INFRASTRUCTURE AND HOUSING FINANCE DEPARTMENT

Housing Finance Quarterly Review

April-June 2010

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The Infrastructure and Housing Finance Department of State Bank of Pakistan presents its Quarterly Housing Finance Review for the quarter ending June 30, 2010.

This review contains data on housing finance, collated on a periodic basis from public sector banks, private banks, foreign banks, DFIs and House Building Finance Corporation (HBFC).

Contents

State of Housing Finance

In Pakistan rapid urbanization has become a challenge for increasing number of people. Studies indicate that lack of finance from a formal source is primarily a supply-side problem. Most of the housing finance is arranged through personal resources. The formal financial sector caters to only 1 to 2 percent of all housing transactions in the country, whereas the informal lending caters up to 10-12% of such transactions. Presently, the formal financial sector provides housing support through two major sources namely the Government owned House Building Finance Corporation (HBFC) and private commercial banks.

The property development industry suffers from low public confidence. Financial weaknesses and the absence of clear, uniform and fair business practices have affected its credibility contributing to the reluctance of financial institutions in providing development and construction finance. There is a strong need to strengthen the property titling and land administrative procedures including improvements of the legal provisions, standardization of processes, and computerization of all relevant revenue record. These steps will enhance the financing by the formal sector. Weakness in the existing legal framework also impedes the financing opportunities of the formal financial sector. Though the Financial Institution Recovery Ordinance, 2001 empowers the financial institutions to foreclose a mortgage property without recourse to the court of law, lack of full implementation of the recovery law in its letter and spirit dilutes its effectiveness in protection of rights of the respective parties, i.e., the financial institutions, mortgagors, landlords and tenants, thus needing a major improvement.

Although the regulatory framework for land registration and transfer regime exists in Pakistan, the process by which land is acquired and registered is cumbersome at times, because of number of institutions and registration procedures required to execute property transactions. Land records are manually maintained leading to errors and omissions and resultantly they have modest commercial value for the mortgagee financial institutions especially in rural and some urban areas. The lack of efficient and reliable system of ascertaining the bona-fide of property titles has forced banks to limit the access of housing finance to a certain number of urban localities within the urban centers.

National and local master plans for town planning and housing facilities are either inadequate or poorly enforced, which lead to inefficient allocation of land and uncontrolled urban development. Lack of transparency and accountability in the planning process also give opportunities to land grabbers/mafias to have valuable inside information as to future infrastructure developments or to be able to influence such plans so that value of its land increases. Over-restrictive building codes and laws on subdivision limit the efficient use of urban land and increase the price to consumers, especially in zones having relatively higher prices of lands in high land price zones. Moreover, the large scale projects often get delayed due to failure of utility companies in connecting new housing developments in time.

The “property valuers” have professional conduct requirements that were established by SBP and the Pakistan Banks’ Association (PBA), whereas majority of real estate builders and developers are working as sole proprietorships or partnerships with limited capital and informal corporate governance structures. Absence of sound governance structure within the housing developer industry creates lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in future. The unstructured and unsupervised nature of business of real estate brokers/ agencies, which could serve as natural arrangers for the provision of financial services, is also a significant constraint to the provision of housing and housing finance. Consequently, it is difficult for financial institutions to verify the character, capital, and capacity of potential clients. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders’ extreme caution for transaction initiated by these venture. As a result, financial institutions are reluctant to enter this market, which in turn causes scarcity of finance and constraints in the supply of housing. In the absence of the formal arrangements between the housing developers/real estate agents etc and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner. Without using a strong regulatory authority to enforce corporate governance and allied standards for this stratum of business entrepreneurship, the quality of availability of housing facilities across population spectrum will not improve.

At present, almost 29 commercial banks, House Building Finance Company (HBFC) and one DFI is catering to housing finance needs. HBFC is the only specialized housing bank in the country, which has been providing housing finance to public since 1952. Commercial banks entered the mortgage business during 2003 contributing very small share in the housing finance system. Only few commercial banks extended housing loans during 2003. Although HBFC's share in the total housing finance has reduced in absolute terms, it is still the only institution that continues to cater to the lower-middle and low-income groups and enjoys the largest customer base.

After demonstrating a promising growth trend during previous five years, the housing finance sector reported a decline of 12% in outstanding portfolio over the last year. The total outstanding reported by banks and DFIs as on June 30, 2010 was Rs. 70.34 billion compared to Rs. 80 billion as on June 30, 2009. The total number of outstanding borrowers has decreased from 117,535 to 101,632 since June 2009; showing a fall of 13.53%.

