**Working Paper – Housing Finance**

Housing finance continues to have very significant relevance on the micro and macro economic health of the country. A well-functioning housing finance system offers incentives for households to save, provides investors with opportunities to gain stable, long term returns, creates large numbers of jobs for skilled and unskilled workers in construction and ancillary industries, enables home owners to leverage their physical assets into financial assets for investment, and contributes greatly to the deepening and broadening of the financial sector.

Housing market activity is thus an important leading indicator of overall macroeconomic activity and has a tremendous impact, both in terms of providing social stability and in promoting economic development. Resultantly, ensuring the availability of housing and the growth of housing finance markets must be a policy priority in Pakistan.

Supply of affordable housing has major impact in terms of improving living conditions, health, education and human development. In order to create an enabling environment for an efficient housing sector to boost up the mortgage finance industry,there is a need ofurgent attention of all key stakeholders.

**Housing Finance Market**

The country’s population is booming and the ever-increasing mass of humanity is moving to the cities like never before. At present about 38 percent of the population of more than 170 million resides in urban areas and this proportion is only rising further each year. The pace of urbanization is leaving existing social infrastructure in the lurch. Studies attest that over 45 percent of the total urban population dwells in slums or irregular settlements which speak volume of the deplorable state of housing finance in the country.

Pakistan is faced with increasing shortage of housing units, particularly for low and middle income groups. According to World Bank estimates, there was a backlog of around eight million housing units in 2009, and the gap between supply and demand is increasing by more than 300,000 units every year. Recently, the macroeconomic environment, particularly financial instability and volatile interest rates, impeded the flow of affordable long-term housing finance. Today, the sector is still plagued by inadequate long-term finance and a complex web of ineffective property titling and land registration systems that do not reliably guarantee property rights, and thus severely limit access to housing finance.

The housing sector has been facing a problem of not only supply shortages but also escalating prices. Pakistan witnessed a real estate boom during 2003 to 2008. Property prices skyrocketed across the country and to buy a home was impossible for an ordinary Pakistani due to the frequently increasing prices. In the year 2008, the real estate bubble came to an end and property market witnessed a slump. All the banks engaged in housing finance business either stopped or slow down the mortgage business at that time.

Although prices settled down in certain parts of 2010 and 2011; these have now again started increasing. The problems of supply shortages and escalating prices are indicative of the fact that the housing sector is grossly underdeveloped and undercapitalized. This sector can be capitalized through enhancing outreach of housing finance. However, in the last decade or so mortgage to GDP in Pakistan has been less than 1 percent and to be exact it was 0.66% as of March-2013. In case the mortgage financing availed by Bank staff is excluded, then the ratio of mortgage to GDP comes to just 0.27% which is a negligible figure whereas the International comparable of Mortgage to GDP ratios are much higher; even the India has 9% mortgage to GDP ratio.

**Mortgage to GDP Ratio – International Comparables**



Within the housing and construction sector in Pakistan, nearly 40 industries are linked, thus providing substantial additional employment opportunities by contributing through a higher multiplier effect with a host of beneficial forward and backward linkages in the economy. With high employment opportunities and growth rate, the Government of Pakistan stipulates that increasing the housing supply can not only reduce the housing shortages, but also give a boost to 40 allied industries linked with it.

**Role of Banks / DFIs in Housing Sector**

Till 2003, HBFCL (House Building Finance Co) was the only specialized housing bank in the country providing housing finance since 1952 while commercial banks entered the mortgage business in the year 2003.

It appears that the Pakistani banking industry took lessons from the global mortgage crisis. After registering a handsome growth until 2008, housing finance portfolio of the banking sector began plunging thereafter.

NPLs of the housing finance portfolio not much increased But due to decline in the outstanding portfolio, the NPL ratio to outstanding loans displaying a rising trend.

Banks continue vigilant lending approach amidst decreased affordability of the borrowers due to inflated prices of property/houses, labour and construction material. Besides, the lack of secondary mortgage market and high rates of housing finance are also the major constraints to the growth of housing finance sector.

