Assessment of the Housing Finance Application in Afghanistan: A case study of Kabul province

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Declaration of authorship

I hereby certify that the work embodied in this thesis project is the result of original research and has not been submitted for a higher degree to any other university or institution.

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Abstract

This project aims to identify the needs, requirements, and views of the private sector with regards to providing housing finance loans and investing in the market for housing finance in Afghanistan. The project is identifying the causes that create housing finance loans in financial institutions that offer housing finance loans in Afghanistan especially in Kabul city.

Afghanistan has a wide public demand for housing finance loans. Financial firms, however, report that the legal infrastructure of Afghanistan needs to be improved before they can invest in developing housing finance loans. After data analysis, the study revealed that housing finance loans, especially Sharia-compliant loans, are highly desirable if they are priced properly and if proper adjudication and law enforcement mechanisms are put in place and strengthened. We believe that the current laws, in general, are supportive of the industry, but the enforcement and interpretation of those laws need additional work.

After data analysis, the study revealed that various factors cause the creation of housing finance loans in financial institutions granting housing finance loans in Afghanistan. The main factors being high loan variable rate, loss of income, general decline in economy and poor credit assessment mechanism, finally a comprehensive literature review was conducted to identify pre-requisites and existing policies and procedures for home financing in Afghanistan, Malaysia, India, Pakistan, Nepal, and the United Arab Emirates.

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1 CHAPTER ONE

1.1 Background of the Study

Afghanistan is a country where Housing Finance has traditionally been given low priority compared to other sectors. In the meantime, most cities in this country face serious housing shortages and the returnees and internally displaced people live in quite bad conditions. Lack of institutional finance is considered the main problem in the development of the housing market in Afghanistan. The development of the housing sector is widely recognized as an integral part of economic development. In addition to the large share that the housing sector occupies in the economy, its importance also arises from the positive externalities and spillover effects, and its impact on the social and political climate, issues of particular importance in developing countries. In most countries, and increasingly so in emerging economies, housing represents a large proportion of a household's expenditure and takes up a substantial part of lifetime income. Usually, it is the largest asset owned by households. The backward and forward linkages to land markets, durable goods manufacturing and development of labor markets with depth and mobility further underscore the significance of this sector, particularly in the 22 processes of economic transition. There is an immense desire and need for housing in Afghanistan particularly among the low-income stratum of the society. A survey by JICA (2011) found that 94% of the low- income residents of Kabul expressed strong desire and need for new housing. Given unfavorable housing conditions, more than 80% of residents from all strata demand new dwellings. The demand for housing is steadily growing and by far exceeds the supply countrywide. World Bank (2008) estimated that Afghanistan needed 1 million units of new dwellings in 2006.

During recent years, all over the world, considerable effort has been made to extend opportunities to housing finances so that ordinary people can own their own homes. On the one hand, the housing finance market has become more competitive as new providers have been encouraged to enter the market. Such providers have been seeking new customers to extend their activities. Thus, the extension of housing finance services is a commercial response to market conditions. On the other hand, the state has been looking to the market to address housing needs. Although having housing problems and reducing public expenditure, the government have sought to encourage the market to specify and solve the needs where possible.

The reality of the housing situation in many developing countries means that new ways of micro financing and community funds have to be encouraged if the poor are to be provided with adequate shelter and basic services.

Access to adequate and affordable credit by any business organization/ individual to a large measure stimulates its growth. Credit refers to money made available to the borrower, which is repayable together with accrued interest at a future agreed date and time. To be advanced credit borrowers must prove that they can meet the repayment terms and conditions.

Financing is a major factor in almost every successful real estate transaction being either purchase of a family first home or to a multimillions' commercial development or purchase. Financial institutions are in the business of balancing their expected returns to the risks entailed in lending their funds. Such risks include defaults in payments and future changes in interest rates. Being rational investors, the financial institutions consider the returns and risks entailed in each investment before making the decisions on whether to lend or not and how much to lend. Lender's risk is reduced when its loan is secured because when a particular real estate secures a debt, the lender gains a right to foreclose and apply the proceeds to settle the debts.

There have been various attempts in recent times to develop housing finance markets in emerging economies. The involvement of the International Finance Corporation (IFC) in the development of such markets in countries such as South Africa, Brazil, and Ghana is an example of such efforts.

Housing finance which is also named as a mortgage is a transaction between two parties where one party (mortgagee) accepts a claim or title to property from another party (mortgagor) as security for the payment of a debt or settlement of obligation, for which the property is given; subject to the provision that when the loan is repaid, or the obligation settled, the property is released or returned to mortgagor free of the mortgagee's claim (Abbott, 1987).

The word mortgage has been derived from a French Law term meaning "death contract". According to this term, the pledge dies when either the obligation is fulfilled or the property is taken through foreclosure (http://en.wikipedia.org/wiki/mortgage-loan).

A person normally can obtain loans either to purchase or secure against the property from a financial institution, such as a bank or credit union, either directly or indirectly through intermediaries. It is worth mentioning that the features of housing finance loans such as the amount of loan, the duration of the loan, its associated interest rate, and method of repaying the loan, and other terms and conditions can vary substantially.

According to Anglo-American property law, housing finance occurs when an owner pledges his or her interest or right to the property as security for a loan. A housing finance is, therefore, a burden on the right to the property just as an easement would be, but because most housing finances occur as a condition for new loan money, housing finance has become the generic term for a loan secured by such real property. As with other types of loans, housing finance has an interest rate and are scheduled to amortize over a set period. All types of real property can be, and usually are, secured with a mortgage and bear an interest rate that is supposed to reflect the lender's risk. Housing finance loan is the primary mechanism used in many countries to finance private ownership of residential and commercial property. Although from a country to another country the terminology and precise forms differ, the basic components which tend to be similar are:

a) Property

The physical residence being financed, the exact form of ownership will vary from country to country and may restrict the types of lending that are possible.

b) Mortgage

Refers to the security interest of the lender in the property which may entail restrictions on the use or disposal of the property, restrictions may include requirements to purchase home insurance and mortgage insurance or pay off outstanding debt before selling the property.

c) Borrower

The person borrowing who either has or is creating an ownership interest in the property.

d) Lender

The term refers to any lender, usually a commercial bank or other financial institution. Lenders may also be investors who own an interest in the mortgage through a mortgage-backed security. In such a situation, the initial lender is known as the mortgage originator, which then packages and sells the loan to investors. The payments from the borrower are thereafter collected by a loan servicer.

e) Principal

The original size of the loan may or may not include certain other costs as any principal is repaid; the principal will go down in size.

f) Interest

The term refers to any financial charge for use of the lender's money.

g) Foreclosure or repossession

The possibility that the lender must foreclose, repossess or seize the property under certain circumstances is essential to a mortgage loan; without this aspect, the loan is arguably no different from any other type of loan.

h) Completion

Legal completion of the mortgage deed, and hence the start of the mortgages

i) Redemption

Is the final repayment of the amount outstanding which may be a "natural redemption" at the end of the scheduled term or lump sum redemption, typically when the borrower decides to sell the property? A closed mortgage account is said to be "redeemed".

1.2 Problem Statement

This project aims to identify the needs, requirements, and views of the private sector with regards to providing housing finance and investment in the housing finance market in Afghanistan. The project is finding the causes that create housing finances in the private sector that offer housing finances in Afghanistan particularly in Kabul.

Afghanistan is a country where public demand for housing finance is quite high. According to financial firms, the legal infrastructure of Afghanistan needs to be improved before they can invest in housing finance. Based on the analysis done in this paper, housing finance, especially Sharia-compliant loans, are highly desirable if they are priced properly and if proper adjudication and law enforcement mechanisms are put in place and strengthened. In general, the current laws in Afghanistan are supportive of this industry, however, the enforcement and interpretation of those laws need additional work.'

After data analysis, the study revealed that various factors cause the creation of housing finance loans in financial institutions providing housing finance loans in Afghanistan. The main factors being high finances variable rate, loss of income, general decline in economy and poor credit assessment mechanism, finally a comprehensive literature review was conducted to identify pre-requisites and existing policies and procedures for home financing in Afghanistan, Malaysia, India, Nepal, and the United Arab Emirates.

1.3 Research Objective

The main objective of this paper is to:

1. Identify the needs, requirements, and views of the private sector with regards to providing mortgage products and investing in the market for housing finance in Afghanistan.
2. Assessment of Afghanistan's housing finance industry and proposing specific recommendation for a functional industry. Research Significance

This research will provide the base for financial institutions and potential investors to take corrective actions regarding their investments in the housing finance sector in Afghanistan. This research serves as important insights for future researchers on the evaluation of housing finance related studies in the market. This research would also financial institutions and the private sector to know the current position of their market and the legal infrastructure as well as the challenges and opportunities in the housing finance sector in the market.

1.4 Research Question

The following questions are answered in this paper

1. To find those factors that prevent financial institutions from issuing housing finance despite the availability of strong market demand for housing in Afghanistan?
2. To find out the legal and institutional gaps that are again preventing the housing finance market to develop in Afghanistan?
3. What are the recommendations for developing and promoting the housing finance market in Afghanistan?

1.5 Research Scheme

Chapter one of this paper introduces the subject, talks about the existing problems, objectives, limitations, and questions on this subject. In chapter two a comprehensive literature review where countries like Afghanistan, India, Malaysia, Nepal and the United Arab Emirates are reviewed to have an in-depth analysis of the topic. Chapter three talks about the method of research and situations like research population, research sample, data collection, testing procedure, and research processes. In Chapter Five, the researcher has done a comprehensive analysis of the subject. In chapter five, the researcher concludes the subject and gives recommendations. Subsequently, the researcher has provided references and appendixes

2 CHAPTER TWO

2.1 Literature Review

This literature review will look into the existing policies for housing finance in Afghanistan, India, Malaysia, Nepal and the United Arab Emirates and find out key elements of this sector. The aim is to list the main challenges in these countries and ultimately make recommendations for the housing finance sector in Afghanistan. The main sources used for this literature review are journals, online publications, and websites.

The literature review will find out the types of loans each country offers and as well as the type of the interest rates applied. It will also find out the repayment period in each country and the collateral security each country gets while issuing a housing finance loan.

2.2 Afghanistan

Housing finance in Afghanistan and in particular amongst the low-income level of the society has an enormous desire and demand. According to a survey done by JICA in 2011 94% of the low-income people, particularly in Kabul, expressed a strong demand for new housing. More than 80% of residents from all levels demand new houses. Interestingly, the demand for housing is increasingly growing and by far exceeds the supply across the country. According to the estimation done by the World Bank (2008), Afghanistan needed 1 million units of new houses in 2006. The report projects that the country's housing needs reach 1.25 million units in 2010 and 1.5 million in the year 2014 (JICA, 2011) .

Given such a huge demand, the supply of affordable houses and the provision of housing finances that can meet the demand of the people is undoubtedly a big challenge particularly in the nonexistence of housing finance institutions and banks. Afghanistan Mortgage and Reconstruction Bank (AMRB) was closed in 2003, the main objectives of this bank were the provision of housing finance and reconstruction of houses. AMRB was active for many years and finally closed down as a result of its bad performance and failed to obtain a banking license which was a requirement under the new banking law. The provision of housing finance in Afghanistan was initially established in 1947. In the first instance, it was small in scale, but then the government started provision of housing finance in the early ’50s through establishing Mosessesa Keesa Omrani (Finance Development Organization). The initial investment in this organization was 30 million Afghanis. DAB was financially supporting the Financial Development Organization (World Bank, 2008) .

In 1954, the government recommended to restructure the Finance Development Organization and it happened. As a result of this restructuring the Afghanistan Mortgage and Reconstruction Bank established. The projects completed by AMRB were Karte Mamoreen, Jada-e Maiwand, and Maiwand Watt apartments and the interest rate charged at that time was 6%.

Meanwhile, no financial institution in Afghanistan provides long-term housing finance to the people (May et al 2008). The majority of people get finances from their families, relatives, and friends. According to Fitrat (2009) which is in line with May et al states that the 2 national banks (Pashtany Bank and Bank Millie) still provide housing loans but do not offer long-term loans; therefore, the impact of such loan is quite low. Housing loans provided by Pashtany and Millie banks were between $400 to $1000 for 2 years. Though Bank Millie tried to make a housing finance department, due to lack of capacity, it failed. Bank Millie receives an interest rate of almost twelve percent for its short-term and limited amount of loans. Based on May et al report, Bank Millie is planning to allocate at least 10 percent of its current loan programs to the housing finance program. Due to the lack of formal long-term loan programs, people resort to the informal sector for securing loans. Informal financing constitutes a large bulk of the Afghan economy. According to World Bank (2008), 85–90 percent of all economic activity occurs within the informal economy. May et al while confirms the instrumentality of the informal financing in the current context of Afghanistan; argue that informal financing can only be effective in “manufacturing and commercial activities”. According to May et al information financing is costly and therefore inappropriate for the development of the housing finance industry and a sustainable private sector (World Bank, 2008).

According to May et al, the main constraints to the development of the housing finance industry are legal issues concerning land possessions, tenure, and legal framework and tenure transfer. Gebremehin (2006) refers to land titling as another challenge. He, for example, points out to a widespread practice of irregular and illegal land occupation in Afghanistan including squatting and grabbing. Land grabbing, in particular, has encouraged an informal market of the real estate. Informal transactions of real estate according to Gebremehin has posed two challenges i.e. "formalization of property titles" and service provision by the municipalities.

May et al point to a variety of laws such as customary law, Sharia law, state law, and civil law as factors complicating land title in Afghanistan. Multiple laws create a problem of ownership. For example, a particular land can be claimed in several ways such as through possessions of customary papers with the confirmation of the local body (such as Jirga or Shura). In most cases, the local body that has certified the possession of land to a particular individual has no official status in the state courts. May et al report that "frequent regime change has led to more than 60 different land laws and amendments to the state law" (p.6). Lack of insurance mechanisms is another challenge facing the housing finance industry. The national insurance company is under-resourced and is not fully functional. In 2007 only one private company began its operation in Kabul. It is argued that unless there are more insurance companies operational, the risk for the provision of housing finance loans will remain very high for the banks in Afghanistan (World Bank, 2008).

May et al concludes that banks in Afghanistan are hesitant to provide long-term loans without insurance on the collateral and no company in the country provides insurance to protect houses against fire and earthquake

Given the above challenges to the development of the housing finance industry, which is promising is the enthusiasm for establishing the housing finance industry and the excess liquidity of the banks. IMF's (2009) report reveals that in 2007 the commercial banks assets exceeded $ 1.6 billion and therefore financing itself is not an issue. Meanwhile, current deposits at the commercial banks are around 1.20 billion US dollars, and the banks are willing to provide housing finance loans and the banks are trying to find ways to security provide loans. What holds the banks back is "inefficient financial intermediaries' function for generating long-term funds and the lack of a legal regime that supports long-term loans such as those for housing" (World Bank, 2008).

Reports indicate, that the commercial banks that are currently operating in Afghanistan view the housing market as a lucrative business. While acknowledging the lucrative nature of the housing finance market, DAB believes that the housing finance market is also instrumental to the Afghan economy as a whole. According to DAB, the housing finance market is conducive to the development of “other industries including infrastructure development”. Additionally, DAB believes that the development of the housing finance market by the private sector can help the Afghan government direct its resources to other economic and social needs of the Afghan people.

The government of Afghanistan established mortgage law in 2009 to address the obstacles facing housing finance loans. The objectives of the law are listed below:

• Secure debt and contracts through the mortgage of immovable property

• Facilitate access to negotiable bank credits through the mortgage of immovable property

• Ensure mutual trust among individuals involved in banking transaction

• Expand trade and credit, attract investment and promote economic growth

This law discusses the creation of mortgage, condition for its creation, conditions of a loan agreement, obligations, responsibilities, and liabilities of mortgagor and mortgagee. From the provisions of the law, it appears that the position of law in regards to Islamic compliance and convention mortgage is neutral.

It appears that mortgage loans will certainly help people meet their housing needs. JICA (2011) found that 70% of Kabul residents’ budget is lower than $ 50,000 while an apartment costs from $80,000 to $100,000. JICA tho9erefore concludes that the current costs of houses in Afghanistan are “beyond the financial capacity of the majority of people (70%)” (World Bank, 2008).

2.2.1 Legal and Regulatory Environment

Lack of an appropriate legal and regulatory regime has prevented commercial banks and, to a lesser extent, microfinance institutions from entering the housing finance market. Inadequate enforcement of laws and structural weaknesses in the housing market have made housing finance an overly risky proposition. Among the reasons commercial banks cite for staying out of the housing market are the inability to establish clear title to the property, the high cost of registering liens, and the lack of secured transaction or foreclosure laws (World Bank, 2008).

Before the financial sector reforms, launched in 2003, there was an urgent need for a strong central bank and a legal framework with prudential regulations for efficient operations of private commercial banks. The restructuring and modernization of the central bank began in mid-2003. The president, through a presidential decree, approved a new central bank law in September 2003 that provides a legal and regulatory framework for a two-tier banking system. State-owned commercial.

Banking and private commercial banking. And grants the central bank autonomous regulatory power for monetary and banking supervision. To further strengthen the financial sector, the central bank is sponsoring laws to enable commercial banks to lend to the private sector: a secured transaction law, a mortgage law, negotiable instruments laws, and a leasing law. These laws, aimed at modernizing the financial sector as well as improving the enabling environment for the private sector, await approval in the Ministry of Justice's Taqnin (law review and drafting department) before being presented to the Parliament. Other programs for reform of the private and financial sectors are underway:

Establishment of a legal framework to facilitate private sector development by promoting private investment and modernizing the financial market. Proposed statutes include bankruptcy, contract, and commercial laws. Of the 10 priority laws to be approved, 4 were signed by the president in January 2007.

