

# Assessment of Housing Mortgage Loan Practices in Ethiopia: The Case of Commercial Banks in Ethiopia

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## Abstract

These days, the need for proper housing has been increasing rapidly with the population, and the source to finance this basic need has been scarce. Though there are mortgage loans provided by commercial banks, the administration hasn't been easy. This research study aimed to investigate the challenges faced by commercial banks in the housing mortgage loan sector and to provide recommendations for improving the sector. A purposive sample has been taken to conduct this research and the study utilised a qualitative research design. The findings revealed that commercial banks face several challenges in the sector, and that there is no regulation for the sector. Finally, it is recommended that the government implements policies and regulations tailored to the specific needs of the country to guide the housing mortgage loan sector.

**Keywords:** Mortgage, Housing, Loan, Bank, Mortgage Loan Sector

## Introduction

The modern mortgage has only been around since the 1930s, but the idea of a mortgage has been around for a lot longer. Mortgages are mentioned in English common law documents that take back as far as 1190. These documents illustrate the beginnings of a basic mortgage system. A mortgage was a conditional sale where the creditor held the title to the property while the debtor could sell that property in order to recover the money paid. Mortgages at the turn of the century were different from mortgages today. In the early 1900s, homebuyers typically had to pay a 50% down payment with a 5-year

amortisation period. This meant that those who bought a house or property typically already had a lot of money. The word mortgage is made from two Latin words, mort and gage. Mort means 'death' and gage means a kind of a 'pledge'. In other words, a mortgage means a dead pledge. This meaning is interpreted in different ways. One interpretation is if a borrower failed to repay the debt or fulfil the pledge, the property was dead to him. Another meaning is that the pledge was dead once the borrower repaid the full loan amount. A mortgage loan is a loan financing instrument that is applicable in almost the entire world with a variation in the degree of applicability (Bebusinessed, 2017).

Loan financing means any money borrowed from (A) a bank, financial institution, hedge fund, pension fund or insurance company or (B) any other entity having as its principal business the lending of money and/or investing in loans, in each case other than public or quasi-public entities or international organisations with a public or quasi-public character (Law Insider, 2020). Loan financing differs from debt financing in that on loan financing funding is made available to both individuals and businesses, and repayment takes the form of equal monthly instalments (EMIs), which include both principal and interest payments. In contrast, on debt financing funding is made available to businesses primarily through the issuance of bonds, stocks and debentures, and repayment takes the form of ongoing interest payments, with principal payments only made at maturity. There are secured and unsecured loan finances. Unsecured loan is a type of long term financing that requires no guarantee or no collateral and an individual financial assessment itself is required for approval. Secured loan is other type of loan which requires a promise security / asset as collateral for

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loan approval. Mortgage loan is a secured long term loan financing in which the property to be purchased by the loan is automatically the collateral. The loan is typically repaid over a period of 15–30 years, depending on the borrower's financial situation and the terms of the loan.

In Ethiopia, during the Imperial era, urban land and housing was largely the property of the feudal elite. At this time, more than 60% of the residential real estate was rental. Then the Mortgage Company of Ethiopia, S.C. was established in 1965 to give loans to the private sector for construction purposes (Terefe, 2015). Then, The Derg implemented a command structure for economic production and the delivery of public services after the revolution of 1974. In this sense, the government actively contributed to the housing supply by developing and running the cooperative housing delivery system. Since the transition in 1991, the government has worked to implement a more market-oriented approach to housing building. The Construction and Business Bank (CBB), a fully owned public corporation with the added purpose of universal banking, was established at this point until it was merged with Commercial Bank of Ethiopia (CBE) in 2015.

Ethiopia is currently struggling in both economic and social aspects. Since the majority of Ethiopia's urban population, today more than ever, lacks the financial resources to build or purchase their own home. The Government has acknowledged that housing conditions are poor and has brought about a major shift in its attitude to fulfil these rights. Nonetheless, the finance sector has been under multiple problems stemming from the national economic policies and inefficiency on the part of the financial institutions (Tadashi, 2021). Commercial banks are presently providing home mortgage loans to Diasporas with a range of incentives due to their need of foreign currency. Commercial banks are thought to lag behind in providing the same services to Ethiopian locals despite offering a well-paved platform and enticing circumstances for Diasporas, such as a longer loan period and cheaper interest rates.

Ethiopia, Africa's second most populated and fifth least urbanised nation, is now under pressure from the continent's fast urbanisation and rising urban housing demand. The majority of the housing stock in Ethiopian cities is substandard, and the formal rental market for cheap housing is largely underdeveloped. According to studies made by habitat for humanity in 2022, 30% of

housing units are in acceptable condition, while 70% need to be completely replaced. Although the housing industry needs to grow quickly, it has been slowed down by a lack of funding. Purchasing a house is a high-level investment. Additionally, the majority of Ethiopians find it difficult to put down a sizable amount of money at once, which increases the significance of mortgage loans in our nation.

According to an article published by Trading Economics in 2022, Ethiopia is among the fastest growing non-oil economies in the world as the government reforms undertaken in recent years have succeeded in opening the economy to foreign direct investments and resulted in expansion of commercial agriculture and manufacturing industry. But recently, Ethiopia is facing both economic and social crisis. Ethiopia's economy decelerated to 5.6% growth in 2021 from 6.1% in 2020, due to civil conflict and the effects of COVID-19 on transport and hospitality. Inflation increased to 26.7% in 2021 from 20.4% in 2020. The annual inflation rate in Ethiopia accelerated for the second straight month to 35.1% in November of 2022. The above data shows how much expensive living in Ethiopia has become, which further insinuates the skyrocketing rent for housing.

While there are no good statistics on new homes built or new residential building permits issued each year, World-Bank (2019) report suggest that demand for new urban housing – a function of new urban household formation and the need to upgrade the existing housing stock – far exceeds the current supply of housing. Moreover, as per the projection of housing in Addis Ababa during 2017 to 2027, the contribution of real-estate developers will reach 15% from its current supply of less than 4% of housing in Addis Ababa (Dakito, 2021). This increase in supply of housing will help meet the demand at *ceteris paribus*, but the supply isn't the only problem for residents in Ethiopia it is also the finance which makes residential mortgage financing essential. In Ethiopia, mortgages have been in existence for several years, but the sector is still relatively underdeveloped compared to other countries. The country's mortgage industry is facing significant challenges that affect its growth and development, including the high cost of finance, lack of access to long-term finance and the absence of a secondary market.