Non-performing loans have increased from Rs. 13.87 billion (June 2009) to Rs. 17.38 billion (June 2010); a 25.31% increase over the year. However, this rise in NPLs is not unique to housing finance and is only depicting the overall increase in NPLs of all sectors witnessed in the banking industry during the past year.

Approximately 673 new borrowers were extended house loans during the quarter, accounting for Rs. 1.94 billion of new disbursements. HBFC accounted for 17.23% of these new borrowers and contributed 44.32% of the new disbursements equivalent to Rs. 86 million.

Financing for outright purchase continued to dominate other sectors (construction and renovation) by comprising almost 58% share in gross outstanding portfolio. Outstanding portfolio for construction and renovation was 31% and 11% respectively.

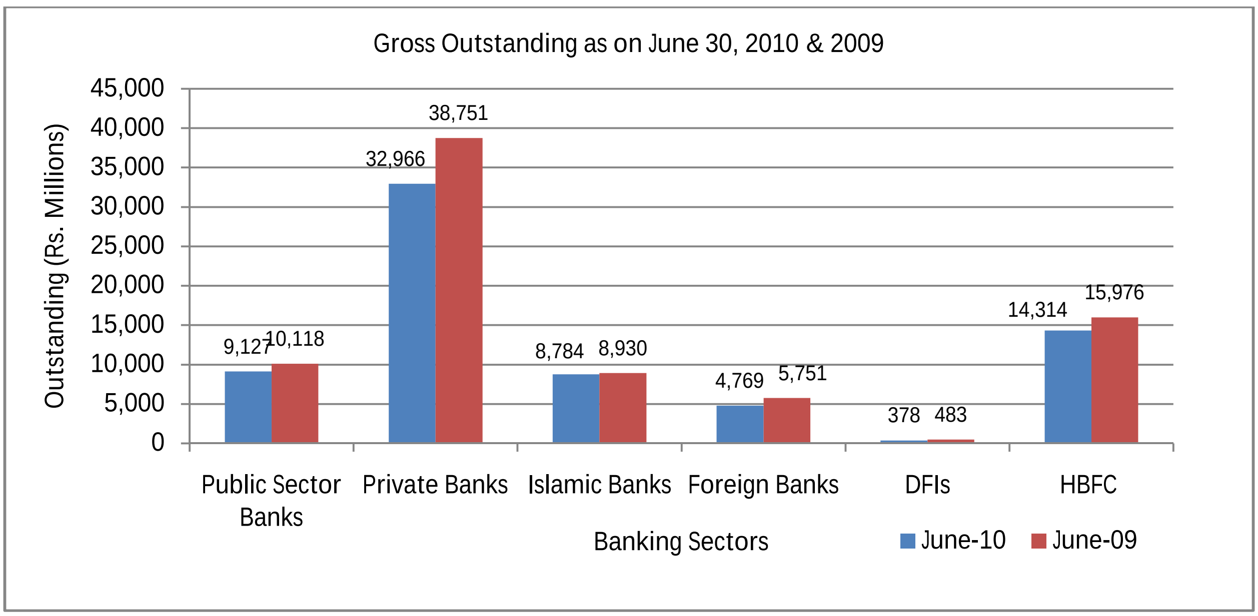
Major Trends

Gross Outstanding

The total outstanding finance as on June 30, 2010 of all banks and DFIs stood at Rs. 70.34 billion. Compared to quarter ending June 30, 2009, outstanding of all commercial banks and DFIs collectively decreased by 12%.

Banking sector-wise total outstanding on quarters ending June 30, 2009 & 2010 are shown in Figure 1. Of the total outstanding, commercial banks accounted for Rs. 55.65 billion with private banks posting Rs. 32.97 billion; a 14.93% decline since quarter ending June 30, 2009. Public sector banks reported an outstanding of Rs. 9.12 billion followed by Islamic banks of Rs. 8.78 billion and foreign banks with Rs. 4.77 billion. Excluding DFIs, all commercial banks collectively posted a 12.44% decline when compared to quarter ending June 30, 2009. The outstanding loans of HBFC were Rs. 14.31 billion; down by 10.40% over the last year. Other DFIs have a meager share of Rs. 0.378 billion in outstanding loans.

