Final Report

Market for Affordable Housing and Finance in Pakistan

April 12, 2010

Submitted by:

AASA CONSULTING

Empowerment Performance Result

Submitted to:

citi acumen FUND

Table of Contents

List of Exhibits

List of Exhibits

Executive Summary

This study, carried out by AASA Consulting, was initiated through a research grant given by Citi Foundation to Acumen Fund Pakistan. Undertaken over a period of ten months, this Study, based on 582 questionnaires, backed up by focus group discussions, tries to assess, quantify and understand, factors which affect housing and housing finance demand for low income urban groups in Karachi, Lahore and Faisalabad. The main objectives of the Study were: (1) to better understand low-income customer demand for housing and housing finance products, (ii) determine the current supply of low-cost housing finance, and (iii) what are the key barriers to supply of affordable housing finance.

Four principle findings emerged from this study:

1. Demand for Housing: Willingness to Acquire Loans

A major finding from the Survey about the willingness to acquire loans by respondents showed that more than half the respondents wanted to acquire a new loan, and for a very large proportion of these, the main purpose for getting a loan was to purchase a house or to have their existing house repaired. Over 50 percent of both owners and renters wanted loans; for owners who wanted loans, 62 percent wanted loans for house repairs; for renters who wanted loans, 61 percent wanted loans to build a house.

As many as 75 percent of owners wanted to repair, renovate or undertake additional construction of their existing houses, indicating that a potential market of home owners who might need credit, exists. Almost half of the owners wanted to take a loan for addition, renovation & repair, ranging between Rs 100,000-300,000, and were looking at a payback period of, on average, 8 years, with a monthly instalment of between Rs 3,000-5,000.

2. Low-income Market Understanding of Housing Finance

While longer time horizons are not preferred (10-15 yrs), shorter time horizons for a housing finance product were acceptable (on average 3-7 yrs).

Additionally, while the precise interest rate that is feasible for this income segment is variable from city to city and based on exposure, there is clearly an understanding and acceptance of the concept of an interest rate (service charge, mark up, fee, etc). What that service charge or markup fee should be, varies within different segments of the income group, by owners/renters and by salaried/non salaried, In practice, low-income groups tend to be more price sensitive to longer tenor loans.

3. Current Housing Characteristics

Another major finding of the study is that 30 percent of low income individuals built their own houses while 70 percent inherited them. Those who purchased their homes, personal savings were the main source of funds to build or buy their houses. And given the household sizes, (49 percent lived in houses with 1-5 persons and 45 percent with an average family size of 6-9 persons), it is safe to say the pressures on current dwellings from a space perspective will only increase. This will require either new housing options as family sizes increase or further construction on current dwellings; given that the average housing size reported is 90 square yards.

4. Savings through BC as a proxy for paying capacity:

Within the surveyed group, while actual 'personal savings' were reported at around Rs. 1,500 per month, about 26 percent of respondents also reported saving through the BC/Committee system. BCs are used for different purposes, often for consumption purposes particularly at the time of marriages, but also as contributions towards home improvement and repairs.

The interesting point to note about the BC system is that the average monthly contribution toward a BC is between Rs. 1,500 – 2,600 and the average total amount of the BC is Rs.100, 000. If this is able to serve as a proxy for payment capacity of the income segment (in addition to information on their current borrowing demands), then it also gives a sense of what borrowing and repayment ability might be for housing finance products.

What the Study tells us, is that clearly while there is demand for housing, there is demand for different products related to housing. Some people in the low-income bracket need land, while at the other end of the low-income bracket, many of those who own their own houses, merely want to renovate or repair parts of their houses.

Based on the market research findings, the Study also highlights the following conclusions:

1. Partnership approaches to bridging the gap between housing supply and housing finance

A key constraint to housing in Pakistan is the lack of financing capacity of the poor, as well as a low penetration of housing finance, especially in the poorest segments of the population. Any desire to address the shortfall in housing in Pakistan must be linked to financing needs as well. Only 1 to 2 percent of all housing transactions in Pakistan are processed through housing finance institutions; otherwise, most housing finance comes from personal sources. Probably 10 percent is estimated to be the informal lending sector. Studies have argued that this lack of finance is primarily a supply problem.

With supply-side and institutional constraints limiting funding to individuals in the low income segment, the one possibility which has been experimented with and also discussed by bankers during the course of this Study was collaborative housing provided through a developer or NGO and a bank financing the project. A collaborative approach with housing developers allows provisioning for the lack of clear land title and a mechanism to assure collateral.

2. Incremental Housing

A point regarding low income housing finance, is that housing and housing demand in this segment, are perceived to be very different from up-market, mortgage or commercial bank-based, housing finance. Low income residents seldom buy houses outright, rather they build incrementally. Housing finance is demanded by the low income sector for home improvement/renovation and/or adding a room or floor, and the model that they usually follow is one of incremental housing.

Since almost all low income house owners across Pakistan build housing incrementally, it is apparent that incremental housing has the main potential for funding for this segment. Given the subsequent demand by low income households for incremental housing credit, which is different from both up-market housing and building houses in one go, short and medium-term loans should be the main focus of finance providers.

1.0 Introduction

This Study on *Understanding the Market for Affordable Housing and Finance in Pakistan* has been undertaken by AASA Consulting for Acumen Fund Pakistan. Undertaken over a period of ten months, the Study tries to assess, quantify and understand factors which affect housing and housing finance demand for low income urban groups in three of the largest cities in Pakistan – Karachi, Lahore and Faisalabad – and explores possible means and forms for meeting that demand.

In October 2008, Acumen Fund Pakistan received funding from Citi Foundation to initiate market research on low-income housing and housing finance in Pakistan. Given Citibank Pakistan's focus on strengthening microfinance institutions and developing affordable housing finance, partnering with Acumen Fund to focus on deepening the knowledge base around critical issues facing both these sectors has been a natural extension of Citigroup's broader goals. This research has the potential to provide great insight into customer preferences and how the affordable housing market can be catalyzed. The research will provide direct, on the ground assistance and share solutions across entrepreneurs and stakeholders in the housing finance sector to leverage social impact even further.

Additionally, the background of this Study rests on discussions which emerged from a Roundtable, entitled 'Innovations in Low Income Housing: Local Challenges and Global Lessons', organised and conducted by Acumen Fund Pakistan in August 2008. The Roundtable brought together a number of leading financial sector and housing sector experts and practitioners who had knowledge and understanding about issues in the housing sector in Pakistan, its affordability and in particular, about financing issues which would affect low income households. Representatives from the State Bank of Pakistan, from the Sindh and Punjab government housing agencies, along with those from commercial banks, microfinance institutions and researchers, were able to highlight some of their own experiences to address broader themes related to the sector and this income segment.

Numerous issues were raised at the Roundtable based on the different sets of interventions and experiences of the participants. Key points which emerged from the Roundtable were as follows:

- As many as 80 percent of established clients would be willing to take short-term fixed-rate loans, and that longer-term loans were less acceptable because they contained high risk and greater uncertainty.
- Variable interest rates are less acceptable to potential clients.
- It was widely recognised by participants, that the majority of low income households build their houses incrementally.

Issues related to the housing sector – such as clean titles, cost of construction, cost of land, – were also discussed as major impediments to affordable housing development. The Roundtable also discussed successful innovative schemes for low income clients, such as Saiban's *Khuda ki Basti (KKB)* model, and recommendations for a land bank facility, were also discussed.

The main objective of this Study on *Understanding the Market for Affordable Housing and Housing Finance in Pakistan* is to better understand the low income customers' demand for housing and housing finance products as well as their need and preference for specific housing-related financial products. In particular, this Study, based on 582 questionnaires in the three cities, backed up by focus group discussions, tries to understand how the existing low income housing market works. The main objectives of the Study were as follows:

- **Demand Side:** to find out about the affordability and preference of potential low income clients for different types of housing finance products.
- **Supply Side:** issues and constraints which potential suppliers of credit were likely to face, and an assessment of how the existing supply side mechanism for housing finance worked.
- **Insights and Recommendations for Practitioners:** the examination of current methods and future possibilities of bridging the gap between the two in a way that contributes to meeting the affordable housing shortage in an effective way.

Despite the fact that the formal financial and housing sector constitute such a small fraction of both markets, most of the research undertaken on housing and housing finance in Pakistan, focuses primarily on the formal sector, both in terms of housing and in terms of finance. There is very little quantitative research on the lower income end, or informal sector side, of housing. This Study attempts to quantify financial and housing issues related to the lower income end of the housing market.

Moreover, given the fact that there is a shortage of reliable data on housing and housing finance, it has become difficult for practitioners and policy makers to understand fully, or intervene in the sector. The absence of practical research which examines the nature of the housing sector, such as demand for housing and housing finance, makes it difficult to enable the sector or provide services. Clearly, there is an urgent need to understand the broader housing sector in urban Pakistan, particularly with regard to low-income groups who manage outside the official financial sector. This Study commissioned by the Acumen Fund on Low-Income Housing Finance in the largest cities in Pakistan, hopes to address some issues which address the housing needs, in terms of physical infrastructure as well as the financial aspects of such housing.

Note: *For convenience of the reader we have highlighted the essential analysis as exhibits in the report.*

2.0 Understanding of the Housing and Housing Finance Sector in Pakistan

2.1 The Demand for Low Income Housing in Pakistan

According to various sets of statistics available from the Government of Pakistan and from the State Bank of Pakistan, the official housing finance market in Pakistan is very small compared to its potential and to comparable countries in the region and in Asia. The most recent set of data, from December 2007, shows that while the housing finance market in Pakistan may have more than doubled in a mere two years, from 2005, growing to Rs 126 billion in 2007, it was still less than 1 percent of GDP.[1] Moreover, since 2007 when there has been a significant slowdown in Pakistan's economic growth, matched with a tight liquidity squeeze and a reluctance on the part of banks and housing finance companies to lend, it is clear that this proportion would have fallen to far less than even this minuscule amount.

The State Bank of Pakistan's assessment about these 'low numbers in housing finance', suggests that these trends have 'aggravated the housing shortage in the country', being partly responsible for a housing shortage calculated at 4.3 million housing units in 1998, estimated to have risen to around 6 million units in 2005 and according to these projections, it would be closer to the 9 million mark in 2009-10[2]. The annual construction rate on the other hand, is supposed to be around 300,000, adding to a growing annual shortfall. Nevertheless, despite these rather dismal sets of numbers, most people – according to some estimates as many as 80 percent of the population[3] – live in and own their own houses. Clearly, there is far more at play than these official numbers reveal.

Over the last few decades, the role of the government in the housing sector has shifted from one that earlier used to provide housing, to one now where it is essentially a facilitator of housing facilities. This shift has led, even in the case of the government's share of housing in public sector programmes, to fall from around 10.9 percent in the 1960s to 5.9 percent in the 1990s, and probably far lower today as the role of government overall has declined.[4] The expanded role of the private sector is now well recognised in official housing (and other) policies, and the National Housing Policy (NHP) of 2001, also emphasises this role. The NHP recognises that housing is linked, along with other issues, with that of financing as well, and that is why the State Bank of Pakistan also has a strong linkage with the NHP. There is recognition that a key constraint to housing in Pakistan 'is the lack of financing capacity of the poor, as well as a low penetration of housing finance, especially in the poorest segments of the population'.[5] Clearly, any desire to address the shortfall in housing in Pakistan must be linked to financing needs as well.

