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**PROJECT PERFORMANCE ASSESSMENT REPORT**

**ARAB REPUBLIC OF EGYPT**

**MORTGAGE FINANCE PROJECT  
(IBRD - 73960)**

**June 26, 2015**

**IEG Public Sector Evaluation**  
*Independent Evaluation Group*

## Currency Equivalents (annual averages)

*Currency Unit = Egyptian Pound (EGP)*

2006	US\$1.00	EGP 5.73
2007	US\$1.00	EGP 5.64
2008	US\$1.00	EGP 5.43
2009	US\$1.00	EGP 5.54
2010	US\$1.00	EGP 5.62
2011	US\$1.00	EGP 5.93

## Abbreviations and Acronyms

ARMs	Adjustable-Rate Mortgages
CAS	Country Assistant Strategy
CBE	Central Bank of Egypt
CBEMI	Central Bank of Egypt Mortgage Initiative
CODE	Committee on Development Effectiveness
EFSA	Egyptian Financial Supervisory Authority
EMRC	Egyptian Mortgage Refinancing Company
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GSF	Guarantee and Subsidy Fund
ICR	Implementation Completion Report
IEG	Independent Evaluation Group
IEGPS	IEG Public Sector Evaluation
IMF	International Monetary Fund
M&E	Monitoring and Evaluation
MLF	Mortgage Liquidity Facility
NPLs	Non-performing Loans
PAD	Project Appraisal Document
PML	Participating Mortgage Lender
PPAR	Project Performance Assessment Report
USAID	United States Agency for International Development
WBG	World Bank Group

## Fiscal Year

Government: July 1 – June 30

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# Contents

Principal Ratings.....	v
Key Staff Responsible.....	v
Preface.....	vii
Summary.....	ix
1. Background and Context.....	1
Macroeconomic Context.....	1
Project Context.....	2
2. Objectives, Design, and their Relevance.....	5
Relevance of Objectives.....	6
Relevance of Design.....	7
3. Key Factors Affecting Implementation and Results.....	9
The Quality of M&E System.....	11
4. Achievement of the Objectives.....	12
Efficacy of Sub-Objective 1: Increasing the volume of mortgage loans.....	15
Efficacy of Sub-Objective 2: Raising the tenor (term-to-maturity) of mortgage loans.....	16
Efficacy of Sub-Objective 3: Providing market-based refinancing loans.....	17
5. Risk to Development Outcome.....	18
6. Efficiency.....	19
7. Ratings.....	20
8. Lessons.....	22
References.....	25
Annex A. Basic Data Sheet.....	27
Annex B. Results Framework Analysis.....	29
Results Framework Analysis.....	29
Annex C. List of Persons Met.....	30
Annex D. Borrower Comments.....	31

## Boxes

Box 1.2. Cairo’s Satellite Cities -- An Expert Opinion.....	3
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This report was prepared by Mariano Cortes, Task Manager, and Chad Leechor, Consultant, who assessed the project in March, 2015. The report was peer reviewed by Charan Singh, and panel reviewed by Monika Huppi. Yezena Yimer provided administrative support.

## Tables

Table 4.1. Outputs: Annual Targets and Results .....	14
Table 4.2. Volume of Mortgage Loans <sup>1</sup> .....	15
Table 4.3. Lengthening of Term to Maturity of Mortgages (in Years).....	16
Table 7.1. Summary Ratings.....	22

## Figures

Figure 1.1. Unemployment and Inflation (2005 - 2014).....	2
Figure 4.1. EMRC Lending Rates and Funding Cost .....	17

## Principal Ratings

	ICR*	ICR Review*	PPAR
Outcome	Satisfactory	Satisfactory	Moderately Unsatisfactory
Risk to Development Outcome	Negligible to Low	Significant	High
Bank Performance	Satisfactory	Satisfactory	Moderately Unsatisfactory
Borrower Performance	Satisfactory	Satisfactory	Moderately Satisfactory

\* The Implementation Completion Report (ICR) is a self-evaluation by the responsible Bank department. The ICR Review is an intermediate IEGWB product that seeks to independently verify the findings of the ICR.

## Key Staff Responsible

Project	Task Manager/Leader	Division Chief/ Sector Director	Country Director
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**IEG Mission: Improving World Bank Group development results through excellence in evaluation.**
**About this Report**

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEG annually assesses 20-25 percent of the Bank's lending operations through field work. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEG staff examine project files and other documents, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, and interview Bank staff and other donor agency staff both at headquarters and in local offices as appropriate.

Each PPAR is subject to internal IEG peer review, Panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible Bank department. The PPAR is also sent to the borrower for review. IEG incorporates both Bank and borrower comments as appropriate, and the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

**About the IEG Rating System for Public Sector Evaluations**

IEG's use of multiple evaluation methods offers both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. IEG evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (additional information is available on the IEG website: <http://worldbank.org/ieg>).

**Outcome:** The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. The efficiency dimension generally is not applied to adjustment operations. *Possible ratings for Outcome:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

**Risk to Development Outcome:** The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for Risk to Development Outcome:* High, Significant, Moderate, Negligible to Low, Not Evaluable.

**Bank Performance:** The extent to which services provided by the Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes. The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for Bank Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

**Borrower Performance:** The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for Borrower Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

## **Preface**

The Egypt Mortgage Finance Project was approved on July 6, 2006, and became effective on May 8, 2007. The estimated project cost was US\$37.1 million and the actual cost was US\$39.1 million, with the differences arising from the fluctuations of the Egyptian pound – the currency in which the loan was denominated. The project was closed as scheduled on July 31, 2011.

The findings in this evaluation are based on a review of the project appraisal document (PAD), implementation completion and results report (ICR), IEG review of the ICR and other documents from the World Bank's operations portal. In addition, IEG carried out a mission to Egypt in March, 2015, to conduct interviews with government officials, prudential regulators of the financial sector, primary mortgage lenders (commercial banks and mortgage finance companies), the mortgage liquidity facility (Egypt Mortgage Refinancing Company), staff members of the World Bank Group based in Cairo, development partners and researchers.

IEG wishes to extend its thanks to the Government of Egypt, other external stakeholders and current and former staff members of the World Bank Group for their cooperation in this evaluation. IEG also wishes to acknowledge the efficient administrative and logistic support provided by the World Bank office in Cairo during a period of frantic activities prior to the high level 2015 Egypt Economic Development Conference in Sharm El Sheikh.

Following standard IEG procedures, a copy of the draft PPAR was sent to the relevant government officials and agencies for their review and feedback, and comments received from the Government have been included in Annex D.



## Summary

This PPAR reviews the **Egypt Mortgage Finance Project** (henceforth “this project”), approved by the Board on May 10, 2006, and closed on July 31, 2011. The project’s objective was to provide – through a newly created *mortgage liquidity facility* (MLF) – longer-term, market-based mortgage loan financing for residential housing for primary lenders in the financial market (both banks and non-bank lenders). This objective was based on the view that such financing was scarce at the time of appraisal, in part because primary lenders did not have access to term finance that was consistent with the mitigation of credit risks. The project set two yardsticks to measure its success: (a) the growth in longer term mortgages; and (b) the issuance of bonds on market terms by the mortgage liquidity facility to fund these mortgages.

**The relevance of the project’s objective** is rated substantial, but the relevance of design is modest. The goal of expanding mortgage markets was well aligned with government priorities in 2006, when the project was approved, and with those in 2011, when the project closed, despite two changes of government in the intervening period. The objective was also consistent with the assistance strategies of the World Bank Group through the duration of the project. The design of the project shows well-articulated outcomes and a results framework with reasonable causal chains linking project activities to results. The project’s main instrument was the MLF which was to be developed, introduced and underpinned by a supportive regulatory framework and an initial funding mechanism. However, the MLF would function effectively only when adequate pre-conditions were met, including a stable macro-economic framework, liquid bond markets and active institutional investors, such as pension funds and insurance companies capable of absorbing long-term fixed income instruments. The project team failed to ensure that the choice of this instrument was appropriate for the prevailing conditions. This flaw diminished the validity of the design.

**The overall outcome** is rated moderately unsatisfactory. The project failed to achieve its objectives. So far, the mortgage liquidity facility (which was incorporated as the Egyptian Mortgage Refinancing Company or EMRC) has not started performing its most important role. Since its moratoriums in late 2008, the EMRC has not served as a centralized issuer of corporate bonds to mobilize long-term funding from domestic capital markets. The EMRC has so far operated on the basis of the funds provided by this project (and shareholders’ subscriptions), which were intended only to be used as bridge finance to get it started.

It is true that mortgage markets expanded since the project was implemented and the tenor (term-to-maturity of mortgage loans) also became longer. The contribution of the project to these outcomes is questionable. Most of the growth in mortgage lending (a key objective) took place before the project began its disbursement (towards the end of 2008). The size of the markets today remains very small at less than one half of one percent of GDP. Furthermore, available evidence shows that the EMRC lagged behind the markets, instead of leading them, in extending the tenor of mortgages.

This outcome has as much to do with the circumstances under which the project was implemented as it does with flaws in project design and implementation. It is clear that

since the commencement of its lending operations in late 2008, the EMRC has not experienced—perhaps until recently--the normal market conditions that prevailed when it was being established. Shocks associated with the escalation in food prices, the fallout from the global financial crisis and later political and social turmoil drastically undermined economic and financial performance. But at the same time, significant design flaws inter-alia the absence of institutional investor base and weaknesses in the macroeconomic framework casted more than a shadow of doubt over the prospect for success of the project even if those adverse developments had not materialized. In addition, since mortgages involved large commitments and were subject to stringent debt service ratios, prospective homebuyers were also hard pressed to get approval for a loan. Thus, recent years have been an inactive period for mortgage origination and housing finance more broadly.

**The risk to development outcomes** is now rated high. In addition to the turmoil in financial markets as mentioned above, the government has also introduced a massive program (known as the Central Bank of Egypt Mortgage Initiative or CBEMI) of subsidized mortgage funds that threatens to make the EMRC irrelevant. For one thing, the CBEMI is endowed with a pool of LE 20 billion from the Central Bank, which makes it approximately four times the size of total mortgages outstanding and 100 times the size of the EMRC. Further, it is impossible for EMRC to compete on pricing. The directive from the Central Bank is for primary mortgage lenders to on-lend this fund to homebuyers at 7% - 8% interest rate with 20 years maturity. The EMRC's funds are estimated to cost 11% if raised on market terms. Thus, EMRC's funds would need to be on-lent by primary lenders at 12%-13%. In addition, the target group of borrowers under the CBEMI is low and middle-income households, which accounts for 97% of EMRC's refinancing. The CBEMI has invalidated the *raison d'être* for EMRC – the scarcity of term funding for primary mortgage lenders.