Figure 1



Non-Performing Loans

NPLs have increased from Rs. 13.86 billion (June 2009) to Rs. 17.38 billion (June 2010); a 25.31% increase during the year. Figure 2 shows comparison of existing NPLs of different banking sectors with last year. Figure 3 compares NPLs as a percentage of outstanding portfolio at the end of quarters on June 30, 2010 and June 30, 2009. NPLs as a proportion of total outstanding have witnessed an increasing trend over the last fifteen months. This overall rise in NPLs is primarily due to rising inflation and high interest rates.

HBFC's NPLs have increased from Rs. 6.14 billion to Rs. 6.42 billion during the year; a 4.41% increase (Figure 2). Although growth of its NPLs remains relatively low in absolute terms when compared to some of the other banking sectors, its percentage share in its total outstanding, however, is the greatest, as 44.82% of its total outstanding constitutes NPLs (Figure 3).

Excluding HBFC, NPLs for all banks and other DFIs have increased by 41.94% over the year from Rs. 7.72 billion to Rs. 10.96 billion. The percentage share of NPLs that all banks and other DFIs (excluding HBFC) constitute is 19.57% of their total outstanding portfolio, compared to a 12.06% as on June 30, 2009.

Among banks, Islamic banks have witnessed the sharpest increase in NPLs during the year in terms of percentage; an increase of almost 89.66%, from Rs. 443 million to Rs. 840 million. However, their NPLs constitute only 9.56% of total outstanding, which was 4.96% on June 30, 2009. NPLs of the public sector banks have increased from Rs. 1 billion to Rs.1.27 billion (an increase of 25.99%) which are 13.86% of total outstanding. NPLs of foreign banks have increased from Rs. 604 million to Rs. 1.02 billion; a 69% increase with 21.42% of its total outstanding classified as NPLs, which was 10.50% on June 30, 2009. Private banks have reported an increase of 37.81% in NPLs from Rs. 5.61 billion to Rs. 7.74 billion which is 23.47% of their total outstanding as against 14.49 % in June 30, 2009. NPLs of DFIs (excluding HBFC) have increased from Rs. 59 million to Rs. 100.41 million, showing as increase in percentage terms from 12.21% to 26.56%.

Figure 2

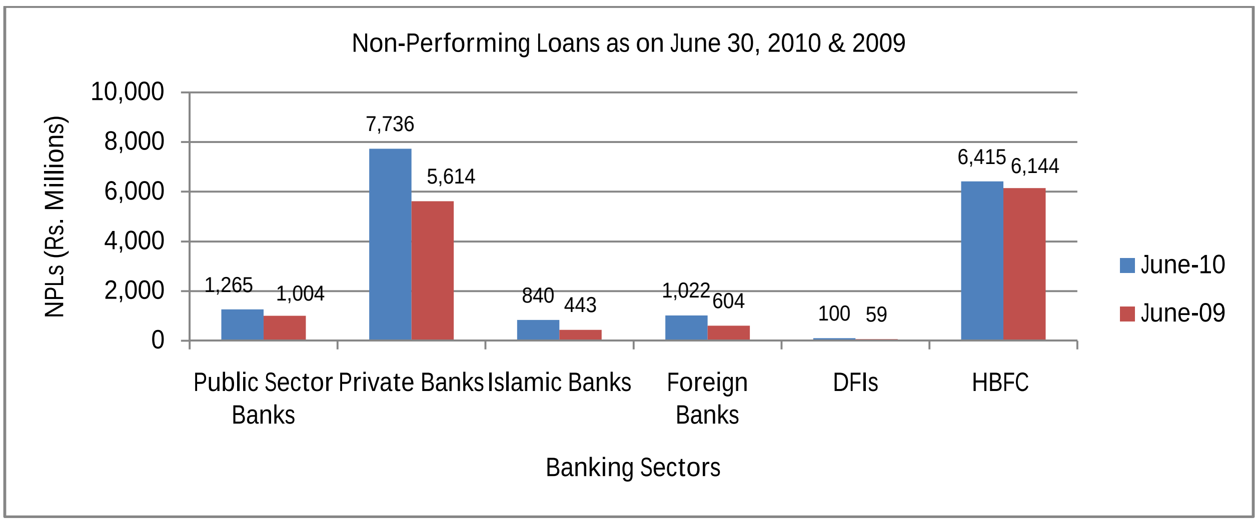
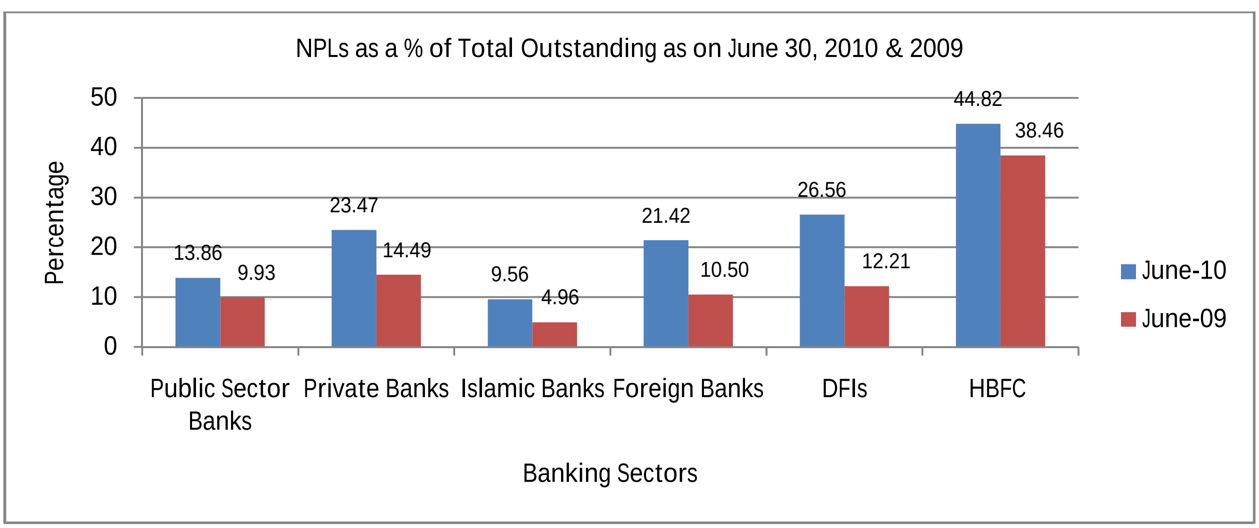


