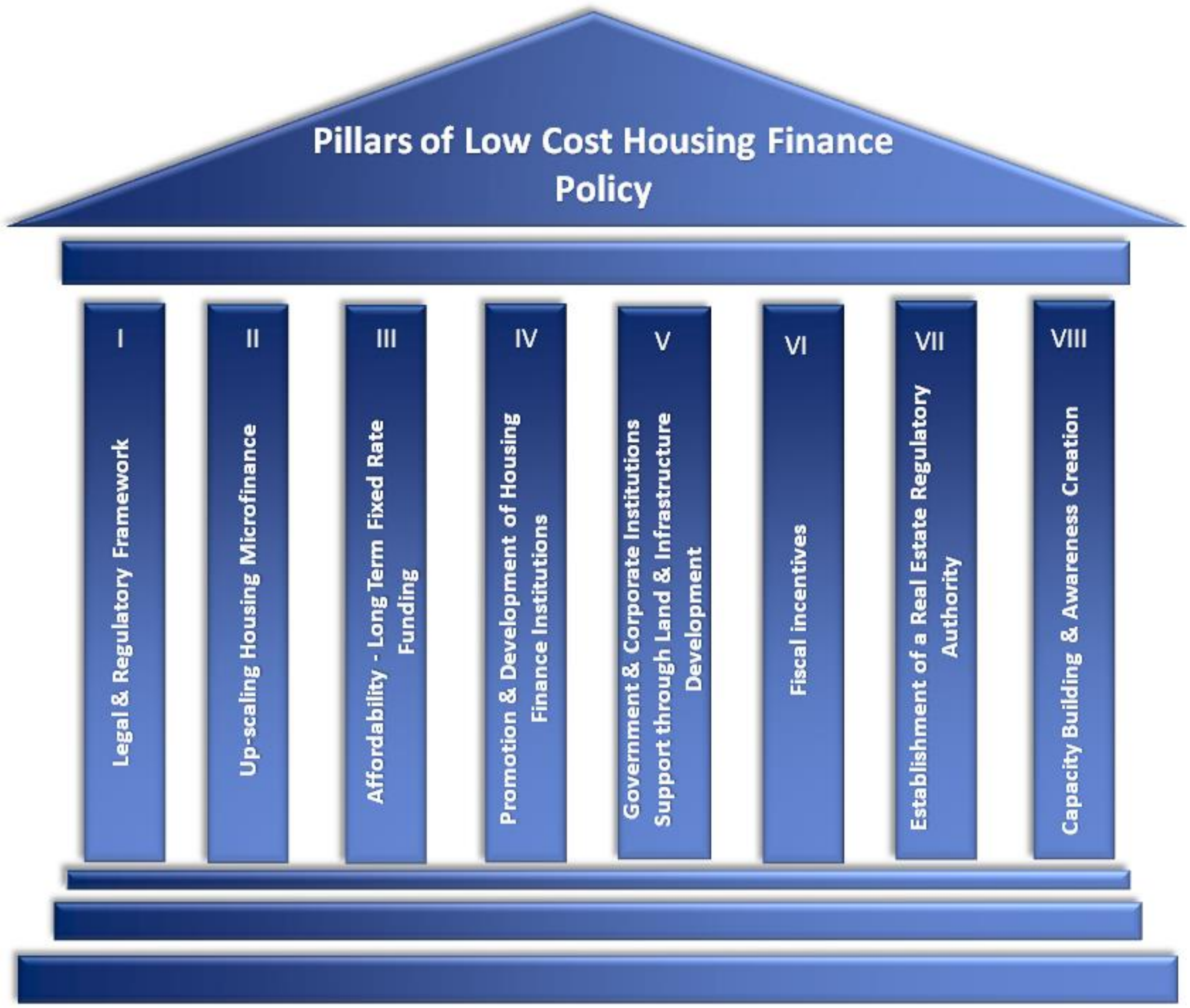
Policy for Promotion of Low-Cost Housing Finance



State Bank of Pakistan

Infrastructure, Housing & SME Finance Department

Executive Summary

Pakistan, like other developing countries, has been facing shortage of housing units; and this basic human need is felt more profoundly at the bottom-of-the-pyramid comprising of the poor and financially under-served segments of the society. According to the 2017 census, Pakistan's population has reached 208 million, growing at an average of 2.4% annually since 1998. The growing number of households implies an increase in the demand for housing. It is estimated that annual demand for new homes is approximately 700,000 a year, whereas, only about half of this demand is met. Overall, the housing deficit is estimated at 10 million units and growing.

The formal financial sector has been failing to provide adequate and affordable housing finance to a large segment of the population. The combined volume of outstanding housing finance from banks and the HBFCL stands at around Rs. 83 billion currently, which is equivalent to only 0.5 percent of GDP. This ratio (referred to as mortgage depth) is low in comparison, not only to advanced economies but also to regional developing economies of India and Bangladesh.

The housing finance market has been marred by both supply and demand side challenges. Key supply side issues faced by the industry are: ineffective foreclosure laws, uncertainty of title deeds, bank's general preference for investment in government securities and risk of maturity mismatch due to unavailability of long term funding. Similarly, key issues related to demand side are escalating property prices, dearth of financing products, unavailability of formal financial services and volatility in interest rates.

The formulation of policy on low cost housing is an attempt to resolve issues faced by the mortgage industry. The policy has been formulated keeping in view international best practices and local market conditions. It strives to increase housing finance portfolio of banks/DFIs from current, Rs. 83 billion to Rs. 250 billion by June 2021, along with increasing the number of borrowers to 200,000 from the current 68,000. The policy constitutes of eight pillars that focus on regulatory incentives and mechanism to address the issue of affordability of low-income borrowers. Key initiatives under these pillars can be summarized as below:

- Definition of low cost housing financing in Pakistan to be adopted as loan amount of up-to Rs. 2 million with the property valuing up to Rs. 2.5 million. The maximum monthly income of a low cost housing finance borrower should be up to Rs. 60,000.

- SBP to introduce a subsidized financing facility for low cost housing by providing liquidity to the financial institutions at subsidized rate. SBP will provide refinance up to Rs. 1 million or 50% of loan amount at a rate of 1% to banks/DFIs and the end borrower rate will be 5%. The remaining 50% of the loan / financing amount shall be provided by the banks/DFIs from their own sources at fixed rate of up to 12% or variable rate of 1 year KIBOR plus risk premium up to 4%. The facility will be provided for both individual house borrowers and housing builders/developers. Similar financing facility will also be provided through the Islamic Financial Institutions.

