Egypt: Overview of the Housing Sector

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Housing investment is a key component of economic development, both because housing is a basic social need and because private home ownership is often an important source of capital for entrepreneurship at the grass roots level. A fully functioning housing market, including clearly defined titles to privately owned property, is an important element in the construction of a dynamic market economy.[2] Developing mortgage finance helps low- and middle-income citizens to acquire ownership of housing and enables these citizens to turn housing assets into a source for financing small business activities.

Currently, there is little to no mortgage financing in Egypt. Though Parliament passed a Mortgage Law in 2001, there have been a total of only 16 mortgages completed since that time. Without a broad access to mortgage financing, low- and middle-income households cannot afford to buy housing in the formal sector. Consequently, most of this part of the population lives in public housing or informal housing units with no clear legal title. The biggest obstacle to mortgage finance in Egypt is property registration, a cumbersome process with high registration fees, as well as the lack of critical legal infrastructure, particularly in terms of contract enforcement, to support it. Other issues include restrictions on extending bank credit to the housing sector; lack of valuation information; lack of credit risk information; and complex regulations.[3]

Potential investors should be aware of these structural challenges before investing in the housing market in Egypt. However, despite these issues, there are still substantial opportunities for foreign investors in housing finance, construction and infrastructure projects. Such opportunities could be significantly enhanced by further legal reforms. In recent years, Egypt has passed a number of laws helping to establish a legal framework for housing finance, though a number of shortcomings remain. International and bilateral organizations are also working with the Egyptians on legal reforms. USAID, for example, has a $35 million project to assist with the development of a mortgage finance system, while the US Appraisal Institute is helping to train and certify appraisers.

The following sections expand on the topics discussed above:

- The importance of housing finance in economic development
- Structural challenges to mortgage finance in Egypt
- The current state of the housing market in Egypt
- Opportunities for foreign investment/ involvement in the Egyptian housing sector

THE IMPORTANCE OF HOUSING FINANCE IN ECONOMIC DEVELOPMENT – OVERVIEW

Improving housing finance supports economic development through several channels: increasing saving, investment and employment; strengthening and deepening the financial sector; and reducing poverty. In many developing economies, including Egypt, the lack of a fully functioning mortgage market constrains the development of the housing sector. Without financing options, low- and middle-income households cannot afford to purchase homes. Since a house is often the primary investment and savings vehicle for those groups, a lack of housing finance also constrains overall saving rates. Low saving and investment rates restrict economic growth and limit economic development. Egypt would benefit from boosting both saving and investment rates.

International experience suggests that living standards increase when there is widespread availability of home mortgages because mortgages have a positive impact on the quality of housing, infrastructure, and urbanization. Mortgage availability for low- and middle-income groups encourages investment in both residential property and other real estate (such as retail shops and other small businesses). This, in turn, encourages medium- to long-term growth. New construction also provides jobs for

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2 de Soto (1997).

3 More details on these issues will be provided in the next pages.

low- and middle-income workers, which certainly are needed in Egypt.

Housing finance also encourages the growth of the financial services sector, which studies have also shown to be a key factor in economic development.[4] If consumers begin to save for down payments and loan repayments, these actions increase both the assets available to the financial services sector, and the demand for more financial services. Additionally, financial markets and intermediaries act as a lubricant in well functioning economies. They perform the crucial task of mitigating information and transactions costs and provide a needed bridge and filter between economic agents of information that otherwise would not be shared. This enables firms to allocate their resources more effectively and increase their productivity, resulting in greater overall economic growth.[5]

Finally, empirical studies show that there is a positive relationship between land distribution equality, poverty reduction and economic growth.[6] More accessible housing finance could lead to more ownership by low and middle income households. Low and middle income households are the most limited in financing options, both because of an inability to afford down payments and also an inability to access capital markets for long-term loans.[7] At the same time, housing is often their biggest expense, accounting for 50 to 70 percent of their budgets. If housing finance can be made more affordable, that will free up resources that the poor can then use for other opportunities, such as starting small businesses. Therefore, improving access to housing finance for low-income households will help reduce poverty, and serve as another channel to increase economic growth.

