real estate valuation and the rules, regulations and procedures administered by the Authority.

General Department for Research, Statistics and Public Information

The General Department for Research, Statistics and Public Information will collect, analyze and disseminate data, statistics and information on the activities of the Authority and will conduct studies and research based on such data, statistics and information, including periodical statistical reports and newsletters. The Department will document, classify and index all data, information, statistics and documents in a manner that permits easy retrieval, access and usage thereof. The Department will prepare and publish information for the public relating to the activities, rules and procedures of the Authority relating to real estate finance and real estate valuation.

General Department for Real Estate Financing Policies and Legislation

The General Department for Real Estate Financing Policies and Legislation will develop policies and procedures for approval by the Chairman and the Board of Directors relating to real estate financing activities, the financial and other criteria for real estate finance companies, the basic conditions of real estate finance, the standardized forms to be used in real estate finance and other issues as directed by the Chairman or the Board of Directors. The Department will prepare any proposed legislation and executive regulations or amendments to legislation and executive regulations necessary for the performance of the duties of the Authority or to reflect changes in the Egyptian economy, the real estate and real estate finance markets and related laws and regulations.

Annex 4

Real Estate Valuation Requirements

The Importance of Reliable Real Estate Valuation

Real estate valuation is essential to the development of a sound real estate finance market, to privatization and to more transparent financial reporting in Egypt. Reliable valuations of real estate prepared by certified valuers according to standards of real estate valuation consistent with those applied in Europe, the U.K. and the United States can reduce the risk involved in real estate transactions by assigning credible market values to real estate. All participants in the market should be able to understand the methodology applied and have an assurance of consistency in valuation. Real estate valuation standards should be correctly applied and supervised. This can be accomplished in Egypt by the establishment of: 1) professional standards of valuation and valuation methodology; 2) qualification criteria for real estate valuers in terms of education, technical knowledge and skills; 3) a code of ethics; and 4) effective supervision of the real estate valuation profession.

International Development of Professional Standards for Real Estate Valuation

Real estate valuation principles and techniques have been practiced around the world for many years, primarily for valuing real estate collateral for bank loans, valuing real estate assets in estates and establishing real estate sales prices. However, the development of real estate valuation as a profession is a more recent phenomenon, arising out of the recognition that competent, objective and professionally prepared real estate valuations are required for sound real estate lending, reliable financial reporting and corporate valuation and a variety of other business activities.

The real impetus for the development of professional standards of real estate valuation and educational and experience qualification criteria for valuers was the series of financial crises in a number of countries in the 1980s and 1990s. The United States, Japan, Thailand and Malaysia experienced periods when real estate prices escalated to unsustainable levels and then collapsed. The savings and loan crisis in the United States in the early 1980s was largely due to lending based on unrealistically high, and frequently fraudulent, real estate values. The Japanese real estate market has yet to recover from the excesses of the 1980s. In 1997, the over-inflated real estate bubbles in Malaysia and Thailand burst, contributing to the financial crises in those countries.

One response to these financial crises has been the establishment of real estate valuation standards and educational and professional qualification criteria for real estate valuers enforced by government agencies or self-regulating organizations (“SROs”). In the United States, the government passed a law that real estate valuations relating to lending transactions by any federally insured financial institution must be prepared in accordance with the Uniform Standards of Professional Appraisal Practice (“USPAP”). These real estate valuations have to be prepared by valuers licensed or certified by one or more of the fifty state real estate appraiser certification boards. In order to be licensed or certified, a real estate valuer must satisfy specific educational, experience and continuing education requirements.

Other countries have adopted valuation standards and codes of ethics for professional valuation practice. In some countries these standards and codes were written into law or regulation while in others, SROs were created to adopt and enforce valuation standards. The largest and most important of these real estate valuation SROs are the Royal Institution of Chartered Surveyors (“RICS”) in the UK, whose valuation standards have been codified in its Appraisal and Valuation Manual (the RICS “Red Book”) and The European Group of Valuers’ Associations

(“TEGoVA”), consisting of the national real estate valuation associations of several European countries, whose real estate valuation standards are set out in its Approved European Property Standards (the “Blue Book”). Real estate valuer professional associations in Canada, Australia and Latin America also have adopted uniform standards of valuation practice. In 1981, The International Valuation Standards Committee (“IVSC”) was established to harmonize the different real estate valuation standards being applied around the world. The IVSC published standards in 1985 and in the years 1994 through 1997. These standards were revised and supplemented as part of the IVS 2000 project and the first edition of the IVSC’s International Valuation Standards (“IVS” or the “white Book”) was published in 2000.

Real Estate Valuation in Egypt

Prior to the enactment of the Real Estate Finance Law, No. 148 of 2001, there were no requirements in Egyptian law or financial institution regulations that real estate valuations be performed according to standard procedures or that the people preparing the real estate valuations meet any qualification criteria. Real estate valuations have been performed by a number of professionals, including engineers, university professors and the valuation staffs of the commercial banks. The recent decline in the real estate market has revealed the weakness of a system without standards. All of the public and private sector officials interviewed during this project emphasized the need for Egypt to establish real estate valuation and qualification standards for real estate secured lending.

The Real Estate Finance Law requires that real estate valuations be performed by real estate valuers registered with the Real Estate Finance Affairs Authority (the “Authority”). The Authority is to establish the valuation standards and qualification criteria for registered real estate valuers. The executive regulations issued by the Ministry of Housing, Utilities and Urban Communities (“MHUUC”) in December, 2001, set general education and experience criteria for registration with the Authority as a real estate valuer but did not establish any requirement that real estate valuers demonstrate knowledge of and expertise in real estate valuation principles and practices. The regulations established some general requirements for real estate valuation practice, including valuation criteria (Article 45), conflict of interest (Article 46), review valuation in the case of dispute (Article 47) and valuation fees (Article 48). The valuation criteria established by the regulations are not sufficient and do not conform to standards of real estate valuation in use around the world.

Article (45). The valuers shall, upon conducting valuation of the property, comply with the criteria provided for in Article (22).

Article (22). Valuation shall be subject to the following criteria:

The value of the property upon purchase.

The improvements incorporated after purchase of the property

The effect of inflation on the real estate market

The current market value of similar properties within the same district or similar districts

In order to fully implement the intent of the Real Estate Finance Law, new executive regulations should be issued setting out: 1) more stringent qualification criteria for real estate valuers; 2) requirements for the examination of applicants to ensure that registered or certified valuers have

the technical knowledge required to prepare reliable real estate valuations; and 3) standards for real estate valuation, including a code of ethics, that are consistent with well established professional real estate valuation practices.

Real Estate Valuation Standards for Egypt

Appropriateness of Models from Other Countries

Existing international real estate valuation standards can serve as models for an Egyptian standard of professional real estate valuation practice. However, the characteristics of real estate markets, valuation practice and valuation concepts, terminology and methodology vary from country to country. For example:

- 1. Differences in the availability and quality of market data;*
- 2. Use of real estate valuations in financial accounting. In the UK real estate valuers work closely with accountants and auditors on financial reporting, whereas in the U.S. and Canada, real estate valuation and accounting are totally separate procedures;*
- 3. Definition of market value. In some countries, the valuer establishes a “market value” based on the actual facts of the transaction, while in others, including the United States, the valuer establishes a “fair market value” that disregards transaction-specific factors*
- 4. Valuation concepts. In some countries market value means “market value under existing use”, while in other countries market value means “market value under highest and best use.”*

The Authority should evaluate the different real estate valuation standards in use in other countries and incorporate those principles and practices of real estate valuation most suitable for the Egyptian market into standards of valuation practice for Egypt. This task will require technical expertise in accounting, the real estate market for residential and commercial properties, real estate valuation practices in other countries, current real estate valuation practices in Egypt and the sources, availability and reliability of real estate market data. The Authority should seek assistance from one or more of its valuation supervisory counterparts in the other countries and from international real estate valuation SROs.

It also is important for the real estate valuation standards adopted by the Authority to be consistent with Egyptian Accounting Standards and, where applicable, International Accounting Standards (“IAS”). The Authority should have Egyptian accounting experts review the valuation standards it proposes before the standards are issued.

Fundamental Real Estate Valuation Standards

Real estate valuation standards address several issues: 1) the definition of market value; 2) valuation methodology; 3) the content of valuation reports; and 4) a code of ethics and professional practice for real estate valuers.

1. Definition of Market Value for Valuation Purposes

Egyptian real estate valuation standards should be based on the fundamental principles of real estate valuation. The first step is to define “market value” for purposes of the valuation.

Article 38 “Market Value” or “Fair Market Value”

The accounting concept of “fair value” and the valuation concept of “market value” are similar, but not identical concepts. In many cases, the fair value of the real estate may be equivalent to the market value, but in some situations, it is not, because the market value may be influenced by the specific circumstances of the transaction for which the valuation is being prepared. For example, the selling prices of real estate may differ due to the availability of financing, sales concessions or other terms and conditions of the sale. The selling price of a house or flat in a cash purchase usually is less than the selling price of the same house or flat if the seller is financing the purchase. In the case of valuing new construction, the question is whether the market value should be based on the building that is actually being built, even if it contains “over improvements” desired by the owner or purchaser for which the general market would not pay full cost, or on standard construction. For income producing real estate, the fair market value also incorporates projections of future cash flow based on assumptions of “stabilized occupancy,” not the current occupancy.

U.S. valuation standards are based on the “fair market value” of the real estate, which is defined as:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of ownership from seller to buyer under conditions whereby the buyer and seller are typically motivated to consummate the sale, both parties are well informed or well advised and acting in what they consider their own best interest, a reasonable time is allowed for the offer of the real estate on the open market, payment is made in terms of cash or customary financial arrangements and the selling price of the real estate is not affected by special financing or sales concession granted by anyone associated with the sale

Article 38 Value Under Existing Use or “Highest and Best Use”

The value of real estate can be based on “market value under existing use” or the “market value under highest and best use”. The market value under existing use is a relatively simple concept, the value of the real estate as it is currently being used, even if that use is not the best use of the real estate. The concept of highest and best use involves assumptions by the valuer about which use of the subject real estate, “from among reasonably probable and adequately supported alternative uses is legally permissible, physically possible, financially feasible and maximizes the utility” of the real estate.

Land value is usually valued based on the highest and best use of the property as if vacant and ready for development. Improvements are valued according to how their existing uses contribute or detract from the value of the land. For example, under highest and best use, the market value of a single family home built on a parcel of land in a prime urban location would be estimated as the sum of the value of the land as if it were developed for a higher use, such as an office building, plus the value of the house (or minus the cost of removal of the house). If the land were valued under its current use as a single-family residence, the valuation would understate the price a buyer would be willing to pay for the land if he could develop it as a commercial property.

However, if the house located on the land is an historic building that could not be demolished, the real estate would have to be valued under its existing use because its highest and best use is not legally permissible.

Valuation Methodology

The next element of valuation standards is uniform valuation methodology. The valuation of real estate involves three methods of valuation: 1) the Comparable Market Value (CMV) [sales comparison] method; 2) the cost method; and 3) the income method. The CMV method compares the subject real estate to similar, recently sold properties; the cost method computes the market value of the land on which a building is situated and adds to it the cost of the building; the income method applies a rent multiplier or discounts the projected future cash flows from the subject real estate to arrive at a market value. The three valuation methods are explained in detail in the various real estate valuation manuals and texts that are generally available. A list of sources for valuation standards information is provided in Exhibit 8.

Selection of the most appropriate valuation method to apply depends on the type of real estate being valued and the market conditions for the subject real estate. In some cases, all three methods should be applied to arrive at separate estimates of market value. The valuer would then arrive at a final estimate of market value based on the three separate value estimates. For non-income producing real estate, the valuer may use only the CMV method or both the CMV and cost methods. The income method is less meaningful for non-income producing real estate because the valuer would have to impute the income generating capacity of the real estate in order to compute a market value using the income method. Proposed standard forms applying the CMV and cost methods of valuation for use in real estate valuation in Egypt have been developed as part of the project. These forms are included in Exhibit 9.

Valuation of Non-income Producing Private Residences

For non-income producing private residences, the market value should be established by the residential Comparable Market Value (CMV) [sales comparison] method. The CMV method computes a market value for the subject real estate by comparing it to similar units that have been sold recently. The market prices for comparable units are the actual sales prices of similar residential units in the same or proximate location as the subject real estate. The valuation should be based on at least three (3) sales of comparable units sold within not more than the prior twelve (12) months. In an active real estate sales market, the comparable sales should have occurred within the most recent three- (3) months. Additional comparable sales may be considered if they contribute significantly to understanding the real estate valuer's final determination of the fair market value of the subject real estate.

As a general rule, the real estate valuer uses the actual sales price of the comparable unit in the valuation. If the real estate valuer is unable to obtain information on the actual sales price of a comparable unit, but has knowledge of the asking price and the actual completion of the sale, the asking price may be used in the valuation and adjusted for market conditions accordingly.

The valuer should make adjustments to the sales prices of the comparable units to reflect the differences between the comparable units and the subject real estate. Adjustments are also made to reflect financing and sales concessions. If the subject real estate is superior to the comparable, the sales price of the comparable should be adjusted upwards and if the subject real estate is

inferior to the comparable, the sales price of the comparable should be adjusted downward. The following adjustments are usually made to the sales prices of the comparable units:

- 1) Location: If the subject real estate is a unit in a multi-unit structure or project, at least one of the comparable sales should be situated outside the structure or project that contains the subject real estate. The sales comparables for units outside the structure or project in which the subject real estate is located should be within 5 blocks (and not more than 1 kilometer) of the subject real estate. If the comparables are located within one block of the subject real estate, no adjustment for location would be required.*
- 2) Site and View: Adjustments should be based on their influence on the sales price, due to the appeal of the site, view, lot size, floor in a multistory building and topography of the subject real estate relative to the comparable.*
- 3) Construction Quality: Adjustments should be based on differences in the quality of construction between the subject real estate and the comparables, including the quality of construction of the structures in which the subject real estate and the comparables are situated and the interior finishing quality of the individual units. Construction quality includes the types of materials and construction methods used as reflected by the cost less accrued depreciation, adjusted for market acceptance.*
- 4) Age: Adjustments should be based on the effective age of the subject real estate and the comparables, which may also be considered as part of the condition adjustment.*
- 5) Condition: If the subject real estate is new construction, condition adjustments should be based on information contained in the listings of the comparables, inspection of the comparables, interviews with knowledgeable parties and other data sources. If the subject real estate is not new construction, adjustments should be made for remodeling, upgrading, including electrical and plumbing systems, and other maintenance items that effectively improve the overall condition of the real estate. The estimated cost to cure deficiencies should be the basis for adjustments for inferior condition. Market studies and depreciated costs should be the basis for adjusting for superior condition.*
- 6) Market Trends: Adjustments should be made for temporary speculative market trends that have inflated real estate prices to levels that are not sustainable.*
- 7) Sales or financing concessions: Adjustments should be made for any costs usually paid by the buyer that the seller agrees to pay, any discount offered by the seller or any financing costs paid by the seller to reflect the effect on the sales price as indicated by the market. Adjustments should also be made if the buyer is assuming the seller's real estate loan or is refinancing an existing loan or sales contract.*

Most of the adjustments are based on the real estate valuer's judgment and experience, not statistical data. As a result, two qualified real estate valuers are unlikely to arrive at the same market value for a given piece of real estate. As the real estate valuation profession develops in Egypt, there should be more consistency in the value adjustments made. The Authority could make a significant contribution to the regularization of value adjustments by collecting sales data and conducting statistical analyses of those data to arrive at reasonable ranges for the different adjustment factors.

The valuer uses the adjusted selling prices of the comparable sales to arrive at a market value for the subject real estate. The valuer does not simply average the adjusted comparable selling prices, but weights each comparable according to his judgment about which comparable is most similar to the subject real estate.

Article 38 Valuation of Small Investment Real Estate

For small investment rental real estate, that is, small residential, commercial or mixed-use real estate affordable to individual investors, the valuer must analyze at least three investment real estate comparables. The investment real estate comparables should be similar to the subject real estate in terms of the use of the property: residential, commercial or mixed-use. They should be located within 5 kilometers of the subject real estate and should accurately represent the market for the units in the subject real estate. The valuer should include a schedule of the subject real estate's actual current rents and estimated market rents. The valuer should reconcile the adjusted sales prices of the comparable sales according to the manner in which such investment properties sell in the market area. The valuer also should indicate what factors typical investors in the market area consider when purchasing similar investment real estate.

Valuation of Investment Real Estate

If the subject real estate is larger income-producing real estate, whether residential, commercial or mixed-use, the income method of valuation should be used in addition to the CMV method. Valuation by the income method can be by discounted cash flow (DCF) or comparable rent multiplier (CRM). The value of the subject real estate using the CMV method should be used primarily to support the valuer's final determination of the market value of the real estate, but should not be weighted as heavily as the market value determined by the income method in the final estimate of value.

The discounted cash flow (DCF) method is based on the expected net income (the rental income less maintenance and administrative expenses) of the subject real estate discounted over a specified time period or over the expected economic life of the real estate. The time period over which the cash flows will be discounted will depend on the intended holding period of the entity purchasing or constructing the improvements on the real estate. If the real estate will be held for a limited period and then sold, the valuer must calculate a residual value of the real estate at the end of that period. The discount rate used in the DCF method should be based on a market interest rate. In Egypt, the interest rate on longer-term bank deposits is the most appropriate discount rate. The discounted cash flow method is appropriate for all types of investment real estate.

The comparable rent multiplier (CRM) method applies the ratio of the selling price of comparable investment real estate to the gross revenues from the comparables expressed as a multiple to the projected gross revenue of the subject real estate to estimate the market value of the subject real estate. This method is appropriate only for residential investment real estate and should not be used for mixed-use or commercial real estate.

Article 38 Valuation of New Construction and Special Purpose or Unique Real Estate

The valuation of new construction and real estate that is unique because of its use, style or construction method may utilize the cost method of valuation. The cost method should not be

used as the principal valuation method for other types of real estate. The cost method must include proper adjustments to the construction cost for physical depreciation of the structure and/or the individual unit. A valuation report that relies solely on the cost method should not be acceptable for determining the market value for the purpose of real estate lending.

Impediments to Implementation of Egyptian Valuation Standards

The principal impediment to the implementation of Egyptian Valuation Standards is the lack of reliable information on the selling prices, terms and conditions of real estate sales. In other countries, valuers obtain real estate sales data from their professional associations, real estate sales professional associations and public records, in jurisdictions where the sales price of the real estate must be registered in the real estate registration records. The Authority could provide a valuable service to the Egyptian real estate market if it could collect data on real estate sales and make the data available to real estate valuers and real estate lending institutions. Information about the parties to the transactions would have to be kept confidential, but data could be coded to protect the privacy of the parties and still disclose the relevant information needed to prepare reliable real estate valuations.