Financial Sector reforms in the 1990s have made it possible to start thinking about financing for the housing sector, and that is one reason why the State Bank of Pakistan has set up a Housing Advisory Group 'to iron-out housing sector-related issues which are critical to the promotion and development of housing finance'.[6] While finance has been a key constraint towards expanding the housing market in Pakistan, particularly for the low income segment, endemic issues related to the legal and regulatory

---

[1] *State Bank of Pakistan, Quarterly Housing Finance Review, 2008, p. 5.*
[2] *State Bank of Pakistan, Expanding Housing Finance System in Pakistan: Strategy for Housing Finance Reforms in Pakistan, June 2008, p. i.*
[3] *Tatiana Nenove, et al, Bringing Finance to Pakistan's Poor: A Study on Access to Finance for the Underserved and Small Enterprises, World Bank, May 2009. Sabbah Rahooja finds empirical evidence of urban ownership of 71 percent. See her, Determinants of Housing Demand Across Income Groups in Pakistan, LUMS, October 2007, p. 41.*
[4] *State Bank of Pakistan, Expanding Housing Finance System in Pakistan: Strategy for Housing Finance Reforms in Pakistan, June 2008, p i.*
[5] *Ibid.*
[6] *Ibid, p. ii.*

framework for housing finance, issues around land registration and titling, and such other key constraints have been impediments as well.

2.2 Availability of Housing Finance in Pakistan

Three studies supported by the State Bank of Pakistan which dealt with housing finance provide us with the following insights related to our Study and to issues regarding the housing sector, more broadly. (Unfortunately, for our purposes these three studies focus on the 'higher end of the income market' which they define as 'households earning more than Rs. 15,000 per month', and do not deal with 'non-bankable households').

Only 1 to 2 percent of all housing transactions in Pakistan are processed through housing finance institutions; otherwise, most housing finance comes from personal sources. Probably 10 percent is estimated to be the informal lending sector. These studies argue that the lack of finance is primarily a supply problem. In March 2008, private banks had a share of 59 percent of the financing advanced to the housing market, with public sector banks providing 13 percent, Islamic banks providing 11 percent, and the House Building Finance Corporation providing 13 percent of the total amount made available. The average loan size of banks (excluding HBFC) was around Rs 2.82 million, with that of HBFC approximately Rs 90,000. The loan portfolio in this market revealed that the highest proportion was comprised of outright purchase loans, followed by construction loans and loans for the purpose of renovation.[7]

Other than the State Bank of Pakistan's studies and reports mentioned here, some independent studies have also examined the housing finance sector. Uzma Hussain's study for the Pakistan Microfinance Network, which builds largely on Sabbah Rahooja's LUMS thesis on housing demand, has the following findings which substantiate this Study:

Constraints to Expanding Housing Markets for Low Income Groups in Pakistan

- Lack of financial resources
- Legal and Regulatory framework issues
- Land Registration
- Titling

- Housing microfinance generally supports home improvement, although some smaller starter units also get their funding from this source;
- The bulk of most households build their unit incrementally over 5-15 years; and,
- Incremental housing has the main potential for funding;
- Short and medium-term loans should be the main focus of finance providers.[8]

Only Tameer Microfinance Bank offers a Housing Loan, while Khushali Bank offers a loan for asset purchase only. Housing loans comprise lending against equitable mortgage; the tenor of the loan is from three months to three years, while the interest charged is 19 percent flat. The maximum loan amount is Rs. 300,000.

Housing Finance Share Through Institutions	
Private Bank	59%
Public Bank	13%
Islamic Bank	11%
HBFC	13%

[7] *These figures and trends are drawn from the following studies: State Bank of Pakistan, Expanding Housing Finance System in Pakistan: Strategy for Housing Finance Reforms in Pakistan, June 2008; State Bank of Pakistan, Housing Advisory Group, Recommendations for Nationwide Provision of Housing Finance, March 2007; and, State Bank of Pakistan, Housing Finance Reforms in Pakistan: Strategy for Strengthening the Real Estate Development Process, January 2007.*

[8] *These insights are drawn from: Uzma Hussain, Scoping Study on Housing Microfinance in Pakistan: A Summary of Findings, Pakistan Microfinance Network, June 2008; and, Sabbah Rahooja, Determinants of Housing Demand Across Income Groups in Pakistan, LUMS, October 2007.*

2.3 Issues in the Financial Sector Impacting Housing Finance

Issues related to housing finance, whether for the formal sector or the informal, whether for the higher end of the market or for the lower income segment, cannot be considered outside the larger financial market and the extent of access to finance by the population at large.

The recent Access to Finance Study undertaken by a number of international and local key actors in the field of finance in Pakistan on the request of the Ministry of Finance and the State Bank of Pakistan, conducted over 10,000 interviews & focus group discussions (FGDs) – to assess the nature of finance in Pakistan. The purpose of the study was, to monitor and measure 'levels of access to formal financial services that can assist in achieving goals of growth and poverty alleviation in addition to helping policy makers, practitioners, researchers and the private sector to more fully understand the current and potential supply and demand for financial services'.

The main findings of the Access to Finance Survey are as follows:

- 89 percent of Pakistanis, urban and rural, are unbanked, and only 38 percent of these would like to open a bank account.
- 56 percent of the total adult population saves/invests either formally or informally; however, 53 percent save informally while formal savers are only 3 percent.
- 84 percent of males and females, in urban and rural areas, are part of at least one 'committee' (BC).
- Contrary to common expectations that money lenders are the ever pervasive source of loans and credit in the informal sector, overall, only 3 percent people borrow from them while 78 percent borrow from the local shopkeepers/grocery stores.
- 70 percent of urban residents take loans from shopkeepers; 55 percent from family and friends, and most borrow to purchase food.
- 80 percent of urban households own their houses.
- Only 5 percent of urban dwellers actually borrow money, either to purchase, build or renovate their residence.[9]

Clearly, in both cases, those related to housing (and, hence, housing finance) as well as the financial sector more generally, it is clear that most of the population – and not just the low income sector – are 'outside' the formal sector net. Most individuals work through the informal sector for their financial and housing-related needs, either taking credit or making savings. For this reason, microfinance institutions and microfinance banks have stepped in to capture some of the market, which was informal in the past. Government and State Bank regulations in recent years have also encouraged microfinance institutions to grow over the last decade. Such institutions have made some interventions in the housing finance sector, as indicated above, but not only is the microfinance sector very small – around 2 million clients – the microfinance sector, barring a few innovative schemes such as KASHF Home Improvement loan (HIL)[10], is also in nascent stage of development.

[9] *Tatiana Nenove, et al, Bringing Finance to Pakistan's Poor: A Study on Access to Finance for the Underserved and Small Enterprises, World Bank, May 2009.*
[10] *Kashf Home improvement loan, Kashf Annual Report 2008*

The quoted figure of eighty percent 'ownership' of housing in Pakistan is an ambiguous figure for at least two reasons. Firstly, we really do not know whether 80 percent of households live in their own personal abodes – a highly unlikely probability – or whether 80 percent of the housing structures across Pakistan are owned by the household, family or families, who live in them, a more plausible and likely possibility. Furthermore, when policy makers or investors use the 80 percent figure to devise housing-related initiatives, i.e., when they try to assess whether there really would be any demand for housing at a time when 80 percent of houses are self-owned, there are further complications. Add to this the fact that some researchers question the figure of a 6-9 million shortfall in houses, and we can see clearly, that there is really no lucid picture or understanding of the size of the housing market in Pakistan. If we accept the most likely interpretation of the 80 percent 'ownership' explanation, that 80 percent of accommodation is owned by one of the family members who live in it, then, clearly, there is demand for housing.

2.4 The Macroeconomic Environment in Pakistan

For the possibility of any housing and housing finance-related schemes to be thought through, there is need to take cognisance of the broad macroeconomic environment in which they are to be considered. Pakistan's economic situation for at least the last two years has been particularly poor, with growth rates falling from an average of above 6 percent in the 2002-08 periods, to nearer 2.5 percent over the last two years. At the same time, the inflation rate, a factor which affects the low income groups much more than the affluent, has been in double digits, rising to 24 percent in 2008-09. The rate of interest also rose to around 17 percent in the same period and has only recently eased a little. All these indicators, as well as signals, that unemployment and poverty are both expected to rise over the short term, suggest that Pakistan's macroeconomic situation is in poor shape and with the IMF stabilisation programme in place, growth is not expected to pick up for at least two to three years, if not more. All these factors will affect how potential housing finance suppliers think about the feasibility of entering the low income housing market.

3.0 Analytical Framework and Methodology

The purpose of this Study was to address as many of these broad questions as is possible, such as those which allow us to better understand low income customers' demand for housing and housing finance products as well as their specific product preferences, determine the current supply of low cost housing and the willingness of lenders to finance the current supply of housing, and allow us to design appropriate financial products that meet the needs of the low income consumer and as well as the needs of lenders.

A point regarding this study on low income housing finance, is that, housing and housing demand are perceived very differently from up-market, mortgage or commercial bank-based, housing finance. *Low income residents seldom buy houses outright, rather they prefer to build incrementally as and when cash windfalls are available.* Housing finance is demanded by the low income sector – but as well as the upper market as well – for home improvement/renovation and/or adding a room or floor, and the model that they usually follow is one of incremental housing. They seldom, if ever, buy property outright. Hence, their needs for finance are very different from those who want what is traditionally called a mortgage, from commercial banks. Since their needs are different, financial products will also have to be different. The size/amount of the product demanded, its tenor, price, instalment size, issues of collateral where land titling and ownership is contentious and suspect, will be far different from those where clean titles exist. Clearly, we need to be careful of making claims for low income clients based on the overall 'market' or demand for housing.

Specifically, this Study is aimed at answering both Demand Side and Supply Side questions. We needed to understand what the market demand for low-cost housing finance products was in urban Pakistan, and what the key market segments were. A main objective was to ascertain the product attribute preferences within these segments (financing size, price, term length, instalment size, collateral, etc), as well as the ability of the potential clients to pay off.

In order to answer some of these questions, the Study was broken down into two broad areas, market assessment of current demand, and the supply of housing finance currently being provided. The main gap exists on the Demand Side and especially in trying to understand and quantify the demand for housing and its constraints, for the low income group.