The main challenge facing the housing sector in Egypt and other Middle Eastern and North African countries is the lack of affordable housing, not a lack of available housing stock. The lack of efficient financing options is a large component, and the single most correctable component, of these high housing costs. Since housing policies affect the entire economy – influencing saving, consumption, financial depth, employment (construction and homes used as a place of business), and government budgets[8] – improving the availability of housing finance would go a long way towards furthering overall economic development and reducing poverty.

STRUCTURAL CHALLENGES IN THE EGYPTIAN HOUSING MARKET

Implementing a fully functioning mortgage market often requires structural reforms that may take a long time to implement. Mortgage finance is not possible until property rights and land registration rights are enforceable, for example. In Egypt, estimates are that over 90 percent of urban housing is in the informal sector – that is, without a formal title. Because the residents do not have a formal title to their property, they cannot use their houses as collateral for other investments, such as building small businesses, limiting economic growth. The lack of formal titles also limits infrastructure development. Since it is not possible for utilities to know who owns the properties using their services, and therefore who is responsible for paying for them, there is a disincentive to develop these services fully.[9]

As already mentioned in the introduction, the lack of mortgage lending in Egypt is due in part to the following issues:

- **Inadequate legal infrastructure:** The lack of well-defined legal procedures for enforcing claims, curing defaults and evicting former owners of foreclosed property has limited the willingness for providing housing finance. Similar reasons limit the availability of mortgage and property insurance. The inadequate infrastructure forces interest rates on secured loans to increase, approaching the level of unsecured loans. Although the Real Estate Finance Laws of 2001 (much of which were put into operation in early 2004) attempt to address this problem, their effectiveness is still unproven.

- **High registration fees, taxes and inefficient property registration procedures:** The regulatory burden is such that much of Egypt's housing is in the informal sector. In comparison to neighboring countries, the percentage of housing in the informal sector in Egypt is much higher. (In Tunisia, for example, only 29 percent of housing is in the informal sector.) Some progress has been made in this area, reducing property registration fees from 12 percent to 3 percent with consideration to further reducing the fees to the administrative cost of registration (less than 1,000 Egyptian Pounds (about USD 173).

- **Restrictions on bank credit to the housing sector:** The Central Bank has imposed a 5 percent ceiling on real estate lending, which local analysts suggest may be raised to 10 percent in the future. This limit applies cumulatively to both the supply and demand side of the market: residential and commercial real estate loans, as well as loans to individuals and housing developers.

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4 See Beck et al (2000).

5 See Schumpeter (1912) and Diamond (1996), among others.

6 Galal and Razzaz provide detailed information on the empirical literature. For example, Alesina and Rodrik have shown that reducing inequality in land ownership across income levels by one standard deviation increases economic growth by more than one percentage point (Alesina and Rodrik, 1994).

7 Erbas and Nothaft (2002).

8 World Bank (2003).

9 de Soto (1997).

- **Lack of risk information for lenders:** There are no credit bureaus in Egypt, though one is currently in development by a group of Egyptian banks and financial institutions, meaning lenders have no way of assessing credit risk of the borrower. Quite often lenders mistakenly assume that low-income people are poor credit risks and so do not tend to lend to them. Instead, lenders assume the rich are a better risk, so that there tends to be a good supply of high-income housing, but a shortage of low- and middle-income housing. Absent this sort of information, potentially creditworthy borrowers (for example the self-employed) often go without funding. In addition, the informal sector—with little incentive to report income to the tax authorities—will be missed by credit agencies as well.

- **Inconsistent approach to property valuations:** The lack of valuation information makes the effective use of financing very difficult, as lenders have very little idea of the true value of property that they will recover in the case of default. A program to train and certify appraisers is currently under development with assistance from the US Appraisal Institute.

STATE OF THE EGYPTIAN HOUSING MARKET

All of the issues discussed above contribute to inefficiencies in the housing sector in Egypt. Comparing Egypt with Algeria, Jordan, Morocco, and Tunisia shows that Egypt has the lowest rate of owner occupied property, the highest ratio of civilians in public housing, and the highest ratio of citizens in the informal housing sector (see Table 1). Egypt and Tunisia have the longest delays in settling foreclosure disputes. All of these measures are either impediments to a well functioning property sector, or indicators of current troubles in that sector.