Figure 3



Number of Borrowers

Total number of outstanding borrowers has decreased from 117,535 to 101,632 since June 2009; a decline of 13.53%. As shown in Figure 4, there is a decrease in no. of borrowers in each category except Islamic banks, where numbers increased from 2171 to 2240.

Figure 4

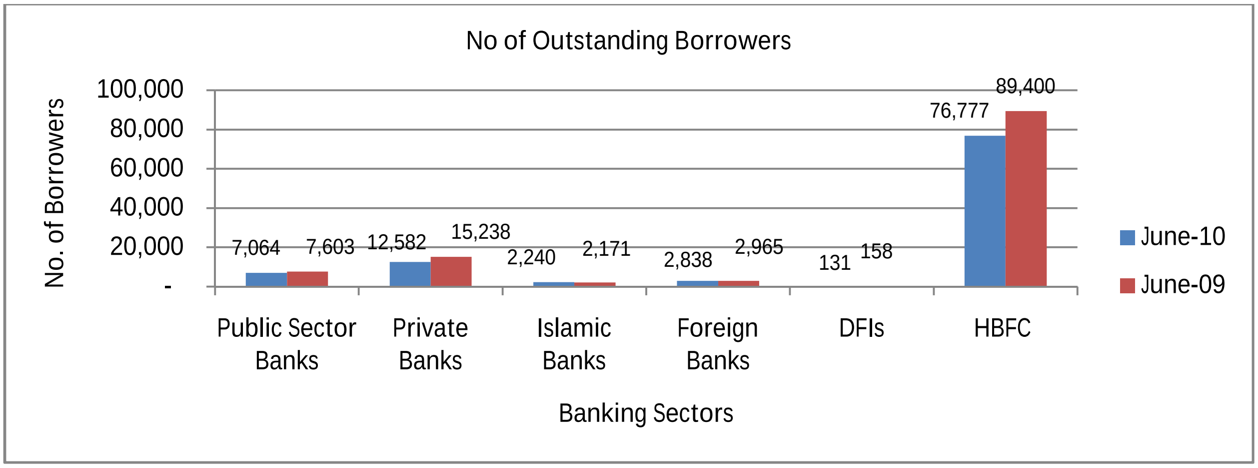
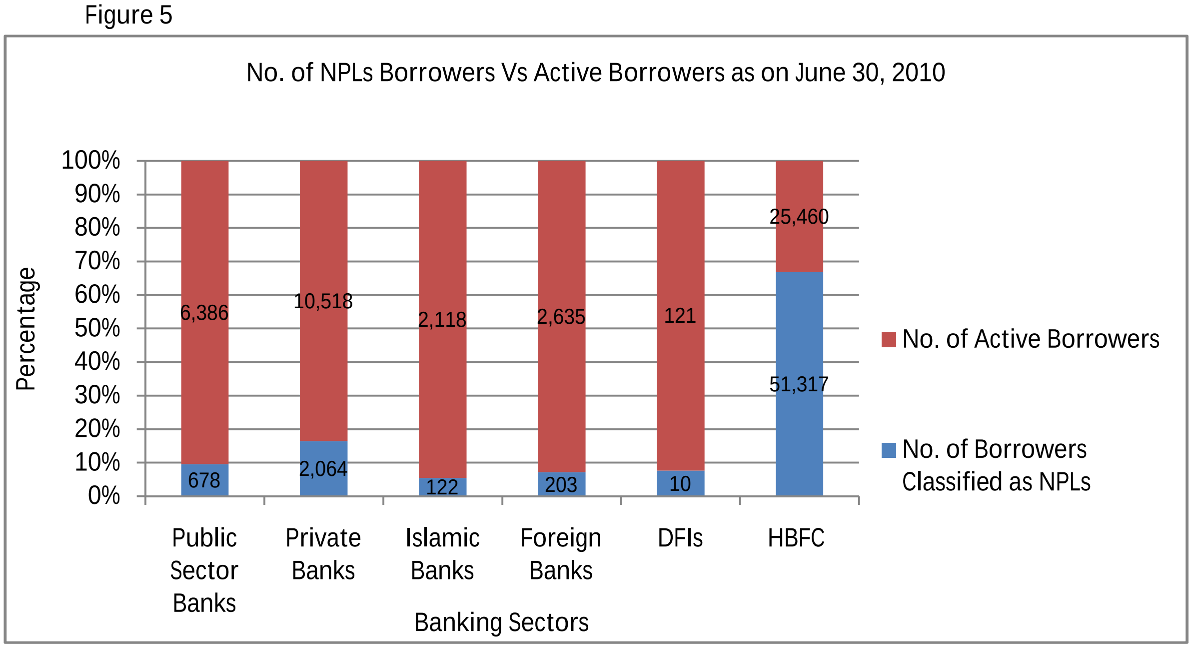


Figure 5 shows number of borrowers that has been classified as NPLs as a percentage of total borrowers. Approximately 53.52% of total borrowers of housing loans have been classified as non-performing. However, this is primarily due to HBFC's number (51,317) of non-active borrowers that have been classified as non-performing, which comes to 66.84% of total borrowers of HBFC. Thus, excluding