HOUSING FINANCE REFORMS IN PAKISTAN

Strategy for Strengthening the Real Estate Development Process

June 2006

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Foreword

Despite the growing economic and social importance that development economists are attributing to housing finance, it remains largely underdeveloped in Pakistan. Private mortgages remain small and unaffordable. Housing finance is expensive and still rationed in favor of higher income populations. This study discusses the present state of the housing finance market in Pakistan against the background of the sustained fundamental constraints that continue to hold back the sector's growth. But it also argues that the housing finance sector in Pakistan is at the tail end of the transition from being a government-dominated to a private sector–led industry; that it is at the development stage where it can finally begin to realize its hitherto untapped potential. In order to realize the potential of housing finance, policy makers, in collaboration with the private sector, need to actively address the challenges facing the sector, notably, strengthening property rights and the land development process, developing the property development framework, supporting the building industry, facilitating the development of the primary and secondary housing finance market, and introducing targeted housing finance programs.

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1. INTRODUCTION

1.0 Introduction

Pakistan faces a critical shortage of housing units. According to conservative estimates, there is already a backlog of 6 million housing units, and the backlog increases by 270,000 units every year. This shortage, together with the less than satisfactory conditions of existing housing facilities, contributes adversely to the quality of life of the general public, especially the urban working class. Already, the national average occupancy rate per dwelling is over six; whereas the per person room density is 3.5 as compared to the international standard of 1.1 per room. The housing shortage is especially burdensome in urban cities and towns, where more than half of the population lives in slums or irregular settlements.

In recent years, due to the high rate of economic growth and nearly quadrupling of remittances after the terrorist events of September 11, the housing sector is facing a problem of not only supply shortages but also escalating prices. Investment in housing in recent years has resulted in a higher ratio of urban property prices to purchasing power, which typically occurs in densely populated cities such as Bombay and Hong Kong.

The twin problems of supply shortages and escalating prices are indicative of the fact that the housing sector is grossly underdeveloped and undercapitalized. One of the ways of improving capitalization of the sector is the provision of housing loans, thereby leveraging home ownership. However, until recently housing finance remained neglected—the supply of housing finance actually decreased from 1.5 percent of GDP in 1994 to approximately 0.5 percent in 2001. Although this trend has experienced a reversal since March 2003 as banks have increased their interest in retail banking, as at 2005, mortgage finance was still less than 1 percent of GDP.

In the face of these statistics, a series of dialogues on promotion of housing finance in Pakistan have taken place between the World Bank Group and the government since 2001. These dialogues have included a study of the issues and options of the development of the mortgage market; a technical assistance program for the Punjab Land Records; two housing finance workshops co-organized with the State Bank of Pakistan; and several World Bank missions.

During the course of this dialogue, the government has taken numerous and very positive steps to encourage the development of a more stable and vibrant housing sector. Notably, it has enacted the Financial Institutions (Recovery of Finances Ordinance) 2001; liberalized and strengthened the regime of mortgage lending by lifting various regulatory restrictions and designing an appropriate prudential framework; published the 2001 National Housing Policy (NHP-2001); and granted fiscal incentives to facilitate mortgagors and banks in the federal budget 2003–04.

All these measures have been buttressed by positive macroeconomic improvements, which have resulted in a drastic fall of mortgage interest markups. In turn, this has led to a surge in mortgage lending since early 2003. Because of the rapid pace with which these reforms have been implemented, some fundamental aspects of a fully functioning, market-driven housing finance sector remain to be addressed before there can be a balanced and sustainable growth of the housing finance market in Pakistan. This paper has been prepared in the spirit of consolidating the knowledge of the constraints to the housing sector that has been in the country during the course of the recent dialogue.

1.1 Background

Several factors limit the supply of housing in Pakistan. Until recently, the macroeconomic environment, particularly financial instability in the 1990s and high interest rates, impeded the flow of affordable long-term housing financing. Today, the sector is still plagued by inadequate long-term finance and a complex web of ineffective property titling and land registration systems that do not reliably guarantee property rights, and thus severely limit access to housing finance.

Recent studies indicate that the lack of finance is primarily a supply problem. Only 1 to 2 percent of all housing transactions in Pakistan are processed through housing finance. Otherwise, most housing finance comes from personal resources. The next source (10 percent) is the informal lending sector, which is poorly regulated, particularly in respect to consumer protection (developers' advances, for instance). The formal financial sector provides limited housing support essentially through three major sources: the government's House Building Finance Corporation (HBFC), specialized housing finance companies, and commercial banks.