- Banks to be assigned housing finance targets with the instructions to make these targets part of the overall business plan and departmental targets.
- The general reserve requirements against low cost housing finance portfolio of banks/DFIs to be waived.
- Bank/DFI's exposure in low cost housing to be exempted from the exposure limit of 10% for real estate sector.
- Microfinance Banks to be allowed to increase housing finance amount up to Rs. 1 million from Rs. 500,000.
- A standardized loan application form is to be issued through PBA to streamline loan processing by banks/DFIs.
- Banks/DFIs to introduce innovations in offering housing loan products.
- SBP to facilitate provincial governments and state owned enterprises/autonomous bodies to avail housing finance from banks.
- Tax incentives, by the Federal Government, to builders and financial institutions on income derived from low cost housing.
- Capacity building and awareness creation.

1 Situation of Housing in Pakistan

1.1 Housing Availability

According to the 2017 census, Pakistan's population has reached 208 million, which comprises of over 32 million households. Between 1998 and 2017, the country's population is estimated to have grown by 2.4 percent on average annually. Within the total population, urban population has grown much faster – posting a 2.7 percent average annual growth – and its share has increased to 36.4 percent from 32.5 percent in 1998. Certainly, growing number of households implies an increase in the demand for housing. With supply growing at a modest pace, Pakistan is facing a serious shortage of housing units.

Currently, the housing deficit in Pakistan is estimated at 10 million units. The shortage is more pronounced for urban population, which according to one estimate is facing a backlog of 3.5 to 4 million units.[1] Making things worse, this quantitative gap is being aggravated by the depleting quality of existing housing stock. According to the World Bank, a startling 46.6 percent of the urban population was living in slums in the year 2009. To put this number into perspective, the overall poverty rate in the same year was less, i.e. 36 percent; this suggests that not just the poor households, but low and moderate-income households are also facing the brunt of shortage of adequate housing facilities.

While bridging the existing gap is already a daunting task, the housing shortage is expected to increase further in future. Consider this: Pakistan's population has increased by 4 million per year over the last 19 years; if we assume a similar rate of increase going forward, then we have to gear up for an additional 600,000 households every year (keeping the average household size at the current 6.5). This compares quite unfavorably to various estimates of additional housing supply that range between 100,000 to 350,000 units per annum, implying that an incremental annual shortage of roughly 400,000 units seems plausible down the road.

1.2 Causes of Demand and Supply Gap in Housing

- **Ineffective Legal Framework**: Presence of favourable and effective laws play an important role in building confidence of financial institutions, which ultimately paves the way for distribution of credit to real sectors of the economy. However, in Pakistan, laws governing financial matters are not supportive. Financial Institutions (Recovery of Finances) Ordinance (FIRO) in 2001 was introduced to empower

[1] See "Expanding Housing Finance to the Underserved in South Asia Market Review & Forward Agenda" by Tatiana Nenova, World Bank

banks to foreclose the property of defaulter without the intervention of the court. However, the same was declared as ultra-vires to the constitution of Pakistan in 2013. As a result, banks have to go through the normal process of foreclosing the defaulter's property.

As a part of creating an enabling environment for financial institutions, SBP in consultation with relevant stakeholders proposed amendments in the FIRO 2001. SBP is facilitating in drafting of rules as required under the amended act.

- **Land records not maintained properly**: Presently, a common record of land, transactions and property rights is not available in Pakistan. Most importantly, there is no electronic mechanism via which modifications and updates can be incorporated in the records. Manual upgradation of information increases the probability of errors and omissions.

- **High registration costs:** In Pakistan, immovable properties are registered under the Registration Act of 1908, which documents the evidence, assurances and title of the property. The registration process is costly in terms of money and time (about a month).

- **Urban land monopoly exists**: The Land Acquisition Act of 1894 authorizes the government to acquire land for public purposes, "such as planned development, provisions for town or rural planning, provision for residential purposes for the poor or landless and for carrying out any education, housing or health schemes of the Government."[2] However, as things stand, this Act in its present form hinders "speedy acquisition of land at reasonable prices, resulting in cost overruns".

According to the World Bank, such land market frictions are pivotal in constraining the supply of housing in Pakistan. While quoting a survey of over 700 real estate firms, the concept paper of Pakistan Housing Finance Project of the World Bank suggests that 79 percent of such firms believe that acquisition and site-development regulations are the most important barriers in housing supply. The study also reports example of Karachi where different government agencies control 90 percent of the land in the metropolis and release portions with minimal or no coordination.

Having said that, while supply side has certainly fallen short of delivering up to the challenge, the demand side is equally responsible. Specifically, financing limitations and high cost of borrowing could not empower the lower-to-middle income segments of the society to afford housing. Nearly all of the urban housing shortage lies in the low-income segment of society. This brings home the point that the formal financial sector in Pakistan

[2] Study on the State of Domestic Commerce in Pakistan; Study 9 "Real Estate in Pakistan" for the Ministry of Commerce, the Government of Pakistan, pp. 19, November 2007

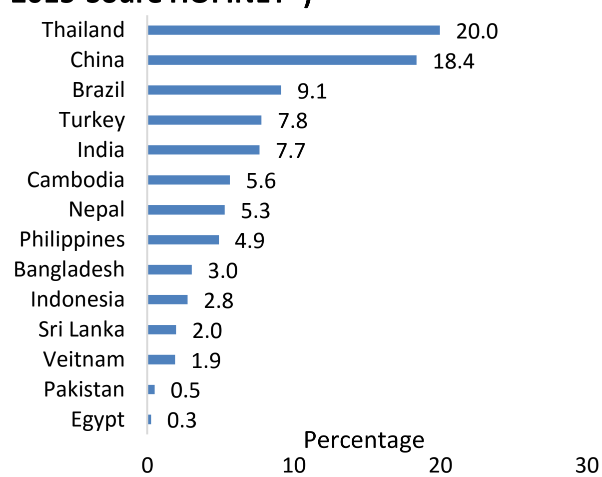
has been failing in providing adequate and affordable housing finance products to a large segment of the population that may cater to its housing needs. Here, it is important to recall that the direct role of government in providing housing needs was downplayed following the adoption of National Housing Policy of 2001 whereby private sector was tasked to play a crucial role in housing supply. Repeatedly, various housing schemes/programs have been announced under the public-private partnerships, but their effective implementation remained elusive. Thus, with real estate development remaining in private sector along with limited participation by the financial sector in providing affordable financing products, housing affordability in the country remains at low level.

2 Status of Housing Finance in Pakistan

According to various estimates, most of the housing-related transactions (construction and/or outright purchases) are done using personal resources. Even if external financing is arranged, it is mostly from informal sources (family, friends, informal lenders, etc.). This kind of arrangement makes up to 10 percent of the total housing transactions in the country. While the share of formal financing in housing transactions is miniscule.

Commercial banks and the government-owned House Building Finance Corporation provide the formal housing finance in the country. Their combined volume of outstanding housing finance stands at around Rs. 83 billion currently; putting this number into perspective, this amount is equivalent to only 0.5 percent of GDP (including banks' staff financing). This ratio (referred to as mortgage depth) is low compared to not only advance economies but also compared with regional developing economies of India and Bangladesh (**Figure 1**).