2.2.2 Lack of a Well-Functioning Collateral System

A bank willing to extend a housing finance loan would face discouraging obstacles in creating a lien against the property to secure the loan and, in the event of default, in enforcing its security.

The procedure for creating liens is bureaucratic, time-consuming, and overly expensive. Even where a valid lien is perfected against the property, the lender has virtually no options available for acquiring and disposing of the collateral in the event of delinquency or default on the loan. Afghanistan presently has no housing finance, secured transaction, or foreclosure law.

Under Sharia, foreclosure or eviction from a property that is the borrower's sole shelter is almost impossible. For this reason, banks that use collateral first ensure that the borrower has two properties, then effect a lien against the second home.

While property disputes are heard in civil court, the judges are poorly trained in property law. Moreover, there is little or no enforcement of judges' decisions.

2.2.3 Housing Microfinance

This activity in Afghanistan was initiated in 2003 under an apex body, the Microfinance Investment Support Facility for Afghanistan (MISFA). In 2008, 15 microfinance institutions were registered with MISFA and 373,000 active borrowers including low and moderate-income families. MISFA had disbursed a total of $420 million loans and had current outstanding loans of $108 million.

2.2.4 Potential Demand

The country's microfinance clients have demonstrated a large demand for housing loans. Indeed, they often use microfinance business loans for home improvements. Besides, one microfinance institution has provided loans explicitly for home improvements.

Estimates suggest that the total demand for housing microfinance could be substantial. In Kabul alone, the financing need for home improvements and new construction in the informal housing sector amounts to an estimated $276 million a year. Today those needs are met through relatives and friends, labor sharing, and family incomes. If microfinance institutions met only 10 percent of the demand, the financing requirement would be about $28 million a year. In meeting this demand, microfinance institutions should initially use their funding from MISFA, mobilized from donors. In the long run, however, market-based. Funding from commercial banks could promote the financial sustainability of microfinance institutions.

2.2.5 Potential Challenges

There are two target groups for nonmortgage housing loans: the self-employed, based in rural and urban areas, and wage earners, based mainly in urban areas. Microfinance institutions are well placed to extend housing loans to these groups; analysis shows that they have more comparative advantages and fewer disadvantages than other potential providers of loans for informal housing (World Bank, 2008).

Even so, several conditions need to be met to ensure effectiveness: detailed knowledge of the housing microfinance market, capacity building in loan appraisal techniques, effective guarantee mechanisms to limit risks, lending methodologies and policies designed for high-risk areas, and cost-effective ways to reach rural clients. Besides, microfinance institutions need to provide loans to women to promote their homeownership (World Bank, 2008).

2.2.6 Housing Policy Directions

The government of Afghanistan has taken some policy measures to overcome the housing shortage in the country. Its primary aims have been to create new serviced and un-serviced land, improve land titling, support home construction and improvement, promote the conditions for housing finance, and establish a housing subsidy program for low- and middle-income communities. The policy on involving the private sector in helping to alleviate the housing shortage needs serious scrutiny, however. Besides, the situation remains too tenuous for financial institutions to begin large-scale lending in the housing sector, with such legislation as the mortgage law and secured transaction law still awaiting enactment by the Parliament. Moreover, an overhaul of land policy is needed, as well as actions to promote housing finance to stimulate housing supply, particularly at the lower end of the market.

Among the key policy, measures are those needed to improve the security of tenure, improve the framework for housing finance, and build the capacity of secondary participants in the housing market (World Bank, 2008).

2.2.7 Financial Sector Overview

Afghanistan’s financial sector is developing, but lending remains very limited, confined to trade financing and short-term business loans to customers well known to the lender. Most banks have avoided lending for industrial financing or housing, which typically involves long-term commitments to the client. One of the main reasons is the lack of an adequate legal framework in the financial sector, to protect banks and other financial institutions in the event of default. The laws do not support foreclosure of borrowers ‘property, a clear disincentive for banks to take the risk of long-term lending. But pending laws, once enacted, should increase banks’ incentive to extend long-term loans.

2.2.8 Recent Developments

In 2002, after the fall of the Taliban regime, Afghanistan’s formal financial sector was dominated by state-owned commercial banks and some specialized banks. Most of these banks were bankrupt or too weak to provide efficient financial services. Moreover, the legal framework for the financial sector was essentially nonexistent or inappropriate. The central bank, Da Afghanistan Bank, had an obsolete structure and staff too unskilled to undertake efficient monitoring and supervision of the financial sector.

Major financial sector reforms are scheduled to be completed by the end of 2008. Meanwhile, the outreach of financial services in Afghanistan remains very limited. Small and medium-sized businesses and the housing sector have almost no access to bank credit and only limited access to banking services. The World Bank, in *Doing Business 2008,* ranked Afghanistan 159th out of 178 economies on the ease of getting credit, a measure that reflects the quality and coverage of the credit information system and the legal rights of borrowers and lenders (World Bank, 2011).

Still, there has been significant growth in private commercial banks since 2004: today 14 private and 2 state-owned licensed commercial banks are operating in Afghanistan. The banks are concentrated mostly in Kabul and provide services primarily to international donors, large businesses, foreign.

Nongovernmental organizations (NGOs), and foreign government agencies. There is also a small but growing number of nonbank financial institutions, including a credit union and 15 microfinance institutions that provide financial services to urban and rural borrowers. A leasing finance company is also operating in Kabul, though with limited capital. But while financial services are expanding, these institutions have yet to broaden their offerings to meet new demands, such as for long-term loans (World Bank, 2011).

2.2.9 Housing Finance

Afghanistan has no bank or financial institution providing long-term housing finances. Before 2002 a government-owned housing finance bank was operating in Afghanistan, but its operating performance and loan portfolio was so weak that it failed to obtain a provisional license in 2003 under the new Banking Law. Some state-owned commercial banks, however, were relicensed under this new law in mid-2003. Before 2002 some commercial banks provided housing loans to their staff and, selectively, to government officials, but these loan activities did not continue into the post-Taliban period.

Afghan businesses and homeowners must rely almost entirely on friends, relatives, and moneylenders to meet their financing needs. Informal financing may play an important part in manufacturing and commercial activities, but such funds are often costly and therefore inappropriate for the long-term private sector or housing development.

To identify pre-requisites and existing policies and procedures for home financing in Afghanistan, and how other countries enabled housing finance loans, it's needed to do a comprehensive literature review of countries like Malaysia, India, Nepal, and the United Arab Emirates, therefore below we have the mentioned countries literature review.

2.3 India

The housing finance system in India had three distinct phases. The first phase was before the 1970s when the government was the only provider of public housing and thus allocated serviced land and houses to individuals (through its various social schemes) based on social equity principles. The 1970s saw two major developments in housing finance. A public-sector housing company, the Housing and Urban Development Corporation (HUDCO), was established in 1970; and a private sector company, Housing Development Finance Corporation (HDFC), was created in 1977. While HUDCO was responsible for assisting and promoting housing and urban development programs, HDFC was responsible for individual lending based on market principles for homeownership in India (Tiwari, 1997).

The second phase was during 1987 when the National Housing Bank (NHB) was formed to promote a sound, healthy and cost-effective housing finance system. During the late 1980s, the government enhanced its involvement and directed various agencies like insurance companies, commercial banks, provident funds and mutual funds (Unit Trust of India) to invest part of their annual incremental resources in housing. The third phase was posted 1990s liberalization era when three distinct groups of housing finance companies had emerged: 1) specialized housing finance companies, 2) housing finance companies created as subsidiaries of some commercial banks, and 3) housing finance companies set up by insurance companies (Tiwari, 1997).

2.3.1 Current Status of the Housing Finance Market

The current financing mechanism prevalent in the country mostly targets middle and high-income sections of the society while low income and economically weaker sections have no or limited access to housing finance. This can be attributed to the mismatch between the demand and supply of housing units and the financial solutions available to address it. On the demand side factors like income levels of people, the growing middle class, and on the supply side factors like the lack of availability of land and finance at a reasonable rate, legal and regulatory framework and the limitations of the public and private stakeholders to provide low-income housing play a critical role. It is worth mentioning that with the emergence of specialized financial institutions and the intervention of the banking sector, the housing sector is attracting a wide range of customers ranging from individuals to corporations to groups. As of June 30, 2012, 56 Housing Finance Institutions were registered with the NHB, offering the following types of loans:

- Home Purchase Loan: conventional home loan meant for purchasing a new home.
- Home Extension Loan: funding any alteration to an existing home.
- Home Construction Loan: This is for the construction of a new home on an existing property.
- Land Purchase Loans: This, one of the most availed types of loan schemes currently in India, is for the purchase of land for investment/construction purposes.
- Stamp Duty Loan: This loan is used for paying the stamp duty (D.Mohanty, 2013).

2.3.2 Financing (Conventional)

In terms of financing, the followings are predominantly offered by Banks in India:

- Fixed-Rate Mortgage (FRM): Considered a traditional type of mortgage, FRM offers borrowers a fixed interest rate over the term of the loan, whether it is 10, 15, 20 or 30 years, with monthly payments that remain the same. At the beginning of the loan period, the majority of monthly payments will serve the purpose of paying off the loan's interest. During the later part, the borrower will be paying more toward the loan's principal (Augustinecortega, 2013).
- Adjustable-Rate Mortgage (ARM): Also known as a floating rate or variable rate mortgage, ARM has set adjustment periods in which the interest rate may increase or decrease, depending on current market conditions. Rate caps are put in place so that the interest rate can never increase or decrease by more than the determined percentage over an agreed period (Augustinecortega, 2013).
- Balloon Payment Mortgage: This, a fixed rate home loan, is usually offered for a short term to borrowers. The payment period is on a monthly installment basis where the borrower starts by paying smaller monthly installments followed by larger payments.
- • Blanket Mortgage: This type of mortgage, mostly preferred by builders and developers, is used to purchase real properties/lands for commercial sale (Augustinecortega, 2013).
- • Bridge Loans: Also known as caveat loan, a bridge loan is a short term interim financing used by those who wish to sell their present home and buy a new one. The repayment period for this type of loan ranges from 14 days to 36 months. The rate of interest is higher; and therefore, it is very expensive than conventional financings (Augustinecortega, 2013).
- • Interest Only Mortgage: In this type, the borrower does not need to pay off the entire capital of his/her housing loan. Borrowers need to pay for interest rates only on the principal loan amount. However, when the mortgage term expires, the borrower needs to pay a large sum of money including dues payment and interest rate (Augustinecortega, 2013).
- • Reverse Mortgage: In this type of housing loan, the borrower can mortgage his/her property with a bank. In return, the bank will pay the borrower a regular payment and allow him/her to stay in the property until his/her death. After the borrower dies, the property is sold off by the bank to recover the loan amounts owed by the borrower. Accessing Loans Mortgage loans in India are provided against collateral security such as industrial property, urban commercial complex, residential house or apartment, possessed in the name of the receiver of the loan. A rented house can be accepted as collateral too if the property is on a lease and the person has the authority to collect the rent under the power of attorney. While on average the minimum

loan amount that can be availed is Rs.5 lakhs, the maximum can go up to Rs.10 crores or more, depending on the borrower's repayment capacity and the city where the loan is disbursed. The minimum tenure that a loan against property has is 5 years and the maximum is up to 15-30 years depending on the Bank's credit acceptance parameters. Also, the borrower has to be between 21 years to 45 years old, have a continuous work experience of at least 3 years and a minimum net monthly income of Rs. 30,000 to be eligible for a loan (Augustinecortega, 2013).

Major Challenges some of the major challenges that the housing finance industry face in India are:

- Absence of Innovations. There are absence and lack of other innovative financing mechanisms, particularly those that target the poor households and link up formal and informal sources of financing. The reason behind this is the repayment capacity of the poor being below the amount necessary to purchase a housing unit, increased frequency of late payments and default, difficulty in establishing clear titles and lack of credit record. Subsidized credit is still viewed as the principal instrument to reach out to the poorer households.
- Archaic Laws and Regulations: The environment on both the demand and supply side of the housing market in India is heavily impacted by unclear and time-consuming legislation and procedures. Local authorities impose their regulations through municipal and development rules. Policies such as the urban policy that restricts the supply of available land for housing construction, and rent control legislation, which protects existing tenants at the expense of all future potential tenants, distort the supply response.
- Affordability of Housing: Affordability of housing is another key issue even if housing finance was more widely available. To make housing affordable, the financial institutions would not only have to offer a reasonable cost of finance but also undergo a complete overhaul of current regulatory land and rental policies, stamp duties on transfer of property and fiscal treatment of property income (Varma, 2013).

The central and state governments have put in place various reforms/measures to improve and enhance the level of housing in India. The Indira Awas Yojana (IAY), Golden Jubilee Rural Housing Finance Scheme (GJRHFS), Bharat Nirman, National Urban Housing and Habitat Policy (NUHHP) are of few examples of initiatives taken by the Government of India. Another example of such initiative is the establishment of the Central Registry of Securitization Asset

Reconstruction and Security Interest of India (CERSAI) on March 31, 2011. The government established the Central Registry to prevent frauds in loan cases involving multiple lending from different banks/HFCs on the same immovable property.

The CERSAI, being partially managed by NHB, provides a database of a security interest over property rights to secure loans and advances granted by banks and financial institutions. It also helps in preventing frauds involving cases where loans are taken from different lenders against the same property as well as the fraudulent sale of property without disclosing the security interest over such property.

2.4 Malaysia

Housing has been one of the highest priorities of the Malaysian government. Building Societies[1] were the largest originators of housing finance in Malaysia during the1960s -70s. Public housing and credit programs, commercial banks and financial companies emerged as major players in the housing finance market that gradually shrank the role of these societies in the 1980s.

Malaysia has been implementing housing programs in accordance with 5-year national economic development and poverty reduction plans, also called Malaysian Plans (MPs). The country has successfully implemented nine MPs so far and is now undertaking the 10th. During the first MP—1966-1970, Malaysia launched the first formal and structured housing program to provide low-cost housing for low-income groups. Even though the emphasis of MPs regarding housing has changed from time to time, depending on the priority of the government, the provision of low-cost housing has been a primary feature in all MPs.

2.4.1 National Housing Policy (NHP)

Ministry of Urban Wellbeing, Housing and Local Government (MHLG) develops updated housing policy to facilitate the implementation of housing priorities described in MPs. The policy is then detailed in an action plan and broken down into projects and programs. The action plan clarifies

[1] A building society, a financial institution owned by its members as a mutual organization, offers banking and related financial services especially mortgage lending.

the roles of federal, state and local government agencies as well as that of the private sector for effective implementation and evaluation of the "thrusts" and "policy statements"[2]. The policy is mostly controlled by state authorities, is localized in character, and translated into regulations that developers and house financiers must comply with (Ezeanya, 2004).

2.4.2 Government and the Housing Finance

With a vision of becoming a developed country by 2020, Malaysia is committed to providing adequate, quality, and sustainable housing for everyone in the country. In addition to regulating the housing sector to maintain minimum quality and ensure affordable prices for all income groups, the government concentrates on the delivery of housing units to the lower-income groups through government-financed housing programs (Ezeanya, 2004).

The Malaysian Government established the Treasury Housing Loans Division—the specialized arm of the Ministry of Finance—in 1971 to finance public entities to provide affordable housing for every Malaysian, especially the low- income groups. These public incorporated companies are Malaysia Building Society Berhad (Banking and Mortgage), Borneo Housing Mortgage Finance (Banking and Mortgage), Berhad Sabah Credit Corporation (Housing and Business Finance) Bank Rakyat (Islamic Banking and Islamic Mortgage) and National Savings Bank (Ordinary Banking and Home Loans).

The Malaysian Government uses these companies to provide public servants with subsidized mortgages (at a maximum of 3% interest rate) using the Employee Provident Fund (EPF)[3]. The government also offers subsidized long-term loans and mortgages to low-income non-government employees for construction/improvement of their houses or for purchasing new property (Ezeanya, 2004).

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[2] NHP is formulated based on six strategic thrusts and twenty policy statements. A strategic thrust is almost equivalent to a strategic objective. Policy statements are used to breakdown the thrusts into manageable units

[3] EPF is the mandatory savings and retirement plan for Malaysian government employees

Besides, every NHP requires the private sector to build a certain number of low-price housing (<RM100,000) for the poor to increase availability and affordability of low-income housing during each MP. Forty-four percent (44%) of the total outstanding housing loan in the market in 1993 belonged to the government. The share was however reduced to 22% in 2004.

To increase liquidity, lower lending risks, and encourage a greater number of mortgage loans by both private (commercial banks and financial companies) and the public sector, in 1986 the Malaysian Government established the secondary mortgage market, Cagamas Berhad— the National Mortgage Corporation. The mission of the Cagamas Berhard is to provide financial products and services that improve the availability and affordability of home mortgages, particularly for lower-income households. Cagamas issues debt securities and uses the funds to finance the purchase of housing loans from banking institutions, selected corporations, and the government. In October 2004, through its single-purpose and wholly-owned subsidiary, Cagamas MBS Berhad (CMBS), Cagamas successfully issued Malaysia's first residential mortgage-backed securities (RMBS), which were backed by the government's staff housing loans. The establishment of the RMBS was the start of the securitization market in Malaysia. At end of 2007, CMBS securitization activities involved a total of five issues of RMBS backed by the government's staff housing loans, of which two were based on the Masyarakat principle (Ezeanya, 2004).

