The Evolution of Mortgage Legislation and the Role of the Banking Industry in Kuwait

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Abstract

The housing sector plays a crucial role in the overall economic development of any society. It holds a significant share in the national economy and its importance is further highlighted by the positive external effects it generates. Additionally, the spillover effects of the housing sector contribute to the growth of other economic sectors. This sector is intricately linked to the land market, commodity markets (especially durable goods), and the labor market. Moreover, it has implications for the social and political climate, as well as other critical issues.

In developing countries, housing expenditure often constitutes a substantial portion of household spending. Due to its long-term nature, housing expenses continue to be a financial burden on individuals throughout their lives. For many families, housing represents their largest asset.

Despite the significant activity in Kuwait's real estate sector, there has yet to be a mortgage law enacted to address and streamline the requirements for borrowers seeking residential property.

This research paper is therefore, calling for the establishment of a mortgage sector in Kuwait which is crucial to cater to the housing demand of segments of the population who may not opt for government housing, face delays in accessing it, or find government loans insufficient for financing suitable housing options.

***Keywords**: Mortgage Law, Banking Sector, Housing, Real Estate, Finance.*

Introduction

The mortgage system serves as an essential financial framework for acquiring real estate, allowing lenders to assume ownership of the property if the borrower defaults on their obligations. Nations with vibrant real estate markets generally possess well-developed mortgage systems.

The housing finance system, often based on mortgage systems, is crucial for the provision of housing services. A lack of efficient systems can hinder the sector's development and lead to housing crises, impacting both the real estate and financial sectors.

Conversely, the efficient operation of the mortgage industry necessitates the establishment of a robust bond/sukuk market over the long run. This will enable financial institutions within the industry to access ample financial resources when needed and create avenues for these institutions to offer long-term funding to the housing sector at suitable intervals. Additionally, the establishment of a secondary mortgage market is crucial as it allows institutions in the industry to sell their mortgage assets to acquire essential liquidity during periods of temporary resource scarcity.

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The Public Authority for Housing Welfare (PAHW) was established , to act as the principal administrator of housing facilities in Kuwait. It is responsible for assigning land, constructing homes, and distributing them to citizens based on their housing application priority within the institution.

This study aims to analyze the housing problem in Kuwait by identifying the trends of demand and supply for the next ten years, to determine the demand gap in this sector. Identify the status of real estate financing in Kuwait, both by the government and by financial institutions. Moreover, analyzes the motives, objectives, requirements, and restrictions on the establishment of a mortgage sector in Kuwait. Finally, analyzes the prospects for the banking sector's contribution to the mortgage field in Kuwait.

Literature Review

This section aims to explore the Kuwaiti housing market, emphasizing the contributions of both governmental bodies and private financial institutions in facilitating necessary funding for residents. It will also examine the affordability of home acquisition for Kuwaiti nationals and analyze the dynamics of supply and demand within the housing sector. The researcher seeks to review pertinent literature related to these themes.

Research conducted by **Alfalah et al. (2022)** examined the effects of newly implemented policies aimed at enhancing affordability within the Kuwaiti housing market, a significant concern given that the study revealed a deterioration in affordability over time, despite the introduction of policies in 2008. These policies included measures to tax unoccupied land and restrictions on corporate ownership or development of residential properties.

Research conducted by **Markaz (2023)** on Kuwait Real Estate indicated Real estate sales in H1 2023 dropped to KD 1,564 million (USD 5.1 billion), compared to KD 1,979 million (USD 6.5 billion) in H1 2022. The study showed that the decline was primarily due to reduced demand caused by high property prices in the residential sector and high interest rates acting as a deterrent to lending.

Al-Kanadari, (2020) conducted research on the effect of monetary policy on the real estate market in Kuwait which shows that money supply and a one-week interest rate in Kuwait have strong positive effects on the real estate market in both the short- and long-runs. Additionally, no significant relationship was found between the real estate market and the short-term interest rate for either the short- or long-run.

Research conducted by **Alfalah et al (2021)** examines Kuwait's housing market in terms of its sensitivity to geo-political events and its demographic characteristics. The study concluded that the Kuwait housing market is relatively volatile, with evidence of mean-reverting behavior and significant response to domestic legislation directly concerned with housing.

AlShalfan, (2013), published a paper that traces the methods of housing welfare distribution and questions their role in promoting justice in an environment of increasing housing application backlog, endless sprawl, and continually rising housing property values.

Research Problem and Questions

Analyzing the issue of insufficient government funding, the significant backlog in housing applications, and the escalating costs associated with land acquisition and housing construction for citizens in Kuwait. Additionally, the increasing population necessitates a closer examination of the private sector's involvement, particularly banks and other financial institutions, in supplying the necessary funding for individuals seeking to purchase homes of their choice. The research's main questions are:

- What are the anticipated trends in housing demand and how does population growth influence both housing demand and financial aspects?
- What is the existing legal framework that regulates and restricts the mortgage market?
- In what ways can governmental bodies and the private sector work together to finance and develop housing projects that address the necessary demand?

- What specific policies and regulations are essential for the formulation and enforcement of mortgage legislation in Kuwait?
- What is the role of the banking sector in providing financial support for private housing to Kuwaiti citizens?

Research objectives

This research intends to investigate the expected housing crisis in Kuwait, which is likely linked to the insufficient implementation of robust mortgage regulations. Additionally, the study aims to pinpoint and propose a feasible and adaptable solution to tackle the issues arising from the disparity between constrained housing availability and high demand, by suggesting a framework for the mortgage sector in Kuwait that incorporates the financing capabilities of financial institutions.

Research Justifications

The significance of the research topic has prompted the researcher to examine alternative approaches to the longstanding housing problem in Kuwait, which has persisted without the engagement of financial institutions. The involvement of scholars in advancing research initiatives is crucial for establishing pathways for future exploration of housing challenges and for suggesting alternative financing frameworks that enhance the sustainability of the housing finance sector.

Research Methodology

A descriptive and critical analysis approach to review the subject research, and to propose a solution to the housing dilemma in Kuwait.

Real Estate Finance and Mortgage Systems

A- Nature of the Mortgage

Mortgages are typically distinguished by an intricate blend of features, influenced by the substantial size of the mortgage and the duration of its repayment term. A mortgage is a financial arrangement where a bank or financial institution provides a loan to a borrower, with the borrower's real estate property serving as collateral to ensure repayment of the loan to the lender[(1)]. A range of factors come into play in determining the interest rate on the loan, the repayment structure, installment due dates, available options for both the lender and borrower, as well as the respective rights and responsibilities outlined in the loan agreement[(2)].

