

**Achievement of Market-Friendly Initiatives and Results Program  
(AMIR 2.0 Program)**

**Funded By U.S. Agency for International Development**

**Strategic Plan for the  
Jordan Mortgage Refinance Company Ltd.**

Final Report

**Deliverable for Financial Markets Development Initiative Component,  
Work Plan Activity No. 636.01  
Consultancy Agreement No. 278-C-00-02-00210-00**

*July 28, 2003*

*This report was prepared by Stephen B. Strauss, in collaboration with Chemonics International Inc., prime contractor to the U.S. Agency for International Development for the AMIR Program in Jordan.*

## Data Page

Name of Component: Financial Markets Development Initiative

Author: Stephen B. Strauss

Practice Area: Financial Sector

Service Offering: Housing Finance

List of Key Words Contained in Report:

- Jordan Mortgage Refinance Company (JMRC)
- Mortgage Loan
- Housing Loan
- Bonds
- Financial Markets
- Commercial Banks
- Investment Banks
- Investors
- Refinancing Facility
- Secondary market
- World Bank

## **Table of Contents**

### **STRATEGIC PLAN FOR THE JORDAN MORTGAGE REFINANCE COMPANY LTD.**

<b>INTRODUCTION AND EXECUTIVE SUMMARY</b>	<b>1</b>
<b>I. STRATEGIC OBJECTIVES OF JMRC</b>	<b>3</b>
<b>II. JMRC TARGET MARKETS</b>	<b>4</b>
<b>III. JMRC TARGET PRODUCTS AND SERVICES</b>	<b>5</b>
<b>IV. IMPLEMENTATION</b>	<b>9</b>
<b>V. PROPOSED ACTION STEPS</b>	<b>10</b>

## **Executive Summary**

The Jordan Mortgage Refinance Company (JMRC) has so far successfully carried out its mandate to promote residential housing finance in Jordan by providing refinancing facilities to commercial banks (primary mortgage loan lenders). JMRC has raised funds to support this activity by issuing and placing its bonds for periods of one, three and five years, with banks and a few other financial institutions having been the main investors in such bonds.

The present situation with mortgage loan activity, and in Jordan's financial markets, creates some needs, and opportunities, which JMRC is well-positioned to fill. Some relevant circumstances are the following:

--Most of Jordan's leading commercial banks are now engaged in residential mortgage lending, for periods of 15 and sometimes 20 years. This activity is now very competitive between the banks, and is growing rapidly.

--These banks (the primary mortgage lenders) are funding these 15-20 year loans primarily with short-term customer deposits. Some banks (presently nine) also make use of JMRC's mortgage loan refinance facility; as of June 30, 2003, JMRC had extended 34 refinancing facilities to nine banks, totaling JD 64.5 million; this represents about 20 % of total mortgage lending by all banks. Most of these refinancing facilities (20 of the total of 34) are for periods of two and three years; the remainder are for various longer periods, including one for 20 years. However, the interest rates on JMRC refinancing facilities are normally fixed for periods of three years, and fluctuating thereafter (in two cases, rates have exceptionally been fixed for five and seven years).

The consequences of this funding situation on the banks are:

- a. The banks, lacking fixed-rate long-term funding sources, extend mortgage loans only on a fluctuating interest rate basis. A few banks fix the interest rate for three years (thanks to the JMRC facility), with a fluctuating rate thereafter.
- b. The banks have a serious and growing maturity mismatch between their 15-20 year mortgage loan assets and their very short (typically one month) funding sources (liabilities). This situation poses a liquidity risk which banks could face at some future point when liquidity in the banking system is not as ample as it is today. The Central Bank is well aware of the banks' growing liquidity gap and has expressed concern about it to the banks' management.
- c. The fluctuating mortgage rates, while in theory protecting the banks against a future increase in cost of funding mortgage loans, in fact creates a credit risk for the banks. A future increase in loan interest rates will cause an increase in the risk of borrower default, because many borrowers who can comfortably service their 9-10 % mortgage loan from current income will have difficulty doing so at higher levels of mortgage loan interest.

A solution to the above problems is for the banks to have an available source of fixed-rate funding for periods longer than three years. JMRC is well-positioned to develop such solutions, thanks to its already well-developed mortgage loan refinancing and bond issuing activities.