**Bank performance** is rated moderately unsatisfactory. The quality at entry had strong aspects but also serious flaws. Among the former, the project had relevant objectives and a clear results framework. However, the likelihood of success was undermined by the use of an instrument (a mortgage liquidity facility) for which supporting conditions were not in place. The administrative arrangements were guided by proper consultations with government agencies, external partners and within the World Bank Group. The monitoring and evaluation system was well designed and implemented as planned, although more attention could have been paid to tracking market benchmarks to ensure that the EMRC operations were on market terms. The quality of supervision was for the most part adequate, but there were shortcomings including what proved to be a costly delay in disbursement and a mid-term review that focus on changing targets rather than adjusting the direction or mission of the EMRC in light of unfavorable developments. In addition, no Board approval was sought for the revised outputs and outcome targets.

**Borrower performance is rated moderately satisfactory.** The Government consistently showed strong ownership of the objectives. Even the CBEMI, which may destroy the EMRC, was done in pursuit of the same goal, but the instrument has changed. Unlike the EMRC which in principle operates on a market basis, the CBEMI provides liberal subsidies for selected homebuyers. The EMRC, which also served as

implementing agency, is a well-managed and competent professional organization that has been caught in a difficult position.

**Among the lessons that emerge from this PPAR are:**

- Housing finance is an integral part of the overall housing markets. Satisfactory outcomes of housing finance initiatives, such as supply response, wider access to housing or improved affordability, depend on many elements of housing policies other than finance, including property rights and registration records, provision of infrastructure, the availability and ownership of land, regulations of land use and the building industry, rent control and housing subsidies. This project shows that constraints in other parts of the housing markets can severely impede effort to develop housing finance. For example, undocumented housing units which represent the majority of the housing stock do not qualify for mortgages, thus significantly restricting the market for mortgages. High vacancy rates in formal housing units and extensive rent control deter new investment in housing construction or renovations, further limiting the supply of mortgage-able (mortgage-worthy) homes.
- Housing finance is not the exclusive domain of formal financial institutions. In designing projects, it is important to have a good understanding of the various formal and informal market players that affect and would be affected by the intervention. In Egypt, formal financial institutions account for a small share of the market. Self-finance plays a large role and so do informal lenders extending personal loans to home buyers. Critically, builders and developers offer extended payment plans, including installment plans of five to eight years, and provide more housing loans to homebuyers than banks and mortgage finance companies combined, accounting for more than two-thirds of the market.
- Developers are usually well positioned to assess and manage the credit risk of home buyers and borrowers but their financing activities raise some concerns. The marketing and construction of housing units allow developers to get to know and often work closely with homebuyers. Developers typically keep the title of a property for the first five years of the installment plans, thereby limiting the risks associated with foreclosure. However, unlike banks and finance companies, developers are not subject official oversight or established prudential rules. Homebuyers interviewed by IEG cited cases where developers failed to deliver the contracted homes and absconded with the funds collected from homebuyers. In a reversal of typical risk-bearing roles, until developers release property titles to buyers, *the borrowers* (homebuyers) face a credit risk while *the lenders* (developers) face little or none of it.
- Many countries have shown interest in following Egypt's example and adopting the mortgage liquidity facility funding model. But this model is not always appropriate. Among the circumstances to consider are:
  - a. Readiness of bond markets. If functioning bond markets are not in place, the mortgage liquidity facility would not be able to perform its most critical role of being central issuer of bonds.
  - b. Local inflation. Even if the bond markets are functional, high and persistent inflation may render the mortgage liquidity facility impotent. As in Egypt's

case, the EMRC has not been able to raise funds at competitive rates. Banks can mobilize deposits at much lower rates.

- c. The presence of non-bank mortgage finance companies. Without access to cheap sources of funds in the form of bank deposits, non-bank financial firms are more likely to draw on the services of the mortgage liquidity facility.
- d. Size of the mortgage market. To compete with banks, the mortgage liquidity facility needs a large scale of operations and frequent visits to the bond markets to reduce the cost of operations. If the size of the mortgage markets is too small, as is the case in Egypt, the mortgage liquidity facility will not be competitive.
- e. The viability of adjustable rate mortgage. If mortgages are predominantly of fixed rates, the case for adopting a mortgage liquidity facility is stronger. Lending large sums on extended terms is not suited for short-term funding like bank deposits. However, where adjustable rate mortgages are viable, supported by laws and consumer acceptance, the case for mortgage liquidity facility is weaker. Banks can rely on short-term deposits to fund ARM without incurring undue interest rate risk albeit maturity risks require continued management.

Caroline Heider  
Director-General  
Evaluation

# 1. Background and Context

## MACROECONOMIC CONTEXT

1.1 This evaluation was conducted in the spring of 2015, four years after the project was closed (July, 2011) and ten years after it was appraised (June, 2005). This was also the most tumultuous period in Egypt's modern history. At the project's inception, the country was experiencing an economic revival following a period of political stability. The benign environment was soon shaken by the global financial crisis of 2008 and then shattered by civic strife of 2011 which came to be known as the "Revolution" in Egypt. The social and political turbulence continued for three more years until a new President was elected in May 2014. Today, Egypt once again appears poised to enter a period of economic recovery.

1.2 At the time of appraisal in 2005, the government was pursuing macro-economic and structural reforms amid large and persistent budgetary imbalances. <sup>1</sup>Efforts were made to coordinate fiscal, monetary and exchange rate policies, including an introduction of inflation targeting and a managed float of the Egyptian currency. Structural reforms at the time aimed at promoting the investment climate and expanding the private sector's role. Several public enterprises, including commercial banks and parcels of public land, were privatized. Import tariffs were reduced and tax administration overhauled to improve efficiency. GDP responded with rising growth. From 2005 to 2007, unemployment fell from 11% to 9%; public debt contracted from over 100% to 75% while inflation dropped from 18% to 6%.

1.3 This solid economic performance did not last, however. A wave of major shocks soon arrived. First, food prices escalated between 2007 and 2008, creating hardship and discontent among a large segment of Egyptians. Then came the global financial crisis of 2008, which cut foreign direct investment and remittances deeply. The economy faltered while social tensions intensified. It did not take long for the mass riots of 2010 in Tunisia and Algeria to hit Egypt. By February 2011, President Mubarak was overthrown.

1.4 Years of social upheavals took a heavy toll on the economy. Tourism and investor confidence plummeted. Tax revenue and foreign exchange earnings dropped sharply while the public expenditures remained high -- both to counter the economic downturn and to appease social unrest. As a result, persistent economic problems became more acute. Of particular importance to financial intermediaries is the public sector's borrowing requirements which have exceeded 10% of GDP each year since 2011. Net aggregate public debt is now above 90% of GDP. Inflation has hovered around 10% in recent years while unemployment has been exceptionally high at around 13%. (See Figure 1.1 below.)

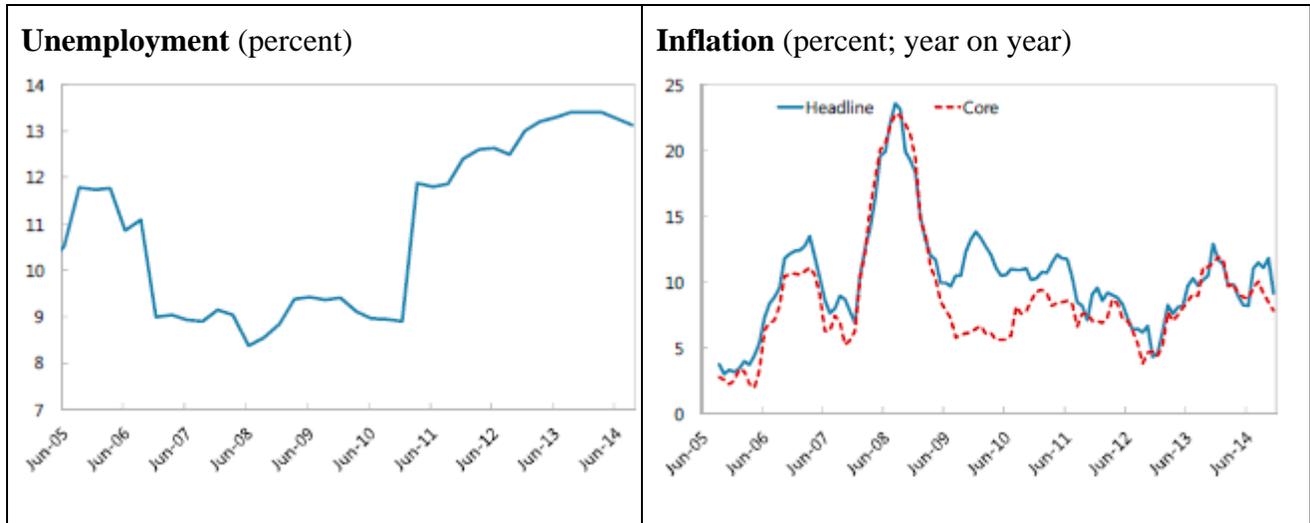
1.5 Signs of normalization began to return in the second half of 2014. The government has started to address long-standing economic issues, with a focus on structural reforms designed to raise investment and create jobs. To rebuild investor's confidence, the

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<sup>1</sup> Public sector deficits had been around 10 percent of GDP for a few years prior to appraisal and were being increasingly financed from domestic sources.

Government held a major international conference on Egypt's economic development in March, 2015.

**Figure 1.1. Unemployment and Inflation (2005 - 2014)**



Source: Central Bank of Egypt and IMF.

## PROJECT CONTEXT

**1.6 Housing Sector.** Like much of the developing world, Egypt has struggled to provide affordable housing to its people, especially low and middle income households. But Egypt's challenge is made more formidable by space constraints, exacerbated by rapid growth of urban population. All of the population centers, including Cairo, are located on a thin sliver of land (about 4% of the country's land area) stretched along the Nile River and Delta, which also serves as Egypt's prime agricultural resource base.<sup>2</sup>

**1.7** This zone of Egypt's arable land is extremely scarce (about 0.036 hectare person) and valuable. The conflict is intense between two fundamental needs: To build more homes or to produce more food. Successive governments have attempted to manage this tension by formally regulating the use of agricultural land for housing construction—but in practice compliance and enforcement has been weak—and by implementing mega-projects to develop new satellite cities in the deserts surrounding major cities, including Cairo.