The Real Estate Valuation Report

In addition to valuation methodology standards, the Real Estate Financial Affairs Authority should specify the form and content of Valuation Reports.

Form of the Valuation Report

Real estate valuation reports should be prepared on the valuation forms specified by the Authority. A real estate valuation report should be dated not more than 60 days prior to the date of the real estate financing agreement for which the valuation report is being prepared. The valuer must certify that the information in the report is accurate, internally consistent, fully supported and sufficiently documented.

Information to be Provided by the Parties

The parties to the real estate transaction should be required to provide the following information on the subject property, as applicable, to the real estate valuer:

- a. An accurate survey or other acceptable legal description of the property*
- b. The complete real estate financing agreement*
- c. Income and expense statements, property leases and a list of any movable property items that are included in the transaction, and*
- d. Any other information that may materially affect the value or marketability of the property.*

Description of the subject real estate

The real estate valuer should be required to inspect the exterior and interior areas of the subject real estate and provide a complete description of the subject real estate and the immediate neighborhood. Model forms for recording property inspection data for homes and commercial or residential investment real estate prepared for use in Egypt are included in Exhibit 9. The real estate valuation report should include, as appropriate, surveys, architectural plans, a sketch or plan of the layout of the subject real estate, including the dimensions and estimates of the gross area of the unit(s) being financed, the gross area of the building in which the unit(s) are located and the number and types of rooms contained in each unit within the subject real estate. Photographs of the subject real are recommended.

Real estate valuation reports for development projects, construction of buildings on land owned by the borrower and on real estate that requires repair, alteration or completion, should include the plans and specifications for such development, construction, repairs or alterations.

Contents of the Valuation Report

The real estate valuation report must be sufficiently descriptive to enable the reader to ascertain the estimated market value of the subject real estate and the rationale for the estimate and provide sufficient detail and depth of analysis to reflect the complexity of the real estate being valued. The valuation report should contain supporting documentation with all pertinent information reported so that the valuer's logic, reasoning, judgment and analysis in arriving at his value conclusion indicate to the reader the reasonableness of the market value reported. Any personal property, fixtures or intangible items that are movable property but are considered in the valuation should be listed, described and appropriately valued.

A Uniform Residential Valuation Report and a Residential Comparable Rent Analysis form for small residential income real estate that have been designed for use in Egypt are included in Exhibit 9. As the proposed Uniform Residential Valuation Report demonstrates, the real estate valuation report should include the following sections:

Description of Subject Property

This section of the report should clearly identify the subject real estate by providing a complete address and legal description. The sales price, contract date and loan charges paid by or sales concession made by the seller must be stated as set out in the real estate financing agreement.

Neighborhood Section

This section should contain an accurate description of the subject neighborhood and the factors that influence the market value and marketability of real estate located in the neighborhood. The information presented in the neighborhood section must be consistent with and support the conclusions reached by the valuer. Unfavorable factors presented in the neighborhood section require the valuer to address the impact of those factors on the value and marketability of the subject real estate.

Site Section

This section must accurately describe the physical characteristics of the site and the specific unit(s) being financed. The valuer should address the quality of construction of the structure, the floor plan(s) of the individual unit(s), amenities, availability of parking

and any other features of the building or project that would materially affect the selling price or marketability of the subject real estate.

Comments Section

The comment section should include any other information the valuer believes would have a material effect on the selling price or marketability of the subject real estate.

Estimate of Value

The market value of the subject real estate as estimated by one or more of the three valuation methods discussed in this chapter.

Reconciliation

If the valuer has used more than one of the three valuation methods to estimate the market value of the subject real estate, the valuer must reconcile the estimates computed to determine a final market value estimate. The reconciliation must contain the conditions and assumptions of the valuation on which the final estimate of market value is based.

Final Estimate of Market Value

The valuer must arrive at a final estimate of the market value of the subject real estate, state the effective date of the value estimate, sign the valuation report and provide his registration number.

Unacceptable Real Estate Valuation Practices

The following should be considered unacceptable real estate valuation practices:

- a. *Inclusion of inaccurate or incomplete data about the subject real estate, the neighborhood or any comparable sale used in the valuation.*
- b. *Failure to report and/or consider any factor that has a material adverse effect on the value and/or the marketability of the subject real estate.*
- c. *Reliance on comparable sales data provided by interested parties to the transaction, without independent verification.*
- d. *The use of adjustments for differences between the subject real estate and the comparable sales that do not reflect the appropriate market reaction to such differences or the failure to make proper adjustments when they are clearly necessary.*

Deficient Real Estate Valuation Reports

Real estate valuers must be responsible for any deficiencies in their reports. A deficient report should be returned to the valuer for correction. Changes to a real estate valuation's estimate of value should be permitted only as a result of a review conducted by an appropriately qualified registered review real estate valuer with a class of certification equal to or higher than that of the valuer who prepared the valuation.

Code of Ethics and Professional Practice

Real estate valuers not only have to follow standard valuation methodologies in performing real estate valuations; they must conform to the highest standards of ethics and professionalism. All real estate valuation standards include a code of ethics to ensure the integrity of real estate valuations. A proposed code of ethics for Egypt is presented in Exhibit 10.

Registration and Certification of Real Estate Valuers

The Need for Professional Qualifications

A well functioning real estate market requires a base of professional valuation skills. Training, examination and certification programs can ensure the professional expertise, integrity and responsibility of real estate valuers. In Egypt, the Real Estate Finance Affairs Authority has the responsibility for ensuring that real estate valuers are well qualified and properly supervised.

International Experience

There is no consistent international treatment for the registration of real estate valuers. The table on the following page shows the number and number per million of population of real estate valuation professionals in selected developed and emerging markets.

THE REAL ESTATE VALUATION PROFESSION IN SELECTED COUNTRIES

<i>COUNTRY</i>	<i>NUMBER OF VALUERS</i>	<i>NUMBER OF VALUERS PER MILLION POPULATION</i>
<i>BRAZIL</i>	<i>5,000</i>	<i>29.39</i>
<i>CZECH REPUBLIC</i>	<i>5,500</i>	<i>535.37</i>
<i>FRANCE</i>	<i>1,750</i>	<i>29.74</i>
<i>GERMANY</i>	<i>8,000</i>	<i>97.38</i>
<i>HONG KONG</i>	<i>1,084</i>	<i>159.46</i>
<i>KOREA</i>	<i>1,724</i>	<i>36.47</i>
<i>MALAYSIA</i>	<i>500</i>	<i>21.50</i>
<i>MEXICO</i>	<i>3,000</i>	<i>30.62</i>
<i>SINGAPORE</i>	<i>519</i>	<i>129.71</i>
<i>UNITED KINGDOM</i>	<i>20,000</i>	<i>334.79</i>
<i>UNITED STATES</i>	<i>80,000</i>	<i>284.14</i>

SOURCE: INTERNATIONAL VALUATION STANDARDS COMMITTEE

Qualification Criteria for Egyptian Real Estate Valuers

The Egyptian government has recognized the importance of having qualified professionals perform real estate valuations. The Real Estate Finance Law, No. 148 of 2001 requires that all real estate valuers be registered with the Real Estate Finance Affairs Authority and that executive regulations be issued to establish the criteria for such registration. Section One of Chapter 6 (articles 38 through 43) of the executive regulations issued by the Ministry of Housing, Utilities and Urban Communities in December, 2001, dealt with the qualification criteria and registration procedures for real estate valuers. A number of comments were made by private and public sector entities about these criteria. Most of the commenters believed the qualification criteria were too liberal. Some stated that there should be technical expertise requirements in addition to the general education requirements. These comments and the recommendations of the project team have been incorporated into the proposed revised Section One of Chapter 6 of the executive regulations presented in Exhibit 4.

Classes of Certification

The proposed executive regulation establishes four classes of real estate valuers, registered assistant valuers and classes “A”, “B” and “C” certified valuers, based on different qualification criteria. The registered assistant valuer class is included to permit recent university graduates in the eligible fields of study to gain the professional experience needed to become certified real estate valuers. The classes of certified valuers are based on an escalating scale of technical expertise to be demonstrated by passing examinations for certification and recertification. Class C certified valuers would be authorized to value only individual residential units. Class B certified valuers would be authorized to value individual residential units and small (under LE 5 million) development projects and investment real estate. Class A certified valuers would be authorized to value any type of real estate.

The Department shall provide for the registration or certification of natural persons in four classes of real estate valuers:

“Class A Certified Valuer” – a person registered with the Department who is certified as qualified to issue valuation reports for any type of real estate

“Class B Certified Valuer” – a person registered with the Department who is certified as qualified to issue valuation reports only for residential, commercial or mixed use real estate having a value of less than LE 5,000,000

“Class C Certified Valuer” – a person registered with the Department who is certified to issue valuation reports only for individual dwelling units having a value of less than LE 1 million

“Registered Assistant Valuer” – a person registered with the Department who is authorized to perform valuation services only under the supervision of a certified valuer.

No person may use the title “certified real estate valuer” or any abbreviation or words to that effect, or issue a valuation report in connection with any real estate transaction under the Real Estate Finance Law No. 148 of 2001, unless such

person is certified for the applicable class of certification by the Department. However, the work upon which a valuation report is based may be performed by a registered assistant valuer if the report is approved and signed by a certified valuer.

Educational Requirements

All applicants for registration as real estate valuers with the Real Estate Finance Affairs Authority should be required to have a university degree in a field of study relevant to real estate valuation.

Any person desiring to act as a registered assistant valuer or as a certified valuer must make application in writing to the Department in such form and detail, as the Department shall prescribe. Each applicant must be at least 21 years of age and hold a university degree in one of the following academic fields:

For All Classes of Certification:

*Urban Planning
Civil Engineering
Mechanical Engineering
Construction Engineering
Architectural Engineering
Planning and Development*

For Class “B”, “C” and “Registered Assistant Valuer” certification only, unless additional specified technical courses have been successfully completed:

*Architectural Design
Business Administration
Economics
Accounting*

Professional Valuation Education

Initially, all applicants for registration and/or certification should be required to successfully complete at least 60 classroom hours of professional education on real estate valuation principles and practices, ethics and Egyptian real estate valuation standards.

In addition to the academic education requirements for registration and certification, each applicant must have successfully completed, prior to the filing of his application, at least 60 classroom hours, inclusive of examination, of instruction in the principles of real estate valuation. The required curriculum to be included in such instruction shall be specified by a decree issued by the Authority. The required instruction shall be offered by a recognized Egyptian or foreign valuation organization, university, college, technical school, training

institute or a governmental entity. Successful completion means certification by the institution providing the instruction of the applicant's completion of 60 classroom hours of instruction and receipt of a passing grade on an examination. The Valuer Examination Committee of the Valuation Advisory Board shall recommend what constitutes a passing grade on an examination.

Upon the recommendation of the Real Estate Valuation Advisory Board, the Authority may, by decree, establish continuing profession education and examination requirements for renewal of registrations or certifications and for certification of the different classes of valuers.

The project team is not recommending minimum hours for continuing professional education or experience. The Authority may want to adopt continuing education requirements in the future when Egyptian institutions of higher education and technical training institutes add real estate valuation courses to their curricula. These continuing education criteria may be satisfied by existing classes offered for degree programs. Applicants should be required to submit an official transcript from the institution of higher education or other evidence of successful completion of classes that satisfy the continuing education requirements the Authority may establish.

Examination for Certification and Recertification

In Egypt, qualification for professional certification is by examination. Qualification procedures for real estate valuers should be consistent with the qualification procedures for other professions. Every applicant for certification, including applicants to become registered assistant valuers, will be required to pass an examination testing his knowledge of the technical skills required for performing the real estate valuations authorized by the class of certification for which he is applying. In addition, every five years real estate valuers will have to pass a recertification examination in order to be recertified.

To be registered or certified as a valuer, or to renew a registration or certification, the applicant must demonstrate, by passing a written examination, at a minimum, that he or she possesses:

- (1) A knowledge of technical terms commonly used in real estate valuation.*
- (2) An understanding of the principles of land economics, real estate valuation processes, reliable sources of valuation data, and problems likely to be encountered in the gathering, interpreting, and processing of data in carrying out valuation disciplines.*
- (3) An understanding of the standards for the development and communication of real estate valuations as provided in this executive regulation*
- (4) An understanding of the types of misconduct for which disciplinary proceedings may be initiated against a certified valuer, as set forth in this executive regulation*

- (5) *Knowledge of the theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate valuation that are appropriate for the class of certification for which application is made.*

There shall be different examinations for each class of certification offered by the Department.

Experience Requirements

Real estate valuations are being performed in Egypt, so some applicants for certification will already have valuation experience. Other applicants may have experience related to real estate valuation, such as civil engineering, architectural engineering, real estate development and real estate lending. Therefore, it is appropriate to require valuation or related experience for qualification as a certified real estate valuer even at the introduction of certification. People applying to become registered assistant valuers will not be required to have employment experience related to real estate valuation. The Authority also may want to consider minimum years of real estate valuation experience for certification and recertification after sufficient time has passed for applicants to satisfy such requirements.

In addition to the educational requirements specified in this Article, applicants desiring to be certified valuers must present evidence satisfactory to the Department that he or she meets the experience requirements specified below. Acceptable valuation or related experience includes employment as a real estate valuer, preparation of feasibility studies for real estate projects, evaluation of plans and specifications for real estate projects, real estate development, real estate lending, real estate sales and such other activities as the Valuation Board may authorize by rule. There is no experience requirement for registration as a registered assistant valuer.

Class A Certified Valuer – at least 10 years of valuation or related experience involving large and complex residential and commercial real estate

Class B Certified Valuer – at least 8 years of valuation or related experience involving both residential and commercial real estate

Class C Certified Valuer – at least 5 years of valuation or related experience involving residential and/or commercial real estate

Moral Character

Applicants for registration or certification with the Real Estate Finance Affairs Authority also should have a good moral character and reputation and should not have been:

Article 38 declared bankrupt, unless he has been rehabilitated; sentenced for a felony, or a crime of fraud or dishonesty unless he has been rehabilitated;

Article 38 denied registration or certification or been disbarred, or had his registration, license, or certificate to practice or conduct any regulated profession, business, or vocation revoked or suspended because of any conduct or practices, unless, because of lapse of time and subsequent good conduct and reputation, or other reason deemed sufficient, the interest of the public is not likely to be endangered

Article 38 dismissed from his position of employment or stricken from the register of a profession for matters affecting honesty and honor within the previous five-(5) years.

Temporary Certification

It may be necessary for the Authority to issue temporary certifications of real estate valuers until the professional education and examination requirements have been implemented. In order to receive a temporary certification, an applicant must meet all other certification requirements. It is recommended that a temporary certification be for a period of not more than six (6) months. During that time, the holder of a temporary certificate must complete the professional education requirement and pass the appropriate examination.

Administration and Supervision of Real Estate Valuers

The project team has made recommendations for the organization of the real estate valuation supervisory function. These recommendations are shown in the proposed organization chart of the Real Estate Finance Affairs Authority and function descriptions presented in the report on the organization structure of the Authority and are discussed in greater detail below.

Central Department for Real Estate Valuation

The Central Department for Real Estate Valuation within the Real Estate Finance Affairs Authority will be responsible for the registration, certification and supervision of real estate valuers. The department also will receive and investigate complaints from the public about real estate valuers and make recommendations to the Board of Directors of the Authority for disciplinary action. The department will provide valuers, users of valuations and the public with information about real estate valuation standards, qualification of real estate valuers, the Code of Ethics and complaint adjudication procedures.

The Central Department of Real Estate Valuation (the “Valuation Department”) is established within the Real Estate Finance Affairs Authority (the “Authority”) to register and certify real estate valuers and administer the provisions of this executive regulation. The Valuation Department shall be managed by its Director who shall be appointed by the Chairman of the Authority

The Director of the Department shall:

*Receive applications for registration and certification of real estate valuers.
Establish and administer the procedures for processing applications for registration and certification.*

Maintain a registry of the names and addresses of people registered or certified under this executive regulation.

Retain records and all application materials submitted to the Department

Establish administrative procedures for receiving and processing complaints from the public against real estate valuers

Establish administrative procedures for disciplinary proceedings conducted pursuant to the procedures established by the executive regulations and the Board of Directors

Provide information to the public about real estate valuation, registration and certification of valuers, standards of real estate valuation and complaint procedures

Establish administrative procedures for making the records of the Department available to the public for inspection in accordance with this executive regulation.

Investigate complaints received from the public against real estate valuers and potential violations as set out in this executive regulation and recommend to the Board of Directors of the Authority appropriate disciplinary actions against registered or certified valuers who have been found to have violated the executive regulations.

Provide technical support and staff in the area of real estate valuation to the Chairman and the Board of Directors of the Authority and the Real Estate Valuation Advisory Board established by this executive regulation.

Real Estate Valuation Advisory Board

Because real estate valuation involves a high degree of specialized knowledge and skills, it is recommended that the Minister of Housing or the Board of Directors of the Real Estate Finance Affairs Authority appoint a Real Estate Valuation Advisory Board to advise the Board of Directors and the Central Department for Real Estate Valuation on matters relating to real estate valuation standards, qualification of real estate valuers and certification examinations. Members of the Real Estate Valuation Advisory Board would represent the Ministry of Housing, Utilities and Urban Communities, the Real Estate Finance Affairs Authority, the Ministry of Higher Education, the Central Bank of Egypt, the real estate valuation profession, real estate developers, the public interest, banks and real estate finance companies. It is also recommended that a Valuation Examination Committee of the advisory board be created to design certification examinations and examination administration procedures and set the minimum passing grade(s). These standards and procedures would be submitted to the Board of Directors of the Authority for approval. The Central Department for Real Estate Valuation, along with the Ministry of Higher Education, would administer the certification examinations.

A Real Estate Valuation Advisory Board (the “Valuation Advisory Board”) is established to provide the Board of Directors of the Authority with technical expertise in the field of real estate valuation. The Valuation Advisory Board is composed of eleven members, consisting of:

The Deputy Chairman of the Authority, who shall be the Chairman of the Valuation Advisory Board

One member representing the Ministry of Housing, Utilities and Urban Communities

One member representing Central Bank of Egypt

One member representing the Ministry of Higher Education

Two members appointed by the Chairman of the Authority who are certified valuers under the provisions of the executive regulations, one of whom is a certified general valuer and one of whom is a certified residential valuer

Two public members appointed by the Minister of Housing, Utilities and Urban Communities who are not related within the third degree of consanguinity or affinity to any real estate valuer or any official or employee of the Real Estate Finance Affairs Authority. At least one of the public members shall be a member of the faculty of one of the fields related to valuation, as specified in this executive regulation, at a university registered with the Ministry of Higher Education.

One member appointed by the Minister of Housing, Utilities and Urban Communities who is a real estate developer with experience in residential and commercial real estate development.