Figure 1: Mortgage Depth (Home Mortgage Loan as Precent of GDP in 2015-Soure HOFINET*)



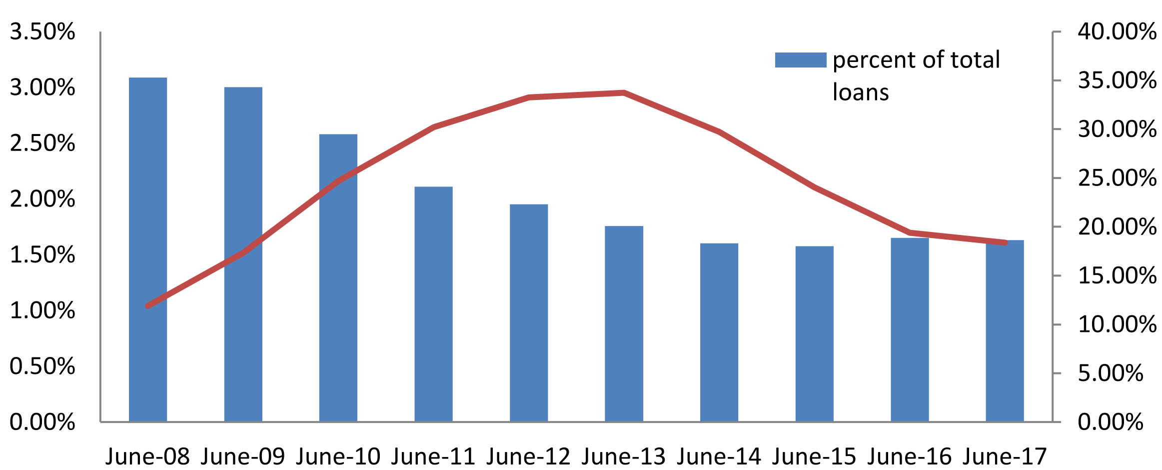
2.1 Trends of Housing Finance in Pakistan

While HBFCL had been in business since 1952, the overall housing finance in Pakistan effectively took off from 2003, when commercial banks started participating in the business. Before this period, even commercial banks were hesitant to take up housing finance due to property title issues as well as weaknesses in the legal infrastructure which made collateral disposal for loan recoveries a cumbersome process.

Following announcement of the National Housing Policy 2001, which was also complemented with strengthening of foreclosure laws and the introduction of Financial Institutions (Recovery of Finances) Ordinance, an enabling environment was created for the promotion of housing finance in the country. Another impetus that the housing sector enjoyed this time around was the huge influx of liquidity in the aftermath of 9/11. Investors parked this liquidity both with commercial banks (as deposits) and in the real estate sector; this contributed to heavy investments in real estate development, which ultimately led to a property boom in the country. Therefore, when banks were allowed to undertake housing finance, they responded positively. Their aggressive marketing campaigns, along with the fact that interest rates were already at their historic-low levels, made sure that a large number of borrowers applied for mortgages.

By end September 2008, mortgages reached to 3 percent of total private sector credit (**Figure 2**). However, when the default crisis hit the banking industry, banks significantly scaled back their exposure from this segment. Delinquencies began to show up as interest rates increased which further pushed banks to exercise caution. Over the next 5 years, not just the share but also the absolute outstanding stock of housing finance shrank.

Figure 2: Share of Housing Finance in Total Private Sector Credit



Recent data suggests some increase in housing finance over the past few quarters. However, it is important to note that these new mortgages primarily cater to the formally salaried middle class and above borrowers (60% of the total portfolio). Banks' risk-averse behavior can be seen from the fact that average loan term is only 13 years, average loan to value ratio stands only at 48 percent. As the World Bank puts it, "variable rates, non-standardized underwriting practices, and significant maturity mismatch expose primary mortgage lenders to higher credit and liquidity risks which are reflected in higher spreads charged on mortgage loans, and higher non-performing loan (NPL) ratios."

Nonetheless, one can hope that if the major impediments on demand and supply side of housing finance are worked upon, this business can flourish. Some trends are encouraging: non-performing loans, as percent of total housing portfolio, have steadily been trending downwards since mid-2013. Moreover, a new and improved section 15 of FIRO has lately been enacted, which will positively impact the housing finance.

2.2 Demand and Supply-Side Impediments in the Growth of Housing Finance

2.2.1 Supply-Side Issues

- **Weak Contract Enforcement**

Banks are of the view that Section-15 of FIRO 2001 was never effective and once a case is admitted by the court of law, the bank loses any practical right to chase the defaulter for loan recovery. When it comes to judicial proceedings, an important dimension is the availability of banking courts: only 11 cities in the country have banking courts. This results in inordinate delays in disposal of cases. Banks are also of the opinion that because of its peculiar nature, the overall judicial system needs specialized training on mortgage finance, housing loan contracts and application of foreclosure laws, etc. Further, property valuation disputes also delays the court process.

- **Uncertainty of Title Deeds**

As mentioned before, the real estate sector in Pakistan suffers heavily from lack of effective system of property titling and land registration. Not only is the entire process costly, but at times, it fails to provide sense of security to owners and mortgagors. The more prominent lacking is in the area of transferring of reliable property rights, which is the key ingredient in making housing finance a safe business for banks. Entitlement issue is so complex and grave that most banks do not consider mortgaged property a reliable security.

- **Risk Exposure**

Another concern that has been raised by the banking industry pertains to the time involved in the execution and registration of sale deed in favor of the customer/borrower. On average, it takes over 30 days for the execution of sale deed and during this period banks are exposed to unnecessary risk. Moreover, the process of verification of property documents is less than satisfactory in some areas of the country. Search certificates confirming the encumbrances on property cannot be relied upon as some of the registrar offices do not have a separate index for each property and the records are not always updated.

- **Banks Preference for Investment In PIBs**

One of the major reasons behind a declining trend in housing finance during the period 2008-13, was the inclination of banks towards the risk free financing. Since interest rates were high, it was convenient for banks to make money via investing in government papers. Importantly, it was not just housing finance, but loan supply to nearly all the segments of the economy was affected.

- **Economic Cycle 2008-2013**

As mentioned earlier, the volume of mortgages as percent of total private sector credit had increased to 3 percent by June 2008. Following the deterioration in the overall macroeconomic and investment climate, the overall consumer and business sentiments in the country took a nosedive. Not only did the global financial crisis trigger a sense of uncertainty, but also the growing security concerns and widening energy imbalances in the country strongly dented domestic business prospects. To make things worse, counter-cyclical macroeconomic policies could not be deployed in Pakistan as vulnerabilities in the external sector had already been morphed into a full-blown BoP crisis; instead, the country had to adopt demand compression policies that necessitated an increase in interest rates and a partial withdrawal of energy subsidies. Policy rate was increased from 8.6 percent on average during FY02-07 to 12 percent and 14 percent respectively in FY08 and FY09. The average PKR parity increased from only Rs. 60 in FY07 to Rs. 78.7 in FY09.

