Concept Paper:
Legal Support to Improve Mortgage Financing in Egypt: Analysis and Recommendations
Egypt Financial Services
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EXECUTIVE SUMMARY

This paper evaluates and identifies areas for improvement of current Egyptian residential model mortgage contracts, presents an overview of the related topic of consumer disclosures, and reports on the steps being taken to support and develop the Egyptian legal mechanism to foreclose a mortgage. We further include a proposed solution to a difficult, widespread, and recurring issue involving the release of sold units from a developer's financing security.

The core legal elements of any successful mortgage finance system are the written contracts that set forth the obligations of the parties and the practical and efficient means to implement a remedy in the event of a breach of those duties. Concomitant with these fundamentals are the assurance that those who are parties to the mortgage contract have a meaningful understanding of their responsibilities, which is often referred to as a "meeting of the minds". It is often true that where a meeting of the minds has occurred before entry into contract through adequate disclosure and explanation of terms, the parties are more likely to fulfill their promises or at least elect to forego a transaction that might have proved imprudent.

Egyptian residential mortgages must be drawn within an exceedingly narrow and unique set of legal parameters under current country law. The most prominent provisions of Egypt's recently enacted mortgage finance legislation specify the material terms of lending documents with such particularity as to effectively permit only a single loan product type to be offered by all lenders. The new mortgage finance law is in this respect quite distinct from mortgage finance frameworks existing in the developed real estate finance markets of most Western countries, in which a wide variety of home finance products are legally permitted, even if based on a common underlying framework. Nevertheless, the Egyptian schema stems from significant religious and cultural imperatives and therefore may be analyzed and improved upon, if necessary, only insofar as reforms do not undermine the original intent of the framers of the law.

Consistent with this approach, our analysis must necessarily extend beyond a simple redrafting of current "model" contract terms or the substitution of standardized Western mortgage documents for Egyptian documents. The Egyptian mortgage law's incursion into specific contract provisions means that document analysis and recommendations are inextricably intertwined with statutory analysis and construction. Most important, before improvements could be suggested, the Consultant required the performance of a thorough legislative history by local attorneys in order to comprehend those requirements of the Egyptian law and supplementary regulations that are immutable.

The foregoing theoretical concerns are in fact borne out by the marketplace. In practice, it was found that certain core provisions of Egypt's Law Number 148 of 2001, better known as the Real Estate Finance Law (REFL), ran contrary to the banking practices desired by prominent Egyptian mortgage financiers and considered essential to maintain basic bank liquidity consistent with international best practices. Although these legal requirements were in many instances mirrored or elaborated by the combination of Cabinet Decree No. 1 of 2001 issuing executive regulations and Prime Minister's Decree No. 465 of 2005 amending those regulations (collectively, the Executive Regulations), which might be revised as needed, the REFL is not expected to be redrafted to any significant extent in the near term and so modifying the Executive Regulations will do nothing to resolve mortgage bankers' liquidity concerns. This paper proceeds on that well founded assumption. Nonetheless, lenders contended that the restrictive design of the REFL, without more, exposed them to heightened risk, therefore adding potential cost to loans and ultimately to the prospective consumer, and, worst of all, was a significant contributing factor that has stifled loan originations to this point in Egypt. Worse, there are indications that the “blockage” caused by the REFL has propelled some in the mortgage banking community to implement loans that simply do not comply with the plain meaning of the law; the fate of such loans is, thus, in some doubt.

In sum and substance the REFL allows only for the origination of a fixed rate mortgage (FRM), as discussed in greater detail herein. A World Bank team, simultaneous with the preparation of this paper, rightly observed the need among Egyptian primary mortgage lenders (PMLs) to better manage their liquidity risk, that is, their ability to match the cost of funds borrowed with proceeds of funds loaned. The World Bank’s proposed Egyptian Liquidity Facility (ELF) is a welcome potential solution to the FRM requirement of the law, and Egyptian lenders’ liquidity concerns.

Because the form and structure of the Model Contract Documents are set forth with specificity in the REFL, this paper devotes much attention to a legal analysis of the pertinent provisions of the REFL in order to ensure the ultimate recommendations for contract standardization are understood in their proper context. For example, certain improvements to the Model Contract Documents that may well have been evident and desirable from a Western perspective may be simply impossible given the plain language and legislative history of the REFL. This legal analysis is followed by a series of specific conceptual suggested improvements, additions, and modifications to the Model Contract Documents as well as an Annex that includes a sample “blacklined” set of the basic Model Contract Document that includes additional, more minor modifications.

This paper next turns to the subject of consumer disclosure. Development of policies designed to inform the prospective mortgage finance consumer, as well as the informational documents that will be provided before and during the loan relationship, are fundamental tools in building a sound mortgage finance system that enjoys public trust and confidence. Indeed, the Executive Regulations require that borrowers be provided with information sufficient to ensure they understand their rights and obligations. This paper presents a conceptual overview of those various forms of regulatory and documentary requirements that have been well established in the United States and which would likely prove useful in Egypt. It is anticipated that model form disclosures can be developed from these concepts to suit the Egyptian mortgage finance scheme.

As observed above, beyond the objective of originating mortgage transactions by well informed parties, lenders and an eventual secondary market must be confident that the law and the judicial system will provide an expedient, fair, and consistent remedy in the event of borrower default. No matter how attractive the loan product, a judicial foreclosure system that may take several years and be subject to much uncertainty will increase risk to the point of discouraging credible lenders and investors from entering the market.

Our analysis of the mechanisms for foreclosure both under the REFL and under prior civil law applicable to non-mortgage loans has revealed a number of shortcomings and open questions that must be resolved, most likely by the Egyptian judiciary. This paper sets forth an overview of the foreclosure system and several of the primary concerns Task I consultants have raised. However, the best consideration and resolution of many of these issues will result from direct interaction with the Egyptian judiciary. A Real Estate Foreclosure Workshop has been proposed that will focus on foreclosure cases brought pursuant to the foreclosure provisions under the REFL and Executive Regulations. It is expected that many of the legal and procedural concerns will be best examined through the eyes of members of the judiciary, and at the same time judges who are unfamiliar with the new laws will have the opportunity to learn more about it. This paper provides a summary description of the essential goals, timing, and plan for the proposed Workshop.

Finally, this paper addresses the legal issue presented when a prospective Egyptian purchaser (investor) of an apartment unit that is secured by, and subject to, the “umbrella” financing arranged between the project developer and its own lender. Of concern is the fact that there is currently no formalized, standardized, legal mechanism by which the newly purchased individual apartment unit may be released from the security given by the developer, and thus could potentially be forfeited in the event of a developer’s default.

This issue is generally resolved through the use of a fairly simple partial release of lien agreement, also referred to as a “splitter” agreement, that is executed at the time of closing and releases the individual unit in exchange for the payoff proceeds. The unit is released, with the construction mortgage remaining in place on the balance of the property. Annex A contains a sample agreement that may be modified to reflect the particular transaction.

The observations made in this report are considered part of an ongoing process of improving the documents, laws, and regulations that govern Egyptian home finance. This paper will be updated and revised as needed in 2006 to capture legal analysis, improvements in the areas discussed, and new challenges that may develop, as a deliverable for EFS. It is hoped that many of the recommendations herein will provide near-term solutions to the early development of the primary mortgage market, and it is expected that further evaluation and improvements will be required over time. It is also hoped that a better understanding of the more troublesome aspects of the REFL from the perspective of international best practices, and the historical basis for the design of the law, may eventually prompt reconsideration of certain provisions of the REFL that will promote wider acceptance of Egyptian mortgage instruments.