The ideal mortgage attributes are subjective and can vary depending on the borrower's needs and the lender's ability to provide them, as well as the national credit rating system. The borrower is always concerned about their ability to repay the debt, which they strive to be as substantial as possible and to bear the burden of the loan, both at the time of the loan agreement and throughout its duration (Gorton & Khan, 2000). This necessitates appropriate interest rates on the loan and an installment size that is within acceptable limits concerning the borrower's income, enabling them to fulfill their other financial obligations. The lender's primary objective is to attain a satisfactory rate of return on the loan while minimizing the associated risks over the loan's duration. This includes mitigating the risk of default and ensuring that the mortgage collateral aligns with the loan's value and characteristics.

Consequently, any efforts to enhance the loan characteristics for one party in the mortgage agreement will incur costs for the other party. For instance, imposing a maximum interest rate on mortgages allevi-

(1) Estate Agents Authority. (2024). Mortgage. Retrieved from http://www.eaa.org.hk/en-us/Information-Centre/Publications/Monograph-Conveyancing/-6-Mortgage

(2) Shea, N. (2017). Seven factors that determine your mortgage interest rate. Consumer Financial Protection Bureau. Retrieved from https://www.consumerfinance.gov/about-us/blog/7-factors-determine-your-mortgage-interest-rate

ates the borrower's financial burden and reduces the likelihood of loan default. However, it simultaneously impacts the lending bank's brokerage margin, thereby diminishing the mortgage's return rates for the bank (Bender, 2008). It is undeniable that the concept of an ideal mortgage loan does not exist, leading mortgage markets to adopt various tools that cater to the requirements of both lenders and borrowers. A multitude of mortgage lending instruments are commonly utilized within this domain.

B- Types of Mortgages

Mortgages worldwide are typically categorized into two main types: government mortgages and traditional mortgages, the latter being offered by different financial institutions.

1- Government Mortgage Loans

Governments worldwide frequently implement initiatives to promote home ownership. One such example is the Federal Housing Administration (FHA), which incentivizes mortgage lending by offering default insurance to borrowers. Additionally, entities like Fannie Mae and Freddie Mac, also known as the National Mortgage Lender in the United States, bolster FHA mortgages by purchasing these loans and transforming them into bonds that are then sold to investors [(1)]. Government mortgage loans are typically issued by institutions specializing in housing finance, such as the Credit and Savings Bank in Kuwait or the Federal Housing Administration in the United States.

These loans are more accessible than traditional commercial loans, with favorable terms. Due to the high demand for government mortgage loans, which offer numerous benefits, they are often provided at maximum capacity. However, in many cases, these loans may not be sufficient to fully finance a borrower's requirements for their ideal home.

2- Financial Institutions' Mortgage Loans

Commercial financial institutions provide loans directly to borrowers for mortgage lending based on market conditions and general lending criteria in a specific area. In Kuwait, banks also offer facilities for mortgage loans. However, it is important to note that this loan type is more commonly found internationally, especially in the United States. Mortgage banks in the US offer two primary types of loans: government loans and conventional loans. Government loans are backed by the Federal Housing Administration and have a maximum limit, as well as strict regulations. Conversely, conventional loans are not directly guaranteed by the government and can be further classified into two distinct types of loans namely conforming loans and non-conforming loans[(2)].

C- Sources of Financing Mortgages

Financial institutions in various countries exhibit variations in their utilization of diverse sources to finance the mortgages they offer to customers. Moreover, there are numerous formulas employed within this domain (Hoenselaar et al., 2021).

(1) Congressional Budget Office. (2024). The role of Federal Home Loan Banks in the financial system. Congressional Budget Office.

(2) Federal Deposit Insurance Corporation. (2023). RMS manual of examination policies: Loans (pp. 3.2-21). Federal Deposit Insurance Corporation.

Conforming loans are loans that adhere to the standard regulations regarding maximum loan limits and maturity dates. As a result, they can be easily sold to government-backed institutions like Fannie Mae and Freddie Mac. These institutions then bundle these loans into packages and sell them to investors in the secondary market. Although these loan packages do not come with a direct government guarantee, there is a semi-implicit government guarantee associated with them. Nonconforming loans refer to loans that are not eligible for purchase by government-supported real estate institutions. However, these loans can still be sold in the secondary market as part of mortgage-backed securities. The primary types of nonconforming loans include jumbo loans, which exceed the debt limit set by government-backed institutions, and non-traditional loans which are tailored to meet customer preferences, interest rate conditions, or competitive market dynamics.

1- Financing Using Customer Deposits

Many banks primarily utilize customer deposits to fund mortgages. However, a significant issue arises from the fact that deposits are typically short-term while mortgages are long-term. This creates an inherent mismatch between the sources of financing and the nature of credit. The lack of compatibility between the financing sources and the loan maturity can lead to liquidity problems for banks if customers fail to fulfill their loan obligations promptly. This problem becomes more pronounced during periods of economic downturn when loan defaults increase on a large scale (Petersen & Rajan, 1995).

Nevertheless, one major advantage of this financing approach is the low cost of financing sources for mortgages. This implies that banks can achieve a substantial margin of intermediation in mortgage contracts by relying on this type of financing.

2- Financing Using Long-Term Sources

Other financial institutions may opt for alternative methods of securing long-term funding for mortgage financing. For instance, they may choose to issue real estate bonds in the bond markets or sukuk, utilizing the proceeds to extend real estate loans. This approach offers a significant advantage in terms of aligning the maturity dates of both the financing sources and their respective uses. By synchronizing the maturity dates of loans and bonds, banks can effectively mitigate liquidity risks that may arise from potential mismatches between debt service dates and the maturity dates of their obligations (Jennie et al., 2014). Alternatively, banks may also explore the option of borrowing from long-term finance institutions such as insurance companies, thereby diversifying their sources of mortgage financing.

D- Mortgage System

A mortgage is a financial mechanism that allows individuals or institutions to secure the necessary funds for purchasing a property, regardless of its type, by using the property itself as collateral. If the borrower fails to repay the loan, the lending institution has the right to take ownership of the property through a legal process known as expropriation. This mortgage system ensures that the property remains under the control of the lending institution until the loan amount is fully repaid. Consequently, the presence of a robust mortgage system is crucial for maintaining an active real estate sector, as it serves as the most effective means of financing property acquisitions for various purposes. This sector holds significant importance within the financial landscape of countries, whether in terms of its size, prevalence, or the number of participants involved.

The mortgage industry regulates the real estate sector, promoting growth and fostering an investment climate. It manages supply and demand, ensuring stable property prices and housing solutions for moderate and limited-income consumers, serving as collateral for lending institutions. Additionally, it encourages real estate developers to create housing options that align with borrowers' income levels, enabling them to secure suitable accommodations [1].