HBFC in such an analysis will be important as it caters to 76% of the total borrowers in housing finance sector which accounts for only 20% of total outstanding portfolio. Thus, by excluding HBFC, 12% of total borrowers of housing loans have been classified as non-performing.

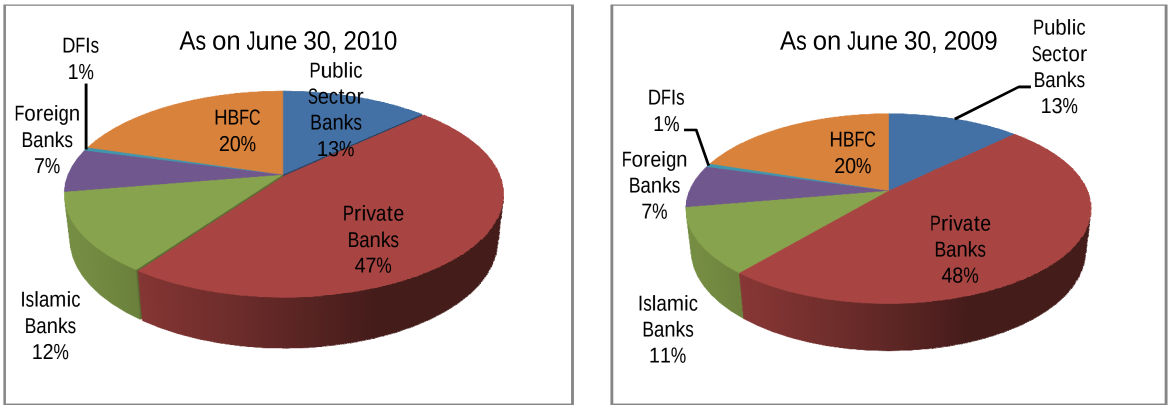
Figure 5



Share of Banks

The overall market share (based on gross outstanding) of commercial banks (excluding DFIs) remained the same since the end of last year, as 79%. Within commercial banks, the share of private banks in the total outstanding decreased marginally from 48% to 47% (Figure 6). Share of public sector banks, foreign banks and HBFC remained stagnant at 13%, 7% and 20% respectively. Share of Islamic increased from 11% to 12%.