SCOPE OF ASSIGNMENT

This Concept Paper is a deliverable pursuant to KRA 1.2. It is a part of the objective of USAID-funded Egypt Financial Services ("EFS") to build the market infrastructure required for real estate financing and other forms of secured lending. Specifically, consistent with the objectives of Task I, this paper supports the objectives of widening access to and increasing the affordability of owner-occupied housing through an improved and more standardized home finance system. This paper further supports the Task I objective of ensuring that banks and other primary lenders will be able to resell home loans or to otherwise obtain long-term funding so that formal-sector finance of housing can grow to significant size in relation to national income.

Independent consultant David C. Wilkes, working closely and with the support and extensive contributions of Task 1 Team Senior Legal Advisor Shamsnoor Abdul Aziz, legal consultant Arthur Dimas, legal consultant Marc Albert, regulatory consultant Greg Taber, and Egyptian attorney-consultants Hassouna & Abou Ali and Arab Legal Consultants, prepared this Concept Paper for USAID and EFS. The specific objectives of the Concept Paper are to:

1) Evaluate and suggest improvements to the Model Mortgage Contract documents required under Egyptian law and related legal analysis;
2) Provide an overview of areas in which consumer disclosure, as it relates to home mortgage finance, can be improved;
3) Provide an overview of steps being taken by the EFS Task I Team to evaluate and improve the process for foreclosing a home mortgage loan;
4) Prepare and provide a suggested legal mechanism for the release of individual apartment units from developer financing agreements.

DOCUMENT STANDARDIZATION

1.1. OVERVIEW

Article 6 of the REFL specifies the terms and conditions of a uniform Mortgage Model Contract and requires the Minister of Investment (MOI) to “issue a decree concerning the ‘forms’ to be used in the agreements” for all types of mortgage loan transactions authorized by the REFL. Aside from actual pricing, virtually all of the significant terms, conditions, and very structure of Egyptian mortgage loan documents are dictated by provisions of the REFL and the Executive Regulations. Because such terms, taken together, result in the specific loan product being offered, they necessarily exert a heavy influence on the volume and quality of loan originations. In particular, the effective legal prohibition of adjustable rate mortgage (ARM) loans, absent any countervailing measures to ensure lender liquidity, make it exceedingly difficult for an Egyptian mortgage lender to originate responsible loans without compensation for liquidity risk.

As detailed below, our review and analysis of the current mortgage market, several years since its inception, as well as the opinions of Egyptian mortgage bankers, strongly supports the conclusion that the contract terms mandated by the REFL have played a material role (though not the only one) in stifling loan originations. Very limited mortgage loan activity following anecdotal reports of strong interest and great enthusiasm on the part of many Egyptian consumers is due in significant part to a loan structure—and the loan documents that must legally follow that structure—that runs contrary to the needs of the lender and consumer and is cumbersome to operate. Nonetheless, it is equally recognized that this is only a portion of the complete picture; improvements in the Egyptian title registration system, credit risk analysis systems, collateral valuation, and consumer education will each play a considerable role in the development of a successful mortgage finance system.

1.1.1. THE NEED FOR STANDARDIZED DOCUMENTS

Standardized contract documents are an essential foundation of a healthy mortgage market. They facilitate an efficient, low-cost transaction in which the obligations and benefits to both the borrower and lender are predictable and transparent, and easily reviewed by third parties for compliance or assignment purposes. Our efforts are primarily aimed at enhancing mortgage origination (the *primary* market). However, improvements related to document standardization will also reap great benefits to the Egyptian economy once a secondary mortgage market develops. As one commentator has observed:

> “[s]standardization is the mantra of securitization. Establishing a base for securitization requires a large number of individual loans with enough similarity to form a homogeneous pool. * * * That creates liquidity in the marketplace and an opportunity to develop an efficient Secondary Mortgage Market. It presupposes that the contracts underneath each of those individual mortgages are the same….”
>
> A homogeneous pool of mortgages suggests that rules are going to be applied consistently in the way the loans are originated, underwritten, and

> serviced. [If the individual loans are not similar], the whole rationale of the exercise is undermined…."[1]

Due to the highly specific mortgage contract requirements of the REFL and the understandable obstacles to modification of the REFL, discussed in detail herein, we proceed on the assumption that standardized documents must be developed within a tightly constricted scope. Although the REFL's requirements may make any discussion of alternative document constructions largely irrelevant, the effect of these requirements on loan originations is of sufficient significance that we deem it worthwhile to provide some detail of the REFL's provisions and a brief history of their origins. This will enable better informed proposals for improvement of both contract documents as well as understanding the need for compensating mechanisms such as the liquidity facility referred to above. Further, and of equal utility, it is helpful to understand the bounds within which change can realistically be accomplished to avoid wasted efforts.

1.2. THE LOAN PRODUCT MANDATED BY THE REFL

Underlying the REFL's effective specification of, generally, a single loan product type (a FRM) are those provisions of the law that deal with the lender's return on the funds advanced to purchase the property.

1.2.1. EFFECTIVELY A SINGLE PRODUCT: FRMS

Article 6(C) of the REFL, as translated for EFS, states as follows:

> "[The Agreement shall state] the number and amounts of the installments of the balance of the price, and the conditions for their settlement, providing they shall be determined until they are fully collected."

Our understanding of this language, which has been confirmed by Egyptian lenders and attorneys we have interviewed, is that it requires the Contract Documents to implicitly provide for a fixed rate of interest at the time of loan origination as well as a fixed term (length of the loan, or "tenor") of the loan installments.[2] If this is true, then it is equally true that the only loan products permitted under Egyptian law are FRMs. For an ARM, it would necessarily be impossible to state, at the origination of the loan, both the number of payments and their amounts because either the payment amount or the tenor of the loan would change in accordance with bank borrowing rates. Specifically, so long as the "installment" amount must be declared at the time of loan origination as well as the number of installments, the REFL prohibits any loan product other than a FRM.[3]

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[1] Proxenos, Soula, "Essentials for Secondary Mortgage Market Development" (Real Property Markets: The "Real" Solution for Economic Development) at 36.

[2] It is noted that one mortgage lender appeared to acknowledge the highly restrictive language of the law but felt it was on sufficiently solid ground in making loans that provide for an adjustable tenor. For reasons discussed herein, it is further important to note that the notion of a FRM technically arises from the concept of "interest" being charged on money lent; in the Egyptian context, the amount charged to facilitate a loan is considered more of a simple "cost" and is often referred to as a "return".

[3] Anecdotally, we have been advised that an earlier provision of the Executive Regulations, which was removed for reasons that are unclear, suggested that the above Article 6(c) provision would in fact

1.2.2. LENDING GROWTH STIFLED BY ARTICLE 6(C)

Lenders we met with universally agreed that they needed greater flexibility in setting the number and/or amounts of the installments paid under a mortgage agreement in order to account for changing interest rates and thus their own risk, just as lenders do in successful mortgage markets around the world. Notably, this concern will become all the more pronounced as depositary institutions (i.e., non-mortgage specific lenders) consider entry into the Egyptian mortgage finance market. Commercial banks will depend on a volume of short-term deposits to generate funding for mortgage loans, and will not readily make long-term mortgage loans because of the liquidity risk they face. This risk is not adequately compensated under the current Egyptian system. This concern is particularly acute during this earliest stage of implementation of mortgage finance, where lenders lack the complex instruments of their Western counterparts, or sufficient loan volume, to hedge various risks.

