Housing Finance Review 2005-2011

INFRASTRUCTURE, HOUSING & SME FINANCE DEPARTMENT

STATE BANK OF PAKISTAN

Team Leader

Syed Samar Hasnain (samar.husnain@sbp.org.pk)

Team Members

Prepared by: Mr. Wasif Hussain (wasif.hussain@sbp.org.pk)

Reviewed by: Mr. Imran Ahmad (Imran.ahmad@sbp.org.pk)

Editing by: Mr. Umar Siddique (umar.siddique@sbp.org.pk)

Formatting & Review by: Mr. Karim Alam (Karim.alam@sbp.org.pk)

For feedback and queries: (ihfd.reporting@sbp.org.pk)

Acknowledgment

The guidance provided by Mr. Muhammad Ashraf Khan, Executive Director, Development Finance Group, State Bank of Pakistan and efforts of Director and officers of Infrastructure, Housing & SME Finance Department in preparing this review are highly appreciated. Editorial services provided by Mr. Umar Siddique of External Relations Department are also acknowledged.

Executive Summary

The review presents different trends and analyses concerning housing finance. It covers the overall situation and the factors hindering growth of housing finance in Pakistan. Report begins with the importance of housing for an economy. Almost 40 industries are allied with construction of houses. Further, housing statistics and state of urbanization in Pakistan have been discussed. Review covers the analysis of government policies and presents trends on disbursements, outstanding, non performing loans (NPLs) and other components of housing finance from year 2005 to 2011. Housing finance showed a vibrant increase from its inception (2002) till year 2008 due to low interest rates and massive expansion in the economy. Afterwards, housing finance portfolio took a dip and kept on shrinking till the end of review date. It was mostly attributable to financial crisis which Pakistan also faced with the world and then rise in mark-up rates. Outstanding housing finance portfolio and non-performing assets in this sector showed inverse relationship. The housing finance gross outstanding portfolio was at Rs. 84 billion at the end of year 2008 which was recorded at Rs. 59 billion at the end of year 2011. NPLs, which were Rs. 12 billion at the end of 2008, reached Rs. 19 billion by end of 2011. Next, the policy initiatives of the State Bank of Pakistan to flourish the housing finance have been discussed. The review also covers a detailed analysis on the portfolios of Islamic Banks and Islamic Banking Industry. Furthermore, review highlights the initiatives being taken by SBP to encourage financial institutions for extending housing finance in an economy.

Table of Contents

Introduction

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. The flood and rains in the recent past also added to worries of effected people. Several factors limit the supply of housing in Pakistan. Until recently, the macroeconomic environment, particularly financial instability in the 1990s and high 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.

Housing sector in Pakistan is still plagued by inadequate long term finance.

Rapid urbanization has become a common phenomenon for developing countries across the globe, indicating economic development. According to the UN-Habitat, half of the humanity now lives in cities, and the urban population will increase to 55.9 percent by the end of 2030[1]. Developing world, with highest growth rate of urban population, absorbs on an average about 5 million new urban residents every month and accounts for 95 percent of the world's urban population growth[2].

As per UN half of world population lives in cities.

The national average occupancy rate per dwelling is over six; whereas the per person room density is 3.5 as compared to the international standard of 1.1 per room. The housing shortage is especially burdensome in urban cities and towns, where more than half of the population lives in slums or irregular settlements.

More than half of our population lives in slums in urban cities and town

Since September 11, 2001, the housing sector has been facing a problem of not only supply shortages but also escalating prices. Although prices settled down in certain parts of 2010 and 2011; these have 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 sector is grossly underdeveloped and undercapitalized.

[1] UNESCAP Publication: Chapter 7:Urban Environment, State of the Environment in Asia and the Pacific 2000

[2] UNHABITAT Publication: Chapter 1: Spatial Harmony, State of the World Cities 2008/2009 Harmonious Cities

`

housing finance. However, in the last decade or so mortgage to GDP has been less than 1 percent. In the last couple of year, mark-up rates have also gone up.

Mortgage to GDP ratio is less than one percent in Pakistan.

Since 2001, the government of Pakistan has taken numerous steps to encourage the development of a more stable and vibrant housing sector. Notably, it enacted the *Financial Institutions (Recovery of Finances Ordinance) 2001*; published the 2001 National Housing Policy (NHP-2001); and granted fiscal incentives to facilitate mortgagors and banks in the federal budget 2003–04.

Housing sector in Pakistan is still plagued by inadequate long term finance.

The Government of Pakistan in its Medium Term Development Framework recognized Housing and Construction as priority sectors both having great potential for employment generation for the poor segments of the society.[3] 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 the 40 allied industries linked with it.[4]

Increasing Housing supply can boost more than 40 allied industries.

Recent studies indicate that the lack of finance is primarily a supply problem. Only one to two percent of all housing transactions in Pakistan are processed through housing finance. Otherwise, most housing finance comes from personal resources. The next source (10 percent) is the informal lending sector, which is poorly regulated, particularly in respect to consumer protection (developers' advances, for instance). The formal financial sector provides limited housing support essentially through three major sources: the government's House Building Finance Company (HBFCL), other DFIs and commercial banks. Given the potential of the housing sector both for the economy and banking sectors, the State Bank of Pakistan (SBP) has been working with the banking sector to create an enabling environment for an efficient housing sector. SBP liberalized and strengthened the regime of mortgage

Only 1-2 percent of all housing transactions are funded by formal sector.

SBP has liberalized and strengthened the regime of mortgage lending.

[3] The MTDF has also identified agriculture, water development and SMEs as priority sectors in addition to housing and construction.

[4] Pakistan Economic Survey 2006-07, Government of Pakistan.

lending by lifting various regulatory restrictions and designing an appropriate prudential framework.

SBP is working on separate PRs for housing finance.

To encourage banks/development finance institutions (DFIs) to increase their investment into the housing and construction sector, SBP issued new regulations for housing loans:

- Banks/DFIs are required to determine the housing finance limit, in both urban and rural areas, in accordance with their internal credit policy, creditworthiness, and loan repayment capacity of the borrowers.
- Banks/DFIs are required to ensure that the total monthly amortization payments of consumer loans, including housing loans, should not exceed 50 percent of the net disposable income of the prospective borrower.
- Banks/DFIs have been allowed to originate a housing loan at a debt-equity ratio of 85:15 for any tenure.
- In order to curb speculation, banks/DFIs are not allowed to provide housing finance purely for the purchase of land/plots.
- Banks/DFIs are encouraged to develop floating-rate housing finance products.
- The house financed by the bank/DFI is required to be mortgaged in banks/DFI's favor by way of equitable or registered mortgage.

Housing loans may originate at a debt-equity ratio of 85:15.

Banks/DFIs are not allowed to provide housing finance for the purchase of land/plots.

Urbanization

According to certain estimates the population of Pakistan is over 173.5 million as of July 2010[5]; increasing approximately at the rate of two percent per annum[6]. Urban population is rapidly increasing. There are approximately 10 urban centers in Pakistan with Karachi and Lahore, the two biggest centers, alone constitutes 62 percent of the total population of these 10 cities. The report, *State of the World's Cities 2008/2009*, by UNHABITAT, estimates that population in these cities of Pakistan will collectively grow at the rate of 30 percent between 2010 and 2020. Moreover, population density has also increased from 142 persons per km^2 in 1990s to 206 persons per km^2 by 2007. Of this highly concentrated urbanization trend, over 45 percent of the

Of the 10 urban centers in Pakistan, Karachi and Lahore alone constitute about 62 percent of its population.

Population density has increased from 142 persons per km^2 to 206 per km^2

[5] All of the estimates are based on the recent projections carried out by the Sub-Group II on Population Projections for the 10th Five Year Peoples Plan (2010-15). The Sub-group consisted of the representatives of the National Institute of Population Studies (NIPS), Federal Bureau of Statistics (FBS) and Planning Commission.

[6] Statistical Yearbook for Asia and Pacific 2007& key indicators for Asia and the Pacific 2008

total urban population is believed to be living in slums. This high concentration of slum households in Pakistan can be associated with a variety of factors, including lack of investment in infrastructure, housing sector, poverty and social & political instability.

High Slum households in the country are attributed to a number of factors.

The housing sector of Pakistan is going through highly testing times. The current issues range from acute shortage of housing units, housing sector functional inefficiencies, etc. to the extra ordinary losses by the floods. A well researched solution to addresses the challenges across short, medium, and long term policies is needed.

Pakistan is the sixth most populous country in the world.

State of Housing in Pakistan

With a population of more than 173.5 million, Pakistan is the sixth most populous country in the world. For developing countries, experiencing rapid urbanization, the inability of the existing social infrastructure to meet the growing needs emanating from urbanization, pose a major challenge for governments, with Pakistan as no exception. The country is currently plagued with problems regarding terrorism; the economy is in a dire state with several sectors under-performing and several others affected due to severe problems in the water and power sector. Poverty is at an extreme level, inflation and markup rates prevail in double digits since early 2009, accompanied by inequitable distribution of income. Moreover, the lack of infrastructure, substandard living conditions, exacerbated by poor law and order situation has really affected the whole economy substantially and the Housing Sector in particular.

Housing sector in Pakistan is still plagued by inadequate long term finance.

Economy in general and Housing sector in particular has been affected badly due to a number of reasons.

The housing sector, already having huge deficit of housing units, further received a negative hit with the 2010-11 floods and rains. The loss to the existing infrastructure from the floods and rains was substantial.

National Housing Policy, 2001

In 2001, the Government assessed the need to improve the supply side of the housing. By keeping in mind the purpose of provisioning of shelters to low and middle income groups, Government announced the 'National Housing Policy (NHP) 2001'. In its true essence, the NHP was very commendable. But in later days, Government failed to implement it in its letter and spirit. Following are the salient features of the NHP 2001

GOP announced a commendable National Housing Policy in 2001

Major emphasis on:

- ✓ Resource mobilization
- ✓ Land availability
- ✓ Incentives for home ownership
- ✓ Tax incentives
- ✓ Incentives to developers and constructors
- ✓ Promotion of R&D activities to make construction cost effective.

One of the features of NHP 2001 was to promote R&D activities in order to make construction cost effective

Objectives:

To create affordability especially for the middle and low income groups. One of the corner-stones of the Policy is to ensure development of housing for the poor and needy and housing for the majority rural population through the use of different instruments like free land, cross-subsidy and concessionary finance, etc.