Figure 6: Share of Banks in Total Outstanding



Disbursements

Fresh disbursements to the tune of Rs. 1.94 billion were made to 673 borrowers during the quarter ending June 30, 2010 (Table 1). Private banks extended new disbursements of Rs. 1069 million followed by Islamic banks with Rs. 657 million, public sector banks with Rs. 65 million and foreign banks with Rs. 57 million. HBFC's fresh disbursements for the quarter were reported to be Rs. 86 million only. Among commercial banks, the number of new borrowers totaled 557, with private banks serving 333 borrowers and Islamic banks 158 borrowers. HBFC extended loans to only 116 new borrowers during the reporting quarter.

Table 1

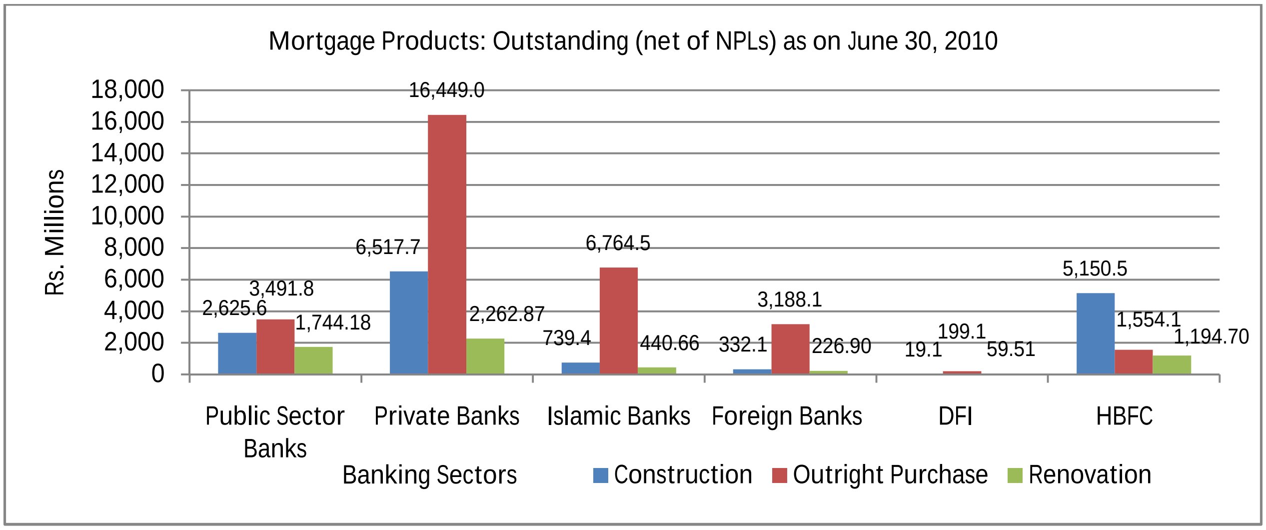
Disbursements (and no. of borrowers) during the quarter ending June 30 2010

	Amount (Rs. Millions)	No. of Borrowers
Public Sector Banks	65	57
Private Banks	1069	333
Islamic Banks	657	158
Foreign Banks	57	9
All Banks	1849	557
DFIs	-	-
HBFC	86	116
Total	1935	673

Sectoral Share

The biggest share of housing finance continued to be attracted towards outright purchase (Figure 7).

Figure 7



The outstanding for outright purchase stood at Rs. 31.65 billion as on June 30, 2010; a 60% share in total outstanding of Rs. 52.96 billion. This is followed by the construction category where outstanding reported at quarter-end stood at Rs. 15.38 billion and that of renovation stood at Rs. 5.93 billion. Active portfolio shows that private banks have taken a lead in financing for all three sectors; construction 42%, outright purchase 52% and renovation 38%.

Analysis of Loan Variables adopted by Banks/DFIs & HBFC

Tables 1, 2 & 3 summarize loan variables across all banking sectors including weighted average interest rate, Loan-to-Value ratio (% financing by banks), average maturity period, average loan size and average time for loan processing.