In designing the market demand survey we undertook the following steps:

- Survey questionnaire design with pre-testing in selected areas.
- Selected a sample area for conducting the questionnaire, identified the income segment, geographic area and representation. The sample size focused on low income households in major urban cities of Pakistan including Karachi, Lahore, Faisalabad, and Rawalpindi.
- The sampling income frame was based on the Average Household Monthly Income by Quintiles, estimated from PSLM/HIES 2004-05 unit record data Adjusted for 2008-09 using CPI (Economic Survey). Exhibit 1 A shows the sample size for the survey. Exhibit 2A & Exhibit 2B gives a further breakdown of the owners & renters sample size between those who were salaried or non-salaried.[11]

[11] *As we show later in the discussion, this differentiation between salaried and non-salaried allows prospective lenders to discriminate between different sets of clients.*

Exhibit 1A
City-Wise Sample Distribution by Ownership

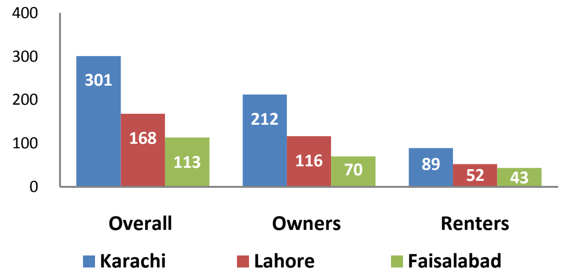


Exhibit 2A
City Wise Sample by Salary and Non Salaried for Owners

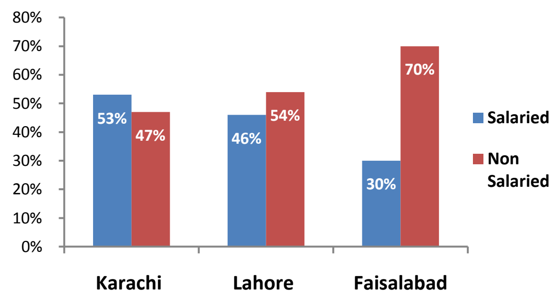
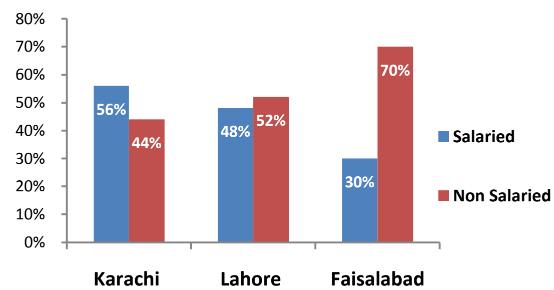


Exhibit 2B
City Wise Sample by Salary and Non Salaried for Renters



We looked at the three largest cities in Pakistan in order to understand the differences in market and regional characteristics. As we show below and as our results indicate, these differences would matter to potential providers of housing finance products who would need to design products taking note of regional differences. The reason why we selected Karachi, Lahore and Faisalabad, was because they are the largest cities in Pakistan, and hence would be of particular interest to assess market demand for housing finance products and would also interest potential suppliers of credit.[12]

We also differentiated between owners and renters, and as our results show, we use these two categories to make numerous arguments. We focus on owners because their interest would most likely be in home extension/improvement and this would provide different insights into the types of home improvement/expansion product that would be of interest to our analysis. Renters, on the other hand, would be more interested in the segment which wanted to buy a house, either outright if that was possible, or incrementally, as is the norm. Another distinction made between categories, is between those who we define as 'salaried' and those who are non-salaried. By salaried we mean those who are government employees and private employees.

The broad objectives which we wanted to achieve, and around which the questionnaire was designed, include the following:

- Understanding socio-economic and current housing conditions.
- Understanding the households' disposable income and savings levels – for both owners and renters – to get insights into people's ability to pay.

[12] *Originally, we had also selected Rawalpindi as part of our sample, but due to anomalies in the Rawalpindi survey data, which may have been a result of regional anomalies or methodological issues, Rawalpindi has been excluded from the Analysis in this report.*

- Understanding existing debt levels and nature of demand for taking new loans.
- Demand for housing finance and ability to pay.

For renters, we also wanted to know whether they would be willing to live out of the city as we were considering models and possibilities to relocate such renters in housing which was some distance from their original locations.

Exhibit 3 A presents the average household monthly income in the three urban areas where the survey was conducted. The distribution of the average household monthly income population is given by quintiles. Following discussions with Acumen Fund, we decided to select the ranges of income of the Third and Fourth quintile. Exhibit 4A was the targeted group. As can be seen from Exhibit 3A and 4A that, while there is some differentiation in income levels in the three cities, there is a broad range of Rs 12,000-33,000 which included these two quintiles.

Exhibit 3A
Average Household Monthly Income by Quintiles
[2008-09 Prices]

Quintiles	Districts	Mean	Minimum	Maximum
1	Faisalabad	6,830	3,336	8,424
	Lahore	9,009	4,368	11,310
	Karachi	9,997	4,680	12,168
	Total	**9,265**	**3,336**	**12,168**
2	Faisalabad	9,733	8,518	11,310
	Lahore	13,296	11,440	15,600
	Karachi	14,335	12,246	16,380
	Total	**13,514**	**8,518**	**16,848**
3	Faisalabad	13,194	11,349	14,898
	Lahore	18,215	15,613	21,372
	Karachi	19,183	16,523	22,282
	Total	**18,179**	**11,349**	**22,880**
4	Faisalabad	19,522	15,600	23,583
	Lahore	25,599	21,840	30,940
	Karachi	26,361	22,308	32,240
	Total	**25,354**	**15,600**	**32,240**
5	Faisalabad	40,537	23,608	127,920
	Lahore	55,064	31,200	382,200
	Karachi	52,924	32,760	225,680
	Total	**51,863**	**23,608**	**382,200**
Total	Faisalabad	17,980	3,336	127,920
	Lahore	24,359	4,368	382,200
	Karachi	24,510	4,680	225,680
	Total	**23,650**	**3,336**	**382,200**

Estimated from PSLM/HIES 2004-05 unit record data Adjusted for 2008-09 using CPI (Economic Survey)

Exhibit 4A
Household Monthly Income*
Third and Fourth Quintiles (Combined)

District	Range [2004-05]	Mean [2008-09] **	Range [2008-09]**	
			Minimum	Maximum
Faisalabad	7,000-15,000	16,000	11,000	23,000
Lahore	10,000-20,000	22,000	16,000	31,000
Karachi	10,000-21,000	23,000	16,000	33,000
Total	**8,000-21,000**	**22,000**	**12,000**	**33,000**

* Estimated from PSLM/HIES 2004-05
** CPI factor 1.56 (2004-05 to 2008-09), Economic Survey

Once we had decided which income group would be part of the Study, the selection of localities, in many ways, becomes a secondary consideration. The target group for us was determined by income, not locality. Nevertheless, we decided to conduct the survey in areas with which we were familiar and knew that a high proportion of the resident population would probably reside in this income range. To further ascertain that we had accessed the correct income group, we conducted the screening of potential clients when we began the survey. A handful of qualifier questions determined whether the respondent fell in the selected category or not.

We conducted 700 household surveys in the four identified cities through local, community based organizations – with the exclusion of Rawalpindi; our sample size was reduced to 582 (see Exhibit 1A, Exhibit 2A & Exhibit 2B). The data collection task was accomplished with the help of local enumerators who were experienced in conducting similar quantitative and qualitative surveys. The enumerators were imparted training, consisting of pre-trial and post-trial survey training sessions.

As a supplement to the quantitative household surveys, we also undertook qualitative focus group discussions. The quantitative survey data was collected and processed which gave us some ideas of how to probe further and the direction in which the questioning should proceed in the FGDs in order to gain better insights from the Study. These FGDs were conducted with similar category of home owners and renters as the quantitative survey and in the same locality where the survey was conducted. We organised two FGDs in each of the four cities where the survey had been conducted, excluding anyone who had been part of the main survey. Some discussions from the FGDs are incorporated in the analysis section of this Report. The Quantitative Survey was supplemented by FGDs as a means to further discuss some of the issues that were raised in the questionnaire, or issues which were not clear when we first asked them. Issues that were not clear from the survey included those pertaining to the tenor of a loan, instalments and particularly, the rate of interest. (It is important to emphasise the fact that we do consider FGDs to be quite limited in their worth and only use them as an indicative instrument helping to fill some gaps).

Two sets of FGDs were held in each of the four cities that were surveyed, both within the same residential locality where the survey was conducted, one which consisted of home owners and the other, that of renters. We excluded any respondent who had been part of the survey process earlier. The FGDs were held after we examined the results from the data and the survey. The purpose of the FGDs with owners and renters was to triangulate and recheck any aspect that might have been missed in the more quantitative assessment. In most cases, the general tenor of the discussion and the findings were largely similar.

Following the Demand Side of the Study, we shifted towards trying to understand the Supply Side, particularly for low income house owners and renters. The purpose of this part of the exercise was to try and examine the numerous relationships that low income residents have with the informal sector suppliers of housing inputs. The discussions were held with those suppliers in the neighbourhood in the localities where we conducted the survey to understand how the poor and low income communities built their houses and to see if these suppliers could play a potential role in financing low income housing; we conducted three such interviews in each city. Some discussion on the informal sector Supply Side is given in the findings and analysis section of the report. Finally, we interviewed the Director of the Infrastructure and Housing Finance Department of the State Bank; the President and CEO of Tameer Bank, a microfinance bank; the MD/CEO, and an Executive Director of the House Building Finance Corporation; and three senior executives from the Housing Finance Department of the National Bank of Pakistan, who run a housing finance facility called 'Saiban'.

4.0 Findings

In this section we present data which emerges from our quantitative and qualitative surveys. We try to capture customer preferences and potential demand, and the suggestions and recommendations of respondents to bridge the supply and demand gap and their preferences for products for key market segments. The analysis outlines the major obstacles in the demand and supply dynamics of the low income housing finance market in Pakistan.

4.1 Demand Side: Survey

The main purpose of this section is to summarise some of the main findings from the data collection exercise and to discuss and describe those findings which stand out or a 'headline on findings. In this section, we discuss more analytically, some of the more important findings which have emerged as a result of the survey.

Socio-Economic Characteristics of Surveyed Households

Exhibits 5A, 5B & 5C summarise many of the interesting findings from the survey. One of the more obvious findings is the variation between the three cities in terms of household monthly income, expenditure and savings. There is even wide and noticeable variation in the contribution and form of those who save through BCs in the three cities. These figures suggest that cities differ in their economic characteristics, as the rest of the data also reveals, implying that potential suppliers of credit will have to take cognisance of regional variation when they decide on possible interventions.

Exhibit 5A
Household Income, Expenditure, Savings & BC Installments for Karachi (Rs.)

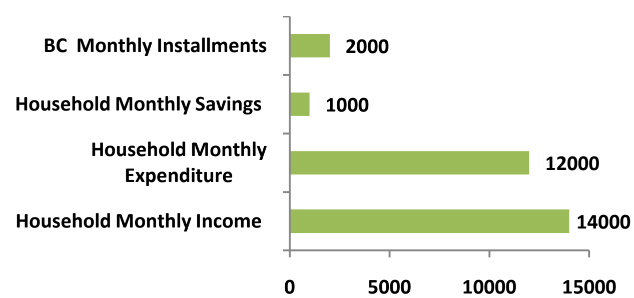


Exhibit 5B
Household Income, Expenditure, Savings & BC Installments for Lahore (Rs.)