**1.8** Nonetheless, large-scale urban encroachment on agricultural land has continued and in fact accelerated since the Revolution in 2011. Meanwhile, the new satellite towns, which are far from job centers and unaffordable to most of the low-income urban residents, have been plagued by high rates of vacancy (Box 1.1).<sup>3</sup>

<sup>2</sup> USAID, 2015.

<sup>3</sup> As of 2008, over 60 percent of the housing units in the eight primary satellite cities of the desert were vacant. (Sims D., 2011 (a).

### **Box 1.1. Cairo's Satellite Cities -- An Expert Opinion**

The new towns around Cairo, towards which successive governments have allocated large amount of resources, need to be reconsidered. These satellite towns mainly benefit the rich and upper classes. From an urban and housing development perspective, they are inefficient and represent unsustainable efforts that have attracted only a tiny fraction of their target populations. After over 30 years of development, the populations of all these new towns has reached about 800,000 inhabitants, representing a small fraction of the 11 million people who live in Cairo's huge informal or 'ashwa'i' areas. These informal areas are absorbing over three-fourths of the city's additional population, and it is these areas which are in desperate need of improved infrastructure, streets and open spaces, schools, and a whole range of basic services.

The large majority of Cairo's inhabitants cannot be part of those new developments and alternative solutions would need to be devised. There are still some well-located desert parcels that remain undeveloped, and moreover there is additional land that could be taken back and redeveloped from failed business ventures. Such land could be used for affordable housing, especially auto-constructed by people themselves, as is most of Cairo, for workshop clusters and enterprise zones, and for a range of urban projects which would benefit Cairo's youthful majority. A great opportunity exists to develop these tracts through planned and transparent land allocations.

*Source:* Excerpts from: Sims, D., 2011 (b).

1.9 Apart from space limitations, the housing markets are also constrained by a variety of administrative and policy issues. For one thing, the system of property registration is difficult and costly to use, despite considerable efforts on the part of the government and development partners, including the USAID and the World Bank, to streamline and upgrade it. In addition, rent control remains applicable to an estimated 42 percent of the properties in Great Cairo, depriving unit owners of the incentive to maintain and upgrade them. In sum, a large share of the housing stock, estimated to be in the range of 50 to 70 percent, lacks adequate documentation or is subject to rent control. Thus, despite wide-spread shortages, an estimated 3.7 million housing units in Greater Cairo are vacant or unusable.

1.10 The vast majority of low-income people find dwellings in the informal housing sector, which accounts for two-thirds of housing units in Cairo.<sup>4</sup> The settlements are primarily located in the outskirts of the traditional core of the city, including areas designated for agriculture or owned by the state. These informal housing units have tenuous legal status, are subject to eviction by the Ministry of Housing, do not have construction permits and lack proper sanitation or adequate roads. Without official property documentation, the residents of informal areas are unable to use their homes as collateral for credit and have little incentive to invest in upkeep and upgrades.<sup>5</sup> No banks or mortgage finance companies would be willing to grant them a mortgage.

1.11 With urban population projected to grow by nearly a million people a year until 2020, housing is and will remain a key political issue in Egypt. Each of the recent government tried to meet their needs by launching larger or better housing mega-projects. In 2008, under the Mubarak regime, the vision of "Cairo 2050" was promoted as a series of mega-projects to

<sup>4</sup> Sims, D, 2011(a).

<sup>5</sup> See Field, Erika (2005).

eradicate the existing informal settlements and create new ultra-modern cities in the desert. But it floundered under controversies and was discarded after the change of government. In 2014, President el-Sisi announced a \$40 billion initiative to build by 2020 a million new housing units in new planned communities across the country.

1.12 **Housing Finance.** As this project was appraised, housing finance was scarce. Most housing units were constructed on the basis of self-finance or financed by developers through installment contracts, which typically involved term finance of about five years. The markets for housing loans were small and faced restrictive regulations. Banks were limited in their exposure in property loans and often lacked the necessary skills to appraise the specialized credit risk. Two non-bank mortgage finance companies were established around the time of appraisal, in part with the assistance of the IFC, but they lacked sources of term finance to scale up their operations.

1.13 Over the years, the government implemented a series of significant reforms, with the support of the World Bank Group (WBG), to create a more enabling environment for financial markets including housing finance. Starting in 2001, a real estate finance law was enacted to give legal foundations for mortgages, collateral and foreclosure enforcement. Additional measures included recognition of adjustable rate mortgages and more liberal support for low-income borrowers, including setting up a Guarantee and Subsidy Fund (GSF) to provide a temporary social safety for borrowers who experience adverse life events such as a loss of employment that lead to payment defaults. Capital market laws were amended to facilitate new financial instruments, including mortgage bonds and securitization. A private credit bureau and a specialized economic court were also established. In 2010, the Egyptian Financial Supervisory Authority (EFSA) was set up to supervise all non-bank financial institutions. A key step undertaken with the support of the WBG was the establishment of a “mortgage liquidity facility” (incorporated as the Egyptian Mortgage Refinancing Company or EMRC), designed to provide term finance for primary mortgage lenders and to mobilize matching term finance from the capital markets through the issuance of market-based medium and long-term bonds.

1.14 In the past few years, housing finance grew significantly albeit it remains small. The market for mortgages rose from LE 300 mil in 2006 to LE 5,232 mil in 2013. Commercial banks became active lenders in the primary markets, as well as sources of funds for other primary mortgage lenders. The number of mortgage finance companies went from 2 to 12 over the same period. Nonetheless, the overall mortgage values outstanding were less than one half of 1 percent of GDP in 2015. Installment contracts offered by developers remain the principal form of housing finance.

1.15 **Financial Sector.** At the time of appraisal, the broader financial system showed many untapped potentials. Among the key features were an extensive government ownership of financial institutions, weak supervision of banks and creditor rights. The banking sector (with 95 percent of financial system’s assets) was dominated by 4 state-owned commercial banks. The insurance industry, pension funds and capital markets were negligible in size and were not contributing to the development of the private fixed-income segment of the market. The ubiquitous presence of the state in finance resulted in limited competition, poor credit

allocation and a large stock of non-performing loans (NPLs), estimated at about 16 percent of total loans.

1.16 One notable feature was the financial depth, as measured by the M2 to GDP ratio, which reflected mature banking habits and a confidence of depositors based on what is widely regarded as an implicit deposit insurance. Although no deposit insurance fund has been officially established, Egyptians generally believe that the government stands ready to honor the obligations of state-owned banks and large private banks. The M2/GDP ratio rose considerably, from 76% in 2000 to 97% in 2005, amid improving macroeconomic environment. The following years, however, saw a sharp reversal, as the M2/GDP ratio declined progressively to 74% in 2012, below the level prevailing 12 years earlier. Even at its low point, the resources mobilized by the banking system were very substantial relative to the size of housing finance, which was well below 5% of GDP.

1.17 **Bond Markets.** Only the government and a few large companies (Telecom Egypt and Orascom, for example) had issued medium-term bonds (of 5-10 years) to the public at the time of appraisal (2005). A total of 11 corporate bond issues were listed on the Egyptian Exchange in 2006, with a combined value of about LE 6 billion. To promote bond markets, the government has made interest income derived from corporate bonds tax free. Income from government securities, however, is taxable.

1.18 As of April, 2014, the corporate bond market was less than one percent of GDP – a small fraction of treasury securities which amounted to 49% of GDP<sup>6</sup>. Most recent corporate issues have been in the form of securitizations, with auto and real estate loans receivables as underlying cash flows. Only five companies currently have outstanding bonds listed on the Egyptian Exchange: Mobinil (telecommunications), GB Auto (automobile manufacturing), Incolase (financial services), EzzSteel (steel industry) and Golden Pyramids (tourism). Trading in secondary markets has not been active, as most bonds are held to maturity. The panics caused by global financial crises and the Arab Spring depressed trading further and drained liquidity from the markets. The total value of bonds traded on the Egyptian Exchange fell from a high of LE 530 billion in 2008 to a low of LE 185 billion in 2012.

## 2. Objectives, Design, and their Relevance

2.1 According to the loan agreement, **the project's development objective** is to provide longer-term, market-based mortgage loan financing for residential housing for primary lenders in the financial market (both banks and non-bank lenders.)<sup>7</sup> The project appraisal document (PAD) further explains that “such financing is scarce at present, in part because primary lenders do not have reliable access to sources of term finance on favorable terms that could help them to mitigate the associated business and lending risks.”

2.2 **The beneficiaries** targeted by the project are clearly spelled out:

- Egyptian households who need to improve the affordability of housing;

<sup>6</sup> Based on data from the Cairo Stock Exchange.

<sup>7</sup> The statement of project objectives in the Loan Agreement and the PAD are the same.

- Investors who purchase the securities that will help to fund the mortgage markets.

2.3 In addition, the project anticipated that the construction industry and related services would benefit from the growth and employment that result from this project.

2.4 The focus of the project was on contributing to building a housing finance market. As such, the project did not incorporate any social or poverty reduction goals. The PAD made it clear that “sound housing finance practice dictates that subsidies should be kept separate from market finance and not allowed to distort financial market incentives.”<sup>8</sup>

2.5 **Criteria for success.** According to PAD, “the project will be deemed successful if:

- (i) The project’s base case projections for growth in mortgage lending by primary lenders and for the lengthening of the term structure of mortgages are realized;
- (ii) The EMRC, as an important component of the financial sector necessary for the mortgage market to continue on a growth path following the completion of the project, achieves financial sustainability on a market basis.”

(From Para 24, page 6, of the PAD.)

## RELEVANCE OF OBJECTIVES

2.6 The relevance of objectives is assessed here with respect to:

- a) Country conditions;
- b) Current (at the time of project closing) World Bank and government strategies; and
- c) The framing of objectives and its ambitiousness.

2.7 **Country conditions:** The objectives of the project were appropriate to the needs of the country. Housing shortages and rising prices were long-standing problems in Egypt. In addition, the lack of appropriate financing instruments made it more difficult to find a solution. A mortgage liquidity facility envisioned in the project to support mortgages could enhance housing affordability and help address a major social and political issue.

