PAKISTAN

HOUSING FINANCE

Is there a business case for FINANCIAL INSTITUTIONS?

- The International Finance Corporation (IFC), a member of the World Bank Group, is committed to supporting the growth in the housing sector.
- To help realize the full potential of the opportunity in Pakistan's housing finance sector, IFC undertook this study to underline the volume in mortgage finance market that could be tapped by expanding portfolios across different income segments in small, medium, and large cities.
- The study also focuses on potential returns on assets that could be achieved on mortgage finance portfolios by banks/DFI.
- The study combines information from various secondary sources such as the Population Census of Pakistan (2017), studies of Pakistan Bureau of
- Statistics, Pakistan Social and Living Standards

 Measurement (PSLM) surveys, research articles,
 as well as information from banks/DFI, and
 views from industry experts.

Presenting
the Business Case
for TAILORED
HOUSING
FINANCE



THE GAP BETWEEN HOUSING SUPPLY AND DEMAND IN PAKISTAN¹

- There is a high demand for housing units from Pakistan's lowincome segment, however the current supply is negligible.
- Only 1% of housing supply caters to 68% of the population
- earning a monthly income of up to US\$ 188.
 - Most of the housing supply targets the high and affluent class in line with commercial viability and affordability.
 - Approximately 56% of housing units cater to 12% of the population earning monthly income of more than US\$ 625.

Housing Finance (HF) has the potential to expand in Pakistan

Despite a low national mortgage/GDP ratio,
Financial Institutions (FIs)
(except for the House
Building Finance Company
Limited (HBFC)) are only
limited to Tier 1 cities for their mortgage finance products.

With the appropriate products, systems, and funding, mortgage finance can be expanded to 26 cities (Tiers 1, 2 and 3), with the potential to reach approximately 500,000 additional clients across different income segments.

TAILORED HOUSING FINANCE IS THE RIGHT MIX OF:

- CUSTOMER PROFILE
- **QUANTUM OF INCOME**
- GEOGRAPHICAL LOCATION
- MODE & PRODUCT OF FINANCING
- PROPERTY USE, SIZE, AND PRICE

1 https://aurora.dawn.com/news/1141727



HOUSING DEMAND BY INCOME LEVEL AND CITY TIER IN PAKISTAN

INCOME SEGMENTS

The PSLM Survey and banks/DFI outline the following customer segments according to their monthly income:

Upper: US\$ 6,250+

Upper Middle: US\$ 3,125-6,250

Middle Middle: US\$ 688-3,125

Lower Middle: US\$ 250-688

An additional loan volume of US\$ 3.8 billion can be created in the mortgage finance market by existing and new Housing Finance players, to serve approximately 500,000 customers.

City	Potential	EXPECTED CAPITAL OUTLAYS FOR PROPERTY ACROSS INCOME SEGMENTS ** (in US\$ million)				
Tier***	Households*	Upper	Upper Middle	Middle Middle	Lower Middle***	TOTAL
Tier 1	360,267	132	1,246	638	760	2,776
Tier 2	96,790	35	335	172	204	746
Tier 3	42,784	16	148	76	90	330
TOTAL	499,841	183	1,729	886	1,054	3,852

^{*} All cities with a population of >300,000 have been selected from the Census of Pakistan 2017 and further categorized into Tier-1, Tier-2 and Tier-3 (based on HBFC tiering system for cities and focus of the banks). Population then has been adjusted into households and discounted with an 80% factor to remove the risks of overage/underage persons, income correction, households with already owned properties, joint families etc.

^{**} Expected capital outlays have been calculated by taking independent pricing indexing by property valuers in target cities for housing units of up to 125 square yards, average loan amounts required and desired monthly incomes.

^{***} This income segment is also currently being targeted through mark-up subsidy scheme of the Government of Pakistan (GoP).

^{****} Tier-1 includes major cities like Karachi, Lahore and Islamabad. Tier-2 includes medium-size cities like Gujranwala, Multan and Sargodha while tier-3 encompasses small cities e.g. Larkana, Sheikhupura and Gwadar.