According to an assessment conducted by USAID in 2019, one of the significant issues affecting the mortgage sector in Ethiopia is the high price of housing. Ethiopia's economy has been growing rapidly, but the real estate

sector has not been able to keep up with the pace of economic growth. As a result, the price of housing has become unaffordable for many Ethiopians, particularly those in the low-income bracket. The high cost of housing has made it difficult for people to obtain mortgages, as they are unable to meet the stringent lending criteria set by financial institutions. Another challenge facing the mortgage sector in Ethiopia is the lack of a secondary market. Without a secondary market, financial institutions are reluctant to provide long-term financing for mortgages. A secondary market allows financial institutions to sell their mortgage assets, which provides them with liquidity and allows them to recycle their funds. Without a secondary market, financial institutions are reluctant to provide long-term financing for mortgages, as they are unable to manage the risks associated with long-term lending. The lack of a secondary market also affects the interest rates on mortgages. Financial institutions in Ethiopia have to bear the full risk of the mortgage, and this risk is reflected in the high-interest rates charged on mortgages. The absence of a secondary market means that financial institutions cannot sell their mortgage assets, and this makes it difficult for them to lower their interest rates.

We have seen in the cases of other countries the effect residential mortgage loan has on the economy of a country and the global economy as a whole. In June 2007, two big hedge funds failed, weighed down by investments in subprime loans. Losses from subprime loan investments caused a panic that froze the global lending system; large international firms collapsed and were bankrupt, etc. The initial cause was financial institutions began to lend to sub-prime borrowers with the common assumption that prices will always rise, and if the sub-prime borrowers are unable to repay their loans, banks can sell the houses and recover the loan. But reckless lending by banks brought more people into the housing market which in turn declined the prices by 25% because of market saturation. What first started as a sub-prime mortgage crisis in USA escalated into the 2007/08 global financial crisis due to complex financial instruments like mortgage-backed securities and credit default swaps (Mridusmita, 2016).

In Ethiopia, even though the level of mortgage loans is increasing in a relatively low rate, it is still showing some effect on the economy. The price on houses has shown a very high fluctuation and is increasing rapidly. Since there is a shortage of housing supply and the increase in

availability of mortgage loans has enhanced the ability of individuals to finance their purchase; the prices are going up. In addition to that mortgage loans are primarily given to employees of the bank which most are taking advantage of by acting as speculators, which desert the objective of housing mortgage loans. Though this may currently seem as a small inconvenience or a competition of buyers it could escalate into a problem that largely affects the economy.

After the CBB has been dissolved and merged into the CBE in 2015, the lack of a functioning mortgage bank has increased the burden on private and public commercial banks to fill the gap. But due to the risk associated with choosing applicants commercial banks limit their selves by issuing a very small percentage of their funds to housing loans. By observing commercial banks involvement in the sector you can settle that their goal is not the return provided by long-term mortgage loans, but rather potential consumers such as the diaspora community and the associated foreign currency revenues. The first private mortgage bank, Goh Betoch Bank S.C, had officially began operation on Oct 2021. Other mortgage banks are also in the process of formation.

Information about the rules and policies the nation adheres to when it comes to mortgage financing for residential units is inadequate. It is still unclear just how much power and restrictions commercial banks have when it comes to deciding on interest rates, loan payback conditions and executing a residential mortgage loan, which demonstrates the lack of knowledge regarding the country's housing financing procedures. As a result, this research aims to narrow the knowledge gap in the area of residential loans and evaluate their effect on the economy.

To achieve the general objective the following specific objectives are identified:

- To explore the approval procedure for loan applicants;
- To analyse the policy / national directive that guides the housing loan service provision;
- To examine the difficulties commercial banks in Ethiopia encounter as a result of mortgage lending policies;
- To inspect the challenges that expansion of mortgage loans creates on the economy.

## Literature Review

The safest type of loan in the financing sector is secured loan. Secured loans must have collateral put up as security for the cash the borrower is getting from the lender. Collateral might be the acquired object, such as a house or vehicle. Until the debt is fully repaid, the lender will retain ownership of the title or deed. A loan can also be backed by other assets. Stocks, bonds and property fall under this category. The most popular method for obtaining huge sums of money is through these loans. As opposed to an unsecured loan, the applicant is in a better position since they may negotiate for lower interest rates and more flexible repayment terms because they have pledged an asset to obtain the loan. The features of each specific secured loan differ from one another. However, they have a few general characteristics in common: assets required as collateral, low interest rates, available for all, customisable, customised according to the applicant's needs. One type of secured loan is mortgage loan. A mortgage is a type of loan used to purchase or maintain a home, land, or other types of real estate; the property purchased then serves as collateral to secure the loan. Mortgage payments usually occur on a monthly basis and consist of four main parts: the principal, the interest, the property tax the individual must pay as a homeowner and the municipal taxes which are calculated based on the value of the home.

A home mortgage is a loan given by a bank, mortgage company, or other financial institution for the purchase of a residence – a primary residence, a secondary residence, or an investment residence – in contrast to a piece of commercial or industrial property. In a house mortgage, the owner of the property (the borrower) transfers the title to the lender with the understanding that the title would be returned to the owner upon the completion of the last loan payment and the fulfilment of all other mortgage requirements. A home mortgage is one of the most common forms of debt, and it is also one of the most recommended. Because they come with lower interest rates than almost any other kind of loan that an individual consumer can find.

In Imperial Ethiopia (i.e., pre-1974), urban land and housing was largely in private hands primarily owned and controlled by a small class of aristocrats. More than 60% of the housing was rental units. Since most urban land was owned by the upper class and there was limited investment

in the housing sector, there was a severe shortage of affordable residential housing for low and middle-income households (Abraham, 2007). During the Derg (1974-1991), The Home and Savings Bank was the sole state bank that provided financing for housing construction, renovation and expansion. This bank was offering long-term mortgage loans to individual citizens and housing cooperatives at interest rates of 7 and 4.5%, respectively, just before the Derg's fall. These rates were subsidised; at the time, the central bank rate ranged from 9 to 10%. The mortgage lending rate was kept below the rate set by the central bank since the government supported subsidising houses in the nation. Due to the communist policies of the state, economic development was weak throughout this time, and inflation lingered about 4%. Since the State dominated the economy, it was strongly discouraged for individuals to take the initiative in many fields, including private mortgage financing.

Following the onset of the financial reform program in early 1990s, the Housing and Saving Bank became the CBB in September 1994. The CBB is now established as a universal bank in line with the dictates of Regulation No. 203/1994 issued by the council of ministers. It caters for banking services, mainly financing loans for construction, repair, modification and acquisition of residential and non-residential buildings, for construction sector activities and for the development of hotels and tourism. It also provides business loans to meet the working capital requirements of commercial and industrial activities. The bank also has the mandate to offer foreign banking services.

The program of significantly subsidised residential housing supply was not supported by the administration that took office in 1991. As a consequence, it started a significant initiative to respond to housing demand and supply in accordance with the demands of the market. It also adopted a market-oriented approach to housing construction. A new policy of holding land through a leasing system was implemented once land was designated state property. The length of the lease ranged from 50 years for commercial and other usage to 99 years for owner-occupied homes. Most subsidies were eliminated under the new market orientation, and mortgage interest rates were liberalised to reflect market rates. However, the Government's financial reforms did not result in expanding residential housing finance in the country. Historically, the CBB was the only bank giving mortgage loans to home builders. Up until 1995, the CBB gave mortgage loans

amounting to \$42 million for the construction of 26,912 residential houses. These were subsidised loans at below market interest rates. Of the total units built, 14,881 houses (55.3%) were built by borrowers whose monthly income was below \$52. This meant the bank played a pioneer role in supporting the financial needs of the middle income group of society for housing construction. A significant obstacle to the growth of mortgage financing in Ethiopia has been the compactness of the mortgage market, which was dominated by the CBB. In those years, some other banks started to enter the mortgage market. For example, big banks like the CBE and the Development Bank of Ethiopia, which were not active before, had increasingly become important lenders to the commercial construction sector at interest rates ranging between 9 and 10% for a maximum of 10 years. There were also signs that private banks are beginning to show interest in providing mortgage loans to the commercial construction industry. The CBE had also been made responsible for providing the loans for purchasers of the condominium housing units.