2.8 **Government strategies:** The objectives of the project were well aligned with the priorities of the government as communicated through policy dialogues with the WBG prior to the time of appraisal. These priorities were substantiated by a broad range of actions. First, a new mortgage law compatible with international standards was enacted in 2001. Second, a new Ministry of Investment was created to inter-alia spearhead the development of mortgage markets, along with a new Mortgage Finance Authority to regulate the new markets. Third, supportive measures were introduced to encourage the formation of non-bank mortgage finance companies. At the time of project closure, the government was introducing a new housing initiative called “**Cairo 2050**”, which aimed to expand housing supply on a massive scale, along with additional support for mortgage lending to finance the purchase of new housing units.

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<sup>8</sup> Para 25, page 6, of the PAD. 2013 Fact Book, European Covered Bonds Council, URL: <http://ecbc.hypo.org/Content/default.asp?PageID=517>

2.9 **World Bank strategies:** The objectives are consistent with the Bank Group strategy at the time of appraisal (CAS 2005) and at the time of closure (CAS Progress Report 2008). The Country Assistance Strategy of May 20, 2005, identified three strategic objectives of facilitating private sector development, enhancing service provision and promoting equity. WBG interventions in the mortgage market were considered an instrument for advancing both the goals of private sector development and promoting equity. Private sector was expected to benefit from a more competitive financial market that is responsive to its requirements. In addition, longer-term finance through mortgages would also improve the affordability of housing and thus promote social equity. The CAS Progress Report of July, 2008, which remained effective at the time of project closure in July, 2011, upheld the strategic objectives of the 2005 CAS and expanded the program of supporting activities. Thus at closure, the objectives of the project remained equally consistent with WBG strategies.

2.10 **Framing of objectives and ambitiousness:** By seeking to help put in a place a mortgage liquidity funding institution, an important cog in an effective housing finance system, the project sought to help advance the development of housing finance in Egypt beyond housing developers' tied funding. Furthermore, EMRC funding would be open to both banks and non-bank intermediaries thus fostering competition in mortgage supply origination, be of longer tenure thus increasing affordability, and, critically, made available at market terms to help prevent resource misallocation and buttress the longer-term financial viability of EMRC.

2.11 **On balance, the relevance of objective is rated substantial.**

#### **RELEVANCE OF DESIGN**

2.12 The relevance of design is assessed with respect to two elements: (a) the relevance of project activities to the objectives; and (b) the quality of the results framework including the identification of exogenous factors with a bearing on such a framework.

2.13 The project objectives and the activities supported are clearly articulated in the project documents, including the Loan Agreement between the WB and the borrower, the Subsidiary Agreement between the borrower and the EMRC. As succinctly stated in the PAD, *“the Egyptian Mortgage Refinancing Company (EMRC), legally incorporated as a joint stock company during project preparation with the assistance of the World Bank, will receive the proceeds of a World Bank local currency loan as a line of credit. The line of credit will support the initial, start-up phase of the EMRC's operations as a second-tier, wholesale, market-based liquidity facility focused on refinancing longer-term residential mortgage loans originated by lenders in the primary market. As it matures, the EMRC is expected to begin issuing bonds or other securities in the capital market to help fund its operations on a market sustainable basis.”* (From PAD, page vi).

2.14 **The results framework** is straight forward. The causal chains linking project funds to EMRC activities and the final results (lending of primary mortgage lenders) are clearly established. In addition, the role of EMRC as an aggregator of funding needs or a centralized issuer of bonds (after a brief initial start-up period) to help overcome bond issuance cost

barriers faced by individual primary mortgage lenders is fully spelled out. Thus, the results framework sets out the project’s anticipated operations and outcomes during the life of the project and beyond.

2.15 The project design builds upon the experience of similar and successful operations, including those of Malaysia, Jordan and West Bank and Gaza. The task team considered a variety of alternatives to the project as designed, including development policy loans, adaptable program loans and housing projects. None were found to be as well aligned with government priorities and strategies of the WBG. The project was also designed to encourage competition and growth in the mortgage markets. One of the intermediate outcomes envisaged was an increase in the number of primary residential lenders in the market. The mortgage liquidity facility (EMRC) was meant to provide open access to all primary residential lenders, including banks and non-bank entities. In a business model known as a “club”, each lender was expected to become a shareholder of the EMRC by buying its shares in the open market. In addition, the WBG through the IFC stood ready to provide technical assistance and equity investment to new market entrants.

2.16 The market-based transactions, however, were not fully specified under the project. Although the EMRC was expected to refinance mortgage loans on a competitive basis, the project did not define a modality for lending (say, through competitive auctions) or a market benchmark for setting interest rates. Instead, the EMRC was expected to review the risk of mortgages to be refinanced and to set the interest rates on a cost plus basis. In turn, no mechanisms were put in place to ensure that the line of credit extended by the Government to EMRC would reflect the prevailing market based financing cost. The PAD referred to the yield curve of the Government as a risk-free benchmark for EMRC’s funding cost, but it was intended to be used for pricing EMRC’s bonds, rather than to set the interest rates on the line of credit extended by the government.

2.17 Underlying the aforementioned results framework were a few critical assumptions whose validity should have been carefully fleshed out at appraisal. To be sure, the project correctly identified some but not all of the key exogenous factors impinging on the results chain articulated in the PAD. The following are among the later: (i) the lack of a buoyant and growing domestic institutional investors base—e.g., pension funds, life insurance companies—that would buy and hold the longer-term mortgage based securities to be issued by EMRC (or lend to EMRC on a collateralized basis, e.g., covered mortgage bonds) to “match” liability maturity and provide a stable source of funding;<sup>9</sup> <sup>10</sup>(ii) an underdeveloped private bond market (see ¶1.18) that would likely not be capable of supporting a cost-effective credit rating, bond underwriting, and servicing infrastructures that would underpin

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<sup>9</sup> See for example Chapter 3 in World Bank, 2012 (a) for a discussion on the role of institutional investors in the development of bond markets in the larger emerging market countries in LAC.

<sup>10</sup> World Bank, 2008. The FSAP Update conducted in 2007 reconfirmed the findings from the initial FSAP of 2002 regarding the lack of a meaningful institutional investor base operating under a risk-based oversight framework. That had hindered the development of fixed income markets, raised doubts about the efficiency of price discovery and the future sound-growth of the market. Moreover, there were also serious shortcomings with the regulation and oversight of occupational pension funds in operation at the time. A US\$500 million Financial Sector Development DPL that closed in June 2007 had included support for reforms that would develop a contractual savings system including the introduction of funded pillar.

EMRC's bond issuance program; (iii) and weaknesses in the macroeconomic framework--chronic fiscal imbalance crowding out private sector financing, and high and volatile inflation increasing long term funding risk.<sup>11</sup> It was not clear also that a sufficiently homogenous pool of mortgages underwritten under sound origination standards was being generated by the various primary mortgage lenders (banks and mortgage companies) that could be refinanced with EMRC and subsequently securitized to take to markets, for example.

2.18 It was also important to have a better understanding of the role in housing finance being played by developers. Somehow they were able to provide medium-term funding for housing purchases and in fact they were a major source (and remain so to this day). It would had been important to ascertain from where their funding was coming from—was entirely self-financed relying solely on their own funds or were they tapping private sources and/or financial intermediaries? In some sense, the EMRC was going to enter into competition in the financing of mortgages (albeit if successful improving housing affordability) with those developers in their role of financiers.

2.19 Thus, despite clear objectives and a reasonable results framework, the design suffered from a serious flaw: it did not ascertain that adequate conditions were in place or would credible be put in place to enable the mortgage liquidity facility to work effectively. Without a stable macroeconomic framework and deep and liquid bond markets supported by active institutional investors, the MLF could—and should not—had been expected to issue bonds at competitive prices (or equivalently at low interest rates). The dearth of institutional investors capable of holding long-term illiquid instruments would result in anemic demand for EMRC instruments and elevated bond yields. High and volatile inflation would drive interest rates higher, while underdeveloped markets would translate into high bond issuance costs relative to proceeds. These factors diminished the likelihood that the EMRC would become an effective source of low-cost mortgage refinancing.

2.20 On balance, the relevance of design is rated **modest**.

### 3. Key Factors Affecting Implementation and Results

3.1 This section outlines significant and unanticipated events that may have affected the implementation and outcomes of the project. The key factors that adversely affected implementation during the life of the project are linked to a range of external and domestic real, financial, and political shocks that generated a quite difficult environment for project implementation. These shocks and its adverse effects lingered for a few years after project closure casting doubts on the longer-term impact of the project.

3.2 The project enjoyed a few years (2006-2007) of benign economic environment, but it was soon engulfed by powerful economic and political turbulence. First came a sharp escalation in food prices helping drive inflation above 20% by mid-2008 and fueling social

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<sup>11</sup> The FSAP Update of 2007 also identified important shortcomings with the public debt management that had contributed to an unreliable yield curve. A reliable "risk-free" curve is a key building block to price private securities, and hence to the development of a market-based funding structure for the EMRC.

tensions. This was followed quickly by a global financial crisis in 2008, depressing foreign investment and tourism, and triggering equity and government bonds portfolio outflows as foreign investors left the country. The banking system proved resilient notwithstanding the loss of some funding. Finally social unrest led to a fall of the Mubarak administration in 2011, and unsettled political conditions for a few years thereafter. Not until the elections of May, 2014, did a semblance of normalcy return to the country.

3.3 Years of economic and social turmoil took a toll on the economy, as well as on the outcome of this project. Rising inflation coupled with years of heavy borrowing by the government to finance exceptionally large and growing budget deficits squeezed private sector funding.<sup>12</sup> Interest rates rose sharply (with short-term government securities carrying a yield of 14%-16% between 2012 and 2014), making it extremely difficult to raise term finance in capital markets at yields that could support sound mortgage funding. Economic growth staggered and unemployment rose.

#### ***Collaboration with development partners***

3.4 This project sought – and benefited from – extensive collaboration between the WB and IFC as well as close cooperation with the USAID.

1. The creation of the mortgage liquidity facility – the EMRC, gave both the WB and the IFC distinctive and complementary roles to play. The WB offered the technical expertise and the seed money through a loan guaranteed by the Government. The IFC made equity investment and became a member of the governing body (board of directors) of EMRC. As director, the IFC provided strategic advice on corporate governance and international experience. One of the IFC representatives also served as a member of the board at the Cagamas Malaysia, one of the earliest example of mortgage liquidity facility and widely considered the best in its category. The transfer of know-how and experience was much appreciated.
2. In addition, the IFC also supported the objective of fostering a more competitive mortgage market by investing in one of the new mortgage finance companies. With the help of the IFC, this mortgage finance company became one of the most successful in the business. It was recently acquired by a major international bank in a transaction that gave the IFC an opportunity to exit its equity position with remunerative returns.