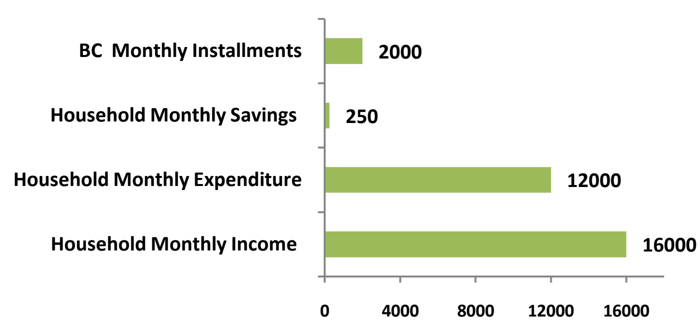
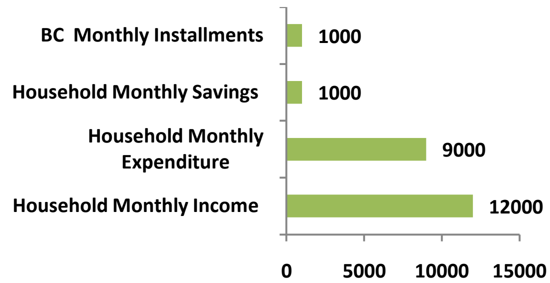


Exhibit 5C
Household Income, Expenditure, Savings & BC Installments for Faisalabad (Rs.)



Two, equally varied sets of results are found throughout; those that revolve around the owner/renter and the salaried/non-salaried categories, which again suggests that these categories need to be examined and considered separately when any thought goes into planning products for them.

As Exhibit 6A reveals, owners seem to have higher incomes, expenditures as well as savings in Lahore and Karachi, while in the case of Faisalabad**,** for some reason, renters have a slightly higher income as well as expenditure than do owners. The savings of owners compared to renters, like Lahore and Karachi, are also higher in the case of Faisalabad.[13]

Exhibit 6A
Household Monthly Income, Expenditure and Saving by City and Ownership
[Reported by Sample Households]

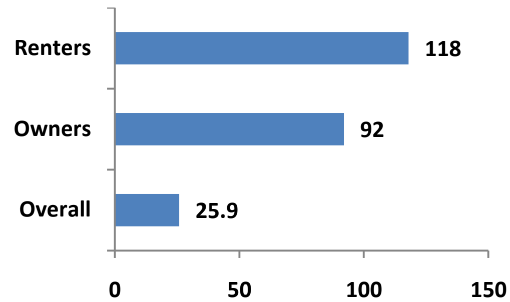
Description			Owners	Renters
Karachi	Income	Mean	15,826	13,816
	Expenditure	Mean	13,675	12,101
	Saving	Mean	1,762	834
Lahore	Income	Mean	19,188	17,178
	Expenditure	Mean	13,732	11,735
	Saving	Mean	1,673	1,474
Faisalabad	Income	Mean	14,040	14,442
	Expenditure	Mean	8,814	9,593
	Saving	Mean	1,287	1,168

Moreover, owners, for example, participate more in BCs than do renters (Exhibit 7 A), for reasons which may have to do with the possibility that owners are longer-standing members of the locality/community

[13] *We need to state at this point, for this observation is repeated on numerous occasions in the data, because in Faisalabad the occupation distribution reveals that higher proportion of self employed are living in rented houses as compared to owned houses.*

compared to renters. It is also possible that owners live in broad neighbourhoods based on familial ties and hence participate in BCs with extended family members. Renters can be transient populations.

Exhibit 7A
Percentage of Household Reported Participation in BC



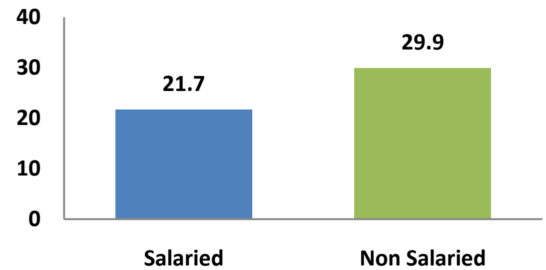
Another important finding is from Exhibit 8A which shows that owners have larger outlays on their BC, but the number of instalments for both owners and renters are similar, although, surprisingly, renters tend to contribute larger instalments.

Exhibits 8A
Household Informal Saving Through BC by Ownership

Description		Overall	Owners	Renters
Number of Households		151	117	34
Amount of BC (Rs.)	Mean	108,702	113,712	91,462
	Median	50,000	50,000	38,750
Length of BC (Months)	Mean	40	40	38
	Median	30	30	26
Amount of Instalment (Rs.)	Mean	2,644	2,475	3,225
	Median	1,500	1,500	1,050

Just as the difference between owners and renters is marked and important when one devises responses, so too is the difference between the salaried and non-salaried. Exhibit 9A, for example, shows considerable difference between the proportions of salaried and non salaried households who participate in BCs, although it is not clear why a significantly higher proportion of the non-salaried, in the two cities of the Punjab, participate in BCs compared to the salaried. One would have assumed, that given higher incomes and with more stable jobs, those who are salaried would have participated more in BCs. However, regional differences do exist and can perhaps be better explained by local culture and knowledge.

Exhibit 9 A
Percentage of Household Reported Participation in BC Salaried/ Non Salaried



Some broad characteristics of the households surveyed, pertain to the fact that approximately half of the owners have a household size of 1-5 persons, and half have a family size of between 6-9 (Exhibit 10A). For renters, while the average family size is smaller, more than half of our sample lives in families with a size of between 1-5 persons. Exhibit 11A shows the employment and literacy profiles of owners and renters and suggests that except for a few minor attributes, there seems to be little significant difference between the two categories.

Exhibit 10 A
Socio-Economic Characteristics of Sample Households by Ownership

Description		Overall	Owners	Renters
Number of Respondent		582	398	184
Average Family Size	Average Family Size	6	6	5
	1-5 Persons (%)	49.1	46.5	54.9
	6-9 Persons (%)	45.0	47.5	39.7
	Above 9 Persons (%)	5.8	6.0	5.4
Household Monthly Income	Mean	15,992	16,492	14,912
	Median	15,000	15,000	13,000
Household Monthly Expenditure	Mean	12,386	12,837	11,411
	Median	11,000	12,000	10,000
Household Monthly Saving	Mean	1,476	1,653	1,093
	Median	1,000	1,000	500

Exhibit 11 A
Household Head - Education and Occupation by Ownership

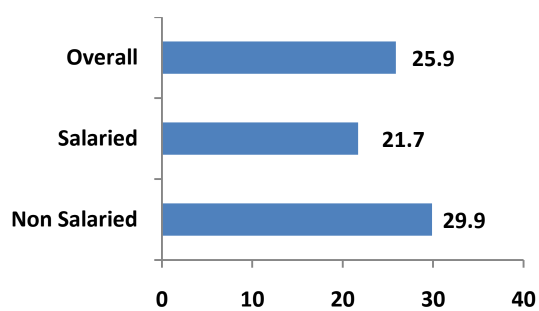
Description		Overall	Owners	Renters
Number of Respondents		582	398	184
Level of Education	Illiterate	19.9	19.6	20.7
	Less than Primary	17.2	16.3	19.0
	Above Primary but less than Metric	23.0	25.4	17.9
	Matriculation	23.9	23.1	25.5
	Intermediate	10.1	9.8	10.9
	Graduate and Above	5.5	5.5	5.4
Occupation	Government Employees	11.5	12.6	9.2
	Private Employees	35.2	33.9	38.0
	Labourer	18.2	16.3	22.3
	Self Employed	26.5	28.9	21.2
	Unemployed	5.5	5.3	6.0
	Retired	2.7	2.8	2.7

Savings Levels

With BCs as the main form of savings for the lower income group, about 26 percent reported saving through a BC, and the highest incidence was observed in Lahore.

Exhibit 12A shows that those who do not receive regular/monthly pay checks, i.e. the non-salaried, make greater use of the BC savings mechanism than those who are salaried. The reasons being, monthly Income holders can plan their saving according to their income whereas those not earning on a regular basis basically go for forced savings. It is also easier for daily wage earners, like shopkeepers, to contribute towards BCs.

Exhibit 12 A
Percentage of Household Participation in BC by City and Salaried and Non Salaried



The mean instalment/contribution to a BC is Rs 2,644, and the median was Rs 1,500, over a 40 and 30 month instalment period, respectively. This is an important finding for the purposes related to housing finance and possible instalment periods. In other words, renters are paying rent, perhaps even saving something, and also contributing towards contributions to BCs. Much of this money could contribute to their repayments for any prospective housing loans. It is also important to note that those respondents who were receiving income on a monthly basis, were considered to be salaried individuals, whereas those who were earning income on a daily or weekly basis, were considered to be non salaried irrespective of their occupation.

BCs are used for different purposes, often for consumption purposes particularly at the time of marriages, but also as contributions towards home improvement and repairs. Out of the home owners in Lahore who undertook home repairs, almost half used their BCs towards this purpose. They act as a form of personal savings but often, as we found in our FGDs, they are not included in what the respondent thinks their personal savings were.

Debt and Borrowing Profiles

One of the somewhat surprising findings related to the degree of indebtedness of the respondents. Exhibits 13A, 13B & Exhibit 14A show that a very low proportion of respondents, i.e. 10 percent, owe debt and the amount of debt in this small proportion varies significantly, from Rs 5,000 in Karachi to Rs 11,310 in Lahore. While owners state that their debt is twice as high as that of renters – Exhibit 13 A, non-salaried respondents were also far more indebted than were those who received regular incomes – Exhibit 15 A. the results also show that most of the debt is taken from relatives/friends. As is usually the case, the size of informal loans (especially from relatives) is small. Also, due to their lower incomes, access to formal financing is limited.

Exhibit 13 A
Percentage Distribution - Household Indebtedness by Ownership

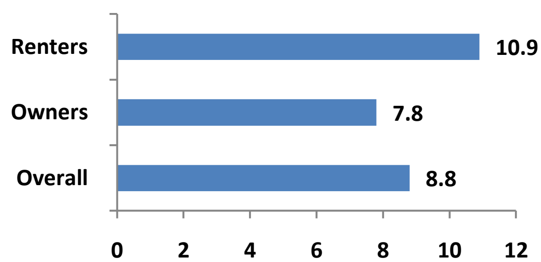


Exhibit 13 B
Household Indebtedness by Ownership (Rs.)

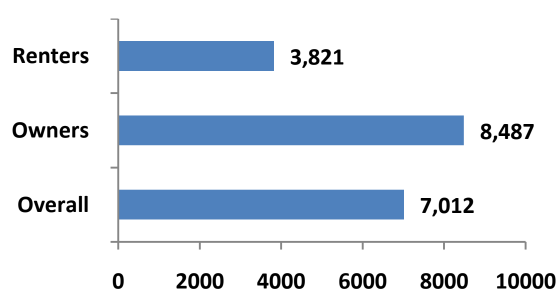


Exhibit 14 A
Household Indebtedness by City (Rs.)