After the merger of CBB with CBE in 2015, there wasn't a mortgage bank in the country which made commercial banks face the burden of providing housing finance. The first private mortgage bank, Goh Betoch Bank S.C, had officially began operation on October 2021 with 1.1 billion Birr signed and 521.5 million Birr paid up capital.

Currently Ethiopians have three methods of financing their housing. First, many of the upper income group house builders opt to finance their homes out of personal resources rather than taking out loans in order to avoid debt and the difficulties of the mortgage system. More crucially, the typical strategy utilised in the construction of informal housing is building progressively and funding the development from savings and current revenue. Secondly, financing for housing is leveraged through "edirs" and community savings schemes. According to GTZ officials, there was close to 400 million Birr (US\$50 million) in 2009 saved in credit unions, which was to be mobilised towards housing and infrastructure improvements. Lastly, housing is financed through mortgage loans. This covers residential and commercial construction. However, it needs to be pointed out that mortgage delivery is limited given the fact that it is provided by commercial banks.

In 2015 it was estimated that, Ethiopia will have approximately 4 million new urban households by 2027 and approximately 9.7 million by 2037. Demand for urban houses is estimated at 471,000 per year from 2015 to 2025,

and 486,000 houses a year from 2025 to 2035. Ethiopia's home financing system, however, needs improvement. In terms of financial accessibility, just 23% of the housing market is funded through mortgages; instead, more than half is financed informally through friends, family and savings organisations. Ethiopia has the difficulty of not being able to improve current stock and build enough new, affordable housing to fulfil the demand needed each year. Because there is a lack of excellent, reasonably priced housing, there are more informal settlements in the major metropolis. The real estate sector has contributed 12.5% to Gross Domestic Product growth in the past 10 years. The growth has largely been attributed to an 8.9% expansion in real estate and construction. On the supply side, adequate developer financing is lacking. The private sector is neglected, with all efforts devoted to the government housing program. On the demand side, demand for formal housing is high, with the government IHDP units fetching up to five times more than the original auction offer.

Until very recently, the Government of Ethiopia did not have an explicit housing policy. The Federal Ministry of Works and Urban Development is the lead agency entrusted with the responsibility for the provision of housing. Recently, the Ministry has prepared a policy proposal on housing development which will serve as a guide for cities and regional governments in meeting the soaring housing demand in the country. The policy envisages two approaches to tackle the housing problem, namely direct government intervention; and promotion of private real estate development. Direct government intervention includes Condominium Housing. This project describes the ambitious goals and efforts set out by the Ethiopian state since 2005 to construct housing for low and middle-income people, to create a significant number of jobs and to promote small enterprises. Ministry of Works and Urban Development deals with the housing programs at large. The ministry provides support and direction at national level whilst a Bureau of Works and Urban Development in each region has been set up to coordinate the specific needs of the area. Under the Housing Development Bureau in the MWUD there are four Directors: one to manage housing finance; one for the implementation mechanisms; one for capacity building and one for research and design.

In 2006, facilitated by the MWUD, the CBE agreed in Memorandums of Understanding with the involved regional states and the city of Dire Dawa to purchase bonds

in order to enable the regions to finance the implementation of the IHDP. The city of Addis Ababa, after exclusively using the city's own budget during the rest years, also started selling bonds to the CBE to finance all factors of the programme, including construction costs. CBE Bank provides funding for the total cost of the programme's implementation in Addis Ababa and in the regions, and not on a site-by-site basis. CBE Bank has also come to an agreement with the HDPO to provide a loan-service to all condominium beneficiaries, whereby the Bank pays 80% of the unit price on behalf of the beneficiary at the handover of the property (the beneficiaries pay the 20% down payment themselves) and the families enter into a loan-agreement with the CBE to pay back this amount subject to interest.

The National Bank of Ethiopia is responsible for regulating the banking and insurance business in Ethiopia and CBB was highly reliant on the Central Bank of Ethiopia for its capital. Following the market-led adjustments implemented post-1991, subsidised interest rates were removed which significantly increased lending rates. Rates increased from 4.5% for cooperatives and 7.5% for individuals to 16% for both, severely reducing the opportunity for the low-income households to secure home loans. Overall, this centralised financial setup has resulted in a housing finance sector that is very limited in its scope and diversity of the products it offers. Eventually in 2015, the CBB was merged with CBE with the official stated reason being creating a strong bank that has a strong contribution to the country's economic growth. Most banking and economic experts agree that mortgage banking services in Ethiopia have either died together with CBB or by the time CBB was made to shift its model to universal banking. The national bank of the country which is entrusted with monetary regulation of the country does not allow private banks and private actors to finance the housing sector or at least it does not encourage them to do so (UN-Habitat Report, 2011).

Private housing developers typically target high-income families in Ethiopia, and the country's housing policy framework is distinguished by initiatives to encourage homeownership. Furthermore, short-term loans are preferred by commercial banks. The housing financing industry has a negligible influence on the growth of the larger financial system due to the low level of formal housing finance institutions' penetration. The housing need evaluation revealed a significant requirement for housing units, which supports the possibility of mortgage

financing in one form or another. The government developed a policy that gave the impression that it would implement more plans to address the nation's housing shortage. In addition to its condo plan, it implied that the private sector, including foreign corporations, and the general public through housing organisations would also be involved in housing. Generally, penetration by the formal banking institutions into the urban housing finance market has been minimal over the past four decades. According to a survey made by PADCO/WASS/NUPI (1996), only 10% of households used the public sector housing bank as the primary source of funding for residential construction, and only 6% used the same source to purchase their plot of land.

For commercial banks, housing finance is an extremely hazardous industry because of income instability and extended maturities. The borrower may stop making payments at a later point in the loan term owing to a lack of income, which would increase the amount of arrears in the financial institution's portfolio. Another risk associated with housing finance is credit risk. The large size of home loans relative to the borrower's income and the underdeveloped regulatory and legal frameworks for mortgage debt recovery are the causes of this. The claim is that banks won't be in a position to readily convert mortgaged property into liquid money in the event of failure without engaging in a drawn-out and expensive judicial process.