#### ***Partnership with other donors***

3.5 The project team worked closely with the USAID and benefited from the collaboration. The USAID was implementing a closely related project, Egypt Financial Services (EFS), launched in November 2004. The EFS comprised a five-year program of technical advisory services and institutional capacity building to help strengthen the regulatory framework for the mortgage market, the property registration system, and dispute

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<sup>12</sup> Between 2008/09 and 2011/12, net credit to government rose from 25 percent of GDP to around 40 percent (and continued to climb thereafter) while credit to the private sector contracted from about 37 percent of GDP to about 27 percent (and continued to decline thereafter). See IMF, 2015.

resolution and enforcement of mortgage collateral. IEG has learned that, as of March 2015, progress has been made in most areas, but work on the property registration system made little headway and has been abandoned.

### ***Project Approval and Financing***

3.6 The project was approved on July 6, 2006, and became effective on May 8, 2007, almost a year later. A mid-term review was carried out on April 7, 2010. The project was closed as scheduled on July 31, 2011. The project had only one component for which the planned disbursement was \$37.10 million. Actual disbursement was \$39.06 million. The difference was due to an appreciation of the Egyptian pound -- the currency in which the loan was denominated -- during the life of the project. The Borrower was expected to contribute \$29.1 million, the sub-borrowers \$38.5 million and other local sources \$104.7 million. At closing, the borrower's contribution in the form of equity stake in EMRC was \$12.42 million and the sub-borrowers' was \$28.02 million, based on the exchange rate prevailing on closing date.

### **The Quality of M&E System**

3.7 **M&E Design.** The objectives are clear and the indicators are well selected. All of the indicators are measurable and reflect the size and tenor (maturity) of the mortgage loans well, but they do not reflect the extent to which the financing is market based. Data collection methods are well understood by the implementing agencies. In fact, most of the indicators for the M&E system are embedded within the EMRC's operations. The requisite baseline data was available and collected.

3.8 **M&E Implementation.** The M&E system as designed was fully implemented by the EMRC. Most of the output and intermediate outcome indicators were generated and tracked by the EMRC. The outcome indicators were obtained from the Central Bank of Egypt with respect to banks' mortgage lending and from the Egyptian Financial Supervisory Authorities with respect to aggregate data on mortgage finance companies.

3.9 **M&E Utilization.** For the most part, the data collected was well utilized. Both the Board of Directors of the EMRC and the task team of the WBG reviewed the output and outcome indicators during regular Board meetings and supervision missions. In addition, a mid-term review was conducted in July, 2010, in which a decision was made to revise the targets for two intermediate outcome indicators. (These revisions, however, were not formally approved by the authorizing authorities and therefore the original targets are used to assess performance in this PPAR.)

3.10 **The quality of M&E system is rated substantial.**

### ***Safeguards Compliance***

3.11 This project was rated as Category C and therefore did not trigger any of the Bank's safeguards policies.

### *Fiduciary Compliance*

3.12 The project's financial management (FM) was consistently found to be satisfactory. All of the interim financial reports and audited reports were received as scheduled. All of the auditor's reports were unqualified.

## **4. Achievement of the Objectives**

4.1 **The project development objective (PDO)** is “for primary lenders in the financial market (both banks and non-bank lenders) to provide longer-term, market-based mortgage loan financing for residential housing. The project’s main target group are the participating mortgage lenders (PMLs) in the primary financial market.” (PAD, ¶21, p. 6). This objective will be subdivided into three elements as follows:

- Sub-Objective 1: Increasing the volume of mortgage loans extended by PMLs;
- Sub-Objective 2: Raising the tenor of mortgages (thus creating longer-term finance);
- Sub-Objective 3: Supporting mortgages through market-based EMRC operations.

4.2 The project appraisal document also envisaged that “the EMRC will be a centralized bond issuer facilitating the development of the Egyptian bond market through frequent issuance of standardized, high quality debt. It was thus to provide PMLs with a cost-effective way to access the capital markets. The EMRC would lower the fixed transactions cost of bond issuance and achieve greater liquidity in its securities than individual issuers<sup>13</sup>.”

4.3 In addition, the following test was suggested in the PAD (¶24) for the achievement of the objective:

“The project will be deemed successful provided:

- (i) The project’s base case projections for growth in mortgage lending by primary lenders and for the lengthening of the term structure of mortgage lending are realized by the Closing Date of the project; and
- (ii) The ECMR, as an important component of the financial sector necessary for the mortgage market to continue on a growth path following the completion of the project, achieves financial sustainability on a market basis.”

4.4 The PAD’s first criterion to judge whether the project was successful is a restatement of outcome indicators. The second rightly focused on the achievement of medium-term financial sustainability by EMRC when its operations (borrowing/lending) are conducted on market terms. Such sustainability was considered necessary to ensure that this entity would continue to play a supporting role in the development of the housing finance market. Notably, EMRC was expected under the project to be issuing bonds in its second year of operation (Table 4.1 below) and every year thereafter through project closure.

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<sup>13</sup> PAD, Ch. 6, page 32.

4.5 This section reviews the outputs delivered by the project, its outcomes, and the extent to which the outcomes are attributable to the contributions of the project. As noted above (Paragraph 3.9), while the targets for outcome indicators were changed due to unfavorable political and economic developments, there are no indications of approval of the revised targets by the relevant authorizing World Bank authority and therefore IEG is required to evaluate performance against the original targets.

***Outputs:***

4.6 The main output envisaged was to establish a mortgage liquidity facility (EMRC), for PMLs that would be both commercially sustainable and market-based. (PAD, Annex 3, p. 24). The mortgage liquidity facility would perform the functions of lending to PMLs and mobilizing funds from the capital markets. The two outputs to be delivered by EMRC were:

- Annual targets of EMRC refinancing loans to PMLs; and
- Issuance of bonds by EMRC to fund the mortgage liquidity facility.

4.7 Actual outputs delivered by EMRC were:

- **Refinancing loans to primary lenders.** With the initial delays in project effectiveness, the EMRC did not provide any refinancing to PMLs in the year 2007. In the following four years -- from 2008 to 2011, EMRC provided refinancing each year, but did not meet any of the stipulated annual targets. In 2011 when the project closed, EMRC's outstanding refinancing loans were less than half of the target envisaged. (Table 4.1 below.) As of year-end 2013, two years after the project closed (a lapse of time that "accommodates" the initial project delays), this output remained 50% below the target value for the fifth year of EMRC operations.
- **Issuance of bonds by EMRC.** Starting from the second year, the project envisaged the sale of bonds by EMRC to mobilize funds for its operations. This output did not materialize. No bond operations were launched during the life of the project. Nor were they initiated as of the spring of 2015, when this review was conducted. As discussed in Section 1 of this review, major external events intervened, including the global financial crisis which unfolded in the second year of the project (2008) and the Arab Spring which ultimately led to the downfall of two governments (in 2011 and 2013). The economic and social turmoil created unfavorable market conditions for EMRC operations. However even if those adverse developments had not taken place, it was not clear that conditions to support EMRC's bond issuances were in place. No meaningful institutional investor base capable of absorbing EMRC's bond issuance was in place nor was it clear that banks would have been in a position to carry those instruments. While banks had ample liquidity, much of it was allocated to T-Bills (they held 95% of outstanding stock), their funding was short-term and carrying longer-dated securities would have increased maturity mismatch risk. Moreover, the public sector had substantial and rising roll-over requirements (around 20 percent of

GDP in YR3/YR4 of the project) and would have been competing with EMRC in issue placements.<sup>14</sup>

**Table 4.1. Outputs: Annual Targets and Results**

		<i>Target Values</i>									
		<b>YR1 2007</b>		<b>YR2 2008</b>		<b>YR3 2009</b>		<b>YR4 2010</b>		<b>YR5 2011</b>	
Output Indicators	Baseline 2006	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Volume of E refinancing loans to PMLs (LE million)	N1	125	NIL	300	131	600	176	800	289	1200	450
EMCRC launches bond operations (Y/N)	N1	N	N	Y	N	Y	N	Y	N	Y	N

*Source:* Project Appraisal Document and EMRC.

**4.8 Thus, less than half of one output and none of the other output were delivered. Overall, significant shortcomings are observed in the project's delivery of outputs.**

***Outcomes:***

4.9 During the life of the project, significant growth occurred in the primary mortgage markets, with both the number of lenders and the volume of housing finance expanding at high rates. Among the outcomes observed are:

- Policy and regulatory reforms including mortgage laws, building code and streamlining property registration;
- Capacity building in public agencies, including the central bank, the housing sector and social welfare, which set the stage for future housing and financial programs;
- A large increase in the outstanding stock of mortgage loans – from LE 300 million in 2006 to LE 4,706 in 2011;
- A significant extension of the term-to-maturity of mortgage loans – from an average of 7 years in 2006 to 16 years in 2011;
- An expansion in the number of mortgage finance companies – from 2 companies in 2006 to 12 companies in 2011;
- A significant increase in mortgage lending by banks – from a negligible amount in 2006 to LE 2,594 million and more than half of the mortgage outstanding in 2011;
- More competitive mortgage markets, with more lenders – both banks and mortgage finance companies -- participating in the markets.

<sup>14</sup> See IMF 2010.

## Efficacy of Sub-Objective 1: Increasing the volume of mortgage loans

4.10 As Table 4.2 below shows, **the volume of mortgage extended by PMLs grew significantly**, exceeding the targets set for all of the years during the life of the project. The moderate pace of growth registered in the later years of the project continued in 2012 and 2013, with the outstanding stock of mortgages reaching LE5,000 million at end-2013.

**Table 4.2. Volume of Mortgage Loans<sup>1</sup>**

Indicator	Baseline Value (2006)	Original Target Values (from approval documents)					Formally Revised Target Values	Actual Value Achieved at Completion or Target years				
		07	08	09	10	11		07	08	09	10	11
Growth in volume of mortgage loans extended by primary lenders annually (LE Million)	300	400	600	1,500	2,400	4,000	NA	2,054	3,229	3,900	3,700	4,500

*Source:* Project Appraisal Document and the EMRC.  
1/Outstanding stock at end-of-period.