The mortgage system incentivizes financial institutions to extend real estate credit to individuals who desire it by assuring the property is being financed as a mortgage. This arrangement not only allows the borrower to secure suitable financing but also safeguards the lender's rights and minimizes potential risks. In the event of the borrower's failure to meet their obligations as per the mortgage contract, the mortgage institutions have the authority to liquidate the mortgaged property. This provision enhances security and streamlines the overall financing process [2].

(1) United Nations Habitat. (2008). Housing for all: The challenges of affordability, accessibility, and sustainability: The experiences and instruments from the developing and developed worlds. United Nations Habitat.

(2) Office of the Comptroller of the Currency. (2014). Mortgage banking (Comptroller's Handbook, V1.0). Office of the Comptroller of the Currency.

E- The Housing Sector in Kuwait

Typically, in Kuwait, the housing sector mirrors the high-income levels and fair income distribution among the populace, resulting in a high standard of housing. The housing industry is known for its well-organized nature, with construction taking place within legal boundaries on either private or state-owned land. Consequently, unauthorized housing developments or constructions on unsuitable land, which are common in other countries, are not prevalent in Kuwait's housing sector.

The housing preferences in Kuwait are characterized by a desire for independent housing among citizens, as opposed to multi-story housing. Expatriate residents, on the other hand, often opt for multi-story housing due to its affordability compared to independent housing. The limited availability of land released by the state hinders initiatives to establish private housing complexes owned by citizens, leading to a dominance of government-controlled housing projects (1). Consequently, the private sector's contribution to the housing sector primarily focuses on constructing residential buildings in designated areas, catering to the expatriate population residing in Kuwait.

The presence of two distinct housing markets catering to citizens and expatriates has resulted in a skewed structure within the sector. The varying housing options available to citizens and expatriates, along with their differing preferences, have given rise to dual housing markets in Kuwait. The housing market tailored for citizens is entirely regulated by the government, encompassing the allocation of land and financial assistance for property purchases and construction, following specified criteria(2). Kuwait's private sector controls expatriate housing, primarily leasing due to challenges in homeownership and bureaucratic hurdles, despite the transient nature of their residency. The housing market in Kuwait exhibits a fragmentation that contributes to a skewed structural framework and a variety of challenges. A primary issue is the inadequate availability of housing for citizens, which consequently drives up housing prices and shifts the emphasis towards the development of private residences. Conversely, there exists an excess of housing aimed at the expatriate demographic. This oversupply can be attributed to the lack of bureaucratic and supply constraints that are typically faced by the primary market.

F- Housing Demand in Kuwait

1- Predictions of Future Demand for Residential Care Services

Table (1) and Figure (1) present the projections of population figures in the State of Kuwait from 2021 to 2031, covering the upcoming decade. The forecast for the Kuwaiti population was determined using a growth rate of 2.98%, representing the average population growth rate among citizens. It is important to highlight that this growth rate is considered one of the highest globally, indicating the youthful demographic profile of the country's citizens (3) .

As for the expatriate population, their numbers were predicted based on using a growth rate of 1.94%, which is the average growth rate of the expatriate population during the past twenty years, and if they continue to grow in the future at these rates. According to these forecasts, the number of citizens is expected to increase from 1.58 million in 2021 to 2.128 million in 2031.

Table 1. Population Forecasts in Kuwait during the Next Ten Years

Total Population	Non-Kuwaiti***	Kuwaiti**	Year
4592677	3006466	1586211	2021*
4698272	3064792	1633480	2022
4806407	3124249	1682158	2023
4917145	3184859	1732286	2024
5030554	3246646	1783908	2025
5146699	3309630	1837069	2026
5265651	3373837	1891813	2027
5387479	3439290	1948189	2028
5512257	3506012	2006245	2029
5640060	3574029	2066032	2030
5770964	3643365	2127599	2031

*Actual statement (Public Authority for Civil Information), **Based on an average growth rate of 2.98% ***Based on an average growth rate of 1.94%.

(1) Kuwait Foundation for the Advancement of Sciences. (2022). Housing Kuwaitis: An overview of the current model and its implications on affordability and quality of life. Kuwait Foundation for the Advancement of Sciences.

(2) Ibid.

(3) United Nations, Department of Economic and Social Affairs, Population Division. (2022). World population prospects: The 2022 revision (Medium-fertility variant). United Nations.

As for the non-Kuwaiti population, their numbers are expected to increase from 3 million in 2021 to 3.643 million population in 2031, and accordingly, Kuwait's population is expected to increase from 4.6 million in 2021 to 5.771 million in 2031.

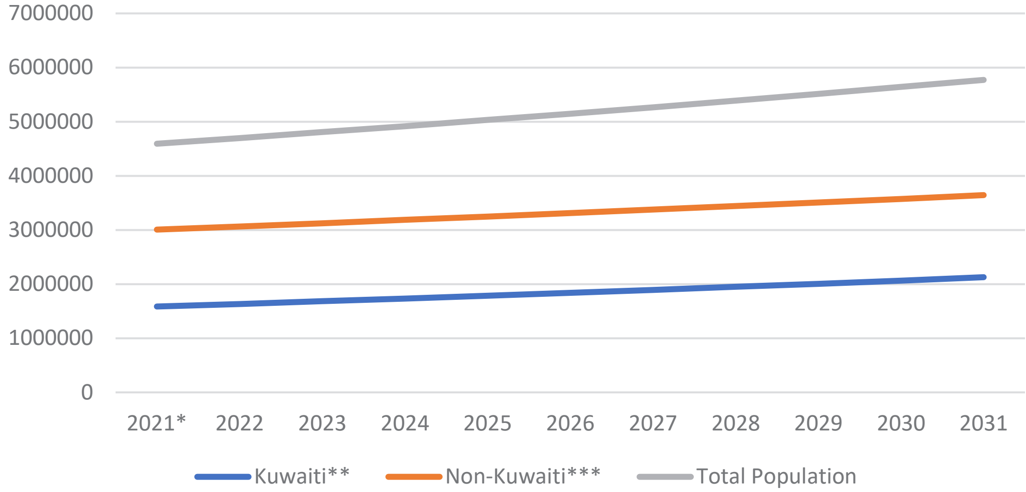


Figure 1. Depiction of Kuwait's Population Forecast 2021 -2031

2- Impact of population growth on housing demand

Population growth in Kuwait is expected to increase demand for housing types, particularly housing care services, due to a doubling of the population within ten years. This intensifies existing challenges faced by the Public Authority for Housing Welfare. Consequently, the looming question remains: how will the situation unfold when the population doubles in the future?

a- Housing demand estimate until 2031

The analysis conducted by the Kuwait Banking Association on Kuwait aimed to predict the future demand for residential care services by examining the projected number of residential care applications. By referring to the trend projections outlined in Table (2) and Figure (2), it becomes apparent that there will be a notable increase in annual applications. Specifically, it is expected that the number of applications will rise from approximately 15 thousand in 2021 to around 20 thousand in 2031.