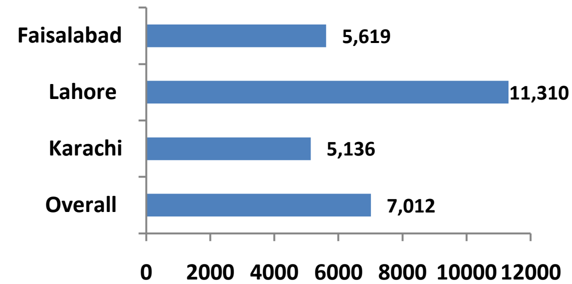
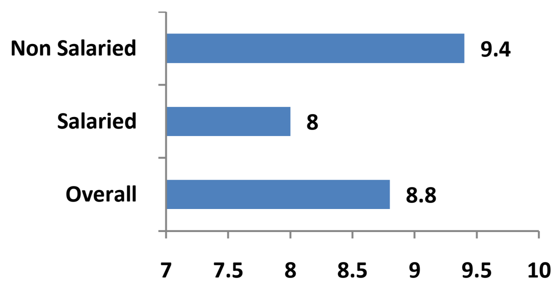


Exhibit 15 A
Percentage of Household Indebtedness by Salaried & Non Salaried



Exhibits 16A & 16B show borrowing practices of the respondents, but since these were less than 10 percent of the sample size, we were cautious not to make too much of these answers. However, it is not surprising to learn that most people borrowed for the purposes of housing related needs -- house repair, land purchase and house purchase -- which comes to 25.6 percent. Marriages were the other main reason to borrow, approximately 23.5 percent. If you take into account borrowing practices of the owners, housing needs had a significantly higher proportion, of 41.7 percent. What is also not surprising, and what is important for this Study, is that while only 10 percent of the population borrow, 80 percent borrow from relatives, while only 5 percent borrow from banks, and that too only those who live in Karachi. Almost all respondents stated that they pay back lenders from their savings. This is an important finding discussed later in this Report, and as we argue above in the earlier sections, reflects the data which emerged in the Access to Finance study.

Exhibit 16 A
Percentage Distribution - Purpose of Getting a Loan

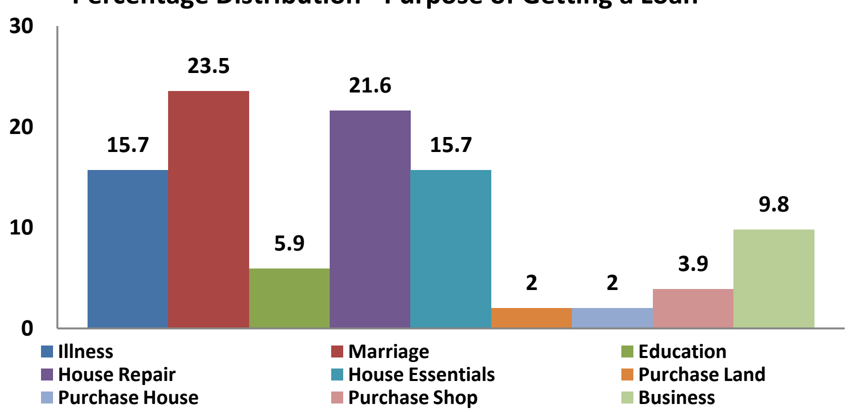
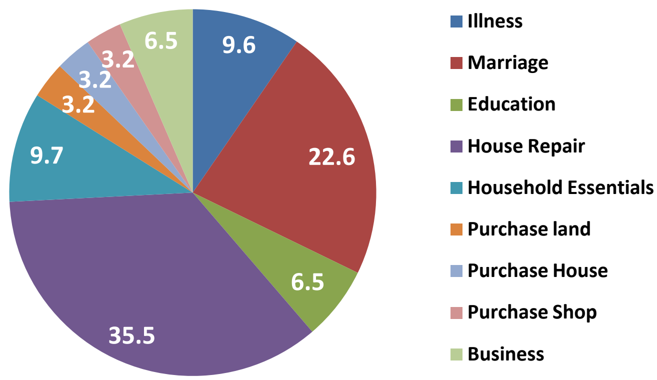


Exhibit 16 B
Percentage Distribution - Purpose of Getting a Loan by Owners



Demand for New Loans (Including Housing Loans)

A major finding from the Survey is revealed in Exhibits 17 A, 17 B, 17 C & 17 D about the willingness to acquire loans by respondents. More than half the respondents want to acquire a new loan, but for a very large proportion of these, the main purpose for getting a loan was to purchase a house or to have their existing houses repaired.

Exhibit 17 A
Percentage Distribution - Willing to Acquire New Loan

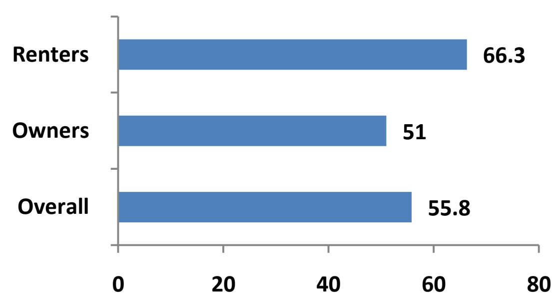


Exhibit 17 B
Percentage Distribution – Purpose of Credit Overall

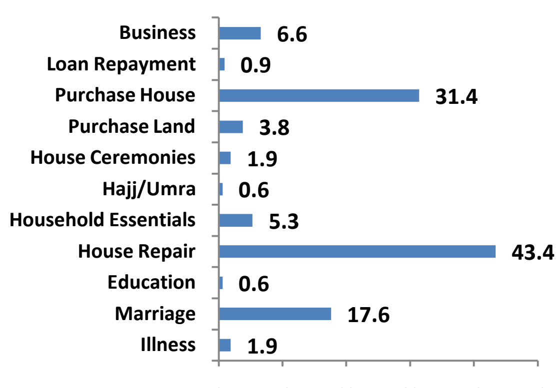


Exhibit 17 C
Percentage Distribution - Purpose of Credit Renters & Owner

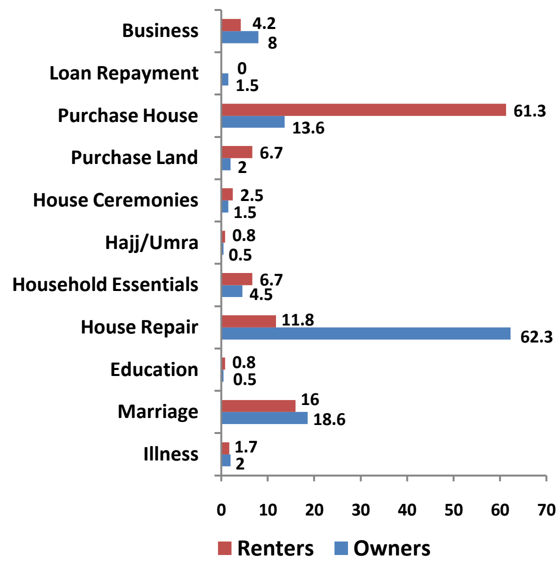
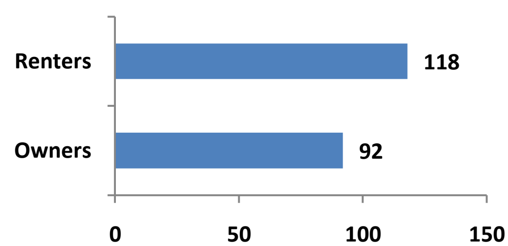


Exhibit 17 D
Households Willingness to Repay Loan by Number of Instalments & Owner / Renter



Marriage was also preferred as a purpose of getting a loan by a large proportion (17 percent) of respondents. 61 percent of renters wanted a loan to acquire a house, while 62 percent of owners wanted to get the loan to have their house repaired. For the most part, potential borrowers were looking at a repayment period beyond four years, which also has important implications for potential lenders. Also, importantly, the amount that households were willing to borrow ranged from between Rs 100,000 in Lahore, to Rs 300,000 in Karachi. This is consistent with the data and is due to income elasticity of demand.

Findings regarding demand for housing finance are summarised as follows:

- Over 50 percent of both owners and renters want loans.
- For owners who want loans, 62 percent want loans for house repairs.
- For renters who want loans, 61 percent want loans to build a house

Moreover, Exhibit 17 D also provides useful insight on how owners and renters view possible loan arrangements. Owners are willing to repay loan in fewer instalments than renters. However on the other hand renters are willing to repay loans over a shorter period of time than are owners, although a large majority of both want the repayment period of a loan to be more than four years. These numbers were also broadly corroborated in the FGD. This point is discussed in greater detail below.

While there was quite a large consensus of the need for loans for different housing purposes – new houses, incremental housing, renovation, repair, etc, from the questionnaire we were not able to ascertain the sort of products that these potential clients would demand. During the survey there were a few questions which attempted to gauge the willingness to pay of clients and the rate at which they would be willing to take loans, but due to ambiguity in their answers, we subsequently discarded the questions from the analysis as they did not help us reach any understanding of the issue. We found in the FGDs that people did not really have a clear idea about the rate of interest that they would be willing to pay. In most cases, FGD participants indicated a low rate of interest was preferred, one that is probably difficult for housing finance suppliers to accommodate. A common rate individuals were mentioning was around 7 or 8 percent per annum. While this is an arbitrary figure based on a handful of Focus Group Discussions, it is important to point out here that most people were willing to pay the rate of interest/mark up or service charge.

Despite suggestions in the FGDs, we cannot conclude that people would not be willing to pay more than 7-8 percent per annum for interest. It is safe to assume that people in general will always say a loan should be "low-interest" or "interest free". Unless a product is offered to them, it would not be possible to judge their acceptance of it. In practice, low-income groups tend to be less price sensitive to small tenor (2-3 year loans) as they use these primarily to address a liquidity/cash flow shortfall and aim to pay it off as soon as possible. They tend to be more price sensitive to longer tenor loans. Indeed, it would be a challenge to generate demand for a long-term mortgage with interest rate levels today. On the other hand, people may be willing to pay more for a shorter tenor home improvement/extension loan.

The size of the loan was easier to agree to and corroborated the answers which we got from the survey. Most people in the FGD agreed to acquire loans to build houses (which do not include the cost of land) from between Rs 300,000-500,000. There were few takers on either side of these figures. Those house owners who wanted to renovate/repair, had estimates of anywhere between Rs 40,000-100,000. In terms of tenor, most residents were not willing to consider very long-term options, and most said that they would agree to loans of 3-7 years. They did not have longer-term time horizons and did not understand or agree to loans which were 10 or 15 years of duration.

Regarding paying back instalments, since most residents in this segment were willing to undertake incremental housing once they had acquired the land, they would move in fairly quickly. Hence, they would transfer their rents that they were paying towards their instalments. They were also willing to use their BCs for this purpose, something that many had already done. However, the BC contribution was not very large and would only be a small addition to the rent they would divert to the instalment.