4.11 The contributions made by the project to these outcomes, however, were questionable. Consider the following:

- a) The project delivered less than two fifths of the target for mortgage loans refinancing and, furthermore with a significant lag vis-à-vis market developments ;
- b) In 2007 and 2008, the project was bogged down in delays and contract amendments. Disbursement did not start until the end of 2008. The mortgage markets, however, grew exponentially—rising from LE 300 million to LE 3,229 million, a ten-fold increase in two years (some 70% of the total growth over the life of the project)<sup>15</sup>. Clearly, the project had nothing to do with this expansion;
- c) In the final three years of the project – from 2009 to 2011, EMRC operations were in full swing, expanding its loan portfolio by more than three folds from LE 131 million to LE 450 million. (See Table 4.1 above.) By then, the growth in the mortgage markets, had decelerated sharply. Market conditions were depressed due to the ongoing economic and social turmoil. In any case by 2011 the mortgages refinanced by EMRC were only 10% of the stock outstanding;
- d) Overall, the mortgage markets were more buoyant and grew faster than anticipated during the project’s life. The EMRC, however, was unable to meet its projected lending targets, providing less than two fifths of the refinancing loans it was expected to deliver. (See Table 4.1 above.) While EMRC may have encouraged some lenders to lend more, its contribution appears to be small.

<sup>15</sup> Banks were the main drivers of this early growth.

4.12 The growth of EMRC lending contributed little to the expansion of the broader mortgage markets. The efficacy of this Sub-Objective is rated **modest**.

4.13 This assessment is corroborated by the findings from IEG’s field work, including interviews with PMLs. Representatives of the industry (both banks and mortgage finance companies) pointed out that they have access to multiple (more than ten) sources of term finance other than EMRC. EMRC funding was welcomed by the lenders, but it was neither necessary nor sufficient. They also found that the competing sources of term finance were more responsive to their needs and provided more streamlined services.

### **Efficacy of Sub-Objective 2: Raising the tenor (term-to-maturity) of mortgage loans**

4.14 The term-to-maturity of mortgages rose significantly from 2006 to 2011. From a relatively short tenor of about 7 years in 2006, the average maturity of mortgages rose to 16 years by 2011 when the project closed, as shown in Table 4.3 below.

**Table 4.3. Lengthening of Term to Maturity of Mortgages (in Years)**

	Baseline	2007	2008	2009	2010	2011
Target (average maturity of outstanding mortgages)	7	8	10	12	14	17
Result (average maturity of outstanding mortgages)		9	11	14	16	16
Average maturity of EMRC loans		N.A.	9	10	13	14

*Sources:* ICR, data provided by EMRC and IEG staff calculations.

4.15 There is, however, no compelling evidence to show that the project contributed significantly to the increase. For one thing as noted above, the role of EMRC in the overall mortgage market was modest, with a market share of less than 10% at its peak. It was unlikely to have had a decisive impact on the average tenor of the market as a whole. Furthermore, the market average increased during the life of the project (2007-11), but the average maturity of EMRC loans lagged behind, as shown in Table 4.3 above.<sup>16</sup> The market average consistently exceeded EMRC’s average. Thus, available data shows that the tenor of EMRC’s loans has followed not led that of the market.

4.16 The WBG, however, may have played an indirect role in extending the tenor of mortgages. The Bank, in partnership with the USAID, helped persuade the Central Bank of Egypt to accept the use of adjustable-rate mortgages (ARMs), which facilitate the sharing of interest rate risks between lender and borrower. This new interpretation of the mortgage law took effect after the project became effective. Thereafter, PMLs were able to extend the tenor of their loans without taking on excessive interest rate risk. This indirect contribution,

<sup>16</sup> Notwithstanding that the average maturity of EMRC funding lagged the market, some of its operations had a longer initial maturity reaching up to 17 years in recent years.

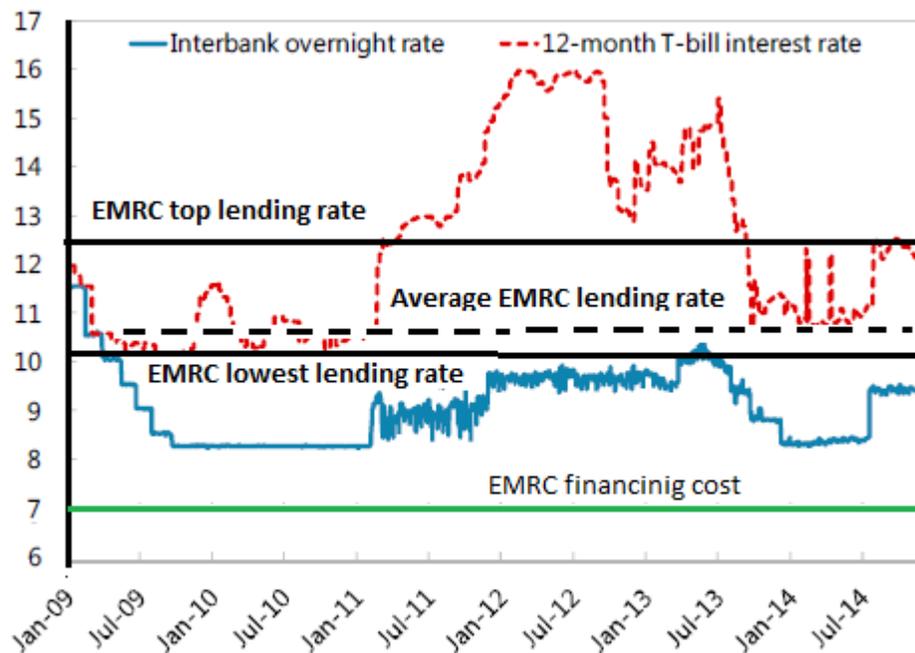
however, should not to be attributed to the project. The project appraisal document (PAD) disavows any responsibility for effecting financial sector reforms. Instead, it refers to the role of other WBG operations, including a concurrent and much larger financial sector development policy loan (of \$500 million), and other development partners, including the USAID, in addressing policy issues. (See Page 43, item a, page 11 of the PAD.)

4.17 Thus, the efficacy of this Sub-Objective is rated **modest**.

### **Efficacy of Sub-Objective 3: Providing market-based refinancing loans**

4.18 Although the EMRC is a competent professional organization with good corporate governance, it has not operated on a competitive or market basis, at least so far. Figure 4.1 below shows the lending rates of the EMRC and its funding cost. The Figure also shows market benchmarks based on short-term interest rates of the risk-free T-bills. Assets with higher risks and longer tenor (like EMRC's refinancing loans) would be expected to carry higher rates than these benchmarks.

**Figure 4.1. EMRC Lending Rates and Funding Cost**



Sources: Central Bank of Egypt and IMF.

4.19 **EMRC's lending operations.** The lending rates are set by EMRC on the basis of its cost of fund adjusted for the assessment of credit risk and counter-party risk. However, since it has been funded at below market rates (at 7% on its line of credit from the government

based on the loan from the World Bank)<sup>17</sup>, its lending rates have also been largely below market.<sup>18</sup>

4.20 From inception, its lending rates have been in the range of 10.3% and 12.5%, as shown in Figure 4.1 above, with an average lending rate of 10.8%. Before 2011, its lending rates were closer to the low end (10.3%) which approximated the benchmark short-term risk free rate and was thus below appropriate market rates for longer term mortgage refinancing loans. After 2011, the EMRC lending rates were well below “risk free” short-term benchmarks and far below appropriate market rates.<sup>19</sup>

4.21 **EMRC’s funding operations.** According to the goal envisioned in the PAD, the EMRC would play a crucial catalytic role in the development of the corporate bond market by issuing longer term fixed income instruments at market determined rates. However, EMRC has not mobilized any funding from the bond markets so far. Its sources of funds have been: (i) a line of credit from the government based on the Mortgage Finance Project of the World Bank (LE 214 million), with the interest rate set at 7%; and (ii) capital subscriptions by shareholders, including the Central Bank of Egypt, banks and mortgage finance companies.

4.22 Contrary to design, the EMRC has not operated on a market basis. The lending rates are below market while the funding is from internal and not market sources. The efficacy of this Sub-Objective is rated modest.

## 5. Risk to Development Outcome

5.1 The single most important event that would determine the long-term impact and financial sustainability of this project took place more than two years after the project closed.

### *The CBE Mortgage Initiative*

5.2 In February, 2014, the Central Bank of Egypt (CBE) launched a stimulus package for the housing sector introducing a massive mortgage fund, totaling LE 20 billion, to refinance banks’ lending to low and middle-income homebuyers at substantially below-market rates. The size of this stimulus was about four times that of outstanding mortgages. The objective was to promote the construction of housing for low- and middle-income groups -- households with incomes from LE 1,000 per month. The low-income component of the package was to provide mortgage loans at 7% interest rates with a 20 year term (and 8% for middle-income households). At the time the measure was announced, the 12-month T-bill rate was about 11%, while market rates for mortgage loans were around 14%. These CBE funds were to be

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<sup>17</sup> The interest rate has been estimated on the basis of EMRC financial statements. In its comments on an earlier draft of this report, the EMRC states that the interest rate on this line of credit is 9.5%.

<sup>18</sup> This analysis does not factor in the opportunity cost of capital that the shareholders of EMRC are facing which is likely above the sovereign’s.

<sup>19</sup> The “risk-free” qualifier refers to the prudential treatment of banks’ exposure to the government which does not incur a bank-capital charge. Credit ratings agencies rated the sovereign’s debt obligations below investment grade.

made available through banks (but not mortgage finance companies), with additional upfront subsidies for qualifying low-income households.

5.3 This initiative is likely to have major implications for EMRC. For one thing, EMRC is not in a position to compete (through its offers of refinancing loans) at competitive rates. Since banks are expected to lend at 7-8% rates, their (effective) cost of funds from the CBE would be expected to be below those rates, although the CBE has not to date set specific rates. To the extent that it relies on the line of credit established under this project, EMRC's refinancing rate would at a minimum be 9% and thus substantially higher than the CBE's refinancing rate. (Since inception, EMRC's lending rates have been in the range of 10.3% to 12.5%, averaging 10.8 %.) Tapping capital markets for funding under current market conditions would most likely result in even higher rates, if at all available.

5.4 Thus the market for low and middle income households, which account for 98% of EMRC's operations, is likely to be "captured" by CBE-supported mortgages. EMRC would need to develop new markets by offering to refinance mortgages made to upper-income families. The demand for EMRC funds in these markets is uncertain at this point since banks and developers have abundant resources to lend at unrestricted market rates. The EMRC Board of Directors considers the challenge of generating new business to be the most pressing issue it is facing today.