Because Article 6(c), without some further accommodation, significantly restricts the form of housing finance products, certain Egyptian mortgage lenders, while mindful of the restrictive language, have found creative ways to hedge their risk. However, such practices run a different risk: that of being struck down by the courts should a dispute arise, thus invalidating entire loan portfolios that are all based on the same “creative” contract terms.

One example of such creative practices is through alteration of the tenor of the loan during the life of the loan as the bank’s own borrowing interest rate changes, despite the fact that Article 6(c) on its face appears to forbid this. For example, a 20-year loan might expand to a 22-year loan when a lender’s own rates change in order to account for the increased costs of funds. The consumer would simply be advised of the change in tenor when it occurs. Despite our skepticism we were advised that loan tenor revision has received a very informal level of approval (apparently not in written form) from the Mortgage Finance Authority (“MFA”), and the lender is hopeful its loans will thus survive judicial scrutiny although equally aware of the potential problems with this. With only a handful of loans consummated, such “extra-legal” practices present mortgage lenders with little institutional risk while allowing them to fulfill their mandate of originating mortgage loans, for better or worse. Of course, should the practice be struck down in the future by the judicial system as contrary to law at a point when many more loans have been originated, this could jeopardize substantial bank assets, as well as any secondary mortgage market that might develop. Article 6(C) is thus an extremely significant provision of the REFL as far as contract documents are concerned.

This legal restriction may ultimately burden the consumer—and the potential for growth in the Egyptian mortgage finance system as a whole—more than the individual bank. This is because the bank will naturally shift costs and risks away from itself and is in a better position to do so than the individual consumer is to protect himself. This may occur through the charging of higher interest rates to account for potential risk, which will have the effect of denying loans to many consumers who otherwise might have qualified, or to imposing a much higher cost to home-buying than would otherwise be necessary. Furthermore, in the event interest rates decline over time rather than rise, consumers may find themselves paying installments that are based on a fixed rate that is no longer justified and represents a windfall to the lender and that, worse yet, represented a superadequate charge by the lender to account for a perceived liquidity risk that never materialized.

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permit lenders to contract with borrowers for variable interest rate loans so long as full consumer disclosure was made. This particular regulation was apparently removed.

1.2.3. HISTORICAL BASIS FOR ARTICLE 6(C)

Notwithstanding the apparent plain prohibition of ARM loans by REFL Article 6(C), EFS was initially advised that the law had been interpreted to permit otherwise and that our concerns about the constraints of the law were unfounded. Indeed, flexible financing instruments exist in non-mortgage transactions in Egypt, albeit these appear to be based on law that predates the 1980 implementation of the current version of Article 2 of the Constitution, which requires that all law be consistent with Islamic law principles[4]. On the other hand, a prohibition against ARM loans seemed to logically derive from the Islamic (Shaari'a) Law prohibition against "growing" money through the charging of interest (referred to as "riba"); a FRM is considered, to the contrary, in the nature of a fixed "cost" for the money lent and therefore acceptable. We were initially advised, however, that Islamic Law requirements did not factor into the REFL.

It is also quite possible that the source of such advice was the Executive Regulation mentioned above that supposedly permitted ARMs but was later repealed. Presented with the foregoing circumstances, the apparent desires of local mortgage companies to originate ARM loans, and the lack of any facility that would compensate for a lack of liquidity, the EFS Task I Team invested substantial effort over the course of several months into developing a plan that would permit lending on variable rate terms. This effort was particularly driven by the objective of creating improved standardized contract documents that would promote greater efficiencies and a higher volume of loan originations. The Task I Team further believed that if this was to be accomplished it was best to first suggest a reformed loan structure with the contract documents to match it rather than designing contract documents around an FRM scheme that was considered undesirable and ignoring the underlying liquidity problems created by Article 6(C). The tentative plan, then, was to implement an interim arrangement by which ARM loans could be permitted that would be followed by eventual explicit amendment to the REFL and Executive Regulations.

Nevertheless, we remained persistently skeptical of both the advice to ignore the apparent plain meaning of Article 6(C) as well as the notion that the REFL could be readily amended. Our skepticism resulted in the commissioning of exhaustive research by Arab Legal Consultants into the legislative history behind REFL Article 6(C).[5] The full text of the report of Arab Legal Consultants (the "ALC Report") is annexed as Annex B.

The EFS Task I Team's concerns were borne out by the ALC Report. For instance, the ALC Report advises:

> "Article 6 of the REFL cannot be fully appreciated in isolation; and in order to provide information and commentary on the basis, history and need for provisions of Article (6) of the REFL [the following] should be considered:
>
> Article (2) of the Egyptian Constitution, which stipulates that the principles of Shari'a (Islamic principles) are the main source of legislation. This constitutional principle introduced in 1980 has as a direct consequence that all legislation should be in conformity with it. It is for this reason that the Ministry of Economy, when it first drafted the law submitted it to the Islamic

[4] *Review and Commentary on Article 6(C)of the Real Estate Finance Law*, Arab Legal Consultants, 7 Aug. 2002 (*See* Annex B), at 3 and n. 1.
[5] ALC Report.

> Research Center (Magmaa Al Bohouth Al Islameya) to attain its approval and ensure that the law is with consistent with Islamic Shari'a.[6]

The ALC Report goes on to detail the pre-enactment debate that occurred concerning an early draft of the REFL that would have permitted both a more standard Western-style contract structure (discussed later in this paper, at Section 3.3) as well as provided greater flexibility in the charging of interest on mortgage finance loans. We have been advised that this debate occurred between the Islamic Research Center (IRC) and the Ministry of Economy (MOE) following the IRC's refusal to approve a two-party mortgage structure because it appears to have included express provisions for the payment of interest in contradiction with Sharia'a Law. The IRC stated in 1999 that it would not approve portions of the law that related to loans with interest and a different solution was sought. The issue was apparently "resolved" by a proposal devised by a legal team from the MOE, which included the notion of a tripartite agreement and the abolition of any reference to "interest". Following this, the IRC issued its approval on March 10, 2001. While it remains clearer that the dispute centered on the structure of the mortgage contract (i.e., dual-party versus tripartite), it appears certain that the effective prohibition (by Article 6(C)) of ARM-type loans stemmed from identical IRC concerns.

It is notable that one sophisticated Egyptian mortgage banker interviewed stated that he did not believe the IRC's application of Sharia'a Law was necessarily correct or the only legitimate interpretation. We were advised that strong legal authority exists to support the view that the only "interest" that is prohibited by Sharia'a Law is that which constitutes "usury", which is, as generally true in Western countries, the charging of an *excessive* rate of interest. Of course, the IRC has already expressed its views of the religious restrictions on charging interest, which are now incorporated into existing law and is unlikely to be changed in the near term. One solution suggested by our interviewee was for the enactment of a second, parallel law that would permit an alternative mortgage finance structure to the REFL and allow the charging of interest (in accordance with the above described interpretation of Sharia'a Law); consumers and lenders would then be able to choose the type of financing they preferred based on their own convictions and beliefs.

To date, based on these findings, the Task I Team determined that, while it might be desirable to modify the model contract documents to provide lenders with greater flexibility in adjusting loan rates to ensure bank liquidity, and that a modification of the REFL might eventually be pursued, the FRM was the only product that truly satisfied the current legal mandates of the REFL. Moreover, given the legislative history of the REFL, the Task I Team determined that recommending the types of legal or regulatory changes needed to permit ARM contract documents would be inadvisable.

1.2.3.1. THE PROPOSED LIQUIDITY FACILITY

Fortunately, it appears that a solution to the liquidity risk concerns of lenders may be implemented in the form of the Egyptian Liquidity Facility ("ELF") that has been proposed by the World Bank.