- **Maturity Mismatch**

Mortgage involves a big sum of loans and people intend to borrow housing loans for at least 5 to 10 years. For the banking industry, this tenure is indeed large. Banks face maturity mismatch as long-term housing loans are currently being funded by short term deposits which will not be a sustainable situation as the mortgage market grows to its potential.

2.2.2 Demand-Side Issues

- **Lack of Affordable Housing Availability**

As mentioned earlier, with rapid urbanization and rising incomes in informal sectors, investments in property has increased manifold over the past decade. This has resulted in a steady increase in property prices, which has created affordability issues among the lower-to-middle income segment.

- **Floating Markup Rates and Unaffordable Installment Amount**

Due to low-income levels and savings capacity of the majority of population, the existing housing finance products have largely become unaffordable. Since banks typically charge variable rates on these longer-tenure loans, households find it inconvenient – and actually daunting – to borrow from banks. Due to variable charges, it becomes hard for them to estimate future monthly installments.

- **<u>Preference of Low Income Families to Resort to Informal Sectors</u>**

A general attitude of majority of our population towards financing requirements is to borrow from friends and/or family. This could be due to lack of awareness about bank loans and misconceptions about loaning facilities and related formalities.

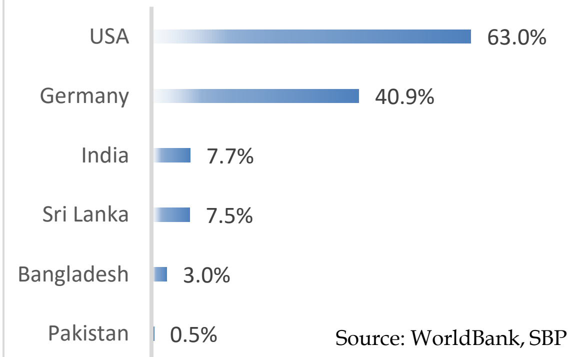
- **<u>Fear of Banks</u>**

Due to limited exposure to banking products and services, a large segment of population is financially excluded. Financial literacy remains low and most of the adult population has minimal or no understanding of housing finance products offered by banks. We also observe limited efforts on part of banks to improve this perception as their focus on retail banking in general has been much less compared to corporate banking. When it comes to marketing, again a laid-back attitude is observed on the part of banks: though some financial institutions market their housing finance products, but majority of banks do not aggressively target their low-end borrowers.

3 Global Perspective

Providing affordable low cost housing is among the top priority areas in the global human development agenda. Due to rapid urbanization, this problem is no longer confined to only low-income countries, middle to high income and developed countries have been struggling in this area as well. In this section, international perspective on housing finance will be highlighted as well as some of the challenges being faced by the stakeholders all over the world. The section will also present country experiences of South Asian economies in terms of their housing finance landscape, achievements and major issues.

Figure 3: Ratio of Housing Debt to GDP



Source: WorldBank, SBP

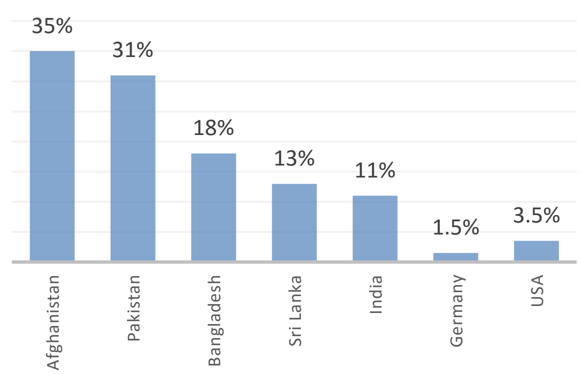
3.1 Mortgage Indebtedness

South Asia's housing and housing finance markets are dynamic but limited in their outreach, mainly catering to the upper-income group. The ratio of mortgage debt to GDP is low in South Asia compared to developed world, ranging from 0.5 to 7.7 percent **(Figure 3)**.

However, current low level of mortgage penetration implies room for growth. Indeed India, Bangladesh and Sri Lanka have done well recently by increasing the mortgage off take. Unfortunately, Pakistan's mortgage to GDP ratio stands at 0.5 percent.

South Asia is home to about half of the world's poor with a clear demonstrated need for low cost housing. The challenge is that these people require out of the box housing solutions because existing products, terms and conditions are not directly affordable for them.

Figure 4: Housing Shortage (percent share of total population) - 2009



Source: World Bank, NLIHC

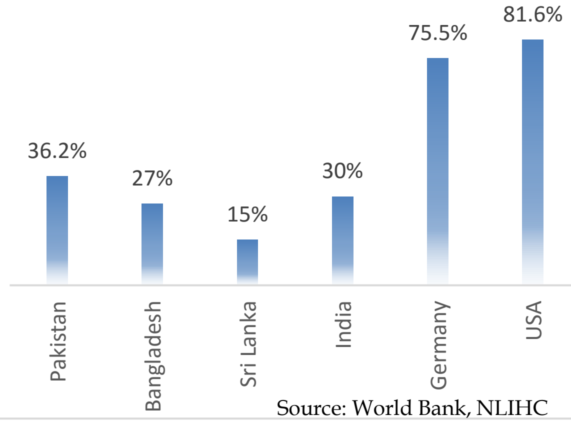
3.2 Housing Shortage

One in every four person on the planet lives in the South Asia region, and more than 14 percent of South Asians have no homes or live in such inadequate housing as urban slums and squatter settlements. Within South Asia, Pakistan's standing is quite underwhelming, with an estimated shortage of more than 10 million housing units. This trend for Pakistan along with rapid urbanization (Pakistan has the highest level of urbanization in South Asia) makes it even more prone to housing shortages and high prices in the future.

3.3 Urbanization

Urbanization is taking place rapidly all over the world. In the next decade or so, 60 percent of the world population will be living in urban dwellings. Most of this increase in urban migration is coming from the developing world, which according to World Bank estimate absorbs an average of 5 million new urban residents every month and is responsible for 95 percent of the world's urban population growth.

Figure 5: Urban Population as percent of total



Source: World Bank, NLIHC

The rapid economic growth in South Asia coupled with significant population increases and growing urbanization trends **(Figure 5)** have all laid foundations for significant potential for housing and housing finance growth in all regional economies.

