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Saudi Mortgage Law Opens Kingdom to Home Lending Surge

By Zainab Fattah

Saudi Arabia's mortgage law, approved two days ago after more than a decade of debate, will encourage banks to expand lending in a \$16 billion market that now accounts for less than 4 percent of all home purchases.

The market may increase to about \$32 billion annually over the next 10 years, providing opportunities for lenders, property developers and middle-class Saudi homebuyers, according to Naveed Siddiqui, chief executive officer of Capitas Group International, a Saudi company focused on Islamic finance.

"The financial sector alone in Saudi Arabia will not be able to fill the gap," he said in a telephone interview yesterday. "The government will have to allow non-banking financial institutions such as mortgage companies to come in to stimulate the market."

The package of five separate laws will overhaul the home-finance market including the creation of mortgage providers, the foreclosure process and the oversight of lenders. Regulations required to implement the law will be issued within three months, Saudi Arabia's finance minister Ibrahim al-Assaf said in comments published by the Saudi Press Agency.

The changes are designed to ease the concerns of lenders discouraged by unclear regulation that can lead to lengthy court disputes. Currently the majority of mortgages are provided by the state's Real Estate Development Fund, which offers interest-free loans to low-income buyers. The fund has a default rate of 30 percent, Director General Muhammad Al-Abdani said in an interview yesterday.

Few Mortgages

About 3.5 percent of all home purchases in the kingdom, the world's largest oil exporter, are financed through mortgages. That compares with 17 percent in the United Arab Emirates and 70 percent in the U.K. Saudi banks provided 29.3 billion riyals (\$7.8 billion) in mortgages last year, 27 percent more than in 2010, according to the Saudi Arabian Monetary Agency, SAMA.

"Clarity on the foreclosure process is likely to allow banks to be slightly more aggressive in mortgage lending," Jan Pawel Hasman, an analyst at EFG-Hermes Holding SAE, said by e-mail. "Mortgages have been one of the key drivers for retail loan growth over the last 12 months."

The regulation will lead to the establishment of licensed mortgage providers overseen by the central bank, Ibrahim Al Naseri, a lawyer who served as a general counsel for the Saudi Market Authority, said in a phone interview yesterday. While most will be private, it's likely that state providers like Fannie Mae (FNMA) and Freddie Mac in the U.S. will be established for refinancing, he said. The state real estate fund will probably help lower-income buyers secure mortgages from banks by granting them interest-free loans of 500,000 riyals, he said.

Deutsche Bank

Almost all banks operating in Saudi Arabia have built up their mortgage business over the last 12 months to 18 months in anticipation of the law change, Hasman said. Deutsche Bank AG (DBK) formed a \$110 million joint venture for mortgages compliant with Islamic sharia law in April 2010 and the Frankfurt-based lender is already giving out 5-year to 20-year mortgages to both Saudis and foreigners living there.

Tamweel PJSC climbed as much as 2.9 to the highest in more than two months today amid investor speculation that the Dubai-based mortgage provider may expand into Saudi Arabia following the law's passage.



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Population Explosion

Saudi Arabia's population quadrupled over the last 40 years to 28.7 million, creating a housing shortage. The Arab world's largest economy needs to build 1.25 million new homes by 2014, according to the country's development plan. In March 2011, King Abdullah announced a plan to spend \$67 billion to build 500,000 homes to tackle the shortage at a time revolution and political unrest prevailed in the Middle East. The monarch also turned the country's housing authority into a ministry with a budget of 15 billion riyals.

Under the new law, the property being purchased will serve as collateral rather than the borrower's salary as it is now. That will help more low- and mid-income people secure loans, said Hossam Al Rashoudi, a spokesman for Maskan Arabia Investment and Development, which is building 600 homes in Riyadh. The law will also help developers by making project financing easier to obtain, he said.

Collateral Changes

Banks currently require applicants to give up control of their accounts by deducting monthly mortgage payments directly. A temporary effect of the law may be a jump in property prices as speculators try to benefit from the law's passage, he said. The increase will be short-lived because prices are already too high for most Saudi buyers, he said.

"The Mortgage Law will energize the property sector of the kingdom by increasing the affordability of real estate units," Dubai-based developer Emaar PJSC (EMAAR) said in an e-mailed response to questions. "It will help drive demand for residential property by making homes more affordable to a larger cross-section of the population."

Provisions about evictions and home foreclosures led to disagreements between the government and the Shura Council, an adviser to the king, delaying its passage for more than a decade. A draft law was approved in April 2011 after the monarch pledged more than \$82 billion to fund homebuilding.

'Magic Switch'

"Enactment of the mortgage law will not flip a magic switch that will automatically turn renters into homeowners," Capitas's general council Nasser Al-Nubani wrote in a report. "In order for the mortgage law to deliver on its long-term objective of increasing homeownership in the kingdom, two critical things must happen: The mortgage law must be supported by effective regulation, and developers must be able to quantify the profitability of building homes for middle-market homebuyers."

Saudi Arabia's Tadawul All-Share Real Estate Development Industries Index, which includes eight developers, climbed 7.7 percent since the law was approved on July 2. That compares with a 2.2 percent gain for the broader Tadawul All-Share Index. (SASEIDX) Emaar shares increased by 6.6 percent that day.

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