Lastly, The Housing Ministry MHLG protects the rights of homebuyers to a greater extent. MHLG has also developed outreach and awareness mechanisms to increase homebuyers' knowledge about standard procedures and possible fraudulent transactions before purchasing a property.

2.4.3 Private Sector and the Housing Finance

Commercial banks (including Islamic) and finance companies have become the primary lenders in the Malaysian housing finance market since 1995. Seventy-seven point three percent (77.3%) of the total outstanding housing loans were granted by the private sector in 2004. Since the end of the financial crisis of 1998, household lending has increased at a high rate compared to business lending. Among other forms of household financing prevalent in Malaysia, home loan constitutes the largest portion (58%) of the total household finance[4]. The ratio of household debt to GDP grew from 39% in 1997 to 78% in 2011. Financial institutions have been willing to finance residential mortgages because such loans are typically viewed as low risk with extensive government support.

2.4.4 Types of Loans

In general, almost all banking institutions and finance companies in Malaysia offer two types of mortgage loans, namely, conventional and Islamic. Conventional loans account for 90% of mortgages. Banks typically offer plain-vanilla mortgages at fixed or variable interest rates or a combination of the two. Approximately 83% of residential mortgages are variable rate mortgages, with adjustable rates pegged to the base-lending rate (BLR) of individual institutions. In an increasingly competitive environment, banks also offer mortgage packages with repayment flexibility, such as graduated repayment schemes (lower initial installment payments that increase gradually over time) and loans with longer maturities. Typically, housing loans have a repayment period ranging from 20 to 35 years or mature when the borrowers turn 60 or 65 (Hua, 2008).

It is common for mortgages to carry fixed interest rates during the first three to five years and BLR- based rates subsequently, until maturity. This reflects the “sell-then-build” concept of residential property development. The products offered under Shariah-compliant financing generally have the same characteristics as conventional mortgages but are based on the concept of Bai’ Bithaman Ajil (BBA)[5]. Islamic mortgages carry mainly fixed profit rates. However, banking institutions have begun to offer variable rate Islamic mortgages following a review of the BBA’s variable rate financing mechanism conducted in November 2004 to promote efficiency in the pricing of this mode of financing (Hua, 2008).

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[4] Household finance includes all types of loans for household purposes e.g. car loan, home loan, education loan etc.

[5] Al-Bai` Bithaman Ajil or deferred Payment Sales is a Sales and Purchase Agreement of an asset e.g. houses, shops, factories and other fixed assets. Among others the Al-Bai` Bithaman Ajil Financing packages are used to purchase house/shoplots, refinance housing loan, purchase land for the construction of a house, construct house on customers' own land and refinance fixed asset.

2.4.5 Major Challenges

Teck Hong Tan, despite efforts by the Malaysian Government, there are various issues relating to a housing delivery system.

- First, public and private house builders have been giving low priority to the low-cost housing program, which falls below the targeted level. The construction of medium- and high-cost housing, on the other hand, has exceeded the targeted level during the Five-Year Malaysia Plans.
- Second, a massive over the construction of medium- and high-cost housing has contributed to the problem of property overhang. Independent analysts blame the government for ineffective policies and programs and corrupt practices by high officials in the public sector. Besides, since low-cost houses bear less profit compared to medium and high-cost ones; therefore, the private sector prefers investing and building medium and high-cost houses to reap more profit.
- Third, many low-cost housing projects have been abandoned. From 1990 to 2005, MHLG records show that 261 projects involving 88,410 houses in Peninsular Malaysia were abandoned. The government claims that it is 1-3% of all projects and cites issues such as developer cash flow problems; dispute between landowner and developer; lack of detailed market study; technical problems at the site; squatter resettlement problems; and developer's internal problems as reasons for abandonment. Meanwhile, the government has created a department to deal with this issue and has taken three measures to limit the problem: strict vetting process while licensing developers; increased monitoring and evaluation of the projects; and recovery of some of the viable projects (Tan, 2011).

Furthermore, the IMF estimates Malaysian housing prices to drastically increase by 2016. The issue has raised global concern because a home loan is the largest portion of the current high household- lending trend (>50%) in Malaysia. According to Malaysia’s Department of Insolvency, 13% of bankruptcy between 2005 and June 2012 were caused by house loans. On the other hand, some analysts thwart the apprehension arguing that Malaysia has a strong enough economy that the price rise will not impact the economy significantly. They base their claim on figures that show relatively low unemployment and higher household income in Malaysia (Abliet, 2013).

Andrew C. Ezeanya, while analyzing Malaysian housing policy, writes that the major problem of Malaysia's residential housing policy is that it has lost its traditional form of identity. He argues that many western-style plans and designs are implemented in Malaysia that does not fit Malaysian topography and environment.

This trend has resulted in deforestation; land degradation and an increase in pollution in some areas.

Malaysia My Second Home (MM2H) Program is promoted by the Government of Malaysia to allow foreigners who fulfill certain criteria, to stay in Malaysia for as long as possible on a multiple-entry social visit pass. The Social Visit Pass is initially for ten years and is renewable. Non-residents are free to purchase residential and commercial properties in Malaysia. All purchasers are subject to restrictions on Malay Reserve Land and properties allocated to Bumiputras (native Malaysians). There is a minimum investment value of approximately RM 500,000 for property purchases, but this varies from state to state. There is no restriction on the number of properties a foreigner can buy although they will require State approval for any property purchase. From 2002 to 2012, the program attracted 19,488 foreign buyers, mostly from China, Bangladesh, Britain, and Iran and 1,659 properties (worth RM1.5 billion - US$495 million) were purchased under the program from 2007 to 2012 (Edge, 2013).

2.5 Nepal

From 1956 until 1985, the Government of Nepal treated the housing sector as a “social service,” and therefore, it remained a low priority in the country’s national economic development plans. The classification of housing changed after 1985 when the government started treating the sector separately from other social services and drafted the National Shelter Policy of 1996. Through this policy, the government envisioned to provide shelter for all, especially for poor and low-income families. Though very promising, the 1996 policy proved to be ineffective mainly because there was no specific agency tasked to oversee and implement it. Additionally, the policy did not contain clear roles of responsibilities, which led to duplication of efforts, gaps in implementation, and conflicts; thus harming the housing sector more than helping it (KumarKarki, 2004).

2.5.1 Current Status of the Housing Finance Market

Although after 1991, plenty of private commercial banks and finance companies emerged, housing finance remained a low priority for them as they had a lot of clients for industrial and commercial purposes. However, this situation changed especially from 1996 to 2000, when commercial lenders reduced to a minimum due to various political crises and the emergence of the Maoist insurgency. On the other hand, the bank's deposits were increasing due to the concentration of people in towns and the increasing transfer of funds/salaries from employees working abroad. Thus, as a survival option, financial institutions started lending for car purchases on an installment basis.

They eventually switched over to loan home from 2001 because the country was experiencing rapid growth in housing and apartment business; driven by the rural to urban migration. Besides the financial institutions, a couple of NGOs also emerged to provide informal lending successfully but they were insufficient in number and coverage. Currently, there are 18 commercial banks and 37 financial companies that provide various types of loans. Some of them include the followings:

- Home Purchase Loan: A conventional home loan provided for the purchase of a new home/apartment.
- Home Extension Loan: This home loan is for funding any alteration to an existing home.
- Home Construction Loan: This is for the construction of a new home on an existing property.
- Land Purchase Loans: This is for funding the purchase of land for investment/construction purposes.

The loan tenure on average ranges from 2 years to 20 years. The lending is on the regular monthly installment basis and the interest rates range from 8 to over 13 percent, depending on the borrower and the bank (KumarKarki, 2004).

2.5.2 Financing

In terms of financing, the following formal and informal financing opinions exist in Nepal:

Formal Sources:

- Commercial Banks: There are 26 commercial banks, many of them owned by wealthy families with other business interests that serve as an important source of housing finance both for purchasers and developers. The typical lending period ranges from 5 to 15 years with an interest rate ranging from 10 to 15 percent per year. Land and or the property serve as collateral.

- Nepal Housing Development Finance Company (NHDFC): The NHDFC, established by the Ministry of Physical Planning and Works (MPPW) in 1990 under the Finance Company Act 1985, provides individual housing loan for a maximum period of 15 years against collateral both for the construction or purchase of a new house and/or improvements of existing properties. The average size of the loan is NPR 150,000 (USD 2,042) the maximum loan amounting to NPR 6.0 million (USD 81,688) with an interest rate of 13 percent per annum (Steekelenburg, 2010).
- Employee’s Provident Fund (EFP): EFP was established under EPF Act (1962) to manage NPR 3.7 million (USD 50,374) fund of 26,000 government employees and military staff which now has evolved into a fund with 440,000 clients and a net worth of NPR 79.15 billion (USD 107 million). The Provident Fund provides housing loans to permanent employees of the government (civil, police, military), semi-government (corporations), academics institutions and organized private sector. Housing loan conditions of the Provident Fund are more attractive than the commercial market or NHDFC. However, this housing finance is available only to subscribers of the fund (Steekelenburg, 2010).
- Saving and Loans (Cooperative) Program: Nepal has an estimated 15,000-registered cooperative society. Although most of these cooperative societies have been established for agricultural development and Agri-marketing in rural areas, housing loans are also part of their service package. Since these loans typically do not require collateral; therefore, they have proven to be useful particularly for poor households to maintain, improve and extend their houses both in (Steekelenburg, 2010).

2.5.3 Informal Sources

- Informal Lenders: In 1991, it was estimated that around 70 percent of housing finance came from the informal sector (friends, relatives or traditional money lenders). However, in recent years there has been a decline in this practice.
- Accessing Loans: The Mortgage Loans are provided against collateral, fixed deposits/government bonds, gold and silver and stable future income possessed in the name of the receiver of the loan (Steekelenburg, 2010).

2.5.4 Major Challenges

Two major challenges that the housing finance industry face in Nepal are:

- Affordability of Housing: The growing commercial banks and financial institutions will not serve the needs of low-income people. It is estimated that 95% of the urban population cannot afford to purchase a ready built property.
- Coverage: The housing finance has been most prevalent in the Katmandu Valley and not in other towns of Nepal (Steekelenburg, 2010).

The Habitat for Humanity started its interest-free home loan to poor people in December 1999, specifically to those who have their piece of land. A total of 225 houses have been built in Nepal through this assistance. The loan amount provided to each household ranged from Rs 60,000 to 100,000 rupees. They normally had monthly repayment, which was about Rs 550 per month. However, in some cases, stages of repayment were made every three to six months as per their earning and repaying capability.

Serve as an important source of housing finance both for purchasers and developers. The typical lending period ranges from 5 to 15 years with an interest rate ranging from 10 to 15 percent per year. Land and or the property serve as collateral. • Nepal Housing Development Finance Company (NHDFC): The NHDFC, established by the Ministry of Physical Planning and Works (MPPW) in 1990 under the Finance Company Act 1985, provides individual housing loan for a maximum period of 15 years against collateral both for the construction or purchase of a new house and/or improvements of existing properties. The average size of the loan is NPR 150,000 (USD 2,042) the maximum loan amounting to NPR 6.0 million (USD 81,688) with an interest rate of 13 percent per annum. • Employee's Provident Fund (EFP): EFP was established under EPF Act (1962) to manage NPR 3.7 million (USD 50,374) fund of 26,000 government employees and military staff which now has evolved into a fund with 440,000 clients and a net worth of NPR 79.15 billion (USD 107 million). The Provident Fund provides housing loans to permanent employees of the government (civil, police, military), semi-government (corporations), academics institutions and organized private sector. Housing loan conditions of the Provident Fund are more attractive than the commercial market or NHDFC. However, this housing finance is available only to subscribers of the fund. • Saving and Loans (Cooperative) Program: Nepal has an estimated

15,000-registered cooperative society. Although most of these cooperative societies have been established for agricultural development and Agri-marketing in rural areas, housing loans are also part of their service package. Since these loans typically do not require collateral; therefore, they have proven to be useful particularly for poor households to maintain, improve and extend their houses both in (Steekelenburg, 2010).

2.6 United Arab Emirates

The UAE housing finance sector was virtually non-existent before 2000. The Dubai property market in its current form is very young, having started with the birth of Emaar Properties in 1997 and the subsequent opening of the property market to non-UAE nationals in Dubai in 2002. Even after 2002, ownership rules and regulations were unclear. The introduction of both foreign ownership rules and the supply of properties targeted to non-UAE nationals fueled demand for properties and resulted in the establishment of the housing finance market.

UAE's housing market began to flourish in 2002, when Dubai—one of the seven states that make the United Emirates, announced that freehold ownership of residential and other types of property in Dubai was available to investors of all nationalities in specially designated zones. It was the single most structural change in the history of housing in the country. Massive demand for housing was created by international residents in Dubai. The government utilized the opportunity and by public interventions (much through the big three firms: Nakheel, Emaar, and Estithmaar) and enabling the housing development environment facilitated gigantic housing supply. Projects such as Dubai Marina with1,026 apartments and 64 luxury villas; Emirates Living with 9,000 units; Jumeirah Beach Residence with 36 residential towers with 6,400 apartments and four hotel towers with 4,000 rooms; Arabian Ranches with 6,900 luxury villas and townhouses; Burj Dubai with six towers; and other large housing projects as Jumeirah Village and Palm Jumeirah took off. Abu Dhabi, Sharjah, Ajman, and Ras-Al Khaimah states started housing projects later in 2009. Among all, Abu Dhabi had the largest projects implemented by big firms—Alder and Al-Sorouh (Boleat, 2005).

The Dubai Islamic Bank, Estithmaar, and Island Capital Group (based in the USA) established the Emirates National Securitization and Finance Corporation (ENSFC) in January 2004 intending to issue mortgage-backed securities (MBS) to be traded on the international markets. Having a real estate market boom, Dubai issued a comprehensive mortgage law in 2008. Specialized courts dedicated to property litigation and foreclosures, which strengthen enforcement procedures, were also established around that time. Despite all these efforts, Dubai real estate market hit with a 2009-credit crisis. Lack of effective regulation, close supervision, proper mortgage system, and high speculation were cited as the main reasons for the crash (Boleat, 2005).

2.6.1 Public Housing Policy

Government housing policies are most favorable to Emirati nationals and are conducive for Emirati residents. In practice, most nationals have been housed by the State and nationals have little need to borrow large amounts to fund their housing. The State has directly built houses and given them to nationals. However, the circumstances in which the properties can be resold are severely restricted and they cannot be mortgaged. Nationals with a total family income of between Dhs7,000 and Dhs70,000 per month are eligible for an interest-free loan of up to Dhs750,000. Grants are available for those with a household income below Dhs7,000. All the private developers have had the benefit of land being “gifted” to them by the State (M.Boleat, 2004).

Two of the largest public housing schemes for Emirati citizens are the Mohammed bin Rashid Housing Establishment (MRHE) and Sheikh Zayed Housing Program Services (SZHP) projects. Under these projects, eligible citizens are entitled to ready-made house grants, interest- free home loans, and land grants. In addition to Dubai, multibillion projects have been recently awarded to giant developers like Alder and others to build houses for Emirati citizens in Abu Dhabi and other states. Lastly, there are many charitable associations in the Gulf Cooperation Council (GCC) countries to provide free houses to low-income groups in these countries (Roy, 2010).

Dubai has a Real Estate Regulatory Authority (RERA) that regulates the contractual agreement terms and conditions of mortgage lending and property renting in the market. A recent initiative by RERA is the rent cap measure to curb excessive rent rises. Although this measure is not well received by financial analysts, the government is strictly implementing it to control property rents. One of the major successes of UAE’s housing policy was opening up the housing sector for foreign investors’ freehold ownership in 2002- 2006. With an already business-friendly, tax-free environment for foreign investment since the 1980s, this initiative attracted a huge number of business and executive people from the region and the rest of the world. Comprising more than 80% of the population, foreign residents are the main driver of the housing business in the country, especially in Dubai and Abu Dhabi (Roy, 2010).

2.6.2 Government and the Housing Finance

The government is involved in housing finance in two ways: 1) through subsidized housing programs for its citizens perhaps for redistribution of oil wealth and 2) through partial ownerships in major housing businesses. The first type of involvement to a greater extent pushes away low and middle-income Emirati citizens as target customers in the housing sector given that they receive house grants, in most cases zero-interest loans and land grants. The second type of involvement is more likely to better implementing housing policies and generating income given the vastness of the construction and housing sector in the country. The government of Dubai for instance fully owns Nakheel and has a 38% share in its subsidiary mortgage company, Tamweel Islamic Housing Finance Corporation—best known for building the Palm Jumeirah. The government also has up to 31.2% share in Emaar Properties and Amlak Islamic Housing Finance -famous as the developer of Dubai Marina. Similarly, the government of Abu Dhabi owns a 39.1% share of Alder Properties and 18% of Sorouh Real Estate. These developers and their respective mortgage finance companies soundly compete in the market. They offer competitive mortgage interest rates, home loan products, and borrower-friendly policies to attract customers (DIFC Global Finance Hub, 2011).