One member, appointed by the Governor of the Central Bank of Egypt, who is not a certified valuer who is employed by a bank that purchases or makes use of commercial and residential valuations and whose position of employment relates to the use of valuations by that institution.

One member, appointed by the Chairman of the Authority, who is not a certified valuer who is employed by a real estate finance company that purchases or makes use of either commercial or residential valuations and whose position of employment relates to the use of valuations by that institution.

A Valuer Examination Committee of the Valuation Advisory Board is established consisting of the representative of the Ministry of Higher Education, who shall serve as the chairman of the committee, the Chairman of the Authority, the representative of the Ministry of Housing, Utilities and Urban Communities, one of the certified valuer members and the public member of the Board who is a member of the faculty of one of the fields related to valuation, as specified in this executive regulation, at an Egyptian university. The Valuer Examination Committee shall recommend to the Valuation Advisory Board the examination specifications for registered and certified valuers, the procedures to provide appropriate examination questions and answers and to administer and grade examinations.

The duties and responsibilities of the Real Estate Valuation Advisory Board would be to:

Recommend to the Board of Directors of the Authority standards of real estate valuation practice.

Recommend to the Board of Directors of the Authority appropriate and reasonable continuing profession educational requirements for the renewal of registrations and certifications and certification of the different classes of certifications established by this executive regulation.

Establish the examination specifications for registered and certified valuers, provide or procure appropriate examination questions and answers, administer examinations and establish procedures for grading examinations.

Advise the Board of Directors of the Authority on matters relating to valuers and valuation standards and the executive regulations and decrees necessary for the Valuation Board and the Director of the Department to carry out their duties.

Perform such other functions and duties as the Board of Directors of the Authority may be deemed necessary to carry out this executive regulation.

Fees

The Board of Directors of the Real Estate Finance Supervisory Board will adopt a schedule of fees for the registration and certification of real estate valuers. These fees should be consistent with the fees charged for certification of other technical professionals in Egypt. For example, Exhibit 12 shows the fee schedules for Civil Engineers. The fee income generated by the Central Department of Real Estate Valuation should be sufficient to pay all direct costs of the Department and the Real Estate Valuation Advisory Board and the Department's and Advisory Board's share of the administrative costs of the Real Estate Finance Affairs Authority.

Dispute and Complaint Resolution

The Authority should provide a means of resolving disputes involving real estate valuations and/or valuers and complaints filed against valuers. Disputes involving real estate valuations, should be resolved by a review of the disputed valuation by a qualified review valuer. The review valuer should be certified in a class of certification at least as high as the class of certification of the valuer whose valuation is being disputed. The review valuer should be retained by the Authority and should file his report to the Head of the Central Department for Real Estate Valuation. If the review valuer determines that the valuation was not prepared in a manner consistent with real estate valuation standards, the Authority should require that the original valuer prepare a new valuation in full compliance with the standards, at no cost to the person who retained the valuer. A valuer whose valuation is disputed has the right to appeal the decision of the review valuer and/or the Head of the Central Department for Real Estate Valuation to the Board of Directors of the Authority.

Complaints from users of real estate valuations or from the public may be filed with the General Department for Control and Supervision of the Central Department for Real Estate Valuation on the forms provided for that purpose. A model complaint form is provided in Exhibit 13. The recommended complaint process is as follows:

Step 1: Screening the Complaint. *Upon receipt of a complaint against a registered or certified real estate valuer or a person performing real estate valuations or claiming to be a registered or certified real estate valuer, the General Department for Control and Supervision will first make a determination of whether the Authority has jurisdiction over the subject matter of the complaint and the individuals involved in the complaint. If the General Department determines that it has jurisdiction over both the subject matter and at least one of the parties to the complaint, it will then determine if there is reason to believe a violation of law, regulation or rule may have been committed.*

If so, the complaint is accepted for investigation and the complaining party is notified in writing of the acceptance of his complaint for investigation. If no, the file is closed without action and the complaining party is notified in writing of the reasons for rejection of the complaint.

Step 2: Investigation. *The person who is the subject of the complaint is given a copy of the complaint and has the obligation to file a written response to the complaint with the General Department within five (5) days of receipt of the complaint. The General Department will evaluate the response and conduct whatever additional inquiries it determines are necessary to determine whether there is sufficient evidence that the respondent has violated one or more laws or regulations or rules administered by the Authority. If the determination is that there is insufficient evidence of a violation, the case is closed without action and both the complainant and the valuer are so notified in writing. If the General Department believes it can prove that the valuer violated law, regulation or rule, the head of the General Department will make a recommendation for resolution to the Head of the Central Department for Real Estate Valuation, who will determine the appropriate resolution of the complaint. If the case cannot be resolved by agreement of the parties, the Head of the Central Department will refer the case to the Legal Office of the Authority. If the case cannot be resolved by formal settlement negotiations, it will proceed to an administrative hearing.*

Step 3: Administrative Hearing Process. *The administrative hearing will be held before a three-member panel consisting of the Chairman of the Authority and two members of the Board of Directors who have been appointed by the Board. The Central Department for Real Estate Valuation has the burden of proving by competent evidence that a violation of law, regulation or rule was committed. If the administrative hearing process results in a finding that a violation was committed, the administrative hearing panel may impose the appropriate sanction(s) provided for in the Real Estate Finance Law and its executive regulations. If the burden of proof is not met, the case will be dismissed.*

Step 4: Right of Appeal. *In those cases resulting in a sanction, the respondent has the right to appeal the decision to the full Board of Directors of the Authority. The decision of a majority of the Board of Directors shall be final. The respondent has all rights provided him by the Laws of the Republic of Egypt to appeal the decision of the Board to a court of competent jurisdiction.*

Annex 5

Real Estate Finance Companies

Real Estate Finance Companies

Definition of a Real Estate Finance Company

The Real Estate Finance Law, No. 148 of 2001 created a new form of Egyptian non-bank financial institution – the real estate finance company. A real estate finance company is an Egyptian joint-stock company that engages in real estate financing activities. Real estate financing activities under the Law (Article 1) include virtually every form of real estate financing in which the lender takes a security interest in the real estate subject to the financing. In order to operate as a real estate finance company, a company must be registered with the Real Estate Finance Affairs Authority (the “Authority”). The Authority will establish the minimum capital requirement and other financial criteria for real estate finance companies and will supervise their activities.

The Central Role of Real Estate Finance Companies

Most of the officials interviewed during this project see real estate finance companies, not banks, as the primary home loan originators in the new Egyptian real estate finance system. Currently only the two specialized real estate banks, the Egyptian Arab Land Bank and the Housing Development Bank, and the Faisal Islamic Bank provide any significant amount of financing to individuals for home purchase. Commercial banks are the principal source of financing for both residential and commercial real estate development and the purchase of commercial real estate, but make few home loans. The home loans made by banks are primarily to borrowers referred to them by the developers they are financing, to their own employees and as an accommodation to large customers.

Real estate lending by commercial banks for all purposes has been limited by Central Bank of Egypt (CBE) regulations to 5% of the bank’s loan portfolio. Recently the CBE issued a new directive permitting banks to hold an additional 5% of total loans for real estate loans made under the Real Estate Finance Law. The CBE has restricted commercial bank real estate lending because of the interest rate and funding risks of “borrowing short and lending long”. Since the primary s of funds for banks are current accounts and short term time deposits with an average maturity of less than 90 days, a concentration in intermediate and longer term real estate loans would expose the banks to the risks inherent in a maturity mismatch between their assets and their liabilities. Before the enactment of the Real Estate Finance Law, real estate secured loans also represented a significant credit risk because of the lengthy and costly execution process in effect at the time.

Banks use their limited real estate lending capacity to make shorter term development and commercial real estate loans and are not expected to utilize their expanded real estate lending authority to originate and hold the home loans authorized by the Law. Since the CBE has not adopted the 50% risk weighting of residential mortgages that is standard in the U.S. and most countries that have adopted the Basle capital standards, the banks have no incentive to undertake residential real estate lending to individuals for their own loan portfolios.

Banks, however, do intend to invest in real estate finance companies along with other banks and/or real estate development companies. There is strong interest by leading developers and bankers in creating real estate finance companies that will originate home loans for developer and bank clients and the general public. The insurance company and pension fund officials interviewed during this project indicated that their companies would consider investing in real estate finance companies if such investment appears prudent and promises a market return. Real estate developers and banks have separately and jointly been actively studying potential

investment in real estate finance companies and are prepared to establish and capitalize real estate finance companies once all of the requisite regulations, rules, forms and procedures are in place.

Ownership Structure and Activities of Real Estate Finance Companies

In order to be classified as a real estate finance company, a company must originate real estate loans that meet the criteria set out in the Real Estate Finance Law. Although the intent of the Law was to create a financial institution, the Law itself does not limit the activities of a company that is licensed as a real estate finance company, so long as one of its activities is originating real estate loans. For example, under the current law and its regulations, a manufacturer of bathroom fixtures could be licensed as a real estate finance company if it decides to make home improvement loans to homeowners who purchase the company's products. While it may be clear that the Authority would not want to license non-financial companies whose primary activities are not directly related to real estate finance as real estate finance companies, the issue of licensing real estate sales brokerage companies (e.g. Caldwell Banker) or real estate developers as real estate finance companies is less well defined.

The Board of Directors of the Real Estate Finance Affairs Authority should establish policies and issue executive regulations relating to: 1) whether an existing company can be licensed as a real estate finance company; 2) the relationship between a licensed real estate finance company and its parent and/or affiliates; and 3) the breadth of activities in which real estate finance companies will be allowed to engage.

Require a Separate Company.

It is recommended that a company wishing to obtain a license as a real estate finance company be required to form a separate subsidiary joint stock company to conduct its real estate financing activities. This will facilitate the Authority's control and supervision of real estate financing activities.

Require Portfolio Diversification and Market-Based Lending.

A related issue is whether the Authority should place any restrictions on "captive" real estate finance companies that are wholly or majority (51% or more) owned subsidiaries of other companies. A captive real estate finance company is likely to provide financing only for clients of its parent and affiliate companies, which could result in an excessive concentration of credit that exposes the real estate finance company to undue risk. For example, the real estate financing subsidiary of a real estate development company would provide loans only to the purchasers of homes in its parent company's projects. Another concern is whether the captive real estate finance company would apply prudent credit underwriting criteria to clients referred by its parent or affiliated companies. For example, a real estate finance company owned by a real estate sales brokerage company could be under pressure to approve loans to clients of its parent that it would not approve on an arms-length basis.

The Authority should require real estate finance companies that are subsidiaries or affiliates of other companies to adopt measures to maintain the independence of their credit granting procedures from the control or undue influence of their parents and/or affiliates. These measures include requiring that: 1) a majority or the Board of Directors of the real estate finance company not be officers, directors, principal shareholders or employees of its parent and/or affiliates; 2) the Board of Directors of the real estate finance company adopt a portfolio diversification policy that will prevent undue concentrations of credit in any one real estate development project; and 3) the Board of Directors adopt an affiliate transactions policy that clearly establishes the independence of the real estate finance company's credit decision-making process. The Authority should require that the founders of a real estate finance company implement these measures and provide documentation to the Authority before a license is granted.

Specify the Activities in Which a Real Estate Finance Company May Engage

The real estate financing activities set out in Article 1 of the Real Estate Finance Law should be the primary activities of a real estate finance company. However, the Authority must balance its mandate to license companies that engage in real estate financing activities with the need to authorize a sufficiently broad range of permitted activities to maximize a real estate finance company's probability of successful operation.

In countries where the laws and regulations governing specialized real estate finance companies restrict their activities to originating and servicing real estate loans, these companies have been granted preferential treatment in terms of taxation, capital requirements and powers. This is not the case in Egypt. Therefore, the Authority should be careful to avoid a situation where the restrictions it places on the activities of real estate finance companies actually increase the financial risks of their operations.

Egyptian banking laws and regulations prevent real estate finance companies from engaging in lending activities other than those specified in Article 1 of the Real Estate Finance Law. However, the Authority could authorize real estate finance companies to engage in non-lending financial activities, such as purchasing real estate loans and real estate installment contracts from other real estate loan originators, developers and Islamic banks for the purpose of investment or for accumulating pools of loans to be sold to a securitization company; originating and/or servicing real estate loans as the agent of one or more originators; issuing letters of credit; accepting deposits relating to its real estate finance activities; direct real estate investment, real estate development and investment in joint-ventures and the shares of other companies.

Purchase (Discounting) of Real Estate Installment Sales Contracts

Purchasing real estate installment sales contracts from developers and Islamic banks would enable real estate finance companies to build a portfolio of short term performing financial assets quickly. If developers could sell the performing installment sales contracts they currently hold to real estate finance companies, they could improve their liquidity and profitability. However, in order to purchase these contracts, the real estate finance company would either have to buy out the seller's equity position in the real estate subject to the contract or the seller would have to subordinate its interest in the real estate to the rights of the real estate finance company. The real estate finance company would have to underwrite the borrowers under the real estate installment sales contracts in the same manner as it would underwrite the loans it originates and would have

to discount the contracts to a price that would provide a market rate of return for the real estate finance company.

Originating and/or Servicing Loans for Third Parties

Real estate loan origination and servicing requires a substantial investment in technology and human resources. In its early years, a real estate finance company may not originate and/or service a sufficient volume of its own loans to cover its origination and servicing costs. A company could generate fee income by originating and/or servicing loans as an agent for another financial institution or a real estate securitization company. Loan origination and servicing for third parties is merely an extension of the real estate finance company's principal business and a means to cover its cost of operations. The Real Estate Finance Law requires that the originator of a real estate loan (the "financier") service the loans it originates. However, it does not appear that the Law precludes the financier from entering into a servicing agreement with a third party to service its loans, so long as the third party servicer is the original servicer.

Providing Letters of Credit

It is unlikely that, at least during the first few years of operation, any real estate finance companies, even those owned by large Egyptian banks, will be considered sufficiently creditworthy for its letters of credit to be accepted by the financial market. However, the Real Estate Finance Law requires that a real estate finance company that sells its loans to a real estate securitization company which, in turn, issues debt securities backed by the loans sold, guarantee the payment of interest and principal on the securities issued. A stand-by or performance letter of credit is the most common method of providing such a guarantee. Therefore, it is essential that the Authority authorize real estate finance companies to issue letters of credit for this purpose. The Authority also should consider authorizing real estate finance companies to issue letters of credit on behalf of its clients. The contingent liability of letters of credit should be supported by capital in addition to the capital required to support the assets shown on a real estate finance company's balance sheet. The capital requirement should be the same as that for banks issuing letters of credit.

Accepting Deposits Related to Real Estate Finance Activities

Real estate finance companies are prohibited from soliciting and holding money deposits, since only banks have the authority to accept deposits from the public. However, in the normal course of its real estate lending activities, a real estate finance company will receive money from its clients and other parties for down payments, reserve accounts and other purposes. These purposes will be specified in the terms and conditions of the real estate financing agreements between the real estate finance company and its clients. A real estate finance company should be authorized to accept and hold for the benefit of its clients, the deposit of money in relation to its real estate lending or servicing activities, so long as all such moneys are placed in a segregated deposit account at an Egyptian bank and are not commingled with the real estate finance company's own funds.

Direct Real Estate Investment

Direct real estate investment in income producing real estate would provide a real estate finance company with an additional source of income and, potentially, capital gains. However, such investments would require the commitment of a significant proportion of the company's equity capital and access to long term funding that is not currently available in the Egyptian financial market. Direct real estate investment also would expose the company to additional risk. If the Authority permits real estate finance companies to own real estate for investment, the amount of the company's resources that can be invested should be limited to a specified percent, say 20% to 25%, of the company's capital. If a real estate finance company chooses to engage in direct real estate investment, its owners will have to invest additional equity capital to support this activity.

Real Estate Development

Authorizing real estate finance companies to engage in real estate development raises policy as well as operational issues. One of the primary reasons for the establishment of real estate finance companies was to provide a means of financing the sale of units built by real estate developers. If the real estate finance company is itself a developer, it will be in competition with existing real estate developers and will concentrate its real estate lending on its own developments. The Housing Development Bank is an example of a specialized real estate financial institution that, until the CBE prohibited real estate investment by banks, has provided financing primarily for its own projects, not the general public. Engaging in real estate development also would expose the real estate finance company to additional financial risks. It is recommended that the Authority prohibit real estate finance companies from engaging in real estate development activities.

Investment in Joint-Ventures and Corporate Equities

Investment in joint ventures and the shares of other companies would diversify a real estate finance company's assets, but would also expose the company to additional risk and potential conflict of interest. In Egypt, banks are permitted to invest in the shares of a joint-stock company in an amount not to exceed 40% of the company's issued capital. The aggregate of all extensions of credit to the company and the bank's ownership of its shares cannot exceed 30% of the bank's capital. It is reasonable to grant real estate finance companies the authority to invest in the shares of a joint stock company in an amount not to exceed 40% of the company's issued capital, provided that the sum of all extensions of credit to the company and the real estate finance company's ownership of the company's shares does not exceed the loan-to-one-borrower limit, which is recommended at 15% of capital.

Recommended Permitted Activities for Real Estate Finance Companies

In summary, the activities of real estate finance companies should be limited to:

1. *Originating and purchasing real estate loans for the purpose of investment or for accumulating pools of real estate loans for sale to securitization companies and servicing, or contracting with a third party for servicing, such loans; and*
2. *Purchasing real estate installment sales contracts for the purpose of investment or for accumulating pools of real estate installment sales contracts for sale to securitization companies and servicing, or contracting with the originator-seller or a third party for servicing, such contracts;*
3. *Originating and settling real estate loans in its own name and simultaneously transferring the loans to an investor or a real estate securitization company (“table funding”);*
4. *Originating real estate loans for a fee, as an agent for another financial institution, an investor or a real estate securitization company;*
5. *Servicing real estate loans for a fee, as an agent for another financial institution, an investor or a real estate securitization company;*
6. *Issuing stand-by or performance letters of credit to guarantee debt securities backed by loans sold by the company and for other purposes;*
7. *Accepting and holding for the benefit of its clients, the deposit of money in relation to its real estate lending or servicing activities, so long as such moneys are not commingled with the real estate finance company’s own funds.*
8. *Investing temporary cash balances in bank deposits, Egyptian government treasury bills and bonds and readily marketable investment grade corporate bonds;*
9. *Investing in joint ventures and the shares of Egyptian companies, to the extent permitted by the executive regulations;*
10. *Owning real estate used in the conduct of its business (“company premises”) and real estate taken in satisfaction of debts previously contracted (“other real estate owned”);*
11. *Owning real estate for investment in an aggregate amount not to exceed 25% of the company’s capital.*

Funding Real Estate Finance Companies

Obtaining and maintaining sources of short and long term funding will be critical to the establishment and growth of real estate finance companies. Without a constant and reliable supply of cash, the real estate finance company cannot sustain itself. Since a real estate finance company will not be allowed to solicit or accept money deposits and the Central Bank of Egypt will not function as a lender of last resort for the real estate finance company industry, the only sources of funds for real estate finance companies will be equity investment by its shareholders,

bank lines of credit, operating income, principal repayments on its loans and the proceeds from the sale of the loans it originates to real estate securitization companies.