ARE THERE OPPORTUNITIES BEYOND AFFORDABLE HOUSING FINANCE? WHAT IS THE POTENTIAL ROA?

- The GoP is currently providing a mark-up subsidy for housing finance whereby housing units of up to 250 square yards and flats/apartments with covered areas of up to 2,000 square feet are being financed by the FIs for first time home-owners. The finance carries a subsidized pricing of up to 9% per annum for a maximum tenor of 10 years and a maximum loan size of US\$ 62,500.
- The markup subsidy scheme is complemented by provision of low-cost housing to low-income groups by Naya Pakistan Housing and Development Authority (NAPHDA), where housing finance is available from FIs for a maximum amount of US\$ 16,875 for a unit of up to 125 square yards and flat/apartment with a covered area of up to 850 square feet.
- However, the opportunity in housing finance is not just limited to income segments currently covered by the markup subsidy scheme.
- Even if the whole markup subsidy allocation is utilized by the banks to build mortgage portfolio, an additional opportunity of US\$ 1.8 billion will remain untapped across uppermiddle income segment. This segment will have better ROA along with lower risk of default.

Pakistan's housing supply across all tiers and locations in 26 focused cities is above US\$ 18,000 on average.

A supply of affordable housing units/apartments (up to 125 square yards) is as critical as affordable mortgage financing. Without adequate affordable housing supply, a 'housing for all' agenda could be difficult to achieve.

RETURN ON ASSETS (ROA)

Assuming higher degree of credit risks as compared to other lending segments, average returns on low income mortgage finance portfolio (currently also covered under mark-up subsidy scheme of the Government) could be up to 2% per annum. In addition to ROAs, such mortgage financing could also offer product cross-sell and higher business growth opportunities.

ROA on mortgage finance to income segments other than those targeted by the markup subsidy scheme could range between 3.50%-4.75%, as estimated from the analysis of FIs' returns on existing consumer mortgage finance portfolio. This also includes the returns on developer finance.

Moreover, mortgage finance products could also be expanded to cover internal employees of FIs, leading to higher staff motivation and retention.

MORTGAGE FINANCE IN PAKISTAN GROWTH • 'ENABLERS' • CHALLENGES

Mortgage and Housing Finance Demand vs. Supply

- URBAN POPULATION IS AROUND 25% more than 208 million people, expected to double between 2030-40.
- MORTGAGE TO GDP RATIO IS 0.3%
 South Asia's average is 3.4%.
- CURRENT HOUSING DEFICIT IS +10 MILLION UNITS expected to increase by 0.4 million units per year.
- LARGE UNDERSERVED MARKET FOR LOW-COST HOUSING

Challenges in Housing

END USERS

lack of affordable housing supply

LAWS AND REGULATIONS

issues with land titling, registration, administration, and record keeping

LACK OF FUNDS

limited medium- to long-term funding for on-lending purposes for mortgages. nascent capital markets for raising long-term funding.

FINANCIAL PROVIDERS

limited capacity of Financial Institutions to offer and manage housing finance.

Policy and Regulatory Environment

- Active regulators like State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP).
- Introduction of National Financial Inclusion Strategy. Establishment of Housing Task Force and NAPHDA. Risk-sharing facility by Pakistan Mortgage Refinance Company (PMRC). Mandatory targets for banks for construction and housing finance.
- Relaxation in general reserve requirements and risk weightages for Fls lending to low-income segment. Relaxation in taxes on low-cost housing projects.
- Markup subsidies for affordable housing finance. Relaxation in regulation for informal income assessment.

FINANCE AND CONSTRUCTION INCENTIVES POST COVID-19

- Policy rate slashed by 625bps to 7% post Covid-19.
- Relaxation of Debt Burden
 Ratio for consumer loans and regulatory criteria for restructuring/rescheduling of loans. Reduction in Capital Conservation Buffer.
 Deferment of principal payment on loan obligations.
- Construction stimulus package including tax incentives.