The Public Authority for Housing Welfare faces challenges in processing over 90,000 residential care applications, highlighting its failure to fulfill its mandated role.

Conversely, predictions concerning the future housing demand indicate a significant increase in demand because of the rapid growth of the population within Kuwaiti society. It is worth noting that the age group below 20 years old represents the largest proportion of the population [(1)], further emphasizing the necessity for sufficient housing provisions.

Based on these projections, it is expected that the PAHW will receive an estimated 314,911 new applications within the next decade, in addition to the existing backlog of applications. As a result, the PAHW will be obligated to provide approximately 407,000 housing units over the next 10 years, with an average of 40,000 homes per year. This will necessitate the release of approximately 160 million square meters of land by the state, averaging around 16

Table 2. Projection of Annual Residential Applications (2021 – 2031)

Number of Applications	Year
14996	**2021**
15505	**2022**
16015	**2023**
16525	**2024**
17034	**2025**
17544	**2026**
18053	**2027**
18563	**2028**
19073	**2029**
19582	**2030**
20092	**2031**
314911	**Total**

Source: Kuwait Banking Association

(1) Ibid

million square meters per year. Moreover, land will also be required for public services such as roads, schools, hospitals, police stations, market complexes, and other essential amenities. Considering the current performance rates of the PAHW or any plausible scenario for its growth in meeting residential care requirements, achieving this objective seems unattainable.

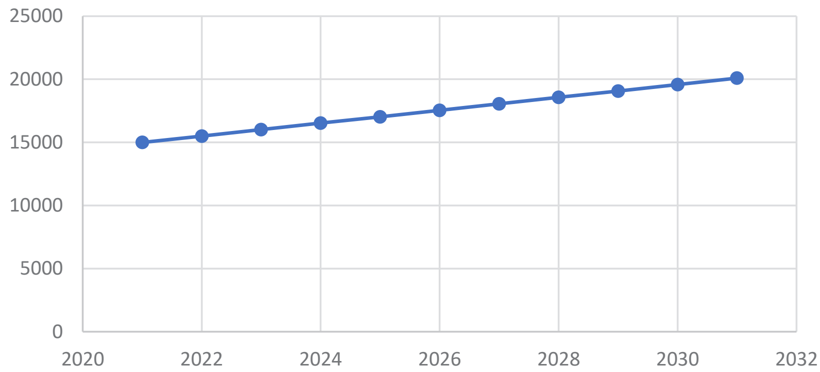


Figure 2. Projection of Annual Residential Care Number of Applications (2021 - 2031)

b- **Kuwait Housing Supply Forecasts**

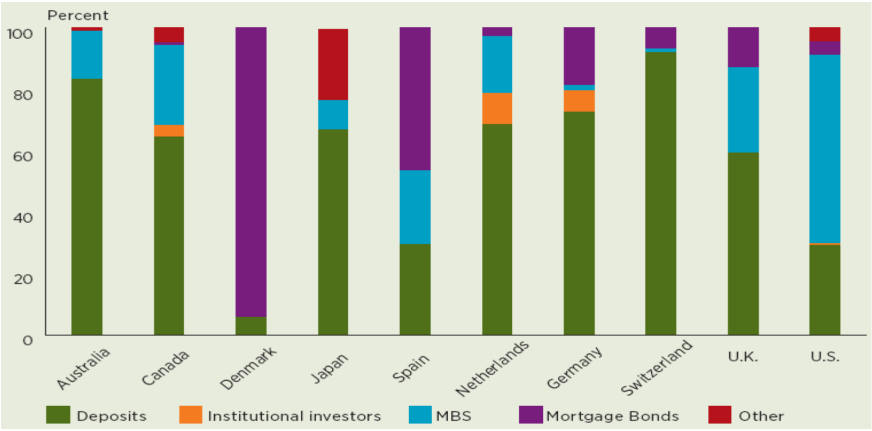
According to the announced plan of PAHW[1], it is estimated that the future projects will include the Nawaf Al Ahmed area located in the western part of Kuwait City, 110 Km away from Kuwait City. The project's total area is estimated at 12.710 Hectares, which will include target units of fifty-two thousand with four hundred square meters for each unit.

The Al Sabryia initiative in Kuwait, situated 60 kilometers from Kuwait City, seeks to construct 104,000 residential units encompassing a total area of 7,970 hectares. Nevertheless, the existing infrastructure provided by the government remains underdeveloped, leading to a projected shortfall of at least 160,000 housing units by 2031. The current housing support system is inadequate considering the increasing demand and the government's failure to meet housing needs. The government must transfer control to the private sector and offer support to facilitate timely access to housing. This strategy should include the encouragement of private sector initiatives and the establishment of a mortgage market in Kuwait.

G- **Financial Institution**

Financial institutions utilize a range of sources to finance mortgage contracts, including customer deposits. This reliance can lead to liquidity challenges if borrowers do not fulfill their repayment commitments, a situation that is particularly pronounced during periods of economic decline. Nonetheless, utilizing deposit funds can be advantageous due to their cost-effectiveness and the potential for intermediation margins.

Additionally, long-term financing options, such as the issuance of real estate bonds in the bond markets, provide temporal alignment and help allevi-



Source: Lea, M. (2010). *International comparison of mortgage product offerings*. Research Institute for Housing America.

Figure 3. Methods of Financing Mortgage Loans in Banks around the World

(1) Public Authority for Housing Welfare. (2020). Future projects plan 2020. Public Authority for Housing Welfare.

ate liquidity concerns. A variety of financing sources exist for mortgage funding. In practical terms, financial institutions frequently utilize a blend of these funding approaches. To illustrate (Lea, 2010), conducted a comparative analysis of real estate financial products in multiple developed nations with thriving mortgage sectors. Within his investigation, he scrutinized the funding sources employed by financial institutions that provide mortgage loans. Lea's research encompassed an all-encompassing graph that juxtaposed the diverse funding sources for mortgage loans across the countries incorporated in his sample.

Banks across the globe depend on customer deposits for their financing needs, as illustrated in Figure 3. However, when it comes to mortgage lending, the reliance on customer deposits varies among different countries, with Denmark being the exception. In countries like Switzerland, Australia, Germany, the Netherlands, and Japan, mortgage institutions primarily or moderately rely on customer deposits to finance their mortgage loans. This preference can be attributed to the lower cost of using deposits as a source of financing compared to other alternatives.