Weighted average interest rate

The overall weighted average interest rate comes to 15.7%; at the end of the current quarter; an increase of 0.1 percentage points when compared to quarter ending June 30, 2009. Highest weighted average profit rate was reported by foreign banks 16.9%, followed by Islamic banks 16.3%, HBFC 16.1%, private banks 15.1% while public sector banks average came to 13.7%.

Average maturity periods

Average maturity period for the quarter ending June 30, 2010 came to 13 years, which is higher as compared to quarter ending June 30, 2009 when it was 11.9 years. HBFC's average maturity period is reported to be 13.6 years, while that of Islamic banks is 11.6 years. Table 1 shows that among commercial banks, private sector banks have extended housing loans for an average tenure 13 years followed by foreign banks with 12.6 years and public sector banks with 11.3 years.

Loan to Value ratio

The percentage of financing (Loan to Value ratio) extended by banks decreased during last year (Table 2). The LTV ratio for housing finance decrease from 57.1% (during quarter ending June 2009) to 49.8%

(during quarter ending June 2010). Average LTVs of commercial banks have decreased from 58% to 42% which demonstrates their cautious approach towards fresh lending. The LTVs for HBFC have increased from 54.2% to 57.2% during the last year.

Average time for loan processing

The reported average time for loan processing is approx. 38 days for all banks and DFIs, which was 26 days in June 30, 2009. This increase is predominantly due to HBFC. Currently, the application processing of most of the banks is a centralized process, where branches forward applications to central branches/head offices for assessment and approvals. Moreover, the processing time can be considerably reduced if land titling issues are resolved and institutional inefficiencies removed.

Average loan size

Average loan size for disbursements made during the quarter ending June 30, 2010 is Rs. 3.5 million for all banks, except HBFC. The average loan size for HBFC is reported to be Rs. 1.2 million for the reporting quarter. Islamic banks have financed with an average financing size of Rs. 2.1 million. Private banks reported an average loan size of Rs. 4.9 million, foreign banks Rs. 3.1 million and public sector banks reported Rs. 1.3 million. The housing finance market is still inclined towards lending to high income groups.

Table 1

	Weighted Average Interest Rate (%)					Average Maturity Period (Years)				
	June-10	Mar-10	Dec-09	Sep-09	Jun-09	June-10	Mar-10	Dec-09	Sep-09	Jun-09
Public Sector Banks	13.7	16.2	14.9	15.3	15.1	11.3	11.3	9.5	11.3	10.6
Private Banks	15.1	14.5	15.0	14.9	15.0	13.0	12.2	12.3	12.2	11.3
Islamic Banks	16.3	16.7	17.1	19.9	17.7	11.6	14.5	15.3	14.3	14.5
Foreign Banks	16.9	16.7	17.7	17.9	17.5	12.6	11.4	12.4	12.0	11.1
All Banks	15.5	15.4	15.7	16.1	15.7	12.3	12.3	12.4	12.4	11.6
DFIs	-	16.5	16.5	17.4	17.8	-	14.5	14.4	14.3	13.8
All Banks & DFIs	15.6	15.3	15.7	16.2	15.8	12.3	12.4	12.5	12.5	11.7
HBFC	16.1	13.6	13.5	14.7	12.5	13.6	16.0	16.0	15.5	15.2
Total Average	15.7	15.3	15.6	16.1	15.6	13.0	12.5	12.6	12.6	11.9

Table 2

	Loan to Value Ratio					Average Time for Loan Processing (days)				
	June-10	Mar-10	Dec-09	Sep-09	Jun-09	June-10	Mar-10	Dec-09	Sep-09	Jun-09
Public Sector Banks	35.1	61.9	66.0	61.4	61.6	24.6	28.9	27.9	30.0	34.6
Private Banks	39.7	53.8	60.3	60.4	58.5	25.1	22.4	23.2	23.0	21.8
Islamic Banks	54.1	60.9	58.5	55.9	56.9	33.2	21.6	23.1	31.0	34.6
Foreign Banks	32.7	48.4	50.2	49.8	51.6	25.5	22.3	23.1	23.0	20.7
All Banks	42.3	55.4	59.2	58.1	57.9	27.8	23.2	23.8	25.0	25.5
DFIs	-	41.8	41.8	42.5	43.3	-	30.0	30.0	30.0	30.0
All Banks & DFIs	42.3	54.9	58.5	57.5	57.3	27.8	23.5	24.1	26.0	25.8
HBFC	57.2	65.0	60.0	55.8	54.2	47.8	30.0	30.0	30.0	30.0
Total Average	49.8	55.2	58.6	57.4	57.1	37.8	23.8	24.3	26.0	26.0