The whole NHP 2001 can be accessed at the following link.

http://www.pakboi.gov.pk/pdf/Sectoral%20Policies/National%20Housing%20Policy%202001.pdf

Ensuring development of the housing for the poor and rural population was the corner stone of NHP 2001

General Statistics[7]

General Statistics	
Description	Stats
Population (2009-10)	170 million
Population Density	214.3/km^2
Urban Population	38% of Population
Projected Growth of Population	1.6%
Housing Backlog	8 million units
Annual Increase in Housing Backlog	300,000 units
Room Density	3.5 persons/room
Per Capita Income	$1197
GDP (FY 2010-11)	$210.8[8] billion
Housing Finance as % of GDP	0.74%

Annual increase in housing backlog is approximately 300, 000 per year.

[7] Source Wikipedia

[8] http://tribune.com.pk/story/180824/economic-survey-2010-2011-pakistan-failed-to-meet-growth-target/

Issues Faced by the Industry

Housing sector in Pakistan is facing a number of challenges.

The following issues pertaining to the Housing and Housing Finance sector prevail due to certain reasons. Firstly, the required support from the relevant institutions is not being provided which is a major reason for the prolonged existence of these hurdles. Secondly, the state of the economy is in inertia therefore it is not providing the boost that is required for this sector to perform to its potential. Thirdly inflation, high transaction costs and high rate of investment makes the eradication of these issues even harder. The issues prevailing are as under:

- ✓ Weak property rights
- ✓ Inadequate land development framework
    - Inefficient legal framework
    - Fragmented land ownership and titling
    - Inefficient land information systems
    - Unused government land
    - High stamp duty/registration fees for conveyance and mortgage deeds
    - Weak tax framework and enforcement environment
    - Ineffective land dispute resolution mechanisms
- ✓ Embryonic property development framework
    - Poor master planning and governance issues at national and local government levels
    - Multiple institutions and administrative procedures
    - Problematic zoning restrictions
    - Restrictive building codes
    - Unreliable utility connections
- ✓ Emerging building industry
    - Fragmented building industry
    - Unorganized real estate agencies
    - Lack of developer finance
    - Skewed tenant laws
- ✓ Rising land prices and rapid urbanization has become a challenge for increasing number of people
- ✓ Housing shortage
- ✓ Lack of housing finance

Inefficient Land Information System is a major challenge for the policy makers

Poor master planning and challenges related to governance at national, provincial and district level hinders growth of the sector

- ✓ Improper implementation of foreclosure laws
- ✓ Outdated building and zoning regulations

Failure to revive the land record system (LRIS) is the prime reason for housing stalemate

The current housing stalemate is the result of several problems:

- ✓ Political and economic environment
- ✓ Failure of the government to intervene on behalf of the consumer
- ✓ The "Cooperatives' Scandals"
- ✓ Growing poverty
- ✓ Deliberate neglect of the housing sector
- ✓ Political ploy of katchi abadis issue
- ✓ Archaic institutional and legal framework at all levels
- ✓ Failure to fully implement the HAG recommendations.
- ✓ Failure to revive the Land Record System and to introduce LRIS (Land Record Information System)
- ✓ Flawed foreclosure laws
- ✓ Lack of implementation of Recoveries Ordinance 2001 Sec 15(2)[9]
- ✓ Over-lapping jurisdiction across various development authorities at different level such as provincial, city, district, cantonments

Overlapping jurisdiction across various development authorities at different levels is yet another source of concern.

Housing Finance in Pakistan

In Pakistan, around 27 commercial banks, House Building Finance Company Limited (HBFCL); a specialized housing bank and one DFI are catering to housing finance. HBFCL is the only specialized bank in the country, which has been providing housing finance to public since 1952. In 1994, the government decided that HBFCL should operate as a market-oriented financial institution. Commercial banks entered the mortgage business during 2003 contributing very small share in the housing finance. Only few commercial banks extended housing

HBFCL is catering to the housing needs as a specialized bank since its inception in 1952

[9] **15. Sale of mortgaged property. -** (2) In case of default in payment by a customer, the financial institution may send a notice on the mortgagor demanding payment of the mortgage money outstanding within fourteen days from service of the notice, and failing payment of the amount within due date, it shall send a second notice of demand for payment of the amount within fourteen days. In case the customer on the due date given in the second notice sent, continues to default in payment, financial institution shall serve a final notice on the mortgager demanding the payment of the mortgage money outstanding within thirty days from service of the final notice on the customer.

loans during 2003. Out of 14 banks, 3 held more than 80 percent share in outstanding. By the end of December 2011, share of HBFCL reduced from 55 percent in 2004 to 22 percent (Table 1 in Annexure B) and commercial banks and DFIs are collectively now enjoying 78 percent share in outstanding. Although HBFCL'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.

The total number of borrowers at the end of Dec-11 was 91,398.

Commercial banks and HBFCL together reported total outstanding of Rs. 59.38 billion, as on December 31, 2011. Table 1 in annexes provides a snapshot of the housing finance in Pakistan. The total number of borrowers at the end of December 31, 2011 was 91,398; HBFCL accounting for more than 75.5 percent of these borrowers. The current overall weighted average interest rate is 16 percent with maturity periods being 12.2 years, on an average. The percentage of financing (Loan to Value ratio) extended by banks has declined from 49.3 percent (during quarter ending December 2010) to 40.1 percent (during quarter ending December 2011). The Housing Finance sector did show progressive performance in the last five years but that progress has not been in line with the potential that this sector has. NPLs of the Banks & DFIs or HBFCL have increased significantly. The yearly shortfall of 300,000 housing units which has accumulated over the years to more than 1.5 million gives the impression that this huge demand remains unattended. And the extremely low housing loans-to-GDP ratio is a further proof to the dismal performance of the housing finance sector. Further, the disbursements being made over the years are so stumpy that it can easily be concluded that the Banks & DFIs are only serving the higher income segment of the society. This shows that the Banks & DFIs are only opting for low risk exposure and easy profits which is also a reason for such an immense shortfall of housing units. The Housing Finance sector has immense potential but so far its performance has remained gloomy due to lack of interest shown by banks & DFIs towards the low income segments.

The housing sector did not saw a significant performance in the last five years.

Housing sector in Pakistan has immense potential for growth.

Boom of Consumer Finance in Pakistan

The evolution of consumer finance is a more recent phenomenon.

Consumer finance is an established financial product across the globe, particularly in mature economies, where it constitutes a significant portion of banks' lending portfolios. In Pakistan, however, the evolution of consumer finance is a more recent phenomenon, as banks have traditionally focused on lending to the corporate sector and public sector entities. While two prominent foreign banks took the lead in introducing credit cards in the banking sector in the mid-'90s, their outreach was limited to the top-tier of salaried customers and businessmen.

Numerous factors have contributed for the widespread popularity of consumer finance in the country.

A combination of factors is responsible for the widespread popularity of consumer finance in recent years: the financial liberalization process over the last decade or so, has led to the creation of a banking system which is largely owned and operated by the private sector, and is free to allocate resources in response to the demands. Secondly, the influx of liquidity in the banking sector since FY02 motivated banks to diversify and expand their earnings base by venturing into previously untapped areas. And thirdly, the easy monetary policy stance of the central bank from FY02 to FY05 provided eligible customers with financing options at historically low rates to meet their consumption demand. In this backdrop, consumer finance emerged as one of the most promising asset products for banks.

Financial liberalization process over the last decade has resulted into creation of private sector owned banking system.

Consumer finance has helped middle-class to raise their standard of living by purchasing various goods which were previously treated as luxuries and in reach of only a few. The demand for these goods has also led the manufacturing sector to expand its capacity, such that both backward and forward linkages have contributed to the expansion in economic activities. Banks' auto loans product and loans for consumer durables, for instance, have been instrumental in this aspect. Though still small in proportion, the rising demand for mortgage finance reflects the individual borrowers' need and financial capacity, to acquire private ownership of housing units. Hence, in promoting their consumer financing products, banks have played their due role in economic development in the country.

Consumer finance helped middle class in raising their standard of living

Despite many positive developments associated with consumer finance, its role in promoting consumerism in Pakistan has generated a debate, with mostly negative connotations.

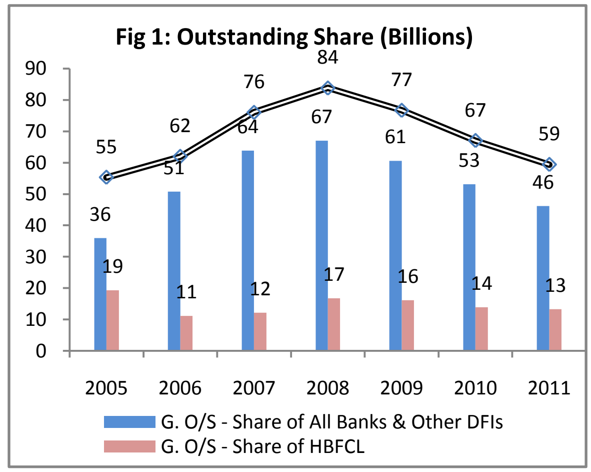
Gross Outstanding

Figure 1 shows the total Gross Outstanding of the mortgage industry, Gross Outstanding of Commercial Banks & DFIs (Excluding HBFCL) and Gross Outstanding of HBFCL.

The gross outstanding of the housing sector saw a rising trend till 2008 and then a downwards journey.

Overall Industry Gross Outstanding Trend

From Figure 1, at the end of year 2006, the gross outstanding of the industry increased from Rs. 55 billion to Rs. 62 billion showed an increase of 13 percent and kept on increasing till the end of year 2008. At the end of year 2008, the gross outstanding amount was Rs. 84 billion showed an increase of 11 percent when compared to previous quarter and increased by 53 percent when compared to Year 2005. After year 2008, the gross outstanding started decreasing, during the year 2009, the gross outstanding decreased from Rs. 84 billion to Rs. 77 billion showed a decrease of 12 percent and kept on decreasing. At the end of year 2011, the gross outstanding decreased of 12 percent from Rs. 67 billion to Rs. 59 billion but remained higher by 7 percent (Rs. 8 billion) when compared to the year 2005.



Share of Commercial Banks & DFIs (Excluding HBFCL)

From Figure 1, by the end of year 2005, the share of banks and other DFIs (excluding HBFCL) was 65 percent (Rs. 55 billion) of industry gross outstanding amount. The share, in terms of percent, of banks and other DFIs continued to grow till the end of year 2007 but in terms of absolute amount grew till the end of year 2008. The share of all banks and other DFIs was 84 percent of the industry gross outstanding amount and increased from Rs. 51 billion to Rs. 64 billion at the end of year 2007. Furthermore, at the end of year 2008 the outstanding amount of all banks and DFIs increased by Rs. 8 billion from Rs. 76 billion to Rs. 84 billion but in terms of share in industry gross outstanding amount showed a decrease of 4 percent from 84 percent to 80 percent when compared to the position reported in year 2007. During the Year 2010, the share of commercial banks, in terms of absolute amount, decreased by Rs. 8 billion (13 percent) from Rs. 61 billion to Rs. 53 billion but remained same at 79 percent of total gross outstanding when compared to the year 2009. At the end of year 2011, the gross outstanding amount of commercial banks and DFIs decreased by Rs. 7 billion (13 percent) from Rs. 53 billion to Rs. 46 billion and the share in industry gross outstanding amount was 78 percent.

