

Housing Finance in Pakistan

Rapid urbanization has become a common phenomenon for developing countries across the globe. This, according to popular notions, especially among economists, is a good sign because rapid urbanization indicates economic development. According to the UN-Habitat, half of humanity now lives in cities, and that the urban population will increase to 60% within next two decades. Developing world with highest growth rate of urban population absorbs on an average about 5 million new urban residents every month and thus accounts for 95 per cent of the world's urban population growth. 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.

One of the major components of the social infrastructure is housing, the lack of which begins to offset the positive effects of economic development. The housing sector is believed to affect an economy in four ways. First, real-side linkages include the effects of housing policy on macro-economic variables as output, employment, income, consumption, savings & investment, prices, inflation and the balance of payments. Second, financial linkages that deal with the relationship between the financial sector- providing housing finance- and the demand for, and supply of, housing. Third, fiscal linkages cover the contribution of government to the supply of housing through tax and subsidy policy. Lastly, socio-economic linkages, implies that if the majority of the population has access to adequate housing, they are more likely to participate economically, socially and politically in their communities.

Developing countries are generally faced with increasing house prices and shortage of housing units. This in turn leads to low income households making a choice between housing consumption or paying for basic needs like food, clothing and health. An important implication of this is that the poor tend to miss out on economic opportunities that emanate from increased activity and urbanization, such as capturing market value increases upon sale of house, or income gained from renting out a room or initiating small scale business/ cottage industry. Therefore, housing plays a crucial role in welfare enhancement of individual households.

The Government of Pakistan in its Medium Term Development Framework has recognized Housing and Construction as priority sectors that pose substantial potential for employment generation for the poor segments of the society.¹ 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.²

Urbanization in Pakistan

According to the certain estimates the population of Pakistan is over 166 million³; increasing approximately at the rate of 2% per annum⁴. Urban population as a percentage of total population has been recording a growing trend. There are approximately 10 urban centers in Pakistan with Karachi and Lahore, the two biggest centers, alone constitute 62% 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% between 2010 and 2020. Moreover, population density has also increased from 142 persons per km² in 1990s to 206 persons per km² by 2007. Of this highly concentrated urbanization trend, over 45% of the

¹ The MTFD has also identified agriculture, water development and SMEs as priority sectors in addition to housing and construction.

² Pakistan Economic Survey 2006-07, Government of Pakistan.

³ The Federal Bureau of Statistics, Pakistan

⁴ 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 instability.

Urban growth is a result of a combination of factors namely geographical location, natural population growth, rural-to-urban migration, infrastructure development, national policies, corporate strategies and other major political, social and economic forces. Therefore, the need for the government and also financial institutions to respond adequately and timely to this resultant increase in demand perhaps has never been more critical. The ability of financial institutions to meet this demand in turn hinges on the overall institutional and regulatory framework of a country relating to housing and financing the housing needs.

Table 1 shows general statistics on housing for Pakistan. Like other developing countries, Pakistan too faces a critical shortage of housing units. According to conservative estimates, there is already a backlog of more than 8 million housing units which is growing approximately by about 300,000 units every year. This backlog, together with inadequate housing facilities has been affecting quality of life of the general public, especially the urban working class. Average national occupancy rate per dwelling in Pakistan is over 6 whereas per room density is 3.5 persons as compared to the international standard of 1.1 per room. The shortage of housing facilities is more acute in urban cities and towns where more than half of the population lives in slums or in irregular settlements. Moreover, the low mortgage to GDP ratio indicates the low volumes of housing finance in the country.

No.	Description	Stats
1	Population	170 million(2009-10)
2	Population Density	214.3/ km ²
3	Urban Population	38% of Population
4	Projected Growth of Population	1.6%
5	Housing Backlog	8 million units
6	Annual Increase in Housing Backlog	300,000 units
7	Room Density	6.7 persons/ room
8	Per Capita Income	\$1067
9	GDP (FY07-08)	\$177,901 million
10	Housing Finance as % of GDP	0.7

In the past years, due to the high rate of economic growth and especially owing to manifold increase in home remittances since 2001, investment into the real estate sector also increased tremendously. However due to shortage of built up homes, less than adequate availability of land for developing new housing facilities, the new capital injection in the housing sector led to escalating property prices. This has also resulted in a higher ratio of urban property prices to purchasing power, a typical phenomenon that is also found in densely populated cities such as Mumbai, Hong Kong etc.

Housing Finance

In Pakistan, around 25 commercial banks, House Building Finance Company (HBFC); a specialized housing bank and one DFI are catering to housing finance needs of different societal groups. HBFC is the only specialized housing bank in the country, which has been providing housing finance to public since 1952. In 1994, the government decided that HBFC should operate as a market-oriented financial institution. Commercial banks entered the mortgage business during 2003 contributing very small share in the housing finance system. Only few commercial banks extended housing loans during 2003. Out of 14 banks, 3 held more than 80% share in outstanding. By the end of June 2010, share of HBFC reduced from 55% in 2004 to 20% (table below) and commercial banks and DFIs are collectively now enjoying 80% share in outstanding. Although HBFC's share in the total housing finance has reduced in absolute terms, it is still the only institution that continues to cater to the lower-middle and low-income groups and enjoys the largest customer base.