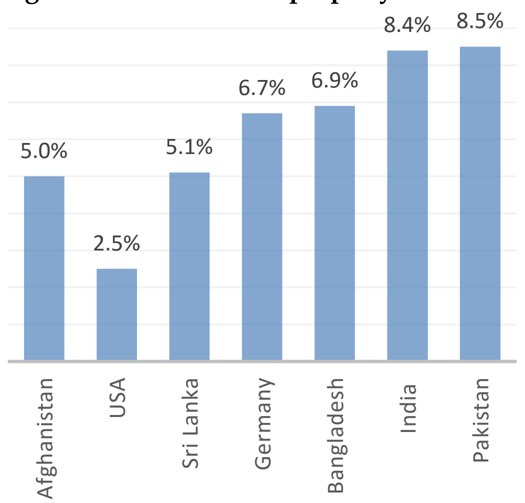
3.4 Key Challenges to Housing Loan Sector in the Region

In South Asia, housing finance reach is currently limited to upper-income population; and the main challenge is to expand the access and availability of housing finance to the middle- and lower-income groups, while developing a housing finance system that is both sound and sustainable.

The rapid increase in land prices over the past decade in most countries, poor legal infrastructure, deficient financial systems, a dearth of long-term funding at fixed rates, limited developer finance, problematic access to housing finance for low-income, rural, and informal population groups makes it difficult to address the challenge of providing affordable low cost housing for most of the population.

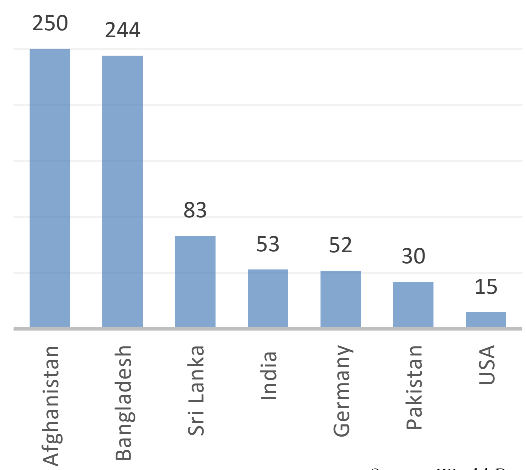
Foreclosure and land administration frameworks i.e. land titling procedures, registration procedures and costs, and a poor regulatory framework for housing and real estate stifle housing markets, as well as lack of an organized database and key information on the housing and housing finance sector are the additional problems which require immediate attention (**Figure 6A & Figure 6B**).

Figure 6A: Cost as % of property value



Source: World Bank,

Figure 6B: Number of days to register property



Source: World Bank,

India and Sri Lanka have tried to address some of these issues by developing credit bureaus in the private sector that have data on borrowers with some details. However, in Pakistan and Bangladesh public credit agencies are in place but with a very limited set of available information. For instance, in Pakistan SBP's ECIB is the only authentic database on borrowers including mortgages. It only records the details of the loan and not the borrower and only for a limited period. ECIB is the consolidated data submitted by banks on outstanding borrowers. Detailed review of housing finance experience of various countries is mentioned in Annexure.

4 SBP Interventions for Promotion of Housing Finance in Pakistan

SBP has undertaken various initiatives to promote and develop housing finance in Pakistan. Key initiatives are highlighted below:

4.1 Pakistan Mortgage Refinance Company

The absence of refinance facility and long-term funding arrangement has resulted in maturity mismatches. This is restricting the product profile of banks to only Adjustable Rate Mortgage (ARM) products. Fixed rate mortgages are non-existent in Pakistan due to unavailability of long term funding at fixed rate. However, this will not be sustainable, as the mortgage market needs to grow to its potential.

Pakistan Mortgage Refinance Company (PMRC) will assist in exploring fixed rate or hybrid models of mortgages, improving liquidity of the financial system, and enabling banks to match maturity profile of their assets and liabilities. PMRC will help banks to have a stable source of funding, especially to support growth of their long terms assets.

In this backdrop, PMRC was incorporated on May 14, 2015 under Companies Ordinance 1984. Government of Pakistan has also notified the entity as a DFI. PMRC is the outcome of collaboration between the Government of Pakistan and commercial banks through facilitation of SBP.

4.2 Prudential Regulations

To cater the financing needs of individuals, Consumer Finance Prudential Regulations (PRs) were issued in 2003. Housing Finance along with Credit Cards, Auto Loans and Consumer Durables Finance was addressed in Consumer Finance PRs. However, over the period, it was observed that nature of Housing Finance in terms of pricing, tenure, collateral, etc. is distinct from other consumer finance products.

Accordingly, SBP, in May 2014, issued separate Housing Finance PRs to encourage banks to follow housing finance more rigorously and prudently. The initiative was taken to motivate banks through changes in general and specific provisioning and reserve requirements. Necessary changes were also made in housing finance PRs to enable banks/DFIs to increase their outreach for provision of housing finance.

4.3 Capacity Building

SBP has kept capacity building of stakeholders on its priority areas. Seminars, workshops, training programs and conferences are organized on regular basis to keep the industry updated of developments in mortgage financing. SBP arranges training programs/workshops, not only for bankers but also for other housing finance stakeholders including general public and housing builders/developers.

Training programs are conducted on pan Pakistan level. Target audiences of the programs vary from operational level housing finance professionals to mid-level management of banks/DFIs. Topic areas are also diverse and detailed to equip participants with necessary skills of extending mortgage finance. Topic areas include housing finance documentation and processing, defaults and foreclosures, Islamic housing finance and general housing finance areas.

5 Benchmarks for 2021

Housing finance in Pakistan currently stands at Rs. 83 billion with 68,000 borrowers. The policy aims to achieve the following benchmarks by June 2021:

1. Increase outstanding housing finance from existing Rs. 83 billion to Rs. 250 billion.
2. Increase number of borrowers from existing 68,000 to 200,000.

6 Roadmap for 2021: Pillars of Policy for Promotion of Low-Cost Housing Finance

6.1 Pillar I: Legal and Regulatory Framework

6.1.1 Definition of Low Cost and Affordable Housing

In line with the broader objective of promoting low cost housing in Pakistan, SBP has defined low cost housing. The definition will be applicable for incentives that are specifically taken to promote financing to the income groups that fall under the low cost housing.

a) Low cost Housing: To qualify under low cost housing, the borrower has to fulfill the following criteria:
   - Purchase price of the housing unit/apartment up to Rs. 2.5 million
   - Loan size up to Rs. 2 million
   - Monthly income of a borrower up to PKR 60,000

6.1.2 Implementation of Financial Institutions (Recovery of Finances) (Amendment) Act, 2016

The expansion of mortgage finance industry, in any country, is dependent on conducive legal framework. Although housing loans are secured by mortgage, financial institutions are not on advantageous side to extend housing finance due to the absence of favorable laws.

In order to address the concern of financial institutions, an act to amend Financial Institution (Recovery of Finances) Ordinance (FIRO) 2001 was enacted in 2016. The amendment, under Section 15 of FIRO Amendment Act 2017, empowers financial institutions to foreclose a mortgage property directly in case of default, and subject to the rules issued by Federal Government. This will aid financial institution in speedy recovery of defaulted loans. Another important feature of this law is the categorization of willful default as a non-bailable offence under Section 20 of FIRO Amendment Act 2017.