UAE government through Dubai International Financial Center (DIFC) has been active in creating instruments and conditions to support the development of funding for the real estate market and the mortgage market. DIFC created legislation and institutions and established the first-ever Real Estate Investment Trust (REIT) in the UAE and the Middle East and Northern Africa (MENA) region. RIETs are the most favored method to attract public ownership of property investments. DFIC already the world's leader in Islamic bonds—Sukuk, also established the secondary mortgage market to refinance home lenders in the real estate sector (DIFC Global Finance Hub, 2011).

2.6.3 Private Sector and the Housing Finance

Relative to its population and gross domestic product, the UAE has an unusually high number of banks—21 local, 25 foreign, 2 specialized, and approximately 50 representative offices of other foreign banks. All the banks and housing finance companies offer housing finance to citizens and residents in line with the federal and state government policies. Among international banks, HSBC was the first one to come into the home loan market in 2003.

Greater market demand for mortgage and other home loans is met by the recently combined mortgage finance companies—Tamweel and Amlak. Until Q1 2008, these two giants accounted for 56% of market share and 23 commercial / Islamic banks accounted for a balance of 44%. During recent years, Chinese and Korean developers have entered the Dubai market. They will probably have a positive impact on the supply side of the housing sector (Benzerroug, 2013).

2.6.4 Types of Loans

All home loan lenders offer house finance products in both conventional and Islamic packages. Therefore, there are both fixed and variable interest rates involved. A mortgage is a big share of the greater house financing loans—that include other types of loans such as house construction, house renovation, land, and similar loan products. Dubai Land Department data has revealed that unlike pre-crisis times, Dh17.8 billion or 40% of the total property transactions in Q1 2013 were done through mortgages.

Banks and housing finance corporations offer home loans to both UAE nationals and expatriates. As of August 2013, mortgage tenure ranged from 12 to 25 years and the mortgage interest rate in UAE was between 4% and 6.5%, on average. The interest rate is subject to the duration of the mortgage and the percentage of the total value of the property financed under the loan. Under the new government regulations, the maximum loan-to-value (LTV1) ratio was 80% for Emiratis and 50% for residents. Also, according to current market trends, the maximum home loan could go as large as AED 15 million (US$4.1 million). Furthermore, the borrowers should be between 25 to 65 years old and are required to have at least AED 8,000-20,000 monthly salary to qualify for the home loan. Last but not the least, mandatory home insurance and life insurance supplements the home loan package (Benzerroug, 2013).

Islamic banking has assumed a more prominent role in the UAE in recent years, and most conventional banks are opening or expanding Islamic banking departments; sharia-compliant consumer and investment products also are being introduced. Government agencies and majority state-owned companies are using Islamic bonds—Sukuk—to finance development and acquisitions. Islamic house finance loans include Murabaha always at a fixed rate, Ijarah mostly at a variable rate and Istisna at both fixed and variable rate (Benzerroug, 2013).

Offering benchmark-based variable rate loans. This method ensures transparency to customers but restricts the maneuvering capacity of lenders. For this reason, virtually all UAE mortgage lenders switched out of EIBOR based mortgage loans in 2009-2010 to return to the COFI approach. The choice of the benchmark is critical to avoiding undesirable consequences52. Short term references tend to be volatile, and significant swings can affect the ability to pay off numerous borrowers (Hassler, 2011).

2.6.5 Challenges

As mentioned earlier, the UAE government, just like other GCC countries, is vastly involved in the housing finance sector. Two types of problems often arise with government housing lenders.

- First, a quasi-monopoly, political interferences and/or the implicit transfer of risks to the state induce lax management practices, leading to frequent public bailouts;
- Second, these banks enjoy specific regulatory advantages and subsidies (sometimes implicit) linked to their special mandates.
- Furthermore, in contrast to other MENA countries, UAE has the highest commercial property to residential housing ratio, making UAE real estate market exposed to a greater risk of dependency on the commercial sector. Just like the 2009 crisis, any withdrawal of expatriates will jeopardize the real estate market again because of lower domestic demand.
- The UAE and other GCC countries lack an institution providing insurance against mortgages defaults by individuals experiencing economic hardship. Time could not be more appropriate for the UAE to institute an Emirates Mortgage Guarantee Corporation. The guarantee facility will help to bring stability in the sector and gain both lenders' and borrowers' confidence in the mortgage industry (Housing Finance International, 2010).

Dubai Real Estate Crisis: Many foreigners started purchasing houses in Dubai after the law of foreign property ownership was passed in 2006. With a 116% rise in house prices from 2007 to 2008 and a 400% rise compared to 2002; the huge flow of foreign capital boosted ambitious Dubai construction market goals. Europeans including the Russians accounted for 20%, GCC Arab and UAE nationals, 28%, Asians 40% and Iranians 12% of property ownership in Dubai. Then the global credit crunch hit. Amlak and Tamweel, the UAE's two largest home finance companies that account for more than 50% of all mortgages, stopped offering new loans. Foreign investors suddenly disappeared at the end of 2008. The overall foreign ownership index was 50% down by Q4 2010, from its peak in Q3 2008. More than half of all the UAE's construction projects, totaling \$582bn, either was put on hold or canceled. The root of Dubai's trouble is its over-ambitious development plan that has included world-famous infrastructures and the tallest building on earth. Also, reports suggest the involvement of high-level speculators than real buyers in the housing market. The country is still recovering from the housing prices fall. Dubai residential selling prices dropped almost 56% from their peak in 4Q08 until 1Q11 while those of Abu Dhabi lost 45% over the same period. Dubai residential market currently has an estimated 93,000 vacant units out of a total of 309,000 stock with an additional 60,000 units expected to come in the market through to 2013. The vacancy rate in Abu Dhabi is more contained at an average of 3% out of the total existing stock of 185,000 units at the end of 2010. To help the market, Dubai and Abu Dhabi governments bailed out the big firms to protect them from defaulting on their bonds. Dubai government announced over US\$45bn worth of future projects, which includes investment in transport infrastructure. Other sources report more than \$70bn construction projects in the pipeline for 2013. This is expected to create more jobs and increase demand for real properties. Global Property Guide supports the argument by stating that Dubai's housing market is now recovering fast, while its neighboring Abu Dhabi, UAE's capital, is still struggling. Apartment prices in Dubai increased by 11.6% y-o-y to November 2012. Villa prices soared by 23.7% over the same period. In contrast, apartment prices in the capital plunged 10.7% and villa prices dropped by 1.8% (REAL ESTATE MARKET OVERVIEW, 2014).

To prevent speculations and another property bubble from emerging, the central bank recently issued circulars to banks cutting the maximum LTV ratio for Emiratis from 80% to 70% for the first property and 60% for the second unit. Besides, the LTV ratio was further cut for expatriates to 50% for the first unit and 40% for the second unit. The new rules are enforced since the start of 2013.

The result of this literature review reveals that countries like Malaysia and the United Arab Emirates offer conventional and Islamic loans whereas in Nepal and India only conventional loans are offered with both fixed and variable interest rates. These loans are issued for construction and purchasing of houses. On average conventional loans have a repayment time of 5 to 35 years and are given in return for collateral security like fixed deposit government bonds, industrial or commercial properties, and residential properties and houses. The loans offered in Islamic countries under Sharia Law generally have the same criteria as conventional loans but carry fixed profit rates (World Bank, 2008).

Similarly, there are several similarities between these countries, for example, the gap between demand and supply, affordability which means that high land and rent prices make housing finance unaffordable for the poor people. Lack of clear policies, property rights and legal framework which is conserved as an obstacle to the improvement of housing finance.

3 CHAPTER THREE

3.1 Methodology

This chapter outlines how the research study will be conducted. It includes the research design adopted, the target population, data collection tools and analysis of the data.

3.2 Nature of Study

A descriptive research was conducted with the sample size of more than 100 where investors, employees of the bank, and those having regular income were asked and approached through a structured questionnaire online for the purpose of collecting primary data.

Additional secondary data was obtained through the use of informational documents made available during research.

Respondents were asked several_questions that focused on housing finance loans in the market, factors hindering the establishment of a housing finance market in Afghanistan, the questions focused on public demand for housing finance loans, type i.e. interest-based or noninterest based, and the pre-requisites required for an enabling housing finance market in Afghanistan.

3.3 Research Population

The target population for this research study includes Commercial Banks, State-owned Banks or National Banks, Da Afghanistan Bank or Central Bank, Ministry of Finance, Commercial and State-owned Insurance Companies, House Developers, Afghanistan Land Authority, Afghanistan Judicial Institutions handling land titling issues, Property dealers, graduate students and professionals from United Nations, and Government organizations.

3.4 Sampling Size

A stratified random sampling method has been used to establish a representative sample of the population. Separate Stratum has been prepared for all the commercial banks, major house developers operating in Afghanistan. Public residents, banks and related institutions are surveyed and interviewed. More than hundred person were participated in the survey and the representatives from the Ministry of Urban Development, Da Afghanistan Bank, Ghazanfar Bank and Afghanistan Builders Association were interviewed.

3.5 Data Collection

Given the sample size, a survey method is best to obtain a representative response. The survey instrument of collecting primary data used for this study is a structured questionnaires and interviews. The questions are being designed to elicit data in accordance with the research questions.

Respondents were asked multiple-choice and open-ended questions that focus on finding the most important factors that are stopping the development of the housing finance market in Afghanistan. It also focuses on the pre-requisites required to facilitate the successful development of the housing finance market in Afghanistan.

3.6 Method of Analysis

The descriptive statistics measures is used to summarize and analyze the results of the questionnaires, the summary statistics were represented in graphical charts and graphs. Using the summary descriptive statistics and graphical data, the most important factors are identified that contribute to the development of the housing finance market in Afghanistan.

3.7 Research Process

A research process involves a systematic process that focuses on being objective and gathering a multitude of information for analysis so that the researcher can conclude. This process is used in all research and evaluation projects, regardless of the research method (scientific method of inquiry, evaluation research, or action research). The process focuses on testing hunches or ideas in a park and recreation setting through a systematic process. In this process, the study is documented in such a way that another individual can conduct the same study again. This is referred to as replicating the study. Any research done without documenting the study so that others can review the process and results is not an investigation using the scientific research process.

3.8 Research Limitation

The major limitation of this research study was to identify professional individuals and institutions who can share their expert opinions regarding the establishment of an enabling environment for housing finance in Afghanistan. The second major limitation had been getting their interest and time while conducting interviews and filling questionnaires and the last limitation had been designing statistical tools to analyze and prioritize the most important factors that hinder an enabling environment for housing finance loans in Afghanistan.

4 CHAPTER FOUR

4.1 Results Analysis

This chapter presents the results of this study. It gives an outline of the research finding and analysis of the various responses gathered from the questionnaire, survey, and interviews. This chapter will attempt to conclude, a summary of findings and finally put forward policy recommendations that can be adapted to guide the financial institutions in the improvement of housing finance loans in Afghanistan.

The data has been collected according to the two following ways:

1. The questionnaire filled by Public
2. Interview with Banks, Government, and other related agencies

Responses of the respondents have been reported, and followed by finding which has been organized according to the following three objectives:

1. Public awareness; their feedback about housing finance loan and their demand for housing finance loans.
2. Assessment of the business environment.
3. Views, needs, and requirements of the private sector.

4.2 Public Trust in Banking

Banking is fundamentally an industry of trust. Without a foundation of reliability, financial institutions will see their accountholders flee to competitors. During our survey, we have asked the participants about their trust in local banks. According to our survey, a strong majority of people have trust in banks.

According to Figure-4.2, Eighty-eight percent (88%) of the respondents trust on local banks in Kabul province. Yet 12% don't have trust in banks or either would prefer not to do their exchange through banks.

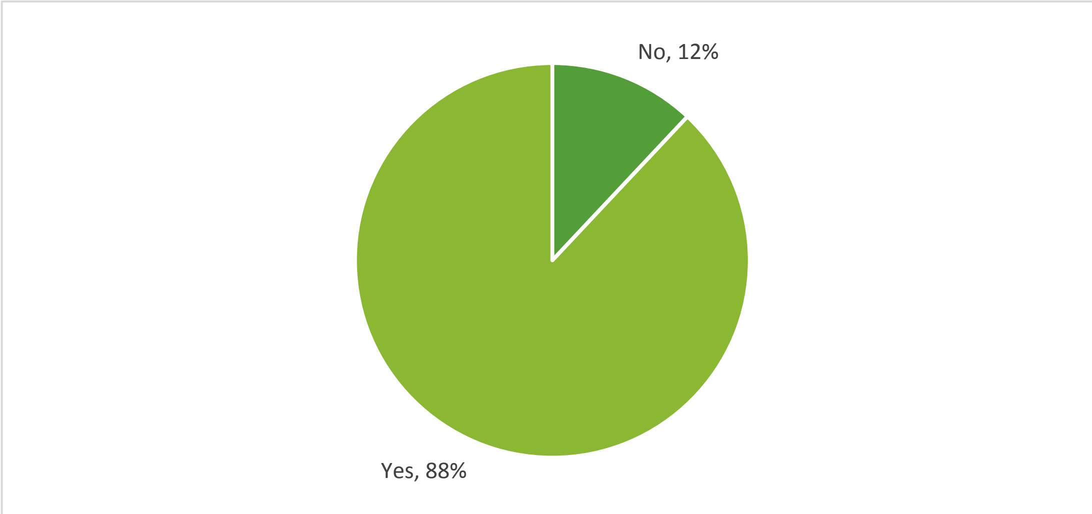


Figure-4.2 Public trust on banks

4.3 Home Ownership

According to **Figure-4.3**, fifty-seven percent (57%) of the respondents have their own home. Most of the respondents acquired their home either through personal financing or inherited it from their families.

According to **Figure-4.3**, out of the 43% of respondents that have not their own home, 30% paid rent, 10% were in a Giraw arrangement, and 3% occupied for a housing finance loan.

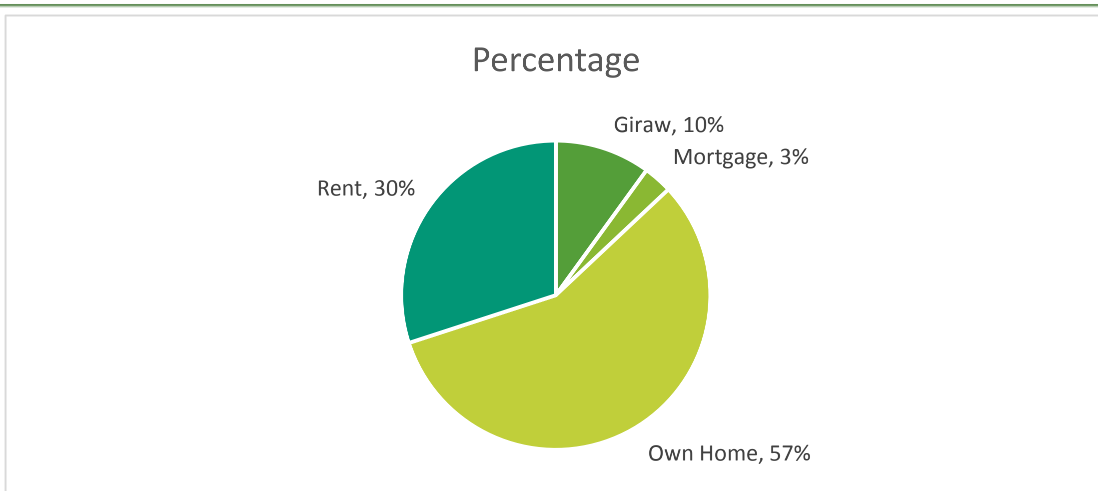


Figure-4.3 Sources of ownership

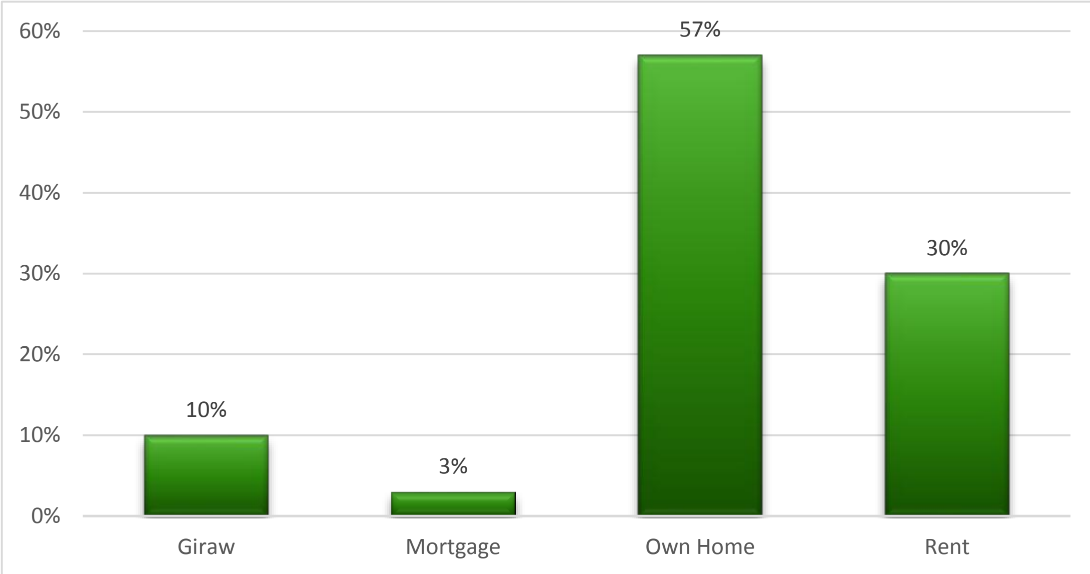


Figure-4.3 Non-ownership home

4.4 Property Acquisition

According to **Figure-4.4,** Forty-Two percent (42%) purchased homes with their own money, 28% took a loan from friends for purchasing houses, 27% inherited from family and 3% of the respondents took a loan from banks.