Table 3

	Average Loan Size				
	June-10	Mar-10	Dec-09	Sep-09	Jun-09
Public Sector Banks	1.3	1.9	2.0	1.8	1.9
Private Banks	4.9	2.3	2.4	2.3	2.5
Islamic Banks	2.1	2.9	2.8	3.3	3.9
Foreign Banks	3.1	2.8	2.7	2.8	2.9
All Banks	3.5	2.4	2.5	2.5	2.6
DFIs	-	3.1	3.0	3.0	3.1
All Banks & DFIs	3.5	2.4	2.5	2.5	2.6
HBFC	1.2	0.7	0.7	0.7	1.1
Total Average/Total	2.3	2.3	2.5	2.4	2.6

Conclusion

The quarter ending June 30, 2010 depicted a decrease in overall portfolio. NPLs of the housing finance portfolio display a rising trend and banks continue to show signs of cautious lending amidst decreased affordability of the borrowers. LTVs have decreased and maturity periods increased. The lack of conducive institutional framework and secondary mortgage market still pose as a major constraint towards the growth of housing and housing finance sector which is one of the potential key drivers of the economy.

Major Initiatives and Achievements

Recognizing the importance of housing sector in boosting the domestic economy, following key initiatives have been taken by SBP to further develop market based mechanisms and enhance the flow of credit to this priority sector.

Implementation of Housing Advisory Group's Recommendations

As part of its earlier efforts, SBP had established a Housing Advisory Group (HAG) with an intention to conduct a thorough analysis on the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations stressing on the need to enhance access of financial services for the development of housing sector. These include reforms in legal and regulatory framework, establishment of secondary mortgage market, development of market intelligence, provision of affordable/ low income housing finance products. SBP had already disseminated the recommendations to the concerned stakeholders and is currently coordinating with the Ministry of Housing & Works, Pakistan Banks' Association (PBA), Association of Mortgage Bankers (AMB) and Association of Builders and Developers (ABAD) for implementation of some of the key recommendations.

Mortgage Refinance Company

SBP and World Bank Group have agreed to work together for implementing key recommendation of HAG for creating financing environment conducive to growth of housing sector by focusing on: establishment of Mortgage Refinance Company, availability of low cost housing finance and establishment of an observatory for real estate market. Work on the establishment of Mortgage Refinance Company is now being pursued aggressively. IFC developed a detailed business plan and feasibility for the Mortgage

Refinance Company. Principal buy-in of the Ministry of Finance has been elicited and equity commitments from the GoP, few banks and HBFC have been received, while remaining banks are being pursued.

Capacity building Program

In addition to initiatives taken to institutionalize housing finance, SBP realizes that a simultaneous development of human capital will play a critical role in ensuring sustainability of housing finance. In accordance with the Cooperation Agreement signed between International Finance Corporation (private sector arm of the World Bank Group) and SBP, a comprehensive housing finance training program was launched. The training covered all aspects of housing finance from product development, loan marketing/distribution and origination to loan underwriting, servicing and risk management. Till date, approximately 250 bankers from over 20 banks have been trained in the mortgage business. More capacity building programs would be conducted in future.

Creation of Web Portal

In a drive to provide different stake-holders with reliable and needed information on various factors of housing/mortgage finance industry, as also recommended by HAG, SBP is working in coordination with the Association of Mortgage Bankers (AMB) for developing a web portal. As an initial step, AMB's website has been created which contains information on basic housing parameters.

Development of Housing Finance Guidelines

Infrastructure & Housing Finance Department of SBP is in process of developing guidelines of housing finance to increase the efficiency of mortgage bankers by adopting best international practices.

Future Outlook

Considering the huge housing backlog, the demand for housing will persist for years to come. However, access to formal finance sector for housing remains a challenge.

Different measures are being taken to improve the housing finance outreach in the country. Major initiative of Mortgage Refinance Company (MRC) would help banks/DFIs in overcoming maturity mismatch and in providing fixed rate mortgages. MRC is expected to be operational in 2011.

Since efforts would be made to arrange international institutional funds, it is hoped that housing facilities would become affordable for low-income groups of the society.

Provinces would be asked to bring down Transaction Costs, which would help boost the housing construction activity, which would attract banks'/DFIs' financing.