[6] ALC Report, at 3 (footnotes and citations omitted).

1.2.3.2. RISKS ADDRESSED BY THE ELF

In all economies, long-term housing loans create significant credit, interest rate, and liquidity risks for the management of the bank. In an economy in which mortgage finance is not fully established, inflation and political pressures to control interest rates expand these risks. Banks in such economies are further hampered by a lack of credit evaluation tools and inadequate capital and liquidity vehicles, which will only resolve themselves over a period of several years. The current lending rate extended to mortgage finance consumers in Egypt is 14%; lenders borrow on a relatively stable basis at about 10%. Long term funding sources for banks are scarce. Lenders advised us that although interest rates have remained relatively stable, they are concerned that interest rates may rise dramatically in the future.

Housing finance lenders in developed mortgage finance economies are often "short funded". This means that the duration of their mortgage assets exceeds the maturity of their funding sources (such as, e.g., bank deposits). Short funding creates an interest rate risk for the lender because rising market interest rates raises the cost of bank funds without immediately raising the return on mortgage assets. This risk is hedged using either high-cost capital market instruments or by using ARM mortgages.

This being said, it should also be observed that ARM instruments shift the interest rate risk to the borrower, thus sometimes increasing the likelihood of default. As a result, still other alternative loan product structures have been designed to manage this issue.[7] However,

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[7] A variety of loan structures were reviewed and considered as possible substitutes for the simple FRM, particularly those that had previously been employed in emerging markets. Although it is beyond the scope of this paper to engage in an in-depth consideration of alternative mortgage finance instruments, as a point of interest three principle structures were reviewed as possible alternatives to the fixed rate-fixed term mandate of Article 6(C):

> **Adjustable Rate Mortgage (ARM):** see comments in text above. In very general terms, to the extent inflation and interest rates in Egypt are reasonably stable, the ARM may provide an appropriate balance of risk between the investor and the financier.
>
> **Dual Indexed Mortgage (DIM):** This type of mortgage is designed to combat the so-called "tilt" effect of a fixed-installment mortgage (whether fixed or variable interest rate), in which a nominally fixed payment is large in real terms at the outset of the loan but its real value is eroded with inflation over time. DIMs have been employed in transitional economies in which the mortgage finance industry is relatively new. While the mechanics and application of the DIM are well beyond this paper, the basic objective of the DIM is to balance borrowers' ability to repay with lenders' concern with real payment, i.e., the declining value of payments as a result of inflation over a long period of time. In essence, payments are based on a fixed proportion of family income, which protects borrowers from sudden shocks if real incomes fall. At the same time, the loan balance is indexed to prices (rather than wages) so that any portion of interest and principal due over and above the portion of income that is paid is capitalized into the amount of the loan that is outstanding; loan maturity is variable to permit shortfalls in real repayments to be offset. In years when incomes are rising relative to inflation, repayments are in fact accelerated. For a detailed discussion of the application of the DIM loan structure, *see, e.g.,* Ball, Gwendolyn, "Dual-Indexed Mortgages in Reforming Socialist Economies: Evaluating the Risks and Institutional Requirements" (The World Bank, Urban Development Division, Housing Policy Debate Vol. 3 Issue 3.); *see also, e.g.,* Jaffee, Dwight M., and Bertrand Renaud, "Strategies to Develop Mortgage Markets in Transition Economies" (The World Bank, Financial Sector Development Dept., December 1996 Policy Research Concept Paper).

beyond designing various loan products to balance liquidity and creditor risks, an external source of risk compensation is in some cases the best solution.

The proposed ELF would permit the REFL, and model contract documents, to retain their single product, fixed-rate loan approach to mortgage finance while assuring compliant lenders of the necessary liquidity to confidently originate loans under this program. As described by the World Bank, the ELF would:

> "[P]rovide term finance to [Primary Market Lenders (PMLs)] in order to reduce the liquidity risk ... incurred in their provision of long term loans for housing. * * * By providing an easy access for ... PMLs to bond finance at any time, the ELF will enable PMLs to make more housing loans, increase the flow of funds to housing and improve the affordability of housing finance in Egypt."[8]

In sum, the Task I Team views the ELF as a solution to what was otherwise a material and significant obstacle to lending under the REFL and the model contract terms that are dictated by the REFL. Therefore, although mortgage contracts made pursuant to Article 6(C) of the REFL will continue to significantly restrict the types and volume of mortgage finance loans in Egypt, the primary obstacle to lending as a result of this law would be removed by the implementation of the ELF.

1.3. TRIPARTITE FORM OF MORTGAGE:

In most developed real estate finance markets, real estate loans consist of two documents: the *bond* (or note), which documents the terms of loan repayment, and the *mortgage*, which provides for the collateral (the real estate). The term "mortgage" is generally used to collectively refer to both sets of loan documents. In contrast, the REFL specifies a highly unusual and very specific form of single-document agreement to effectuate the mortgage transaction. Pursuant to REFL Article 6 there are three parties to the mortgage contract: (a) the borrower-purchaser ("investor"); (b) the lender ("financier"); and (c) the seller of the real estate.

1.3.1. ORIGIN OF THE TRIPARTITE CONTRACT DESIGN

Once again, in considering possible reforms to the highly unique mortgage contract design specified by the REFL, we sought advice on the legislative history of the law. This was particularly important in view of the likelihood that any eventual secondary market might be uninterested in a tripartite loan structure that was quite unfamiliar and untested.

As noted in the foregoing sections, the tripartite form of agreement also resulted from legislative concerns expressed by the IRC. Early drafts of the REFL proposed a standard

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Adjustable Rate Mortgage with Variable Tenor (ARMVT): Another novel mortgage instrument, the ARMVT adjusts its maturity and principal payment with changes in interest rates, such that the monthly installment remains the same. ARMVT mortgagors bear interest rate risk by bearing a tenor risk. This approach has been employed widely in Hong Kong. Indeed, this approach is strikingly similar to that which has been employed by at least one Egyptian lender in response to what it perceives as a restriction of Article 6(C) of the REFL. *See*, *e.g.,* Chow, Ying-Foon, Charles Huang, and Ming Liu, "Valuation of Adjustable Rate Mortgages with Automatic Stretching Maturity" (Journal of Banking & Finance 24 (2000) 1809-1829).

[8] Egyptian Liquidity Facility: Preliminary Business Plan, World Bank, Draft for discussion Aug. 1, 2005.

two-party mortgage structure with a traditional separation between the agreement of the seller and buyer of the property from the agreement between the lender and the borrower/buyer.[9] On review of this scheme, the IRC believed that the two-party mortgage contract implicitly condoned offering loans bearing interest.[10] The IRC seems to have proposed an alternate loan structure by which, similar to common Sharia'a Law banking practices in other countries, the lender takes title to the real property and then re-sells it to the buyer at a higher price, which is then repaid in installments, akin to "rent". The MOE apparently rejected this proposal as inconsistent with standard mortgage finance practices, and the resulting structure was the tripartite agreement (described in detail below), which was seen as a solution that was compliant with Sharia'a Law.[11]

1.3.2. MECHANICS OF THE REQUIRED CONTRACT

This "tripartite" mortgage contract anticipates a transaction that is not intuitive or likely to be easily comprehended by the average loan applicant, although to some extent full comprehension of the legal mechanics of the transaction by the "man in the street" are not essential. According to REFL Article 6 the flow of obligations is as follows:

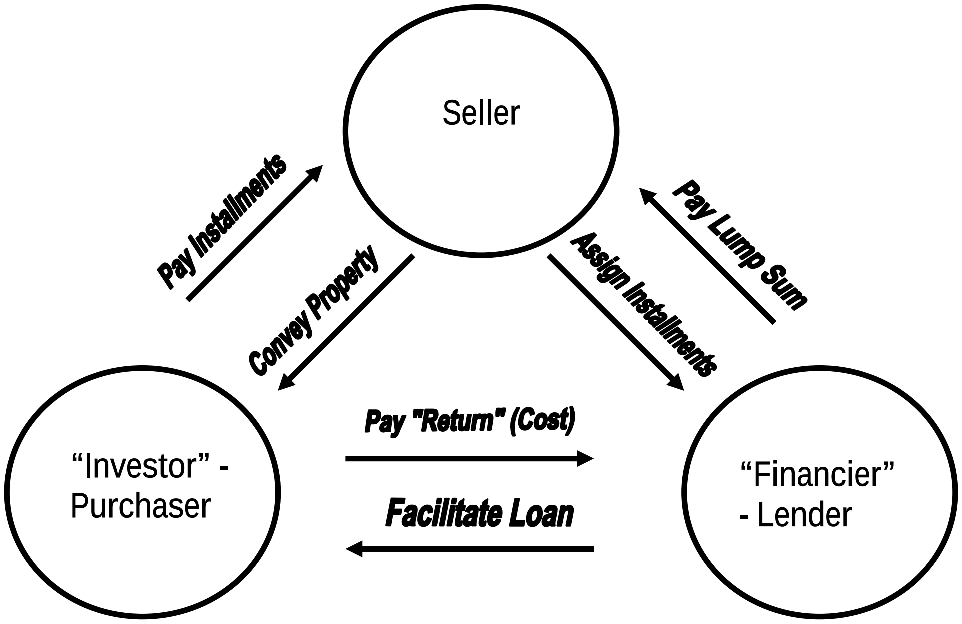
(a) Investor agrees to pay balance owed to Seller (after down payment) in installments in exchange for ownership of the real property;

(b) Financier agrees to pay lump sum price of real estate to Seller in exchange for Seller's assignment of Investor's installment payments (i.e., includes cost of financing, or "return");

(c) Investor agrees to pay installment payments to Financier (by assignment) in exchange for facilitation of the mortgage.

This is graphically depicted as follows:

[9] ALC Report, at 4.
[10] *Id.*
[11] *Id.*



Notwithstanding the uniqueness and likely problems that may result from this form of agreement, it is mandated by the REFL and must be accepted as such. As a result, the model contract documents must reflect the tripartite agreement even though, for the reasons described below, this structure is likely to prove an obstacle to advancing the primary mortgage market and any eventual secondary market.

The tripartite form of agreement is cumbersome and certainly hampers the primary and secondary markets[12], but is not fatal to the loan origination process and has some rationale under the current system. This loan structure provides the Seller with his or her anticipated lump sum cash payment at the time of sale rather than forcing the Seller to wait for registration to be completed in order to "close" the loan, which would surely make most mortgages highly unattractive to Sellers.

Specific concerns and recommendations concerning the tripartite form of agreement include:

(a) The obligations of the parties are difficult to comprehend, and, if understood by the average investor-applicant, will likely be perceived as some form of legal gamesmanship rather than a straightforward transaction; this has the effect of placing the lender in a superior knowledge position in the agreement;

(b) The tripartite agreement is unusual, if not unique, in international practice, which will have the dual negative effect of deterring potential non-Egyptian primary lenders

[12] Particularly in the early stages of a new mortgage market, investors in the secondary market will be uncomfortable with the new mortgage instruments, even where the mortgages are in a familiar and standard form; investors will typically require various credit enhancements (e.g., third-party participation in the deal or guarantees by international entities or government guarantees and investments). Early securitizations may require the payment of a premium to investors because of a lack of data and familiarity. With experience, much better deals will occur. Nevertheless, as discussed herein, the Egyptian tripartite agreement will present investors—from the very outset—with a high degree of unfamiliarity and likely discomfort with the "standard" Egyptian mortgage instrument being offered to the SECONDARY MORTGAGE MARKET. This should be considered carefully. *See*, Proxenos, Soula, note 1 above at p. 36.

from entering the market and further deterring potential secondary market purchasers from acquiring these loans because they are an unfamiliar instrument. Given the choice between the Egyptian mortgage document and those offered in many other countries, secondary market participants would have little incentive to purchase Egyptian loans absent a significant discount for this perceived risk.

1.3.3. PRACTICAL PROBLEMS OF MORTGAGE FINANCE COMPANIES

Several additional problems have been noted by the mortgage finance companies we interviewed. These problems pertain to specific lending situations that neither the current REFL, Executive Regulations, nor the contract documents adequately provide for, as follows:

1.3.3.1. SEMI-FINISHED APARTMENTS

Mortgage finance companies have run into several cases involving provision of financing to the investor (borrower) when apartments are not yet completed. In such a situation, for example, the apartment building may be constructed, plumbing and electricity installed, but work remains to be completed. At this point, the real estate developer delivers the property to the investor, and the investor will then hire another contractor to complete the work. The mortgage finance company faces a problem in drawing the contract and identifying the third party to the contract. If the investor intends to borrow an amount certain from the lender, this amount will include a portion to be paid to the original developer and a further portion to be paid to the contractor who will complete the unit. The seller (real estate developer) will not wish to be a party to the contract because the investor's borrowing amount is higher than necessary to satisfy the developer, and the investor really only needs to borrow a lesser amount to satisfy the developer. A simpler two-party agreement between just the borrower and mortgage finance company would allow the borrower to obtain only the amount needed to satisfy the developer.

Mortgage finance companies are attempting to resolve this issue by originating two loans for the same unit; the first loan with the developer as third party, and the second with the builder who will complete the apartment. This generates additional paperwork and is administratively more costly and burdensome. Further, the last contract with the developer who will complete the project cannot be classified as a purchase agreement, a construction agreement or a repair agreement.

1.3.3.2. REPAIR OF UNITS

A separate issue arises in the case of a tripartite renovation contract. In such a situation, the investor (borrower) would prefer to repair/complete the unit himself. However, this cannot be accomplished under the tripartite agreement, which requires the developer as a third party.

1.3.3.3. ALTERNATE COLLATERAL

Another situation arises when the investor uses an alternate security to finance the purchase of the unit. In such a situation, the unit is not yet built and essentially has no value as security. The borrower, however, would like to borrow the money in order to pay the developer before the unit is built. Again, the tripartite agreement is unsuited to this type of transaction.

The tripartite form of agreement required by Article 6 of the REFL impairs the ability of mortgage finance companies to originate mortgage loans in these fairly common situations. A two-party agreement would be preferable, but no such change appears possible absent a change in the law.

1.4. UNILATERAL ASSIGNMENT OF MORTGAGE

The Contract Documents should be modified to better spell out the respective rights and obligations of the parties in the event of a decision by the borrower to assign the mortgage. Current law, as discussed in detail below, provides much protection and latitude to the borrower, but may also jeopardize many loans if further specificity concerning assignment is not added to the Contract Documents.

1.4.1. THE LAW

Article 7 of the REFL provides the investor with the right to assign the mortgage to another investor virtually at will. The investor must obtain the financier's approval, but the REFL's scheme places the burden upon the financier to reject the investor's assignment and only with very good reason to do so. Specifically, according to the translation of the REFL that has been provided, Article 7 states as follows:

> "The financier shall not refuse to accept disposing of, leasing out or enabling a third party to exclusively occupy the security realty, except for serious reasons that would expose his interests and rights to danger."