The share of commercial banks and DFIs saw a rising trend till 2008 and then a decreasing trend till 2011

At the end of Dec-11, the gross outstanding of the commercial banks and DFIs, excluding HBFCL, stood at Rs.46 billion.

Share of HBFCL

From Figure 1, at the end of year 2005, the share HBFCL was 35 percent (Rs. 19 billion) of industry gross outstanding amount. At the end of year 2008, the outstanding amount, in terms of amount, increased by 42 percent from Rs. 12 billion to Rs. 17 billion and the share in industry outstanding increased from 16 percent to 20 percent. By the end of year 2009, the outstanding amount decreased by 6 percent (Rs. one billion) from Rs. 17 billion to 16 billion and the share in the industry outstanding amount from 20 percent to 21 percent. Furthermore, at the end of year 2010, the outstanding amount of HBFCL decreased by Rs. one billion from Rs. 14 billion to 13 billion when compared to previous years and decreased by Rs. five billion in comparison to year 2005. Further, during the year 2011, the share of HBFCL in industry outstanding amount was 19 percent which was 21 percent in previous year and 35 percent in the year 2005.

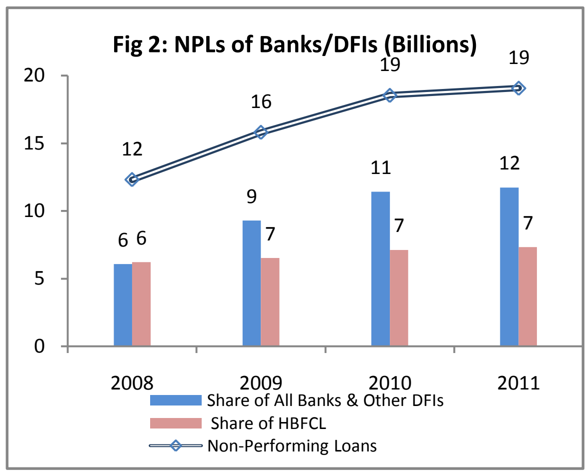
At the end of Dec-11, amount outstanding in respect of HBFCL was Rs.13 billion.

Non-Performing Loans

Figure 2 demonstrates the condition of Non Performing Loans (NPLs), Share of Commercial Banks & DFIs (Excluding HBFCL) and Share of HBFCL in industry NPLs.

Overall Industry NPLs Trend

From Figure 2, at the end of year 2008, mortgage industry witnessed the NPLs at Rs. 12 billion. During the year 2009, the NPLs amount increased by Rs. four billion, in terms of absolute amount, from Rs. 12 billion to 16 billion and in terms of percentage, increased by 33 percent when compared to previous year. During the year 2010, the NPLs increased by Rs. three billion, in terms of absolute amount, from Rs. 16 billion to Rs. 19 billion and increased by 16 percent when compared to previous quarter and increased by 37 percent when compared to the NPLs reported in year 2008. At the end of year 2011, the NPLs amount remained unchanged at Rs. 19 billion when compared to year 2010 and increased by 7 billion and 33 percent when compared to NPLs recorded at the end of year 2008.



Share of All Banks & DFIs (Excluding HBFCL) in Industry NPLs

From Figure 2, at the end of year 2008, the NPLs of commercial banks & DFIs (excluding HBFCL) were recorded at 6 billion accounted for 50 percent of the total industry NPLs. During the year 2009, the NPLs of commercial banks & DFIs (excluding HBFCL) increased by Rs. 3 billion (50 percent) from Rs. 6 billion

NPLs of the mortgage industry increased from Rs. 12 billion in 2008 to Rs. 19 billion in 2011.

to Rs. 9 billion. At the end of year 2011, the NPLs of commercial banks & DFIs (excluding HBFCL) were recorded at Rs. 12 billion showing an increase of Rs. 1 billion (9 percent) when compared to previous year and showed an increase of 100 percent (Rs. 6 billion) when compared to the NPLs recorded at the end of year 2008.

The rising trend in NPLs is attributable to the prevailing macroeconomic conditions of the country.

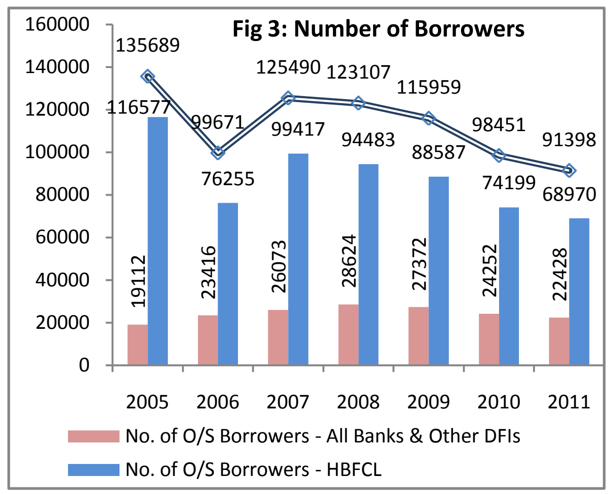
Share of HBFCL in Industry NPLs

From Figure 2, at the end of year 2008, the share of HBFCL's NPLs in industry NPLs was recorded at 50 percent (Rs. 6 billion). During the year 2009, the HBFCL NPLs increased by Rs. 1 billion (17 percent) from Rs. 6 billion, as of year 2008, to Rs. 7 billion. Furthermore, for the year 2009, 2010 and 2011, the NPLs of HBFCL remained at Rs. 7 billion. Moreover, the share in industry NPLs during the year 2009, 2010 and 2011 was 44 percent, 37 percent and 37 percent respectively.

The share of HBFCL in total industry NPLs is about 50%.

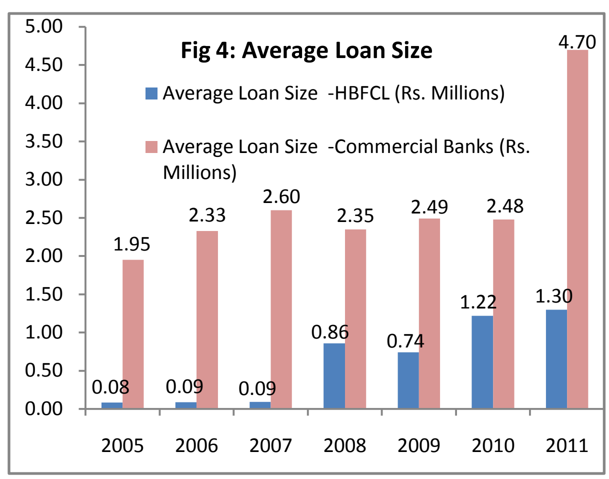
Number of Borrowers

From 3 shows the number of total borrowers, number of borrowers of all banks & DFIs (Except HBFCL) and number of borrowers served by HBFCL. From Figure 3, total number of outstanding borrowers, during the year 2005, were recorded as 1,35,689 out of which 86 percent of borrowers were from HBFCL and 14 percent from commercial banks & other DFIs. During the year 2008, the total borrower decreased by 19 percent (2383 borrowers) from 1,25,490, as of year 2007, to 1,23,107 and at the same time the share of all banks & DFIs (except HBCL) and HBFCL was reported as 23 percent and 77 percent respectively. At the end of year 2010, the total outstanding borrowers were reported as 91,398 out of which 25 percent served by all commercial banks and DFIs (except HBFCL) and 75 percent catered by HBFCL.



Average Loan Size

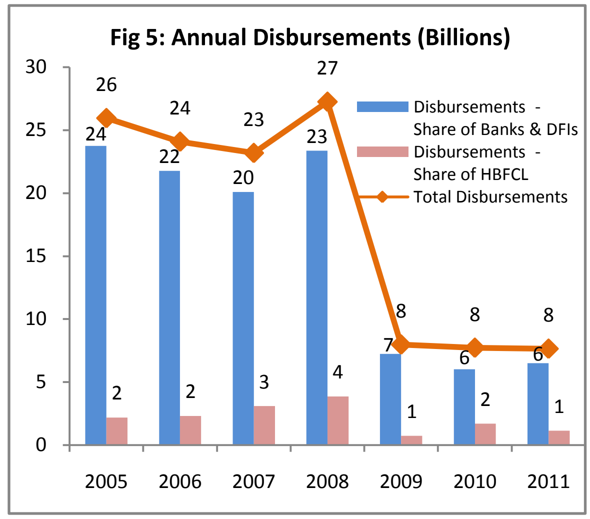
The average loan size of HBFCL was Rs. 0.08 million and of all banks and DFIs was Rs. 1.95 million, as of December 2005. The average loan size of HBFCL and all banks and DFIs continued to grow every year. By the end of year 2011, the average loan size of HBFCL and all banks and DFIs was Rs. 1.3 million and Rs. 4.7 million respectively. The average loan size of HBFCL has grown by 1525 percent in year 2011 when compared to year 2005. The



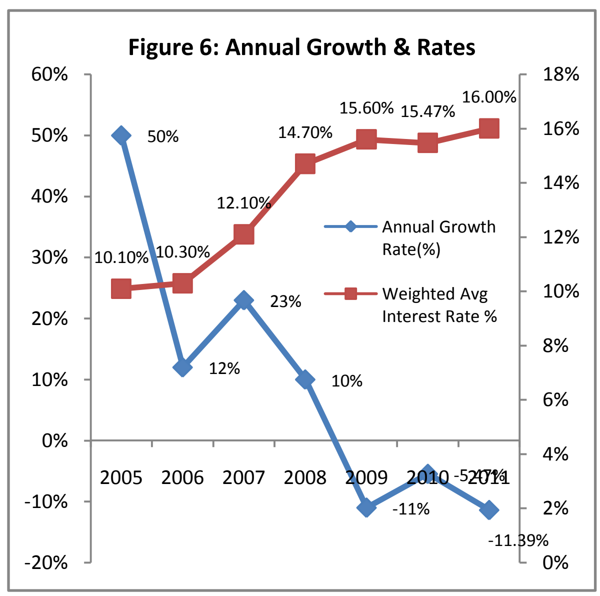
average loan size of all banks and DFIs has grown by 141 percent in year 2010 when compared to year 2005. The enormous percentage change in average loan amount is, perhaps, due to high prices of property in the country.