Investment in the housing sector is limited due to the low level of domestic savings and a shortage of external resources. Private housing developers in Ethiopian cities have primarily targeted high-income households to date in order to maximise a positive rate of return as well as due to the relative absence of mortgage finance and the limited financial means of low and middle-income households. The country's relatively low overall level of financial savings, as well as Ethiopia's early phases of rebuilding its financial system and doing so at a gradual and cautious pace, is a challenge as it doesn't meet the accelerating demand of the citizens (UN-Habitat Report, 2011).

For lenders providing mortgage loans it is not uncommon to charge borrowers to compensate for the time of loan period and risks involved since a mortgage loan is long term by its nature. If we see from lenders perspective it is mandatory to charge a certain percentage on yearly basis since they are in the process of doing business. Additionally, the money provided to borrowers is in the

form of deposits collected from a significant segment of the population, which have a limited maturity time and cost to access the money. The principal amount relies on the value of the house or the cost of construction, and the principal amount depends on the amount of interest payments. In conclusion, the existing price of houses in the market is a major constraint to access loans for housing in the country. Hence, a specific interest rate applied on inflated house prices would result in higher monthly interest payment.

Mortgage loans play a crucial role in the real estate industry and are essential for many individuals and families to purchase homes. The expansion of mortgage loans has the potential to stimulate economic growth, as it increases aggregate demand for housing, creates jobs and contributes to the overall health of the economy. However, the expansion of mortgage loans can also create challenges that impact the economy negatively. Currently in our nation, we have noticed a significant increase in demand of proper housing which intern lead to the expansion of the need of housing mortgage loans.

## Research Method and Materials

A research design is a framework or blueprint for conducting research. It details all the necessary information needed to structure and solve the research problems. A good research design seeks to ensure that the research project is conducted effectively and efficiently. For this study, the student researcher will employ a descriptive research design. The study fits within the provisions of descriptive research design because the data for the research will be collected from purposely selected commercial banks in Ethiopia and reported according to the data obtained from those samples. A survey research design has been utilised to get information that is relevant on residential mortgage loan practices of Commercial Banks in Ethiopia. This study concentrated on gathering qualitative data since the research's scope covered commercial banks' operations in relation to residential mortgage financing as well as its difficulties and future prospects. Despite being primarily qualitative, the study features a few quantitative data points that can help with market insights and the accomplishment of the study's stated goals.

The research has centered its population to be on all commercial banks in Ethiopia whose headquarters reside in Addis Ababa. A purposive sample's primary

goal is to provide a sample that can be logically taken as representative of the population. The sampling for this study was carried out by using expert knowledge to pick non-random sample components that reflect the diversity of the population. In order to escalate the representativeness of the sample, number of respondents were selected randomly from ten commercial banks that the researcher believes are representatives of the population. The selected commercial banks are: CBE, Awash Bank, Dashen Bank, Bank of Abyssinia, United Bank, Nib Bank, Bunna International Bank, Abay Bank, Debub-Global Bank and Amhara Bank. These banks were selected by their dominance in the sector and representativeness of all three generations of banks.

Using Google forms, a descriptive approach of data analysis was used to examine the survey data. In order to provide a clear grasp of the topic numerically, the descriptive statistical findings were presented through charts and graphs that were produced for each variable in the research. The literature review previously organised was also used to cross-examine the accuracy of the data received from respondents.

## Results and Discussion

The data have been presented using graphs and charts. A narrative analysis is also employed to analyse the open-ended questions that have been included to assess the thoughts of the survey respondents regarding the market and national directives. In order to evaluate the data that has been collected and to give the results meaningful context, the qualitative data is also utilised to study and comprehend the market's current patterns. This research used the major banks in the nation as a sample. The credit analysis and appraisal departments of these banks served as the research's subjects. According to the specified research objectives, the gathered data from the study is examined and presented in the sections below:

### Mortgage Loan Approval Process

From the 10 banks that were selected as a sample 4 of them are not currently issuing new loans but have done so in the past. The following analysis of the loan approval process will show the process they have been taking. The following questions were articulated in order to assess the housing loan provision practices of commercial banks.

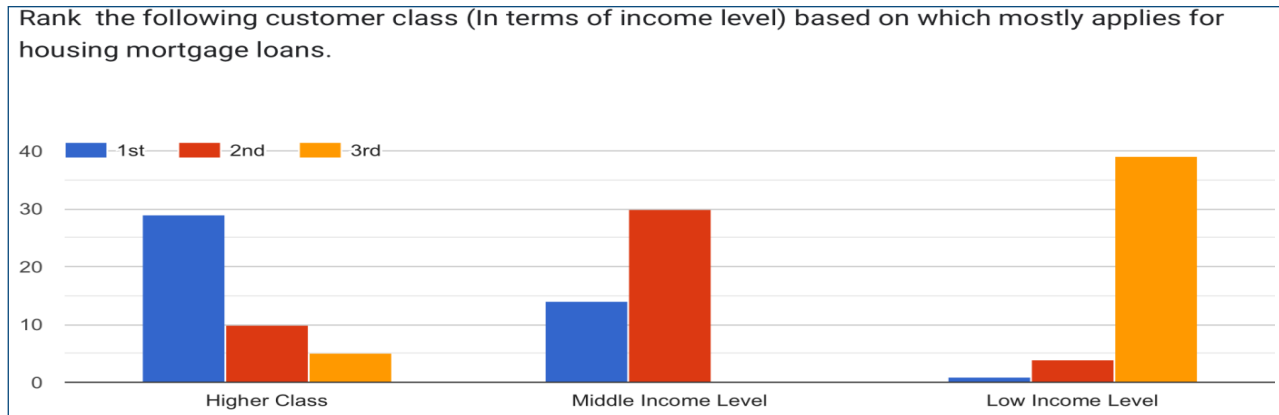


Fig. 1

According to the data, the middle-income level customers mostly apply for housing mortgage loans, followed by the higher-class customers, and then the low-income level customers. This indicates that the middle-income group has a higher demand for housing mortgage loans, possibly due to the availability of affordable housing options and their ability to meet the eligibility criteria for such loans. On the other hand, the low-income group may face challenges in meeting the income and credit requirements

for housing mortgage loans, while the higher-class group may have enough financial resources to purchase homes without resorting to loans. Our review of different literatures supports this data.

When applying for a loan, the lender will typically consider various factors to determine whether you are eligible for approval. Some of the common qualification criteria for loan approval such as; credit score, Income, employment history, etc.