Both commercial banks and HBFC together reported total outstanding of Rs. 70.34 billion, as on June 30, 2010. Table below provides a snapshot of the housing finance in Pakistan. The total number of borrowers at the end

of June 2010 was 101,632; HBFC accounting for more than 75.5% of these borrowers. The current overall weighted average interest rate is 15.76% with maturity periods being 13.6 years, on an average. The percentage of financing (Loan to Value ratio) extended by banks has declined from 57.1% (during quarter ending June 2009) to 49.8% (during quarter ending June 2010).

Housing Finance Statistics

	2010	2009	2008	2007	2006	2005
Gross Outstanding (Rs million)	70,337	76,663	83,786	76,004	61,957	55,293
Gross Outstanding US \$ (in millions)	882	921	1,058	1,237	1,016	924
• Share of All Banks & Other DFIs	80%	79%	80%	84%	82%	65%
• Share of HBFC	20%	21%	20%	16%	18%	35%
No. of Outstanding Borrowers	101,632	115,959	123,107	125,490	99,671	135,689
• All Banks & Other DFIs	24,855	27,372	28,624	26,073	23,416	19,112
• HBFC	76,777	88,587	94,483	99,417	76,255 ⁵	116,577
Annual Growth (%)	(5.4) ⁶	(8.5)	10	23	12	50 ⁷
5 Year Growth (%)		142.7 ⁸	274			
Weighted Average Interest Rate (%)	15.76	16.15	14.65	12.14	10.31	10.10
Average Maturity Periods (Years)	13.6	12.6	12.2	12.8	13.6	13.2
Average Loan Size						
• HBFC (Rs. Millions)	1.22	0.74	0.86	0.092	0.087	0.083
• Commercial Banks (Rs. Millions)	3.55	2.49	2.35	2.60	2.33	1.95
Non-Performing Loans (Rs million)	17,368	15,260	12,314	N.A	N.A	N.A
NPLs as a % of Total Outstanding - Overall	24.71%	19.90%	14.7%	N.A	N.A	N.A
• All Banks & Other DFIs	19.57%	14.42%	9.1%	N.A	N.A	N.A
• HBFC	44.82%	40.97%	37.6%	N.A	N.A	N.A
Consumer Finance as a % of Private Sector Credit	9.40%	10.80%	11.42%	14.41%	14.87%	
Housing Finance as a % of Consumer Finance	22.26%	21.47	19.81%	17.23%	14.96%	
Housing Finance as a % of Private Sector Credit	2.09%	2.32	2.26%	2.48%	2.23%	

Institutional Challenges Faced by the Housing/Housing Finance Sector

Although efforts are being made by the government, SBP and other stakeholders to increase housing supply and improve the overall conditions in the housing & housing finance market, there still remains an acute housing shortage, particularly for lower income groups, which make up a substantial part of the population. Several constraints curtail the growth of the housing sector. The constraints currently being faced by the housing sector in Pakistan can be generalized into three principal themes—the weak property rights and inadequate land development framework, the embryonic property development framework, and the emerging building industry. These constraints are not unique to Pakistan as other development economies also faced them albeit to a varying degree, during the process of development of their housing sector.

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

⁵ Since figure for HBFC is not available, it has been estimated using average loan size of 2007 and 2005

⁶ Six months growth since December 2009

⁷ Growth rates were high since commercial banks had just entered the mortgage market

⁸ Growth since 2005

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

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

The increase in property tax revenues has not been equating to the rise in construction activities and property prices. Reasons include poor enforcement and coverage. The institutional framework for identifying, acquiring, and servicing land available for construction and subsequently selling the constructed housing units is underdeveloped.

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

In Pakistan only the "property valuers" have professional conduct requirements that were established by SBP and the Pakistan Banks' Association (PBA), whereas majority of real estate builders and developers are working as sole proprietorships or partnerships with limited capital and informal corporate governance structures. Absence of sound governance structure within the housing developer industry creates lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in future. The unstructured and unsupervised nature of business of real estate brokers/agencies, which could serve as a natural arrangers for the provision of financial services, is also a significant constraint to the provision of housing and housing finance. Consequently, it is difficult for financial institutions to verify the character, capital, and capacity of potential clients. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders' extreme caution for transaction initiated by these venture. As a result, financial institutions are reluctant to enter this market, which in turn causes scarcity of finance and constraints in the supply of housing. In the absence of the formal arrangements between the housing developers/real estate agents etc; and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner. Without using a strong regulatory authority to enforce corporate governance and allied standards for this stratum of business entrepreneurship, the quality of availability of housing facilities across

population spectrum will not improve. Above all tenancy laws are skewed in favor of tenants and therefore also act as an impediment to the provision of housing finance aimed at generating rental incomes.