Despite the of huge socio-economic benefits of housing finance, the higher management of banks/ financial institutions still seem less interested in housing finance business.

**Rise of Islamic Housing Finance**

The Islamic Housing Finance has also emerged as most demanded option for Housing Finance. The Statistics of last year (2012) showing that almost **50%** of total housing finance disbursement in Pakistan in a single year was through Islamic Banking Industry. Although, the share of Islamic Banking in Pakistan’s banking industry is close to 10%, however in case of house financing the share of Islamic Banking Industry is **25%** in terms of gross outstanding as of March 2013. This share was just 17% a year ago.

The Gross outstanding of the banking sectors decreased over the year except for Islamic Banks which showed an increase of 12% as stated in SBP Quarterly Review of Housing as of March 2013. According to the report, the share of Conventional Banking (excluding HBFCL), Islamic Banking Industry and HBFCL in the total outstanding was 51 percent, 24 percent and 25 percent respectively as on March 31, 2013. Islamic Banking Divisions-IBDs (12 windows) and Islamic banks (05 banks) have 27 percent and 73 percent share respectively (IBDs share increased to 27 percent from 21 percent over the year) in housing finance portfolio of Islamic Banking Industry, which shows that conventional banks also consider the Islamic mode of financing an important part of their business strategy.

**Housing Finance Statistics**

After registering a promising growth trend till 2008, the housing finance sector has been showing declining trend afterwards. The gross outstanding reported by banks and DFIs (including HBFCL) as of March 31, 2013 was Rs. 52.6 billion. It was Rs. 58.6billion as of March 31, 2012 showing a decline of Rs. 6 billion (10.2 percent) over the year and Rs. 55 billion at the end of December 31, 2012. The total number of outstanding borrowers also decreased from 89,125 to 82,346 over a year; showing a fall of 7.6 percent and 2.9 percent decline when compared to last quarter. Non-performing loans decreased from Rs. 20.13 billion (March 31, 2012) to Rs. 18.36 billion (March 31, 2013); a 8.8 percent decrease over the year. The stock of NPLs as on December 31, 2012 was Rs. 18.94 billion.

Around 505 new borrowers were extended house finance during the quarter (Jan-Mar, 2013), accounting for Rs. 2.3 billion of new disbursements. HBFCL accounted for 38.6 percent of these new borrowers and contributed 12.9 percent of the new disbursements equivalent to Rs. 292 million.

**Last 8 years Trend of Housing Finance Industry in Pakistan**

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| **Overall Industry Gross Outstanding of Housing Finance (In Billions)** |
| **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** |
| **55** | **62** | **76** | **84** | **77** | **67** | **59** | **55** |
| **Annual Disbursement of Housing Finance (In Billions)** |
| **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** |
| **26** | **24** | **23** | **27** | **8** | **8** | **8** | **8** |

*(Source – SBP Housing Finance Review – 2005 to 2011)*

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| **Non Performing Loans (NPLs) of Housing Finance Industry including All Banks/DFIs and HBFC (In Billions)** |
| **YEAR** | **2008** | **2009** | **2010** | **2011** | **2012** |
| Share of Banks/DFIs in NPLs (a) | 6 | 9 | 11 | 12 | 11 |
| Share of HBFC in NPLs(b) | 6 | 7 | 7 | 7 | 8 |
| **TOTAL NPL (a + b) in Billions** | **12** | **16** | **19** | **19** | **19** |
| % Share of NPL in Gross Outstanding Housing Finance | 15% | 21% | 28% | 32% | 34% |

**Endeavors by the State Bank of Pakistan**

* **Separate PRs for Housing Finance**

The separate set of Prudential Regulations (PRs) for housing finance were prepared by SBP and shared with the stakeholders for their feedback/comments. The comments have been incorporated in PRs. Currently, the draft PRs are being further reviewed internally and would soon be discussed in the Banking Policy Committee (BPC).