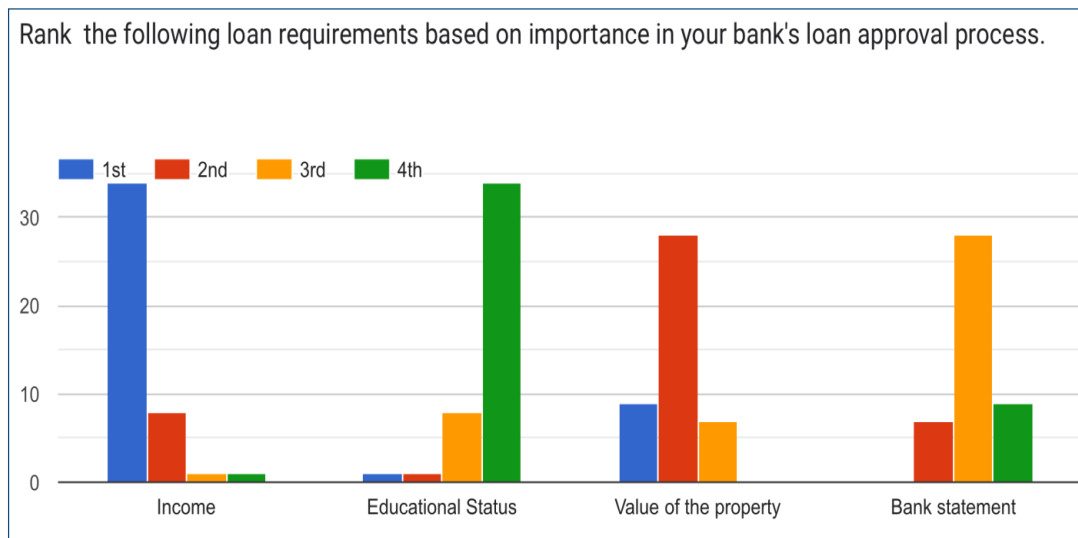


Fig. 2

According to the data, income is the most important factor considered by the banks in the loan approval process, followed by the value of the property, bank statement and then educational status. This indicates that the bank places a high emphasis on the borrower's ability to repay the loan, as reflected by their income level. This explains why low-income groups are denied to get mortgage loans. The

value of the property is also an important consideration, as it serves as collateral for the loan. The bank statement is likely used to assess the borrower's creditworthiness and financial stability. Educational status may be considered as a factor to assess the borrower's ability to secure and maintain a stable income, but it is not as crucial as income, property value and creditworthiness.

According to the reviewed literature of Rinaldi, Household Debt Sustainability, a few of the key factors that are significant in determining whether to approve or deny a loan application and evaluate a potential borrower's credit worthiness include income, credit score, work history and property value. Therefore, the researcher believes that a steady income, a high credit score and a valuable property are the criteria that are crucial for eligibility.

### Loan Maturity Period and Interest Rate

When applying for a loan, the lender will typically determine the qualified loan amount and maturity period based on various factors, such as your creditworthiness, income and debt-to-income ratio. The qualified loan amount is the maximum amount that the lender is willing to lend you, based on their assessment of your ability to repay the loan. The maturity period, on the other hand, is the length of time you will have to repay the loan, usually in the form of monthly payments. The maturity period can vary depending on the type of loan and the lender's requirements, but it typically ranges from a few months to several years. It's important to carefully consider the qualified loan amount and maturity period before accepting a loan, as they will affect the total cost of borrowing and your ability to repay the loan on time.

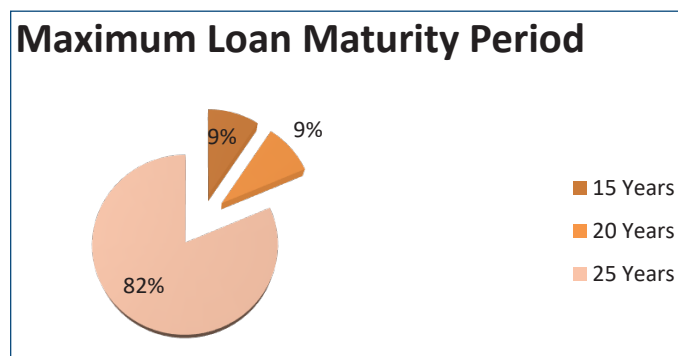


Fig. 3

We asked our respondents the maximum and minimum loan amount that is eligible for loan application in their respective banks. Their answers were that it depended on different others factors and differs for different applicants based on their income, repayment capacity, age, value of the property and others. On the literature review the researcher stated that mortgage loan is unique from other kind of loans as it is tailored for each individual so that it can fit as the requirement of the borrower and the

lender. The data collected from the respondents prove this statement right.

According to our data, the minimum period for mortgage is not clearly stated as the maximum period for most banks is 25 years, when it is 20 years for Dashen Bank and 15 years for NIB Bank. The maximum period could change depending on the age of the borrower. For borrowers close to their retirement, the period left till their retirement is their maximum period. In the reviewed literature, a maximum loan maturity period of 30 years is allowed, depending on the borrower's financial situation and the terms of the loan.

Interest rate is the cost of borrowing money from a lender, expressed as a percentage of the loan amount. It's the amount of money you will have to pay in addition to the principal amount borrowed, and it's the primary way that lenders make money from loans. A low interest rate can make it more affordable to borrow money, while a high interest rate can make it more expensive and may not be feasible for some borrowers. It's important to understand the interest rate and how it affects the total cost of borrowing before accepting a loan offer.

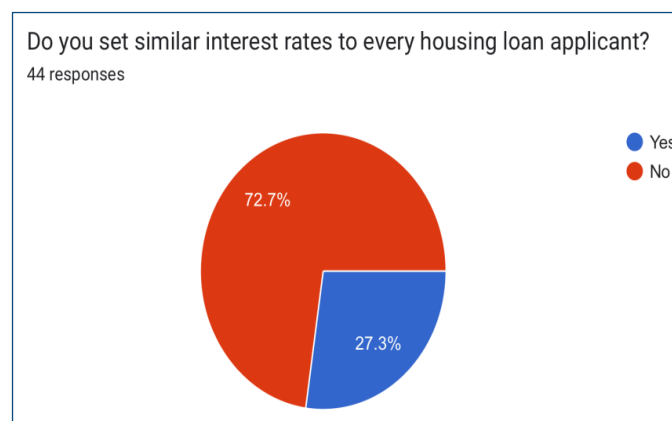
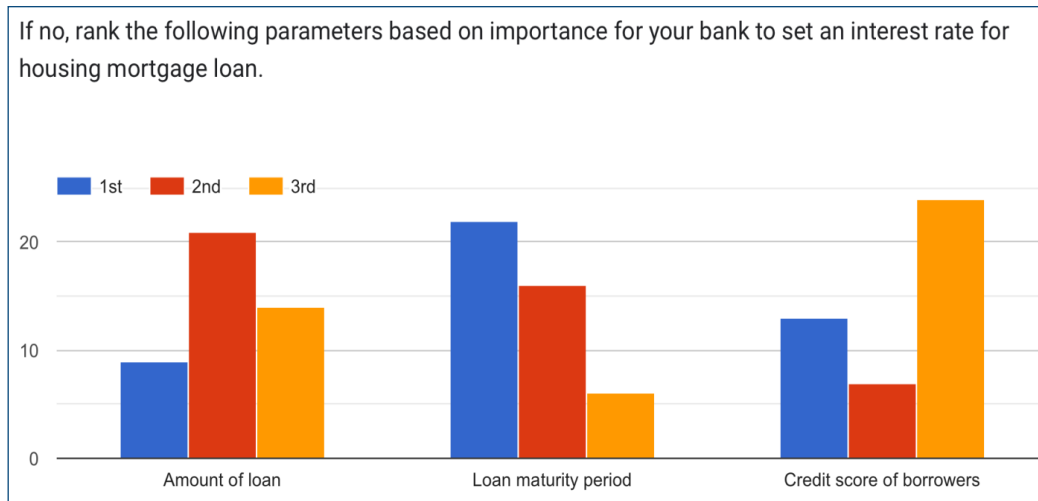


Fig. 4

When asked if the banks set similar interest rates for every housing applicant, respondents from Dashen Bank stated that they used a flat interest rate of 8% for employees of the bank but different rates for customers. Whereas other banks charge various applicants with varying interest rates. Interest rates are based on how well loan applicants complete their credit requirements, as was also indicated in the literature analysis. This demonstrates that the data obtained from the relevant literature and questionnaire respondents is 75% consistent.