It is therefore proposed, as a major new initiative, that JMRC begin issuing bonds for longer maturity periods, starting with five years, then seven years, such issues to be concluded before the end of 2003 or early in 2004, and marketed to a broad investor group including the general public. These bonds will permit JMRC to extend its mortgage loan refinance facility to the banks for periods of five, then seven, years at fixed rates, permitting the banks in turn to offer fixed mortgage interest rates to borrowers for corresponding periods. It is assumed that the banks will be encouraged, by their own management and the Central Bank, to utilize the JMRC refinance facility for these longer periods as a means to substantially reduce the asset-liability maturity mismatch on mortgage loans.

It is intended that these new JMRC longer-term bonds will be aimed at a broader investor group, including the general public, and that there will be an active secondary market for these bonds. They will be priced at coupon rates which will maintain an acceptable interest rate structure for the JMRC refinancing facility and mortgage lending, while at the same time offering an attractive return to the investing public.

A second major new initiative on the part of JMRC will be to begin the purchase from primary lenders of portfolios of residential mortgage loans, with recourse to the seller. This new initiative will enhance the ability of JMRC to promote residential mortgage lending by various financial institutions, including Islamic banks.

Other initiatives and planned actions by JMRC are set forth in the Strategic Plan below. This Plan includes the following sections:

- I. Strategic Objectives of JMRC
- II. JMRC's Target Markets to be served;
- III. JMRC Target Products and Services to be offered;
- IV. Implementation
- V. Proposed Action Steps

## **I. STRATEGIC OBJECTIVES OF JMRC**

JMRC's key strategic objectives are to:

- Promote the development of residential housing in Jordan by improving the efficiency of housing finance and enhancing the private sector's role;
- Improve the efficiency with which medium- and long-term funds for mortgage lending are mobilized from a variety of sources;
- Enhance the attractiveness of mortgage lending to primary lenders by reducing the liquidity risks and other risks of mortgage lending.

Because residential mortgage lending to the general population involves banks' extending mortgage loans for periods of 15 years or more, and because there are uncertainties and risks for both borrowers and lenders associated with such transactions, JMRC's near-term objectives will include:

- Developing mechanisms to lengthen the fixed-rate sources of funding for mortgage lending beyond the relatively short periods currently feasible, and
- Developing other mechanisms and services to reduce the risks inherent in mortgage lending.

Additional objectives of JMRC's activity in housing finance are:

- To offer investors a variety of attractive and tradable investment instruments, enhancing the liquidity of the financial (bond) markets and broadening participation in such markets.
- To encourage competition among primary mortgage lenders, to move toward greater standardization of mortgage loan conditions, and to improve the conditions and service offered to the borrowers (the public).

This Strategic Plan is intended to identify actions JMRC intends to take to meet all the above strategic objectives.

## **II. JMRC'S TARGET MARKETS**

JMRC's target market consists of the following current and potential customer categories:

1. Lenders engaged in the financing of private residential housing. Such lenders include the following categories:
  - Commercial Banks
  - Islamic banks
  - Institutions managing special programs such as the Housing and Urban Development Corporation.
2. Investors in JMRC financial instruments, such investors falling into the following categories:
  - Commercial banks
  - Other financial institutions such as insurance companies
  - Individual investors (domestic)
  - Investors based outside Jordan
3. Private owners of residential property (mortgage loan borrowers). Categories of such borrowers include:
  - Low to moderate-income households
  - Middle to affluent households
  - Other small-unit mortgage borrowers (small individually-owned commercial or industrial enterprises).

### III. JMRC'S TARGET PRODUCTS AND SERVICES

The products and services JMRC provides, and plans to provide, are outlined below. The target customer category to which such products and services are directed is identified.

1. Investment instruments to be offered through the financial markets:

- a. JMRC will continue its current activity of issuing bonds for relatively short maturities (up to 12 months), for placement primarily with commercial banks.

b. NEW INITIATIVE ONE:

For longer maturities, JMRC will meet primary lenders' critical need for longer, fixed rate funding sources, and the financial market's need for a stream of attractive investment instruments, by initiating a new program of issuing long-term, fixed-rate bonds for investment by a broad investor group including the general public.