Initiatives taken by Government of Pakistan

Reformation of the real-estate sector will require specific steps to strengthen the titling and land recording system in Pakistan. This requires amendments in land acquisition acts, rewriting of urban rent laws, computerizing the land registers, adjusting the legal context to consider only formally registered transfers of property and establishing effective dispute resolution mechanisms to deal with disputed properties pending resolution by the courts of law. Reformation of the real-estate sector will also require an overhaul of the property registration system in Pakistan. This will specially be important for banks as it will help them gain greater confidence in loan documentation.

Despite all the above impediments that exist in the housing sector, the Government of Pakistan has shown its commitment to long-term housing sector development reforms. It has recognized Housing and Construction as an industry and a priority sector of the economy. It announced the National Housing Policy (NHP) in 2001 with a focus on an enabling strategy aiming at resource mobilization, development of a housing finance system, provision of incentives through tax rationalization and enforcement of effective foreclosure laws. Although dedicated and focused efforts are being made by the Government, SBP and other stakeholders to increase housing supply and improve the overall conditions in the housing market, there still remains an acute housing shortage, particularly for lower income groups, which account for a substantial part of the population. There is also a significant level of commitment required on the part of the Government as well all stakeholders to constantly analyze the issues in the housing sector and make efforts to eliminate redundancies and inconsistencies in the housing market. To strengthen the institutional framework following steps are essential:

- i. Development of long-term plans for housing sector development in conjunction with the central planning agencies.
- ii. Participation of the private sector, NGOs, community-based organizations, and consumer protection group in housing policy formulation at national, provincial and municipal levels;
- iii. Conducting studies on impact assessment of regulations on housing & initiatives concerning development of housing facilities in the country.

Initiatives taken by State Bank of Pakistan

The State Bank of Pakistan is fully cognizant of all issues and constraints and therefore besides establishing a dedicated Infrastructure and Housing Finance Department, it has already embarked on a number of key initiatives to strengthen the market based housing finance mechanism, which are as under:

- SBP established a Housing Advisory Group (HAG), with an intention to conduct a thorough analysis on the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations stressing on the need to enhance access of financial services for the development of housing sector. 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. Summary of the HAG recommendations given below:
 - i. Reforming Legal Framework Affecting Foreclosure, Transfer, Tenancy, Rent Control and Acquisition of Immovable Property.
 - ii. Rationalization of transaction costs.
 - iii. Establishing an integrated nationwide land registration information system
 - iv. Increasing supply of land for affordable housing.
 - v. Structuring and streamlining large scale developer's finance.
 - vi. Provision of housing finance for affordable and low cost/income housing facilities.

- vii. Promotion and development of real estate investment trusts (REITs)
 - viii. Provision of long term funding for housing loans.
 - ix. Developing housing market information system.
 - x. Capacity building of the mortgage banking industry in Pakistan.
- 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 will involve restructuring of HBFC by removing inefficiencies and strengthening the institution.
 - The establishment of Mortgage Refinance Company (MRC) is also on the common agenda of SBP and World Bank and will be 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. Significant milestone has been achieved on this initiative. A 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 inject Rs. 1.2 billion as equity into MRC. IFC and ADB are also analyzing the business plan and feasibility and would hopefully contribute around 30% equity. Memorandum & Articles of Association have been prepared as a part of incorporation process.
 - Efforts are being made with the 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. SBP is currently working jointly 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.
 - Realizing the fact that housing finance be institutionalized, simultaneous efforts to develop human capital will also be ensured. A Cooperation Agreement was signed between International Finance Corporation and SBP to launch a housing finance training program in Pakistan. The training covering all aspects of housing finance from product development, loan marketing/distribution and origination to loan underwriting, servicing and risk management was conducted. Till date, approximately 200 bankers from over 20 banks have been trained in the mortgage business.

Notwithstanding the weak infrastructure and allied facilities concerning housing finance in Pakistan, fact remains that Pakistan's mortgage market continued to develop albeit at a slow pace initially with more concentration in large cities prior to last decade. However, it does give comfort that strategic measures to address key impediments and challenges have been initiated and a roadmap has been set for further direction.

Actions to be taken by Ministry of Housing & Works

It will be pertinent for the Ministry of Housing and works to play a focal role in mobilizing resources to correct inefficiencies in the housing sector. The ministry will have to broaden its mandate and instruct Federal, Provincial and Local government quarters to rationalize transaction costs. The other areas include better utilization of government lands, bringing unregulated tracts of lands (Katchi Abadis) under regulation by the government. The ministry also needs to strengthen the tax framework and enforcement environment.

Other Areas/Issues pertaining to Housing Finance

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 constraints the supply of housing.

Credit rating of developers/builders

The unstructured and unsupervised nature of real estate brokers is also a significant constraint to the provision of housing and housing finance. Only valuers 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.

Affordable/low-cost housing

At present, financial intuitions are not aggressively working to find solutions for addressing the acute shortage of 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 intuitions 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.

Micro-housing

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 commercial banks/DFIs would also 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.