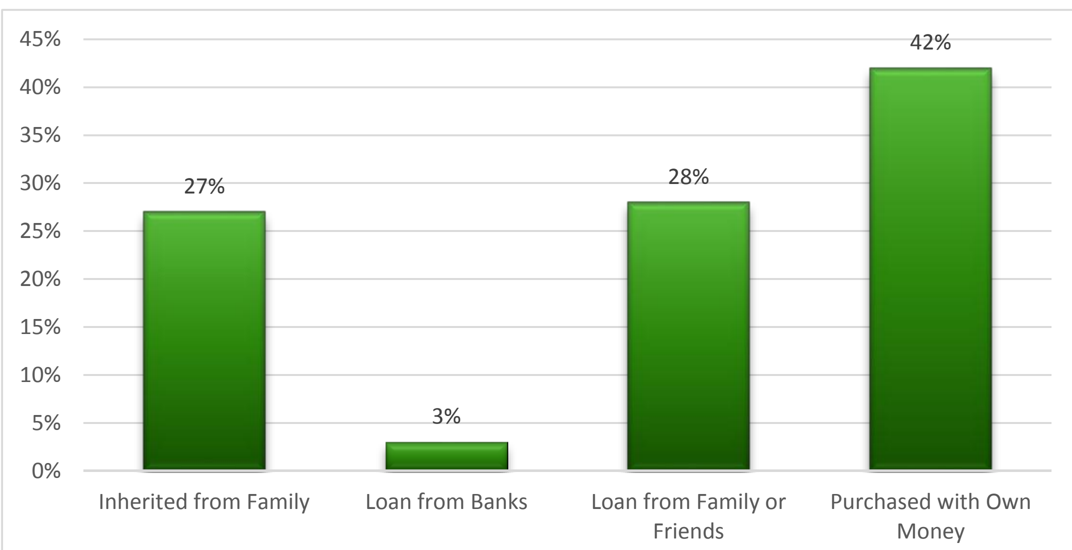


Figure-4.4 Property Acquisition

4.5 Gender Size

Figure-4.5 outlines the number of respondents and their relation to the estimated population. Eighty percent (80%) of our respondents were male and (20%) were female.

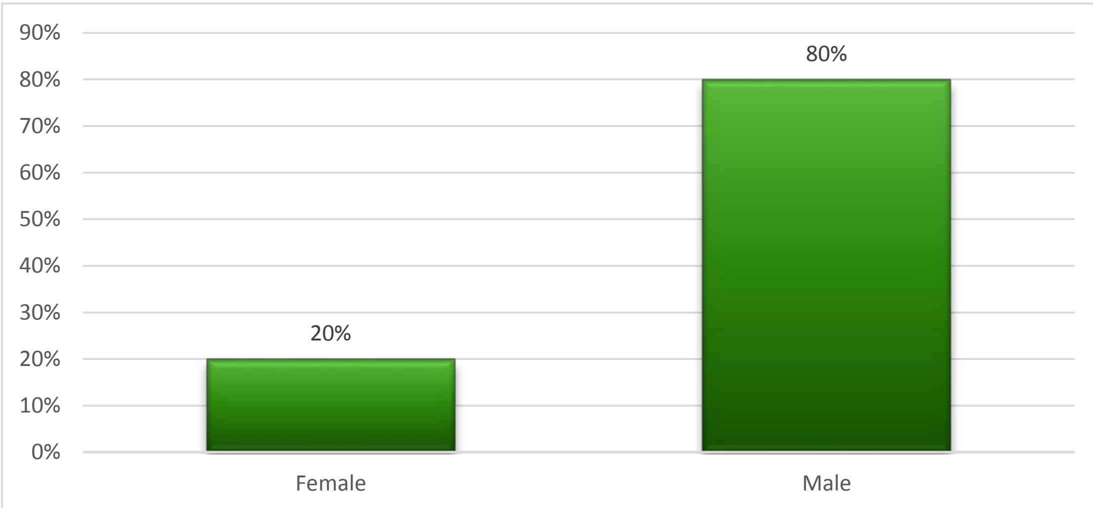


Figure-4.5 Gender size

4.6 Market Demand for Housing Finance

According to **Figure-4.6,** our survey shows an overwhelming demand for housing finance loans. The majority of the respondents 54% reported that they are interested in getting a long-term loan for purchasing new homes but 19% are not willing to take long term loans for purchasing new homes.

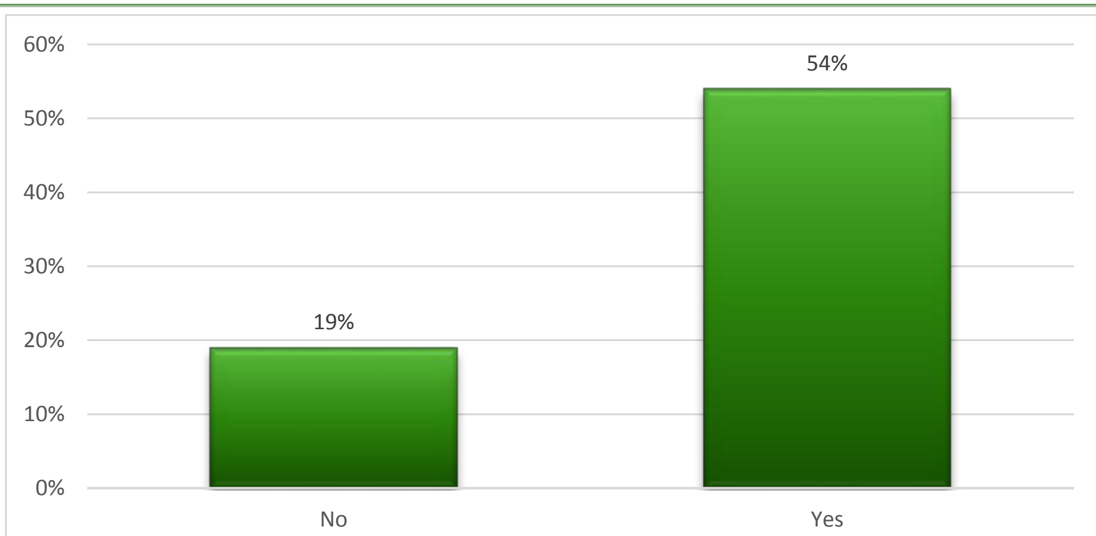


Figure-4.6 Market Demand for Housing Finance

4.7 Type of Loan

We asked participants which type of loan are you inserted in? According to Figure 4.7, 88% preferred Islamic housing loans while 12% preferred interest-bearing loans.

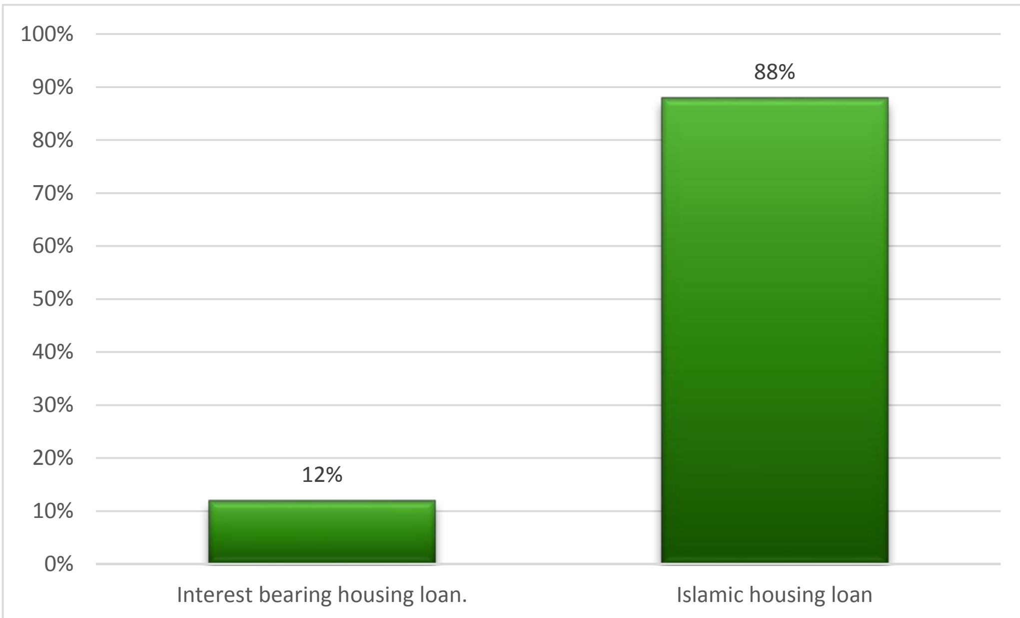


Figure-4.7 Market demand for the type of loan

4.8 Housing Finance Timeline

We asked participants which of maturing timeline do you prefer the most? According to Figure 4.8, 38% preferred a 5-10 year timeline, 33% preferred more than 10 years timeline, 20 % of respondent preferred 3-5 years of a timeline and the remaining preferred between 1-2 years timeline.

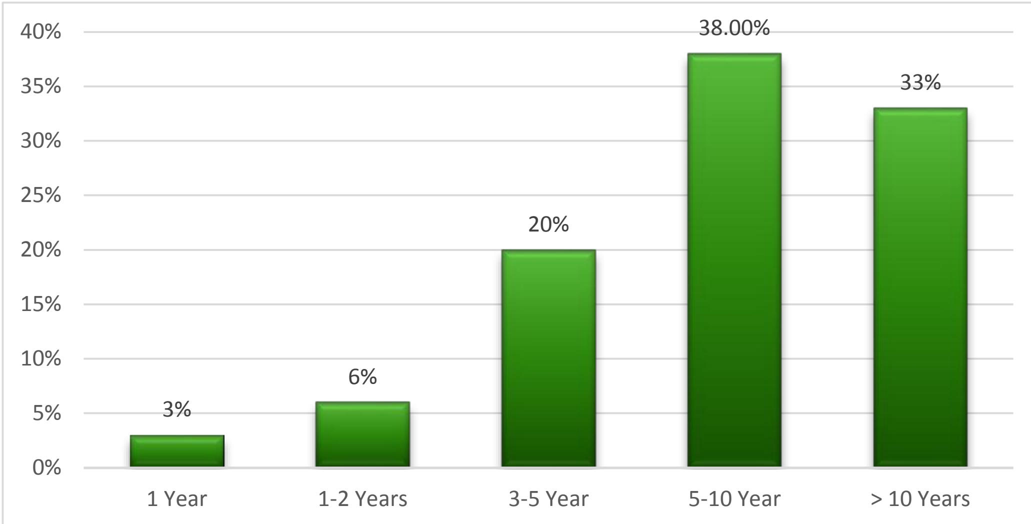


Figure-4.8 Housing finance timeline

4.9 Land Titling System

According to Figure 4.9, 80% percent of the people who have been surveyed, believe that there isn’t an effective ownership titling system, although the survey shows 20% believe that there is a system in place for ownership titling system.

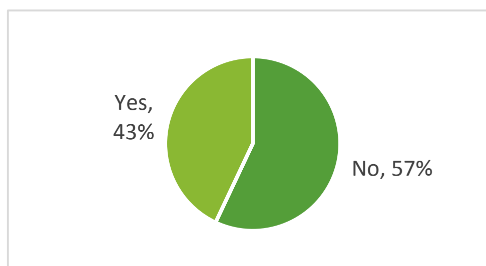


Figure-4.9 Sources of land titling system

Establishing a clear title to land is a major problem in Afghanistan. There is no coherent land registration law. In addition to several traditional means of property transfer, conflicting registry schemes have been put into place over the decades. And corruption and forgeries often lead to several competing claims to the same piece of property. In Kabul, an estimated 70 percent of residents live on a property that has not been formally registered.

The land title has been complicated by the several legal regimes in place: customary law (Rawaj), civil law (Qanoon Madani), religious law (Shari'a), and statutory or national state law. Besides, frequent regime change has led to more than 60 different land laws and amendments to state law. Accordingly, a property might be lawfully held in a few distinctive courses, including through a standard archive confirmed by the neighborhood Shura or Jirga, while Shuras and Jirgas are not authoritatively perceived by the court framework, they frequently give the best method to finish up an exchange or resolve a land debate.

Given the complexity, it is unsurprising that few people have the skills or training to conduct a proper title search and declare title free and clear. Nor is there adequate capacity in (or records for) property appraisal, resulting in unreliable information on the true sales value of a property. Adding to the problem, real estate licenses can be obtained for a small fee, and there is no mechanism for verifying credentials (Gebremedhin, 2006).

To help bring people into the formal land titling regime, the Supreme Court has cut the number of steps required to register property from more than 30 to just 4 or 5. That has reduced both the time required and the opportunities for corruption. Besides, the government has committed to lowering the cost of registration from 10% of the property value to 2%.

4.10 Willingness for Getting Housing Finance Loans

As figure 4.10 shows 53% believe getting mortgage loans is not permissible in Islam, therefore, there isn't any willingness to housing finance loans, although 47% has a different belief for not having the willingness to the housing finance loans. The important issue is that the banks ask for too much upfront collateral. The below table has pointed out some of the key reasons that discourage people to get housing finance loans.

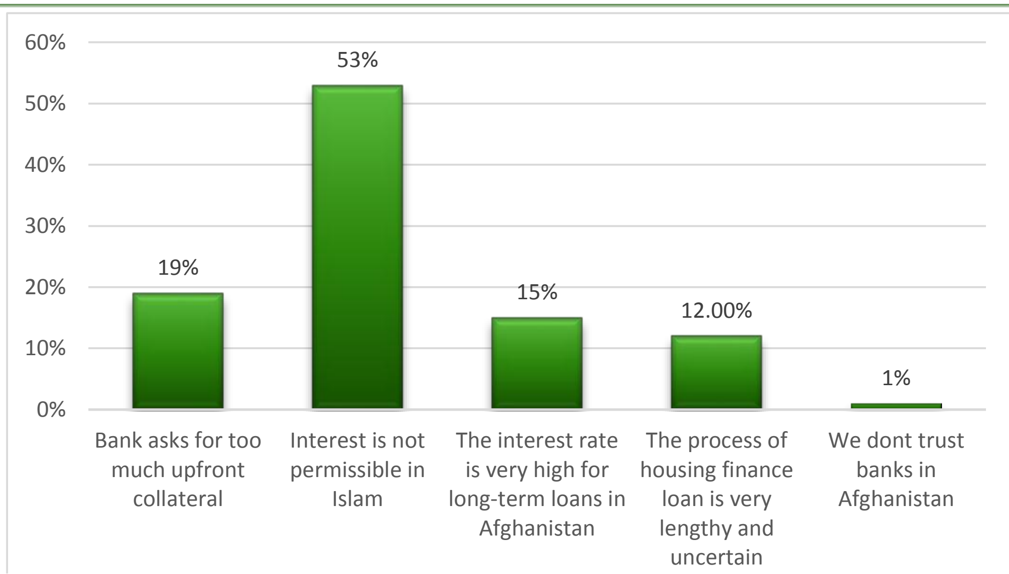


Figure-4.10 Willingness of respondents for getting

4.11 Findings from Interview Sessions

1. There is a need for the creation of a Shariah Board at the central bank level which could be able to provide a standardization of practice among Islamic banks through Islamic banking business activities. Currently, all banks follow the rules and direction as provided by their own Shariah Board and this has resulted in differences of rules, guidelines and sometimes-conflicting modes of practice.
2. Islamic housing finance products are not available in the market because of many major issues, which do not make the offering of the product practicable. Below are those issues:
    a. Islamic housing finance product based on the principle of Murabaha:
        i. There is no rule and guidance on the double taxation issue as the modes of a Murabaha contract will involve two sets of buying and selling i.e. firstly between the developer/seller and the bank and secondly between the bank and the customer.
        ii. There is no recognition of the concept of beneficial ownership in Afghanistan. Although the law of the land is Shariah laws and that all laws must not contravene any of the rules of the Shariah, the legal recognition of trust and equity laws is essential to capture the rules on beneficial ownership and such provisions on it must be documented. It is understood that the concept is only being applied traditionally and customarily. Hence, there may be major issues if such rights are to be enforceable in the courts of law since it is not available anywhere in the legal system.
    b. Islamic housing finance product based on the principles of Ijarah:
        i. There is no institution on insurance/takaful in the country, which will be able to insure/protect the interest of the bank acting as a lessor in this contract. It is understood that insurance is nearly non-existent in the country and if it does exist, it is very limited and only applicable to restricted matters and for a very limited amount of coverage.
        ii. Bank, as a lessor, will have to bear the responsibility to the property until the termination of the leasing agreement and upon full transfer of ownership of the property to the customer. In this regard, the bank will not have the

capacity to play an active role in providing active monitoring of the condition of the property and paying for the costs of maintenance, wherever needed.

iii. Similar to item 2 (a)(i) above, there is no recognition of beneficial ownership in any of the laws of the land and this recognition is important since, under the concept, the customer will be the beneficial owner of the property despite legally, it is owned by the bank.

c. Islamic housing finance based on the principles of Musharaka: No laws are governing the rules of partnership in Afghanistan and there is no specific institution/ authority dealing with such matters.

d. Islamic housing finance products based on the principles on Bai' Istisna': The practice of Bai' Istisna' has not been applicable so far in Afghanistan due to the absence of rules available on the product and the lack of demand on it.