5.5 Finally, as access to the CBE facility is limited to banks, non-bank primary mortgages lenders are being put at a competitive disadvantage thus likely diminish market competition while raising doubts about their financial viability.

## 6. Efficiency

6.1 The PAD presents an economic and financial analysis that shows a plausible scenario in which the EMRC becomes commercially viable by the time of project closing. It does not, however, demonstrate that the project would offer positive net present value in economic or financial terms. No standard cost-benefit analysis is presented in either the PAD or ICR.

6.2 Nonetheless, available evidence suggests that project resources were used efficiently in the implementation of the project. Among the indications are:

- No long delays in implementation were experienced, other than those associated with initial changes in the legal agreements, which held up disbursement by about one year. Nonetheless, disbursement was completed before the scheduled closing date;
- The rate of staff turnover was low, with key members of the team remaining with the project from inception through closure;
- No malfeasance or misuse of funds was reported;
- No increases in project cost were encountered, other than the unanticipated appreciation of the Egyptian pound;
- Although important outputs, including the issuance of EMRC bonds, were not delivered as planned, the project was implemented and closed as schedule.

6.3 The project efficiency of resource use is rated **substantial**.

## 7. Ratings

7.1 The overall outcome is rated moderately **unsatisfactory**. Although the objectives of the project were relevant, the design was not, and thereby diminished the likelihood of success. While the efficiency in the use of project resources was substantial, the project ultimately did not achieve the goal envisaged.

7.2 The most important shortfall in efficacy is that—more than seven years after it started operations—the mortgage liquidity facility (incorporated as the Egyptian Mortgage Refinancing Company or EMRC) has not performed its key function of serving as a centralized issuer of corporate bonds to mobilize long-term funding from domestic capital markets. The EMRC has so far operated on the basis of the funds provided by this project (and shareholders' subscriptions), which were intended only to be used as bridge finance to get it started. It is true that the mortgage markets expanded as expected and the tenor (term-to-maturity of mortgage loans) also rose considerably. The contributions of the project to these outcomes, however, are modest. For one thing, most of the growth in mortgage lending took place before the project began its disbursement. For another, the size of EMRC operations was too small to exert a major influence on the average tenor of the market or the lending volume.

7.3 This outcome has as much to do with the circumstances discussed in section 3, (Paragraph 3.1-3.3) as it does with flaws in project design and implementation discussed in section 2, (Paragraph 2.17-2.19). It is clear that since the commencement of its lending operations in late 2008, the EMRC has not experienced—perhaps until recently—the normal market conditions that prevailed when it was being established. But at the same time, significant design flaws casted more than a shadow of doubt over the prospect for success of the project even if those adverse developments had not materialized. In addition, since mortgages involved large commitments and were subject to stringent debt service ratios, prospective homebuyers were also hard pressed to get approval for a loan. Thus, recent years have been an inactive period for mortgage origination and housing finance more broadly.

7.4 **The risk to development outcomes is now rated high.** In addition to the depressed financial market as discussed above, the government has also introduced a massive program (known as the Central Bank of Egypt Mortgage Initiative or CBEMI) of subsidized mortgage funds that threatens to make the EMRC irrelevant or drive it out of business (see Section 6). For one thing, the CBEMI is endowed with LE 20 billion of funding from the central bank, which makes it approximately 100 times the size of the EMRC. For another, the pricing under the CBEMI makes it extraordinarily challenging for EMRC to compete particularly when it starts to rely on capital markets for funding. The directive from the central bank is for PMLs to on-lend CBEMI's funds to homebuyers at 7% - 8% interest rate with 20 years maturity. The EMRC's funds are estimated to cost 11% if raised on market terms. Thus, EMRC's funds would need to be on-lent by primary lenders at 12%-13% at a minimum. It could be argued that CBEMI has completely invalidated the *raison d'être* for EMRC—the scarcity of term funding for PMLs.

**7.5 Bank performance is rated moderately unsatisfactory.** Quality at entry had strong aspects but also serious flaws. Among the former, the project had relevant objectives and clear results framework based on international experience. However, the likelihood of achieving project objectives was undermined by design flaws which involved the use of an instrument (a mortgage liquidity facility) for which supporting conditions were not and were unlikely to be in place in a timely manner. The PAD is also virtually silent as to how it was possible for housing developers to be able to play a significant role in the financing of housing purchases--albeit at shorter than typically desirable tenures. Developing an understanding of their funding mobilization inter-alia would have shed light on the extent of competition they represented for EMRC regarding housing finance. The administrative arrangements were guided by proper consultations with government agencies, external partners and within the World Bank Group. The monitoring and evaluation system was well designed and implemented as planned, although more attention could have been paid to the tracking of market benchmarks to ensure that the EMRC operations were on market terms. On balance, quality at entry is rated moderately unsatisfactory.

**7.6** Project supervision benefited from the presence of key staff, including the task team leader, in the field office. The close and frequent consultations between Bank staff and implementing agencies allowed for rapid resolutions of technical issues, including taxation of interest income. As a result, the project was able to complete its disbursement earlier than projected. However, the quality of supervision also suffered from a few shortcomings. First, the delay more than one year in resolving issues of legal agreement turned out to be costly, as the beginning of disbursement coincided with the onset of the global financial crisis. Second, the mid-term review aimed too low, focusing on changing the targets, rather than adjusting the direction or objectives of the EMRC under quite unfavorable developments. In addition, no approval was sought from the relevant authorizing authority for the revised outputs and outcome targets. The quality of supervision is rated moderately satisfactory.

**7.7 Borrower performance is rated moderately satisfactory.** The Government consistently showed strong ownership of this project's objectives. Even the CBEMI, which may destroy the EMRC, was done in pursuit of the same goal, but the strategy has changed. Unlike the EMRC which in principle is to be operated on a market basis, the CBEMI provides liberal subsidies for selected homebuyers. The performance of the Government is rated moderately satisfactory. The implementing agency, the EMRC, is a well-managed and competent professional organization that has been caught between rocks and hard places. It has not, however, operated on a market basis as envisaged in the objectives. The performance of the implementing agency is rated moderately satisfactory.

**Table 7.1. Summary Ratings**

<i>Ratings</i>	<i>ICR</i>	<i>IEG Review</i>	<i>PPAR*</i>
Outcome	Satisfactory	Satisfactory	Moderately Unsatisfactory
Risk to development objectives	Negligible	Significant	High
Bank performance	Satisfactory	Satisfactory	Moderately Unsatisfactory
Borrower performance	Satisfactory	Satisfactory	Moderately Satisfactory

## 8. Lessons

8.1 **Housing finance is not an island.** This project is a stark reminder that housing finance is embedded in the broader financial markets, economy, and political situation of a country. The social upheavals since the global financial crises of 2008 battered the financial system. With rising inflation and falling investor confidence, financial depth (M2/GDP ratio) fell sharply, as did capital markets activities. Housing finance which seemed poised in 2005 for a major spurt in growth and innovations was put on hold. However, a recovery may have begun in 2015.

8.2 **Housing markets shape housing finance.** Housing finance is also an integral part of the overall housing markets. Satisfactory outcomes of housing finance initiatives, such as responsiveness, wider access or improved affordability, depend on many elements of housing-market policies other than finance, including property rights and registration records, provision of infrastructure, the availability and ownership of land, regulations of land use and the building industry, rent control and housing subsidies. This project shows that constraints in the housing markets can severely impede effort to broaden and revitalize housing finance:

- a. First, a large proportion of housing units, including more than half of those in greater Cairo, is located in informal settlements, without proper registration and documentation. Resolving these legal uncertainties has been shown to spur owners to undertake upgrade investments efforts that could be supported with properly designed housing finance instruments increasing the overall demand for housing finance. However with unclear legal status, these housing units are not eligible for credit from regulated financial institutions and therefore lessened the need to refinance their mortgage portfolios' with EMRC.
- b. Second, a large percentage of new housing units (in government-sponsored satellite cities mostly located in deserts surrounding major urban centers) is left unoccupied. Although these properties are by and large legal and properly documented, the demand is limited due to the distance from jobs and employment opportunities. Housing finance may help enhance affordability, but it cannot overcome more fundamental issues of the housing system.

- c. Third, millions of formal and fully documented residential units, including 42% of those in Cairo, are subject to rent control. Property owners hope to see a better day but are now unable to sell or recover the investment cost. Other than those occupied by owners, most of the units are left vacant or in disrepair.
- d. Thus, the volume of home purchases and investment in the sector (e.g., for rental property) is determined by housing policy and broader social objectives of the Government. For the time being, these various constraints have significantly restricted the scope of housing finance. Today, the mortgage markets are less than half of one percent of GDP.

**8.3 Housing finance is not the exclusive domain of formal financial institutions.** In designing the project, it is important to have a good understanding of the various formal and informal market players that affect and would be affected by the intervention. In Egypt, formal financial institutions account for a small share of the market. Self-finance plays a large role and so do informal lenders extending personal loans to home buyers. Critically, builders and developers offer extended payment plans, including installment plans of five to eight years, and provide more housing loans to homebuyers than banks and mortgage finance companies combined, accounting for more than two-thirds of the market.<sup>20</sup>

**8.4 Developers are usually well positioned to manage credit risk.**

Builders/developers, especially those operating on a large scale, may possess significant competitive advantages in providing housing loans but they also raise concerns. The case of Egypt provides an illustration. First, developers are well positioned to assess the credit risk of buyers/borrowers. The marketing and construction of housing units allow developers to get to know and often work closely with homebuyers. Second, developers typically keep the title of a property for the first five years of the installment plan and thereafter transfer the title but retain the property as collateral. The risk of foreclosure and litigation faced by developers is much lower than that of banks or finance companies. With the skills and experience that they have accumulated, many of the developers in Egypt have also set up formal mortgage finance affiliates. However, unlike banks and finance companies, developers are not subject to official oversight or established prudential rules. Homebuyers interviewed by IEG cited cases where developers failed to deliver the contracted homes and absconded with the funds collected from homebuyers. In a reversal of typical risk-bearing roles, until developers release property titles to the buyers, *the borrowers* of the home loans (homebuyers) face a credit risk, while *the lenders* of the home loans (developers) face little or none of it.