Mortgage bonds and mortgage-backed securities (MBS) are different financing methods in different countries. Denmark heavily relies on bonds for mortgages, while Australia, Canada, the Netherlands, and the US do not have limited use of bonds. There is no clear pattern for providing essential financing for mortgage lending, but global banks primarily use deposits, emphasizing the importance of liquidity ratios. Banks must maintain high liquidity to mitigate risks from liquidity shortages, especially during potential real estate crises.

H- **Related Laws**

The growth of the mortgage sector in Kuwait has been significantly impeded by the government's failure to supply private housing and the limitations imposed on foreign ownership of real estate. This situation has been exacerbated by the 2008 legislation namely Law No. (8) and Law No. (9), that forbids banks and financing institutions from engaging in the sale, purchase, or transfer of rights to private housing plots.

Kuwaiti financial institutions, including banks and finance companies, have curtailed their lending for real estate developments to between 40% and 50% of the total property value. This adjustment is a direct consequence of the regulations established by the Central Bank of Kuwait, specifically laws No. 8 and 9/2008, which have significant implications for the investment real estate sector.

The shift in focus by banks and finance companies towards this measure led to a decrease in investor interest in acquiring loans or any form of related financial services. This was primarily due to the perception that investing in real estate does not yield significant returns, resulting in a prevailing atmosphere of recession in the investment real estate market. This situation mirrors the conditions observed in the private housing real estate market, where there is a lack of both supply and demand.

Law No. (8) of 2008 fell short of its intended objectives in delivering residential lands amounting to 100,000 units within 3 years of its enactment. The allocation of such a significant quantity of residential land is contingent upon factors that cannot be easily addressed by merely mandating the government to provide these properties in the legislation, particularly with the imposition of a short timeframe of 3 years. In his analysis titled "An evaluative examination of Law No. (8) of 2008 imposing charges on undeveloped lands," he underscored the importance of reassessing the provisions of this law from both a substantive and procedural standpoint and evaluating its effectiveness in realizing the legislative aims for which it was promulgated, notably the prevention of monopolies and the provision of undeveloped land to deserving citizens in need of housing assistance (Al-Yassin, 2021).

However, these laws do make an exception for Islamic banks, but only after obtaining a judicial ruling from the Court of Cassation. The primary objective behind the enactment of these laws was to break the monopoly of unused lands that are held for speculation, thereby inflating their prices. The first law introduced amendments to the title and certain provisions of Law No. (50) of 1994, which regulates the exploitation of vacant lands. The second law amended certain provisions of the Commercial Companies Law No. (15) of 1960. Nevertheless, the most significant negative consequence of these laws is the increased difficulties faced by citizens in purchasing private housing. This is primarily due to the adverse impact on the available financing channels for private housing acquisition.

Kuwait offers two primary financing channels for private housing purchases: the Credit and Savings Bank, which provides a maximum loan of seventy thousand dinars, and commercial banks, which offer long-term housing loans through Murabaha or a salary-based borrowing system. However, high land and house prices make it challenging for young Kuwaitis to acquire residential homes with limited financing options.

The Credit and Savings Bank's government financing is limited due to its timing and insufficient loan size, which is tied to housing assistance applications, despite increasing construction and housing equipment costs. A proficient mortgage system can provide a parallel real estate funding avenue, complementing the Credit and Savings Bank. It must bridge financing deficits, cater to borrowers' needs, and consider mortgage characteristics.

The existing terms and conditions for real estate loans in Kuwait vary depending on the lending institution. The Credit and Savings Bank offers real estate loans with specific conditions, such as a maximum loan amount of 70,000 dinars for building or purchasing a new house, with a repayment period of around 58 years. Additionally, the maximum limit for expansion and renovation purposes ranges from 25,000 to 30,000 dinars, to be repaid in equal monthly installments over a maximum period of approximately 25 years(1).

In contrast, commercial banks provide real estate loans with different terms compared to the Credit and Savings Bank. For instance, the maximum loan amount for building or buying a new house is also 70,000 dinars. However, the maximum repayment period is 15 years, with a minimum of two years. Moreover, the interest rate on mortgages is the discount rate at the Central Bank of Kuwait plus 3%, with periodic adjustments every five years within a range not exceeding 2%(2). Given the rising costs of construction and land prices, the current maximum mortgage amount may not be suitable and may require periodic adjustments if the borrower's repayment capacity allows for it.

I- Establishing a Mortgage Sector in Kuwait

The real estate sector in Kuwait encounters significant obstacles stemming from the government's predominant role in housing service provision. The state's ability to supply adequate housing has been limited, resulting in prolonged waiting times and numerous families lacking suitable accommodation. To address escalating prices, a comprehensive restructuring of the residential real estate market is essential. The introduction of a mortgage sector could enhance operational efficiency and contribute to market stability. Presently, the residential real estate market in Kuwait is experiencing a downturn, primarily due to financing challenges that hinder liquidity. Furthermore, the establishment of a mortgage sector encourages the entry of specialized institutions in real estate finance, thereby diversifying the market and promoting healthy competition. Moreover, by leveraging the mortgage system as a fundamental guarantee for loans, it becomes possible to develop a sector for debt downtime insurance. This insurance serves to protect both borrowers and lending credit institutions, further enhancing the overall stability and security of the mortgage sector(3). The surge in the need for housing, specifically for smaller homes, is a direct outcome of the noticeable changes in the lifestyle of Kuwait's population. In the past, extended families used to live togeth-

(1) Credit and Savings Bank. (2024). Loan guidelines: Classification by type. Retrieved from http://www.scb.gov.kw/

(2) Central Bank of Kuwait. (2007). Supervisory instructions on rules and regulations for banks' extension of consumer loans and other installment loans (Chapter 2, pp. 2-6). Central Bank of Kuwait.

(3) Bank for International Settlements. (2013). Mortgage insurance market structure, underwriting cycle, and policy implications. Bank for International Settlements.

er, with parents and children sharing the same residence. However, there has been a shift towards smaller families, often known as nuclear families, where couples opt to live independently.

This transformation has led to a greater demand for housing due to the expanding population. As a result, it underscores the importance of a strong mortgage industry that can enable timely access to appropriate housing for newly formed families.

The anticipated growth of Kuwait's youth demographic, especially among individuals under the age of 20, is likely to drive an increase in housing demand in the coming years. The Public Authority for Housing Welfare (PAHW) is confronted with significant challenges stemming from constrained resources. The existing framework is insufficient, resulting in bureaucratic hurdles and protracted waiting periods for housing support. To guarantee that citizens can access affordable housing, it is essential to investigate alternative systems. Encouraging private sector initiatives to address the needs of various income brackets is crucial; however, sustainable funding through an appropriate mortgage system is necessary for extended durations. Presently, the residential real estate market in Kuwait is characterized by sluggishness and limitations.