Annual Disbursements

The total disbursements, as of year 2005, were Rs. 26 billion. The total disbursements of year 2005 contained Rs. 2 billion of HBFCL and Rs. 24 billion of all banks and DFIs. The share of HBFCL was 8.47 percent of total disbursements made in year 2005. The share of all banks and DFIs was 91.53 percent of the total disbursements made in year 2005. The share of HBFCL continued to grow till the end of year 2008. The share of HBFCL and all banks and DFIs was 14.20 percent and 85.80 percent respectively of the total disbursements made in year 2008. In year 2009, the share of HBFCL in total disbursements made in year 2009 declined to 9.19 percent. In year 2010 HBFCL's share in total disbursements was 9 percent of the disbursements made during the year. The total disbursements showed downward trend till year 2011 except in year 2008. In year 2008, the disbursements were increased by 18 percent when compared to year 2007 and increased by 5 percent when compared to base year 2005. After year 2008 disbursements showed downward trend. In year 2009 disbursements decreased by 71 percent when compared to year 2008 and decreased by 69.30 percent when compared to base year 2005. The yearly disbursements in year 2010 decreased by 33 percent when compared to yearly disbursements of year 2009 and decreased by 79.40 percent when compared to base year 2005. The decrease in yearly disbursements in year 2010, in terms of absolute amount, was Rs. 19,301 when compare to base year 2005. During year 2011, total disbursements made by the housing finance industry were Rs. 7,636 million. Commercial Banks and Other DFIs (except HBFCL) disbursed Rs. 6,498 million during the year showing an increase of 8 percent (Rs. 482 million) over the last year. Meanwhile, HBFCL disbursed Rs. 1,138 million during the year ended December 2011. Yearly disbursements made by HBFCL decreased by 16.98 percent (Rs. 560 million) over the year from December 2010 to December 2011.

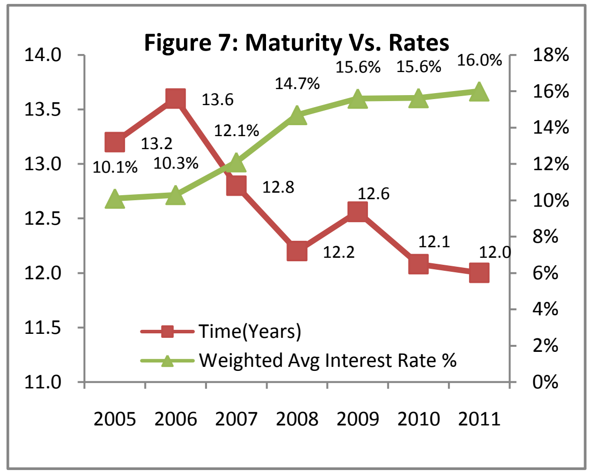


Total disbursements decreased from Rs. 26 billion in 2005 to Rs. 8 billion in 2011.



Annual Growth and Markup Rates (%)[10]

The industry has shown growth in early years because of the entry of commercial banks. The industry continued to grow till year 2008 but at diminishing rate. In year 2008, the weighted average markup rate jumped by 260 basis points. The markup rates showed upward trend. Due to high markup rates, the affordability of finance became out of reach. Increase in markup rates lowered the disbursements and decrease in disbursements lowered the growth. There is inverse relationship between the markup rate and growth in disbursements.



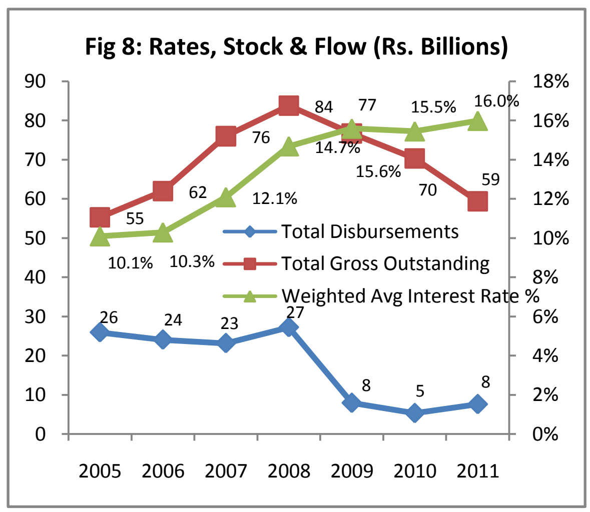
Average Maturity Periods (Years) Vs. Weighted Average Interest Rate

The average maturity period in year 2005 at 10.10 percent was 13 years. The maturity period increased to 13 ½ years in year 2006 when rate was 10.30 percent. Markup rate continued to increase and the average maturity period continued to decrease. When the rate goes up the affordability of loan for longer term is not viable. The average maturity period came down to 12 years when the rate was 16 percent by the end of year 2011. There is inverse relationship between the markup rate and the average maturity period.

Weighted average interest rates increased from 10 percent in 2005 to 16 percent in 2011

Weighted Average Interest Rate Vs Disbursement & Outstanding

The graph shows the relationship between the interest rate and the outstanding amount and the disbursements. As the interest rate grew the amount of disbursement grew but at diminishing rate. In year 2009 the disbursement amount took a large dip as the interest rate was continue to grow and in a result outstanding amount started decreasing. There is inverse relationship between disbursements and interest rate and direct relationship between disbursements and outstanding amount.



[10] Growth rates were high since commercial banks had just entered the mortgage market.

Share of Banks in Housing Finance (category-wise)

The overall market share (based on gross outstanding) of commercial banks (excluding DFIs) slightly changed by 1 percent over the last year, from 79 percent to 80 percent. Within commercial banks, the share of private banks in the total outstanding, overt the year, increased marginally from 46 percent to 48 percent (Figure 9). The share of public sector banks in the total outstanding, over the year, remained unchanged, at 14 percent. The share of foreign banks decreased from five percent to one percent due to takeover of portfolio of one foreign bank by a commercial bank. Share of HBFCL marginally decreased by one percent and that of Islamic Banks marginally increased by one percent from year 2010 to year 2011.

The share of Islamic Banking Industry (Islamic Banks and Islamic Banking Divisions of Conventional Banking), Conventional Banking (excluding HBFCL) and HBFCL in the total outstanding was 17 percent, 61 percent and 22 percent respectively on Dec 31, 2011 (Figure 9.1). IBDs (13 windows) and Islamic banks (05 banks) have 28 percent and 72 percent share 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.

Fig 9: Share of Banks As on Dec-11

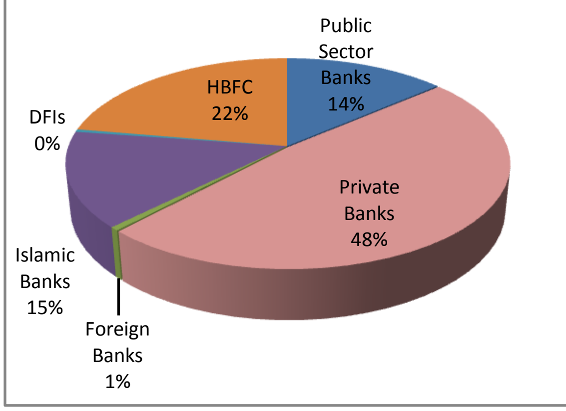
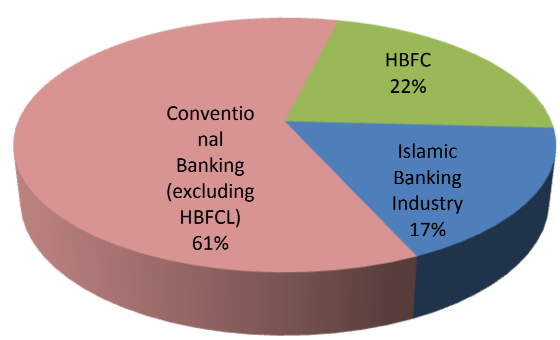
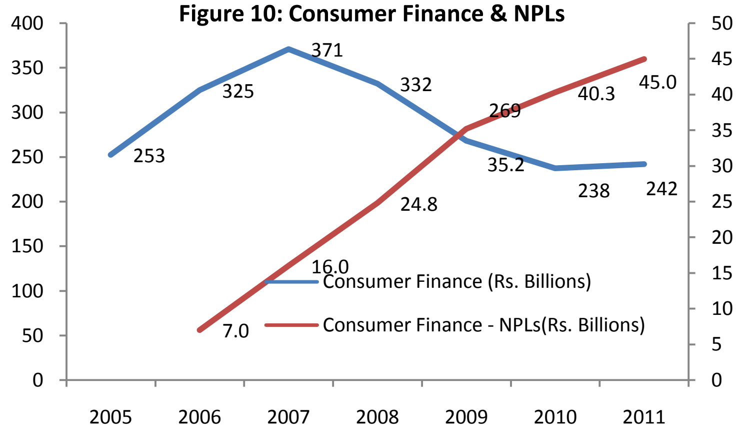


Fig 9.1: Share of Banks as on Dec-2011



Consumer Finance & Consumer Finance NPLs [11]

Figure 10: Consumer Finance & NPLs

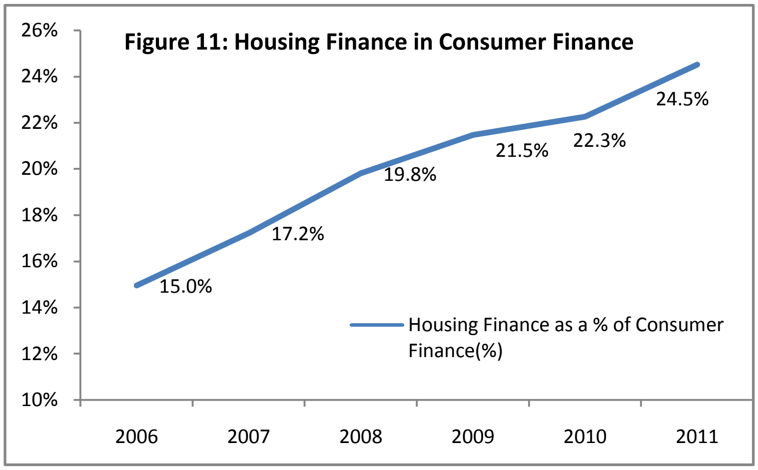


[11] Source: Quarterly unaudited data submitted by banks via Reporting Chart of Accounts (RCOA).
Consumer Finance - Domestic operations only

Housing Finance as a % of Consumer Finance

The housing finance has shown the improvement when the commercial banks entered into this. The size of housing portfolio continued to grow till year 2011 as part of consumer finance.