State Bank of Pakistan is facilitating the Federal Government in drafting rules for section 15 of FIRO. It is expected that the issuance of the rules once enacted will ensure the effective implementation of the act in letter and spirit.

6.1.3 Targets to Banks for Low Cost Housing Finance

In order to channelize credit to low cost housing borrowers, SBP will assign targets to banks/DFIs. The targets will be assigned from October 2018 onwards. Banks will be advised to incorporate the assigned targets in their overall business plan and departmental targets. While assessing performance of banks' management, the bank/DFI's Board of Directors (BoDs) will review the achievements against housing finance targets. SBP will also reflect performance of a bank against the assigned targets in its annual inspection ratings.

6.1.4 Relaxation in Property Assessment for Low-Cost Housing Finance

SBP encourages financial institutions to provide housing finance to the borrowers in low cost housing projects. In order to reduce the transaction cost of the small sized loans, relaxation will be allowed in housing Finance prudential regulation HF-7 by permitting banks/DFIs to use one model property assessment, for a low cost housing society/project only, in place of valuing each individual unit within that society/project.

6.1.5 Relaxation in General Reserve Requirements for Banks/DFIs

Banks/DFIs, under the prudential regulations for housing finance, are required to maintain a general reserve against the respective housing finance portfolios. Currently, Bank/DFIs maintain general reserve in the following manner:

General Reserve against Housing Finance	
Percentage of classified housing finance to total housing finance	General Reserve (percent of active/performing Housing Finance Portfolio)
Below 5	0.5
Below 10	1.0
Up to and above 10	1.5

In order to facilitate bank/DFIs in extending housing finance to low income groups, the general reserve requirements against low cost housing finance portfolio of banks/DFIs shall be withdrawn. The relaxation shall only be applicable on Bank/DFI's housing finance portfolio of low cost housing loans as defined by SBP.

6.1.6 Relaxation in Loan to Value (LTV) Ratio

Banks/DFIs, extending housing finance to low income groups, will be allowed relaxation in housing Finance prudential regulation HF-4 by way of increase in LTV ratio to 90:10.

6.1.7 Allowing Regulatory Relaxation in the Limit on Bank/DFI's Exposure on Real Estate Sector

Banks/DFIs, in terms of IH&SMEFD's circular no. 01 of 2014, are required to limit their exposure on real estate sector up to 10%. However, in order to incentivize banks/DFIs for providing low cost housing finance, bank/DFI's exposure in low cost housing, as defined by SBP, shall not be included for calculating the real estate exposure limit.

6.1.8 Product Innovation

In Pakistan, mortgage products are by and large homogenous across the financial institutions. There is a dire need of product innovation. Housing finance is currently dominated by variable rate mortgages with no presence of fixed rate mortgages. In order to ensure takeoff of the housing finance, product innovation is required. Introducing fixed rate mortgages will provide needed comfort to the borrowers against fluctuating interest rates. In addition to fixed rate mortgages, there is also a need to introduce mortgage products with respect to varied income segments. Banks/DFIs are encouraged to introduce innovative products, which may include the following features/options:

a) Availability of fixed/hybrid rate (floating and fixed)
b) Availability of specified Interest-only period products to make regular home loans affordable
c) Step-up payment option wherein initial installments are lower and repayment schedule is linked to expected growth in borrower's income
d) Discounted rates for borrowers through institutional arrangements with various public/private sector entities
e) Availability of flexible tenures and maximum loan tenure as allowed under Prudential Regulations for Housing Finance
f) Products with no prepayment penalty option

6.1.9 Standardization of Housing Finance Application Form

The dissimilarities and complexities in loan applications of banks/DFIs hinders easy access of potential borrowers to avail housing finance facilities. Accordingly, a standardized loan application form has been developed in consultation with banks/DFIs with a view to streamline and simplify loan application processing by banks/ DFIs. The standardized application form is to be issued through PBA.

6.2 Pillar II: Upscaling Housing Finance Limits for Microfinance Banks

Housing finance is an important tool to increase the living standards of the poor in urban and rural areas. It is, therefore necessary to enhance the role of Microfinance Banks (MFBs) in housing finance. For this purpose, SBP will initiate following measures:

6.2.1 Regulatory Exemptions for MFBs

MFBs are regulated under the Prudential Regulations (PRs) for Microfinance Banks. These PRs restrict MFBs from optimally participating in housing finance. In the light of Prudential Regulation R-5 (A) and R-6, MFBs are limited to extend housing finance up to PKR 500,000, to any single borrower.

In order to enable MFBs to fully utilize their potential, MFBs will be allowed to extend housing loans up to PKR 1 million. Regulatory cap of 60%, on exposure above PKR 250,000, on housing loans will also be removed.

6.2.2 Rationalization of Lending Rates and Increased Tenor for Housing Loans

MFBs may be able to avail long-term wholesale funding lines from PMRC. The availability of long term funding will aid MFBs in rationalizing the interest rates and extending housing loans for longer tenors.

6.3 Pillar III: Affordability

Affordability is a key factor that could instill growth in housing finance. Even with the current low discount rate regime, borrowers are unable to afford installments of a housing loan. This is the reason that growth in the housing finance has mostly taken place in the upper income segments, with the lower income strata still deprived of full access to the institutionalized housing finance.

In view of the above, SBP has decided to take the following measures:

6.3.1 SBP Financing Facility for Low Cost Housing

In an effort to make housing finance affordable to the low income groups, SBP will introduce a subsidized financing facility for low cost housing. The financing facility will provide liquidity to the financial institutions, at a subsidized rate, for extending housing finance to low income segments. The initiative also aims to facilitate housing builders/developers, through banks/DFIs, in increasing the supply of low cost housing units. It is expected that the proposed scheme will encourage even those financial institutions, for extending housing finance, that are currently not active in providing low cost housing finance. Similar financing facility will also be provided through the Islamic Financial Institutions.

Salient Features of SBP Financing Facility for Low Cost Housing

Category I - Individual Housing Finance Borrowers:

- **Participants:** All Banks/DFIs
- **Loan Amount =** up to Rs. 2 million
- **Extent of Refinance:**
  - Up to 50% by SBP
  - Remaining 50% by bank/DFI from its own funds
- **Eligibility of Borrower:**
  - First time home owner
  - Monthly income up to Rs. 60,000
  - For construction of new houses/flats and renovation of existing housing units/flats
  - Maximum value of up to Rs. 2.5 million
- **Loan Tenor:** Up to 12½ years
- **Borrower Rate for SBP Refinance**: 5% (including bank's spread of up to 4%)
- **Options for Borrowers on 50% by Banks/DFIs:**
  - Up to a maximum of 12% fixed rate for entire duration of the loan

    or
  - 1 year KIBOR plus risk premium up to 4%

Category II - Low Cost Housing Finance for Builders/Developers:

- **Participants:** All Banks/DFIs
- **Loan Amount =** Up to the extent of low cost housing units
- **Extent of Refinance:**
  - Up to 50% by SBP
  - Remaining 50% by bank/DFI from its own funds
- **Eligibility of Projects:**
  - Low cost housing unit selling price, under the project, up to Rs. 2.5 million.
- **Loan Tenor:** up to 5 years
- **Borrower Rate for SBP Refinance**: 5% (including bank's spread of up to 4%)
- **Borrower Rate For the 50% Finance Extended by the Participating Bank/DFI**: Bank and borrower may mutually agree on fixed or floating rate.