The government considers housing and construction as one of the sixengines of long-term economic growth alongside agriculture, small and medium enterprise development, energy, trade, and information technology. Recognizing that there are at least 40 industries that are directly or indirectly related to housing construction, and the housing sector's potential to contribute to Pakistan's long-term economic development, the government has begun to take steps to encourage the development of a more stable and vibrant housing sector. Notably, it has (i) established a new (nonjudicial) procedure for recovering secured claims, (ii) relaxed housing finance restrictions, (iii) introduced credit information services, and (iv) appointed of Housing Advisory Group (HAG). Positive macroeconomic reforms have also resulted in a more enabling environment for the sector.

Given the potential of the housing sector both for the economy and banking sectors, the State Bank of Pakistan (SBP) has been working with the banking sector to create an enabling environment for an efficient housing sector. This work includes implementing the covenants of the NHP-2001 relating to increased provision of housing finance (see Annex A).

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

- Banks/DFIs are required to determine the housing finance limit, in both urban and rural areas, in accordance with their internal credit policy, creditworthiness, and loan repayment capacity of the borrowers.
- Banks/DFIs are required to ensure that the total monthly amortization payments of consumer loans, including housing loans, should not exceed 50 percent of the net disposable income of the prospective borrower.
- Banks/DFIs have been allowed to originate a housing loan at a debt-equity ratio of 85:15 for up to 20 years.
- The removal of maximum per party limit of PRs 10 million, in respect of housing finance.
- In order to curb speculation, banks/DFIs are not allowed to provide housing finance purely for the purchase of land/plots.
- Banks/DFIs are allowed to provide housing loans up to 10 percent of their net advances.
- Banks/DFIs are encouraged to develop floating-rate housing finance products.
- The house financed by the bank/DFI is required to be mortgaged in bank's/DFI's favor by way of equitable or registered mortgage.

In addition, the federal government has provided a host of fiscal initiatives, notably the following:

- Tax credit on borrowing under housing loans from financial institutions has been enhanced to PRs 500,000 or 40 percent of the income of the mortgagor, whichever is less.
- The limit of property income for withholding tax has been raised from PRs 100,000. to PRs 200,000.
- All new construction of housing on plots, measuring up to 150 square yards and flats/apartments having an area of 1000 square feet, have been exempted from all taxes for a period of five years.

However, in spite of these affirmative measures, which have facilitated an increase in provision of housing finance by banks from PRs 1.93 billion to PRs 39.68 billion during March 2003–06, the shortage of finance continues to constitute a major constraint in housing production and maintenance, especially for the urban working class.

This report has been prepared to identify potential opportunities for developing a market-based primary and secondary housing market, so as not only to further increase the resources available for housing and in turn expedite economic development, but also to improve social cohesion of the society. A rapid growth in housing finance will significantly contribute to the economy in the form of additional employment and support to a variety of allied industries.

1.2 Section synthesis

This study focuses on households enjoying an income greater than PRs 15,000 per month. While it does discuss some incentives for inducing lenders to go down-market and bridge the gap between middle-income groups and nonbankable households, this is not the primary focus of the study. Inaugurating a preliminary savings scheme, or requiring employers—including public sector employers—to appropriate some funds as benefits to first-time home buyers among their employees whose earnings would be under a certain level are examples of possible measures.

Section 2 briefly describes the performance of the principal actors in the housing sector—the commercial banks and the House Building Finance Corporation (HBFC). The focus is on the recent performance and not their historical involvement or noninvolvement with housing finance. While a more detailed historical analysis would provide valuable information for explaining present performance, it has not been included here to keep the paper succinctly directed toward possible future options for promoting the sector.

Section 3 discusses the constraints facing the housing sector in Pakistan using three principal themes, namely, the weak property rights and inadequate land development framework; the embryonic property development framework; and the emerging building industry. The purpose of the section is to identify those factors in the macro- and microeconomic environment that are holding back a more aggressive growth of the housing finance sector in Pakistan. The section is by no means exhaustive in its listing of these factors. Its intention is only to highlight primarily those for which external public intervention is required in prompting corrective action.

Section 4 concludes the paper with some modest policy recommendations and options. The recommendations are premised on the fact that a market-based system of housing finance provides real economic benefits and positively impacts savings, investment, output, and employment. The government has commendably already started implementing some of the recommendations included in this section. The purpose of this section is to detail the other complementary reforms that will strengthen the likelihood of a more sustainable long-term growth of the sector.