In the Middle East and North Africa, developing the housing sector is particularly important to support the needs of a quickly growing population. Population growth in the Middle East and North Africa is among the highest in the world. The rise in the working age population is particularly significant, requiring more jobs to prevent the current high unemployment rates from increasing further. In Egypt, the unemployment rate is around 12 percent, while the population aged between 20 and 29 years grew about 30 percent between 1990-2000, and is projected to grow a further 20 percent between 2000 and 2010.[10] New housing construction therefore serves two purposes: providing shelter and construction jobs.

Due to these demographic issues, housing and construction represent almost 50 percent of the Egyptian government's investments.[11] In 1998, for example, the government subsidized housing program financed about half of all low-cost units built in the formal sector (approximately 63,000 units).[12] The public sector owns about 29 percent of all housing units in urban areas, compared to 25 percent in Algeria and only 8 percent in Tunisia.[13]

Despite this emphasis on housing, Egypt currently has a supply-demand mismatch in the sector. There is an excess inventory of medium- and high-end properties, while the demand is for low-income housing. Low- and middle-income households do not have access to financing that would allow them to purchase any of the available housing units. MERIS (Middle East Ratings and Investors Service) estimates that total annual demand for housing units is approximately 750,000 units (480,000 for newlyweds; 220,000 for replacement of marginalized areas; and 50,000 for old buildings that are about to collapse). However, total supply to the formal real estate market was only 260,000 units in 2004 (see Table 2), about 35 percent of demand.

Rent control regulations further exacerbate the situation. While Egypt has cancelled these regulations for new leases, existing stock is still subject to them. The result is that over 1.8 million housing units in Egypt are vacant. Over 1 million of those are in Cairo, resulting in a vacancy rate of 14.5 percent, very high by international standards. These units are vacant for several reasons: parents may be keeping them for their children's future use; owners may not want to rent them because the low rents they can receive due to rent controls do not make it worthwhile; or owners may not be able to find buyers who can afford to buy the unit due to the lack of available financing options.[14]

The Mortgage Law of 2001

The Egyptian Parliament approved a new real estate mortgage law in 2001 (although much of it was not implemented until 2004) to regulate real estate bank financing. The law, which is geared towards encouraging housing of low and middle-income groups, allows banks to offer subsidized and non-subsidized loans for the purchase of houses as well as administrative and commercial units and renovating existing ones. The goal is for borrowers to be able to make a 20% down payment and pay off the remainder in installments over 20-30 years. Buyers will receive title while still subject to mortgage. Further, under the new law, banks supposedly will be able to foreclose on loan defaulters in case they default on payments for between six and nine months.

Egypt modeled its Mortgage Law after US mortgage regulations, but there are some serious differences. Financing from both bank and non-bank mortgage lending groups is permissible according to the 2001

[10] World Bank (2005).

[11] MERIS, Middle East Rating & Investors Service (2004).

[12] Erbas and Nothaft (2002).

[13] World Bank (2005).

[14] World Bank (2005).

law, but the two groups are not regulated identically. If a bank is lending money for housing finance, the contract is between the bank and the buyer, as in the US. However, this type of lending is strictly regulated, including the 5% ceiling on all lending to the housing sector discussed above.

On the other hand, in Egypt the non-bank finance houses, as described under law 148, operate similar to banks but are not limited by strict regulations and lending percentages. A non-bank finance house operates as a third party entity between buyers and sellers. Finance houses purchase properties from sellers, increase the price as appropriate under market conditions, and then resell the property to buyers using the installment method. It is recognized that the lender's lien on the property being financed gives it the rights to benefit from the outstanding percentage of loan to the original purchase price of the real estate. Since it is the buyer who retains the physical rights to possession, the difference in price due to mark-up is the compensation for the outstanding loan-to-value percentage.

To encourage the development of this sector, the government created a program that subsidizes housing payment for three months in the event of unemployment so that the default rate drops and the non-bank institutions are not disadvantaged.[15] Another difference is that leasing companies retain property ownership and can repossess assets without having to follow tedious enforcement guidelines.