3. According to the banks' expressions, we have reached to this result that there are following five generic causes which stop banks from processing the housing finance loans:
   a. Lack of proper insurance companies
   b. Land titling problems
   c. Lack of capital for long-term loans
   d. Corruption in court system
   e. Difficulties in tracking individual
4. There is a major lack of knowledge and awareness by the public on Islamic housing finance products and the Islamic banking system in general. This has resulted in them having misunderstanding on the concept and fundamental theories of the system and many of them are still comparing its similarities with conventional products in terms of the excess of payment. As such, there is a real need for a lot of training; awareness programs, etc. to be conducted to explain and promote the system to the public and this physical engagement with them may serve as the most practicable way to solve the issue. However, this responsibility shall not be under the shoulder of DAB but instead commercial banks and other organs such as the Association of Banking and Finance of Afghanistan.
5. There are needs to exist a specific authority dealing with lease matters in the country and clear leasing law, which governs all matters regarding lease whether operational or

financing lease. At the moment, lease matters are only dealt with between the parties and if there is any dispute that arises, such matter will be handled by the Ministry of Justice.

6. The current law of foreclosure, according to the practice, is very strict as the courts deal with such cases based on the strict Shariah and customary rules. Based on the current practice, it is not easy to get approval/permission from the court to allow for a property to be sold off as they only allow it in extreme circumstances and the event of default in financing facility payment does not constitute one of the valid reasons allowing doing so. The court's approach is that they will as best as possible try not to displace people from their homes considering the conditions of the people, which are mainly poor, and that they do not have other assets except for their house.
7. For Islamic banking to develop further, Shari'a scholars should be allowed to apply their reasoning and depart from the rules from the Hanafi School of Jurisprudence if a solution is not found within the rules of the school. However, such an application must be only done on a strict and case-by-case basis where there are no other alternatives available and that full study and research on the matter have been conducted. The example of this application can be seen by the practice in Malaysia where there is no rule specifying the laws to be restricted to a particular school of thought and that the Shariah scholars on limited situations do apply the cross-school approach in searching for a viable solution to the issue in hand.
8. Generally, if the government wishes to solve the housing issue faced by its citizen, it should regulate and put a rule on the interest rate (for conventional products) and profit rate (for Islamic products) to limit it so that it would not make the price of the houses beyond the reasonable reach of the people. At current practice, developers tend to sell properties up to 100% of profit margin and those developers and banks tend to charge interest/profit rate also at a high rate making the house prices totally beyond the reach of ordinary citizens. The government may also play a role by giving incentives such as subsidizing the financing rate/ property price bearing in mind the financial condition of the vast majority of the Afghan people, which are under the category of the poor class.
9. There is a need to have a reformed address/postal system for properties in Afghanistan. Currently, we understand that there is no proper address/postal system and such an issue

will affect many other related matters such as security, housing finance, and foreclosure procedures.

10. ABA foresee a bright future for the real estate/property industry, especially due to its high demand. In Afghanistan, the demand for properties especially residential properties is always more than the supply especially when the statistics show that more than 70% of the Afghan people are without a home or a registered home. There is no specific regulation on selling properties in Afghanistan, the developers apply both methods although most the developers prefer and apply the concept of "sell then build" to gain capital for construction purposes.

According to ABA, there is no regulation/guideline explaining or regulating matters about the profit or selling price of the properties in Afghanistan. The profit can be 0% and reach up to 100% of the cost of the property. Normally, developers will not sell less than 30% of the profit margin and the price will go higher depending on factors such as demand and location. The current trend of the developers from the private sector is to sell the property based on "taking the profit as much as possible" especially when there is no regulation to govern this.

There is no regulation on payment by the purchaser against the property completion stage.

Normally the main source of funding of the developers is via financing from banks. However, there is often a conflict of interest in this situation as the shareholders of banks are often the shareholders of the developer's company.

There is a regulation, which requires a minimum capital of USD 100,000 to set-up and operates construction business activities in Afghanistan. However, this regulation is merely on paper and there is no enforcement of such requirements. Also, this regulation does not tally with the nature of the construction project, for example, the regulation imposes a minimum of USD 100,000 capital but there is no limitation to the size of a project that the company can undertake. Hence, often companies will register with the minimum amount of capital i.e. USD 100,000 but will undertake projects worth of million dollars and above.

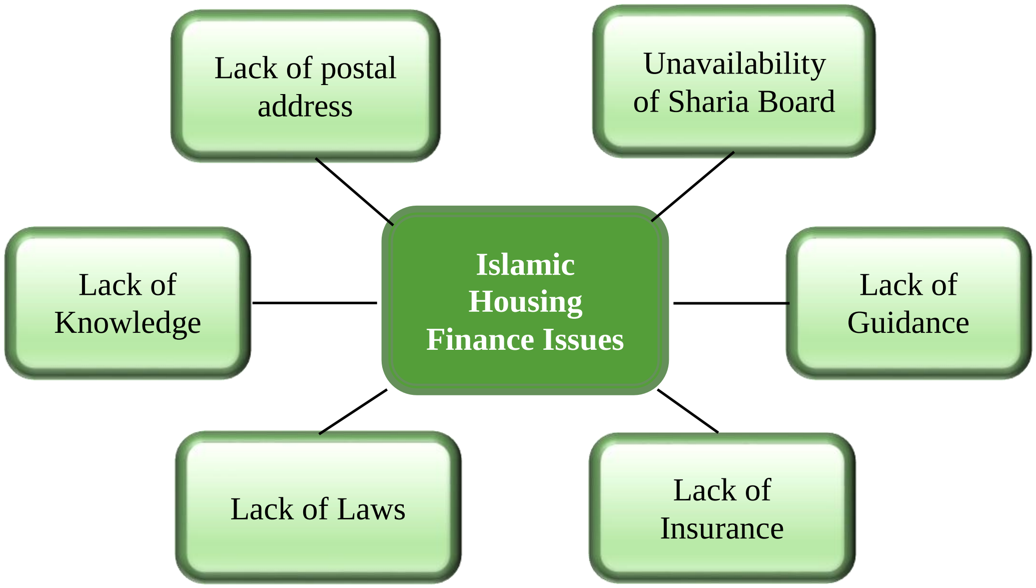
MoUD has created a master plan for 14 provinces in Afghanistan and each plan shall take into consideration the population and growth rate of that particular place. The master plan will also depend on the category of the land whether it is meant for residential or commercial use. To ease and allow proper monitoring of the development, the master plan is partitioned into 3-time period stages i.e. each of 5 years.

Coding Table

Themes	**Codes**	**Excerpts**
Islamic Housing Finance Issues	HFI1	• Unavailability of Sharia Board at central bank level
	HFI2	• Lack of rules and guidance on the double taxation
	HFI3	• Lack of insurance institution to protect the interest of lessor
	HFI4	• Lack of laws governing the rules of partnership
	HFI5	• Lack of knowledge and awareness by the public
	HFI6	• Lack of postal address system for properties
Obstacles for Bank to Issue Housing Finance Loans	OFB1	• Lack of proper insurance companies and titling problems
	OFB2	• Lack of capital for long-term loans
	OFB3	• Corruption in court system
	OFB4	• Difficulties in tracking individual
Development Opportunities	DPO1	• High demand
	DPO2	• Lack of regulations for profit/selling price of the properties
	DPO3	• Application of "sell then build" concept to gain capital.
	DPO4	• Availability of funding source

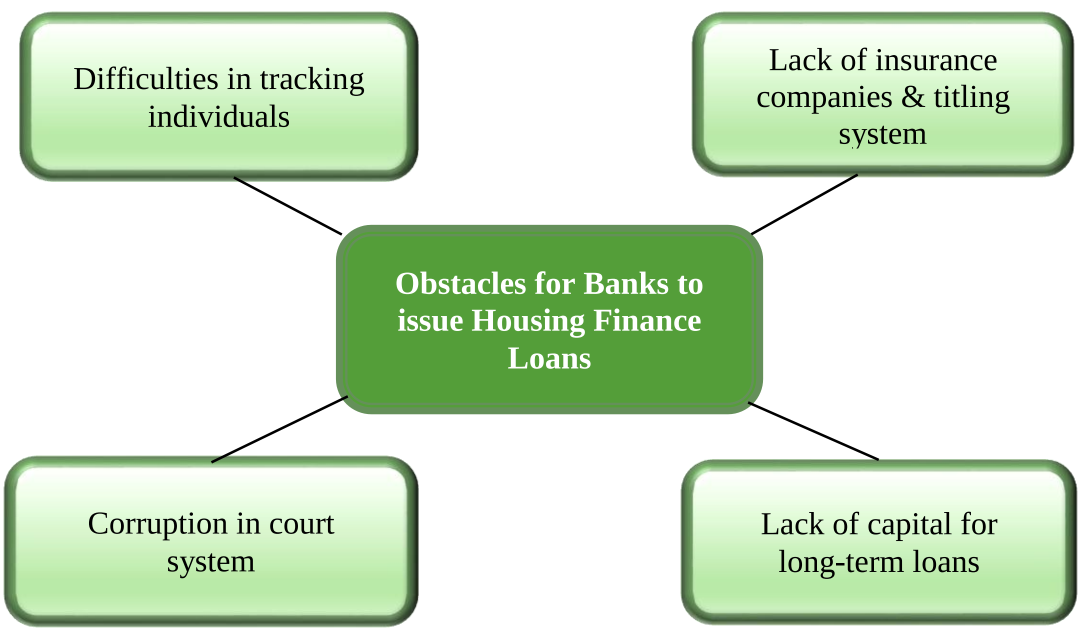
Graph 1 shows main issues that hinder housing finance product. Unavailability of Sharia Board at the central level which could be able to provide a standardization of practice among Islamic banks through Islamic banking business activities, lack of guidance on the double taxation issue as the modes of a Murabaha contract will involve two sets of buying and selling, lack of insurance which will be able to insure/protect the interest of the bank acting as a lessor in Ijarah contracts, lack of laws governing the rules of partnership in Afghanistan in a Musharaka contract, lack of knowledge and awareness by the public on Islamic housing finance products and the Islamic banking system in general and finally lack of postal address as there is no proper address/postal system and such an issue will affect many other related matters such as security, housing finance, and foreclosure procedures.

Graph 1: Main Issues for Islamic Housing Finance Products



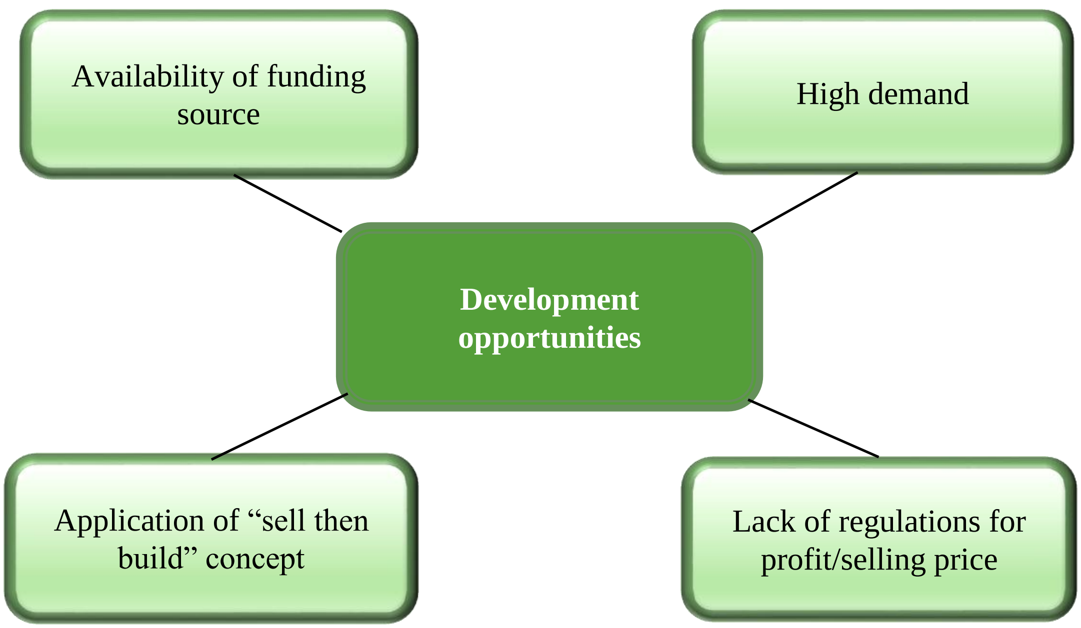
Graph 2 shows the main issues that hinders the banks and private sector on issuing housing finance products. Lack of proper insurance companies and titling problems, lack of capital for long-term loans, corruption in court system and finally difficulties in tracking individuals are those main issues.

Graph 2: Obstacles to Banks to Issue Housing Finance Loans



Graph 3 shows the development opportunities for housing finance products in Afghanistan. High demand (the demand for properties especially residential properties is always more than the supply especially when the statistics show that more than 70% of the Afghan people are without a home or a registered home), Lack of regulations for profit/selling price of the properties; the profit can be 30% and reach up to 100% of the cost of the property depending on factors such as demand and location which gives a high incentive to join this sector, application of "sell then build" concept to gain capital also helps the builders existence in the market and finally the main source of funding of the developers is via financing from banks. However, there is often a conflict of interest in this situation as the shareholders of banks are often the shareholders of the developer's company which makes is again an incentive for the builders to be in this sector.

Graph 3: Obstacles to Banks to Issue Housing Finance Loans



4.12 Views, Needs, and Requirements of the Private Sector

4.12.1 Provision of Housing Finance

There was an overall agreement between all sector representatives that the provision of housing finance is a necessity that will lead to economic growth because of the size of the housing market, the huge public demand, and because the housing market is connected to so many different sectors.

We asked bank representatives specifically about their views regarding investment in housing finance. All bankers stressed the importance and necessity of housing finance. Words such as important, necessary, crucial, and conducive appeared repeatedly in interviews. Bankers were very cognizant of the tremendous market demand for housing finance loans. They also stressed that housing finance products will be very conducive to the economic growth of the country and create jobs. The creation of partnerships between different sectors, especially between banks and developers, appeared in several interviews.

Developers, particularly, emphasized the need for banks to step in and meet the public demand for housing finance products. Developers emphasized the need for low-interest long-term loans. Their view was that the few options that currently exist for loans that can be used towards the purchase of a residential property are short term and very high-interest products that do not make the product feasible, or attractive, for the majority of the population.

We asked government officials specifically how they plan to meet the growing demand for housing. The response from our participants was almost unanimous. Housing finance products were seen as the most feasible way of meeting the increasing demand for housing nationwide. The government officials that we interviewed thought that the government is ready and willing to support a robust national housing finance program.

4.12.2 Needed Prerequisites for Developing Housing Finance

We asked interviewees from the different sectors what prerequisites they need for developing housing finance products. The overwhelming consensus was more supportive laws and a more effective court system. Participants felt that current laws were either non-supportive, too vague, or did not address the real challenges. Our analysis is that rather than the laws; the enforcement of laws is the primary challenge. Other areas of emphasis for an enabling environment included better security, a healthy economy, and greater employment to enable people to afford a housing finance loan and greater capacity within banks. This last point was of particular interest as many of the experts we interviewed expressed the lack of capacity and experience within banks with housing finance loans.

4.12.3 Challenges and Barriers to Investing in Housing Finance Market

The experts we interviewed echoed many similar themes from the needs and pre-requisites when we asked them what were some of the major challenges and barriers to starting housing finance loans. The biggest two areas of challenge highlighted by the experts from banks, developers, and government representatives were: 1) an ineffective court system and 2) lack of law enforcement. The courts were viewed as both corrupt where enforcement of laws was selective, and bureaucratic where repossession of property in case of default was almost impossible for banks.

The lack of a unique identification system for individuals and the lack of an effective postal address system were highlighted as major difficulties. The bank representatives felt without a clear tracking system it would be very risky for them to provide long term loans. Other areas that were emphasized included the lack of a clear financing mechanism for banks. Bankers felt their current financing structure was not sufficient to provide large-scale housing finance loans. Lack of capacity in dealing with housing finance loans and a clear payment collection mechanism were also mentioned by several of our participants as distinct challenges that banks were faced with.

According to the government representatives and developers we interviewed, the cost of purchasing a house coupled with a weak economy, high unemployment, and the current interest rates for loans, were barriers that made owning a house very difficult for a major portion of the society.

4.12.4 Housing Finance Market Implications

The results of the household survey identify market potential for housing finance loans. According to the survey, roughly two-thirds of survey respondents owned their homes, but 97% of homeowners acquired their homes through personal financing or inheritance. This suggests that a sizeable portion of the population might not own their home because they do not have the means to acquire one, and thus require an alternative financing mechanism. Direct questioning about the demand for housing finance loans corroborates these findings. Over four-fifths of survey respondents reported that they are interested in acquiring long-term loans to purchase new homes.

Afghanistan’s housing market is currently being developed. Market value in the five cities studied in this report is worth an estimated $15.8 billion. According to the literature review, however, investors are incentivized to develop higher-cost living units due to their greater profit margins. These development strategies juxtaposed against low household incomes create an environment in which housing finance loans are highly desirable if they are priced properly.