1.3 Conclusion

This study is not the most detailed assessment of the housing sector in Pakistan. It is not intended to be. Rather, it is a crystallization of the fundamental constraints to the growth of the sector, and the key policy reform options that would have the greatest impact on its future. The study aims to contribute toward a housing strategy that increases the number of middle-income families with access to affordable housing finance, which will help mobilize dormant or locked savings and generate new savings. In turn, each dollar invested in the housing sector is likely to catalyze economic activity in other sectors—providing a much-needed economic boast to the economy, which has not yet responded to recent positive macroeconomic developments. Second, by increasing the number of middle-income families able to access market resources for housing finance, the government can direct freed-up resources to social housing programs targeting the poorest urban dwellers. For example, if mortgages with maturities of 15 to 20 years and rates of 8 to 10 percent were available to households earning PRs 6,000a month—the lower threshold of the middle-income category (1999–2000 figures)—such households could afford, without subsidies, housing valued at PRs 250,000.

2. THE HOUSING FINANCE MARKET IN PAKISTAN

2.0 Introduction

Consumer lending in Pakistan has taken off in recent years. Banks used to be conservative with their consumer loans, offering credit cards only to their wealthy clients. Now banks are expanding aggressively into consumer and automobile loans. The housing loan market is also becoming an important kind of consumer loan. Yet, despite the rapid retail credit expansion in an increasingly sophisticated and highly profitable banking sector in the midst of impressive overall macroeconomic growth, the housing finance portfolio's full potential is yet to be realized. Though the total cumulative disbursements both by commercial banks/DFIs and HBFC have grown to PRs 84,190.6 million (March 2006), the housing portfolio still represents only a fraction of the banking sector's loan portfolio (Table 2.1).

Table 2.1 Housing Finance by Banks and HBFC (PRs million)

Year	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06
Banks/DFIs				
Net Outstanding	1,932	5,602	21,468	39,552
Cum. Gross Disbursements	2,959	7,464	25,090	48,073
HBFC				
Net Outstanding	18,023	18,428	20,583	19,085
Cum. Gross disbursements	30,063	31,974	34,446	36,518
Total Net Outstanding	**19,955**	**24,030**	**42,051**	**58,637**
Total Cum. Gross Disbursements	**33,022**	**39,438**	**59,536**	**84,591**

Source: SBP

This section briefly describes the performance of the principal actors in the housing sector—the commercial banks and the House Building Finance Corporation (HBFC). The focus is on their recent performance and not their historical involvement or noninvolvement with housing finance. While a detailed historical analysis would provide valuable information for explaining present performance, it has not been included to keep the paper succinctly directed toward future options for the sector.

2.1 Commercial banks

In the past few years the number of banks/DFIs offering a menu of housing finance products has grown to 29, and a few are also looking at securitizing their portfolios. Presently as many as 15 banks/DFIs have more than PRs 1 billion of housing portfolios and dominate the sector with 96.82 percent of the total housing portfolio by banks/DFIs (excluding HBFC) (Table 2.2). Other than ABN Amro, Standard Chartered, and Citibank, based on international market experience, all the other banks are local and have recently entered the housing finance market.

A review of the loan portfolio shows that 67.36 percent (March 2006) of the property loans are for outright purchases; 19.83 percent are for construction, and 12.81 percent are for renovations (Table 2.3). In a nascent market, this is not surprising. The need for verifiable collateral for the loan makes construction loans more difficult to finance, while renovation loans tend to be smaller, of a shorter maturity, and lower profit margins for the banking institution. The number of loans disbursed for the year ending March 31 stood at 23,727 for all three categories and have been growing rapidly (construction: 60.84 percent; purchase: 61.58 percent; and renovation: 71.73 percent). Again, because this is a new market, the high disbursement percentages are not surprising. However, it is also a time when caution against bad loans should be at its highest. Desire to capture competitive market share can obscure good lending practices and build up bad loans.

Table 2.2
Banks/DFIs with More than PRs 1 Billion Housing Loans (as on March 31, 2006)