Current financing options

Since the Mortgage Law was passed in 2001, there have been only 16 mortgages completed. Instead, financing is done either with a personal loan or through the housing developer. In either case, loans are for less than 8 years. In addition, since borrowers are unable to use the property as collateral for the loan, the loans are at high interest rates, making it especially difficult for low- and middle-income households to buy a home.

When developers finance housing, they use an installment system. The down payment is normally between 25 and 50 percent of the purchase price, with the rest of the payments occurring over the next 3 to 8 years. The title does not formally transfer until the entire amount has been paid. The high down payment is a severe constraint, especially for low-income households.

In April 2005, the Egyptian government approved a joint cooperation program between the Mortgage Financing Authority and the National Bank of Egypt. The program is designed to finance mortgages with interest rates at or below 12 percent and a term of 10 to 20 years. While this program sounds promising, it is not clear when or how it will be implemented.

OPPORTUNITIES FOR FOREIGN INVESTMENT/INVOLVEMENT IN THE EGYPTIAN HOUSING SECTOR

There are opportunities for foreign investment in housing finance, housing construction and associated infrastructure. Possible investment areas include the following:

- **New cities:** In 2000, about 64 percent (42.5 million) of Egypt's population lived in urban areas. By 2025, this number is projected to rise to 83 percent (78.8 million) due to natural population increases and migration.[16] To accommodate this demand, the Egyptian government plans on increasing the number of new urban cities from the current 17 cities to 59 cities by the end of 2017,[17] creating substantial opportunities for investors in financing, housing construction and infrastructure.
- **New housing developments:** The structural reforms discussed above are necessary before a fully functioning mortgage market can exist in Egypt. In the near term, many analysts suggest that the most potential in Egypt may be in projects that support construction of low-income housing, with a lease-purchase option, rather than in straight mortgage finance (similar to OPIC's Jopa Villas project in Kenya[18]). This way, financiers would be able to support the provision of low- and middle-income housing, and perhaps structure the deal such that a local bank provided financing. These projects could serve as demonstration projects and provide a step in creating a more robust mortgage market.
- **Existing housing:** There may also be opportunities for private financing in the middle-income market. There is high demand for housing among the middle class, while at the same time there are many vacant units. The mismatch exists because households cannot obtain financing to purchase these units. Providing financing will help both buyers and sellers. The new owners will have housing, and the sellers will be able to invest capital that had been locked up in the vacant units in other areas.

Current players

Some of the international companies and organizations currently involved in the Egyptian housing market include:

- There are 4 firms offering mortgage financing in Egypt, Al Tameer Co., Egyptian Housing Finance Co., National

[15] It should be noted, however, that Egyptian policy makers (academics, various political parties) are currently discussing changes in the approach to these subsidies. Under the new proposals subsidies would be shifted away from the three month payment and would instead help low income borrowers with down payments.

[16] PlanBleu.

[17] MERIS (2004). These plan would also include the creation of new urban areas around existing cities.

[18] OPIC is providing finance and insurance for construction of affordable housing units in Nairobi, using a unique, long-term lease-for-purchase program.

Societe Generale Bank, and the Arab Investment Bank.[19]
  - Al Tameer has authorized capital of $86.2 million, and is owned by a consortium of Egyptian banks, both public and private.
  - The Egyptian Housing Finance Company (EHFC), a private company dedicated to long-term affordable housing finance, was formed in 2004 with the help of the IFC, who took a $1.6 million equity share (20%). [Egyptian banks own 50%; the German Company for Investment and Development (DEG) owns 20%; and the Indian Mortgage Finance Corp. owns 10%]. EHFC will target middle class buyers, with a 14% rate and a maximum of 10 years tenor.
- Century 21, ERA, and Coldwell Banker realtors have offices (or officers) working within this market.
- Stewart International, a large US based international company that provides services to support the real-estate financing industry, such as title assurance, and escrow services worldwide; is reportedly in the process of establishing a new holding company to provide these services in Egypt. Stewart reportedly will control 55% of the new company, and its three Egyptian partners {Coldwell Banker Middle East/ Mansour and Maghraby, the Olympic Group, and the Osman Group} will each control 15%.[20]
- USAID's current major project is a $35 million Financial Services Project, whose objectives are to provide technical assistance, training and information technology to both public and private sector participants in the real estate and finance industries. This five-year project has four parts:
  - Legal reform and technical assistance and training to lenders to develop an environment conducive to a fully-functioning real estate finance industry
  - Modernization of property registration in urban areas: USAID has a pilot project in two districts in Cairo to create a systematic title registry that they hope to use as a template for the registration process
  - Establishment of a credit information system to assist lenders in assessing risk
  - Development of a broader range of financial instruments for the capital markets to increase financing opportunities.
- Chemonics International Inc. is implementing the USAID project.[21] The project will provide assistance to the Ministry of Justice (for property registration), the Ministry of Investment (Mortgage Finance Authority and Capital Market Authority), and the Central Bank of Egypt (for credit information services).
- The US Department of Commerce's Commercial Law Development Program is working to help implement and refine Egypt's new real estate legal framework.
- The World Bank is currently in discussions with the GOE on a program that would
  - Expand property registration based on lessons learned from the USAID-funded pilot registry program
  - Support development of secondary markets for real estate finance.
- Canada plans to support the establishment of a housing and real estate unit within the Egyptian Ministry of Housing.