While the demand and market capacity for housing finance loans are present, commercial banks have encountered difficulty in offering such loans. Ineffective adjudication and unreliable law enforcement were cited as the two most important reasons why housing finance has not received significant investment. Banks are concerned that the government might not support the regulations that oversee the housing finance market, and thus the investment that banks make would be unprotected and subject to extreme risk. Interviewees thought that laws and regulations governing housing finance loans need to be developed, made clear, and enforced for the housing finance market to grow.

5 CHAPTER FIVE

5.1 Conclusion

The basic objective of the study was to identify needs, requirements, prerequisites, recent investments in the housing sector, and public demand for mortgage loans in Kabul city. After data analysis, the study revealed that various factors cause the creation of housing finance loans in financial institutions granting housing finance loans in Afghanistan. The main factors being high housing finance variable rate, loss of income, a general decline in economy and poor credit assessment mechanism. The key findings and conclusions of this study are:

- 52% of the respondents from the household survey reported that they were interested in obtaining housing finance loans.
- 80% of the respondents from the household survey reported they prefer long-term loans, and only 20% reported that they prefer short-term loans.
- 71% of the respondents from the household survey reported that they prefer non-interest based (sharia-compliant) housing finance loans, 9% reported that they are interested in conventional

loans, and 20% of the respondents reported that it does not matter whether the housing finance loan is interest-based or not.

- 72% of the respondents from the household survey reported that they are not able to pay more than AFN 380,000 (USD 5,000.00) down payments for a house.
- 42% of the respondents from the household survey reported that they prefer to buy homes from their own money, 28% prefer to have housing finance loans from family and friends, 27% reported that they have their houses inherited. Most importantly, only 3% of the respondents prefer having housing finance loans from the bank.
- Previous estimates by the World Bank and Da Afghanistan Bank put the housing demand at 1.5 million dwellings by the end of 2014. If we assume a conservative average of $40,000 per dwelling the housing demand in Afghanistan by the end of 2018 will be 70 billion USD.
- Based on expert and focus group interviews, the primary factors that are preventing banks from providing housing finance loans include: a) non-supportive laws, b) land titling problems, c) corruption in the court system, d) lack of capital for long-term financing, e) difficulty in the repossession of property in case of default, and f) difficulties in tracking individuals (including the lack of unique individual identification, and lack of postal addresses).
- Banks view housing finance loans as a crucial product for their business and are very interested in offering housing finance products. All the bankers interviewed as part of this study stated that their institutions are eager to offer housing finance loans both interest-based and non-interest based if the above challenges are addressed.
- Government agencies, banks, and developers see housing finance loans as an opportunity that addresses the increasing housing demand, as well as a means to bolster the nation's entire economy.
- Most commercial banks are keen to launch a housing finance product in the near term. Bank e Millie intends to allocate 10% of its loans to the housing sector and has set up a mortgage finance department to carry out the plan. But implementation has been delayed by lack of capacity. All commercial banks and microfinance institutions in Afghanistan need basic housing finance tools and training before they can introduce housing finance
- Lack of Homeowners Insurance:

  Afghan banks are reluctant to offer large loans without insurance on the collateral. But no company in Afghanistan currently offers homeowners insurance protecting against fire or earthquake, a specific concern in Kabul and the surrounding region. Although the country's insurance law was revised in January 2006, only one private insurance company has since started doing business. The Insurance Corporation of Afghanistan began operating in Kabul in October 2007, though it obtained its formal registration only in February 2008. Meanwhile, the public sector Afghan National Insurance Company is barely functional and substantially undercapitalized. Until more private insurance companies establish operations and begin providing homeowners insurance in Afghanistan, the risk of lending to homeowners may remain too high for banks.

- Lack of judiciary training in property law:
  Afghanistan lacks judges with good training in property law. Property disputes are heard in civil court, where the judges are generally poorly versed in property issues. The Rule of Law Program, a year-long training course for judges funded by the U.S. Agency for International Development, focused very little on property law. While there is now a property tribunal set up in Kabul to resolve property disputes throughout Afghanistan, the results have been poor because of a lack of training and authority. Provincial-level courts have had little or no impact on the way disputes are settled. Instead, tribal or informal means of dispute resolution are usually used. This approach works well for members of the dominant ethnic group or tribe, but less so for members of a minority or women. Fair outcomes have been possible, but in cases where one party has political or other influence, the result is often biased (UNHCR 2003). The Afghan civil code recognizes mediation and arbitration as legal forms of dispute resolution.

5.2 Recommendation

5.2.1 Home finance working group:

A policy-working group sponsored by appropriate Government entities should be set up in collaboration with sector stakeholders. This Group should consider the most appropriate policies for Afghanistan to facilitate homeownership and address the issues raised in this report. This is a short-term goal.

5.2.2 Affordable housing:

Specific mechanisms are required to be designed to facilitate the provision of adequate housing to all sections of society. For low income, this could include housing microfinance, rental frameworks, financing for self-construction, etc. This is a medium-term goal.

5.2.3 Housing finance regulation:

The current legal and regulatory framework should be reviewed to ensure its adequacy to support a developed home finance sector. This should include aspects such as minimum product standards in loan to value and payments to income, foreclosure, etc. This is a short-term goal.

The prerequisites for developing the housing finance market. These include a sound legal environment for market participants such as financial institutions, housing developers, and property buyers and sellers; improved systems for property titling and registration and enforcement of liens; and establishment of a legal and regulatory framework for the insurance industry

5.2.4 Islamic home financing:

A strategy to establish an Islamic home finance industry and the provision of products should be established. This strategy should incorporate actions, including (a) Capacity building of government and industry representatives on the principles of Islamic finance; (b) Review and update as required of legal, fiscal and regulatory frameworks to ensure Islamic home finance products can be provided; (c) Create awareness of Islamic home finance through media campaigns; (d) Establish supporting frameworks for Islamic finance including professional development of Islamic scholars.

5.2.5 Consumer protection:

Appropriate consumer protection and campaign on home finance literacy should be undertaken. To protect consumers this should include minimum disclosure requirements, complaints handling procedures and independent arbitration process. Alongside this to ensure home finance and its implications are understood as a campaign to explain home finance and how it works should also be undertaken. This is a medium-term goal.

5.2.6 Develop the housing finance market by enhancing capacity in commercial banks:

Introducing new housing finance products and putting into place a guarantee facility to mitigate the risks for commercial banks relating to property titling and registration or enforcement of liens.

5.2.7 Develop housing microfinance:

By creating incentives for microfinance institutions to engage in nonmortgage lending. To create such incentives, the government and donors should provide technical assistance to microfinance institutions in piloting and rolling out expanded microfinance lending for the housing sector.

5.2.8 Establishment of home insurance:

Afghan banks are reluctant to offer large loans without insurance on the collateral. But no company in Afghanistan currently offers homeowners insurance, so the government, donor agencies & private sectors must work in this area and establish some home insurance companies to support banks accordingly. A bank willing to provide a housing finance loan would face discouraging obstacles in creating a lien against the property to secure the loan and, in the event of default, in enforcing its security. Support creation of the property insurance industry and review insurance law to ensure that it attracts insurance companies to the market

5.2.9 Enhance land titling and registration system:

This required to review existing title records and claims, simplify and reduce the cost of registration and transfer, and integrate formal and informal transfer systems. Move toward computerization of all land ownership records, map all property boundaries, and improve the security of tenure for all families, including those lacking titles.

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Questionnaire

Dear Madam/Sir,

I am Edrees Bahadur, pursuing my master's degree in business administration at Kardan University. The purpose of this survey is to identify the needs, requirements, and views of the private sector with regards to providing mortgage products and investing in the market for housing finance in Afghanistan. This survey will also assess Afghanistan's business environment for the development of the housing finance industry and identify existing challenges, barriers, and opportunities for investment by financial institutions and housing developers combined with specific recommendations on ways to remove the barriers and make the industry functional.

Thank you,

Edrees Bahadur

Public Questionnaire

1- Do you have a bank account and keep your deposits/savings in the bank?

Yes

No

2- Do you trust banks in Afghanistan for your day-to-day financial transactions in comparison to other traditional financial intermediaries such as money dealer?

Yes

No

3- Where do you take a loan from when you need money?

a) Family
b) Friends
c) Banks
d) Money Dealers
e) employer

4- Do you want to buy or own your own house in Afghanistan?

Yes

No

5- Do you know what is a mortgage loan?

Yes

No

6- Do you have your own home or rented a house?

a) Own Home
b) Rent
c) Giraw
d) Mortgage

7- What is the source of property acquisition?

a) Purchased with Own Money
b) A loan from Family or Friends
c) Loan from Banks
d) Inherited from Family

8- Are you interested to take a housing loan to buy a house?

Yes

No (if not why) ________________________________

9- Which type of housing loan are you interested in?

a) Islamic housing loan

b) Interest bearing housing loan.

10- Are you interested in long term mortgage loan to buy a house?

Yes

No (If not why?)________________________________

11- Are you willing to accept a mortgage loan repayable at less than a year time frame?

Yes

No

12- Do you believe that the time given to the borrower is sufficient to make the payment?

Yes

No

13- Do you believe that there is an effective ownership titling system?

Yes

No

14- Do you believe that a house is a good investment?

Yes

No

15- Which of the below mortgage maturing timeline do you prefer the most?

a) 1 year

b) 1 to 2 years

c) 3 to 5 years

d) 5-10 years

e) > 10 years

16- Which mortgage loan would you prefer?

a) 15% conventional interest loan

b) 15% profit sharing Islamic loan

c) Either

17- Why are you not willing to get a mortgage loan?

a) The interest rate is very high for long-term loans in Afghanistan

b) Interest is not permissible in Islam

c) We don’t trust banks in Afghanistan

d) Bank asks for too much upfront collateral

e) The process of mortgage loan is very lengthy and uncertain

Questionnaires for Commercial Banks

1. Does your bank offer Islamic banking services?

   Yes

   No

2. Do you offer mortgage loan products to your customers?

   Yes

   No

3. What type of mortgage loans do you offer to your customers?

   a) Conventional banking short-term loans

   b) Murabaha

   c) Mudarabah

4. How many mortgage loans do you process in a month?

   a) None

   b) 1-5

   c) 6-10

   d) more than 10

5. What is the maturity period offered on your bank's mortgage loans?

   a) Six months

   b) 6 months to 1 year

   c) 1 to 3 years

   d) 3-5 years

   e) above 5 years

6. How much interest does your bank charge on the principal amount for mortgage loans?

   a) 1% to 5%

b) 5% to 10%

c) 10% to 15%

d) more than 15%

7. What kind of collateral does your bank expect from a customer in mortgage loans?

a) Land/deed Title

b) Guarantee letter from another individual or institution

c) Good credit rating of customer

d) Moveable assets

8. How much collateral does your bank require on the principle amount for mortgage loans?

a) 20% of the principal amount

b) 20-50% of the principal amount

c) 50% to 100% of the principal amount

d) More than 100% of the principal amount

9. What are the top 5 reasons among the following, that stopping banks from processing a large number of mortgage loans despite a huge demand for housing in Afghanistan?

a) Land titling problems

b) Corruption in the court system

c) Lack of capital for a long term loan

d) Lack of proper insurance companies

e) Islamic Shari'a law

INTERVIEW SESSIONS SCRIPT

INTERVIEW SESSION WITH DA AFGHANISTAN BANK (DAB)

Date: 9 November 2019

Time: 9:00 AM – 12.00 PM

Interview with:

Wahidullah Nosher – Deputy Governor of Da Afghanistan Bank

Interview Questions and Answers:

1. **Question:** In many countries, banks' main business activities as stated in the laws are only restricted to money lending and borrowing whereas in Islamic finance products such as Murabaha, banks' will act as a trader in buying and selling tangible assets such as properties and commodities to their customers. The current banking laws in Afghanistan are silent on this issue, as such, on which regulation shall Islamic banks/ banks offering Islamic products shall rely on to legalize their business activities in this respect? Or does the silence in the laws imply that the banks are allowed to do as such?

Answer: Indeed the current Afghanistan banking law has no specific provision on the matter. As currently practiced procedure is that any bank wishing to conduct Islamic banking activities will submit a formal request/application to DAB and upon approval DAB will grant a special permit to that particular bank to allow them to conduct banking activities according to the Islamic modes and principles. Such an application is given on a case-by-case basis but DAB under this project and other related projects are trying to improve the law and system to be more adaptable to Islamic Finance in a more systematic manner.

2. Question: Is this the basis on which the current banks offering Islamic products in Afghanistan conduct their Islamic business activities or is there any specific regulation/ circular from DAB giving them the specific permission on this?

Answer: Answer as per the above.

3. Question: Are banks allowed to own or become the legal owners of the property and list it on their balance sheet?

Answer: If DAB has granted the bank (upon its application) with specific permission to conduct Islamic Banking activities, then the bank is allowed to conduct Islamic business activities in any way that the Islamic models and principles require. These will include products based on trading such as Murabaha and leasing such us Ijarah where the bank shall become legal owners of properties and list them on its balance sheet in the course of the financing facility offered to its customers.

4. Question: Who takes care of tenancy matters in Afghanistan and would they have powers over financing leases as well?

Answer: We have a financing lease law, which was issued about 3 months ago to regulate matters regarding leasing in the country. The Ministry of Justice issued it and the same ministry will take care of all issues surrounding it including enforcement of actions. The lease law will include all types of the lease whether operational or financing lease.

5. Question: To what extent do you think people would prefer Islamic home financing loans to conventional banking loans based on the latest survey? What is your basis for this opinion?

Answer: Based on the 2013 survey conducted by Harakat, a survey conducted on 1,159 families in 5 major Afghanistan provinces has shown the result that more than 90% of the people expressed their interest in Islamic financing loans over conventional banking loans.

6. Question: Are there any tax implications for Islamic financial products especially when it involves more than one contract e.g. purchase and sale.

Answer: We are not too sure about this issue, as there are no Islamic banking products available in the market so far which has been subjected to double taxation issues. Also, there is no Islamic home finance facility yet available in the market that could test this scenario; hence no parties have faced this issue. Nevertheless, we are interested to know from the tax authority on their views when such an occasion is to happen.

7. Question: Will there be any incentives to promote the take up of Islamic Banking and Finance (IBF) in Afghanistan?

Answer: Absolutely. The financial strength of banks in Afghanistan is very good with the availability of 70-90% of deposits under the current accounts in all banks and that commercial banks also have up to USD 4 billion of liquidity. This financial strength would give huge interest to banks to diversify their business activities and to take up IBF activities due to the huge demand.

Also, DAB is committed to promoting IBF due to the large population of Muslims in Afghanistan and based on the recent survey, they preferred Islamic products to conventional ones. However, DAB would not be able to show and offer active sort of incentives to banks to offer Islamic products and to actively promote it to the people at large as DAB is not in the position to do so and such responsibility shall be on the banks themselves as well as other organs. In terms of tax incentives, DAB is also not in a position to provide any such incentives as such matter is under the powers of the ministry of finance and tax authorities. Nevertheless, DAB supports such action and are keen to know the view and proposed plan by the tax authority with regards to this.

DAB's strong interest in promoting Islamic banking in the country can already be seen from its support in putting together the Islamic Banking laws which are now at final stages of approval and the permission granted to banks to conduct Islamic banking activities without being too rigid in terms of the rules and conditions.

8. Question: Is there any recognition of the concept of beneficial ownership in Afghanistan and are there any anticipated obstacles for the creation of such recognition for IBF?

Answer: Generally, the laws in Afghanistan are based on Shari'a law. Although Shari'a law recognizes the concept of beneficial ownership, however, this is yet to be legally documented in any of the applicable laws in Afghanistan. There is no trust law in the country at the moment, which normally captures the provision on this. Nevertheless, we are always moving towards it.

9. Question: What has, in your view, been the obstacles in growing IBF in Afghanistan?

Answer: From our point of view, we think that the knowledge and awareness of the people on Islamic products may be the main obstacle to the growth of IBF in Afghanistan. There is a real need for a lot of training, awareness programs, etc. to explain and promote the system to the public at large especially when they may not have any knowledge whatsoever on it. However, it is not under the responsibility of DAB to conduct such training/programs but perhaps commercial banks and other organs such as the Association of Banking and Finance of Afghanistan that should take-up this task. This will largely benefit them as well.

Besides, there are also security issues faced such as no proper insurance framework to provide guarantee/collateral to the payment of the facility and this is a major issue for banks in assessing the credit risk of the customer. These are among the main obstacles to the application of Islamic financial products in the country.

10. Question: What are the banks' motivations to grant home financing to the public?

Answer: The most important motivation for banks to offer housing finance loans to the public is because many of the people here are still homeless. Secondly, we would wish to offer Islamic house finance loans to the people because the vast majority of the people are Muslims and they would, of course, prefer Islamic products to conventional ones.

11. Question: Do banks have an end-to-end system for house financing facility?

Answer: At the moment I can say that we do not have an end-to-end system for Islamic house financing facilities, as there is no such product being offered yet in the market.

12. Question: How is the performance of house financing so far?

Answer: This question needs to be addressed to commercial banks, as they would probably have the best knowledge of it. We do not have any records at the moment but we have granted permission to banks to conduct Islamic business activities upon their request.

13. Question: Under Ijarah financing, banks are allowed to use either a fixed or floating rate. What are the current market preferences for financial institutions in Afghanistan? Would a fixed rate be a competitive mechanism?

Answer: This is left entirely at the discretion of the banks as they have the right to determine the commercial aspects of their business and DAB will not interfere with this matter and accepts any position taken.