S. No	Name of the Banks/DFIs	Amount Outstanding (in PRs million)	Number of Housing Loans Outstanding	Market Share (%)	Average Loan Size (in PRs million)	Wt. Ave. Markup Rate (%)	Average Maturity Period (years)	Housing Finance as Percentage of Total Net Advances
1	Bank Alfalah Ltd.	7,972.5	3,780	20.02%	2.11	10.50	9.83	6.41%
2	United Bank Ltd.	4,117.0	1,046	10.34%	3.94	10.99	15.67	1.98%
3	Union Bank Ltd.	3,213.8	1,213	8.07%	2.65	11.83	10.83	4.49%
4	Habib Bank Ltd	2,822.2	2,024	7.09%	1.39	11.00	11.50	0.93%
5	ABN Amro	2,611.0	927	6.56%	2.82	12.35	12.95	7.11%
6	Askari Bank	2,299.6	1,062	5.78%	2.17	8.46	11.58	2.69%
7	Standard Chartered Bank	2,230.2	519	5.60%	4.30	11.67	8.92	4.32%
8	Faysal Bank Ltd.	2,091.2	543	5.25%	3.85	11.97	15.39	3.21%
9	National Bank of Pakistan	2,068.1	1,870	5.19%	1.11	12.02	12.04	0.76%
10	Meezan Bank Ltd.	1,932.0	893	4.85%	2.16	11.54	12.00	8.98%
11	PICIC (DFI)	1,909.5	1,433	4.80%	1.33	11.59	12.50	9.12%
12	MCB Bank Ltd.	1,773.8	636	4.46%	2.79	12.91	10.67	1.01%
13	Prime Commercial Bank Ltd.	1,316.9	527	3.31%	2.50	10.23	12.33	4.80%
14	Bank of Punjab	1,125.9	1,530	2.83%	0.74	11.72	12.67	1.58%
15	Citibank	1,065.2	705	2.68%	1.51	14.22	9.14	2.57%
Totals and Simple Averages		**38,548.9**	**18,708**	**96.82%**	**2.06**	**11.53**	**11.87**	**2.45%**
	Other Banks/DFIs	1,264.8	1,531	3.18%	0.83	N/A	N/A	N/A
Total of Banks/DFIs (A)		**39,813.8**	**20,239**	**100.00%**	**1.97**	N/A	N/A	N/A

Source: SBP

Overall, statistics suggest that banks remain very cautious in their lending strategy to the housing sector. Housing-related risk is presently manageable due to the relatively small size of the housing finance portfolio. It is still much below the new 10 percent ceiling as a proportion of the deposit base.[1] The limited exposure allows banks to manage the liquidity risk by leveraging their stable deposit base, but this is not sustainable in the long term due to the relatively short maturities of bank deposits (the bulk of banks' deposits are less than one year in duration. In addition, the active lenders are typically the smaller private commercial banks with limited branch networks that compete with large nationalized banks for securing deposits. As a result, banks are currently forced to restrict their housing loans to 10–15 years.

In part, the banks' cautious approach to lending is because they are still attracting the requisite expertise and resources required to exploit this business area and manage its associated risks. The requisite expertise to undertake housing finance transactions is yet to become more widely available among market players in the financial system as well as in related institutions and industries, and also among regulatory or supervisory bodies. The financial sector lacks experienced sales and origination staff, especially in high-impact areas like construction and developer finance. The lack of experience and expertise impedes this reorientation of the financial sector approach to utilizing market mechanisms and actively mobilizing private sector resources for investing in housing. Some bankers are still more focused on making large loans to the manufacturing/industrial sector and do not yet understand the centralization/standardization/portfolio approach that is required for consumer finance.

[1] The SBP limits bank exposure to house finance to 10 percent of the net loans.