The presence of a mortgage industry in Kuwait is anticipated to enhance the influx of foreign investments, given the growing interest of foreign investors in the country(1). With the entry of foreign investments into Kuwait, a substantial rise in demand for real estate services is expected across various sectors. It is undeniable that a well-established mortgage sector will play a pivotal role in attracting foreign investments and easing the process for foreign investors.

The Kuwait real estate boom faces challenges due to a lack of a developed mortgage sector, exacerbated by rising demand for residential, commercial, and investment properties. Inadequate financing options hinder property supply, increasing prices and meeting demand. The real estate industry in Kuwait lacks essential establishments like valuation and brokerage institutions, and adequate insurance facilities. An efficient mortgage sector could create opportunities for specialized institutions to prevent manipulation, speculative pressures, and consumer exploitation. The dynamic mortgage industry in Kuwait ensures liquidity and vitality, but current financing options are limited to Credit and Savings Bank and commercial banks, which may not meet borrowers' financial needs, particularly in housing. Therefore, the existence of an active mortgage sector is essential to ensure the injection of sufficient and appropriate liquidity into this sector, thereby contributing to its continued growth and development(2).

The mortgage system can attract non-traditional financiers to the real estate finance market, increasing capital availability and alleviating the burden on public finances. It can contribute to residential care services and facilitate infrastructure projects, allowing developers to lead construction and finance housing acquisitions, reducing government involvement.

J- Objectives of Establishing a Mortgage Sector in Kuwait

Kuwait's primary goal in establishing a successful mortgage industry is to achieve several overarching objectives:

- The goal is to increase suitable housing ownership among Kuwaiti citizens, regardless of their housing situation or the Public Authority for Housing Welfare (PAHW) acquisition process.
- Kuwait's real estate industry is being improved by easing financial constraints, increasing supply, and driving demand while facilitating financing for various commercial properties.
- The government is aiming to establish an independent housing sector alongside the care sector, allowing individuals from different incomes to quickly acquire suitable housing, shifting the sector

(1) International Monetary Fund. (2023). Kuwait: 2023 Article IV consultation—Press release; and staff report (IMF Country Report No. 23/331). International Monetary Fund. https://doi.org/10.5089/9781513979081.001

(2) Chiquier, L., & Lea, M. (2010). Housing finance policy in emerging markets. World Bank Group. Retrieved from http://documents.worldbank.org/curated/en/833371468152071863/Housing-finance-policy-in-emerging-markets

away from government control. By offering suitable housing options and funding that align with individuals' needs and facilitating their timely transition, the burden on (PAHW) can be alleviated.

- Competition in the real estate loan sector can improve access to financing for all consumer segments by reducing down-payment rates, lowering interest rates, and improving loan conditions, despite the state's current financial sector restriction. This limitation hampers the sector's ability to develop effective housing financing methods and strategies that cater to the diverse income groups within the population(1).
- Establishing a secondary market for mortgage trading in Kuwait serves to enhance the liquidity of the mortgage market. This allows mortgage institutions to effectively manage their loans by providing an avenue to sell them when liquidity is required(2). Moreover, it enables these institutions to attain more favorable rates of return, thereby incentivizing their continued participation in the mortgage sector. Simultaneously, the development of such a secondary market contributes to the growth and expansion of the capital market within the country.
- Kuwait's financial sector is the primary employer of national labor, requiring job enhancement in mortgage and real estate financing. The mortgage sector's demand surpasses conventional financial establishments due to its promotion capabilities.

K- **Mortgage Sector Requirements**

Achieving the goals for the mortgage industry in Kuwait requires addressing several key prerequisites:

- **Land Monopoly**: The state's control over land is driving up prices due to limited supply. A successful mortgage sector needs to manage this issue to avoid exacerbating land price increases.
- **Mortgage Regulation**: Implementing a comprehensive mortgage law is essential. This law should cover financing guidelines, institution organization, licensing, resource mobilization, supervision, and lending terms to protect the sector and manage risks.
- **Private Sector Involvement**: Encouraging private businesses to participate in real estate projects, particularly those related to Public Authority for Housing Welfare (PAHW) programs, can reduce financial burdens and provide more flexible solutions than government organizations.
- **Infrastructure Development**: Developing infrastructure in peripheral regions supports balanced growth and stimulates real estate investments.
- **Bond Market Development**: Establishing primary and secondary bond markets will enhance liquidity in the mortgage sector and facilitate financing by converting real estate bonds into liquid assets.
- **Financial Assistance**: The government aims to assist individuals not using Credit and Savings Bank resources by covering mortgage expenses and promoting the role of mortgage institutions.
- **Loan Systems**: Implementing a system for financial institutions to offer housing loans will boost the mortgage sector and improve access for first-time borrowers, including increasing mortgage limits to match rising construction costs.
- **Interest Rates and Funding**: Supporting affordable mortgage interest rates for first-time borrowers will reduce the financial burden and encourage demand for housing beyond government provisions. The government should also allocate funds to support mortgage loans and provide low-interest preliminary loans.
- **Legislative Reform**: Modifying Laws 8 and 9 of 2008 is crucial to remove administrative barriers and implement efficient, modern bureaucratic processes to support the real estate and mortgage sectors.

(1) Kuwait Financial Center, Markaz. (2022). Housing problem in Kuwait and the way forward. Kuwait Financial Center, Markaz.
(2) Nenova, T. (2010). Expanding housing finance to the underserved in South Asia: Market review and forward agenda. The World Bank. Washington, DC.

L- Restrictions on Developing a Mortgage Sector in Kuwait

The most important constraints to developing an efficient mortgage sector in Kuwait are as follows:

- Implementing an annual land release system for real estate developers can address the housing sector's insufficient supply, enabling expansion and catering to local demand across income segments.
- Ensuring essential infrastructure, such as roads, electricity, water supply, sewage systems, and telecommunication networks, is crucial for the development of newly liberated lands.
- Enhancing the efficiency of licensing processes, streamlining construction permit procedures, and expediting property ownership transactions are essential steps to facilitate development projects within the real estate sector. This includes revising relevant legislation and regulations to optimize contract conclusion and registration processes.
- Kuwait's mortgage law lacks a comprehensive legal framework for real estate financing, hindering its development. It should outline regulations for real estate financing systems, lending institutions, licensing requirements, financial resource mobilization, supervision mechanisms, lending conditions, and risk mitigation strategies. This law should address key aspects of the mortgage system, ensuring an effective mortgage sector.
- The mortgage industry faces challenges due to insufficient data on the housing market, leading to inefficiencies. To improve market efficiency, extensive data on housing prices, building permits, transaction details, financing options, and interest rates should be promoted.