Securitization of real estate finance company loans is the linchpin of the entire real estate finance system created by the Real Estate Finance Law. Every official interviewed during this project stated that the creation of a viable, financially feasible means of securitization of real estate loans by the Capital Market Authority (CMA) was a condition precedent to any investment in real estate finance companies. The proposed CMA regulations for real estate securitization companies do not appear to establish a financially sound system for securitization. A detailed discussion of the issues of securitization and possible solutions is presented in the report on securitization.

Assuming that a viable system of securitization of real estate loans can be designed and implemented, real estate finance companies also will need a dependable source of short term financing to fund the real estate loans they are accumulating for sale to securitization companies. A bank line of credit (“warehouse line of credit”) is the only source of such liquidity, in the absence of a commercial paper market. In order to be licensed, the incorporators of a real estate finance company should be required to have a written commitment from a bank for a line of credit of at least LE 2 million. On an ongoing basis, a real estate finance company should have unused lines of credit in an amount at least equal to its unfunded loan commitments.

Registration and Licensing of Real Estate Finance Companies

Articles 27 through 33 of Chapter Five of the Executive Regulations issued in December 2001 deal with the requirements and procedures for registration with and licensing by the Real Estate Finance Affairs Authority.

Chapter Five: Companies of Real Estate Financing

Article (27)

The company licensed to practice real estate financing activity shall be an Egyptian Joint stock company with a minimum issued capital of LE fifty million, the minimum paid upon incorporation is 25% and the balance to be paid within a maximum of one year from registration in the commercial registry.

Article (28)

The application for licensing of real estate finance companies shall be on the form designed by the Authority, and shall include the following:

- A) The Company’s preliminary contract of incorporation and by-laws*
- B) The Company’s commercial registry*
- C) Qualifications and experiences of the Company’s directors and branch managers*
- D) Declaration of incorporators and directors of not being subject to declaration of bankruptcy over the last five years, or provision of certificate of rehabilitation.*
- E) Declaration of incorporators and directors of not being subject to felony or misdemeanor penalty for honor and honesty marring crimes over the last five years, or provision of certificate of rehabilitation.*

- F) *Certificate by Authority enrolled auditors accepting auditing of the company's accounts.*
- G) *Receipt in substantiation of payment of licensing fees.*

Article (29)

Licensing fees shall be LE 5,000 for 50,000,000 capital companies, and 10,000 for companies having higher capital.

Article (30)

Following are prerequisites for licensing:

- A) *Submit complete the documents referred to in Article 28 above*
- B) *The executive director shall have a minimum of ten years practical banking or financial experience after obtaining university degree in the same field*
- C) *Directors of finance, legal, and engineering departments and branch managers shall have a minimum of ten years practical banking, financial, or legal experience after obtaining university degree in the same field*

Article (31)

The authority shall give the applicant a certificate indicating receipt of the application and the attachments thereto. Within ten days from lodging the application, the authority shall require the applicant by virtue of a statement handed thereto, to complete whatever documents that may be required within the following three month period, otherwise said application shall be deemed null.

The authority shall decide upon the application for licensing and communicate its decision via registered mail with acknowledgement of receipt to the applicant, within thirty days from the date the required documents shall have been completed.

Article (32)

License shall be granted by a resolution issued by the board of directors of the authority. The application for licensing shall not be rejected except with a reasoned decision only in such cases cited by Article (31) of the law.

Article (33)

The companies licensed to practice real estate financing business shall be listed in the register of corporate persons and companies designed by the authority for that purpose. Such listing shall include the data that appertain to each company, the capital thereof, branch addresses, names of the members of the boards of directors, directors, and financial auditors.

Minimum Initial Capital Requirement for Real Estate Finance Companies

Article 27 sets the minimum issued capital for licensing as a real estate finance company at LE fifty (50) million, of which 25% must be paid on incorporation and the balance to be paid within one year. The entire amount of the initial capital must be paid in cash.

An initial LE 50 million capital requirement seems excessive and the short time to pay up 100% of the required capital does not seem reasonable in light of the initial capital requirements for other non-bank financial institutions. The table on the following page shows the minimum capital requirements for other non-bank financial services companies in Egypt.

Instead of imposing a minimum capital requirement in an amount so high it will be a barrier to entry for legitimate investors, the Authority should develop a schedule of basic minimum capital requirements. The basic minimum capital requirement should be paid-up in full in cash before the company begins operations. The cash paid up by the shareholders should be deposited in an account at an Egyptian bank. The cash must remain in the custody of the bank and no withdrawal of the cash can be allowed until the legal representative of the real estate finance company having power of attorney submits evidence of the registration of the company with the Authority.

Like the companies licensed by the Capital Market Authority, the minimum initial capital for a real estate finance company should depend on the activities in which the real estate finance company intends to engage. For example, if a real estate finance company's sole activity is to originate home loans for sale to a securitization company or other investor, it does not require a large amount of capital. However, a real estate finance company whose primary activity will be originating and holding large real estate development and commercial real estate loans in its own portfolio will require more capital to support its lending activities.

Minimum Initial Capital Requirements of Non-Bank Financial Institutions

<i>Class of Institution</i>	<i>Minimum Initial Capital (LE in millions)</i>	<i>% Paid-up</i>
<i>Real Estate Finance Company</i>	<i>50</i>	<i>25%; balance within 1 year</i>
<i>Insurance Company (life and non-life)</i>	<i>30</i>	<i>50%; balance within 5 years</i>
<i>Financial Lease Company</i>	<i>0.50</i>	<i>100%</i>
<i>Securities Brokerage Company</i>	<i>0.25</i>	<i>25%</i>
<i>Securities Underwriting and Promotion Company</i>	<i>3</i>	<i>50%</i>
<i>Companies that Issue Securities or Share in their Capital Increase</i>	<i>3</i>	<i>50%</i>
<i>Securities Clearance and Settlement Companies</i>	<i>3</i>	<i>50%</i>
<i>Companies Engaged in the Formation and Management of Securities Portfolios</i>	<i>3</i>	<i>50%</i>
<i>Investment Funds</i>	<i>5</i>	<i>100%</i>
<i>Venture Capital Companies</i>	<i>10</i>	<i>100%</i>

In determining an appropriate initial minimum capital requirement, consideration should be given to the purposes of capital for a real estate finance company. Capital will:

- 1. be a principal source of long term funding for real estate loans held for investment;*
- 2. provide financial resources to cover start-up operating expenses during the first few years of operation;*
- 3. absorb operating losses during the start-up period and ongoing losses that may be incurred in the real estate finance company's loan and investment portfolio;*
- 4. determine the largest loan the real estate finance company can make to any one borrower; if the company intends to make large development and commercial real estate loans it must have sufficient capital to permit it to engage in those activities; and*
- 5. be one of the primary determinants of the company's financial strength for the banks that provide lines of credit, rating agencies and capital market investors.*

The initial capital requirement for a real estate finance company should be the amount of capital sufficient to absorb all losses during the first three years of operation, support the projected asset growth of the company and meet, at all times, the minimum leverage ratio of 10% of assets. For example, a real estate finance company that expects to have LE 200 million in assets at the end of its third year of operations and projects total net losses of LE 2 million during its first three years of operation would require minimum initial capital of LE 22 million, LE 20 million to meet the 10% leverage ratio requirement for LE 200 million in assets and LE 2 million to absorb losses. Of course, the Authority would require an additional capital cushion in case the company's losses and/or asset growth exceed their projections, and would probably set the minimum initial capital requirement at about LE 25 million.

The following proposed minimum capital schedule should be applied. In each case the minimum capital would be the greater of the amount shown or the amount of capital required to meet the 10% leverage capital requirement at the end of the third year of operations. The minimum capital would have to be paid up in cash before the real estate finance company could begin operations.

<i>Real estate finance companies that limit their activities to originating loans for sale</i>	<i>LE 5 million</i>
<i>Real estate finance companies that limit their activities to originating loans for investment and for sale</i>	<i>LE 10 million</i>
<i>Real estate finance companies that intend to engage in all permitted activities (including direct real estate investment)</i>	<i>LE 20 million</i>

Additional Contributed Capital

The incorporators of a real estate finance company may wish to contribute assets to the company to provide additional capital. Such assets may be in the form of marketable debt securities, shares, real estate loans, real estate installment sales contracts or real estate to be used as the premises of the real estate finance company for carrying out its business. The debt securities and shares contributed should be assigned to the real estate finance company and kept in a

safekeeping (custodial) account with the same bank that holds the company's deposit. The contribution of real estate loans and real estate sales installment contracts should be evidenced by a purchase and sale agreement between the party contributing the assets and the real estate finance company. The contribution of real estate should be evidenced by a deed conveying the real estate to the company. The conveyance of the real estate must be registered at the Real Estate Registration Office.

The values of the non-cash assets contributed as additional capital should be established as follows:

- 1. Marketable (traded) securities (debentures, finance bonds or shares) should be valued at their closing bid or quoted price as of the date immediately preceding the date of contribution;*
- 2. Real estate loans or real estate sales installment contracts should be valued in accordance with Egyptian accounting standards relating to the valuation of financial assets, less any allowance for losses required by the executive regulations;*
- 3. Real estate should be valued at its market value, as established by a valuation conducted by a certified real estate valuer according to the executive regulations on real estate valuation.*

Application for a License

Articles 28 through 33 of Chapter Five of the executive regulations set out the procedures for licensing real estate finance companies. The executive regulations do not include the application form to be completed by an applicant for licensing as a real estate finance company. A real estate finance company application form must be developed before any applications for a license can be filed with the Authority.

In addition to the documents and certifications listed in Article 28, the incorporators of real estate finance companies should be required to submit a business plan for the company, including financial projections for the first three (3) years of operation. The business plan should state the real estate financing activities in which the company intends to engage, its sources of funding, including a commitment from a bank to provide the company with a line of credit, and any agreements the company may have negotiated with 1) developers to provide real estate loans for home buyers; 2) developers, banks or other real estate finance companies to purchase real estate loans and/or real estate sales installment contracts; and 3) securitization companies to sell the loans originated by the company.

Real estate finance companies also should be required to obtain and maintain a surety bond from an Egyptian insurance company in the amount of at least LE 500,000, naming as beneficiaries, the Authority and any person who has a claim against the surety on the bond based on any default or violation of any duty or obligation of the licensed real estate finance company.

Article 32 of the executive regulations states that the Board of Directors of the Authority will approve or deny an application for a license as a real estate finance company. It may be advisable to have the Chairman of the Authority approve or deny applications so that the applicant can appeal an adverse decision to the Board of Directors. Alternatively, the Board of

Directors could appoint a committee of the Board to decide on applications for licensing, with the right of appeal to the full Board.

Financial Reporting to the Authority

The Real Estate Finance Law (Article 33) and the executive regulations (Article 34) require that real estate finance companies submit semiannual reports to the Authority. There is a problem with Article 34 of the executive regulations because it says that financial reports will be filed within “one month from the expiry of the six-month period stipulated in the second paragraph of article (33) of the law.” However, the second paragraph of Article 33 of the Law states: “the company shall submit its financial statements to the administrative authority every six months at the date to be determined in the executive regulations.” The financial reporting dates should correspond to the most common fiscal year for Egyptian companies. The Authority should also consider establishing a standard fiscal year, e.g. June 30 or December 31, for all real estate finance companies.

Semiannual financial reports may not be frequent enough for effective supervision and control of real estate finance companies. However, the regulations cannot require more frequent financial reporting because the Law specifies “every six months”. If possible legally, the executive regulations should require quarterly supplementary financial or statistical reports in addition to the statutory semiannual financial reports.

Financial reporting for real estate finance companies will be similar to the financial reporting for banks. The primary difference will be the accounting for “Loans Held for Sale”. These are the loans the real estate finance company is accumulating for sale to a securitization company. Unlike “Loans Held for Investment,” Loans Held for Sale are reported at the lower of cost or market for accounting purposes rather than at historical cost, less an allowance for loan losses. An Allowance for Loan Loss can be established for Loans Held for Sale or the estimated future credit losses can be charged against income in the income statement. Exhibit 14 shows a representative balance sheet and income statement for a real estate finance company.

Financial Criteria for Real Estate Financing Companies

The Real Estate Finance Law, Article 32, requires that executive regulations be issued to “define the financial criteria to which the company shall be committed.” Article 35 of the Executive Regulations lists the following financial criteria for real estate finance companies.

Article (35)

The licensed company shall comply with the following:

- A) The assets of the company should be evaluated in accordance with Egyptian standards of Accounting and Egyptian auditing standards specified by the ministerial decrees issued in that regard*
- B) The sufficiency of the capital should not be less than ten percent (10%) of the total assets of the company*
- C) The current assets of the company should not exceed 25% of the current (circulating or floating) liabilities thereof*

- D) *The total loans obtained by the company should not exceed 10 times its capital.*
- E) *Setting the regulations necessary for good performance in accordance with paragraph 4 of Article 32 of the Law.*

Valuation of Assets

Item (A) of Article 35 requires that Egyptian accounting and auditing standards be applied in evaluating the assets of a real estate finance company. If Egyptian accounting and auditing standards do not require real estate finance companies to establish appropriate valuation allowances and/or an allowance for loan loss on their balance sheets and to provision for projected loan losses in their income statements, the executive regulations should impose such requirements. Real estate finance companies that sell loans with servicing retained also will have to account for the value of the retained servicing rights.

a. Allowance for Loan Losses

A real estate finance company should be required to establish and maintain an allowance for loan losses (“ALL”) at a level that is adequate to absorb the estimated credit losses associated with its loan portfolio (including all binding commitments to extend credit). To the extent not provided for in a separate liability or capital account, the ALL should also be sufficient to absorb estimated credit losses associated with off-balance sheet credit instruments.

The term “estimated credit losses” means an estimate of the current amount of the loan portfolio (net of unearned income) that is not likely to be collected; that is, net chargeoffs that are likely to be realized for a loan or pool of loans. The estimated credit losses should meet the criteria for accrual of a loss contingency (i.e., a provision to the ALL) set forth in the executive regulations. When available information confirms specific loans, or portions thereof, to be uncollectible, these amounts should be promptly charged-off against the ALL.

Estimated credit losses should reflect consideration of all significant factors that affect repayment as of the evaluation date. Estimated losses on loan pools should reflect historical net chargeoff levels for similar loans, adjusted for changes in current conditions or other relevant factors. Calculation of historical chargeoff rates can range from a simple average of net chargeoffs over a relevant period, to more complex techniques, such as migration analysis.

Portions of the ALL can be attributed to, or based upon, the risks associated with, individual loans or groups of loans. However, the ALL would be available to absorb credit losses that arise from the entire portfolio. It would not be segregated for any particular loan, or group of loans.

For purposes of a real estate lending company’s financial reports an adequate ALL should, after deduction of all assets classified loss, be no less than the sum of the following items:

- 1. For loans paid current, that is, within 30 days, whether analyzed and provided for individually or as part of pools, 1 percent of the total outstanding balance(s) of the loan(s)*
- 2. For loans past due over 30 days up to 90 days, whether analyzed and provided for individually or as part of pools, 10 percent of the total outstanding balance(s) of the loan(s)*
- 3. For loans past due over 90 days up to 180 days, whether analyzed and provided for individually or as part of pools, 20 percent of the total outstanding balance(s) of the loan(s)*

4. *For loans past due over 180 days up to 360 days, whether analyzed and provided for individually or as part of pools, 50 percent of the total outstanding balance(s) of the loan(s)*
5. *For loans past due over 360 days, whether analyzed and provided for individually or as part of pools, 100 percent of the total outstanding balance(s) of the loan(s)*

Furthermore, management's analysis of an adequate ALL level should be conservative to reflect a margin for the imprecision inherent in most estimates of expected credit losses. This additional margin might be incorporated through amounts attributed to individual loans or groups of loans, or in an unallocated portion of the ALL.

Estimated credit losses should reflect consideration of all significant factors that affect collectibility of the portfolio as of the evaluation date. While historical loss experience provides a reasonable starting point, historical losses, or even recent trends in losses, are not by themselves, a sufficient basis to determine an adequate level. Management should also consider any factors that are likely to cause estimated losses to differ from historical loss experience, including but not limited to:

1. *Changes in lending policies and procedures, including underwriting, collection, chargeoff, and recovery practices.*
2. *Changes in local and national economic and business conditions.*
3. *Changes in the volume or type of credit extended.*
4. *Changes in the experience, ability, and depth of lending management.*
5. *Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans.*
6. *Changes in the quality of an institution's loan review system or the degree of oversight by the board of directors.*
7. *The existence of, or changes in the level of, any concentrations of credit.*

Article 38 Accounting for Servicing Rights

Servicing of loans includes collecting installment and interest payments from the borrowers; monitoring delinquencies, executing on the security realty, if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, agent banks and others providing services; and accounting for and remitting installment and interest payments to the holders of beneficial interests in the loans, i.e. the investors in the securities issued when the loans are securitized. Servicers typically receive fees for servicing loans sold for securitization and bear the costs of servicing.

Servicing becomes a distinct and separate asset or liability ("servicing rights") when the servicing function is contractually separated from the underlying loans by sale or securitization of the loans with servicing retained by the originator-seller or by a separate purchase or assumption of the servicing. When an originator sells loans for securitization and retains the servicing, which it is required to do under the Real Estate Finance Law, the originator has to recognize a servicing asset or liability on its balance sheet. The value of the servicing asset will

depend on the revenue generated by servicing fees, the price at which the loans were sold and the risk of loss of servicing revenue.

Leverage Capital Ratio

A 10% leverage capital ratio (item B) is appropriate for a real estate finance company and is consistent with the leverage ratio for Egyptian commercial banks that will come into effect in December, 2002. For purposes of computing the leverage ratio, capital should be defined as the sum of its paid-up capital (including surplus) contributed capital and retained earnings. The Authority may want to consider imposing a risk-based capital ratio in addition to the leverage capital ratio. However, since the activities of real estate finance companies will be limited to only a few classes of assets, a risk-based capital requirement may not be warranted.

Article 32 of the Real Estate Finance Law also requires the executive regulations to determine a ratio of capital to liabilities. Since the leverage ratio is 10%, the maximum capital to liabilities ratio would be 1:9, or 11.11%. The ratio commonly used to measure a company's debt burden is the total debt to capital ratio, expressed as a multiple. With a 10% leverage capital ratio, the maximum total debt to capital multiple would be 9x.