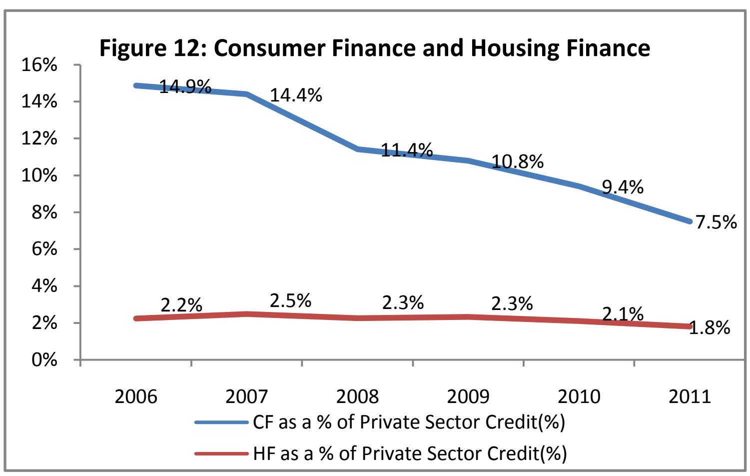
Consumer finance NPLs increased from Rs. 7 billion in 2005 to Rs. 45 billion in 2011



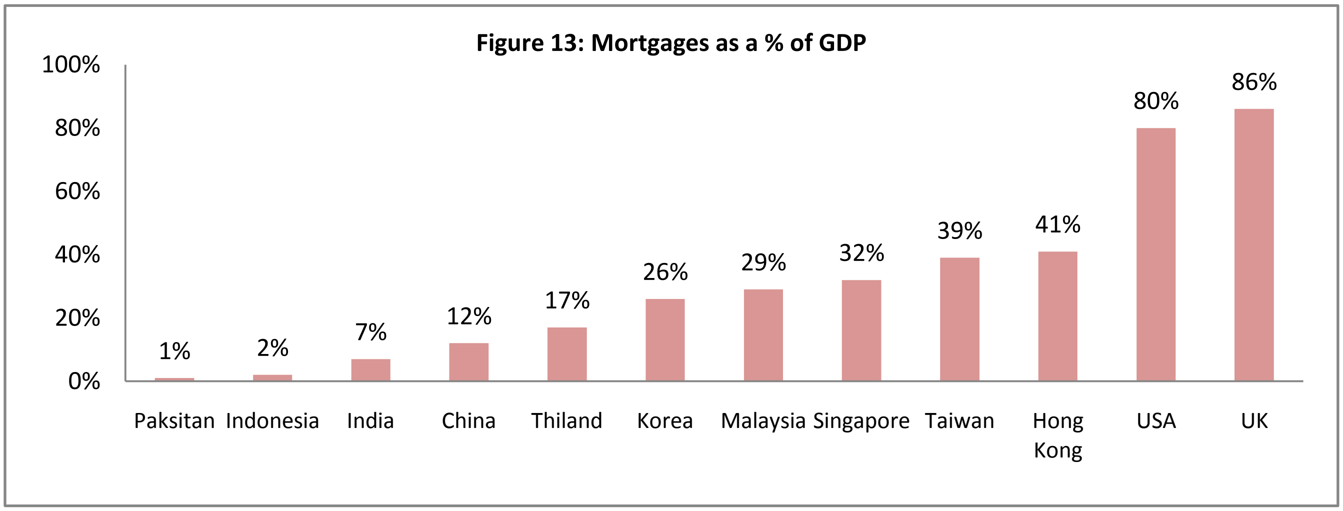
Housing finance share in consumer finance increased from 15 percent in 2005 to 24.5 percent in 2011

Consumer Finance as a percentage of Private Sector Credit/ Housing Finance as a % of Private Sector Credit

Housing finance as percent of private sector credit declined from 2.2 percent in 2006 to 1.8 percent 2011



Mortgages as a percentage of GDP – Country-wise (2009)



Housing Finance Regulations

Key aspects of the current Prudential Regulations, which are part of prudential regulations of consumer finance, pertaining to housing finance are as under:

Purpose of loan permitted	To purchase, construct/build or renovate the residential property or for land purchase and construction thereupon.
Maximum permitted Debt Equity ratio	85:15
Maximum permitted Debt burden ratio	Monthly amortization payments of all consumer loans should not exceed 50 % of net disposable income.
Loan tenure	Based upon the internal credit policy of Banks/DFIs

Maximum permitted debt burden ratio has been set in Prudential Regulations of consumer finance

All non-performing loans should be classified and provided for in the manner laid down in Prudential Regulations.

Interest rate/Markup to be charged shall be based upon Banks/DFIs internal lending parameters. Mark up has to be charged on the basis of 360 days per year.

For updated version of Prudential Regulations, Banks/DFIs shall visit SBP website (http://www.sbp.org.pk/publications/prudential/index.htm).

Regulatory Requirements for Consumer Financing[12]

Housing finance regulations are currently part of Consumer regulations.

Since prudential regulation of housing finance is a part of prudential regulation of consumer finance, it seems relevant to shed light on some of the regulatory requirements for consumer financing. SBP has reviewed Prudential Regulations for Consumer Financing, and continues to issue directives in response to the changing market dynamics, to ensure the prudent risk management of banks' consumer finance portfolio.

Safeguards have been laid out in Consumer regulations

Some of the safeguards laid out in the regulations are:

1. Prior to offering consumer finance as a product, banks/DFIs are required to establish appropriate risk management systems, in addition to strong internal audit and control functions. They have to ensure that the staff involved in dealing with customers and processing these applications are adequately equipped and trained.
2. Banks/DFIs are required to ensure the implementation of effective collections procedures and mechanisms to efficiently obtain repayment of monthly loan installments, while also dealing appropriately with delinquent customers.
3. Banks are required to obtain the e-CIB Credit information report prior to approval of a loan to ensure that the customer has a clean credit history and is not over-leveraged.
4. Banks are advised to institute necessary checks to ensure that clean loans are not used to participate in Initial Public Offerings (IPOs).
5. Specified limits on the exposure against total consumer financing as well as percentage of classified consumer financing, both in terms of capital, are laid out in the Prudential Regulations.
6. Banks are required to ensure that total financing facilities are commensurate with the borrower's income.
7. Banks are required to maintain a general reserve at least equivalent to 1.5 percent of the consumer portfolio which is fully secured, and 5 percent of the unsecured portfolio, to protect them from the pro-cyclical nature of this business.
8. Banks follow stringent provisioning requirements against classified loans, which protect them from potential erosion in asset quality.

Banks are required to obtain e-CIB report prior to approval of a loan.

Banks are required to maintain a general reserve for secured and unsecured portfolio.

[12] Source: Banking Policy and Regulations Department (BPRD), State Bank of Pakistan

Housing Finance Policies of Banks/DFIs

It is very important to compare the policy with practices. Housing finance policies of the banks set parameters that cover demographics, income and financing terms for the borrowers. Demographics cover areas namely nationality, age, and profession of the borrower. Income covers the borrower's salary (if employed) or income (from business) and employment tenure. Financing terms include setting financing limits, loan tenure, debt-equity ratio and the debt burden of the borrower.

There is a big difference in written policies of the banks and their actual practices

But difference has been found between the written policies and the actual practices. The actual housing finance policies practiced by the banks in Pakistan are very stringent and cater only to the high income groups. Most of the banks are financing only in big cities i.e. Karachi, Lahore, Islamabad and Rawalpindi. Banks have internally identified the positive areas even within big cities. Banks do not finance out of these positive list areas. Areas are segregated on the basis of ease in transfer of title documents and marketability and accessibility.

Banks segregate areas on the basis of ease in transfer of title documents and marketability and accessibility.

Banks do not cover the middle income groups even when the middle income groups fulfill the criteria identified in the policies. There is strong need to devise the policies which are helpful for banks and for borrowers as well.

Initiatives taken by State Bank of Pakistan

The Housing Advisory Group

In pursuance of National Housing Policy (NHP) - 2001 issued by the Government of Pakistan in December 2001, and to implement the recommendations of the Housing Finance Conference held in December 2002, SBP constituted an Advisory Group on Housing Finance, comprising eminent bankers and housing sector specialists. The group had the mandate to identify bottlenecks, propose measures for instituting an effective and broad-based housing finance system in the country. The Advisory Group had developed Reform Agenda required for the promotion and development of a sustainable market-based housing finance system in the country. As a first step, it has been successful in persuading the Government to provide fiscal incentives to housing sector in the Federal Budget 2003-04, in liberalizing credit regime for housing finance,

SBP constituted HAG to implement recommendations of housing finance conference in Dec-2002

HAG has made a number of recommendations and various projects are in different stages of completion.

broadening the scope of Credit Information Bureau at SBP, establishing Credit Information Bureau in the private sector for consumer loans, rationalizing stamp duties, registration fee, and property taxes, and ascertaining enforcement of Recovery Procedure in case of default by mortgagors. The journey still remains far from over as still not all of the recommendation have been practically adapted although efforts are in place and the process is being carried forward.

The HAG made a number of recommendations to enhance access to financial services. SBP has already disseminated the recommendations to the concerned stakeholders and is also in the process of initiating measures for establishment of secondary mortgage market.

Mortgage Refinance Company

The establishment of Mortgage Refinance Company (MRC), as recommended by the World Bank, has been initiated to explore fixed rate or hybrid models of mortgages, improve liquidity of the financial system, and enable banks and housing finance companies to prudently match maturity profile of their assets and liabilities. In the medium to long-run, the establishment of MRC will also aid in the provision of low cost housing finance. MRC will also facilitate development of private debt market and open-up investment opportunities for long term institutional investors, such as pension and provident funds, and insurance companies, which are looking for diversification of their investment portfolios. Business plan and financial feasibility study has already been carried out. At present, projected equity commitments have been secured from commercial banks. Government of Pakistan has also been very supportive on this initiative and has committed to equity into MRC. IFC and ADB are also analyzing the business plan and feasibility and would hopefully contribute equity. Memorandum & Articles of Association have been prepared as a part of incorporation process.

Equity commitments for MRC have been secured from commercial banks.

IFC and ADB would make equity contributions hopefully.

HAG has made 10 recommendations a detailed report.

A little chronology below sets out its main features and milestones with current status.

- ✓ This Housing Advisory Group (HAG) after an in-depth study has come up with a set of recommendations. Provision of long term funding through the formation of a Mortgage Refinance Company is one of the 10 recommendations put forward by the HAG committee. MRC is not only aimed at providing liquidity facility to primary mortgage lenders and enabling them to prudently match maturity profile of their assets and liabilities, it would also help in developing hybrid mortgage models and develop capital markets.

