

East meets west in the heart of the Silk Road

# Using **CUSPAP** to build a war-torn **AFGHANISTAN ECONOMY**

BY JEREMY BROOKS

**T**wo weeks after U.S.-led forces captured the Iraq capital of Baghdad in 2003, Philip Smith was dispatched to the city of Basra by the Government of Britain. A veteran of the financial services and real estate industries, he had retired about a decade earlier, relocated to Moscow in 2000 from California, and become a consultant to banks throughout Eastern Europe and the Middle East. The Brits tapped Smith to help re-establish the payment systems in Basra and later to organize the post-Saddam Hussein election, establish budgets for the offices of the future president and prime minister, and restore their banking system.

While none of these tasks would be straightforward, the latter was particularly prickly in the context of the recent overthrow; payment systems were broken and looters had sieged the central bank before setting it ablaze. Unfazed, Smith set to task on a crucial first priority – ensuring money





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*~Philip Smith*



got into the hands of citizens in the form of salaries, pensions, etc. While the vandalized bank was repaired, Smith led a team that got cash flowing back into the streets. They did so from the back of a truck and storage containers.

“The system worked,” says Smith, who holds degrees in accounting and finance, applied economics, and real estate. “We were paying state employees, oil company salaries, teachers. Some people never missed a pay period . . . we were handling about \$40-50 million in cash every month . . . We showed the local people how to put banking systems in place.”

This boon to the locals was not so well received by the Americans in Baghdad, Iraq, who felt this flash finance happened too fast, says Smith. “In Baghdad, they didn’t quite get it. We were criticized quite severely and told to slow down.” He didn’t much care. He had been hired by Britain to help Iraqis and he delivered on that promise.

Since he first dipped his toes into international development aid in the late-1990s as a retiree-turned-volunteer, the now 70-year-old has taught bankers in countries from Kosovo to

Kyrgyzstan about international banking standards; helped them establish proper appraisal professions; introduced mortgages (his own mortgage on his Moscow abode having the distinction of being the fourth one ever issued); and led seminars on everything from accounting to risk assessment.

Recently, he worked on a project in Afghanistan to establish its appraisal profession, building on previous work he had done in the country to kick-start its finance sector that dated back to 2002. During the past two decades, Smith has worked for governments and foreign aid agencies from the UK, Europe and the U.S. For this particular project, the funder was USAID, and Smith worked as a consultant for the U.S.-based international development firm Chemonics International Inc. The projects preceding Smith’s work on creating an appraisal profession in Afghanistan were top down in nature, encompassing everything from establishing a regulatory regime for their banks and teaching them about financial statement analysis, to introducing mortgage financing. They would lay the groundwork for this next endeavour.



In the wake of decades of war, Afghanistan’s economy, like its cities and towns, was in need of rebuilding. It is not a developed nation, but it is a country with many landowners, so using real estate-based loans to kick-start its economy made sense. The heavy lifting that Smith had encountered with each successive project he worked on shared common elements, including the need to adopt modern rules and regulations around lending and borrowing, and, from there, a way to educate Afghans on how borrowing against their own assets could help them, and their country, prosper.

The situation in Afghanistan is not unlike that in many of the countries Smith has worked in where tradition, not regulations, guide matters such as real estate. What a property was worth and how much one could borrow against it were values that had no foundation in international standards, as you would expect to find in developed countries with an established appraisal profession. Real estate deals were typically brokered at a dining room table over a cup of tea, sealed with a handshake and little else. Smith says that earlier he had encountered a similar scenario in Kosovo, which he turned into an opportunity to teach their banks about appraisals. He would later do the same thing in Serbia.

In the absence of an appraisal profession, what Smith says he saw in these countries was banks haplessly lending far more money than a property was worth. He described the “classic scenario” in Afghanistan: a property with a market value of \$500,000 netting a loan worth \$1 million. Worse still for the bank’s risk managers who okayed the loans was the fact that they had no true value to help them recoup their investment if a deal went sour. Each project Smith worked on revealed the next weak link in the chain that needed to be strengthened in order to build an effective finance sector in Afghanistan, and knowing the value of what a property was worth became the bedrock.

At the same time that Smith was teaching Afghanistan’s banks about the importance of appraisals, the consumer side of the lending coin revealed another unique challenge. Smith discovered that most Afghans had never heard of a mortgage and had no idea they could borrow money against their homes. He says public awareness campaigns were developed to introduce them to the idea. Overcoming this dearth of public knowledge would also require restoring their trust



in a banking system known for corruption – including one highly publicized fiasco at the Kabul Bank in which more than \$800 million was diverted to personal beneficiaries, including the then-president’s brother.