WORLD BANK GROUP (WBG): HOUSING SECTOR ENGAGEMENTS IN PAKISTAN

Pakistan's Housing Finance Sector Development		IFC's Role in Pakistan's Housing Finance Sector		
	2007 to 2010	World Bank and IFC, as part of the Group, recommend the establishmand other key reforms		
SBP issues Prudential regulation on HF	2013 to 2014			
Inauguration of PMRC	2015 to	IFC provides advisory services to PMRC to support the establishment and operation of the refinancing facility		
	2016	WB and SBP draft National Financial Inclusion Strategy with Housing Finance as a priority area		
Naya Pakistan Housing Program PMRC commences operations	2017 to 2020	WB approves a \$140 million package for PMRC and \$5 million in technical assistance to GOP WBG's Housing Finance Conference supports	IFC develops a comprehensive housing program, leveraging WB efforts WB disburses US\$140 million financing package to PMRC comprising of Risk-sharing	
		institutional readiness for the Naya Pakistan Housing Program	Facility, convertible sub- debt, and line of credit	
	2021	IFC disburses approximately US\$ 3 million in equity investment to PMRC		
		WB proposes US\$ 350 million add GoP efforts to enhance access an Finance for the bottom three inc includes lines of credit, Risk-shar and technical assistance to SBP	d affordability of Housing ome quintiles. Package	
Goals:	Goals:		IFC: Institution building in housing finance; market study;	
Improve Mortgage/ GDP from 0.3%		Housing Finance knowledge-sharing. Enhancing access to mortgage finance (beyond low-cost		
Establish a thriving mortgage and		housing), potential investments in Housing Finance Companies (HFCs), promoting green affordable housing, mortgage insurance, scaling Real Estate Investment Trusts.		
housing market Establish an effective		Support in implementing Real Estate Regulatory Authority Act and revised foreclosure laws, improvement in housing finance		
legal framework to support housing finance		companies' regulations. World Bank: Additional financing of Housing F improving access to land, infrastr		

IFC FINANCIAL INSTITUTIONS GROUP (FIG) GLOBAL HOUSING SECTOR PROJECTS

IFC FIG had an aggregated exposure of US\$ 2.2 billion with over 60 committed projects in the Housing Sector as of 2020.

Investments in the sector include equity, senior and subordinated loans.

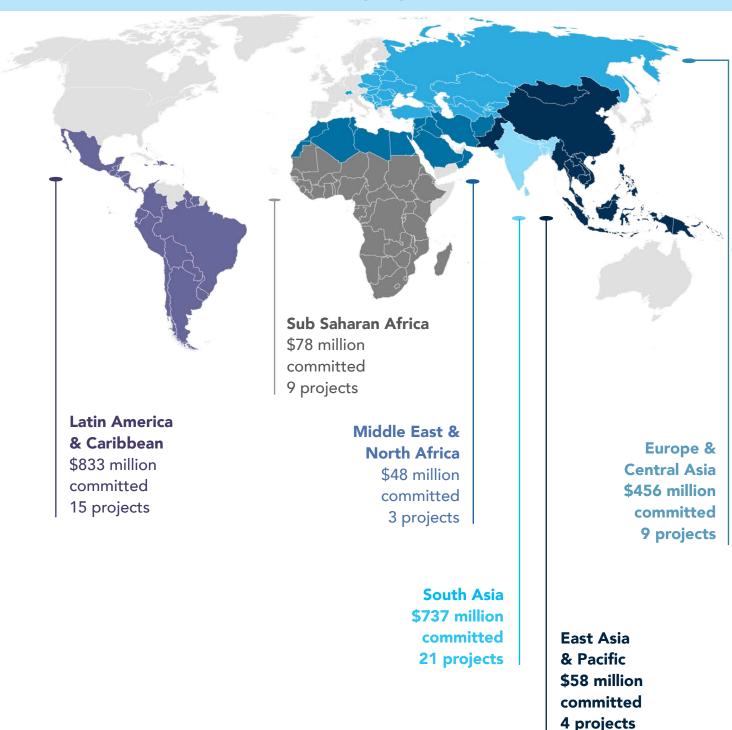


FIG AFFORDABLE HOUSING FINANCE **ADVISORY SUPPORT: CUSTOMIZED** INSTITUTIONAL ADVISORY

Financial Institution/ **Practitioner**

Refine existing business and operating model to deepen market penetration; market analysis to define size and specifics of target segment.