MRC would work on PPP Model.

- ✓ SBP engaged IFC to conduct a feasibility study and prepare a preliminary business plan for setting up a mortgage liquidity facility in Pakistan i.e. the Mortgage Refinance Company (MRC) through public private partnership.

MRC would provide financial resources to PMLs.

- ✓ MRC's business model and feasibility report was presented to prospective investors and stakeholders on December 4, 2009 to seek equity commitments. Following are the objectives of MRC:
    - Develop the Primary Mortgage Market
        - Provide financial resources to enable primary mortgage lenders (PMLs) to grant more loans at fixed/hybrid rates and for longer tenure
        - Prepare PMLs for BASEL II compliance by narrowing the gap between the maturity structure of the housing loans and the source of funds
        - Ensure loan standardization across primary lending institutions which is necessary for any future securitization of mortgages
    - Develop the capital markets
        - Provide more private debt securities (Bonds) with different maturities and rates for investment of surplus funds
        - Promote ABS as a tool for raising funds from the capital markets
        - Create a Yield Curve to serve as a benchmark for other institutions

MRC would provide more private debt securities.

SBP and Ministry of Finance are actively pursuing the incorporation of MRC.

SBP is working on Housing Finance Guidelines

Examples in regional countries

- ✓ Cagamas Berhad, Malaysia.
- ✓ Jordan Mortgage Refinance Corporation.
- ✓ Egyptian Mortgage Refinance Company.

Housing Finance Guidelines

Guidelines for Housing Finance have been drafted and sent to PBA and feedback has been received from them. And the amendments suggested by PBA are being looked into. The guidelines are expected to be issued soon.

SBP is working on issuing separate Housing finance Regulations for the industry.

Housing Finance Prudential Regulations

A well defined, effective, and prudent regulatory framework is always instrumental for stability and growth of an economy. Housing and housing finance are central sustainable growth and development of an economy.

Since housing finance is different from other products of consumer finance like personal, car, and credit card loans on many grounds, there has been growing demand from all stakeholders to separate housing finance from consumer finance and to launch full-fledged housing finance prudential regulations.

There is a feeling that the existing prudential regulations of SBP do not address all needs of housing finance sector.

The existing prudential regulations of SBP do not address all needs of housing finance sector, hence providing impetus for separate housing finance prudential regulations. The initial draft of housing finance prudential regulations has been prepared and a final version would be issued soon.

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 developed by Canada Mortgage and Housing Corporation. The training covered all aspects of housing finance from product

SBP gives immense importance to human capital and caters it through capacity building programs.

development, loan marketing/distribution and origination to loan underwriting, servicing and risk management. Presently, that training module is being used through local resources for training programs. Till date, approximately 500 bankers from over various banks have been trained in the mortgage business. More capacity building programs would be conducted in future.

Pakistan lacks an information depository about housing and urban affairs.

The capacity building program focuses on enriching the human capital of the IHFD team through certain training programs – both local and foreign. For training programs arranged by SBP, information is available at SBP website (http://www.sbp.org.pk/departments/ihfd-tp.htm)

Creation of Web Portal/Housing Observatory

Pakistan like most of the developing countries possesses a variety of information sources with data relevant to the field of housing and urban affairs. However this information is seldom in one place, often not accessible, provided in different formats, and frequently characterized by different definitions or geographic groupings that reduce the utility of the outputs due to inconsistencies.

There is a challenge of making coordinated efforts by the private and public sector organizations.

Pakistan lacks information about housing and urban affairs due to multiple reasons, however, some of the reasons are as under:-

1. Lack of effective and coordinated efforts required to be put by the private and public sector agencies/organizations.
2. Lack of standardization in registration process being followed by registration authorities at local government level in provinces.
3. Some of the semi urban and rural areas either do not have registration authorities or it is not mandatory for the general public to get their housing plan approved by any of the authority.
4. The housing societies though have the data of their respective projects, yet they do not have any opportunity to share or disseminate this information.
5. There is no single entity maintaining comprehensive data/info on housing and housing finance.

Housing societies do not have any opportunity to disseminate or share their information.

One of the recommendations of HAG was the establishment of Housing Market Information System (HMIS). Accordingly, the CMHC was also requested to exchange their experience, who forwarded a standard project outline for establishment of an entity maintaining data base on housing sector.

One of the recommendation of HAG was the establishment of Housing market Information System (HMIS)

Efforts were made to seek assistance of WB for establishment of an observatory for real estate market. The observatory for real estate market will be established with the intention of minimizing information asymmetries that currently plague the system. The proposed Housing Portal/Observatory is to provide a complete, reliable and objective description of the housing sector in the country - from the demand and supply of housing, to the quality and use of the existing housing stock, including an assessment of production capacity in terms of land, building materials, capital and labor and to identify trends and emerging issues which may require action.

The proposed housing portal would provide a complete, reliable and objective description of the housing sector

SBP has been working with the Association of Mortgage Bankers (AMB) for developing a web portal on housing finance which would also support the creation of observatory for real estate. In this regard, AMB has created, on SBP's instructions, its website which can have the potential to be an information hub.

Adoption of corporate governance structures by large scale developers will be a step towards removing major inefficiencies.

Large-Scale Developer Finance

Housing will only be affordable if large scale developer financing is streamlined and bottlenecks are removed. The fragmented building industry needs to be organized with formal corporate governance structures and remove major inefficiencies such as lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in the future. Consequently, it is difficult for financial institutions to verify the character, capital and capacity of potential clients. As a result, financial institutions are reluctant to enter this market, which in turn causes scarcity of finances and hampers the supply of housing. Guidelines have been prepared for Housing Developers' Financing by banks/DFIs, which would soon be issued.

Credit Rating of Developers/Builders

Credit rating of developers/builders may result in enhanced financing to the mortgage industry.

The unstructured and unsupervised nature of real estate brokers is also a significant constraint to the provision of housing and housing finance. Only valuators have professional conduct requirements that were established by SBP and the PBA. The real estate agencies, which could be natural brokers or arrangers for the provision of financial services, remain unorganized and insufficiently supervised. The protection of individual purchasers remains limited as the market is dominated by cash transactions and lacks transparency and no systematic information is available. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders' extreme caution.

Financial institutions are not aggressively lending low cost housing facilities due to a number of factors.

Affordable/Low-Income Housing Finance

At present, financial institutions are not aggressively lending to low cost housing facilities because of the following reasons:

- Intermediation costs for the provision of housing loans to low income groups are higher than that for the middle and upper income groups due to smaller loan size, lack of documented income, higher incidence of circumstantial defaults due to negative propensity to save.
- Property titling in low income areas is comparatively more difficult as representatives of mortgagee financial institutions needs to visit at least 5 different offices for the verification of title documents
- Initiation and successful closure of low income residential projects are also marked with barriers to site permits, environmental clearance and lack of infrastructure and utilities connections. Resultantly, the residential ownership has remained predominantly equity financed and capitalization of housing sector has not been able to realize its true potential.

Property titling in low income areas is comparatively difficult.

Foreclosure Issues

Banks are legally protected through the Recoveries Ordinance 2001; however, operationally they are facing different problems. Rules, which had to be issued after the promulgation of the Recoveries Ordinance 2001, have not been framed. The process of foreclosure is too lengthy and costly. In an ordinary case it almost takes 12 to 18 months and a hefty amount to obtain the decree. Additionally, decisions are not made purely according to the Recoveries Ordinance 2001, particularly, while granting the stay. Banks have also indicated fewer numbers of judges in the banking courts.

Banks are legally protected through recoveries ordinance 2001.

There is strong need to make the process of foreclosure effective and suitable actions on following matters are desirable:

Banking courts require judges to deal with financial matters.

- Implementation of the Financial Institutions (Recovery of Finances) Recovery Ordinance,2001
- Appointment of judges in the Banking Courts
- Capacity building of the judges appointed in the Banking Courts – so that they properly follow the Recoveries Ordinance 2001 for cases involving property foreclosures.

Addressing foreclosure issues would restore the confidence of financial industry.

SBP is taking the above matters with the concerned ministry for action. Fixing the foreclosure issues will restore the confidence of the banks and would be beneficial for development of housing finance in Pakistan.

Housing Microfinance

A vast majority of people in Pakistan may require small loans for building/upgrading their houses. Slum areas and katchi abadis in urban areas and all other sub-urban and rural areas are in need of small and micro-housing. MFBs have been allowed to extend housing finance upto Rs. 500,000/-. It is hoped that not only MFBs but also commercial banks/DFIs would cater to the needs of poor segment of the society by designing products offering credit upto Rs. 500,000/-. Efforts would be made in coordination with all stake-holders to cater to micro-housing needs.

MFBs have been allowed to extend housing finance of Rs.500,000.

IH&SMEFD has prepared a report on the potential of Micro Housing Finance and is planning to hold a seminar on Housing Microfinance in collaboration with stake-holders.

Other Initiatives

ABAD is working to implement the condominium law with the Sindh government.

- ✓ SBP and World Bank have agreed to work together for implementation of key HAG recommendations and bring a financing environment conducive to growth of housing sector. This involved restructuring of HBFCL by removing inefficiencies and strengthening the institution.
- ✓ SBP has played its part in facilitating the introduction of Condominium laws. A report has been prepared on the need for Condominium laws. Furthermore this report

has been forwarded to ABAD (Association of Builders & Developers) for feedback. SBP has played its part and now ABAD is trying to implement the condominium law with the collaboration of Sindh Government.

The demand for housing will persist in the country for the years to come.

Future Outlook

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

- ✓ Different measures are being taken by SBP to improve the housing finance outreach in the country. The establishment of Mortgage Refinance Company (MRC) would help banks/DFIs in overcoming maturity mismatch and in providing fixed rate mortgages.
- ✓ Since efforts would be made to explore the possibility of tapping international institutional funds, it is hoped that housing facilities would become more accessible.
- ✓ Provinces would be asked to bring down Transaction Costs, which would help boost the housing construction activity, which would attract banks'/DFIs' financing. SBP is holding meetings with Federal & Provincial Governments to ensure implementation of the Housing Advisory Group (HAG) recommendations.

SBP is coordinating with federal and provincial governments to ensure implementation of HAG recommendations.

