Issues and potential of Islamic home finance in Pakistan

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BUSINESS RECORDER Pakistan witnessed a real estate boom during 2003-2007.

Property prices skyrocketed across the country and to buy a home was a step beyond the bounds of possibility for an ordinary Pakistani.

The expatriate Pakistanis invested their money in real estate and the continuous flow of dollars swelled the volume of market.

According to modest estimates during 2003-2007, the money invested into the real estate market was nearly equal to Rs 250 billion rupees and this resulted into an upward and sharp increase in the prices which produced a hyper effect on the market.

But, now market analysts are of the view that the real estate bubble has come to an end and market is going through a slump.

What really happened is that a conventionally unorganised and unnoticed sector recorded an amazing level of growth, which was unsustainable.
At the same time the country's housing situation is aggravating with each passing day.

Our burgeoning population, its stunning 2.4 % annual growth rate and strong inward migration (rural-urban migration) trends are compounding the problem.

The decrease in the average household size or the nuclear family is also gaining popularity in the urban centers.

It is also resulting into a higher need for smaller houses to catering to smaller households.
There are nearly 19 million houses in the country against the population of 150 million and the required number of housing units for the population is 25.83 million.

Thus, we are falling short of nearly 6 million houses.

This is a huge number if seen against the backdrop of the housing units being built annually.

We have to construct more than 500,000 housing units annually to meet the backlog in 20 years.

We have not taken the factors of population growth and stock depletion into account.

At present the number of housing units being constructed is only 300,000 which is really a fraction of the gigantic demand.
Housing Finance in Pakistan: Progress, Prospects and Problems There are a number of skeptics in the country who have expressed doubts about the emphasis being given to housing financing in the country.

Their mindsets are still frozen in the traditional way of public sector and government led growth model supplemented by a corporate and industrial sector.

According to the basic economic law (identity) for generating national income in any economy-developing or developed:

GDP = Private Consumption + Private Investment + Public Consumption + Public Investment + Exports - Imports In Pakistan, private consumption is the largest single component of GDP, accounting for 80 percent of the total GDP.

Thus, it is obvious that any move to boost private consumption will have a much larger impact on the GDP growth than any other services sector with a multiplier effect of 3 to 4, but also enhances the overall level of private savings.

How does this happen? In absence of owner-occupied housing the owner does not have any compulsion or incentive to make any forced saving out of the current disposable income.

But in his quest to obtain mortgage financing he has to save at least 20 percent of the total cost upfront as down payment in form of equity.

In addition, every month he has to allocate some extra income over and above monthly rental income to meet the mortgage instalment.

Thus, this action results in forced or compulsory saving and if aggregated across households with identical behaviour leads to an increase in level of domestic savings in the country.
In order to provide an institutional arrangement and direction to reform housing finance, a standing Advisory Group was established at SBP to implement the recommendations of the Housing Finance Conference held in December 2002 and take up the practical problems faced in the course of implementation.

The Advisory Group was able to sequence the reform agenda required for the promotion and development of a sustainable market-based housing finance system in the country.

The credit regime for housing loans has been liberalised.

Banks' exposure to housing finance has been enhanced by removing the limit of 10% of their net advances.

The response of the banking system to these incentives and measures is encouraging as not only the number of active banks engaged in housing finance is increasing, but banks are also vigorously marketing their housing finance products.

This can be gauged from the increase in housing finance disbursements by the banks over years.
It is important to point out that banks are selective in their approach and at present focusing on outright purchase and renovation loans mainly to upper income groups for unlocking their equity investments in housing properties.
This trend may continue for some time, but as banks develop expertise in origination, underwriting, appraising and monitoring housing loans then construction finance for middle-income groups would be the major focus of the banks.

SBP has also approached the Honourable Chief Justices of Supreme and High Courts and has requested them to issue instructions to law enforcement agencies, courts and registrars regarding recovery laws and instituting training for speedy resolution of property disputes.
Growth trends and future prospects of Islamic home financing After the steps taken by SBP to promote housing finance in Pakistan and interest taken by banks to do home financing, the housing finances sector is growing.

It is important to note that share of Islamic banking in Pakistan's banking industry in close to 6.4 %, however, incase of mortgage financing the share of Islamic product is 20%.
Today, Islamic Banking is available through 5 full-fledged Islamic banks and 12 conventional banks having Islamic banking branches.

Islamic banks are currently able to offer at least 75% of the product range available in contemporary conventional banking.

On the consumer banking side, clean lending products like Personal Loans still pose a challenge.

None of the banks have any Microfinance or Agriculture business although a few have started offering financing to SME sector.

This offers a huge opportunity to extend the reach of the banking sector and multiply the size of Islamic banking geometrically.

The market share of Islamic banking industry is close to 6.4% of total banking industry assets.

Differences between Islamic & Conventional Mortgage Finance The principle differences between Islamic and conventional housing finance is that the former is equity based and the latter is debt based.

In an Islamic mortgage situation both the bank and the client share ownership [equity] and therefore share the risk of equity ownership.

In conventional banking, the client owns all the equity and the banks loan to the client is secured on the value of the property.

Issues and challenges faced by the Islamic housing finance sector

a) Taxation Issues High rates of duties and fees still remain a major impediment in property transactions and so far no provincial government has rationalised these on conveyance deeds, despite the covenants of National Housing Policy 2001 and recommendations of Advisory Group on Housing Finance to this end.

b) Capacity Building Capacity building is another major challenge being faced by Islamic mortgage finance Industry.

Proper understanding of Islamic mortgages and their equal treatment vis-a-vis conventional products is vital for the practitioners.

The State Bank of Pakistan plays its role as a facilitator, guide and catalyst as it believes that as a matter of priority provision of training to bank staff is of pivotal importance for creating understanding and developing expertise in originating and underwriting housing loans at the primary mortgage market.

In this connection, SBP conducts elaborate training program in association with IBP, IFC and NIBAF, besides holding special training sessions for senior officers of banks with foreign experts of housing finance from Malaysia, India and other countries.

c) Asset Liability Matching Presently, banks are funding their housing portfolio through demand and time liabilities, thus running an asset-liability mismatch on their balance sheets by borrowing short and lending long.

However, as the primary mortgage market gains momentum and acquires a critical mass then banks would be looking for alternate ways and means to fund their mortgage portfolios to match their mortgage assets.

(d) Issue of Legal Titles It is important to note that in Pakistan, it is difficult to create mortgages on property due to different title documents in various part of the country.

Subsequently, banks are reluctant to offer mortgage financing apart from major cities.

The provincial governments, district governments and local government authorities have a major role to play.

Allocation of land for genuine and approved new housing schemes along with clean title deeds, developer financing, provisioning of infrastructure and individual mortgage financing have to become available in an integrated fashion. Hence, based on the above discussion, it is important that the obstacles related to the growth of Islamic mortgages financing in Pakistan needs to be removed, so that the current low mortgage to GDP ratio of Pakistan increases.

Currently, it is less than 1% of the GDP and is lower than that of India, which has a ratio of 5% and that of European countries which have mortgages to GDP ratio of over 50%.

Moreover, growth in mortgage finance will have a positive impact on the economic growth in Pakistan, as this will lead to increase in employment opportunities for semi skilled workers and industries associated with housing sectors like cement, steel ,wood, paint and textiles will be positively impacted , leading to the real economic growth and asset creation , thus achieving the objectives of Islamic economic system.

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