Moreover, if the financier fails for whatever reason to notify the investor of its reasons for rejection, in writing within 30 days, the assignment is considered to be automatically approved.

These provisions are of concern because they potentially put the lender at serious risk and in an unfair position. Ultimately, if this provision becomes problematic in practice, the overall costs will be shifted back to the consumer anyway in higher-cost loans and servicing. In many other countries, assignment of the mortgage may be permitted but is rarely allowed solely at the will of the borrower, as here. So long as the assignee is of sufficient creditworthiness, there is in fact no real need for a right of assignment: the new investor would instead make application for a new mortgage loan (possibly with a different lender on different terms) that would pay the seller his or her price and "take-out" the seller's loan. If the new investor was of insufficient credit, then the original lender would not wish to have the assignment made in the first place.

Of primary concern is the lack of underwriting of the assignee. The lender is not provided with a right to evaluate the credit of the assignee, nor is there a requirement that the assignee have equity in the property (i.e., as contrasted with the original investor's requirement to put at least 10% down payment according to the Executive Regulations). Indeed, it is quite plausible that in a market downturn, in which the market value of the property has dropped to equal or below the amount of the loan, the original investor may look to dispose of the loan by assignment; under Article 7 the assignee merely takes over the payments with no equity in the property and no incentive to keep making payments if his own situation changes, putting the lender at serious risk.

It is unclear what would constitute the "serious reasons that would expose [the financier's] interests and rights to danger" sufficient to support a rejection of assignment. The issue seems to welcome litigation that could easily tie up and delay installment payments. This adds greater uncertainty to the anticipated loan cash flows, making it more costly to generate, service, and insure loans.

In addition, the financier's obligation to notify the investor of the reasons for rejection, in writing, within 30 days from the date the investor's notifies the financier of the intent to assign is problematic. Several concerns are raised on this point:

- The law does not specify the manner in which the investor must notify the financier of such intention. It is highly plausible that an investor may simply assign his right and then say that he called the financier by telephone but received no rejection in writing – a claim that would be difficult to disprove.

- If the investor does notify the financier in writing, there is no specification of when the 30-day period begins to run, i.e., from mailing of the notice or its receipt.[13]

- The 30-day requirement, in a mortgage market in which a lender may eventually service thousands of loans, may be insufficient to underwrite the assignee, particularly in Egypt, where credit verification is still in its infancy. At the very least, provision should be made for a good faith extension of this period if needed.

- There is no legal mandate by which the assignee is required to provide his or her credit information to the financier, or within any particular time-frame. At best, assignees would have every incentive to wait as long as possible, thus shortening the financier's 30-day window in which to reject.

Fortunately, the design of Article 7 offers several windows by which these items may be addressed without the need to amend the REFL itself. It is recommended that such items be addressed through a combination of amendments to the Executive Regulations and the addition of clarifying provisions to the model contract documents. The following points should be dealt with, as appropriate:

- The Executive Regulations and/or Contract Documents should clarify that the phrase "serious reasons that would expose his interests and rights to danger" may include various underwriting concerns of the financier, which are within the discretion of the financier to determine.

- The Executive Regulations and/or Contract Documents should further provide at least a general requirement of compliance by the assignee with the underwriting

[13] The Civil Law and Civil Code have not been reviewed at this time in this regard; it is quite possible that such issues are fully covered in those areas of the Egyptian Law.

requirements and application and approval process of the financier, and that failure to so comply can be the basis for rejection of the assignment application.

- The Contract Documents should specify the precise notification obligations and underwriting rights of the financier and a right of extension of time by the financier if needed. But, the specific underwriting standards, equity requirements, and approval standards of the financier should not be detailed in the Executive Regulations or the contract documents in order to provide the financier with the needed flexibility to make appropriate decisions concerning a potential assignee who is unknown at the time of loan origination. This is particularly so given the current *ad hoc* nature of credit review in Egypt.

- The Executive Regulations and Contract Documents should provide the financier with the right, upon appropriate notice and mutually agreeable terms, to inspect the property in order to make an updated evaluation of the value and condition of the security.

- While the REFL provides that upon the financier's failure to object within 30 days of the investor's notice to assign the mortgage is considered to be assigned, the Executive Regulations, in contrast, state that the financier must give a written approval to the investor in order for the assignment to take place. What would happen in the common situation where the investor has properly requested to assign and the financier never gives its approval? According to the REFL the assignment is valid. According to the Executive Regulations, it is invalid because the lender did not give a "written approval." The Model Contract Documents can be used to clarify this issue between lender and borrower.

1.5. MODEL CONTRACT DOCUMENT MODIFICATIONS

In addition to the concerns discussed above, which primarily involve contract issues deeply intertwined with the REFL and Executive Regulations and may require legislative attention, the current versions of the Model Contract documents present a number of other items that are more easily modified in the documents themselves. Our comments follow, first conceptually and then with the annexed first draft of "blacklined" suggestions for modifications to specific language in Annex C.

1.5.1. The Preamble to the Model Contract contains many of the basic items identifying the transaction, but fails to specify the total price being paid for the real property. Preamble Section 3 refers to percentage of unit, Article 7, paragraph 1 refers to gross and principal price. The Preamble should include the purchase price (see Revisions to Preamble Section 3), and Article 7 should be changed to reflect the final price.

1.5.2. Article 45 of the REFL specifies that "The valuing experts shall notify the finance parties"; this should be reflected in the Model Mortgage Contract in the last paragraph of Preamble Section 5, which deals with appraisal issues. Appraisal engagement is a contract relationship between the lender and the appraiser, and the appraiser should notify the parties as to his valuation determination.

1.5.3. Section 5 of the Preamble sets forth the fact that the real estate has been appraised by three appraisal experts. The language suggests that the appraisal determination is the basis for the price paid. This is not necessarily so. Rather, the appraisal is merely a part of the underwriting function and the basis for the loan that is being made. The seller and investor presumably negotiated a price that is not necessarily (and should not be) based upon the appraisal experts. Were it otherwise, early-stage sales negotiations would never move forward because the parties would not know the price until the appraisal experts had been engaged and completed their work; moreover, a true market is developed through buyer and seller negotiations, as opposed to an approved appraisal panel that "sets" real estate prices. Indeed, placing the power of *setting* value (as opposed to *determining* value) has the effect of slowing the development of the real estate market – appraisers should respond to sales to determine value, and not the other way around.

1.5.4. Article 3 of the Model Contract provides that "[t]he common and subject-for-use parts are non-viable for division or disposition either wholly or partially." It is unclear whether this is a representation and warranty or a statement of fact or some kind of agreement of the parties that the property will not be treated inconsistent with this statement. This requires clarification.

1.5.5. Article 4, Section 1 of the Model Contract, as translated, states that the investor ("Second Party") "shall also incur partial cost of maintaining…" the common areas. This should be clarified to state that the investor is "responsible" for this cost. Additionally, this provision should be kept in mind in the preparation of condominium regulations, such that the individual owner's responsibility for common area maintenance as stated in the Model Contract is consistent therewith. It is also noted that, in the absence of some form of Homeowners' Association for a given property being mortgaged, this provision of the Model Contract may be unenforceable or impossible to comply with.

1.5.6. In a related context, Article 4 of the REFL deals with obligations by the second party regarding the common parts of the real estate. However, the common parts are not defined. It should be made clear in the contract documents that common parts include main walls, entrances, roofs, elevators, passages, corridors, floor bases, pipes, and tubes connecting electricity or any other utilities that serve the building in which the subject unit is located, among other similar items.