6.3.2 Establishment of Pakistan Mortgage Refinance Company (PMRC)

PMRC has been granted permission to commence business effective June 12, 2018. Keeping in view the distinctive mode of PMRC operations, its low risk profile and mono-line business activity, SBP has granted the regulatory relaxations to PMRC in capital and reserve requirements. PMRC has also been allowed to avail preferential risk weights for its refinance portfolio and securities issued, owing to its low risk profile. Moreover, Banks/DFIs availing refinance from PMRC have been provided with regulatory incentives. These relaxations/incentives will aid PMRC in operating as viable business entity on sustainable basis.

PMRC will also contribute to the development of bond market since it will introduce a new asset class, Conventional and Islamic, for investors. PMRC bonds will progressively have longer maturities than the current debt instruments in the market and would be an investment instrument combining a high degree of security with a yield higher than PIBs.

6.4 Pillar IV: Promotion and Development of Housing Finance Companies (HFCs)

Despite the existing shortage of housing stock and increasing demand for housing finance, banks are reluctant to take greater role in the housing sector. Consequently, the resulting unsatisfied demand for housing finance necessitates establishment of Housing Finance Companies (HFCs).

Securities and Exchange Commission of Pakistan (SECP) regulates HFCs. Historically, lack of long term funding has remained a major hurdle in the development of HFCs in Pakistan. However, with the PMRC in place, the issue is expected to be addressed to a considerable extent.

In order to create an enabling regulatory environment for HFCs, SBP and SECP will devise a regulatory regime for HFCs particularly focusing on the companies willing to operate outside major cities in Pakistan. SECP, in collaboration with PMRC, would also initiate an awareness drive to promote HFCs as a viable business opportunity to potential investors. PMRC will also ensure availability of long-term funds for HFCs to address funding constraints.

6.5 Pillar V: Government and Corporate Institutional Support through Land and Infrastructure Development

Land represents a significant portion of cost of a housing unit. Provision of land at affordable and/or subsidized rate would significantly reduce the cost of a house; thus making it affordable to low income borrowers. The achievement of intended outcome of a housing finance policy is further bolstered, if Government/corporate institutions' support is provided in the form of subsidized land. As such, intervention is proposed in the following area:

Proposed Model for Utilization of Available Government and Corporate Institutions' Land

- Earmarked land to be offered free of cost to the developer for at least 50% houses/apartments in low-income category.
- Developer offering maximum number of low-income flats/units free of cost would be awarded the project through open bidding process.
- Developer will be free to use the remaining land as per his choice for residential purpose with 10% for commercial use.
- Federal and provincial ministries/departments, universities and corporates institutions etc. may use this arrangement for housing of their employees.

6.5.1 Utilization of Available Land

Utilizing large parcels of vacant Government and corporate institutions' land for low cost housing projects is one way of addressing housing shortage for low-income borrowers. Allocation of free land, under public private partnership (PPP) model, to the commercial builders and developers would incentivize private sector towards low cost housing projects. Provision of subsidized land would ensure low cost housing projects remain affordable to the target populace.

6.6 Pillar VI: Fiscal Incentives

In Pakistan, banks and Development Finance Institutions are not providing long term fixed rate funding options. Thus, they rely on short-term deposits and short-term bank borrowings to finance their mortgage portfolios. In order to address the issue of the maturity mismatch, Pakistan Mortgage Refinance Company (PMRC) has been established to provide long term funding for housing sector. A major source of funding of PMRC is expected to be issuance of securities and bonds to the institutional investors and public. In order to make PMRC business model viable and sustainable, Federal Government, in consultation with SBP, has exempted PMRC from corporate income tax. Further, in order to attract a larger pool of investors to invest in PMRC, the Federal

Government has announced i) exemption of corporate income tax on the income and gains derived from investments in PMRC bonds for the period of 5 years and ii) exemption of capital gains tax on the resale of PMRC bonds by the investors for the period of 5 years.

Moreover, large portion of the housing units' shortage falls in low income groups. With the passage of time, people are moving towards the urban areas for better opportunities which is causing shortages of housing units in urban areas. The situation calls for the immediate actions by the Government to encourage supply of low cost housing units. In consultation with SBP, Federal Government has granted 50% income tax exemptions to housing builders/developers on their income earned from the low cost housing projects under which the maximum sale price of a single housing unit is Rs. 2.5 million.

6.7 Pillar VII: Establishment of a Real Estate Regulatory Authority

Real estate sector in Pakistan lacks a dedicated regulatory framework. Corporate investors are, therefore, reluctant to participate in business transaction that pertains to housing developers/projects. Moreover, homebuyers also remain uncertain regarding their investment in under-construction projects.

With this in perspective, SECP has drafted a bill for the establishment of a Real Estate Regulatory Authority (RERA) in Pakistan. RERA will act as a central agency to co-ordinate and advise all efforts of the Government regarding the development of the real estate sector in Pakistan. Establishment of RERA will aid in development and employment of mechanisms to effectively and transparently supervise the existing and developing areas in Real Estate Sector.

6.8 Pillar VIII: Capacity Building and Awareness Creation

The importance of capacity building cannot be overemphasized. SBP plans to continue the capacity building of banking industry on housing finance through seminars, workshops, training programs, and conferences. Training sessions on variety of topics including product development, mortgage documentation and foreclosure will be planned in coordination with National Institute of Banking and Finance (NIBAF). Moreover, SBP will also arrange practical training programs for bankers in underwriting and servicing of low income housing loans. The programs will be initiated in major cities of Pakistan.

It has also been observed that most of the Primary Mortgage Lenders (PMLs) do not keep their websites up to date with mortgage calculator that provides a potential borrower an idea regarding the monthly installment and loan eligibility. In most cases, institutional website is the first point of contact for a housing borrower who is interested in availing housing finance. An institutional website with updated mortgage calculator also provides an opportunity to the potential borrower to choose the institution that caters to his/her financing need in most effective manner. It also, indirectly, encourages the mortgage lenders to offer competitive terms and conditions to the borrowers. In order to ensure dissemination of this information to general public, banks/DFIs would be required to update their websites with mortgage calculators.