Refined customer segmentation; drill down to detailed customer profiling and maximizing wallet share; develop an array of housing loan products.

Refine existing appraisal framework to assess informality; Integrating underwriting with analytics; develop credit scoring capabilities.

Gap assessment of data architecture; focus on opex reduction; apply business intelligence to improve monitoring; increase efficiencies

Focus on creating specialized skill sets for informal client acquisition; retention of quality staff; continual upgrading of training content.

Refine RM strategy – early warning signals; detailed and nuanced RM framework for informal lending.

Housing Finance Sectoral/ Apex Institutions

Business Model and **Strategy**

Product Development

Credit Management

Digitization/ **Analytics**

Organization Structure/ Human Resources

Risk **Management** (RM)

Define the strategic vision and identifying the right mix of capabilities to reach the vision. Apply international best practices for capital market development.

Identify requirements of new product offerings (rental housing, credit quarantee schemes, informal income) for better coverage of target segment. Work closely with the FIs for implementation.

Identify, design and promote standardization of credit parameters and documents for better assessment of the informal segment.

Support best practice sharing in implementing digitization to support informal segment housing finance, including designing and developing training programs

Design Training of Trainer (ToT) programmes focused on upskilling partner FIs by creating specialized skill sets required for informal segment assessment.

Support in defining risk management framework required for informal segment and implementation of the same with partner Fls.

IFC TECHNICAL BENCHMARKING: AFFORDABLE HOUSING DIAGNOSTIC TOOLKIT

Development of Diagnostic Toolkit for Benchmarking of Affordable Housing Finance Institutions

WHY? We have synthesized our learnings from managing a Housing Finance Investment Portfolio of more than US\$ 2 billion across 60 projects globally, into a toolkit to help Financial Institutions benchmark their existing Housing Finance Operations against best-in-class practices in affordable housing finance.

OUTCOME

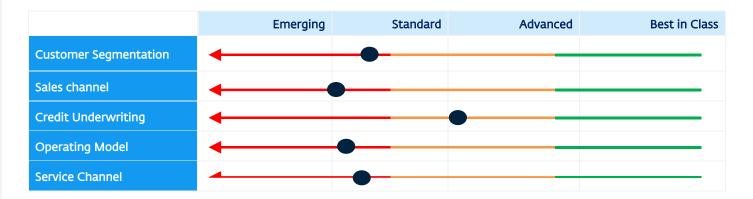
The outcome of the toolkit is a gap analysis document which helps the institution understand critical gaps which need to be filled in order to meet future aspirations and goals in Housing Finance.

HOW DOES IT WORK?

The toolkit covers the following aspects of Housing Finance Operations of a Financial Institution:

- 1. Strategy & Business Model
- 2. Operating Model
- 3. Product Design
- 4. Credit Underwriting
- 5. Data Analytics & Technology Penetration
- 6. Risk Management
- 7. HR & Organization Structure
- 8. Collections

Illustration of a Business Model classified as Emerging



CASE STUDY: AADHAR



Through Investment and Advisory Services, IFC Helped Aadhar Housing Finance Launch and Scale up Its Affordable Housing Business in India

AADHAR was established in 2010 with IFC's equity investment of US\$ 4.4 million (20% equity) to provide housing loans to low income segments in low income states. IFC also provided advisory services to Aadhar to enable it to become the first housing finance company in India that is focused on low income customer segments.