M- Proposed Structure of the Mortgage Sector in Kuwait

It is suggested that the mortgage sector in Kuwait should encompass the following institutions at a minimum:

- Mortgage lending institutions, including commercial banks, specialized banks, and real estate investment funds, operate under Islamic law or traditional frameworks. They create financing options, ensure funds availability, monitor repayments, assist borrowers, and evaluate loan default risks.
- Mortgage brokers, who earn a commission, act as intermediaries between individuals seeking real estate loans and lenders. They present options, and explain benefits, costs, repayment periods, and limits, with the lending institution primarily responsible for the loan.
- Mortgage insurance is essential in the real estate sector to mitigate risks and secure larger loans. It protects against payment defaults and broadens property ownership. Lending institutions require borrowers to provide insurance documentation, including life and mortgaged property policies. Reputable insurance companies are selected, and payouts are directed to the institution responsible for property repairs.
- Real estate appraisal and valuation organizations assess properties for mortgages, considering factors like age, financial status, and potential risks. Their goal is to determine property value efficiently, align mortgage value with the loan amount, and avoid financial implications.
- Real estate refinance institutions are crucial players in the mortgage sector, serving as intermediaries between primary lenders like banks and sources of financing such as the bond market. By facilitating long-term mortgage lending operations, these institutions offer better rates and more favorable terms than banks could provide independently. Additionally, they provide temporary liquidity through mechanisms like repurchase agreements to support lending during periods of tight liquidity, rising interest rates, or increased borrowing demands (Fisher, 2011). Establishing a real

estate financing institution is crucial for banks with limited resources to address potential maturity mismatches between assets and liabilities, especially when there are no available funds or complex securitization processes due to market conditions.

These institutions are vital for supporting mortgage lending, especially during times of economic instability when traditional banks may not provide adequate credit. Their main functions include:

- **Providing Extended Financing**: They offer financial institutions extended financing at favorable rates, reducing funding costs and mortgage interest rates, increasing loan accessibility, and expanding the borrower base.
- **Ensuring Liquidity**: They supply the necessary liquidity to maintain confidence in the mortgage industry during economic downturns.
- **Promoting Competition**: They help diversify the mortgage sector by enabling a variety of lenders to operate beyond major institutions.
- **Managing Balance Sheets**: They assist commercial banks in converting short-term liabilities into long-term assets, aiding in balance sheet management and serving as lenders of last resort if needed.
- **Adhering to Best Practices**: They encourage adherence to industry best practices by setting clear loan eligibility criteria and improving risk management, thus mitigating mortgage risks.
- **Facilitating Market Growth**: They can act as an intermediary between the capital market and mortgage market, supporting the development of a secondary mortgage market by providing long-term funds.
- **Enhancing Financial Sector Depth**: By connecting long-term investment entities, like pension funds or insurance companies, with mortgage markets, they bolster the financial sector's depth.
- **Supporting Government Initiatives**: They can aid in promoting homeownership through targeted refinancing options and mortgages for low-income borrowers, without direct government market intervention.

N- Secondary Mortgage Market

In the primary mortgage market, banks directly issue mortgages to homeowners for the purchase, construction, or refinancing of homes. Conversely, the secondary mortgage market involves the buying and selling of loans originated in the primary market by lenders and investors. Additionally, investors engage in the trading of bonds backed by pools of syndicated mortgage loans in the secondary market (Mitchel, 2004).

Secondary mortgage markets play a vital role for financial institutions in nations with an established mortgage sector, as they improve liquidity and enable the sale of financial instruments when necessary. In Kuwait, banks utilize these markets to dispose of loans, improve risk management, maintain liquidity, and increase profits from a variety of credit transactions. This practice is consistent with their traditional banking operations within the Kuwaiti financial environment.

The mortgage can be sold either individually or as part of a loan pool or package. Loan pools or packages are created by bundling together loans with similar attributes, such as loan type, terms, interest rate, or maturity date. This practice, also known as securitization, enables banks to sell loans at a premium price and minimize transaction expenses (Schwarcs et al., 2018).

O- The Potential Impact of the Banking Sector on Mortgages in Kuwait

An examination of the impact of the banking sector on Kuwait's mortgage industry requires a thorough assessment of its financial stability and liquidity. The sector has demonstrated remarkable resilience amid economic fluctuations, effectively seizing opportunities even in adverse conditions. This capacity for adaptation has led to notable growth rates and a significant presence within the financial and commercial spheres, thereby playing a crucial role in the country's economic advancement and crisis management strategies.

Kuwaiti banks are recognized globally for their exceptional performance, with a multitude of branches and subsidiaries established in various countries. Their expansion into regions such as the Middle East, North Africa, Europe, and Asia has bolstered their competitiveness on the international stage. Among the largest banks in the Gulf region, Kuwaiti banks excel in terms of asset size and shareholders' equity, consistently upholding the highest capital adequacy ratios.

This demonstrates the robust capacity of the banking sector to manage unexpected crises and respond promptly during challenging periods. By the conclusion of 2023, the capital adequacy ratio for the banking sector, following the Basel 3 standard, exceeded 19.0% (1).

This increase reflects the strength of banks and their ability to deal with credit, market, and operational risks and the consequent shocks to balance sheet items, despite the significant expansion of facilities during the period, which enhances the stability of the Kuwaiti banking sector and financial stability in general.

The latest data suggests that the financial stability metrics of domestic banks are "stable and strong". As of the conclusion of 2023, the ratio of net non-performing loans was recorded at 1.1%, a minimal figure that does not present any significant threats to the industry. Additionally, it is important to highlight that banks are well-protected from any negative impacts of these loans, given their coverage ratio with provisions is an impressive 266%. Kuwaiti banks have persistently given priority to their fundamental operations, especially in terms of lending and banking activities. The ratio of core income to total revenue has progressively climbed to over 80% by the end of 2023. Furthermore, the banking sector in Kuwait has shown favorable levels of return on average equity (ROAE), exceeding 11%.

According to the recent data issued by the Central Bank of Kuwait (Q1 2024), the liquidity ratio is over 21%, the non-performing loans to total loans ratio stood at 1.5%, the non-performing loan coverage ratio is over 308%, and the net profit margin is over 40%. These sound indicators are the outcome of the prudent proactive policies and balanced framework of regulatory and supervisory prudential instructions adopted by the Central Bank of Kuwait since the global financial crisis.

It is also noteworthy to mention that interest rates have climbed to reach 4.25%. The Central Bank of Kuwait reports progress in local banks' money supply, deposit balances, and credit facilities while maintaining vigilant supervision to enhance financial resilience and ensure optimal service delivery despite challenging operational conditions.