Also, importantly, the amount that households were willing to borrow ranged from between Rs 100,000 in Lahore, to Rs 300,000 in Karachi (Exhibit 23 B). This is due to the purpose for which households want to borrow. For instance in Karachi, 43 percent households wanted to borrow to purchase a house, while corresponding percentages were 14 and 20 for Lahore and Faisalabad, respectively.

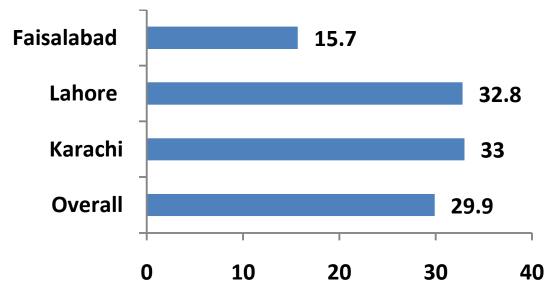
Housing Characteristics of Surveyed Households

Exhibit 18 A, which looks at owners, tries to examine how they bought/built their own houses, and it seems that only 30 percent built their houses, while 70 percent inherited them.

For those who bought their house, personal savings were the main category of source of funds to build or buy their houses.

The amounts of finance reported by Karachi respondents were quite low as compared to other cities. However, one should relate the amount with the covered area and other qualities of housing. The exhibit clearly reveals that average of (mean or median) covered area is quite low in the case of Karachi.

Exhibit 18 A
Percentage Distribution - Owner Financing for Purchase/Construction Home by City



For those owners who renovated and repaired their own houses – Exhibit 19 A – personal savings were the major sources to finance this additional construction, although in Lahore, BCs also contributed a great deal. (We are not sure if respondents considered their BC contributions to be 'personal savings' but this could very much be the case).

Exhibit 19 A
Percentage Distribution - Owner Financing for Home Improvements

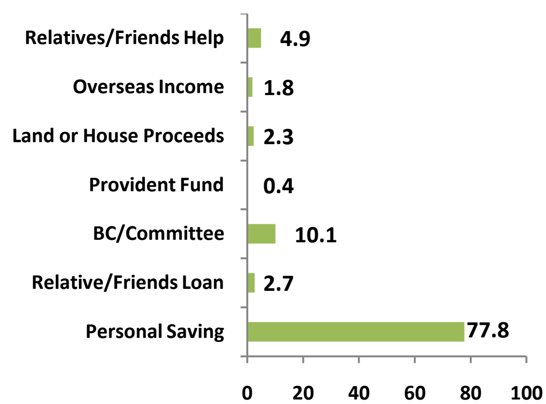
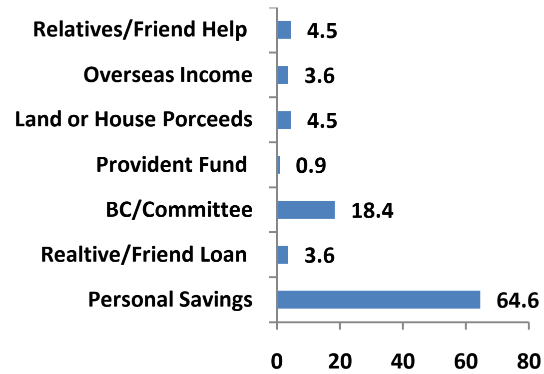


Exhibit 20 A shows the distribution of those owners who built beyond just repair and renovation, where personal savings once again dominating sources of funds, and BCs playing a large role in Lahore.

Exhibit 20 A
Percentage Distribution - Owner Financing for Additional Construction



Given all the background information around the housing sector as well as results from our survey, it should come as no surprise that only 30 percent of those who said they owned their houses said that they constructed or purchased them. This would also include those who constructed their houses incrementally, which we argue is probably the main model used by the low income groups. A lack of personal funds and the absence of loans seem to be the main impediment to home ownership.

92 percent of home owners said that they had documents, or clean titles, to claim ownership. In the FGD when this was probed further, most reaffirmed that this was the case. However, we have no way of verifying whether these documents would be acceptable to banks or other suppliers of credit as collateral. As we argue above, most banks and other lending institutions maintain that the absence of clean titles is one of the main impediments to them making advances for housing finance.

Exhibits 21 A shows further that a majority of house owners reported some additional construction to their houses, or renovation and repair. This is not surprising, for as we argue in this Report, houses are built incrementally and it seems, a majority continue to add to their residences over time when they have saved up enough money to do so.

Exhibit 21 A
Percentage Distribution- Owner Financing for Home Improvement

Description	Overall	Karachi	Lahore	Faisalabad
Owners Interviewed	398	212	116	70
Owners reported Additional Construction (%)	56	40	70	83
Owners reported House Renovation (%)	53	57	20	94
Owners Reported House Repair (%)	20	14	3	69

Often an additional room is added or some other form of construction takes place. Because of the fact that house owners are constantly adding to their premises once they have saved some money, they are a clear potential client for suppliers of credit, for they own their houses and probably have the documents to show for this as well.

The results also highlight some issues related to renters reveal an important finding which probably affects their ability to participate in BCs as well, that renters on average have been residing in their premises for only 5 years compared to 17 years for owners, suggesting that the latter are probably more embedded in the locality and have built up longer, more substantial relationships in the area.

Other than this marked difference, there is nothing particularly substantive which differentiates the housing characteristics of owners and renters, with the difference that more owners seem to have *pucca* residences than renters, and that more owners live in separate houses compared to renters who may be living in 'portions'. Rents the renters pay in the three cities are more or less similar, and that most renters find out about residences from friends and family rather than through a formal apparatus.

From Exhibit 21 A, it can be easily computed that 56 percent of the owners added to their home. 30 per cent of owners bought/built their house, but 56 percent added to their homes in some form.

Demand for Housing and Housing Finance - Owners

Exhibit 22 A reveals that more than half of those who own and live in their own houses, wanted to either buy another house (12 percent), or wanted to undertake repairs and construction in their existing house. As many as 75 percent of owners, wanted to repair, renovate or undertake additional construction of their existing houses, indicating that a potential market of home owners who might need credit exists. Building on this, Exhibit 23 A, 23 B, 23 C & 23 D shows that almost half of the owners wanted to take a loan for addition, renovation & repair, ranging between Rs 100,000-300,000, and were looking at a payback period of, on average, 8 years, with a monthly instalment of between Rs 3,000-5,000. Clearly, this is quite unrealistic as it does not reflect the interest rate, which is discussed below.

Exhibit 22 A
Percentage Distribution - Owners Need to Purchase Additional House

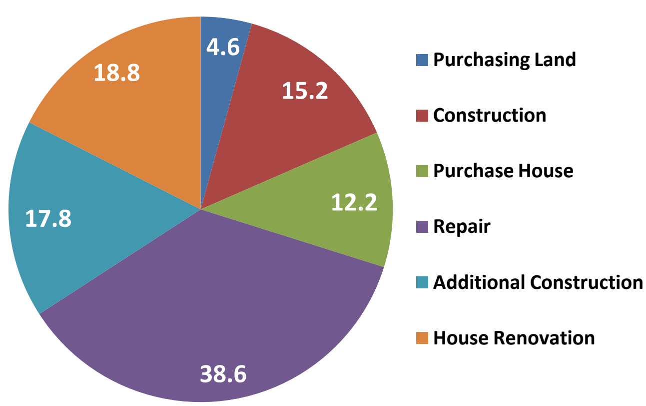


Exhibit 23 A
Percentage Distribution - Owners Willing to Acquire Loan for Addition, Renovation & Repair

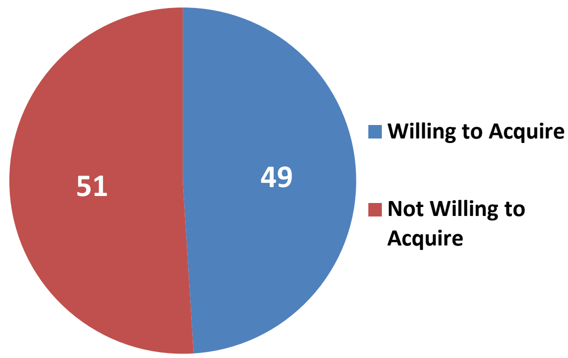


Exhibit 23 B
Credit Required by House Owners for Addition, Renovation & Repair by City (Rs.)

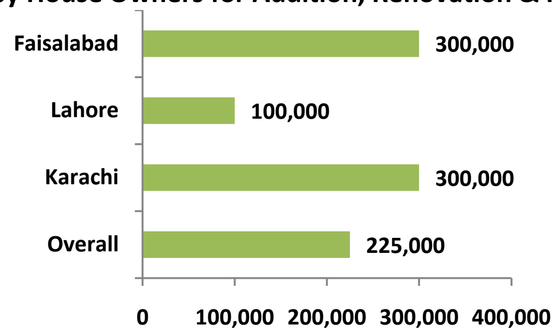


Exhibit 23 C
Repayment Period Months by City for Addition, Renovation & Repair

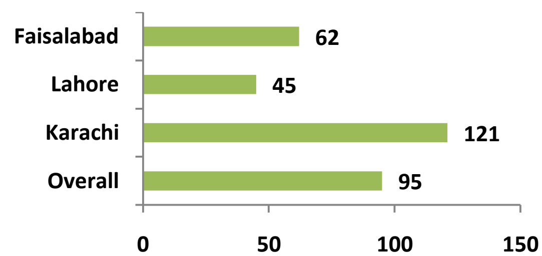


Exhibit 23 D
Monthly Instalments Amount by City (Rs.) for Addition, Renovation & Repair

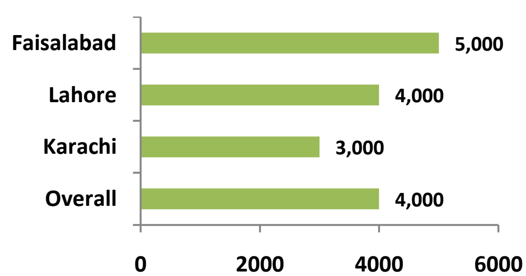


Exhibit 24 A enquires into why 95 percent of renters never attempted to apply for a loan, with almost three-quarters of Karachi's renters said that they were unaware of loan facilities. This proportion seems high given Karachi's highly commercialised environment, especially in comparison, when very few people in Faisalabad said that they were unaware. However, half in Faisalabad said that they would not take a loan due to 'religious factors'. About a quarter in Karachi said that the procedures to acquire loans were difficult and cumbersome.