Annexure

Country Experiences

Measures Adopted by Different Countries to Promote Housing Finance

Due to the importance of housing, countries around the world have introduced number of measures to improve the access and availability of housing finance for low-income population. A comparison of initiatives taken by India, Bangladesh, Sri Lanka, Pakistan, USA and Germany is presented in Table 1.

Table 1: Country Specific Housing Finance Initiatives.

Attributes	Pakistan	India	Bangladesh	Sri Lanka	USA	Germany
Specialized Banks for Housing Finance Sector	✓	✓	✓	✓		✓
Specialized Bank Branches for mortgage lending	✓	✓	✓	✓	✓	✓
Credit Guarantee Institutions		✓	✓	✓	✓	✓
Priority sectors advances / low interest rate lending for housing		✓	✓	✓		
Annual lending targets for Housing loans		✓	✓			
Composite loans by Banks for housing	✓	✓	✓	✓		✓
Provision of Loans without collateral/ third party guarantees			✓			
House loans securitization		✓			✓	✓
Secondary Market for mortgages					✓	✓

Priority/mandatory lending

Reserve Bank of India assigns priority sector lending targets to banks. The priority sectors are defined as those sectors of the economy which, if not designated as priority sector, may not get timely and adequate credit. Typically these are small value loans to farmers for agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections. In Brazil, also, commercial banks are directed to lend R$ 0.65 for every R$ 1 received for deposits in savings account, to housing finance.

Housing Provident Fund

- *China* – the Chinese government in Shanghai in 1991 introduced the housing provident fund (HPF), in order to mobilize funding for housing development. Under the HPF, all employees were required to contribute a proportion of their salaries to HPF and employers contributed a similar amount; employees are allowed to either draw from their HPF savings when they retire, or can use these savings to purchase homes in the private housing market. Currently, HPF is implemented in most cities in China.
- *Mexico* – the size of mortgage market in Mexico is 9.9 percent of GDP (2016), and the predominant lenders in this market are the mandatory housing provident funds. Major lenders include INFONAVIT (for private employees) and FOVISSTE (for public employees). Together the two funds contributed around 82 percent of housing finance loans by number (2009).

The so-called 'spicy measures' to cool down property prices

In order to keep intact the housing affordability, Hong Kong took a number of restrictive measures (jointly taken by the Legislative Council and the Hong Kong Monetary Authority) in late 2010. These measures primarily included charging restrictive duties on property re-selling within short duration.

Secondary market for mortgages

Secondary market for mortgages enables more recycling of funds and reduces capital adequacy requirements. In Pakistan, housing loan is a capital-deficient sector and offers great scope for mortgage-backed securitization development and its secondary market. Through secondary market and securitization, not only needs of the borrowers and investors can be met, it may also create a long-term debt market for Pakistan's deprived money and capital market.

Housing Market in South Asia

In the following section, major achievements and challenges being faced by regional peers in their respective housing finance market will be briefly discussed. A detailed country comparison of key indicators and facts for selected South Asian economies is reported in **Table 2**.

Table 2: Country Comparison				
Indicator	**Pakistan**	**India**	**Bangladesh**	**Sri Lanka**
Total Population (millions)	208	1,311.1	161.0	20.6
Urban Population (% of Total)	39.2	32.8	34.3	18.3
Owner-occupied units (% of Total)	73.7	86.6	80.4	82.1
Outstanding House loans to GDP (%)	0.5	7.7	3.0	6.8
Housing Requirement / Shortage (million units)	>10	30	more than 5	0.375
Public Enterprises involve in housing Finance	Yes: House Building Finance Corporation (HBFC)	Yes: National Housing Bank (NHB)	Yes: Bangladesh House Building Finance Corporation (BHBFC)	Yes: Housing Development Finance Corporation (HDFC)
Mortgage Refinance Institution	Exists but not fully operational	Yes: NHB functions as a refinance bank	Yes	Yes: State Mortgage & Investment Bank
Credit Guarantee Institution	No	Yes	Yes	Yes
Secondary Market	No	No	No	No
Securitization of Mortgage loans	No	Yes	No	No
Main Source of Funding	Deposits	Deposits, low cost funding from regulator	Deposits	Low cost Government Deposits
Large Scale housing finance: Developer Market	Developer market exists but no financing tool for this segment	Developer finance for upper-end construction is easily obtained	Available through Bangladesh Infrastructure Finance Fund Limited (BIFFL)	No Developer market

India

India's major achievements for the housing sector include

a) Development of a housing price index RESIDEX, launched in 2007, after which, speculative demand can be monitored by the authorities;

b) Having a central bank subsidiary, National Housing Bank (NHB) which regulates the specialized housing finance companies (HFCs), and acts as a second-tier lender to all mortgage originators;

c) Disintegration of housing loans from public enterprises only to private financial institutions which are controlling more than two thirds of the market at current;

d) Securitization of the house loans: Although the penetration of such deals has remained low because of regulations and liquidity issues. There is no secondary market for these securities yet, and cross-border issuances are not allowed by the regulator;

e) Development of products for large-scale developer finance: Developer finance for upper-end construction is easily obtained through a rich variety of possible sources, including bank finance, self-finance, and the capital markets.

The major challenges to India in housing finance are reaching low-income group, improving procedural requirements, and improving funding with banks, credit bureaus and regulations.

Bangladesh

Bangladesh's major achievements in the housing finance sector include:

a) Bangladesh Bank was successful in creating a competitive environment in the housing finance sector which benefited the consumers as well as the economy;
b) The commercial banks, in both the public and private sectors, have established house mortgage finance departments;
c) Low cost government deposits - an important source of funding housing finance in Bangladesh - are driving the growth. Nationalized/public commercial banks enjoy the large chunk of such deposits.

They also have a similar set of challenges to their housing sector as those of the region, however their banking sector is more vibrant and more interested in mortgage financing, therefore one can expect an increased role of commercials banks in housing sector in near future.

Sri Lanka

In contrast to the regional countries, population in Sri Lanka is not a problem, as its population growth is lowest in the region. Most housing is permanent in nature and 76 percent is owner occupied. The developer market does not exist in Sri Lanka. Despite this, the housing finance sector of Sri Lanka is only 7.5 percent of GDP. The housing finance market in Sri Lanka is segmented between private commercial banks and state-owned banks, with a small number of other financial institutions making housing loans.

Sri Lanka's achievements in the housing finance sector include:

a) Transition from a system of directed credit in a highly segmented market toward an integrated housing finance system;
b) Increased role for private commercial banks
c) A functioning secondary mortgage market
d) Establishment of Housing policy in the National Development Strategy

e) The Government land has been put together to higher and better uses, with the proceeds from the increased land value paying for housing for displaced dwellers and for low and middle-income housing construction

The Government has maximized the use of the existing housing stock by providing basic public services and upgrades as part of the Housing policy in the National Development Strategy.