JMRC's long-term bond issuance program will have the following characteristics:

- A series of bond issues will be planned for, to provide a steady stream of investment instruments to the market. The first two issues will be for amounts of JD 5 million each.
- These new issues will be specifically targeted to a broader investor group than has been the case with JMRC bonds so far. The general public (individual investors) will be specifically targeted, with special marketing and education efforts made to attract such investors.
- The tenor of these bonds will be as long as possible at fixed interest coupon rates. The objective will be to issue bonds for various maturities, for periods of (initially) five and seven years before the end of 2003 or early in 2004, with an ultimate objective of even longer maturities for later issues.
- There will be special efforts and mechanisms to ensure secondary market liquidity at all times, especially for the smaller bond investor (see below on the role of the Investment Banker in this regard).
- JMRC will engage a professional intermediary (Investment Bank) to advise, manage and underwrite its long-term bond issues. This intermediary will play a major role in the distribution of the primary issue, in particular with new categories of investors (the general public), and in ensuring liquidity through an active secondary market for the JMRC bonds. JMRC will select this Investment Bank through a competitive process open to qualified local institutions. The

requirements for a successful bidder will be defined very specifically, to include commitments (a) to underwrite the first JMRC five- and seven-year bond issues, and (b) to serve as a secondary market-maker for any buy-sell transactions up to the amount of JD 10,000 per transaction per day.

-- JMRC and its investment banker/advisors will seek to establish appropriate pricing benchmarks for the issuance of new five- and seven-year JMRC bonds. The five-year JMRC bond can be based on the five-year Government bond rate of 4.25 %. As there is no seven-year Government bond issue, a benchmark for JMRC seven-year bonds can be established by JMRC agreeing with the Government on a rate for the Government to purchase seven-year JMRC bonds. In any case, as there is a 1 % differential between the Government 3- and 5-year rate, the differential between the 5- and 7-year rate should also be roughly 1%. Assuming this to be the case, then JMRC's cost of funds from the bond issues, plus its usual 1 % margin for the refinancing facility to the banks, plus the bank's customary 3.50 % to 4 % margin over the JMRC refinance rate, maintains the interest cost to the mortgage loan borrower at reasonable levels (between 9 and 10 % p.a.) with interest rates fixed for the initial five or seven year period of the loan.

-- JMRC will explore alternative investments which it can use to place excess liquidity arising from its bond-issuing activity, such investment to be consistent with JMRC's low-risk bond-issuer status.

-- JMRC will seek agreement with the Government on mechanisms to use the proceeds of new bond issues (temporary excess liquidity) to offset JMRC's interest cost on its long-term loan from the Government, to avoid JMRC's incurring a loss on such temporary liquidity prior to its being placed in new refinancing facilities with banks.

-- To permit JMRC's long-term bonds to be issued in the very near future, the first issues will be done under the existing legal and regulatory framework. At the same time, JMRC and its advisors will explore possible new legal and regulatory framework permitting the further development of attractive mortgage bond instruments.

-- The AMIR Project will support JMRC in preparing for the issuance of these new bonds to the public, and will also assist in developing education and training programs relating to investing in long-term JMRC bonds, and in housing finance generally.

- b. JMRC will take the initiative, assisted by the AMIR project, in exploring and proposing ways to improve the legal and regulatory framework for financial market instruments to support housing finance. Examples of such instruments requiring a new legal framework are Mortgage Bonds issued by a housing finance institution (such as JMRC) and backed by pools of mortgage loan

assets; and “pass through” bonds, also with mortgage loans as collateral and issued through a special purpose vehicle.

- c. JMRC bonds will retain the current privileges, namely the Central Bank of Jordan’s agreement to consider holdings of JMRC bonds in low risk categories for capital adequacy and liquidity ratio purposes of commercial banks holding such bonds. Also, interest and capital gains from JMRC bonds will be exempted from taxes for all categories of investor, including individuals.

## 2. Services for mortgage lending institutions:

- a. JMRC’s housing loan refinancing program, currently available to all commercial banks, will be continued as at present, but also significantly enhanced in the following ways:

-- Refinancing for longer periods, at fixed rates, will become available when JMRC begins issuing longer-term bonds. Such refinancing will meet one of the critical needs of primary mortgage lenders, namely to better match their funding of mortgage loans with the long-term maturities of such loans, and permit the banks to offer a fixed interest rate for longer periods.