Exhibit 24 A
Renter – Never Applied for Loan by City

Description		Overall	Karachi	Lahore	Faisalabad
Number of Renters		223	89	52	43
Never Attempted to apply loan	Number	175	84	48	43
	Percentage	95.1%	94.4%	92.3%	100.0%
Reasons for not applying	Unaware	51.6	71.4	40.6	7.1
	Due to Strong Conditions	12.6	4.1	28.1	7.1
	Religious Factor	15.8	-	25.0	50.0
	Long and Difficult Procedure	20.0	24.5	6.3	35.7

However, a majority of those who own their houses say they want to renovate, repair or add to their properties. In terms of what potential borrowers would offer as collateral, FGDs suggested that owners would be willing to place their titles/deeds of their property without much hesitation. It is improbable that most owners in the low income bracket would have many assets to use as collateral, although one microfinance bank has successfully been using jewellery as collateral for their emergency loans.

Demand for Housing and Housing Finance - Renters

Of those who rent their houses, Exhibit 25 A, more than half have tried to acquire/make a house, but most said they would be unable to repay loans that they would take, and that they had limited resources to do so. Exhibit 26 A shows that more than 95 percent of those who rented houses, never applied for a loan due to different factors, such as 'religious reasons', that they were unaware of housing loan facilities, etc. During the survey, renters were asked whether they would be willing to relocate and whether they would be willing to live in housing schemes built to accommodate new home owners, with some of the schemes outside of the city where land is available and cheaper. Exhibit 27 A & 27 B shows that for the potential clientele of such a facility, those who currently rent, half would consider relocation. Of those who said that they would not go; a majority said that they would prefer to be near their work place and near their relatives.

Exhibit 25 A
Percentage Distribution - Attempt to Make Own House by City

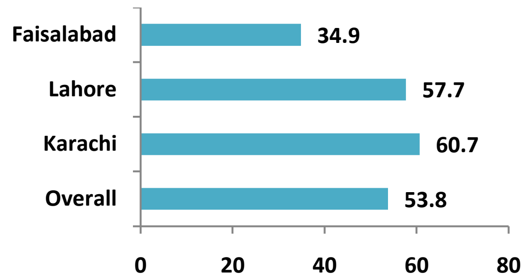


Exhibit 26 A
Percentage Distribution - Never Applied for Loan by City

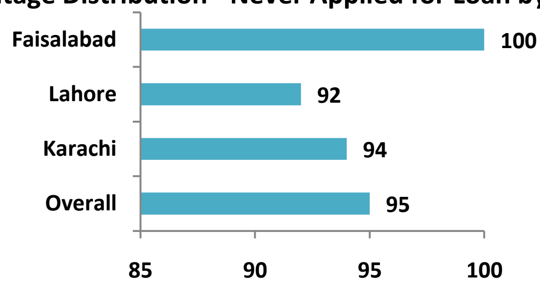


Exhibit 27 A
Percentage Distribution - Renters Agree to Live Out of the City

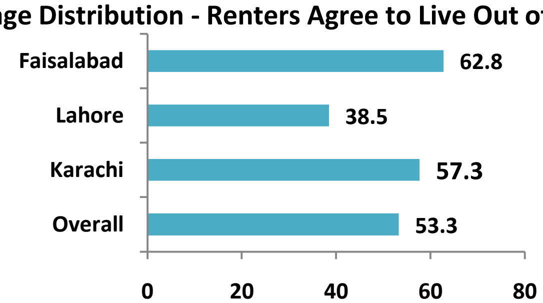
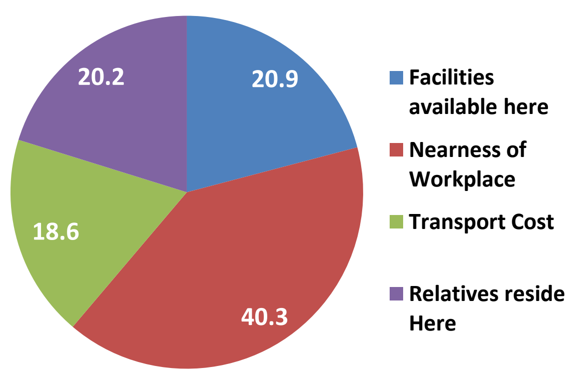


Exhibit 27 B
Percentage Distribution – Reasons for not going out of the City



Based on the data from the questionnaire, not many people agreed to relocate to somewhat further distances from where they were currently living, although during the FGDs, perhaps because we explained this concept in a better manner, a large proportion of people were willing to move to planned communities some distance from where they were currently living if they could get a house of their own. The possibility for relocation seemed far greater when discussed in the FGDs than it did during the survey.

4.2 Demand Side: Focus Group Discussions (FGDs)

- Based on the FGD findings, we are not sure that one can conclude that people would not be willing to pay more than 7-8 percent per annum as interest. It is safe to assume that people in general will always say a loan should be "low-interest" or "interest free". Unless a product is offered to them, it would not be possible to judge their acceptance of it.
- In practice, low-income groups tend to be less price sensitive to small tenor (2-3 year loans) as they use these primarily to address a liquidity/cash flow shortfall and aim to pay it off as soon as possible. They tend to be more price sensitive to longer tenor loans. Indeed, it would be a challenge to generate demand for a long-term mortgage with interest rate levels today. On the other hand, people may be willing to pay more for a shorter tenor home improvement/extension loan.
- The Rs. 300,000-500,000 loan amount probably refers to people looking to build/buy a new house, whereas the 40,000-100,000 refers to owners looking to extend their homes.

4.3 Supply Side: Informal Sector Interviews

The purpose of conducting interviews in the informal sector, was to better understand how low income communities built their houses and how they interacted with suppliers of goods and services in the informal sector. As we know, low income communities build their houses incrementally and interact with suppliers of goods and credit in their neighbourhoods. This is a well established and working system and it can only be replaced by the organised sector if one gets a fair assessment of why it works so well. These interviews were meant to understand this relationship.

In each low income settlement where the FGDs were held, we also interviewed a few of the local suppliers, or middlemen, who helped people build or, as was more likely, renovate and repair their houses. In most cases, informal suppliers used to provide cement, steel, blocks, and other hardware, on short-term credit, probably not linked to any formal interest rate. These middlemen were critical to the ability of owners to repair, extend or renovate their houses. Although individual credit advanced was not very high – most middlemen may have extended goods and supplies to individuals, worth anywhere between Rs 15,000-30,000 – they had made many such transactions and had many outstanding, which meant that they may have been owed a large amount of money at any given moment. Such transactions were of a very limited tenor – a few months, at best – and seemed to be cleared up in very few, rather than many, instalments. There were also cases of some default, or long-standing debt which did not seem that it would be paid back. Importantly, a social mechanism where familiarity within the same neighbourhood mattered most was evident as it acted as collateral. However, there seemed to be few clear means of enforcement of collecting the debt, except for social pressure and moral suasion.

4.4 Supply Side: Formal Sector Interviews

In addition to the informal sector FGDs, some interviews were held with individuals from institutions that were involved or aware of, housing and housing finance related issues. The purpose of these interviews was to gauge from other active and potential players in the market, as to how they perceived the low income housing market and what they felt the issues were. Some broad findings from the survey were also discussed with these individuals to ascertain their understanding of the results. The main purpose was to discuss general issues related to the sector, some of the constraints and hurdles that these institutions themselves felt, and more importantly, to get a sense of the possible impediments and possibilities towards providing finances to the low income housing sector.

We emphasize this point primarily to reiterate, as we do in numerous places of this Study, that the segment we were looking at, which is the low income housing sector, is not part of the clientele of mainstream banking in Pakistan. As we argue elsewhere, the formal sector requires formal documents, especially lease and clean titles, something that many house owners do not have. Moreover, as we also show, most potential clients are not fully integrated into the formal financial and banking sector in the country. We summarise some of the points raised in discussions by them, below.

Along with the more generic issues that were raised, regarding clean titles, the high cost of construction, legal issues, etc, the points on which most bankers agreed included:

i. Low income borrowers cannot deal with variable rates of interest and need fixed rates applied to their loans; moreover, they felt that most low income borrowers do not have long time horizons (above 12 years) which raises the cost of borrowing. For bankers, this was considered to be a poor choice given that they tend to lend with variable rates and that they have longer term horizons than do the poor. This is particularly true for banks, for which the only possibility is to give 10 year plus mortgages to people looking to purchase a house, who are preferably salaried. The MFB we spoke to felt that its costs were far higher than they are for mainstream commercial banks, and that this adds considerably to their lending costs making borrowing for low income clients even more expensive.

ii. When informed about the market structure and demand for smaller, shorter duration loans for repairs and renovations, etc, the bankers recognized the possibility of such loans, but they felt that the administrative and transaction costs of making many such small loans would be too high and not profitable for large banks.

iii. For microfinance banks, supposedly a key player in the low income housing market, the criteria set by the State Bank of Pakistan on who can qualify for microfinance, including housing, loans, was too low to make economic sense; those with a monthly income of Rs 15,000, would take many years to pay back a loan of say, Rs 500,000. Given the costs of funds of around 14 percent and administrative costs of around 13 percent in 2009, microfinance banks would need to charge a minimum rate of interest of 27 percent, making it impossible for borrowers to pay back their loans.

iv. Some innovative financial institutions are exploring longer term mortgages in order to make monthly installments affordable for this income segment. While longer term products may not be suitable to everyone in the lower income segment, having interest rates higher than ten percent may be even more unacceptable.

v. Any lending scheme for even low income borrowers – and not necessarily for houses – would require steady streams of income, preferably for clients who are salaried or have regular jobs; since many low income earners have jobs of a different nature, banks would discriminate against such potential clients. Banks would always prefer to lend to those who have steady incomes, as long as they fulfilled all the other criteria.

4.5 Analysis of Results

Based on the survey and the FGDs, it is clear that there is demand for housing finance for essentially two kinds of products a) home extension / improvement and b) home purchase / building. The primary target market for the former will be owners, while for the latter will be renters. Home improvement/extension products would probably require smaller amounts and shorter tenors, while home building/purchase would need larger amounts with longer tenors. An equal proportion, of both owners and renters, want loans, but for different purposes. While it is understandable that renters seek loans in the range of Rs. 500,000 in order to buy property, the approximately Rs. 400,000 need of owners for house repairs and renovations, seems overstated.

There are at least two explanations of why there is bound to be demand for housing in a country where the huge majority is still young. Firstly, most houses, as the survey also confirmed, are inherited, since we have been dealing with the low income groups, and one would assume that they do not have the ability to buy new houses. Hence, given the fact that family sizes in Pakistan tended, in the past, to be large, houses would be divided which would mean that space per individual 'owner' or family would reduce across generations. Congestion and higher density would be a major reason for some component of the family to shift out and demand new housing. Secondly, with modernisation taking place and the growing need for 'independence' and nuclear families, more and more families will demand housing. It is clear that in the near and medium-term future, demand for housing will grow, especially when supply is far limited than demand, and a backlog is added on every year.

What the Study tells us is that clearly while there is demand for housing, *there is demand for different packages and products related to housing*. Some people in the low-income bracket need land, while at the other end of the low-income bracket, many of those who own their houses, merely want to renovate or repair parts of their houses. Clearly, there is demand for a broad spectrum of products within the low-income segment of cities. The survey also highlights the fact that there are great regional differences in culture, income, savings and other factors which affect housing and housing demand, and hence, some differentiation on the basis of regions will also be necessary, along with product differentiation.