Liquidity

Item C) of Article 35 establishes a maximum current ratio. Generally, regulations set a minimum current ratio to ensure that a company has sufficient cash and liquid assets to pay its current obligations as they come due. Perhaps the intent of setting a maximum current ratio was to force real estate lending companies to invest their financial resources in real estate loans.

Liquidity is important for any financial institution, not only as a source of cash to pay the institution's current liabilities, such as payroll, other operating expenses and the current interest and principal due on borrowed funds, but as the means used to disburse funds on the loans originated by the institution. Banks obtain these funds primarily from deposits and insurance companies from the premiums paid by its clients. For non-depository real estate finance companies, the major sources of cash to fund its operations are:

- 1. Cash investment by its shareholders;*
- 2. Interest and dividends earned and collected on its investment and real estate loan portfolios;*
- 3. Fees and charges collected for originating and servicing real estate loans, for issuing letters of credit and for providing other services to third parties;*
- 4. Repayment of principal on its loans and investments;*
- 5. Proceeds from the sale of loans, securities and other assets;*
- 6. Net income from investment real estate, if the company is engaged in direct real estate investment;*
- 7. Borrowed money, primarily lines of credit from banks.*

The current ratio is not an appropriate measure of liquidity for a financial institution. Instead of the current ratio specified in item C) of the executive regulations, the Authority should establish ratios that are in common use to measure the liquidity position of a financial institution. The liquidity position of a real estate finance company should be measured by two ratios: 1) the Liquidity Ratio; and 2) the Interest Coverage Ratio

Article 38 Liquidity Ratio

The Liquidity Ratio is the ratio of the monthly average balance of short-term liquid assets, including cash, current accounts at Egyptian banks, term deposit accounts at Egyptian banks that mature in 30 days or less, Treasury bills or bonds of the Egyptian Government and marketable investment grade corporate bonds that mature in 90 days or less and other receivables that mature in 30 days or less, to the prior month's average balance of short term liabilities. Short-term liabilities include accounts payable and all interest and any portion of the principal amount of any borrowing that is payable on demand or within 30 days. A real estate finance company should maintain a Liquidity Ratio of not less than 20% or 25%.

Article 38 Interest Coverage Ratio

The interest coverage ratio is the ratio of the company's income available to pay the interest expense on its debt and is calculated as:

Interest, fee and other income before interest expense, taxes, depreciation and amortization

Divided by

Gross interest expense incurred

Real estate finance companies should maintain an interest coverage ratio of at least 1:1.

Capital to Support Lending Operations

Item D) of Article 35 of the executive regulations establishes a 10:1 ratio of total loans to capital. A real estate finance company could never reach this ratio and still comply with the minimum leverage capital ratio of 10% since the company would always have assets on its balance sheet in addition to loans. Perhaps a better measure to ensure that a real estate finance company has sufficient capital to support its loan origination volume when it is selling a significant portion of its loans is to require additional capital to support the volume of loans it sells during a specific financial reporting period.

If a real estate finance company has full recourse liability for loans that have been sold, accounting principles would require that the sale transaction be recorded on the books of the originator-seller as a financing, not a sale. In other words, the sold assets would remain on the books of the real estate finance company and it would record a debt liability. Since the assets would remain on the company's books, the company would have to maintain the 10% leverage capital to support the assets sold.

However, if the real estate company has less than full recourse on the loans it sells, accounting principles will require the company to either establish a recourse reserve as a liability account on its books or treat the recourse liability as a contingent liability. Since a contingent liability is not on the company's balance sheet, the Authority should require that the company maintain additional capital against these off-balance sheet liabilities. The amount of capital that the company will have to hold will depend on the terms of its recourse obligation.

Even if a real estate lending company has no recourse liability on the loans it sells, it should maintain capital sufficient to cover the risks involved in originating and servicing loans sold for securitization. The following amounts of capital are recommended:

If the company will service the securitized loans it sells:

3% of the first LE 100 million in loans sold

plus, 2% of the next LE 100 million

plus, 1% for each LE 1 million in transactions in excess of LE 200 million

If the company will not service the securitized loans itself, but will have the loans serviced by an agent of the company:

3% of the first LE 200 million in loans sold

plus, 2% of the next LE 200 million

plus, 0.5% for each LE 1 million in transactions in excess of LE 400 million

Policies and Procedures for Safe and Sound Operation

Item E) of Article 35 of the executive regulations requires real estate finance companies to have policies and procedures for “good performance in accordance with paragraph 4 of Article 32 of the law.” Article 32 basically states the same thing. The executive regulations should provide guidelines for what constitutes “good performance”. Exhibit 15 of the report on financing rules provides several models for policies and procedures for loan underwriting. The executive regulations should provide similar guidelines for other areas of the company’s operations, including, but not limited to: liquidity management, risk management, loan classification, affiliate transactions, insider dealing and dividend policy.

Supervision of Real Estate Finance Companies

The Central Department for Real Estate Finance Activities within the Real Estate Finance Affairs Authority will have the responsibility for supervising real estate finance companies. The General Department for Registration and Licensing will receive and process applications and make recommendations to the Head of the Central Department on the approval or denial of license applications and applications for changes in the authorized activities of and the merger, closure or sale of all or a significant part of the assets of real estate finance companies. The Head of the Central Department will have prepared a summary of the reasons for approval or denial of any application received by the department and submit the summary to the Board of Directors (or the Chairman of the Authority, if the executive regulations are amended).

The General Department for Control and Supervision will have the responsibility for ongoing oversight of licensed real estate finance companies. Oversight will be conducted primarily through off-site surveillance of the companies. The Central Department will analyze the semiannual financial reports and any supplementary financial or statistical reports the Authority may require real estate finance companies to submit to determine if the company meets all of the financial criteria established by the executive regulations and is being operated in a safe and sound manner. The General Department for Control and Supervision may conduct on-site examinations of the books and records of a real estate finance company at any time. The

Authority may determine that such on-site examinations should be on a regularly scheduled basis, or only when the General Department for Control and Supervision has determined, based on its analysis of the financial statements and reports submitted by a real estate finance company, that an on-site examination is warranted. Banking regulations call for biannual on-site examinations and more frequent examination as needed. There is no reason for real estate finance companies to be examined on-site more frequently than banks.

Fees

Article 29 of the Real Estate Finance Law and Article 29 of the executive regulations establish a maximum licensing fee of LE 10,000. The executive regulations relate the amount of the licensing fee to the initial capital requirement

Article 29

Licensing fee shall be LE 5,000 for 50,000,000 capital companies and LE 10,000 for companies having higher capital.

There is little logic in relating the licensing fee to a real estate finance company's initial capital, other than that incorporators who can afford to invest more capital can afford a higher fee. If a scale of licensing fees is applied, it should relate to the activities in which a real estate finance company intends to engage. The licensing fees for companies engaged in securities activities are based on the types of business in which the securities companies will engage. However, it seems needlessly complicated to have a scale of licensing fees for real estate finance companies. The licensing fee should be set at LE 10,000 for all real estate finance companies.

The licensing fee is paid only on the issuance of the license. The executive regulations are silent on recurring fees to be paid to the Authority to cover the cost of control and supervision. The Authority should consider assessing an annual fee based on total assets and the annual volume of loan originations. However, Article 29 of the Law may prohibit such annual assessments.

REAL ESTATE FINANCE BROKERS

Regulation of Financing Brokerage Activities

Article 38 of the Real Estate Finance Law, No. 148 of 2001 requires that "none but the intermediaries whose names are recorded in a table provided by the administrative quarter for the purpose, may exercise mediation works between the financier and the investor in the finance agreement" and that "the executive regulations shall determine the rules, conditions and procedures for recording in such table." Real estate financing brokerage activities are commercial activities under the Commercial Law, No. 17 of 1999 and would be subject to the provisions of that Law as well as the Real Estate Finance Law. Sections One and Three of Chapter 6 of the Executive Regulations issued in December 2001 specify the qualification criteria for registration as and the duties of a real estate financing broker.

Definition of Real Estate Financing Brokerage

A real estate financing broker is a person who, for compensation, acts on behalf of one or more of the entities authorized to exercise the activity of real estate lending to: 1) solicit real estate loans; 2) accept and process applications for real estate loans; 3) negotiate between a borrower and a lender; 4) settle real estate loans; or 5) purchase or sell real estate loans. Such activities are called “financing brokerage activities”. An employee of a lender who engages in any of these activities for his employer would not be considered a real estate financing broker.

The authority should determine whether to include a “loan correspondent” within the definition of “real estate financing broker”. A loan correspondent is a person who, in the regular course of business, directly or indirectly originates and settles loans in his own name utilizing funds provided by a lender and simultaneously assigns the loans originated to that lender. Since the real estate financing system envisioned under the real estate finance law includes institutions that will accumulate real estate loans for securitization, the authority may want to consider requiring registration of loan correspondents that are not banks, public juridical authorities or real estate finance companies, or employees of such institutions, as real estate financing brokers.

Qualification Criteria for Registration with the Authority

The qualification criteria for real estate financing brokers set out in Section One of Chapter 6 of the Executive Regulations, relate only to a natural person. In Egypt, registration generally applies only to individuals, not juridical persons. However, for real estate financing brokerage activities, the Authority should consider registration of juridical persons.

The executive regulations state that a person with only a high school certificate and five years of experience who has not been convicted of a crime or an offense involving moral turpitude or breach of trust or declared insolvent qualifies for registration as a real estate financing broker. Egyptian government authorities, associations and other institutions made a number of comments about these requirements, primarily that they were too lax.

While the duties and responsibilities of a real estate financing broker do not call for the level of knowledge and expertise required for real estate valuers or execution real estate agents, the qualification criteria for real estate financing brokers should be more stringent than those set out in the executive regulations. Frequently the real estate financing broker will be the only person with whom the borrower has contact in a real estate financing transaction. The broker will be responsible for informing the borrower about his financing options, explaining the terms and conditions of the financing and evaluating the borrower’s eligibility for financing.

The recommended qualification criteria for an individual who wants to be registered as a real estate financing broker are:

- 1. Be a citizen of the Republic of Egypt*
- 2. Be at least 21 years of age*
- 3. Have a degree or certificate from a university, college or technical institute registered with the Ministry of Higher Education*
- 4. Have been employed for at least five (5) years, at least three (3) of which have been in a position involving lending, real estate financing, real estate sales, real estate*

development, accounting, law or such other fields as the authority may authorize by decree;

- 5. Not have been convicted in a crime, or in an offense involving moral turpitude or breach of trust or been declared bankrupt or insolvent unless rehabilitated.*
- 6. Have a good moral character and reputation and not have been dismissed from his position of employment or stricken from the register of a profession for matters affecting honesty and honor within the previous five (5) years*

Examination

It is essential that the real estate financing broker possess the technical knowledge to carry out his functions. As is the case with the registration of real estate valuers and execution real estate agents, it is recommended that applicants for registration and renewal of registration as a real estate financing broker be required to take and pass an examination to demonstrate their knowledge of applicable laws and regulations relating to real estate financing and real estate financing practices.

Supervision of Real Estate Financing Brokers

Section Three of Chapter 6 (Articles 49 through 52) of the Executive Regulations sets out some of the duties of real estate financing brokers.

Section Three

Real Estate Financing Brokers

Article (49)

The broker shall hand the applicant for financing a copy of the form set by the Authority showing all the key conditions of the financing agreement and should explain all the terms and the risks associated therewith. The investor should sign a statement that he has received a copy of the agreement and has read it before signing the agreement; this statement shall be enclosed with the real estate financing agreement.

Article (50)

The fees of the real estate financing broker will be fixed by the financier, provided that the fees should not exceed the limit set by the Board of Directors of the Authority.

Article (51)

It is prohibited for the broker to receive any payment, commission or any interest that is related to his work except from the financier which commissioned him to endeavor to have a contract concluded.

Article (52)

The broker has to make entries in his books of all transactions performed thereby and shall maintain relevant documents and provide the parties to the agreement and the Authority certified copies thereof.

The duties specified in these articles are appropriate for real estate financing brokers. In Article (49) the real estate financing broker should also be required to give each applicant a statement that the broker is the agent of the lender, not the applicant. This statement should explain the duties and responsibilities of the broker, any limitations on his authority to approve or process the loan application and the right of the applicant to file a complaint against the broker with the Authority.

The requirement that the real estate financing broker file copies of the financing documents with the Authority is somewhat questionable. There is no reason why the Authority should maintain a file of copies of the real estate financing agreements arranged by registered brokers. In fact, disclosing the information about the financing transactions could raise issues of the confidentiality of financial records. It is recommended that Article 52 be revised to read:

The broker has to make entries in his books of all transactions performed thereby. The broker shall have all documents executed in triplicate and shall retain one copy of all relevant documents in his files for at least five (5) years. One copy of the executed original documents shall be turned over to the financier by which the broker was retained and the third to the borrower under the agreement. Certified copies of all documents shall be provided to all other parties to the agreement. Every month the broker shall file a statistical report to the Authority, on the forms provided by the Authority, reporting the volume of loans arranged in that month and such other information as the Authority shall require as specified in a decree issued by the Authority.

Prohibited Conduct

The Authority should issue an executive regulation or decree that describes what conduct on the part of the real estate financing broker is prohibited and could lead to disciplinary action or the imposition of the penalties under Chapter VIII of the Real Estate Finance Law.

A person registered as a real estate financing broker should not:

- 1. Make a false statement or representation for purposes of inducing a lender to extend credit for a real estate loan or for purposes of inducing a person to request or accept a real estate loan from a specific lender or lenders.*
- 2. Make a false statement or representation about his ability to secure a real estate loan for a prospective borrower.*
- 3. Make a false statement or representation about the return rate, amount of loan or other terms and conditions of real estate loans offered through the real estate financing broker or a prospective borrower's ability to satisfy the credit criteria of a lender.*

4. *Solicit or accept a fee from a prospective borrower to secure a real estate loan from a lender on behalf of the borrower. The real estate financing broker may only receive compensation from the lender(s) he represents.*
5. *Fail to disclose, or make a false statement or representation about, the relationship between the real estate financing broker and the lender(s) with which he has a contract of representation.*
6. *Fail to disclose, or make a false statement or representation, about the availability of real estate loans from lenders other than those with which he has a contract of representation.*
7. *Give compensation to a person to refer borrowers to him, without disclosing to the borrower that the referral was in return for such compensation.*
8. *Give or receive compensation or anything of value to influence the independent judgment of a real estate valuer in determining the value of the real estate relating to a real estate loan.*

EXECUTION REAL ESTATE AGENTS

Purpose of the Execution Real Estate Agent

The Real Estate Finance Law, No. 148 of 2001 establishes a non-judicial real estate execution procedure for real estate loans under the Law in which the security realty is sold at a public auction conducted by a “real estate agent” appointed by the justice of execution within whose jurisdiction the security realty is located. The execution on the security realty is “under the hand” of the justice of execution, but not conducted by him. The procedures for the execution on the real estate, including annotation of the writ of execution at the Real Estate Registration Office, notice to all interested parties, establishment of the basic price and other terms and conditions of the sale and the conduct of the execution sale are to be carried out by the appointed real estate agent. The justice of execution may only appoint a real estate agent registered with the Real Estate Finance Affairs Authority.

Qualifications for Registration as an Execution Real Estate Agent

The execution real estate agent must be familiar not only with the relevant provisions of the Real Estate Finance Law and its executive regulations, but with the provisions of the Civil Code and the Civil and Commercial Procedures Law because the provisions of these laws will apply where no special provision is made in the Real Estate Finance Law. Few people other than lawyers will be knowledgeable about the provisions of the Civil Code and the Civil and Commercial Procedures Law applicable to the execution on real estate. Therefore, it may be advisable for the Authority to require that an applicant must be a lawyer to be eligible for registration as an execution real estate agent. In the United States, the government sponsored secondary mortgage market agencies, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, designate specific law firms to act as their agents in non-judicial real estate foreclosures.

There may be other professionals besides lawyers who possess the knowledge and experience required to be an execution real estate agent. These may include employees of banks engaged in loan collection, workout, restructuring and execution on collateral, bank investment services departments engaged in real estate management for clients, persons registered as bankruptcy trustees, estate executors and other people with legal training who are not practicing lawyers.

It is recommended that the following qualification criteria be adopted for registration of execution real estate agents.

- 1. A juridical person may not register with the Authority as an execution real estate agent.*
- 2. A natural person may apply to the Authority, on the forms to be provided by the Authority, for registration as an execution real estate agent if he satisfies the following qualification criteria:*
 - a. Be a citizen of the Arab Republic of Egypt.*
 - b. Be at least 21 years of age*
 - c. Be a lawyer or hold at least a university degree in the field of law, business administration or economics from a university registered with the Ministry of Higher Education*
 - d. Have at least 10 years of experience in one or a combination of the following areas:*
 - 1) Law practice with a practice area in bankruptcy, banking, real estate or civil procedure;*
 - 2) University professor of law, civil procedure, real estate, bankruptcy or related fields;*
 - 3) Employment with an Egyptian bank with responsibility for real estate lending, loan workouts, loan restructuring or execution on collateral;*
 - 4) Employment with the investment services department of an Egyptian bank with responsibility for real estate management and/or sales;*
 - 5) Bankruptcy trustee registered with the Ministry of Justice;*
 - 6) Executor of estates.*

Examination Required

All applicants for registration as an execution real estate agent should be required to pass an examination to demonstrate their knowledge of the execution provisions of the Real Estate Finance Law and its executive regulations, the applicable provisions of the Civil Code and the Civil and Commercial Procedures Law, the ethical standards applicable to execution real estate agents and the principles of real estate valuation. The examination should be prepared jointly by the Authority and the Ministry of Justice.

Moral Character

All applicants must have the honesty and integrity required to conduct a real estate execution proceeding. An application for registration with the Authority should be denied if the Authority determines that the applicant:

- 1. Has paid money or other valuable consideration, except the required fees, to any member or employee of the Authority for approval of his application for registration or to any person responsible for the preparation, administration or grading of examinations in order to obtain a passing grade on the examination.*
- 2. Has attempted to obtain approval of his application for registration by means of knowingly making a false statement, submitting false information, refusing to provide complete information in response to an application question, or engaging in fraud, misrepresentation, or concealment.*
- 3. Has been disbarred, or has had his or her registration, license, or certificate to practice or conduct any regulated profession, business, or vocation revoked or suspended by any Egyptian governmental authority or has had an application for such registration, licensure, or certification to practice or conduct any regulated profession, business, or vocation denied by any Egyptian governmental authority.*
- 4. Has been convicted or found guilty of, or entered a plea of nolo contendere to, regardless of adjudication, a crime in any jurisdiction which involves moral turpitude or fraudulent or dishonest conduct. The record of a conviction certified or authenticated in such form as admissible in evidence under the laws of Egypt or other nation shall be admissible as prima facie evidence of such guilt.*
- 5. Is confined in any jail, postadjudication; is confined in any prison or mental institution; or, through mental disease or deterioration, can not entrusted to carry out the duties of an execution real estate agent.*

Code of Ethics

It is critical to the integrity of the execution proceeding that the execution real estate agent adheres to the highest ethical standards. The Authority should adopt a Code of Ethics for execution an real estate agent that specifies his personal obligations and responsibilities. As a condition of registration, each registered execution real estate agent should sign a statement that he will comply with these standards and that he understands that a violation of the Code of Ethics will be grounds for suspension or revocation of his registration or other disciplinary action.