Conclusion

The troubles facing the financial sector are not insurmountable. Each can be addressed with deliberate and consistent public sector reforms at the national and federal levels. In fact, individually, none of the problems listed in this section can completely forestall the development of the sector. Collectively, however, they present a serious concern for the long-term development of the sector. An inefficient legal framework; fragmented ownership and titling procedures; inefficient land information systems; inaccessible, unused government land; high stamp duties and registration fees; weak tax frameworks; and ineffective land dispute mechanisms dampen the willingness of banks to increase their mortgage portfolios. Poor master planning, multiple housing administrative institutions and procedures, problematic zoning restrictions, restrictive building codes, and unreliable utility connections further hinder

Consumer finance NPLs increased from Rs. 7 billion in 2005 to Rs. 45 billion in 2011 the property development process; and a fragmented building industry, unorganized real estate agencies, the lack of developer finance, and skewed tenant laws also limit the interest and capacity of the private sector to increase the supply of affordable housing.

Well coordinated efforts of required from all stakeholders to achieve success in any endeavor.

The success of SBP in its efforts is subject to the response of the concerned authorities in federal and provincial governments such as Stamp Duty Authorities, Ministry of Housing & Works, and Ministry of Law & Justice etc. However, ineffective role of these institutions is contributing in the dismal state of affairs currently prevailing in the country. The demands and suggestions made by SBP to the following initiatives require urgent attention of all key stakeholders.

1. **NHP-2001**

   The measures/recommendations in various sections of the National Housing Policy have not been implemented. For example, creation of land banks, rationalization of different costs involved in sale/purchase and transfer of housing units. A review and revision of the said policy should also have been carried out.

Banks for the first time have been protected legally through recoveries ordinance 2001

2. **Recoveries Ordinance 2001**

   An enabling framework is the first and foremost element of facilitating deepening and broadening of housing finance in Pakistan. Therefore, it is important to reform the various laws affecting foreclosure, transfer, tenancy, rent control and acquisition of immovable properties so that the present uncertainty in the legal system could be removed for establishing efficient real estate market in Pakistan through greater provision of credit from the financial system.

   Banks are legally protected through the Recoveries Ordinance 2001; however, operationally they are facing different problems. Rules, which had to be issued after promulgation of Recoveries Ordinance 2001, have not been framed. The process of foreclosure is too lengthy and costly. In an ordinary case it almost takes 12 to 18 months and hefty amount to obtain the decree. Additionally, decisions are not made purely according to the Recoveries Ordinance 2001, particularly, while granting the stay. Banks have also indicated the shortages of judges in the banking courts.

The process of foreclosure is too lengthy and costly.

There is a shortage of judges in the banking courts. Further there is a need for their capacity development.

There is strong need to make the process of foreclosure effective and facilitative. The following actions must be taken immediately.

a) Shortage of suitable judges in the Banking Courts
b) Capacity building of the judges appointed in the Banking Courts – so that they properly follow the Recoveries Ordinance 2001 for cases involving property foreclosures.

A coordination committee involving representatives of key stakeholders may be formed to oversee the HAG implementation.

3. Implementation of HAG Recommendations

SBP has disseminated the HAG recommendations to different stake-holders and implementing agencies. The status of implementation of HAG recommendations has been given in the Annexure A. If the HAG recommendations are implemented in true letter and spirit, the housing industry would flourish at very high pace. A Coordination Committee, involving representatives from federal government, provincial governments, ABAD and SBP, may be formed to oversee the implementation of HAG recommendations as well as NHP-2001.

Development of secondary mortgage market will be helpful in generating fixed rate long term funds.

4. Development of Secondary Mortgage Market

Housing also contributes to financial sector as it is durable and provides secured collateral. It will be an important factor in promoting long term bond market. SBP is working on the development of Mortgage Refinance Company (MRC), which will provide long-term finance to banks/DFIs. MRC will float the bonds in the secondary market to generate the funds. The development of Secondary Mortgage Market will be helpful in generation of long term funds on fixed rate for financial intuitions.

Housing specific PRs may shift focus of banks from consumer to housing finance.

5. Strengthening of Regulatory Framework for Housing Finance

SBP is working on revising the housing finance PRs and on separating them from consumer finance. This action will shift the focus of management of banks from consumer finance to housing finance. Revision in PRs will facilitate/encourage the banks in increasing the housing finance portfolio.

6. **Role of Govt. & SBP in promoting housing & housing finance**

Providing shelter to the masses is the mandate of every government. Government of Pakistan is taking 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 the serious actions for the implementation of HAG recommendations and collaborate with SBP for the involvement of financial institutions.

Most of the HAG recommendations fall under the domain of government institutions.

Government must utilize its unused land by developing it with the help of private builders. Housing microfinance must be encouraged and facilitated to cater the low income group. For low income groups, subsidized interest rate may be introduced. There must be strong collaboration of policy makers with the private developers. There must be programs to create the awareness about the importance of housing finance in the economy.

Government must utilize its unused land with the help of private builders in a transparent manner.

Government must encourage and facilitate housing for lower and middle income groups.

7. **Role of Banks & HBFCL in enhancing outreach**

The banks and HBFCL can play very important role in extending housing finance and educating people with financial literacy. It is the mandate of HBFCL to facilitate the low and middle income groups. But since last three years HBFCL is stressing on recovery and disbursements were very low. The big banks and HBFCL are having branches in almost all the major and small cities. HBFCL must ensure that it is meeting its mandate of facilitating low and middle income group. It is evident that banks and DFIs educate people wherever they provided financial services. There is need to exploit new markets, introduce innovative products and extend the outreach.

There is a need of introducing innovative products and exploring new markets.

8. **Role of Microfinance Banks**

Microfinance can play very important role in flourishing housing finance. Microfinance banks are already having setups in rural areas and have the vast experience of collection. The commercial banks usually complain about non-feasibility of small loans. Microfinance can help the poor to fulfill the need of shelter. There is a need to devise policies for housing microfinance by MFBs.

Micro lenders can play a significant role in extending small housing loans to poor.

Annexes

Annexure A

Status of Recommendations made by the Housing Advisory Group[13]

	Recommendations	Status
1	**REFORMING LEGAL FRAMEWORK AFFECTING FORECLOSURE, TRANSFER, TENANCY, RENT CONTROL AND ACQUISITION OF IMMOVABLE PROPERTY**	
	a) Implementation of Recovery Ordinance 2001 There is lack of implementation of the recovery law to the detriment of the mortgagee financial institutions.	This matter pertains to Min of law, Justice and Parliamentary Affairs, whom letters have been written to highlight the issue.
	b) Amendments to Recovery Ordinance 2001 There is a need of making amendments to the Recovery Ordinance 2001.	Regarding 'Reserve Price' & 'Wider Circulation', amendments for the ordinance were drafted in consultation with SBP's Legal Counsel, which have, however, not been forwarded to concerned ministry because case on Section 15 of RO 2001 is subjudice in the Supreme Court of Pakistan.
	c) Establishing an Electronic Public Registry In order to weed-out malpractices in case of sale of attached properties, it is recommended that an electronic public registry be created.	Printed copy of HAG Recommendations has been sent to various stakeholders for implementation.
	d) Transfer of Property only through a Registered Instrument It is recommended that Section 53-A be removed from the statute book and a clear statement be made that no proprietary interest is to be recognized on the basis of possession or "other performance" pursuant to an unregistered instrument.	Apart from forwarding HAG Recommendations, letters have been issued to concerned authorities for taking action on such items.
	e) Rewriting Urban Rent Laws In order to expedite settlement process between tenants and landlords, rewriting the urban rent laws will play a positive role.	
	f) Amendments to Land Acquisition Acts The law should be amended to clearly state that a provincial government may acquire land for the purpose of private housing schemes under such terms as may be specified. The Punjab Government has framed rules that allow the government to acquire land for a private housing scheme provided that 80% of the required land has already been purchased by the sponsoring company. The legal status of these rules remains somewhat suspect. It is recommended that a clear statutory scheme for land acquisition for private housing schemes be included in the Land Acquisition Acts in force in the provinces and also the capital territory.	
2	**RATIONALIZATION OF TRANSACTION COSTS**	
	a) Rationalizing Cost of Stamp Duty and Registration Fee on Conveyance	Provincial governments have been

[13] As on December 27, 2010

<table>
<tr><td rowspan="3"></td><td>and Mortgage Deeds
Rates of stamp duty and registration fee should be rationalized and a 1% aggregate rate of stamp duty and registration fee on conveyance deeds and 0% rate of stamp duty and registration fee on mortgage deeds is stipulated.</td><td rowspan="2">requested to rationalize the costs, wherever possible.
Last year, Federal Govt. reduced CVT from 4% to 2%. Now, it is provincial matter, after the 18th amendment.</td></tr>
<tr><td>b) Rationalization of Commercialization Fee
In order to minimize the disparity seen in actual transaction prices and those recorded for tax purposes and encourage corporate entities in the construction sector, it is proposed that commercialization fee should be reduced to 10%.</td></tr>
<tr><td>c) Automating Land Records and Improving the Tax Collection System
Institution of an automated land record system (the subject matter of Recommendation No. 3), in tandem with rate rationalization and improving the revenue collection system, has the potential of encouraging documentation of property transitions by reducing the direct transaction costs (i.e. cost of logistics) and opportunity cost, which would have a positive impact on the revenue collection of the provincial governments.</td><td>Provincial governments have to initiate steps for automating land records.</td></tr>
<tr><td rowspan="2">3</td><td colspan="2">Establishing an Integrated Nationwide Land Registration Information System (LRIS)</td></tr>
<tr><td>a) Streamlining the Role of the Public Sector
b) Promoting Area Specific Private Sector Initiatives in Cities
c) Capacity Building of the Existing System</td><td>Federal Govt may consider creating a National Land Record Information System Authority.</td></tr>
<tr><td rowspan="5">4</td><td colspan="2">INCREASING SUPPLY OF LAND FOR AFFORDABLE HOUSING</td></tr>
<tr><td>a) Utilization of Existing Allotted Land by the Private Sector
The private sector needs to be encouraged to utilize the land for construction of housing units by punitive actions such as imposition of hefty non-utilization penalty/tax if the plots remain vacant after 5-7 years of allotment or altogether forfeiting the private title etc.</td><td>Provincial governments may offer some incentives for builders/developers. Punitive actions should also be framed for defaulting parties.</td></tr>
<tr><td>b) Reforming Katchi Abadis
It is important to reform and regularize the structures of irregular settlements and subsequently vertical development of these areas should be instituted.</td><td></td></tr>
<tr><td>c) Vertical Land Allotment Policy to Pursue Densification
A densification oriented land allocation policy needs to be adopted and pursued, whereby the proportion of land for high-rise buildings should be increased (e.g. in Karachi city from 5% to 30%) and the share of land allotted for undivided houses should be reduced (e.g. in Karachi city from 55% to 30%). Moreover, within the total share of high-rise buildings a certain portion, e.g. 25% to 40%, should be earmarked for low cost housing facilities.</td><td>Punjab Govt has announced policy for builders, which, inter alia, contains that builders/developers would have to specify 20% of the project land for low-income groups. Other provincial governments are being pursued for the purpose.</td></tr>
<tr><td>d) Auctioning of Existing Land by the Government
The vast tracts of vacant public land could be utilized for construction of housing facilities, especially low income housing schemes. An early release of these parcels of land in large numbers could help in reducing the housing prices. For mitigating land price escalation due to speculation, the city governments, in association with real estate</td><td></td></tr>
</table>