-- The current favorable treatment of JMRC refinancing to commercial banks will be maintained, namely the Central Bank of Jordan’s agreement to a 50 % risk-weighting of commercial banks’ housing mortgage loans refinanced by JMRC, and exemption of such loans from the general loan provisioning requirement.

-- In future, banks using JMRC refinancing will be encouraged to link their mortgage loan interest rate pricing explicitly to the JMRC refinancing interest rate indicator.

- b. NEW INITIATIVE TWO:

JMRC will begin a program to purchase mortgage loan portfolios from primary lenders. This program will provide liquidity and lending capacity to the primary lenders who sell their portfolios.

This mortgage loan portfolio purchase program will include a variant which will be specifically directed to the needs of Islamic banks who finance housing, who will be able to enhance their liquidity and financing capacity by selling their portfolios to JMRC.

It is not intended that JMRC will itself administer the mortgage loans purchased. Rather, the bank selling the portfolio to JMRC will normally continue to administer and collect the loans, under arrangements entered into between that bank and JMRC. In certain cases, JMRC may elect to place the

administration of the portfolio it has acquired with a bank other than the selling bank.

The mortgage loan repurchase will be done with recourse to the selling primary bank. At a second stage, portfolio purchase without recourse may be considered, to be done by JMRC or more likely by a special purpose vehicle created for that purpose.

c. NEW INITIATIVE THREE:

JMRC will begin a program of insuring a portion of the mortgage loans extended by primary lending banks. This insurance program will be aimed specifically at mortgage loans to lower-income borrowers.

3. JMRC will expand its services directed to the mortgage loan borrower, or which will improve conditions for the mortgage loan borrower. For example:

a. NEW INITIATIVE FOUR:

JMRC will establish a Mortgage Borrower Service Unit which will pool customer housing loan requests and place them with banks with which cooperation arrangements have been entered into. This Unit will improve underwriting criteria, competition and standardization of mortgage lending. The objectives of this Unit will be to facilitate the mortgage borrowing process for the consumer and direct them to commercial bank lenders, not to compete with the banks.

b. JMRC will encourage simplification of procedures in the mortgage loan market, including development of a credit bureau, and the development of training programs in mortgage lending for the staff of the primary lending banks.

c. JMRC will seek to encourage measures to reduce the various fees and costs associated with mortgage lending.

d. The privileges currently enjoyed by JMRC regarding waiver of mortgage deed transfer fees will be maintained.

4. JMRC will develop other products and services, for example:

a. JMRC will continue and enhance its refinancing of mortgage loans offered under the Government subsidy program through the Housing and Urban Development Corporation.

b. JMRC will consider establishing a housing finance company to provide housing loans to individuals in a real estate developments financed by major institutions.

- c. JMRC will consider whether it is desirable to expand its business scope into the area of small office (commercial) mortgage lending. No action will be taken in the near term on this concept, but it is recommended that the needed change in the JMRC By-Laws be made to permit such expansion if JMRC management later determines, after careful study, that such expansion is appropriate and does not impair JMRC's low-risk profile.

#### IV. IMPLEMENTATION:

There are several actions which will need to be taken to implement this Strategic Plan.

- A. The proposed new initiatives will require the following implementation actions to be taken.
  - Issuance of bonds for five and seven years, to be offered to the public, will require the agreement of JMRC's Board of Directors.
  - Purchase of mortgage loan portfolios will require an amendment to JMRC's By-Laws by Shareholder action, upon the recommendation of the JMRC Board of Directors.
  - Mortgage loan insurance to be provided by JMRC to the banks will require an amendment to JMRC's By-laws by Shareholder action, upon the recommendation of the JMRC Board of Directors.
  - The concurrence of the World Bank will be sought for those actions above which involve amending JMRC's By-Laws.
- B. An increase of JMRC's capital should be done to strengthen its capital base, to ensure its debt/equity ratios are maintained in the future, and to support JMRC's enhanced activity and proposed new initiatives. Such a capital increase should be for an amount of between JD 5 million and JD 10 million. The addition of new categories of shareholder, in particular non-bank financial institutions such as insurance companies, will be encouraged. Such capital increase requires JMRC Shareholder action upon the recommendation of its Board of Directors, and the concurrence of the World Bank.
- C. JMRC will also take the initiative, together with AMIR, in exploring, preparing and promoting needed changes in laws and regulations permitting a broader scope of mortgage bond issuing activity.