This Study shows that both house owners and renters have an eagerness for housing and housing finance products. Nevertheless, almost all houses are built, usually incrementally by low-income earners, on the basis of their own, personal, savings.[14] The banking sector does not play a role in funds meant for housing in Pakistan. This is also not surprising, when only 11 percent of Pakistanis are defined as 'bankable', and have bank accounts and use the formal banking sector. Banks, in order to lend, have numerous requirements, most of all, that the potential client open a bank account. Whatever else one may think about Pakistan's housing finance market, this factor may be the most important and explains why there is no formal sector housing finance market in Pakistan. The Study has not looked at issues of land-titling and other larger issues about financial regulation, closure, repossession and other legal aspects, yet these too do hinder the development of any minimum model of housing finance.

Any attempt to bridge the supply and demand gap for housing and housing finance, will have to deal with issues of the cost of capital, the tenor, instalments payments, etc, between those who are willing to

[14] *This insight is based on the extended work of Arif Hasan.*

supply housing finance and those who are willing to borrow. It was very clear that all those who wanted to borrow for whatever product related to housing, were not willing to borrow at more than a rate of interest of 8 percent, or thereabouts, although as we explain above, this is more an ideal type or preferred rate and not necessarily the final rate. The bankers we spoke to in Karachi, were willing to lend at only 3 or 4 times that rate. While the government owned House Building Finance Corporation is lending at a subsidised Kibor+3.5, or around 17 percent at the moment, a microfinance bank said that it would be viable for them to lend only at around 27 or 28 percent, since the cost of capital would be around 14 percent and the rest would be administrative charges and overhead costs. Clearly, there is a huge mismatch between the suppliers of credit and those who want to borrow, to the extent that one banker stated during the formal sector supply side interview, that there would be 'absolutely no housing market for the low-income segment, at anything above 8 percent. We also found during the FGD that while there was such a negative reaction to the possibilities of providing housing finance to the low income sector, issues of collateral were not raised. Moreover, there was a general perception which was mentioned, that the poor have no titles or deeds which would allow them access to formal sector funds. What is clear is that the formal sector is just not interested in the low income housing sector. Moreover, during FGDs in Orangi, Karachi, participants stated that their area had been designated a 'no-lending area' by one housing finance institution, and rather than examine specific houses and owners, entire areas of the city were considered to be out of bounds for the institution.

We also found from the Survey, that the low-income segment did not have a long-term view on loans, and usually saw a time horizon of around 5-7 years, not more.

Linked to this issue of the rate of interest, is also the issue, more on the supply side, of a floating vs. a fixed interest rate. The Kibor rate is a floating rate and most borrowers would find it difficult to adjust to a highly variable floating rate over a 10-15 year-plus time horizon, especially the low income group. Incomes for this group may rise and fall with the state of the economy, which is also linked with the rate of interest. For example, 2008 and 2009 would probably have been the worst time possible to launch a low-income housing product for a number of reasons. Firstly, the interest rate has been close to 18 percent in recent months. Secondly, there has been a noticeable downturn in economic activity since 2007, and since many of the low income segment work in the informal sector, their earnings and income would also have fallen. Thirdly, with the inflation rate in 2008-09 of 24 percent, even those on guaranteed, but fixed incomes, would have had a problem repaying loans – even though the real value of their debt would have been considerably reduced. These are also the reasons why the up-market real estate and housing finance sectors have suffered in the last two years. One can presume that the lower-end would have been squeezed even further.

However, if the economic situation were to improve, with higher and more robust growth and a lower rate of interest, would that substantially improve the low income housing finance market? If the rate of interest falls to single digits and higher growth – say 5 percent plus of GDP – returns, *and* there is low inflation, one could perhaps speculate that this might be a possibility. Our survey was conducted at a time of high inflation, low economic growth and activity, and high interest rates (although most respondents may not have known what the cost of borrowing would have been). All these factors would also have affected perceptions adversely. It is conceivable, given many caveats, that a more stable environment could be conducive to the growth of a financial sector for low income households. However, as we argue in a number of places in this Study, there are too many structural and institutional factors and constraints which would make it difficult for this to happen.

The rate of interest is critical when one examines the repayment stream of the low-income group. If their rent is around Rs 2,000-4,000 a month and if they can add another Rs 300-700 from BCs, their annual repayment, without any interest on say, a Rs 300,000 loan would be, let us assume, Rs 36,000, on a repayment of a consistent stream, without any interruptions, of Rs 3,000 per month., Even then it would take them more than eight years to repay just the capital amount. A 12 percent interest rate approximately doubles the amount they would have to pay or the tenor of the loan. We found from the Survey, that the low-income segment does not have long-term view on loans, and usually sees a time horizon of around 5-7 years, not more. One could even argue that the repayment period is not so important; the ability to pay or indirect willingness to pay (monthly instalment) might be a more important indicator for financing

Many of the households in the low income sector are outside the formal financial sector. For them, savings and loans take place usually in the informal sector. The BC system is probably the best example of savings which are not captured by formal banking and savings data. Given the fact that more than a quarter of households save through BCs, this segment becomes an important potential for a well-designed financial instrument which replaces it. For example, while the average savings of our sample was around Rs 1,500 per month, the mean amount of the BC was Rs 100,000, with a 'tenor' of 40 months and a monthly instalment of Rs 2,644. Adding this up, and not counting the rent paid by those who are part of BCs, at least Rs 4,000 are being saved/contributed towards some instalment. However, it is important to note, before we jump to conclusions that this could substitute as a house loan, that BCs are usually consumption loans, often used for marriages, although as some respondents said, they can be used for house renovation too. BCs are not perfect substitutes for house loans, but some savers could be persuaded to perhaps shift to a more formal housing finance product, depending on the financial product designed.

Commercial banks require clean titles for land holding in order to be able to lend against the property. While many home owners claimed that they had clean ownership titles, most studies in the past have identified problems related to titling which hold back the development of a housing finance sector in Pakistan. Those institutions which currently lend for housing in Pakistan claim that their lending rates are restricted by legal and titling difficulties, and that there will have to be considerable progress on that end for the private sector to start lending to this low income market.

The House Building Finance Corporation, has advanced the largest number of housing loans in the country in the formal sector and has a client base of nearly 100,000, it has, over the period 2005-09 on average, made only 5,000-7,000 new loans annually from its 54 branches across Pakistan. While 75-90 percent of these loans have been of less than Rs 500,000, this number of the largest housing finance institution in Pakistan, is perhaps 0.1 percent of total demand. Similarly, the largest commercial bank in Pakistan, which boasts around 6,000 housing finance clients, has made less than 100 loans over the last year through its 1,500 branches, a fact which speaks volumes of a completely non-existent official housing finance model in the formal sector.[15]

If these supply side and institutional constraints limit funding to individuals in the low income segment, the one possibility which has been experimented with and also discussed by bankers during the course of this Study is collaborative housing provided through a developer or NGO and a bank financing the project, as is the case of Saiban and the Khuda Ki Basti IV project in Lahore. Our study does not look at the mechanics of such streams of funding, but many of the respondents claimed that they were willing to move to housing schemes a distance from the city and live in such projects. It is not certain that they would be willing to do so, but this might be one of the avenues where both demand and supply could meet.

[15] *This was conveyed to us during the interview.*

5.0 Conclusions

We argue that given the fact that 89 percent of Pakistanis are considered to be ‘unbanked’, and that only 1 or 2 percent make use of formal sources of finance for their homes, and yet only 20 percent live in rental housing, the low income segment has very different financial needs, means and profiles than the middle or higher income segments.

Since almost all low income house owners across Pakistan build housing incrementally, quite clearly, incremental housing has the main, if not only, potential for funding for this segment. Given the subsequent demand by low income households for incremental housing credit, which will be very different from either up-market housing or from building houses in one go, short and medium-term loans should be the main focus of finance providers.

One of the more important findings from the data collection and survey is the fact that more than half of those who own their houses, want to repair, renovate or construct further on their properties. More than 75 percent of those who own their houses want to undertake some form of additional construction for their home. This could be the potential market in the segment amongst low income house owners which could be targeted through smart and short term home improvement loans, especially since almost half of those who own houses have shown a willingness to take a loan.

We argue, based on our focus group discussions, that many of the low income respondents had difficulty in trying to understand the notion of interest rates, and how their potential loans would be affected. However, during the course of further discussion, we found that there was some understanding of the cost of the loan or a mark-up or service charge. However, we feel that this lack of understanding is not a handicap in making loans to potential consumers, as the microfinance sector has shown. Just as microfinance institutions incorporate a rate of interest or service charge or mark up, products could be developed which have such elements built into them.

While there is demand for finance for housing, institutional constraints and supply side issues, hinder meeting that demand. Even if financiers are willing to provide credit, the low-income segment will not be willing to take on loans with variable and/or high interest rates. Moreover, for commercial institutions providing unsubsidised credit, it is clear that the low-income segment does not have the ability to pay back loans borrowed at current (or even middle-distant) interest rates. These potential clients also have unrealistic, short time repayment horizons and tenors; they do not envisage a loan product which looks at 10-15 year terms. For banks, on the other hand, this may be the only option. The findings suggest that in the current economic and financial climate, there are few possibilities for housing finance on a large scale for individuals in the low income segment. At best, some loans for renovation, expansion and repair could be made, but the transaction costs to banks for such products would be exorbitant, and it seems that this need will be filled by the local informal sector neighbourhood supplier. There does not seem to be a profitable or viable individual-based housing finance market for commercial institutions in Pakistan at the moment.

The following concluding points sum up our analysis and lead the way for possible courses of action that would provide easy and affordable access to low income housing finance.

5.1 Provide Housing Finance to the Low Income Group through Collective Efforts.

If there is any possibility to provide housing finance to the low income group, it is probably only through larger, collective efforts, such as Saiban and Khuda ki Basti-type schemes, or then through developers. Experience has shown that such projects and products work well, and can also be profitable for all those involved. However, where subsidised credit is involved, on which the State Bank of Pakistan is taking a stricter view and wants to ease it out altogether, such schemes will become less attractive. Perhaps the first step towards building an affordable menu of broad and diverse products for the low income sector might have to come through the efforts which focus on land records, land titling and on the legal side, rather than through the mechanisms of the financial markets.

5.2 Designing Financial Products

Given these key issues which have emerged, and given the constraints that exist in the low income housing finance sector, there is still need to examine possible ways to go ahead and design affordable housing finance products which could be proposed by the financial sector. The instrument/s will have to be short term, with fixed interest rates, at an interest rate which allows low income households to economically and financially accept the loan and allow smaller instalments. Clearly, for a single product or instrument to do this, would be difficult. Moreover, given insight from this Study, the product would be better suited to the incremental housing needs of low income clients, rather than to outright purchases. Financial institutions will have to devise products which suit different needs of clients, perhaps even relevant to different cities, especially if individual loans are to be made the main focus.