CONCLUSION

Home ownership, with well-established property rights, forms the foundation of a healthy financial system. In the U.S., for example, despite the sophistication and scale of the U.S. capital market, mortgages remain its cornerstone. The existence of this large, stable pool of finance – with a well-diversified risk basis (and much of it insured) – has been critical in the development of U.S. capital markets. Moreover, creation of a "homeowner class" is one of the surest methods to help a society achieve long-term political stability. As the preceding review of the Egyptian mortgage market makes clear, the Egyptian government has begun the process of building out the institutional capacity and infrastructure necessary to grow a sector that will bring broad economic and social benefits.

[19] Hafiz (2005).

[20] Nametalla (2005).

[21] Chemonics is working with the US Mortgage Banker's Association and the Egyptian Banking institute, as well as the following Egyptian firms: Bahaa-Eldin Law Office; Hassouna &Abou Ali; Zarrouk, Khaled & Co.; FinBi Consulting; ARABSOFT; and Quality Standards Information Technology.

Table 1: Housing Indicators Comparison, MENA and select countries [22]

	Gdp per capita $US-1992 [A]	House price to income [B]	Housing Credit (%) [C]	Owner occupancy (%) [D]	Public Housing (%) [E]	Informal Housing [F]	Construction Costs ($US/M^2) [G]	Permit Delays (months) [H]	Foreclosure Delays (months) [I]
Algeria	2,060	12		45	25	4	500	2	
Egypt	**600**	**7**	**7**	**32**	**29**	**65**	**67**	**3**	**24**
Morocco	950	7	7	46	15	16	158	3	
Jordan	1,240	3	19	75	12	15	150	7	3
Tunisia	1,440	6	6	67	15	29	359	12	24
USA	21,790	4	44	61	1	5	500	36	5
Turkey	1,630	5	3	60	5	51	110	2	6
Mexico	2,490	4	18	83	54	16	267	3	6

Definitions: [B] Median House market price to median income; [C] ratio of housing loans to total loans in government and financial institutions (in per cent); [D] percentage of dwellings occupied their owners; [E] percentage of dwellings owned managed and controlled by the public sector; [F] percentage of dwelling not incompliance with current regulations and those that occupy land illegally; [G] present replacement cost per square meter of a median priced unit; [H] median time to get approvals, titles and permits for a 50-200 unit residential subdivision at the urban fringe where residential development is permitted; and [I] typical time from start to finish of foreclosure (including eviction) an a seriously delinquent mortgage.

Table 2: Supply of Housing [23]

	2002/2003		2003/2004	
	Number	**%**	**Number**	**%**
URBAN HOUSING				
Economy Level	125,600	50.1%	131,000	50.4%
Medium Level	32,000	12.8%	35,000	13.5%
Above Medium Level	9,000	3.6%	10,000	3.8%
Total URBAN	166,600	66.5%	176,000	67.7%
Economy Housing at Rural and Land Reclamation	84,000	33.5%	84,000	32.3%
Grand TOTAL	250,600	100.0%	260,000	100.0%

[22] Erbas and Nothaft (2004).

[23] MERIS (2004).

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