## V. PROPOSED ACTION STEPS

The proposed new initiatives, and necessary decisions of JMRC corporate bodies, should be carried out under the following schedule of action steps:

### NEW INITIATIVE ONE:

The issuance of new five- and seven-year JMRC Bonds offered to the general public will require the following actions to be taken:

- JMRC Management obtains JMRC Board agreement to the proposed public bond issues.
- Immediately following Board approval, JMRC will initiate the competitive process for selection of an Investment Bank to manage the first five- and seven-year bond issues. A limited group of qualified institutions will be invited to bid. The bids will be required to include advising and managing the new issues; underwriting their successful placement; and ensuring a liquid secondary market for smaller investors in the bonds. The selection of the Investment Bank should take place not more than three weeks after the invitation to bid.
- JMRC begins marketing its five-and seven-year refinance facilities with primary lenders, based on the coming new bond issues and the Investment Bank's commitment to manage and underwrite the new issues.
- JMRC and its Investment Bank complete the Offering Prospectuses for the both the JMRC five-year and seven-year bond issues; meet all requirements for approval by the Jordan Securities Commission; and receive JSC approval for the two public bond issues.
- JMRC will reach agreement with the Government concerning placement of seven-year JMRC bonds (for benchmarking purposes), and concerning mechanisms for offsetting Government loan interest by using the excess liquidity arising from the proceeds of the newly-issued bonds.
- The new JMRC Five-Year bond issue shall be offered to the public for subscription.
- One month thereafter, the new JMRC Seven-Year bond issue shall be offered to the public for subscription.

It would be desirable to have completed the closing of both new bond issues by year-end 2003 or early 2004. Doing so will depend on the speed with which the above decisions and actions can be taken.

NEW INITIATIVES TWO AND THREE:

JMRC's ability to purchase mortgage loan portfolios from primary lenders, and to insure a portion of mortgage loans to lower income borrowers, will require changes in JMRC's By-Laws, which must be proposed by JMRC's Board of Directors, and approved by a JMRC Shareholder Assembly. Concurrence of the World Bank to these proposed changes in the By-Laws should also be obtained.

The first action to be taken is therefore for JMRC Management to present its proposed changes in the By-Laws to the JMRC Board of Directors for its approval. It is anticipated that final Shareholder approval can be obtained not later than the first quarter of 2004.

The specific steps which will be taken are as follows:

- JMRC Management proposes the changes in the By-Laws to the JMRC Board of Directors.
- The Board approves and recommends the proposal to the JMRC Shareholders, who must approve the change in By-Laws at an extraordinary meeting of the Shareholders.
- The concurrence of the World Bank for these changes in the By-Laws is sought.
- Meanwhile, during the period after Board approval and before Shareholder approval, JMRC management markets the concepts of portfolio purchase and loan insurance with primary lending banks, and develops the necessary procedures and documents, so that these two new services can be offered and transacted immediately following Shareholder approval, which is expected to take place not later than the first quarter of 2004.

NEW INITIATIVE FOUR:

Establishing a new Mortgage Borrower Service Unit within JMRC may be done by the action of JMRC Management. It is expected that this new Unit will be operating within the next two months.

SUMMARY OF ACTIONS to obtain the approval of JMRC governing bodies to implement the proposals in this Strategic Plan:

-- JMRC Management prepares its proposals, to be presented to the JMRC Board of Directors for approval, of the following actions:

1. New five- and seven-year bond issues to be offered to the public
2. Changes in the JMRC By-Laws to permit:
  - Purchase of portfolios of mortgage loans from primary lenders;
  - Insurance of mortgage loan risk covering portions of loans made by primary lenders to low-income borrowers;
  - Expansion of JMRC business to cover small office (commercial) mortgage loans;
3. Increase in JMRC's capital by an amount of between JD 5 million and JD 10 million.

-- The Board of Directors' approval will permit JMRC Management to proceed with the issuance of the proposed five- and seven-year bonds to be sold to the public.

-- The Board of Directors, if it approves the proposed changes in the By-Laws and increase of capital, will recommend these proposals to the JMRC Shareholders for their approval. These changes in the By-Laws and the proposed capital increase will also be presented to the World Bank for its concurrence. An extraordinary meeting of the Shareholders, called at the request of the JMRC Board of Directors, will then consider and approve the proposed changes in the By-Laws and increase of capital.