- 1. An execution real estate agent shall maintain knowledge of and comply with all applicable laws and executive regulations governing the execution on security realty and shall not knowingly participate or assist in any violation of such laws or regulations.*

2. *An execution real estate agent shall not accept appointment by a justice of execution if he has any rights to or interest in the security realty that is the subject of execution or if any of the parties involved in the execution proceeding is related to him to the third degree of consanguinity.*
3. *An execution real estate agent shall perform his duties honestly, impartially, objectively and independently, without accommodation of personal interests.*
4. *An execution real estate agent shall not engage in criminal conduct or any conduct involving dishonesty, fraud, deceit or misrepresentation or commit any act that reflects adversely on his honesty, trustworthiness or professional competence.*
5. *It is a violation of this Code of Ethics for an execution real estate agent to accept the payment of undisclosed fees, commissions, or things of value in connection with the execution proceeding for which the execution real estate agent was appointed.*

Administrative Procedures Applicable to Real estate Financing Brokers and Execution Real Estate Agents

Registration and Renewal Procedures

Articles 41 through 43 of the executive regulations set out the procedures for the registration and renewal of licenses for real estate financing brokers and execution real estate agents. Article 43 should be amended to make it clear that renewal of registration is not automatic, but will require 1) recertification by passing an examination to test the knowledge and expertise of the applicant and 2) the payment of a renewal fee.

The authority is required to maintain a current list of registered real estate financing brokers and execution real estate agents that will be made available to the public. The authority also should maintain a list of brokers and agents who have been subject to disciplinary actions.

The Authority will establish a schedule of fees for the registration of real estate financing brokers and execution real estate agents. These fees should be consistent with the fees charged for certification of valuers and other technical professionals in Egypt. The Authority should not approve an application for registration or renewal of a registration until all applicable fees have been paid. An applicant should not be allowed to sit for an examination unless he has paid the examination or reexamination fee.

Fees should be charged for the following:

1. *An application fee for registration*
2. *An examination fee*
3. *A reexamination fee*
4. *A fee for renewal of a registration*
5. *A delinquent renewal fee in addition to the renewal fee*
6. *A fee for an extension to renew a registration of not more than six months*

Revocation or Suspension of Registration

The Board of Directors of the Authority should be empowered to revoke or suspend, for a period not to exceed 10 years, the registration of a real estate financing broker or an execution real estate agent, place any such real estate financing broker or execution real estate agent on probation, or apply the penalties set out in Part VIII of the Real Estate Finance Law, No. 148 of 2001, if it finds that the registered real estate financing broker or execution real estate agent:

- 1. Has violated any provisions of the Real Estate Finance Law No. 148 of 2001 or its executive regulations, any Code of Ethics, any lawful decree, order or rule of the Authority which is binding upon him or her or, if an execution real estate agent, any order or instruction of a justice of execution in an execution proceeding conducted by the execution real estate agent.*
- 2. Has made a false affidavit or affirmation intended for use as evidence by or before a justice of execution, the Authority or any member thereof.*
- 3. Has accepted money or other valuable consideration, except the fees to which he is entitled by law or regulation.*
- 4. Has been guilty of fraud, misrepresentation, concealment, false promises, false pretenses, dishonest conduct, culpable negligence, or breach of trust or has aided, assisted, or conspired with any other person engaged in any such misconduct and in furtherance thereof; or has formed an intent, design, or scheme to engage in such misconduct and committed an overt act in furtherance of such intent, design, or scheme. It is immaterial to the guilt of the registered real estate financing broker or execution real estate agent that the victim or intended victim of the misconduct has sustained no damage or loss or that the damage or loss has been settled and paid after discovery of the misconduct.*
- 5. Has been convicted or found guilty of, or entered a plea of nolo contendere to, regardless of adjudication, a crime in any jurisdiction which directly relates to the activities of a registered real estate financing broker or execution real estate agent, as applicable, or which involves moral turpitude or fraudulent or dishonest conduct. The record of a conviction certified or authenticated in such form as admissible in evidence under the laws of Egypt or other nation shall be admissible as prima facie evidence of such guilt.*
- 6. Has become temporarily incapacitated from acting as a real estate financing broker or an execution real estate agent because of drunkenness, use of drugs, or temporary mental derangement; however, suspension of a registration in such cases shall only be for the period of such incapacity.*

7. *Is confined in any jail, postadjudication; is confined in any prison or mental institution; or, through mental disease or deterioration, can no longer safely be entrusted to conduct the activities of a real estate financing broker or execution real estate agent, as applicable.*
8. *Has failed to inform the Authority in writing within 30 days after pleading guilty or nolo contendere to, or being convicted or found guilty of, any felony.*
9. *Has been found guilty, for a second time, of any misconduct that warrants disciplinary action, or has been found guilty of a course of conduct or practice which shows that he or she is incompetent, negligent, dishonest, or untruthful.*
10. *Has made or filed a report or record, either written or oral, which the registered real estate financing broker or execution real estate agent knows to be false; has willfully failed to file a report or record required by law or regulation; has willfully impeded or obstructed such filing, or has induced another person to impede or obstruct such filing. However, such reports or records shall include only those which are signed or presented in the capacity of a registered real estate financing broker or execution real estate agent, as applicable.*
11. *Has obtained a registration by means of knowingly making a false statement, submitting false information, refusing to provide complete information in response to an application question, or engaging in fraud, misrepresentation, or concealment.*
12. *Has paid money or other valuable consideration, except the required fees, to any member or employee of the Authority to obtain a registration .*
13. *Has failed or refused to appear at the time and place designated in a subpoena issued with respect to a violation of applicable law or regulation, unless such failure to appear is the result of facts or circumstances that are sufficient to excuse appearance in response to a subpoena from the circuit court; nor shall a person who is present before the Board of the Authority or a member thereof or one of its authorized representatives refuse to be sworn or to affirm or fail or refuse to answer fully any question propounded by the Board, the member, or such representative.*
14. *Has obstructed or hindered in any manner the enforcement of the Real Estate Finance Law, No.148 of 2001 or its executive regulations or the performance of any lawful*

duty by any person acting under the authority of the Real Estate Finance Law, No.148 of 2001 or its executive regulations, or interfered with, intimidated, or offered a bribe to any member of the Board or any employees of the Authority or any person who is, or is expected to be, a witness in any investigation or proceeding.

Annex 6

Financing Rules

Recommendations for the Executive Regulations on Underwriting Criteria

IV. *Most of the financing rules set out in Article 3 of the executive regulations apply to real estate loans made to individuals for the purchase of a home. The other forms of real estate lending authorized by the Law are not addressed.*

V. *Financing Procedures*

Clause (A) of Article 3 of the December, 2001 Executive Regulations does not establish standard procedures for real estate financing. It merely states that “the financing procedures shall be clear and definite.” This is not sufficient to ensure consistency among individual loans to be sold in a securitization or to manage the risks inherent in loans held for investment. It is recommended that new executive regulations be issued, or Article 3 of the existing regulations be amended, to establish guidelines for lending procedures and loan documentation.

A) The Board of Directors of the financier shall adopt financing policies and procedures that shall conform to the financing rules set out in the Annexes to this regulation and incorporated herein by reference.

Proposed general financing guidelines setting out standards applicable to all real estate loans and the required content of real estate lending policies and procedures and specific financing procedures for loans to land owners to build a house (“build-on-own-land”) loans, rehabilitation loans, development loans and investment real estate loans are included in Exhibit 15 of this report.

Prudential Risk Ratios for Real Estate Financing

Clauses (B), (D) and (F) of Article 3 of the December, 2001 executive regulations set out the standard risk ratios used in residential real estate lending to individuals. All of these provisions should be revised to better incorporate the intent of the Law.

Loan-to-Value Ratio

The loan-to-value (“LTV”) ratio establishes the maximum amount of a loan that can be granted relative to the value of the real estate being financed. Clause (B) of Article 3 sets the maximum LTV at 90%. Even for a low risk single-unit, moderately priced, owner-occupied principal residence, a 90% LTV is too high for Egypt, considering the lack of expertise in real estate valuation, the unreliability of the data on which real estate valuations are based and the

uncertainty about the funding and coverage to be provided by the proposed Guaranty Fund. For developer and investment real estate loans, a 90% LTV would expose the lender to excessive risk. A scale of LTVs based on the type of real estate being financed and the purpose of the loan be adopted. The proposed scale of LTV limits where the only security for the loan is the security realty is shown in table on the following page and a proposed loan-to-value rule providing for exceptions to the maximum LTV limits is included as Exhibit 16.

Risk Diversification

Clause (D) of Article 3 of the executive regulations establishes a loan-to-one-borrower maximum of 10% of the capital of the lender. Loan-to-one-borrower limitations are appropriate only for loans the lender intends to hold in its loan portfolio. Loans originated for sale in securitizations need not be subject to the loan-to-one-borrower limitation if the lender is originating the loan as the agent for the real estate securitization company (“RESC) or other loan purchaser. Loans originated for a securitization would be subject to the loan concentration limits set by the RESC or other purchaser of the loans.

The 10% loan-to-one-borrower limit is more restrictive than the loan-to-one-borrower limitation for banks. Banks are prohibited from having aggregate extensions of credit to and investments in any one borrower in excess of 30% of the bank’s capital base. The argument for a more stringent loan-to-one-borrower limit for non-bank real estate lenders- especially newly organized real estate finance companies- is that the capital is lower than that of banks and that banks have a greater ability to raise new capital. In addition, the Central Bank of Egypt will not provide capital support for a non-bank lender as it does for banks. The lack of availability of CBE intervention to prop up a real estate finance company if a large borrower defaults is a legitimate argument. However, since all of a real estate finance company’s loans will be secured by real estate whereas many of a bank’s loans are unsecured commercial credits, the argument also could be made that the loan-to-one-borrower limit for real estate finance companies should be the same as that for banks. It is questionable whether the loan-to-one-borrower limitation for governmental entities (i.e. “public juridical persons”) should be the same as that for banks or real estate finance companies or if one should be imposed at all.

PROPOSED MAXIMUM LOAN-TO-VALUE RATIOS

MAXIMUM LOAN-TO-VALUE RATIO OF 75%

Loans to individuals secured by real estate with a value of LE 250,000 or less for the purchase, construction on own land, completion, rehabilitation, repair or expansion of an owner-occupied individual dwelling unit that is the principal residence of the borrower

MAXIMUM LOAN-TO-VALUE RATIO OF 70%

Loans to individuals secured by real estate with a value greater than LE 250,000 but not more than LE 500,000 for the purchase, construction on own land, completion, rehabilitation, repair or expansion of an

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Clause (D) of Article 3 relates only to borrowers who are natural persons- “one individual investor, the spouse, and relatives thereof to the fourth degree”- or to companies in which the lender owns more than 10% of the company’s shares- “or to other corporate persons in whose capital the financier contribution exceeds 10%”. The regulation does not aggregate loans to an individual borrower with loans to companies owned or controlled by the individual borrower. The regulation also does not establish a loan-to-one-borrower limit for borrowers that are juridical persons, such as developers or investors in commercial real estate. The risk exposure to the lender of large development and commercial real estate loans is much greater than that of loans to an individual and his relatives.

It is recommended that Clause (D) of Article 3 of the Executive Regulations be revised to increase the loan-to-one-borrower limit to 15% of the lender’s capital and to include loans to borrowers other than individuals.

It is prohibited for a real estate lender to have an aggregate of all extensions of credit to plus all equity investments in any one person in excess of 15% of the lender’s capital base. For purposes of this regulation the lender’s capital base is its total shareholders equity (net worth). Extensions of credit include loans, whether or not all of the proceeds of the loan have been fully disbursed, investment in bonds or other debt securities, guarantees, letters of credit and unused commitments.

Extensions of credit to and equity investments in any one natural person include extensions of credit to the borrower, his immediate family, to any partnership or joint venture in which the borrower or a member of his immediate family is a partner or principal and to any company in which the borrower, any member of the borrower’s immediate family or the borrower together with one or more members of his immediate family owns more than 20% of the issued voting shares or which the borrower, any member of his immediate family or the borrower together with one or more members of his immediate family otherwise controls, directly or indirectly. Immediate family means the spouse and minor children.

Extensions of credit to and equity investments in any one juridical person include extensions of credit to or equity investments in the borrower, any company or joint venture in which the borrower owns more than 20% of the voting shares of the company or has more than a 20% interest in the joint venture or otherwise controls the company or joint venture. For purposes of this regulation, an extension of credit to a sole proprietorship shall be considered an extension of credit to a natural person.

In addition to the restriction on loans-to-one-borrower, there should be restrictions on the loans a real estate finance company can make to its officers and directors, including the families and related interests of such officers and directors. The proposed rules would permit a real estate finance company to make loans to its officers and directors up to the loan-to-one-borrower limit

only for the purchase, construction or rehabilitation of a principal residence occupied by the officer or director.

Payment-to-Income Ratio

Clause (F) of Article 3 establishes a 40% maximum payment-to-income ratio. Payment-to-income ratios are appropriate only for individual borrowers. For corporate borrowers, measures of the ability to service debt are based on the ratio of income available for debt service to debt service, called coverage ratios.

Individual Borrowers

Applying a 40% payment-to-income ratio to qualify individual borrowers where income is based on a tax certificate issued by the Tax Department or, if the loan payments are to be made as a payroll deduction, certification by the employer, as specified in clause (E) of Article 3, may result in many creditworthy home loan applicants being denied real estate credit. It is widely recognized that a person's income from all sources may not be reported on his tax return. It is unlikely that prospective borrowers will report all of their income to the tax authorities for two years in order to obtain a real estate loan.

It is standard credit underwriting practice for a lender to include stable income from all sources in evaluating a loan applicant's ability to pay. Income includes wages and salaries, interest and dividend income, income from a business owned by the borrower, bonus and fee income, remittances from abroad and the income from all co-borrowers. If after investigation and verification, the lender determines that the borrower's income from any and all sources is expected to continue in the future, the lender usually includes that income when computing the maximum loan payment the borrower can afford.

For individuals, it is recommended that the payment-to-income ratio be based on the total stable income of the borrower. Definitions of the types of income to be included in calculating the ratios and reasons for exceptions to the ratios are presented in Exhibit 17. The proposed payment-to-income ratios for loans to natural persons are:

1. Monthly Housing Expense-to-Income Ratio

The monthly housing expense is the total payment the borrower is required to make according to the financing agreement. In general, where the borrower is a natural person, the subject property is the borrower's primary residence and there is no non-occupying co-borrower or guarantor, the monthly housing expense-to-income ratio should not be greater than 30 percent of the borrower's monthly income. If the subject property is investment property and/or there is a non-occupying co-borrower or guarantor, the occupant's monthly housing expense-to-income ratio should not exceed 40 percent of the borrower's monthly income.

2. Monthly Debt Payment-to-Income Ratio

The monthly debt payment is the sum of the monthly charges for the following:

a. Monthly housing expense

- b. *Monthly payments on all installment debts with more than 10 months of payments remaining*
- c. *Monthly payments on credit card and other revolving or open-end accounts. In the absence of a stated payment, 5 percent of the outstanding balance will be considered to be the required monthly payment.*
- d. *Car lease payments, regardless of the number of payments remaining*
- e. *Monthly fixed obligations, such as education expense*
- f. *Aggregate monthly negative net rental income (i.e. net loss) from all investment properties owned*
- g. *Monthly payments on installment debts secured by financial assets in which repayment may be obtained by liquidating the asset may be excluded from the monthly debt payment-to-income ratio for qualifying purposes regardless of the payment amount or number of payments remaining. If the payments due on a debt are made less frequently than monthly, the lending institution will apply the appropriate factor to convert the payment to a monthly payment.*

If the borrower is a co-borrower or guarantor on a debt for another person, the lender must determine who actually makes the payments on the debt when deciding whether the contingent liability should be included as a debt payment

In general, the monthly debt payment-to-income ratio should not be greater than 35 percent of the borrower's stable monthly income. If the subject property is investment property and/or there is a non-occupying co-borrower or guarantor, the occupant's monthly debt payment-to-income ratio should not exceed 45 percent of the borrower's monthly income.

Borrowers Other Than Individuals

A determination of the sufficiency of a juridical person's income to support additional debt service requires a more sophisticated analysis. Since a corporate borrower usually will be seeking a real estate loan for an income producing purpose, the lender should look first to the ability of the development project or investment real estate being financed to generate sufficient cash flow to cover the debt service, based the valuation report and a feasibility study of the development project or investment real estate.

If the loan is for the purchase of investment real estate, such as an office building, hotel or shopping mall, the income generated by rental or sale of the commercial units is the primary source of repayment of the loan. If the lender makes a real estate loan to a developer to build a housing project, the primary source of repayment will be the proceeds from the sale of the homes or the conversion of the development loan to home purchase loans to the individual home buyers. The projected cash flow from the real estate being financed should be at least 1.25 times the required debt service on the loan.

Uniform Residential Financing Application

The Authority should adopt a uniform residential financing application for individuals applying for a loan to purchase a home. A proposed application form is shown in Exhibit D.

Real Estate Valuation Standards

Perhaps the most significant omission from the financing rules established in Article 3 of the executive regulations is the lack of any procedures for real estate valuation. Every official interviewed during this project cited the need for uniform standards for real estate valuation and professional qualifications for real estate valuers as the highest priority issue that must be addressed by the executive regulations. The procedures a real estate lender must follow in obtaining a valuation report on the surety realty for a real estate loan are included in the General Financing Rules presented in Exhibit 16. Detailed proposals for the establishment of real estate valuation standards and criteria for professional certification and valuer professional education are presented in Report on Real Estate Valuation.