OPERATIONALIZATION AND IFC'S INVESTMENT

AADHAR was awarded 2010 a license of Housing Finance Company and IFC provided equity of US\$ 4.4 million (20% equity) Innovation 2014 Introduces Innovative for low-Product: No Income income **Proof Product** for households informal segment **Established** 2016 Housing loan marketportfolio reached player US\$ 280 million (76% cumulative average growth rate (CAGR)) since inception Key 2019 Blackstone (world's alliance largest alternate asset manager) acquires 97.7% stake in Aadhar **Strengthening** 2021 Aadhar files for initial **foundations** public offering of up to US\$ 999.7 million

CUSTOMER PROFILE

Ticket Size Home loans with average ticket size of INR 840,000 (~US\$ 11,700) in urban and semi-urban geographies of India. 90% disbursement up to INR 20 lakhs ticket size (~US\$ 28,000)

Client Segment Aadhar customers include people from informal segment who do not have adequate income proof documents. Composition - Salaried (66%), Self-employed and others (34%)

IFC'S INVESTMENT ACHIEVEMENTS

- IFC helped mobilize US\$ 10 million for the greenfield company
- Success of Aadhar helped spur other HFCs in India to achieve CAGR between 30%-60% of their loan portfolios.

IFC'S ADVISORY SUPPORT

- Helped Aadhar develop and launch new housing finance products targeting lower income households.
- Introduction of Responsible Finance Framework for client protection and awareness.

Note: Portfolio numbers as of Annual Report 2019-20

CASE STUDY: AAVAS



IFC helped Aavas Financiers Scale Up its Affordable Housing Business in India and Venture into Affordable Green Housing

AAVAS FINANCIERS LIMITED (erstwhile Au Housing Finance Limited) was incorporated in February 2011 to provide housing finance for low and middle income customers in rural and semi-urban areas of India. The majority of its portfolio is for self-constructed houses, hence the dependence on developers is quite low. The majority of Aavas customers have limited access to formal banking credit to finance their housing needs because of limited availability of income proof documents, minimum banking history and non-availability of credit bureau scores.

Ticket Size	Home loan average ticket size of INR 850,000 (~US\$ 12,000) in rural and semi-urban India
Business Performance	100,000+ active customers; asset under management (AUM) growth at a CAGR of 41.2% (industry average: 14.7%), AUM of US\$ 1.32 billion
Client Segment	65% of cases from low income states in India, 40% of customers have no previous loan with a financial institution. Composition: 40% salaried; 60% self-employed
Technology & Analytics	Re-engineering of business processes through extensive use of technology and digital (60% of cases disbursed in <10 days)
Asset Liability	Healthy Asset Liability Management profile with positive asset liability gap for next three years
Growth NPL ROA	Demonstrated track record of high growth and healthy asset quality (NPL<1%) and profitability (ROAs>2.5% each year FY15-20).

Note: Portfolio numbers as of Annual Report 2020-21

Aavas begins operations	2012	Extensive handholding and guidance from IFC during inception	
Strong	2017	IFC Investment of	
business and operating model	201/	US\$ 20 million for supporting housing finance to individuals in low- and middle- income groups	
Listing	2018	As of March 2020,	
on Stock Exchange	20.0	Aavas market valuation was approximately US\$ 1.8 billion.	
Established player in market	2019	IFC Investment of US\$ 50 million for expansion of Aavas' operations in frontier states of India	
Diversifying product portfolio	2020	IFC Advisory signs project with Aavas to introduce and scale up affordable green housing finance product in India	

CASE STUDY: BANCO LA HIPOTECARIA

IFC is a long-time partner of Banco La Hipotecaria, a primary mortgage lender in Latin America, specializing in serving low and middle-income segments



LA HIPOTECARIA (LH) is a full-service housing finance bank, based in Panama, that specializes in the origination and servicing of residential mortgage loans for low to middle-income population, with a proven capacity to securitize these loans. LH is a pioneer in residential mortgage backed securities (RMBS) in Central America (out of which eight have been cross-border). IFC helped expand LH's operations in El Salvador and Colombia.

IFC'S INVESTMENT ACHIEVEMENTS

- IFC has provided revolving long-term credit lines, not readily available in the market, to meet LH's business model of securitizing mortgage assets.
- With IFC's equity investment in LH, the company was able to expand into Colombia, thereby increasing the access of low to middle-income population to long-term mortgage financing in El Salvador, Panama, and Colombia.
- IFC helped LH tap international investors for mortgage-backed securities thereby increasing the funding required to address the housing finance needs of the low to middle-income population.