**8.5 A checklist for reviewing a mortgage liquidity facility.** Many countries have shown interest in following Egypt's example and adopting the mortgage liquidity facility. But this model is not always appropriate. Among the circumstances to consider are:

- a. **Readiness of bond markets.** A mortgage liquidity facility that seeks to fund itself through capital markets needs liquid and active bond markets, with reliable benchmark instruments to establish a yield curve with 15 to 20-year maturities. If

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<sup>20</sup> According to estimates of a mortgage market participant. No data is available for the size of the overall housing finance market.

such markets are not in place, the mortgage liquidity facility would not be able to perform its most critical role of being central issuer of bonds at competitive rates.

- b. **Local inflation.** Even if the bond markets are functional, high and persistent inflation may render the mortgage liquidity facility impotent. As in Egypt's case, the EMRC has not been able to raise funds at competitive rates. Banks can mobilize deposits at much lower rates.
- c. **The presence of non-bank mortgage finance companies.** Without access to cheap sources of funds in the form of bank deposits, non-bank financial firms are more likely to draw on the services of the mortgage liquidity facility.
- d. **Size of the mortgage market.** To compete with banks, the mortgage liquidity facility needs a large scale of operations and frequent appearance in the bond markets to reduce the cost of operations. (The issuance cost of bonds – in percentage terms – is high when the volume is small.) If the size of the mortgage markets is miniscule, as it is in Egypt, the mortgage liquidity facility will not be competitive.
- e. **The viability of adjustable rate mortgage.** If mortgages are predominantly of fixed rates, the case for adopting a mortgage liquidity facility is stronger. Lending large sums on extended terms is not suited for short-term funding like bank deposits. The appeal of a mortgage liquidity facility is its ability to raise term funds on fixed rate at low cost. However, where adjustable rate mortgages are viable, supported by laws and consumer acceptance, the case for a mortgage liquidity facility is much weaker. Banks can rely on short-term deposits to fund ARM without incurring undue interest rate risk. (The liquidity risk remains, however, and needs to be mitigated.)

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## Annex A. Basic Data Sheet

### ARAB REPUBLIC OF EGYPT: MORTGAGE FINANCE PROJECT (LOAN IBRD - 73960)

#### Key Project Data (amounts in US\$ million)

	Appraisal estimate	Actual or current estimate	Actual as % of appraisal estimate
Total project costs	36.73	38.69	105.33
Loan amount	37.10	39.05	105.25

#### Cumulative Estimated and Actual Disbursements

	<i>FY07</i>	<i>FY08</i>	<i>FY09</i>	<i>FY10</i>	<i>FY11</i>
Appraisal estimate (US\$M)	1.70	13.80	26.00	34.70	37.10
Actual (US\$M)	0.94	0.94	26.51	31.49	39.05
Actual as % of appraisal	55.29	6.81	101.96	91.93	105.25
Date of final disbursement: January 24, 2011					

#### Project Dates

	Original	Actual
Initiating memorandum	12/20/2004	02/10/2005
Negotiations	05/02/2005	05/09/2006
Board approval	08/15/2005	07/06/2006
Signing	11/12/2006	11/12/2006
Effectiveness	05/08/2007	05/08/2007
Closing date	07/31/2011	07/31/2011

**Staff Inputs (staff weeks)**

<b>Stage of Project Cycle</b>	<b>Staff Time and Cost (Bank Budget Only)</b>	
<b>Lending</b>	<b>No. of staff weeks</b>	<b>US\$ Thousands (including travel and consultants costs)</b>
FY05	14.91	127.87
FY06	37.12	281.15
<b>Total:</b>	<b>52.03</b>	<b>409.02</b>
<b>Supervision/ICR</b>		
FY07	16.10	107.73
FY08	12.04	90.29
FY09	15.05	88.85
FY10	6.03	64.38
FY11	19.40	132.48
FY12	5.38	21.02
<b>Total:</b>	<b>74.00</b>	<b>504.75</b>

## **Annex B. Results Framework Analysis**

### **Results Framework Analysis**

#### **Project Development Objectives**

The project's development objective is for primary lenders in the financial market (both banks and non-bank lenders) to provide longer-term, market-based mortgage loan financing for residential housing. Such financing is scarce, in part because primary lenders do not have reliable access to sources of term finance on favorable terms that could help them mitigate the associated business and lending risks. The Egyptian Mortgage Refinance Company (EMRC), the liquidity facility, will provide such a source

#### **Revised Project Development Objectives (as approved by original approving authority)**

##### **(a) PDO Indicator(s)**

## **Annex C. List of Persons Met**

### **IFC**

Nada Shousha, Manager

### **Central Bank of Egypt**

Tamer M. El Batesh, Head of Portfolio Management

May Abulnaga, Consultant, Regulations Department head

### **USAID**

William M. Patterson, Director

Rasha Abdel-Hakim, Senior Economist & Program Manager

Alexander J. Albertine, Economist

### **Egyptian Mortgage Refinance Company (EMRC)**

Lobna Helal, Chairman & Managing Director

Ola Bidair, Senior General Manager

Ahmed F. Hafez, Chief Financial Officer

### **The Egyptian Housing Finance Company**

Hala Bassiouni, Former CEO

### **TAMWEEL (Mortgage Finance Company)**

Dr. Ahmed Zahran, Managing Director

Hamed Salama, Head of Internal Audit

### **Egyptian Financial Supervisory Authority**

Sherif S. Samy, Chairman

### **The Ministry of Housing**

May Abdel Hamid

### **ERRADA**

Hisham Ragab

### **World Bank, Cairo Office**

Sahar Naser, Program Leader

### **American University in Cairo**

David Sims, Housing Specialist and author of “Understanding Cairo” and “Desert Dream”

## Annex D. Borrower Comments



Ministry of Planning and International Cooperation  
Sector for International Organizations  
International, Regional & Arab  
Financing Institutions  
Dear Sundberg,

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<b>WORLD BANK OFFICE CAIRO</b>
Date Received : 06/24/15
Action By : .....
Copy To : .....

June, 10th 2015

Reference to your letter dated May 29, 2015 concerning Mortgage Finance Project (IBRD-73960) Draft Project Performance Assessment Report.

And upon the results obtained that were included in the Implementation Completion Report (ICR) prepared jointly by the World Bank (WB) and the Egyptian Mortgage Refinance Company (EMRC), that the project's performance is rated "Satisfactory" in general. Hence, the Government is strongly supporting EMRC's views to upgrade the rating assigned to the borrower "Moderately Satisfactory" at least one notch up, based on the following:

**On page ix, the report states the reason for rating the Overall Outcome as moderately unsatisfactory we would like to highlight the following:**

- EMRC was incorporated in June 2006 but actual operation started in August 2008 concurrent with the first World Bank Loan disbursement, i.e. the operational assessment of EMRC should be 6-7 years in total and not "more than 10 years.
- Unfortunately the start of operation coincided with major external and internal unfavorable developments –which should be assessed as force majeure- that the PPAR repeatedly acknowledges. The World Bank team responsible for follow up on the project realized the impact of these developments and adjusted two intermediate outcome indicators, yet the PPAR refused to acknowledge these revisions and assessed the project on the original targets ( see paragraph 3.9 & 4.5)
- The PPAR hinges the failure of the project to achieve its objectives on the fact that EMRC did not issue any bonds. Although the report acknowledges that EMRC has not experienced normal market conditions since 2008 that allow it to issue bonds, it still insists that it was the flaws in the design that lead to this failure and concluding in paragraph 4.9 that " The economic and social turmoil created unfavorable market conditions for EMRC operations. However even if those adverse developments had not taken place, it was not clear that conditions to support EMRC's bond issuances were in place. No meaningful institutional investor base capable of absorbing EMRC's bond issuance was in place nor was it clear that banks would have been in a position to carry those instruments"
- EMRC disagrees with this conclusion as it was clearly conveyed to Mr.Chad Leechor during our meeting that two large local banks were ready in July 2014 to manage and underwrite EMRC first bond issuance for a total amount of EGP 100 million (under a shelf registration program of EGP 500 million). It was the impact of the economic / monetary and fiscal developments on the projected growth of the primary mortgage market and thus the need to avail funding that stopped EMRC from going ahead.



Ministry of Planning and International Cooperation  
Sector for International Organizations  
International, Regional & Arab  
Financing Institutions

Further on page ix, the PPAR also states that “It is true that mortgage markets expanded since the project was implemented and the tenor (term-to-maturity of mortgage loans) also became longer we would like to highlight the following:

- EMRC has reservations on the data presented in Table 4.1 as the actual refinancing loans are sometimes expressed as Gross Refinance Figures in some years and in other years as Net outstanding refinance figures. Also EMRC strongly believes that the actual figures need to be compared to the revised not the original targets.
- EMRC cannot validate the calculation of Average Maturity of EMRC from 2008 to 2011 as presented in Table 4.3. EMRC data confirms that it disbursed loans of a maturity of 10 years in 2008, 12 years in 2009, 15 years in 2010 and 17 years in 2011. Adjusting the numbers indicates that EMRC was not lagging behind but more or less in line with the market.
- It is also to be noted that EMRC started operation in 2008 and announced to the market that it is offering refinance loans up to 15 years. However since around 8 primary mortgage lenders were already operative and depended on their internal funding (deposits in case of banks and equity in case of companies) to fund their business it was obvious that the refinancing by EMRC would lag behind in total volume and maturity. Furthermore, up to 2013 EMRC had a seasoning period (where the loans had to stay on the books of the PML before they are eligible for refinancing) of 6 months (reduced to 3 month in 2014), thus the time lag will continue.

Concerning paragraph 4.13 and 4.14 we would like to highlight the following:

- The PPAR did not conduct any in-depth analysis of the primary mortgage market which reflected on its assessment of EMRC contribution to market growth as well as understanding of the market dynamics and development.
- The exponential growth in the market between 2006 and 2009 was mainly driven by the banks which represented at the time around 70-80% of the market. Being highly liquid and with cheaper cost of funds compared to EMRC (please note that the average cost of World Bank loan is 9.5%, and not 7% as incorrectly stated
- in PPAR) the banks that refinanced their portfolios with EMRC were encouraged to do so to close the tenor mismatch (total loans disbursed to banks during the period 2008 - 2011 amounted to around EGP 235 million with maturities of up to 17 years). However the banks appetite to refinance (if they do not come to EMRC they only have one source of funding which is their deposit base and not ten sources as mentioned in the PPAR) is still small as the size of their mortgage portfolios is negligible compared to their total loans/assets.