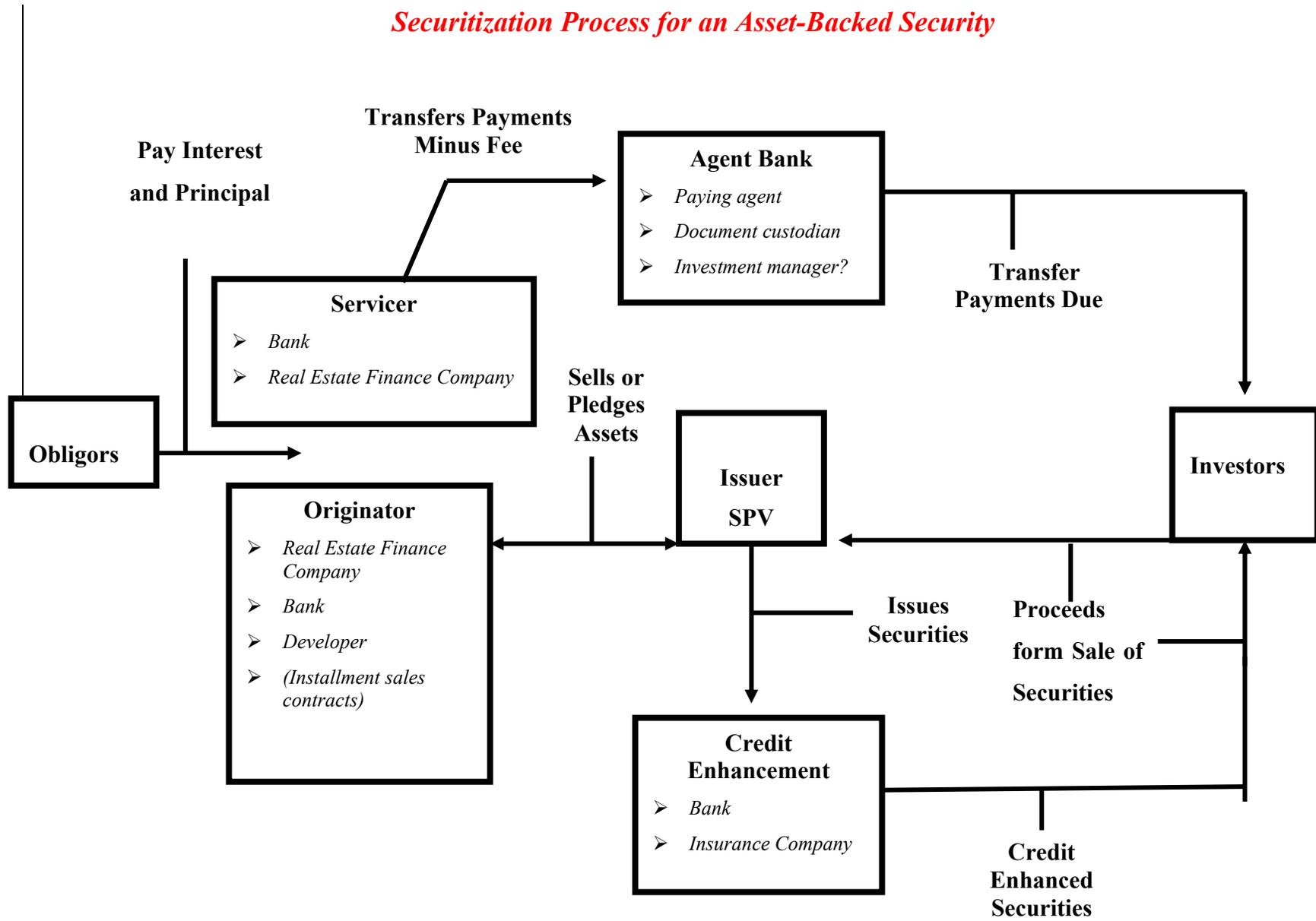
Annex 7 Securitization

Issues of Securitization

What is Securitization?

Securitization is the process by which loans or other financial assets are sold to a third party that issue debt securities backed directly or indirectly by the loans or other financial assets purchased. A chart of a representative securitization transaction is shown on the following page. The obligations on the securities are primarily serviced by the cash flows of the discrete pool of loans or other financial assets that, by their terms, convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the holders of the securities. The securities issued are called “asset-backed securities” or “ABS”. Securities backed by pools of mortgages are called “mortgage-backed securities” or “MBS”. Under the Real Estate Finance Law, real estate loans will back the debt securities issued, so the securities can be referred to as “real estate loan-backed securities” or “RELBS”.

Securitization Process for an Asset-Backed Security



The draft securitization regulations define securitization as follows:

Article (289)

Real Estate Securitization activity shall be deemed to mean the transactions of assigning the portfolios of financial rights and sureties annexed thereto arising from real estate financing agreements executed in accordance with the provisions of Real Estate Finance Law promulgated by law no. 148 for the year 2001 to the companies licensed to practice the business of securitization of financial rights. Those companies shall issue bonds whose principal and the yield thereupon shall be paid from the proceeds of the assigned portfolio of rights.

What Entity Will Purchase the Real Estate Loans and Issue the Real Estate Loan-Backed Securities?

Normally, a Special Purpose Entity (“SPE”) is established to purchase the securitized assets. In other countries, the SPE may be a company, a trust or take either form. Exhibit 21 presents excerpts from the laws and regulations of several countries relating to the permitted legal forms of SPEs. Regardless of its legal form, the SPE is a passive, bankruptcy remote entity created for the limited purpose of acquiring financial assets and issuing securities. Unlike traditional issuers of corporate debt obligations that are operating companies with ongoing business operations, SPEs have no activities other than purchasing pools of financial assets and issuing securities backed by those pools of assets, have few, if any, employees and have agents that perform the issuer’s necessary day-to-day functions.

The draft securitization regulations specify that in Egypt, the SPE will be a joint stock company to be called a “Real Estate Securitization Company” whose purpose is “confined only to practicing the business of securitization.” In addition, “mutual investment funds taking the form of joint stock companies may practice the securitization business” if they obtain a license for this activity from the CMA. A Real Estate Securitization Company may not issue any bonds or financing instruments other than “Securitization Bonds”, but will be authorized to issue more than one Securitization Bond, so long as it maintains a separate account for each securitization transaction.

What is the Form and Structure of a Securitization Bond?

The draft securitization regulations refer only to Securitization Bonds without defining what financial structures these bonds may take. Securitization bonds are not general obligations of the real estate securitization company credit enhanced through the pledging of specific real estate loans as collateral because the second paragraph of Article 11 of the Real Estate Finance Law and the second paragraph of Article 302 of the draft securitization regulations explicitly state that the source of payment of the interest and repayment of principal on the bonds will be only the proceeds from the securitization portfolio.

Real Estate Finance Law, Article 11, Paragraph 2:

The assignee quarter shall settle the rights resulting from the securities issued thereby on their maturity dates out of the proceeds of the assigned rights.

Draft Securitization Regulations, Article 302, Paragraph 2:

In all cases, the obligation on the part of the real estate securitization company shall be confined only to the fulfillment of such obligations ensuing from the securitization bonds on the proceeds of the rights included in the portfolio, after deducting the commissions and fees.

However, unlike asset-backed securities in other countries, the securitization bonds do not represent an ownership interest in either the underlying real estate loans or in specified cash flows arising from the underlying securitization portfolio. Under the Capital Market Law, only investment companies are permitted to sell shares that represent undivided interests in a pool of assets. Therefore, the CMA has determined that Securitization Bonds should not represent undivided interests in either the securitization portfolio itself (Pass-Through Securities) or in specific cash flows generated by the securitization portfolio (Collateralized Real Estate Loan Obligations). What apparently has been conceived is a hybrid between a traditional corporate bond and an asset-backed security. The CMA should clarify the nature of the securitization bonds authorized by the Law and the securitization regulations and clearly define exactly what rights are conveyed to the investors in these bonds. The CMA also should consider the implications of the different financing structures commonly used in securitizations to determine the most appropriate structures for the new Egyptian real estate loan securitization market.

What Financing Structures Should be Considered for Securitization Bonds?

The structure of securitization bonds is important because of the potential difference in timing between the cash inflows from the underlying loans and the scheduled payments of interest and principal on the bonds. The real estate loans under the Real Estate Finance Law will be amortizing loans, generally with monthly payments of interest and principal. If the interest and principal repayment dates on the Securitization Bonds differ significantly from those of the underlying pool of loans, the issuer must assume substantial reinvestment risk that could threaten the financial soundness of the bonds. The risk would be the greatest with a traditional bond structure in which interest is paid annually, semiannually or quarterly during the life of the bond and the principal is repaid in full at maturity. For example, if securitization bonds with a 13% interest rate, interest payable semiannually, and the principal amount of the bond payable at maturity are collateralized by fully amortizing real estate loans with monthly payments of interest and principal, the issuer will have to reinvest the monthly cash flows from the loans until the interest payment dates and the final maturity date. If the reinvestment rate is 11%, the reinvested cash flows from the real estate loans probably will not generate sufficient income to pay the interest on the bonds. Such a structure is inherently financially unsound and should not be permitted under the securitization regulations.

Pass-Through Certificates

To avoid excessive reinvestment risk, the timing of interest and principal payments on asset-backed securities usually tracks the timing of interest and principal payments on the underlying loans or receivables. As securitization has become more sophisticated, the financial structures of asset-backed securities have become quite complex, with multiple classes of bonds having different payment schedules and different maturities. However, at the initial stage of development of securitization, it would not be prudent to allow the issuance of complicated collateralized securities. These securities involve significant risks that could be magnified in a market where

there has been no experience with either securitization or with the underlying real estate loans themselves.

The most basic form of asset-backed security is the pass-through certificate. The pass-through structure has usually been the first form of securitization introduced in most countries. A pass-through certificate provides its owner with a pro rata ownership interest in a pool of loans or receivables. An issuer of pass-through certificates primarily acts as a conduit for the investors by collecting and proportionally distributing the cash flows generated by the homeowners making payments, usually monthly, on their real estate loans, net of servicing and other fees. Because home real estate loans are fully amortizing assets, a holder of a pass-through certificate receives some return of principal at each payment date. Complete return of principal and the final maturity of the pass-through do not occur until the final real estate loan in the pool is paid in full, although most pass-through structures permit a “clean-up call” on the certificates when the loan pool is reduced to a specified level. The pass-through of the cash flows received from the underlying loan results in a great deal of uncertainty about the timing of principal repayment on the securities.

Pay-Through Bonds

The simplest bond structure for securitization bonds that would reduce, but not eliminate the uncertainty about principal repayment on the securities is the pay-through financing structure. Unlike a pass-through certificate, a pay-through bond represents a claim on the cash flows generated by the underlying real estate loans, not an ownership interest in the real estate loans themselves. Although the payment terms of a pay-through bond may not exactly match the payment terms of the underlying loans, the relationship between them usually is close. In most cases, the payments of interest and principal on the underlying loans, and interest from the short term reinvestment of payments on the loans, are expected to be the sole funding sources for payments on the bonds. Interest on the bonds is paid on the same schedule as the underlying loans, i.e. monthly, quarterly, semiannually or annually. Scheduled principal repayment and prepayments are “paid through” in whole or in part to the bondholders in the form of mandatory calls on the bonds. Because the pay-through bond still involves uncertainty about the amount and timing of principal repayment, investors who want a specific return on an investment over a definite time period may not find the pay-through bond structure attractive or may demand a higher premium to compensate for the risk of the mandatory calls.

Collateralized Real Estate Loan Obligation

A collateralized real estate loan obligation (a collateralized mortgage obligation or “CMO” in other countries) is a type of pay-through bond that is divided into classes having different payment priorities. They are similar to pay-through bonds in that the source of payment of interest and principal on the bonds is the cash flow from the underlying loans, but they differ from the simpler form of bond structure in that they convey ownership claims only on the cash flows assigned to specific classes of securities (called “tranches”) based on specified principal distribution rules. Because the underlying loans are amortizing, collateralized obligations are usually divided into “fast-pay” and “slow-pay” classes that have different priorities as to the payment of principal. The final maturity of each class is based on the scheduled amortization of

the underlying loans and, if there are reliable statistical data on prepayment experience, assumed prepayments. All principal repayments, including prepayments, are made first to the class having the earliest maturity date until it is retired and then to the class with the next earliest maturity date until it is retired, and so on until the principal is repaid in full on all of the classes.

Structured collateralized bonds involve significant risks in markets such as Egypt, where there is little, if any, historical statistical data on the performance and prepayment experience of the underlying loans. Potential shortfalls in cash flow and miscalculations of the amount of principal repayment would have to be covered by guarantees, cash reserves, liquidity facilities or other forms of credit enhancement.

Impediments to the Implementation of Securitization of Real Estate Loans

The Sale of Real Estate Loans Must be a “True Sale” to a “Bankruptcy Remote” Entity

The greatest impediments to the securitization of real estate loans under the Real Estate Finance Law are the questions about 1) whether the real estate securitization company is “bankruptcy remote” from the originator-seller of the loans and 2) whether the sale of the real estate loans by the originator (the “financier”) of the loans to the real estate securitization company satisfies the legal requirements for a “true sale” of the loans. This issue has arisen because of the requirement in the third paragraph of Article 11 of the Law that:

The financier shall guarantee settling the rights resulting from the aforementioned securities. Agreement may also be reached on a third party’s guarantee for settling these rights according to the rules to be determined in the executive regulations of the present law.

In an attempt to ensure that investors in the real estate loan-backed securities authorized in the Real Estate Finance Law would have confidence in the creditworthiness of the issuers of securities, Parliament added this paragraph to the Law. The requirement that the originator-seller of real estate loans (the financier) guarantee the payment of interest and principal to the purchasers of securities seems to contravene the fundamental requirements for securitization – a true sale of the assets and the bankruptcy remoteness of the issuer. As a result, the Law may have prevented the development of the very securitization market it was intended to foster.

What is “Bankruptcy Remoteness?”

An issuer is bankruptcy remote if the insolvency of the originator-seller of the underlying real estate loans would not result in an interruption of the cash flows from the originator-seller to the holders of the securitization bonds or in any other way affect the pool of underlying loans backing the securities. Provisions designed to ensure that the issuer is bankruptcy remote have been included in the draft securitization regulations:

- 1. Limiting the activities of the real estate securitization company to securitization transactions (Article 291);*

2. *Prohibiting the financier from having representation on the board of directors of the real estate securitization company (Article 292); and*
3. *Prohibiting the real estate securitization company from incurring any other debt (Article 300).*

However, simply requiring that the real estate securitization company be structured to be bankruptcy remote does not ensure that the assets held by the real estate securitization company will be protected from the claims of the creditors of the originator-seller in the event that the originator-seller becomes subject to a bankruptcy proceeding.

Importance of a True Sale in Securitization Transactions

The transfer of the real estate loans to the real estate securitization company must be in the contractual form of an absolute assignment. Courts refer to such a structure as a true sale. Theoretically, a “bankruptcy-remote” entity has purchased real estate loans that have effectively been placed beyond the reach of creditors of the originator-seller in a subsequent bankruptcy of the originator-seller. The holders of the securitization bonds collateralized by the real estate loans purchased have a first priority claim on the real estate loans that are held for their benefit by the securitization company through a trustee or an agent bank.

Generally, recourse to the originator-seller of the real estate loans will be the most important factor in determining whether the transfer of real estate loans from the originator-seller to the real estate securitization company is a sale or merely a pledge of collateral by the originator-seller. If the guarantee provision of Article 11 of the Real Estate Finance Law is interpreted to mean that the originator-seller is selling the loans with full recourse, the credit risk of the real estate loans has not been transferred to the real estate securitization company, but has been retained by the originator-seller. The economic nature of the transaction, regardless of the actual terms of the contract of sale, is a secured financing. IAS and US accounting standards, and banking regulations, will require the originator-seller of a loan with a performance guarantee or full recourse to retain the sold loans on its books and record a debt liability.

The treatment of a loan sale as a secured borrowing creates serious concerns for the issuer of the real estate loan-backed securities and the investors who purchase these securities. If a bankruptcy judge determines that, regardless of terms of the purchase and sale agreement (PSA) transferring the loans to the real estate securitization company, the transaction was not a true sale, but a loan, the real estate loans that were sold would be treated as part of the bankruptcy estate of a bankrupt originator-seller. In addition, the re-characterization of a sale of loans as a collateralized borrowing effectively annuls the securitization transaction, frustrating investor expectations. To maintain the viability of this financing mechanism, the purchasers of the securitization bonds must be able to rely on the apparent form of the transaction. Uncertainty about how courts may view the transaction will reduce, if not eliminate, the market for these securities.

Possible Solutions to the Problem

There may be no solution to the problem created by the third paragraph of Article 11 of the Law except amendment of the Law or the enactment of a provision in an amendment of the Capital Market Law that would supersede the Real Estate Finance Law. Amendment of the Real Estate Finance Law to remove the guarantee requirement is unlikely unless the Parliament can be made to clearly understand that the provision it added to the Law precludes securitization of real estate loans. As a result, no real estate finance companies will be formed, no real estate loans will be sold for securitization and the intent of the Law will be frustrated.

It is possible that a securitization of real estate loans could be treated as a true sale, despite the guarantee mandated by the Law, if a legal ruling can be obtained that the guarantee is a separate and distinct transaction from the sale of the real estate loans and is not full recourse. Legal experts at the Ministry of Justice, the CMA and the Real Estate Finance Affairs Authority could make a formal determination that if a securitization of real estate loans meets specific criteria, the courts should construe the transaction as a true sale and the sold assets should not be included in the originator-seller's bankruptcy estate.

There are minimum requirements that would have to be in place for a finding to be made that the sale of real estate loans under the current law could be treated as a true sale. The first requirement is for the parties to execute a purchase and sale agreement (PSA) memorializing the sale of the real estate loans. The PSA must clearly state that the parties intend the transaction to be a sale of the loans, not a secured borrowing and that the originator-seller retains no control over the loans sold to the real estate securitization company. The contract must also clearly state that all risk of loss on the loans is transferred to the real estate securitization company, regardless of any guarantee the originator-seller may provide to the investors in the securitization bonds issued by the real estate securitization company.

The next requirement is to have the guarantee agreement required by Article 11 of the Law be a separate agreement between the originator-seller and the real estate securitization company.

The third requirement is to construct the real estate securitization company as a completely separate entity over which the originator-seller has no direct or indirect control in order to avoid possible substantive consolidation in a bankruptcy proceeding. Deficiencies in structural or operational separation can result in the substantive consolidation of the transferred loans held by the real estate securitization company with the bankruptcy estate of the originator-seller. There may be some question about whether the 20% ownership of the real estate securitization company by an originator-seller permitted under Article 297 of the draft securitization regulations would be considered direct or indirect control of the real estate securitization company by the originator-seller.

The fourth requirement is for the transaction between the originator-seller and the real estate securitization company to be an "arm's length" transaction in which the real estate securitization company pays the market price for the loans it purchases and for the collection on and administration of the securitized loans ("loan servicing") by the financier.

The final requirement is that a third-party provider of credit enhancement for the securitization bonds can assume all or part of the liability of the originator-seller for the required guarantee. The investors in the securitization bonds would have a claim against the provider of the credit enhancement rather than the originator-seller. Since most of the originator-sellers will be newly organized real estate finance companies without any record of performance, the guarantee of the

originator-seller will not be highly regarded by either the rating agencies or investors. Article 302 of the draft securitization regulations permits the real estate securitization company to secure additional guarantees for the securitization bonds, which could be senior to the guarantee of the originator-seller.