LH commences operations	1997 Company licensed in Panama		
IFC's first investment	2004	IFC provides 3-year credit line of US\$15 million IFC provides 7-year credit line of US\$ 20 million for opening in El Salvador	
IFC's second investment	2009	IFC provides a US\$ 25 million credit line to holding company. IFC makes equity investment in the holding company of US\$ 3.5 million (13.5% ownership)	
Became a regulated bank	2010	LH becomes a regulated bank in Panama	
	2011	With IFC's support, LH begins operations in Colombia	
	2012	IFC invests in loan of US\$10 million	
	2014	IFC provides credit line and invests in bond of US\$ 30 million	
	2021	IFC and LH sign a US\$ 50 million credit line to expand mortgage financing in Panama and El Salvador, with a focus on women-headed households.	

CASE STUDY: PRIORBANK





Through Investment and Knowledge support, IFC helped Priorbank in Belarus to enhance Mortgage Finance portfolio and introduce Green Mortgages

PRIORBANK is the sixth largest bank in Belarus and the largest private bank in a country dominated by state-owned banks. Historically focused on corporate lending, Priorbank's strategy has seen a shift towards SMEs and retail lending, with a focus on mortgages. Target client base for mortgages has been the upper-middle income population.

IFC'S INVESTMENT ACHIEVEMENTS

- IFC's housing loans have provided Priorbank much-needed longterm local currency funding which is enabling them to realize their mortgage lending strategy.
- IFC has also supported Priorbank to increase their knowledge and capacity for green housing finance through training and introduction of the Excellence in Design for Greater Efficiencies (EDGE) certification system for green mortgages.

KEY MILESTONES			
Priorbank starts operations	1989	Minsk Innovative Bank, Priorbank's predecessor, is founded	
Strengthening payment system	1994	Priorbank became first Belarusian FI to join Visa, MasterCard	
IFC's first investment in Belarus' financial sector	2003	IFC Investment of US\$ 14 million in Priorbank for on-lending to private enterprises	
IFC's investment in mortgage in Belarus	2004	IFC Investment of US\$ 20 million for on-lending in many sectors including leasing and mortgages	
IFC's first green housing finance project in Belarus	2020	IFC Investment of US\$ 50 million in senior loan to grow housing finance and residential energy efficiency loan portfolios as well as to offer green mortgages	



Acronyms

ALM Asset Liability Management
AUM Asset Under Management

CAGR Cumulative Average Growth Rate
DFI Development Finance Institution

EDGE Excellence in Design for Greater Efficiencies

FIG Financial Institutions Group

FIS Financial Institutions
GDP Gross Domestic Product
GOP Government of Pakistan

HBFC House Building Finance Company Limited

HF Housing Finance

HFCs Housing Finance Companies

IFC International Finance Corporation

INR Indian Rupee
LH La Hipotecaria

NAPHDA Naya Pakistan Housing and Development Authority

NPL Non-performing Loan

PMRC Pakistan Mortgage Refinance Company

PSLM Pakistan Social and Living Standards Measurement

REIT Real Estate Investment Trust
RERA Real Estate Regulatory Authority

RM Risk Management

RMBS Residential Mortgage Backed Securities

ROA Return on Assets

SBP State Bank of Pakistan

SECP Securities and Exchange Commission of Pakistan

ToT Training of Trainers

WB World Bank
WBG World Bank Group

For more information, please contact:

International Finance Corporation

20-A, Shahrah-e-Jamhuriat, Ramna 5, G-5/1, Islamabad, Pakistan.

Tel: +92 (51) 227 9631-33

www.ifc.org

© International Finance Corporation 2021.

The material in this work is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. IFC encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly, and when the reproduction is for educational and non-commercial purposes, without a fee, subject to such attributions and notices as we may reasonably require.

IFC does not guarantee the accuracy, reliability or completeness of the content included in this work, or for the conclusions or judgments described herein, and accepts no responsibility or liability for any omissions or errors (including, without limitation, typographical errors and technical errors) in the content whatsoever or for reliance thereon. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries. The findings, interpretations, and conclusions expressed in this volume do not necessarily reflect the views of the Executive Directors of The World Bank or the governments they represent.