		developers, could also offer housing schemes on completed housing/projects basis.	
	e)	**Creation of City Based Land Banks and Satellite Towns** Land banks should be designed to acquire land/properties from the land owning agencies and sell these to third parties for development so as to yield a number of benefits viz. clear title to land, transparency in allocation, specific targeting of developmental objectives, utilization of strategic land parcels, and involvement of communities. The land banks could also facilitate establishment of self-sufficient satellite towns near industrial areas, which would help in reducing pressure on major urban centers.	
	f)	**Amending Land Acquisition Act**	Covered above 1(f)
		STRUCTURING AND STREAMLINING LARGE SCALE DEVELOPER FINANCE (LSDF)	
5	a)	**Registration of Real Estate Builders and Developers (REBADs) with Association of Builders and Developers (ABAD)** Since the Karachi based Association of Builders and Developers (ABAD) is perhaps the most effective representative trade body of REBADS in the country with a membership of around 450 builders and developers, it is important for a REBAD to get registered with ABAD for becoming eligible for credit from the formal financial system as registration would ensure that the member would observe the necessary code of conduct instituted by ABAD to the relief of the lender.	While issuing guidelines for large-scale developer finance, this aspect would be taken care of. Banks/DFIs would be advised to extend finance to only those builders/developers which are registered with associations like ABAD (in case of Karachi).
	b)	**Credit Rating** Banks may be encouraged to establish business relationship with REBADs on the basis of their past performance and the commercial and financial viability of the REPs, thereby making the credit rating of REPs a viable alternate to credit rating of REBADs. However, where appropriate and possible, the credit rating of REBADs should also be encouraged.	Rating Agencies are ready to undertake credit rating of REBADs. However, since a partnership is created in most of the projects, project rating would be encouraged.
	c)	**Government Schemes on Completed Housing/Projects Basis** In order to mitigate the speculative price spiral, the land owning government agencies such as city governments should announce government schemes on completed housing/project basis in association with REBADs and financial institutions (for both developer finance and end user financing), thereby making it less attractive for the speculators to participate in the auction process. Moreover, such an undertaking would increase the supply of constructed housing units rather than that of plots- which usually remain vacant even after many years of auction.	Provincial governments may initiate steps for schemes on completed/ housing project basis.
	d)	**Encouraging REITs** Real Estate Investment Trusts (REITs) is an alternate model of developing real estate and is more transparent and structured than the traditional real estate development process in Pakistan. Therefore, institution of REITs should be encouraged in letter and spirit.	SECP is already trying to encourage REITs.
	e)	**Encouraging Joint Ventures with Foreign Developers** In order to modernize and increase capitalization of the real estate sector,	

		it is important that joint ventures with foreign developers should be encouraged. This would, inter-alia, help in transfer of technology and management know-how.	
	f)	**Simplification of Documentation for Banks** For streamlining the provision of credit to REBADs it is important that documentation should be simplified and a standard set of documents should be instituted with the mutual consent of ABAD and PBA.	Under study.
	g)	**Standardization of Valuation Methodology** For the promotion and development of REITs, property valuation is the linchpin as it provides the basis to price REITs units. Therefore, for standardizing the valuation process PBA/MBA needs to screen the various different valuation methodologies, which are used internationally, and adopt the one that fits best in Pakistan's scenario.	The matter was taken up in a meeting with Association of Mortgage Bankers (AMB). AMB said that they were not facing any problem in respect of valuation methodology.
6	**PROVISION OF HOUSING FINANCE FOR AFFORDABLE AND LOW COST/INCOME HOUSING FACILITIES**		
	a)	**Need of Innovative Solutions** For the provision of housing finance to low income groups, there is a need of instituting targeted measures so as to bring parity between monthly installments of housing loan and the monthly rentals. In this regard, Housing Finance Companies (HFCs) and Microfinance Institutions (MFIs), alongside NGOs, need to take the lead in initiating housing projects for low income groups with autonomous and self-regulating structures within their jurisdictions/boundaries. Since low cost housing projects are usually located at a distance from the city centers, therefore, availability of transportation facilities is essential for their success.	A Seminar is being held to explore avenues of long-term funding for microfinance banks to enable them to extend housing finance.
	b)	**Establishing Autonomous and Self-Regulating Structures (Condominium Act)** There is a need of devising a universal Condominium Act for instituting autonomous and self-regulating structures, which, inter-alia will be applicable to low cost housing projects.	A study on Condominium Act was carried, which was shared with ABAD for further action.
	c)	**Amending Land Acquisition Act**	Covered above 1(f)
7	**PROMOTION AND DEVELOPMENT OF REAL ESTATE INVESTMENT TRUSTS (REITS)**		
	a)	**Notification of REITs Rules** In the context of Pakistan, it is expected that REIT's structure would help in regulating existing fragmented and informal property development mechanism as these could bring forth efficiency in price discovery mechanism of real estate and yield improved market valuation of property prices, besides enhancing the liquidity of the real estate market. Moreover, REITs could provide an opportunity to the government and private sector to sell their real estate properties at market values.	SECP is already trying to encourage REITs.
	b) c) d) e)	**Amendments to Rent Control Laws** **Rationalization of Transaction Costs** **New Law development – Condominium Law** **Conducive Tax Framework for REITs**	
	PROVISION OF LONG TERM FUNDING FOR HOUSING LOANS		

8	**Establishing Pakistan Mortgage Refinance Company (PMRC)** The objective of the PMRC will be to provide long-term funding for housing finance.	The World Bank had submitted a proposal to assist SBP in the establishment of a Mortgage Refinance Company (MRC). The feasibility study and business model of MRC developed by IFC were shared with banks/DFIs to sell the idea and seek equity commitments. It would be a DFI with public-private partnership. GoP and few commercial banks have confirmed equity participation. IFC/ADB have shown agreement for injecting equity into MRC.
	DEVELOPING HOUSING MARKET INFORMATION SYSTEM (HMIS)	
9	**a) Upgrading Websites of Primary Mortgage Lenders (PMLs)** An information portal relating to HMIS should be designed to, inter-alia, cover the various facets of the construction projects financed by mortgage lenders, which are either at the stage of marketing or in the process of construction. **b) Mortgage Bankers Association (MBA) to Support a Dedicated Website for HMIS** The MBA should play an active role in developing HMIS in the country through financially supporting a separate website for HMIS, which would be available to general public. In this regard MBA should establish a task force on HMIS to figure out the components and design of the HMIS incorporating information portals	Consequent upon issuance of letter from SBP, many PMLs have upgraded their websites in relation to housing finance products and services. With support of SBP, AMB has been able to get the website developed, which is being enriched to make it a housing market information portal.
	c) Setting-up of a Housing Observatory needs to be set-up for integrating information relating to real estate sector in Pakistan A Housing Observatory should be established at either SBP or Pakistan Bureau of Statistics (PBS) with an aim to produce authentic, timely, transparent and integrated data relating to housing sector in Pakistan.	The World Bank had also submitted a proposal to assist in the establishment of a housing observatory in Pakistan. A formal Expression of Interest was received from Ministry of Finance. The establishment of the Observatory will address the information needs of both borrowers and lenders on the housing sector as a whole and cover greater information than an HMIS. However, later on, World bank priorities in Pakistan have changed.
	DEVELOPMENT OF MORTGAGE BANKING INDUSTRY IN PAKISTAN	
10	**Capacity Building of Mortgage Bankers Association (MBA)** Development of mortgage banking industry involves a number of stakeholders; therefore, it is important to bring all the players at one forum through Mortgage Bankers Association (MBA).	SBP-AMB meetings are frequently held to improve AMB's standing, so that banks/DFIs which are currently not its members, obtain membership.

Annexure B

Housing Finance Statistics

Table 1	Housing Finance Statistics (Rs. Billions)						
	2011	2010	2009	2008	2007	2006	2005
Gross Outstanding	59.38	66.74	73.38	83.78	76.00	61.96	55.29
Gross Outstanding US $ (in Billions)	0.66	0.83	0.89	1.06	1.24	1.02	0.92
Share of All Banks & Other DFIs	78%	80%	79%	80%	84%	82%	65%
Share of HBFCL	22%	20%	21%	20%	16%	18%	35%
No. of Outstanding Borrowers	91,398	98,446	112,785	123,107	125,490	99,671	135,689
All Banks & Other DFIs	22,428	24,252	26,402	28,624	26,073	23,416	19,112
HBFCL	68,970	74,194	86,383	94,483	99,417	76,255[14]	116,577
Annual Growth (%)	(11)%	(10) %	(11) %	10%	23%	12%	50%[15]
Weighted Average Interest Rate (%)	16%	15.76%	15.6%	14.65%	12.14%	10.31%	10.10%
Average Maturity Periods (Years)	12.2	13.6	12.6	12.2	12.8	13.6	13.2
Average Loan Size							
HBFCL (Rs. Millions)	1.3	1.22	0.74	0.86	0.092	0.087	0.083
Commercial Banks (Rs. Millions)	4.7	3.55	2.49	2.35	2.60	2.33	1.95
NPLs (Rs. Billion)	19.07	18.53	15.260	12.314	N.A	N.A	N.A
NPLs as a % of Total Outstanding - Overall	32%	27.76%	19.90%	14.70%	N.A	N.A	N.A
All Banks & Other DFIs	25%	21.50%	14.42%	37.60%	N.A	N.A	N.A
HBFCL	55%	52.06%	40.97%	37.60%	N.A	N.A	N.A
Consumer Finance as a % of Pvt Sector Advances	7.5%	9.40%	10.80%	11.42%	14.41%	14.87%	
Housing Finance as a % of Consumer Finance	24.51%	22.26%	21.47%	19.81%	17.23%	14.96%	
Housing Finance as a % of Pvt Sector Advances	1.8%	2.09%	2.32%	2.26%	2.48%	2.23%	

[14] Since figure for HBFCL is not available, it has been estimated using average loan size of 2005 and 2007
[15] Growth rates were high since commercial banks had just entered the mortgage market