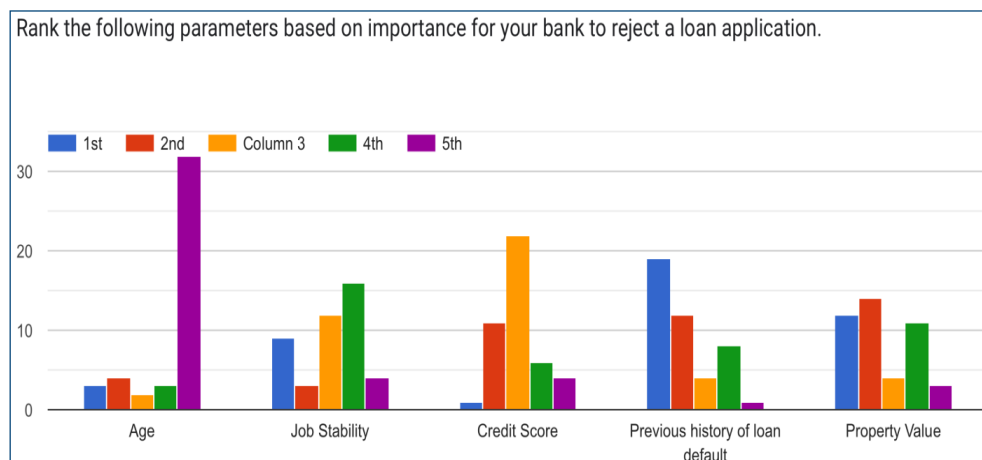


**Fig. 5**

According to our respondents, loan maturity period is the most important followed by amount of loan and credit score. The loan maturity period is important because it affects the bank’s risk exposure. Longer loan maturity periods increase the risk of default and the possibility of interest rate fluctuations, which can affect the bank’s profitability. Especially in our current economic situation where inflation is rapid and interest rates are varying rapidly maturity period is essential. The amount of the loan is also important because it determines the size of the bank’s exposure to potential losses. The larger the loan,

the greater the risk to the bank if the borrower defaults. Finally, the credit score of borrowers is important because it is an indicator of the borrower’s ability to repay the loan. Borrowers with higher credit scores are generally considered less risky and are more likely to receive favourable interest rates.

In Addition to this, the literature review of this research states that the value of the property is also very crucial as it represents the strength of the collateral put and the more valuable the property, the less interest rate is set for borrowers.



**Fig. 6**

Based on the responses received, a previous history of loan default is the most important parameter as it indicates that the borrower has not been able to repay their debts in the past and poses a high risk to the bank. The credit score is also an important parameter as it reflects the borrower’s

creditworthiness and their ability to repay the loan. Job stability is the third important parameter, as it indicates the borrower’s ability to generate a stable income and therefore their ability to repay the loan. The property value is the fourth important parameter as it determines

the collateral value of the loan and the bank’s ability to recover its funds in the event of default.

Age is the least important parameter as it does not directly reflect the borrower’s ability to repay the loan, although it can be an indicator of their future earning potential and overall financial stability. In line with the literature review, the borrower’s moral character and past loan repayment history, particularly default loans are important indicators to establish eligibility. The applicant’s credit eligibility is also affected by other variables including payment history, debt-to-credit ratio, length of credit history, new credit and the amount of credit sought. The information

obtained from the literature review and the collected data are consistent since the main factor assessed from both is previous history of loan default.

### Loan Approval Process

Scientific loan approval process refers to the use of data-driven and evidence-based methods to assess a borrower’s creditworthiness and determine their eligibility for a loan. This process typically involves analysing various factors, such as the borrower’s credit history, income, employment status, debt-to-income ratio and other relevant information.



Fig. 7

Employees of the sample banks were asked if they believe their respective banks follow a scientific loan approval process, 77.3% responded in a positive way while the others believed the banks didn’t follow a scientific method. According to our literature review, there are mainly eight distinct steps used in the mortgage loan

process: pre approval, pre-qualification, house shopping, mortgage application, loan processing, underwriting, pre-closing and closing. Therefore, the researcher believes that the commercial banks in Ethiopia follow these eight major procedures.