1.5.7. Article 7 of the Model Contract also states that the financier "shall receive promissory/commercial notes in return for the value of installments." This language appears to apply to a case in which the real property has not been registered, in which case the Model Contract is not technically a mortgage. To the extent the Model Contract is designed to be a true mortgage, then this language is contradictory to that purpose. The Model Contract should provide a clearer explanation of the timing, events, and any procedures related to this conversion into a mortgage upon completion of the registration process.

1.5.8. Article 9 regulates the registration of the unit by the seller in the name of the buyer. However, in order to complete this registration, the mortgage finance companies are requiring the seller to provide the financier (lender) with power of attorney in order to place the registration of the unit in the name of the investor (borrower). A provision to this effect should be included in Article 9.

1.5.9. Article 11 of the Model Contract provides for a pledge by the investor to submit a certificate attesting to his annual income; the Model Contract should clarify that this is to be submitted to the financier (as opposed to the seller, who is also a party to the contract). It is also unclear why this provision is included at the time of executing the Model Contract, because a submission of annual income would have necessarily been part of the loan application and underwriting process that would have preceded the Model Contract. (The representation might be justified as an additional update of this important information at the time of closing.) Presumably at the time of executing the Model Contract the financier has already been satisfied that the borrower-investor meets the income requirements and has adequately proved that fact.

1.5.10. Article 11 further partly specifies the nature of the tripartite assignment of the installment payments to be paid to the financier instead of the seller. The Article should clarify that the seller is releasing his rights to receive the installment payments from the investor in consideration for the lump sum balance paid by the financier and the mutual covenants contained in the Model Contract.

1.5.11. Article 11 further refers to the investor's obligation to obtain insurance in favor of the financier. The Model Contract should specify a date by which such insurance must be provided or else the financier is under no obligation to fund the loan. The insurance should, of course, be finalized no later than the date that the loan is funded and the investor becomes the owner of the real property. It is further unclear why Article 11 seems to require insurance of as little as "50%", and there is no specification of what "50%" references (Total value? Total price? Total loan balance?).

1.5.12. Article 11 further references insurance against fire and other hazards based on the "remaining portion of the full price." This may be an issue of language translation, but it is unclear what "the full price" refers to. Typically, insurance (for fire and other hazards) only covers the building(s) and not the land. The "full price" of the property (also as distinguished from the "value" as determined by the appraisers) includes land as well. Therefore, if Egyptian insurance does not cover the land (this will need to be verified), then the Model Contract seems to require an impossible condition.

1.5.13. The Model Contract should ensure that the financier is the "named insured" under any insurance contract procured in its favor.

1.5.14. Article 12 of the Model Contract refers to the investor's right to assign the contract. Assignment rights are discussed in detail above in this Memorandum under the discussion of Article 7 of the REFL and the Executive Regulations and should be referenced. The Model Contract, to the maximum extent possible, should require some form of underwriting process by the financier for the assignee and a process for review and approval or rejection as agreed by the parties. It is further suggested that a model application for assignment form should be developed.

1.5.15. Article 13 lists the financier's obligations. We suggest that language be added to obligate the financier to notify the investor if the financier will be assigning its rights according to Article 17 of the Mortgage Contract; note that such notification should not require the investor's consent to the assignment but merely serves as notice to the consumer.

1.5.16. Article 15 of the Model Contract provides the parties' rights in the event of foreclosure. Although the foreclosure system is addressed in a separate section of this Paper, one point in the Model Contract should be considered: in the event of "gross damage to the building's value as a result of the investor's or occupant's negligence…", the investor may be required to submit "an adequate guarantee to this effect". Clearly this is a significant item of security for the holder of the loan and, as written, the Model Contract is extremely vague about what would constitute "an adequate guarantee", who makes that determination, what is the time-frame within which the determination is made, what happens if there is a dispute over this, and what the parties do after the guarantee is submitted. Presumably too, if there is "gross damage to the building's value", the loan might need to be accelerated; insurance may or may not apply to provide for reconstruction. These are complex issues, each of which requires a detailed explanation of the parties' rights and obligations in the Model Agreement, and must be addressed. Of course, these issues should be addressed by local counsel in the context of any Civil Law provisions that may apply in lieu of the need for an agreement.

1.5.17. Article 17 of the Model Contract provides for the financier's right to sell the mortgage to a securitization firm and the investor gives the right to the financier to disclose an enumerated set of items to the securitizing firm. Language should be added to broaden the scope of these items to permit disclosure of any other information that may be relevant to the assignment and securitization of the loan. Further, this Article should be broadened to account for the fact that the loan may be sold to a party other than a "securitization firm", such as another bank, etc.

1.5.18. Article 18 of the Model Contract provides for notification by the parties of a change of address for correspondence. This provision should include a period of days within which such notice shall be given and the consequence of failing to do so (e.g., option to declare a default); the Article should also make clear that such notification is required to be sent to any successor entity to the financier (such as a securitization firm or a new loan servicing agent).

1.6. MODEL CONTRACT DOCUMENT ADDITIONS

A brief summary of several additional provisions and sections that should properly be included in the Model Contract Documents follows. The following is not intended to be exhaustive by any means and should be added to as needed. All such proposed provisions should first be considered by local counsel to advise on local requirements and practice.

1.6.1. Definitions: the Model Contract should contain a section that defines all operative terms (e.g., “investor”, “financier”, “registration”, “schedule”, “loan”, “repayment”, “acceleration”, “interest rate”, “property”, etc.);

1.6.2. Article 11, paragraph 3 of the contract covers payment. Date of the month upon which payments are to be made, as well as the manner, form, and place of payment should also be included;

1.6.3. Details and mode of disbursement of the lump sum payment to the seller;

1.6.4. That the loan is solely intended for the real property purchase (or construction, renovation etc.) and for no other purpose whatsoever.

1.6.5. Investor’s obligation to maintain the property in good order and condition and make any necessary additions or improvements; Investor’s obligation to avoid doing anything that might impair the financier’s security;

1.6.6. Investor’s obligation to maintain the insurance/pay premiums at all times, their failure to do so being an event of default; the financier may also obtain such insurance (provided that is possible in Egypt) if the investor fails to do so and charge the cost back to the investor;

1.6.7. Financier’s (and its successor’s) continuing right, on reasonable terms, to inspect the property as needed;

1.6.8. No change of property use permitted without financier’s consent;

1.6.9. General representations and warranties, such as that the investor is not the subject of any material litigation or liquidation, that he/she and the seller are not aware of any material defects in the property or its registration that have not been disclosed to the financier;

1.6.10. Financier's right to obtain updated proof of insurance upon reasonable request;

1.6.11. Indication of any additional charges that are added to the installment payments in the event of late payment (overdue charges/penalties) and any "grace period", and the fact that the financier's failure to enforce any such charge or default does not constitute a waiver of the financier's right to do so then or for any future event of default;

1.6.12. That if the financier is required to incur expenses (such as attorney's fees and other charges, etc.) as a result of an investor's default, these charges may be added to the loan balance;

1.6.13. Any escrow provisions that may apply;

1.6.14. Provisions for release of mortgage upon completion of investor's obligations.

CONSUMER DISCLOSURE

1.7. OVERVIEW

The development of consumer protection policies is one of the key issues that policy makers need to address in developing mortgage markets. A sound and modern borrower protection policy is a precondition for borrower confidence in the mortgage finance system. Borrowers must be enabled to make informed choices in complex transactions to satisfy their own interests. The aim of borrower protection legislation and disclosures is to ensure transparency of information and ease the comparison of varying products.