As the pieces of the puzzle essential for developing Afghanistan’s finance sector slotted into place, Smith focused his attention on the keystone: creating an appraisal profession and training professional appraisers. Without them, any kind of borrowing, whether it was to rebuild a town, help a widow raise her children, or help someone open a small business, would continue to be a crapshoot. Step one for Smith became finding the right model for the appraisal profession in Afghanistan to use.

After comparing systems from countries around the world, he chose to model the Appraisal Institute of Canada’s (AIC) *Canadian Uniform Standards of Professional Appraisal Standards (CUSPAP)*.

“This is how I got involved with the AIC,” recalls Smith. “You have to set up an organization properly. [After doing some research] I liked Canada’s standards better than anybody else’s. So I asked for permission to use their materials as a guide to develop standards that would adapt to the market in Afghanistan.”

An educator at heart (Smith estimates that, since 1973, he has taught some 10,000 participants at his various seminars), he says his approach in Afghanistan was first to explore with them the benefits of *CUSPAP*, and then help them tailor it to their unique needs or circumstances. “I first explain that there are international standards that have been identified,” says Smith. “Let me show you what the standards are. [Then] let’s adapt them to your country.”

Part of being an effective teacher, says Smith, is being a good listener. With any group he has worked with in a given country, from governments to bankers, he has always asked them questions about how things have been done to better help them help them devise the best way for things to be done moving forward. This is the process that enabled him to uncover the ill-founded nature of lending in Afghanistan.

Smith is also an avid traveller and self-described history buff who likes to research a country’s past, then learn as much as possible about its present from the people he meets in public. In countries like Afghanistan, with vastly different cultural and



religious norms, Smith’s inquisitive nature proved fortuitous. He learned, for example, that when Islamic finance is the norm, foreclosure is not a black and white issue. “You do not take a person’s house from above their head,” he says. Another cultural nuance Smith uncovered in Afghanistan that would significantly affect how appraisers would perform their jobs in the field was the fact that it is culturally insensitive for a man to enter another man’s home when he is not there.

Smith does not view himself as some kind of Westerner-cum-finance-missionary; he does not pretend to have all the answers. He is more interested in using his expertise within the context of a country (its customs, its traditions) to help them devise a path towards success. Drawing on past experiences, Smith says he has seen how pushing Western financial ideas upon a population that is not equipped to handle them leads to trouble. He saw this unfurl in Russia when consumer lending floodgates were opened. Russian citizens welcomed the opportunity to purchase appliances and all manner of household luxuries on credit, but they had no concept of how to pay it back. “Do not do something that is going to change the way people live,” cautions Smith.

Therefore, a pair of partners native to Afghanistan would take ownership of Smith’s training (the *CUSPAP* model that he “Afghanized”) and manage the appraisal profession going forward: they were the Afghanistan Institute of Banking and Finance (AIBF) and the Afghanistan Bankers Association (ABA). The AIBF now oversees real estate appraisal training, the ABA is responsible for examinations, and together they are creating the Afghanistan Appraisal Association, which is the body that will adopt the modified *CUSPAP* to maintain standards, award licenses and enforce the standards of practice of the new appraisal profession in the country.

Ignoring for a moment the integrity appraisers will bring to the nascent finance sector in Afghanistan, the benefit of training Afghans to be professional appraisers is important in its own right. Smith figures there are more than 1.5 million potential mortgages in the country. If an appraiser earns the average of \$250–300 per appraisal and does several each week, that is a far better living than the current average annual income, which Smith pegged at between \$700 and \$1,000. Enabling thousands of citizens to earn a better income will create further benefits for the country, like a more robust tax base. “We made a calculation that the income taxes from brokers and appraisers, plus the income taxes from the construction salaries for all the needed new construction of homes in the country, could pay for half the budget of Afghanistan,” says Smith.

Because Afghanistan’s banks are not big enough to facilitate all the potential lending within the country, Smith says he is already imagining the next phase of the country’s development: packaging mortgages into securities to create a secondary market that attracts larger investors, both within its borders and beyond.

“Once the banks use their existing liquidity, you have to be ready to have something in play,” says Smith. “You have to build a secondary market at the same time.” Current laws may prohibit the securitized mortgage scenario Smith



envisions, but that has done little to temper his enthusiasm about the idea.

“The possibilities are there,” he says. “Some people just cannot envision them.”

Never one to let an idea sit idle (Smith admits he has owned about 55 companies in his life, including three newspapers), he nevertheless acknowledges that the ambitious nature of what he would like to see happen in Afghanistan is not only tempered by existing Afghani laws, but also by the country’s competing needs on other fronts.

“That work is progressing,” says Smith. “It does not go very fast. [Creating an appraisal profession] is not the most important thing on the parliamentary agenda.” 🇦🇫