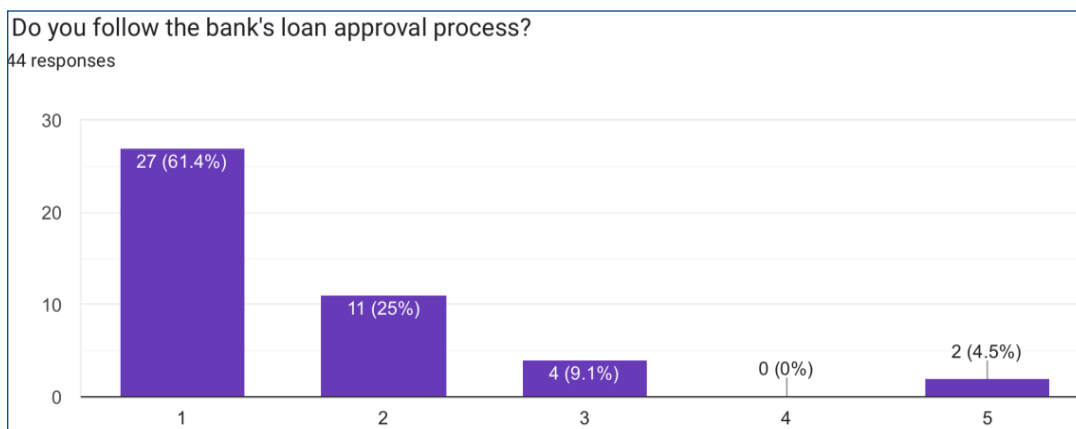


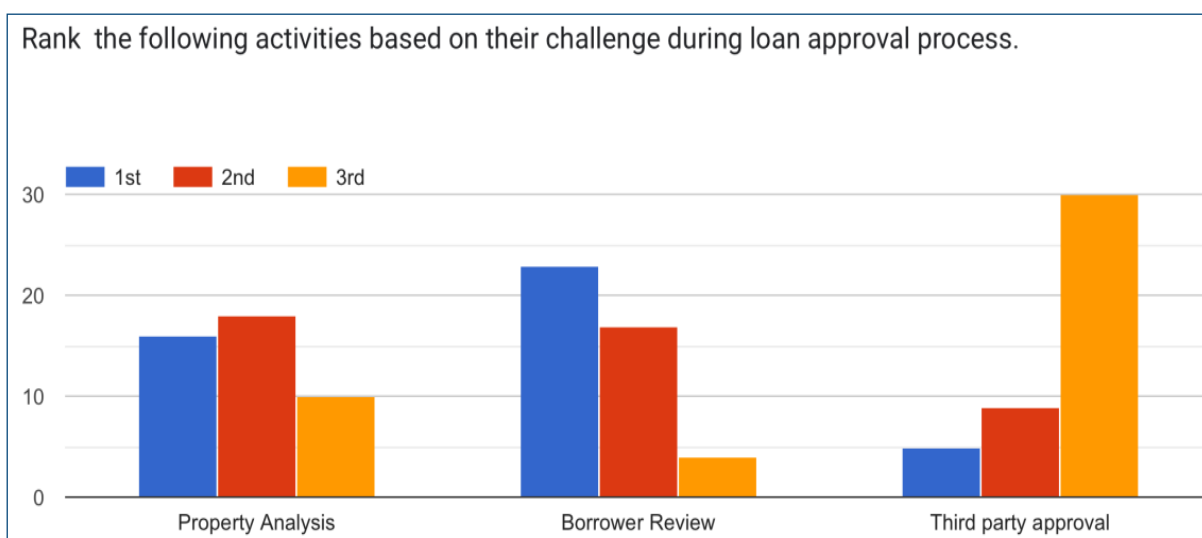
Fig. 8

Based on the given responses, it appears that the majority of respondents (86.4%) follow the bank's loan approval process, with a rating of 1 or 2, indicating that they always or usually follow the process. Only two respondents rated themselves as never following the bank's loan approval process (a rating of 5). It is worth noting that there are a few respondents who rated themselves as a 3, indicating that they sometimes follow the bank's loan approval process. This suggests that there may be some variation in the degree to which the loan approval process is being followed, even among those who generally follow the process. Overall, the results suggest that most respondents are following the bank's loan approval process, which is an important aspect of lending and borrowing that helps ensure that loans are approved and processed in a consistent and fair manner.

Banks use multiple modes of communication to inform loan applicants regarding loan approval and rejection. The results suggest that loan applicants are most commonly informed about loan approval and rejection via phone call, while some lenders also use written communication such as letters and emails. The use of multiple communication

channels may help ensure that loan applicants receive timely and effective communication regarding their loan status. When asked the modes of communication used to follow up with borrowers regarding debt collection, respondents replied that phone call and physical visit are the most commonly used modes of communication to follow up with borrowers regarding debt collection. This indicates that lenders prioritise direct communication with borrowers, which may help to resolve debt collection issues more quickly and effectively. The use of multiple communication channels, particularly phone call and text message, may also help to ensure that borrowers receive timely and effective communication regarding their debt collection status.

For commercial banks, housing finance is an extremely hazardous industry because of income instability and extended maturities. The borrower may stop making payments at a later point in the loan term owing to a lack of income, which would increase the amount of arrears in the financial institution's portfolio. In order to assess the challenges of commercial banks regarding residential mortgage loan, the following questions were constructed.



**Fig. 9**

As shown on the graph above borrower review was ranked as the most challenging activity by almost half of the respondents, followed by property analysis and third-party. As for the conclusion drawn from the examined literature, verifying the truthfulness of the applicant's income information is the most difficult task since loan applicants frequently submit fabricated or inflated documentation.

Before accepting the loan, the bank checks to see if the applicant's source of income is real, reliable, and steady. Borrower review is time and resource-intensive process, so this analysis can be useful for lenders and loan officers to prioritise their efforts and allocate resources effectively during the loan approval process.

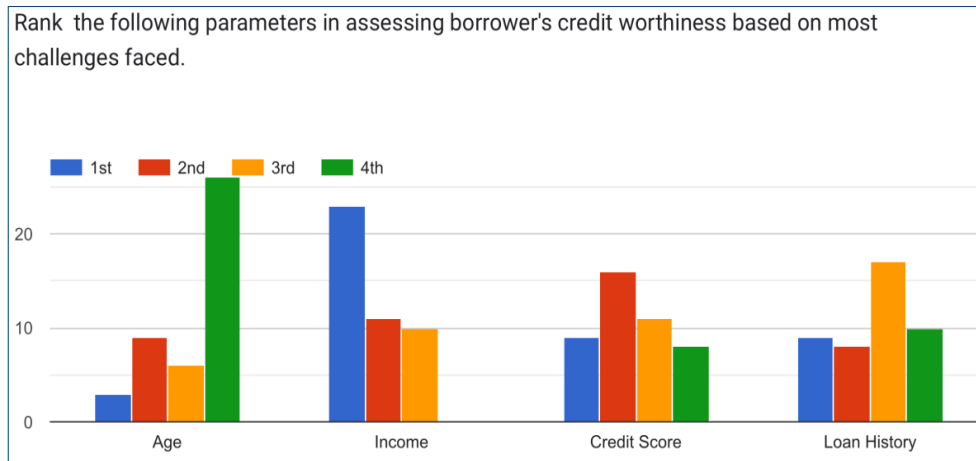


Fig. 10

Since we considered borrowers review as the most challenging process of the loan approval process according to our collected data and the literature review, we further investigated the parameters that are challenging in assessing the borrower's credit worthiness. The rankings suggest that income is the most challenging parameter to assess when determining a borrower's credit worthiness, followed by credit score, loan history and age. The results suggest that lenders and loan officers should focus on assessing a borrower's income and credit score when determining their credit worthiness, while age and loan history may be less significant factors, unless there is a loan default in their history. The analysed data harmonises with Income verification theory, as it explains that income verification is a critical factor in assessing a borrower's creditworthiness as it helps lenders determine whether the borrower can afford to repay the loan. However, income verification can be challenging, particularly for

self-employed individuals or those with irregular income streams.

### Debt Collection and Policy to Guide the Housing Loan Service Provision

Debt collection refers to the process of pursuing overdue payments from individuals or businesses. The debt collection process typically involves sending letters or making phone calls to the debtor to request payment, and may escalate to legal action if the debtor continues to default on their payments. Debt collection is an important aspect of credit management, as it helps creditors recover unpaid debts and maintain their financial stability. However, debt collection practices are regulated by law and creditors and debt collectors must follow certain guidelines and ethical standards when pursuing debts.