The asset quality of Kuwaiti banks plays a crucial role in supporting their performance. As of the end of 2023, the total assets of the Kuwaiti banking sector reached over KD 120 billion, reflecting a growth rate of more than 18%. This indicates the strength and stability of the sector(2).

Kuwait aims to draw in over USD 200 billion in foreign direct investment (FDI) from 2020 to 2035, to establish itself as a prominent international center for trade and finance (3). This influx of foreign investment not only benefits the Islamic and conventional banks directly through their banking services but also through the investment accounts they offer. Additionally, the FDI inflow plays a crucial role in the trading volume of the Kuwait Stock Exchange(4). Kuwait has several advantages for attracting FDI among which are

(1) Central Bank of Kuwait. (2022). Economic Report 2022. Central Bank of Kuwait.

(2) Ibid

(3) Kuwait Direct Investment Promotion Authority. (2019). Foreign Direct Investment (FDI) in Kuwait. Kuwait Direct Investment Promotion Authority.

(4) United Nations Conference on Trade and Development. (2023). Investing in Sustainable Energy for All (World Investment Report). UNCTAD.

a well-managed financial market a strong banking sector and an open market economy allowing Kuwait to enjoy free convertibility and full transferability in the foreign exchange market.

The banking sector enjoys liquidity that enables it to finance and grow its assets and cope with the decline in liabilities, with the liquidity ratio (expressing underlying liquid assets/short-term liabilities) reaching 22.5% at the end of 2023, which is higher than the percentage determined by the Central Bank of Kuwait (18%). This ratio is also a good indicator that enhances the ability of banks to provide financing needs for projects for various sectors of economic activity in the country.

Given the global market turbulence, local banks in Kuwait have leveraged their surplus liquidity-resulting from increased deposits and stagnant growth in credit facilities by investing in Central Bank of Kuwait deposits and bonds, thus raising their liabilities with the Central Bank. The development of the Kuwaiti banking sector and other financial institutions is essential for national economic growth and stability. This involves providing necessary credit, loans, and banking services. The steady expansion of banking activity in recent years, primarily financed by private sector deposits, has been accompanied by strong financial performance and capital adequacy ratios exceeding the Central Bank's minimum requirement of 12%.

Currently, the Kuwait Credit Bank (KCB) faces a backlog of 90,000 to 120,000 mortgage applications due to inadequate funding and capacity, limiting its ability to approve only 12,000 new real estate loans annually. KCB is the sole provider of mortgage financing to Kuwaiti citizens and companies, as commercial banks are prohibited from offering such services. This backlog is projected to create a demand exceeding 12 billion Kuwaiti dinars on local banks' loan portfolios.

The current Public Authority for Housing Welfare (PAHW) strategy of providing independent housing units to all citizens will not effectively address Kuwait's housing crisis. Instead, a shift from horizontal to vertical expansion constructing more housing units on the same land alongside fostering private sector involvement and establishing a mortgage industry, is necessary.

The Kuwait Banking Association has identified a significant opportunity for Islamic banks, contingent on the anticipated mortgage law reform. This reform is expected to significantly impact on the banking sector, potentially driving substantial growth. According to the Central Bank of Kuwait, total loan facilities in the country amount to approximately 50 billion Kuwaiti dinars.

Conclusion

The research highlights the crucial role of the housing sector in Kuwait's economic development, noting its extensive positive effects on other sectors and its interconnection with land, commodity, and labor markets. However, Kuwait's current housing finance system is deficient due to the absence of a comprehensive mortgage law, which hampers efficient credit allocation and contributes to a near housing crisis.

Key Findings Include:

1- **Housing Finance Challenges**: Insufficient housing finance services provided by banks, coupled with excessive dependence on government assistance, are resulting in extended waiting times for housing and loans, thereby hindering residents' capacity to fulfill their housing requirements.

2- **Surge in Housing Demand**: As of 2023, the Public Authority for Housing Welfare (PAHW) is confronted with a backlog exceeding 90,000 requests for housing assistance. Given the anticipated population growth by 2031, it is expected that the demand for housing services will increase markedly.

3- **Rising Property Prices**: The existing framework for housing care services is contributing to rising property prices, thereby complicating the pursuit of homeownership. In Kuwait, the average cost of a 400-square-meter home is approximately 200,000 dinars (around $700,000), which presents a significant obstacle when evaluated against international benchmarks.

4- **Banking Sector Potential**: The banking sector in Kuwait, characterized by its increasing diversity, specialized knowledge, and substantial liquidity, is strategically equipped to foster the establishment of a robust mortgage market, which is essential for meeting the demands of housing finance.

In conclusion, the study highlights the necessity for a strong mortgage industry to tackle housing difficulties and enhance accessibility, utilizing the capabilities of the banking sector to respond to the increasing demand and property price challenges in Kuwait.

Recommendations

The study indicates that Kuwait's existing housing strategy, which prioritizes horizontal development, is insufficient considering the increasing population and constrained land availability. Future planning efforts should therefore concentrate on vertical expansion and the implementation of creative financing solutions.

Key Recommendations Include:

1- **Private Sector Involvement**: The government needs to delegate authority over the housing sector to private entities to guarantee the provision of timely and suitable housing. This shift necessitates the establishment of a strong mortgage industry.

2- **Mortgage Sector Development**:
- **Funding**: Financial institutions ought to consider utilizing long-term financing mechanisms, such as mortgage bonds, to mitigate the liquidity risks that arise from the inherently short-term characteristics of deposits.
- **Bond Market**: The development of an efficient bond market is essential for the effective management of debt instruments and the enhancement of liquidity.

3- **Foreign Investment**: Promoting foreign investment in the real estate sector has the potential to increase market liquidity and generate employment opportunities within the local community.

4- **Regulatory and Structural Reforms**:
- **Land and Mortgage Laws**: Eliminate state land monopolies, establish a thorough mortgage legislation framework, and assess current regulations, particularly Laws 8 and 9, to promote an effective mortgage industry.

5- **Private Sector Participation**: Facilitate the involvement of private developers in addressing housing challenges and reassessing the land allocation procedures to expedite the processing of housing applications.

6- **Infrastructure and Licensing**:
- Provide essential amenities to support the mortgage sector.
- Implement a licensing system for mortgage-related institutions (financing, brokerage, valuation, insurance).
- Expand and establish a secondary bond market to mobilize financial resources for the housing sector.

The study emphasizes the necessity for a transition towards vertical housing development, increased involvement of the private sector, the refinement of regulatory structures, and the creation of an effective mortgage and bond market to tackle the housing issues faced by Kuwait.

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