14. Question: What are the minimum and maximum financing tenure for house financing loans in Afghanistan?

Answer: There is no central bank regulation on this, but from my knowledge, Banks in Afghanistan normally grant house loans (conventional product), which are the only ones applicable so far, a minimum of 1 year and a maximum tenure of 5 years with no interest charge. This, however, is only the package for the bank employees and does not apply to other people.

15. Question: Is there any plan to allow secondary financing?

Answer: Currently there is no secondary financing available as we are focusing on the primary stage first. Having said that, we are moving towards this already with the draft of the Sukuk law, which is currently with the Ministry of Justice for their review. This is the first step for many things to come. Once the Sukuk law has been approved, we will bring the necessary changes to the housing finance law for adaptation processes.

INTERVIEW SESSION WITH GHAZANFAR BANK

Date: 16 November 2019

Time: 10:00 AM – 11:30 AM

Interview with:

Ali Mushtaq – Head of Islamic Banking, Ghazanfar Bank

Interview Questions and Answers:

1. Question: Can you explain about the types of Islamic banking products that your bank has and offers so far?

Answer: Currently, we only have a few Islamic products offered in the market. On the savings account, we have 2 types firstly Mudarabah savings account and secondly, Mudarabah fixed deposit account. The other one that we have is the current account, which is based on the Islamic principles of Wadi'ah. We also have an equipment-financing product based on the concept of Murabaha.

2. Question: Do you have any Islamic housing finance loans?

Answer: We have no Islamic housing finance loans yet.

3. Question: What are the major issues and challenges to create Islamic housing finance products in Afghanistan?

Answer: The main issue I think would be the issue of Qabalah (Land Title) as banks would not want to become the owner of properties due to many responsibilities which will create a lot of liabilities especially in the current legal framework of the country. For instance, when the bank becomes the owner of the property, it will have to bear the cost of maintenance and insurance of the property and there is currently very limited insurance service available in the country. Also, there are issues with the court system where the court will become the decision making authority for matters such as foreclosure in mortgage set-ups and based on the practice here, it is not easy to get the approval/permission from the court to allow for a property to be sold off as they only allow it in extreme circumstances and in the event of default in financing facility payment does not constitute one of the valid reasons allowing to do so.

On a general note, the public views Islamic loans as less profitable due to zakat issues. For instance, on the Mudarabah deposit product, customers will be subjected to a 20% tax by the government and another 2.5% charge for zakat. Hence, the customer will end up obtaining less from an investment deposit in a conventional product.

4. Question: What are the requirements for banks to conduct Islamic banking business activities and how is the practice?

Answer: Any banks that wish to conduct Islamic banking activities must apply directly to DAB and DAB will review their application accordingly. If granted,

DAB will issue the bank with a circular stating that the bank has the permission to offer Islamic banking products to its customers. The circular is very general and there is no specific rule or conditions stated there. We have also gone through this process and obtained permission on this.

However, the main problem lies in the regulatory framework of the industry that is still vague. Its practice solely depends on the rules and directions provided by the Shariah Board of the bank, which the bank shall follow such made decisions accordingly.

5. Question: What are the rules and principles followed by the Shariah Board of your bank?

Answer: Generally, the law of the country provides that any Islamic rules and application must be based on the rules of the Hanafi School of jurisprudence.

6. Question: One of the modes of Islamic housing finance loans is by the practice of Ijarah (leasing) and this differentiates and recognizes the concept of beneficial and legal ownership. Does the law in this country recognize the concept of the two and how is it applied?

Answer: Indeed, under Ijarah model of housing finance, there is the differentiation between the beneficial and legal ownership of the property. Such a principle is also derived from the general rules of the Shari'a laws. However, such rules and principles are legally not documented anywhere in any of the laws of the country but it is being practiced by the people traditionally, customarily and historically. Hence, there may be major issues if such rights are to be enforceable in the courts of law since it is not available anywhere in the legal system.

7. Question: What do you think are the major obstacles for the growth of Islamic banking products such as Islamic housing finance loans in the country?

Answer: I think the major obstacle to the growth of Islamic banking products is the issue of public knowledge and awareness. The vast majority of the people still are unaware of the concept of Islamic banking products and its fundamental theories and whenever they noticed that they would end up paying higher than the financing amount similar to conventional products, they will not accept the concept. There is a huge need for banks and academic institutions to conduct awareness programs and training which can explain and provide them clarification on the concept and application so that they will at least have a clear idea on the system and not judge blindly.

8. Question: You mentioned that your bank also offers equipment financing based on the principles of Murabaha. How does it work and how does the bank ensure the security of the payment? Is it by way of mortgage of the same property?

Answer: In the Murabaha equipment financing product, we would require collateral by the customer to secure the payment of his financing facility. However, as per our bank practice and even the prevailing market practice is that we do not use the same financed property as the collateral but instead, require the customer to provide a different property as security.

One of the reasons behind this is because of the value of the equipment being financed will almost always decrease in value and may not be able to match the financing facility price in the event of default of payment. Generally, even the real estate properties in this country tend to decrease unlike in most of the worldwide countries where house value always increases in value by year.

9. Question: In a Murabaha-based product, there will be two occasions of buying and selling of the same property, one between the developer and the bank and second between the bank and the customer. Normally, this will incur double taxation issues whereas in substance it is merely one single transaction. What is your view on this and whether Islamic banking products will always be a step behind from conventional products due to this issue?

Answer: Indeed, a Murabaha-based product will incur a double taxation issue due to the nature of the product. At the moment we only have one product that is based on Murabaha, which is an equipment finance product, and as far as it has been practiced, there is no double taxation issue probably due to the nature of the equipment, which is relatively small in value. However, I do think that tax issues will be applicable for houses as the value is high. This is also among the reasons we do not do Islamic housing finance products yet due to this cost issue and that the tax rate is quite high. I believe that if Islamic housing finance loans are to gain success like conventional products, this issue must be addressed and resolved by the tax authority at least by giving special treatment to Islamic banking activities.

10. Question: Who takes care of tenancy matters in Afghanistan and would they have powers over financing leases as well.

Answer: There is currently no leasing department yet in Afghanistan and the Ministry of Justice deals with matters of leasing in the country. However, financing lease is a major issue in the country and has not been offered by any financial institutions until now mainly because of the lack of insurance framework in the country. Insurance is only available in very limited situations and offered by very limited companies.

11. Question: What are the banks' motivations to grant housing finance loans to the public?

Answer: I think that the main motivation for banks' is a demand for the housing sector in Afghanistan. Having said that, there are still many issues from the bank's side and the customer's side. For instance, on the customer's side, there is no stable income for the vast majority of the Afghan people, hence creating high credit risks issue.

12. Question: Under Ijarah financing, banks are allowed to use either a fixed or floating rate. What are the current market preferences for financial institutions in Afghanistan? Would a fixed rate be a competitive mechanism?

Answer: I believe that banks here would prefer a fixed rate because unlike other countries, there is no international interest-benchmarking rate used in the country like LIBOR, etc. Hence, a fixed rate would be a better option.

13. Question: What are the minimum and maximum financing tenure for housing finance loans in Afghanistan?

Answer: The situation in Afghanistan is very different from other countries due to its conditions. From my experience, the maximum tenure granted for a home loan (as there are no Islamic housing finance loans yet) is 3 years but 100% of the facilities that our bank has offered and are offering via its conventional product to date is only for 1 year. This is also almost the case for all other financing facilities offered by banks within the country. I would suggest that the maximum financing tenure should be at least 5 years.

14. Question: What are the procedures on a charge, security, and foreclosure for properties in Afghanistan?

Answer: The procedures are all stated in one code i.e. the law of mortgage of immovable property and any matters about it is dealt with by the courts of law. Internally, our legal department will deal with these issues when they arise.

15. Question: How do you fund the housing finance e.g. from deposit/ securitization/ capital injections etc.?

Answer: Currently, all of our funding comes from our depository products. The financing facilities are secured from collateral and that collateral must be a registered property with the government. For your information, there are many properties, which are not registered with the government, and they remain so due to the non-availability of enforcement actions.

16. Question: How do you manage risks concerning housing finance loans?

Answer: Our risk department deals with risk issues. They will conduct an initial evaluation and the report will be presented to the Chief Executive Officer, who also serves as a member of the Risk Committee of the bank. Then they will deliberate on the issue and decide accordingly.

17. Question: What is your policy about the client's information?

Answer: We have dedicated officers dealing with the information of our customers. This department will deal with the Public Credit Registry (PCR) under the Credit Bureau of DAB.

18. Question: What are the main challenges in the housing finance industry that you face today?

Answer: There are a lot of challenges in the housing finance industry that needs to be addressed. For example, the weak and lack of an insurance system in the country, a non-comprehensive legal system, double taxation issue faced by Murabaha products, the inefficiencies of the postal/house address system, trainings to the judiciary system to make them aware of Islamic banking products and applications, the weak credit policy system and last but not least, the political system of the country which needs to be strong and stable are the main challenges.

INTERVIEW SESSION WITH MINISTRY OF URBAN DEVELOPMENT

Date: 23 November 2019,

Time: 10:30 AM – 12:00 AM

Interview with:

Mr. Yawari – Director of Housing Sector, Ministry of Urban Development

Interview Questions and Answers:

1. Question: Can you describe briefly the planning law in Afghanistan?

Answer: At present, we have an existing law on property development but it is quite old and not in a detailed manner. As we speak, we are now actively working on developing a revised comprehensive set of laws governing property development, which includes strengthening the existing law and inserting other new provisions to make the system better for the benefit of the Afghan people.

2. Question: Can you briefly explain about the housing development in Afghanistan and the processes involved?

Answer: Housing is defined as "providing shelter for individuals" and that any application to build a house should meet the conditions and climate of the country. In Afghanistan, people can be classified into 3 groups i.e. people from the low class, which consist of about 60% of the population, middle class, about 20% and upper class, about 20%. The license and requirements granted to developers to develop residential properties shall depend on these classes. As explained earlier, currently we do not have a complete and comprehensive code that regulates matters on housing development in the country and explains the procedures. Our current practice is to refer to codes from other countries such as in Europe and southeast Asia and try to follow the best practices and adopt them in our country.

3. Question: Who decides on the zoning of land for residential or commercial use?

Answer: Another department called Directorate of Planning and Urban Development does this. This department has created a master plan for 14 provinces in Afghanistan and each plan shall take into consideration the population and growth rate of that particular place. The master plan will also depend on the category of the land whether it is meant for residential or commercial use. To ease and allow proper monitoring of the development, the master plan is partitioned into 3 time period stages i.e. each of 5 years. I also give a large contribution in this process by giving advice and opinions although the task is not directly under my department. Right now, the plan is being executed in the province of Kandahar.

4. Question: Is it a straightforward process to change the use of an existing building?

Answer: At the moment there is no law regulating such process. A person seeking to change the use of an existing building will need to prepare a master plan for this purpose. This application will be presented to a special committee in which they will review the application and decide on it accordingly. In this sense, it is quite a straightforward process.

I have previously proposed to the government that only the minister shall be given the authority to decide on such matters, with his view is to be discussed in the 'council of ministers' meeting and to be presented straight to the President for his ultimate decision. Unfortunately, this proposal was not accepted. Now, I can say that the process is more given on a discretionary basis by the person having the authority to decide.

5. Question: How is the planning enforcement process in Afghanistan?

Answer: We are now in a transitional period between the old laws to the new laws. Therefore, at present, there are no specific enforcement actions on matters relating to housing laws and regulations. Having said that, the ministry is committed to emphasizing a stricter regulation including enforcement actions soon. However, this is never a straightforward process. Afghanistan has been facing a lot of corruption problems, which makes enforcement actions a more difficult task. For example, if a person wishes to change something about his property, he will just change it as and when he wishes without having to go through strict procedures and approval procedures as required as he will have inside connections with the government/ relevant authority which would at any time save him against any legal actions.

6. Question: Is there a master plan for housing development in Afghanistan?

Answer: Yes, as explained before, there is a master plan for 14 provinces in Afghanistan and now we are in the process of executing the plans. We are also seeking resources and assistance from external parties to execute the plans bearing in mind the limited expertise and resources that we have. This master plan also involves different phases such as water, traffic lights, type of houses and each subject matter needs technical advice from the subject matter expert. Hence, we are involved in different stages of planning.

We have also established another special committee to evaluate developers in the country. The evaluation process shall cover every single aspect of the developer company such as its financial strength, staff, etc. So whenever we receive a plan, we shall conduct a proper evaluation process such as reviewing the architecture plan, etc. and only after all of these are satisfied then we shall give formal approval. The decision-making process will also include the deputy minister himself.

7. Question: Is there any restriction on the recognition of beneficial ownership for property developers, corporation or individual sellers?

Answer: We have limited knowledge on this matter but we believe that this should not be an issue. In fact, in some situations this concept may have already been applied with the ownership of a property/good is transferred to the purchaser after the payment is made. We believe that this may be put into proper legal documentation but I foresee that this may involve a lot of procedures.

8. Question: What are your views of Islamic finance products and their future in the country?

Answer: I believe that we are very open to the introduction of the system especially when the Afghan people are traditionally and historically attached to the Islamic norms and culture. After all, Afghanistan is an Islamic country and wants Islamic activities. I think that previously, the system used to exist in the country but probably on an informal basis or not similar to today's modern application. Nevertheless, I believe that we should always move towards it especially when there is a lot of support and encouragement from many groups of people. This is also the reason why the amount of Islamic deposits at banks now is even higher than conventional products and people have always demanded more from this industry.

INTERVIEW SESSION WITH AFGHANISTAN BUILDERS ASSOCIATION (ABA)

Date: 30 November 2019

Time: 9:00 AM – 3:00 PM

Interview with:

Hamidullah Habibi – President Afghanistan Building Association

Mohammad Rafi Amiry – General Manager, Harirod Group of Companies

Amanullah Mangal – President of Fast Eagle Construction Company

Interview Questions and Answers:

1. Question: How do you foresee the housing development in Afghanistan for the next 5-10 years?

Answer: We foresee a bright future for the real estate/property industry, especially due to its high demand. In Afghanistan, the demand for properties especially residential properties is always more than the supply especially when the statistics show that more than 80% of the Afghan people are without a home or a registered home. There are also a lot of investments coming into Afghanistan either from local or international investors. As such, we are quite optimistic about the future of the industry and that it will be growing bigger by time.

2. Question: What is the current process/procedure of selling properties in Afghanistan e.g. whether it is based on a build then sell or sell then build process?

Answer: There is no specific regulation on this and at present, the developers apply both methods although most of the developers prefer and apply the concept of "sell then build" to gain capital for the construction purposes.

3. Question: Are there any regulations on the profit margin upon developers from the sale of the properties?

Answer: There is no regulation explaining or regulating matters concerning the profit or selling price of the properties in Afghanistan. The profit can be 0% and reach up to 100% of the cost of the property. Normally, developers will sell not less than 30% of the profit margin and the price will go higher depending on factors such as demand and location. The current trend of the developers from the private sector is to sell the property based on "taking the profit as much as possible" especially when there is no regulation to govern this.

4. Question: Is there any regulation on payment by the purchaser against the property completion stage?

Answer: Currently there is no regulation as such. The developers are allowed to charge and demand payment of whatsoever percentage of the selling price from the purchaser and at any time of the property development stage.

5. Question: What is your view if a regulation governing payment against the property completion stage is imposed to protect the interest of the purchaser? For example, only when the property is at least 30% completed then the developer can ask for payment from the purchaser and this will increase accordingly as per the property development stage?

Answer: On our side, we have no issue if this regulation is to be imposed. This will be good to protect the end customers but there may be a problem to many developers in terms of cash generation for them to start with the property construction especially when they do not have any other sources of funding except by solely relying on the payment received from the purchasers. If such regulation is to be imposed, we would suggest that a maximum of 30% amount can be collected from the purchaser before the start of the construction of the property for cash generation and that the developer should bear the 70% remaining construction expenses. Only after the full completion of the property can the developer collect the balance 70% selling price of the property from the customer.

6. Question: How do the developers get funding for their housing projects?

Answer: Normally the main source of funding of the developers is via financing from banks. However, there is often a conflict of interest in this situation as the shareholders of banks are often the shareholders of the developer's company.

7. Question: Is there any minimum amount of paid-up capital to set-up a construction company?

Answer: There is a regulation, which requires a minimum capital of USD 100,000 to set-up and operates construction business activities in Afghanistan. However, this regulation is merely on paper and there is no enforcement on such requirements. Also, this regulation does not tally with the nature of the construction project, for example, the regulation imposes a minimum of USD 100,000 capital but there is no limitation to the size of a project that the company can undertake. Hence, often companies will register with the minimum amount of capital i.e. USD 100,000 but will undertake projects worth of million dollars and above.

8. Question: Why would developers often aim for a high project value when they only have a limited source of capital/funding?

Answer: Because the developers will be able to charge the highest amount of profit due to the high risks that they take. Plus, there is no insurance applicable in Afghanistan unlike other countries to mitigate the risks of the developers. Hence, this would justify their actions.

9. **Question:** Whether there is any support from the government on housing development such as tax incentives?

Answer: There is no support from the government on housing development in Afghanistan whether in terms of tax incentives or others. Tax will be at the same rate to all developers i.e. 20% of the profit plus 2% for the deal (22% total) regardless of how much projects that the developer develops for the development of the country and the benefit of the Afghan community. There are also no tax incentives to us even if we lower down the prices of the properties to make it more affordable to the people. Therefore, we can say that there has been no support from the government to the developers up to date.