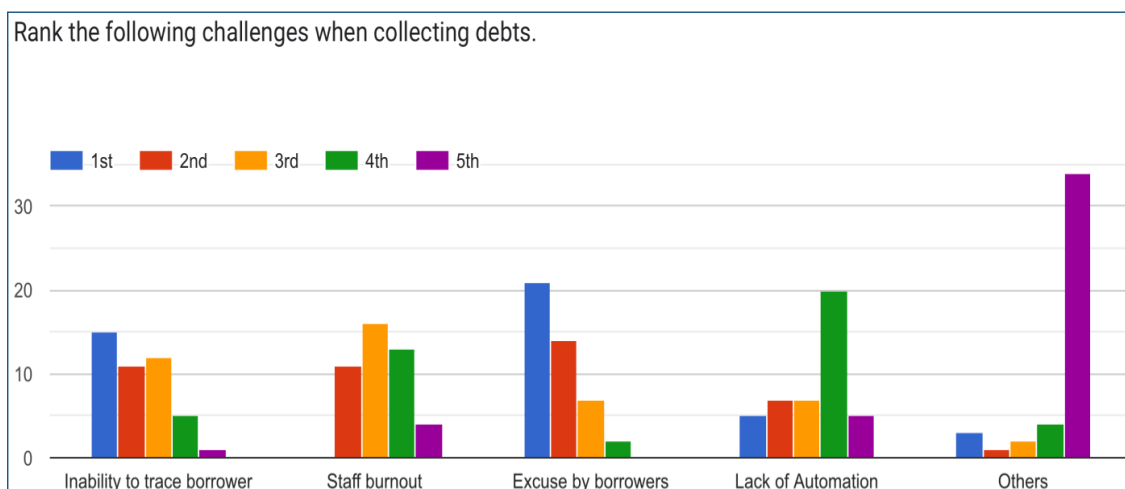


Fig. 11

Credit portfolio departments, which are responsible for following and collection of unpaid loans, find excuses by borrowers as the most challenging part of debt collection, followed by the inability to trace borrowers and staff burnout. These factors may require lenders to develop more effective communication strategies, improve their tracking and tracing mechanisms, and provide support to staff members dealing with debt collections. The lack of automation was ranked as the least challenging issue, indicating that lenders may be investing in technology to streamline their debt collection processes. In contrary to our data, information asymmetry theory clarifies that lenders and borrowers have different levels of information and knowledge, which can complicate debt collection efforts. Borrowers may have more information about their financial situation than lenders, and they may use this information to their advantage during debt collection negotiations. This can make it challenging for lenders to effectively collect unpaid loans, even if they have effective communication strategies and tracking

mechanisms. This theory suggests that lenders need to address this imbalance of information by gathering more data about borrowers and their financial situation. This can involve conducting more thorough credit checks, verifying income and employment information, and using data analytics to assess a borrower's creditworthiness.

The respondents were also questioned about the criteria they use to label accounts as doubtful. All banks agreed that the borrower's ability to repay the loan is the most important criterion to take into account, and any loan that has been dormant for more than 180 days (90 days in the case of Dashen Bank) is seen to be suspect, and additional attention will be paid to the account. The literature review also revealed that if loans are not returned according to the predetermined repayment schedule, banks would often designate them as default loans. Following intentional follow-up, the banks give up on the loan if the borrower misses numerous of the scheduled payments, designating it as a questionable account and ultimately a default loan.

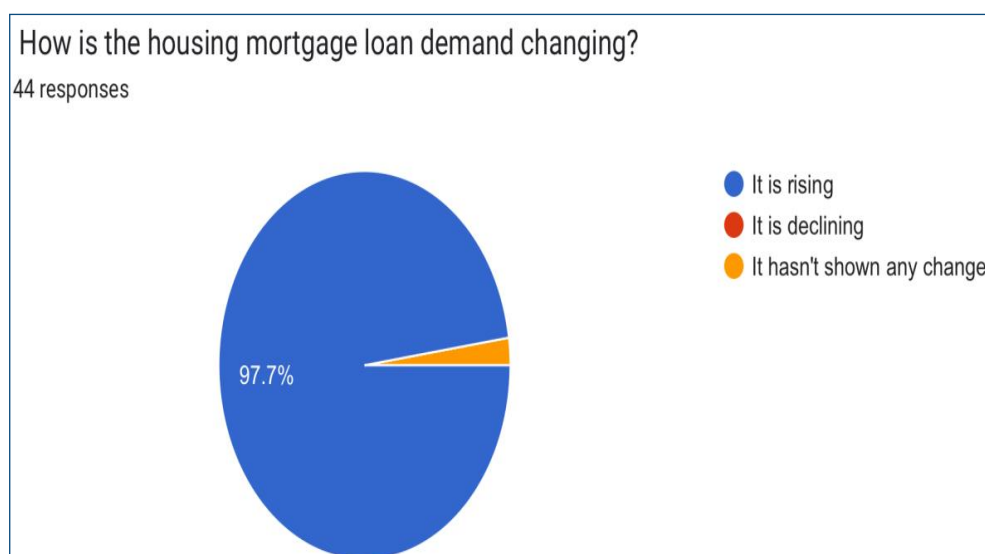


Fig. 12

Almost all respondents agree that the housing mortgage loan demand is rising as the population in the urban areas of the country is increasing rapidly. As illustrated in the literature review, demand for urban houses is estimated at 471,000 per year from 2015 to 2025, which also shows it significantly rising. However, the issue is that there are not enough resources dedicated to meet this demand. More than half of the respondents replied that there is no policy/ or national directives to guide the housing mortgage loan service provision. The others stated some directives

issued by the National Bank of Ethiopia. Except for the Diaspora loan guidelines that have been set up the other directive mentioned by the respondents were for loans in general and about Asset classification and provision, such as SBB/69/2018. Consequently, the researcher presumes that as it has been analysed from the respondents as well as the literature review, no housing mortgage loan directive has been issued by the FDRE government to address the need of mortgage loan financing and its service provision.

## Conclusion

Based on the research, we can conclude that, the middle-income level customers mostly apply for housing mortgage loans and most parameters used for the loan approval process are individualised to each client, with income being the most influential. Though there are various considerations on deciding whether to reject or accept a loan, history of loan default holds the upper hand as it highly interrelates with the other parameters. In conclusion, the rejection or approval of the loan, the interest rate, the maturity period, and the amount of loan accepted all depend on the capacity of the applicant. We determined that all the sample banks use the scientific loan approval process and the employees follow the procedures provided by their respective banks.

The researcher has established that commercial banks face numerous challenges during the approval and repayment collection process. The major challenge discovered was borrower review, which consists of assessing the authenticity of documents about income, credit score, loan history, age and other information since it is exposed to a high rate of forgery by loan applicants. Excuse by borrower and inability to trace borrower were also discovered to be highly challenging when collecting debts, which further lead to staff burnout and high expenses. These challenges reduce the profitability of the banks. It has also been determined that the country doesn't have policy and regulations that guide the housing mortgage loan service, though it is essential since the mortgage loan sector can highly influence the economy of the country as a whole by creating slow economic growth, income and wealth inequality, risk of deflation, etc.

Regardless of the challenges commercial banks that operate in this sector face, there are also prospects of improvement as the demand for housing finance is increasing. The lack of regulations and policy on this specific market could have some positive impact considering that it would allow the country to develop new policies that are well oriented with the situation, history and culture of the country with renovation that helps shield the country from crisis that have happened in other nations due to housing finance schemes.

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