Article (302)

Without prejudice to the financier's obligation to guarantee fulfillment of the payments due for the securitization bonds issued by the real estate securitization company against the securitization portfolio assigned thereby, the company may obtain additional guarantees in the interest of the bond holders including insurance policies, in person or in kind guarantees, or any other forms of guarantee deemed suitable thereby.

The problem with this solution is that every expert and official consulted on this issue as part of this project said that the specific word used for guarantee in the Law meant a 100% guarantee and the draft securitization regulations do not interpret the guarantee to be less than 100%. Credit enhancement for asset-backed securities usually covers only a percent of the total amount of an issue because the underlying loans or receivables collateralize the securities. It is highly unlikely that a portfolio of 500 or more well diversified real estate loans to individuals for home purchase would suffer catastrophic defaults and losses on default simultaneously. Therefore, it is not necessary to provide a 100% default guarantee. Unless the guarantee requirement in the Law could be interpreted to mean less than a 100% guarantee of the securitization bonds, the costs of the guarantees may make securitization less financially feasible. Since these costs will be passed down to the borrowers on the underlying loans, real estate loans will become less affordable for Egyptian homebuyers.

Another problem is the breadth of interpretation of what constitutes a guarantee. The credit enhancements commonly used for asset-backed securities include a number of other structures besides a guarantee. The guarantee requirement should be broadly interpreted to include the range of credit enhancements used for securitizations. A list of standard credit enhancements is provided in Exhibit 4.

Conclusion

Until the legal issue of a true sale of real estate loans under the provisions of Article 11 of the Real Estate Finance Law is resolved, there will be no securitization of the real estate loans originated under the Law. Without the ability to remove real estate loans sold from their books, banks will not originate real estate loans. It is unlikely that banks and other prospective organizers of real estate finance companies will invest their funds in institutions that have a limited ability to fund real estate loans. The real estate finance system in Egypt will not develop and the status quo will be maintained.

Lack of Securizable Loans

It will be some time before there is a sufficient volume of real estate loans originated under the Real Estate Finance Law to permit securitization. The Real Estate Finance Affairs Authority was only recently established and is not yet fully operational. A number of the regulations, rules and

forms necessary for real estate finance companies to begin operations have not yet been issued. Optimistically, it will be a year or more before real estate finance companies will begin to reach their potential.

It is unlikely that banks that are in the process of establishing affiliated real estate finance companies would begin originating real estate loans on their own balance sheets. It is possible that foreign banks that have experience in originating real estate loans in other countries will begin originating real estate loans for securitization through their Egyptian subsidiaries or affiliates.

Real estate related assets other than real estate loans originated under the Real Estate Finance Law could be securitized if authorized by the Capital Market Authority's securitization regulations. However, the current draft regulations limit real estate securitization activity to "portfolios of financial rights and sureties annexed thereto arising from real estate financing agreements executed in accordance with the provisions of Real Estate Finance Law, No. 148 for the year 2001".

The Capital Market Authority should give serious consideration to expanding the types of real estate related financial assets that can be securitized. The specialized real estate banks, and perhaps some of the large banks, have portfolios of real estate loans that could be securitized. However, the foreclosure provisions of the Real Estate Finance Law were not retroactive. Therefore, all existing mortgage loans remain subject to the unwieldy foreclosure procedures of the Civil Code. Performance guarantees would be required for these loans to be securitized.

The installment sales contracts currently held by many real estate developers and Islamic banks and commercial real estate loans currently on the balance sheets of Egyptian banks also could be securitized. The installment sales contracts are relatively short term and have a performance history, which will make them easier to securitize. The securitization of these real estate financial assets could relieve some of the pressure on the banks' liquidity and capital and the developers' liquidity and profitability.

Limited Capacity of the Egyptian Capital Market

All of the capital market experts interviewed during this project did not believe that the Egyptian capital market could support the estimated LE 10 billion to LE 20 billion annual volume of real estate loan transactions. Initially, issue size would have to be relatively small, LE 30 million to LE 50 million. Interest rates on the securitization bonds would have to be at least 13% and probably higher. When all of the costs and fees associated with the securitization transaction are taken into account, the interest rate that would have to be charged on the underlying real estate loans would probably be over 15%. At a 15% interest rate, real estate loans would not be affordable to many middle income Egyptian families. Higher income people could decide that with deposit interest rates at 11% to 12%, they would prefer to pay cash for their home purchases rather than finance at a rate of 15% or more.

Most of the experts interviewed felt that interest rates in Egypt were being kept artificially high to defend the Egyptian pound, but that this situation could not go on indefinitely. Once the pound is devalued or allowed to float at market exchange rates, domestic interest rates are expected to decline to levels where real estate finance would be affordable.

There has traditionally be strong regional interest in Egyptian securities. The marketing director of a major Egyptian investment bank estimated that about 70% of all of the shares listed on the stock exchange were owned by non-Egyptians. There was a consensus that Gulf region investors would be receptive to real estate loan-backed securities. Many of these investors would be familiar with asset-backed securities from other countries and would not view Egyptian real estate loan-backed securities with as much skepticism as domestic investors. However, the expectation that the Egyptian pound will be devalued has dried up the stream of foreign investment in Egyptian pound-denominated securities. When the pound has stabilized, foreign, and particularly Gulf region, investment is expected to resume at its historical, or even higher, levels.

Another alternative that had widespread support is to issue US dollar-denominated real estate loan-backed securities. Apparently, the Central Bank of Egypt routinely covers the foreign exchange risk for foreign currency denominated securities and loans. If real estate securitization companies could issue securitization bonds at current US dollar interest rates and not be exposed to foreign exchange risk, they could pass through the low US dollar interest rates available today to the borrowers of real estate loans. Loan interest rates could be 8% to 9% or even lower, making housing finance affordable to many middle income families.

The Capital Market Authority Draft Securitization Regulations

The draft securitization regulations require some modification to better incorporate the legal and operational characteristics of securitization. The staff of the Capital Market Authority was provided with the securitization regulations and laws of several countries that have introduced securitization in the last ten years or so. These can provide useful insight into the requirements for comprehensive securitization regulations.

There are some issues that cannot be dealt with by regulation, such as taxation, the priority of claims of employees and creditors and the bankruptcy treatment of assets held for the benefit of securitization bonds holders by originator-sellers and loan servicers. These issues should be resolved through the structure of the securitization transaction and securitization companies themselves and/or by obtaining a ruling from the relevant ministry.

A detailed analysis of the draft securitization regulations is beyond the scope of this project, but the following list of issues and questions points out some of the areas of concern.

Chapter One – General Provisions

Article 289

The definition of real estate securitization activity could be broadened to include real estate financial assets other than real estate loans under the Law.

The sources of funds to pay interest and principal on the bonds should include cash reserves, payments by guarantors or insurers, earnings on temporary investments by the real estate securitization company and the capital of the real estate securitization company.

Chapter Two – Licensing

Article 291

Under this article, real estate securitization companies appear to be going concerns that will issue a number of securitization bonds collateralized by different pools of loans. It is more common for a real estate securitization company to be established for a single bond issue and then to terminate when the bond issue is paid off in full. Managing and accounting for multiple issues of securitization bonds to ensure that there is no commingling of separate bondholders' funds and rights will require more than the separate accounting required in Chapter Five of the regulations.

Five million in capital, only half of which must to be paid in cash, may be sufficient for a limited volume of issuance (up to LE 100 to LE 150 million), but could prove inadequate to support a larger volume of issuance. A real estate securitization company should be required to maintain capital at a specified percentage of the aggregate outstanding balance of all securitization bonds issued.

It is not clear whether mutual investment funds taking the form of joint stock companies would have to infuse an additional five million in capital (LE 2.5 million in cash) to be licensed as a real estate securitization company, although the Capital Market Law and its regulations require additional capital for each activity in which a securities company engages.

Article 292

This article is intended to ensure the independence of the board of directors of the real estate securitization company by prohibiting representatives of any financier selling loans to the company and any credit rating agency that rates its bonds from sitting on the board of directors of the company. When a real estate securitization company is established, the financiers from whom it will purchase loans may not be known. It is possible that a director of the company who is independent when he is elected to the board may lose that independence in the future if the institution with which he is affiliated begins to sell loans to the real estate securitization company. This article is silent on whether representatives of companies owning financiers are eligible to sit on the board of a real estate securitization company.

This article should include a requirement that the real estate securitization company may not use a name that the same as or so similar to the name of any one of its shareholders or any financier from whom it intends to purchase loans as to imply that the financial strength of the shareholder or financier stands behind the real estate securitization company.

The name of the real estate securitization company shall not include the name of any financier or any of its associated companies, or imply any association with any financier or any of such companies;

Article 293

This article should be expanded, or a new article added, to address the management of the real estate securitization company. It is recommended that the regulations require that, like an investment fund, a real estate securitization company be required to "contract the management of its activities to a specialized entity." By outsourcing its management activities, the company can avoid any question of the priority of claims of employees.

Article 294

In addition to the organizational documents required by this article and Article 135 of the Capital Market Executive Regulations, a company seeking a license as a real estate securitization company should submit documents establishing its bankruptcy remoteness. These would include a resolution of the board of directors of the company in organization that it may not declare bankruptcy, voluntarily enter into insolvency proceedings or make material changes to its organizational documents without the unanimous vote of all directors. In addition, the organizational documents should mandate that the real estate securitization company will: 1) maintain its office separate and distinct from the offices of any originator-seller or its affiliates; 2) conduct business solely in its own name; 3) have a managing director, other officer or agent charged with day-to-day management; and 4) pay its own expenses. The organizational documents also should include all contracts for services to be provided to the real estate finance company by third parties.

Chapter Three – Assignment of the Securitization Portfolio

Article 295

A second paragraph should be added to this article, or a new article added, to include the criteria for a true sale of the securitization portfolio to the real estate securitization company. The following are representative true sale provisions:

The securitization portfolio must be isolated to the extent possible from the financier(s) from which the real estate securitization company has purchased securitized real estate loans. The financier must effectively transfer all rights and obligations in the securitization portfolio to the real estate securitization company and not retain any residual interest in the securitization portfolio. The real estate securitization company shall have the exclusive right to pledge or exchange its interest in the securitization portfolio. The ongoing duties and responsibilities of the financier are limited to those specified in the first paragraph of this article. The assignment of the securitization portfolio shall be subject to the following conditions:

- 1. the transfer must be such as to totally divest the financier and all of its associated companies of all rights and obligations originating from the securitization portfolio and all risks in connection with the real estate loans assigned;*
- 2. the real estate securitization company shall have no right of recourse against the financier or any of its associated companies for any loss sustained in connection with the securitization portfolio after the transfer thereof, except for a guarantee of the securitization bonds or other form of credit enhancement provided by the financier under separate agreement with the real estate securitization company;*
- 3. the financier, at its own discretion, may enter into agreement to 1) repurchase or substitute a real estate loan if there has been a breach of any of the terms, conditions representations or warranties of the assignment agreement or 2) repurchase fully from the real estate securitization company all of the*

securitized real estate loans remaining when the outstanding amount of the securitization portfolio has declined to a level that makes the securitization bond uneconomical to carry on to full repayment or settlement;

- 4. under the terms of the assignment agreement, the financier shall be under no obligation to provide additional real estate loans to the real estate securitization company to maintain a “coverage ratio” of collateral to outstanding securitization bonds. A financier may enter into a separate agreement with the real estate securitization company to provide this form of credit enhancement.*
- 5. the services provided by the financier specified in the first paragraph of this article as the “servicing agent” of the real estate securitization company must be provided on an arm’s length basis on market terms and conditions;*
- 6. as servicing agent, the financier has no obligation to remit funds to the real estate securitization company or a paying agent designated by the real estate securitization company unless and until the funds have been received by the financier from the obligor(s) on the underlying real estate loans;*
- 7. all expenses incidental to underwriting, conveyance of the securitization portfolio including expenses for credit enhancement may be paid by the financier or a related company of the financier, but neither the financier nor any of its related companies shall bear any recurring expenses for the securitization transaction after the securitization portfolio has been assigned to the real estate securitization company.*

Article 296

The Capital Market Authority will need more detailed information about the securitized real estate loans and the structure of the securitization bonds that the real estate securitization company intends to issue. This information includes, but is not limited to, the following:

A detailed description of the structure of the securitization bonds and all significant agreements relative to that structure;

Corporate profiles of all parties involved, including guarantors, providers of credit enhancement or liquidity facilities, custodians and paying agents;

A detailed description of the securitized real estate loans, including the cash flow profile and, if available, historic levels of delinquency, default and loss on default for similar portfolios of real estate loans; and

An explanation of how the cash flows from the real estate loans are expected to meet the real estate securitization company’s obligations to holders of the securitization bonds.

Article 297

The Capital Market Authority should confirm with the Central Bank of Egypt (CBE) that a real estate securitization company in which a bank registered with the CBE holds a 20% ownership position will not be construed as an affiliate of the bank.

Chapter Four – Issuance of Securitization Bonds

Article 298

This article states that the provisions of the Capital Market Law (and presumably its executive regulations) shall apply to the issuance of securitization bonds. The provisions of the Capital Market Executive Regulations relating to bonds and financial notes (Articles 34 through 38) do not accommodate the financial structures employed in securitization transactions. These provisions relate to bonds issued by operating companies, not a specialized securities company whose sole purpose is the issuance of bonds.

Article 34 of the Capital Market Executive Regulations limits the value of issued debt securities to the net asset value of the company, in other words, a debt to equity ratio of 1:1. Obviously a real estate securitization company will be much more highly leveraged. The Capital Market Authority can grant permission to exceed this limit, but the securitization regulations should state that the maximum amount of issued securitization bonds will be a specified multiple of the capital of the real estate securitization company. For example, if the Capital Market Authority determines that a real estate securitization company should maintain capital at 3% of its total assets (LE 3 for every LE 100 in assets), the company could issue up to 97% of its total assets in securitization bonds (LE 97 for every LE 100 in assets), for a debt to equity multiple of 32.33X.

Article 35 requires approval of the bond issue by the general assembly of the shareholders of the company. For real estate securitization companies, the board of directors should be empowered to make the decision to issue securitization bonds. Convening a general assembly of the shareholders every time the company plans to issue a securitization bond is unwarranted since the sole business of the company is to issue bonds.

Article 37 requires that “bonds or financial notes of the same issue entitle their holders to equal rights vis-à-vis the Company.” Securitization bonds give the investors rights to the cash flows from the underlying securities, not claims on the assets of the real estate securitization company, except to the extent that those assets are pledged against a specific bond issue. Additionally, real estate securitization companies must be authorized to issue different classes of securities within the same bond issue with different rights to the cash flows from the underlying securities, not “equal rights” as required in Article 37. The securitization regulations should include provisions regarding the interests of holders of securitization bonds that supersede the provisions of Article 37.

Article 38 requires that bonds have coupons. Asset-backed securities generally do not carry coupons because the payment of interest and principal vary from interest payment date to interest payment date. The amount of interest and principal received will depend on the cash flow received on the underlying real estate loans. Holders of asset-backed securities do not submit a coupon to receive the interest and principal due. The paying agent of the real estate securitization company maintains a schedule of payments due to bond holders, makes the appropriate payments when due and prepares financial reports to that effect.

Article 39 states that the rules and provisions relating to shares are applicable to bonds. The rules and provisions relating to shares should be carefully analyzed to determine

whether any are not appropriate for securitization bonds. If so, provisions must be included in the securitization regulations to supersede the conflicting provisions of the Capital Market Executive Regulations.

Article 299

A prospectus for a securitization bond must provide detailed information about the underlying financial assets, the classes of bonds being issued and the rights of holders of each class of bond. The information required under Article 299 and Articles 37 and 42 of the Capital Market Executive regulations might not be sufficient for full disclosure for securitization bonds. The staff of the Capital Market Authority should evaluate the prospectus requirements in other countries to determine whether the provisions of the existing and proposed regulations are adequate.

Article 300

The third paragraph of Article 300 limits the value of securitization bonds outstanding to the value of the underlying pool of loans collateralizing the bonds. Asset-backed securities typically have some amount of overcollateralization, but not enough to cover all contingencies. The provisions of Article 300 may be problematic as the underlying loans pay down and temporary cash balances are held until an interest and/or principal payment date. The article does not specify what a real estate securitization company must do if the value of the bonds should fall below the value of the underlying pool of real estate loans.

Article 301

This article addresses the use of proceeds from the securitization portfolio. The second paragraph says that the “real estate securitization company shall keep the surplus of the above proceeds in an independent account whose deposits shall be utilized for limited risk investment, provided that the balance of such account shall be reimbursed in full to the financier on the final maturity date of the bonds and after being fully amortized.” This paragraph should be deleted in its entirety and replaced with a provision that states that any surplus shall be used as additional security for the securitization bonds and can be paid out to bond holders if the proceeds from the underlying real estate loans are not sufficient to meet the payment obligations to bond holders and can cover losses on the underlying real estate loan portfolio. Any surplus remaining after retirement of the securitization bonds in full should not be “reimbursed to the financier” because the financier has no rights in the surplus. Paying out the surplus to the financier would violate the principles of a true sale of the real estate loans. The real estate securitization company should retain any surplus.

Chapter Five – Management of Securitization Transactions

The provisions of Chapter Five (Articles 304 through 307) totally ignore the role of third parties in securitization transactions. The regulations should specify the nature and qualifications of third parties usually involved in securitizations, such as the paying agent,

document custodian and investment manager. Segregation of accounts for each securitization transaction alone does not constitute management of real estate loan-backed securities. The provisions of the Capital Market Executive Regulations relating to investment managers for investment funds can serve as a guide for the regulations that should be issued for third parties providing services to a real estate securitization company, although the powers of such third parties will not be as broad as those of an investment manager.

Article 305 requires that the financier deposit the amounts collected on the real estate loans on behalf of the real estate securitization company to an account of the company. Usually the financier, or financiers in a multi-seller securitization, pays the amounts collected from the obligors on the underlying loans to the paying agent of the issuer, not directly to the issuer. By this method, there can be no commingling of funds with the funds of the real estate securitization company or between different securitization bond issues. It is also customary for a document custodian of the real estate securitization company to hold the original documents of the underlying real estate loans.

Article 306 calls for a quarterly evaluation of the securitization portfolio. This is not frequent enough to monitor the condition of the portfolio. At a minimum, the securitization portfolio should be evaluated monthly. The accounting systems used by the real estate securitization company or its agents should be capable of producing a daily trial balance.

The evaluation report should include, at a minimum, delinquency statistics on the real estate loan pool and earnings on temporary cash balances in addition to the items specified. Post-issuance financial reporting is becoming more detailed to provide better information about the securitized loans to the issuer, its auditors, the rating agencies and investors.

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