Notably, Article 3(A) of the Executive Regulations requires that the "finance procedures" should be presented "in a manner than guarantees the investor's full comprehension of his rights and obligations."[14] Article 3 also calls for the investor to sign a declaration stating that he or she has reviewed the documents.

The object of Egypt's disclosure requirements and documents should be to improve and standardize consumer information and assist prospective borrowers in choosing the mortgage loan best suited to their needs. This will occur through at least three mechanisms:

- Disclosure documents that assist the consumer in making an informed decision;
- A regulatory scheme that addresses unacceptable lending practices; and
- Improvements in consumer education and public awareness.

1.8. INFORMING THE CONSUMER

Information is a crucial issue in mortgage transactions because of their complexity, relative high cost, and long duration. It is inevitable that the lender will have better information about its own product than the borrower. At the same time, considering that most consumers will not be experienced in mortgage transactions, it is important to ensure that the consumer is not overwhelmed by transactional information. A volume of complete but confusing and complex information can be just as useless, from the consumer's point of view, than no information at all. The consumer must also have the opportunity to digest and consider the information. Therefore, it is important to make certain that an appropriate level of information needed to make an informed decision is provided in a manner and at a time when it may be most effective.

1.8.1. DISCLOSURE MODELS

A number of useful models for providing such information are found in Western lending requirements. The principles of each of the following regulatory schemes and disclosure forms should be considered for application in Egypt, as appropriately modified.

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[14] If this translation is accurate, a word such as "assures" might be better than "guarantees" as it would be impossible and unnecessary to "guarantee" that the investor understands every detail of the transaction. A provision to this effect can at least be included in the Contract Documents, if not the actual modification of the Executive Regulations.

The need for effective disclosure forms prior to, at the time of, and following the closing of the loan transaction is particularly acute in Egypt, where few consumers are familiar with mortgage finance. As in Western systems, truth-in-lending disclosure documents and related regulations must be developed and refined. Several suggested methods of providing consumer mortgage information that can be developed by EFS include:

- A standardized pamphlet provided at the initial contact with the consumer that describes the mortgage finance concept in plain, simple terms, the obligations of the parties, and the types of events that might result in foreclosure, as well as a candid description of the nature of the foreclosure remedy.

- As the closing draws near, the consumer should be provided with a regulated form statement that indicates a good faith estimated of the itemized costs of the transaction, including the charges the buyer is likely to pay at the time of settlement, and indicating the sources and applications of all funds.

- Also prior to closing, a disclosure statement that informs the buyer whether the lender will service the loan or transfer it to another lender or servicing company, as well as information advising the consumer of what steps may be taken to resolve complaints or answer questions.

- Post-closing, statements should be delivered to the consumer annually or more frequently that summarizes all payments made, the balance due, and any escrow deposits and payments made during the year. This statement may also indicate any shortages or surpluses in the account and advise the consumer of the action being taken.

- Post-closing, a statement should be delivered to the consumer in the event the loan servicer or lender sells or assigns the servicing rights to a consumer's loan to another loan servicer; this should occur prior to the transfer.

- Post-closing, consumers should timely be provided with clear notification of delinquency or interest rate changes (in the event an ARM product might be permitted) and the time and manner in which corrective action may be taken.

1.8.2. REGULATORY DISCLOSURE MECHANISMS

Executive Regulations should be expanded to require the utilization and periodic revision of the foregoing disclosure mechanisms, and should provide the MFA with authority to produce and revise standardized form disclosure documents from time to time as needed.

Regulations should further be produced to address the following:

- The means by which copies of all disclosure documents and consumer acknowledgements shall be maintained on record with the lender;

- Advertising requirements related to mortgage finance promotion;

- Disclosure of the calculation of the annual percentage rate, where applicable;

- Definition, prevention of, and enforcement means related to, predatory lending practices that take advantage of uninformed or distressed consumers; and,

- Definition, prevention of, and enforcement means related to, schemes by which fees, kickbacks, or anything of value is paid in exchange for referrals of closing services, required use of particular companies for loan-related needs, and similar unethical practices that might result in a bias that disfavors the consumer.

FORECLOSURE

In order to further the analysis and recommendations for improvement of the current mortgage foreclosure system in Egypt that will be understood and embraced by the judiciary, EFS is in the process of preparing materials for proposed Real Estate Foreclosure Workshops among distinguished judges.

The following provides an outline of the proposed Workshops:

1.9. PURPOSE

To assist the National Center of Judicial Studies (NCJS) at the Ministry of Justice (Ministry) with a workshop among judges hearing cases primarily involving two parties to a real estate finance contract, i.e., lenders and borrowers. The workshop will focus on foreclosure cases brought pursuant to the foreclosure provisions under the REFL and Executive Regulations.

1.9.1. GENERAL RESPONSIBILITIES

The Ministry is responsible for preparing judges for enforcement actions under the REFL and Executive Regulations. The most important enforcement action from a lender's standpoint is foreclosure. Under the law, foreclosures are expected to be less time consuming and less onerous for lenders as a result of recent improvements in the law. However, members of the judiciary would benefit from a workshop to prepare for foreclosure cases that are sure to come before the courts. EFS has offered to assist the NCJS and Ministry with such a workshop, which is proposed to last two days.

1.9.1.1. DELIVERABLES

1. An experienced officer of the court in the United States will draft written materials for a two-day workshop including:

- Recommended qualifications for an Egyptian Facilitator and an assistant (to take detailed notes of the workshop);
- Course outline of topics;
- Brief review of the law, practical aspects of the real estate finance contract (mortgage) and the interest of the parties;
- Brief review of the foreclosure provisions under the law and relevant provisions under the Civil Code;
- Specific provisions in the law that are not clear or may be problematic;
- Issues that may result in judicial confusion or delay;
- At least three case studies on mortgage foreclosure:
    - One case study may describe a non-controversial case to test understanding by the participants. The workshop facilitator is

    expected to guide participants through the steps leading to final resolution;
  - The remaining case studies should illustrate problems with the law. If needed, the facilitator should be prepared to help participants identify issues before possible solutions are considered.
- Wrap-up;
- Exam to test understanding of the participants (optional);
- Procedural checklist of documentation requirements, e.g., certified copy of mortgage contract; repayment history showing default signed by responsible official from lending institution; other documents recommended by judges.

2. Incorporate comments from the Ministry into final form.

1.9.1.2. OUTCOMES

1. Higher understanding and improved awareness of foreclosure provisions under the law;
2. Greater understanding of issues and problems the judges are likely to face and valuable feedback from learned judges;
3. Analysis of written notes from the workshop and evaluation before consideration is given to more workshops;
4. A consensus from the judiciary on how to resolve issues and problems likely to arise from foreclosure actions;
5. Deliver certificates.

UNIT RELEASE MECHANISM

The Task I Team has addressed the legal issue that arises when a prospective Egyptian purchaser (investor) seeks to buy an apartment unit that is secured by, and subject to, the “umbrella” financing arranged between the project developer and its own lender. There is currently no formalized, standardized, legal mechanism by which the newly purchased individual apartment unit may be released from the security given by the developer, and thus could potentially be forfeited in the event of a developer’s default.

The means by which this issue is resolved is the use of a partial release of lien agreement, also referred to as a “splitter” agreement, that is executed at the time of closing and releases the individual unit in exchange for the payoff proceeds. The unit is released, with the construction mortgage remaining in place on the balance of the property. A sample agreement is in Annex A and would need to be revised for the particular transaction.