* **Setting up of PMRC**

SBP, being the facilitator, had made significant progress since the development of feasibility report and business plan in year 2009 by IFC. GOP has committed Rs. 1.2 billion (20 percent of the equity of Rs. Six billion), commercial banks/DFIs & HBFCL, on consolidated basis, committed the equity of Rs. 3.2 billion (53 percent of minimum regulatory capital) and IFC & ADB, in principally, agreed to participate Rs. 900 million (15 percent of total equity) each.

Process of revalidation of feasibility and business plan of the proposed entity according to current scenario is underway.

* **Mortgage Guidelines**

The draft guidelines were shared with the stake-holders. These draft guidelines are internally under discussion in SBP before formal dissemination to banks/DFIs.

* **Guidelines for Financing to Housing Developers/Builders**

The draft guidelines, after consultation and sharing with stake-holders are under internal review at SBP, before formal approval from SBP higher management for dissemination to banks/DFIs.

* **Follow-up and implementation of recommendations of Housing Advisory Group (HAG)**

Almost all the actions pertaining to SBP, as mentioned in HAG recommendations have been initiated. Printed copy of HAG recommendations have been shared with all the implementing agencies. Presentation on HAG recommendations were made to different government departments to expedite work on implementing the HAG recommendations.

* **Housing Information System (Housing Observatory), starting with strengthening of Housing Finance /Data/Information at SBP**

A Housing Observatory is meant to work as an information hub pertaining to housing and housing finance related areas, useful for all decision makers at federal and provincial/local level. A concept paper on the formation of Housing Observatory has been prepared by SBP and shared with the relevant stake-holders for their views and comments.

* **Housing Finance Product Development and Diversification**

The Housing Finance Consultative Group (HFCG) consisting of various stake-holders has been constituted to discuss and explore ways for enhancing housing finance outreach. The first meeting of HFCG was held on May 6, 2013. HFCG will also work on different suitable products for low and middle income groups.

* **Housing Microfinance Regime**

The working group on Housing Microfinance has been constituted which had two meetings. The group will work on products for low income groups and recommendation to flourish housing microfinance.

* **Recovery Laws & Provisioning requirements**

There is a need for urgent review of Recovery Laws and also provisioning/classification requirements and FSV estimation for housing finance considering the nature and features of mortgage finance, which are distinct from other consumer finance constituents.

**Conclusion**

Development of Housing and Real Estate Sector has a direct impact on GDP growth, growth of Financial Sector, Construction Material Industry, Employment; Capital Market as well as Insurance Industry. Also, providing shelter to the masses is the mandate of every government. Hence the Government must take serious actions to reduce the shortages of houses in rapid urbanization. Most of the recommendations made by HAG pertain to the government institutions. There is need to take action for the implementation of HAG recommendations and collaborate with SBP for the involvement of financial institutions.

In order to achieve the objective to improve mortgage-to-GDP ratio from existing 0.66% to say **2-3%,** the State Bank of Pakistan can play a vital role. SBP may take following initiatives on immediate basis.

1. SBP should call a meeting of CEOs of all the banks and present them the current housing finance situation and also motivate them to take measures to enhance housing finance in their respective banks. Currently only few banks are catering Housing Finance Facility. SBP should instruct all commercial banks to start housing finance.
2. SBP should encourage the banks to increase their housing finance portfolio at least up to a certain level (may be correlated to certain percentage of total consumer financing of the bank) by the end of some target deadline (say) Dec-2014.
3. There should be one standard eligibility criteria for all banks. Currently eligibility criteria of some banks for housing finance is very strict. It should be relaxed and standard criteria should be observed by all banks.
4. As of March-2013, the outstanding of housing finance in the country was 53 Billion for commercial loans extended to the customer whereas the outstanding housing finance of bank employees was Rs.76 Billion. It reflects that the share of bank employees in housing finance is greater than the overall housing finance outstanding extended to others. This is mainly because bank employees get housing finance on subsidized rates. Hence SBP should take measures to keep the housing finance rate at lower side. Banks should also be instructed by SBP that their profit margin on housing finance should not exceed from certain cap defined by SBP. (Banks should also take the housing finance as social responsibility and not as only profit generation mode).