Table 2.3 Housing Finance in Pakistan (Amount in PRs million) Performance of Commercial Banks / DFIs Since March 2003	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06
Total Number of Active Banks	**9**	**22**	**26**	**29**
Net Outstanding as on				
Housing Loans Outstanding	**1,931.62**	**5,602.30**	**21,468.05**	**39,552.31**
Increase		3,670.68	15,865.75	18,084.26
Percentage Increase		190.03%	283.20%	84.24%
Number of Housing Loans	2,305	4,341	12,559	20,239
Increase	-	2,036	8,218	7,680
Percentage Increase	-	88.33%	189.31%	61.15%
Average Loan Size	0.838	1.291	1.709	1.954
Construction Loans	**461.45**	**1,028.79**	**3,683.90**	**7,843.99**
Increase	-	567.34	2,655.11	4,160.08
Percentage Increase	-	122.95%	258.08%	112.93%
Number of Construction Loans Outstanding	981	1,266	3,872	6,369
Increase	-	285	2,606	2,497
Percentage Increase	-	29.05%	205.85%	64.49%
Average Loan Size	0.470	0.813	0.951	1.232
As a Percentage of Total Housing Loans	23.89%	18.36%	17.16%	19.83%
Outright Purchases Loans	**1,243.33**	**3,815.62**	**14,891.85**	**26,642.42**
Increase	-	2,572.29	11,076.22	11,750.57
Percentage Increase	-	206.89%	290.29%	78.91%
Total Number of Outright Purchase Loans Outstanding	1,058	2,400	6,768	10,645
Increase	-	1,342	4,368	3,877
Percentage Increase	-	126.84%	182.00%	57.28%
Average Loan Size	1.175	1.590	2.200	2.503
As a Percentage of Total Housing Loans	64.37%	68.11%	69.37%	67.36%
Renovation Loans	**226.84**	**757.89**	**2,892.30**	**5,065.90**
Increase	-	531.05	2,134.41	2,173.61
Percentage Increase	-	234.11%	281.62%	75.15%
Total Number of Renovation Loans Outstanding	266	675	1,919	3,225
Increase	-	409	1,244	1,306
Percentage Increase	-	153.76%	184.30%	68.06%
Average Loan Size	0.853	1.123	1.507	1.571
As a Percentage of Total Housing Loans	11.74%	13.53%	13.47%	12.81%
Cumulative Gross Disbursements up to the Quarter Ended				
Disbursements	**2,958.83**	**7,464.08**	**25,090.25**	**48,073.16**
Increase	-	4,505.25	17,626.17	22,982.91
Percentage Increase	-	152.26%	236.15%	91.60%
Number of Loans Disbursed	2,968	5,701	14,567	23,727
Increase	-	2,733	8,866	9,160
Percentage Increase	-	92.08%	155.52%	62.88%
Construction Loans	**672.94**	**1,451.40**	**4,258.62**	**9,124.77**
Increase	-	778.46	2,807.22	4,866.15
Percentage Increase	-	115.68%	193.41%	114.27%
Number of Construction Loans Disbursed	1,268	1,954	4,673	7,516
Increase	-	686	2,719	2,843
Percentage Increase	-	54.10%	139.15%	60.84%
Outright Purchases	**1,841.12**	**4,916.77**	**17,187.04**	**32,741.02**
Increase	-	3,075.65	12,270.27	15,553.98
Percentage Increase	-	167.05%	249.56%	90.50%
Number of Outright Purchase Loans Disbursed	1,320	2,873	7,683	12,414
Increase	-	1,553	4,810	4,731
Percentage Increase	-	117.65%	167.42%	61.58%
Renovation Loans	**444.78**	**1,095.91**	**3,644.59**	**6,207.37**
Increase	-	651.13	2,548.68	2,562.79
Percentage Increase	-	146.39%	232.56%	70.32%
Number of Renovation Loans Disbursed	380	874	2,211	3,797
Increase	-	494	1,337	1,586
Percentage Increase	-	130.00%	152.97%	71.73%

Source: SBP

2.2 The House Building Finance Corporation (HBFC)

Housing finance in Pakistan has historically been provided by the House Building Finance Corporation (HBFC), a government entity originally established in 1952 to provide housing finance to the public. Banks have not historically been major providers of housing finance. From 1952 to 1972, HBFC made loans only to (prospective) home owners for construction of homes in urban areas. During this period HBFC's origination activities were quite modest, averaging PRs 18 million (US$300,000) annually. In 1972, HBFC's mandate was expanded to allow it to provide construction financing to housing projects, finance to housing authorities and housing corporations, and rehabilitation loans; and to undertake real estate development projects. Following this expansion of scope, HBFC's volume of originations increased significantly, averaging around PRs 500 million (US$8.3 million) between 1972 and 1979. In the 1980s and 1990s HBFC was averaging around PRs 1.5 billion (US$25 million) in annual disbursements/originations.

In 1994, the government decided that HBFC should operate as a market-oriented financial institution, and in that year SBP stopped lending to HBFC. Since then, HBFC has been relying on repayments from its loan portfolio as its main source of funding new loans. In June 1999, the Supreme Court of Pakistan ruled that all financial institutions in Pakistan should be "Islamized." This effectively shut down HBFC's retail lending program while they "retooled" to offer Sharia-compliant housing finance programs. It was not until February 2002 that HBFC returned to the retail market with a new "Islamized" housing finance program (Ghar Aasan). HBFC's originations during the past two quarters have been running at an average monthly rate of PRs 175 million (US$2.92 million) and are expected to run approximately PRs 2 billion (US$33.34 million) for the year.

In a review of the housing finance sector conducted by the World Bank in 2002,[2] HBFC was characterized as a failed institution, with a "flawed" charter, poor governance, high levels of nonperforming loans (in excess of 30 percent), inadequate risk management procedures and accounting systems, administratively-driven underwriting and pricing policies, ineffective loan servicing procedures, and high administrative costs. Supervision of the HBFC was characterized as "a low priority," and periodic reporting of HBFC to SBP was said to inadequately reflect HBFC's condition as known to its management. This report summarized that HBFC appeared to be "in a state of latent bankruptcy," and that its "insolvency status appeared to be grossly underestimated."

Since then, however, HBFC has made significant strides in improving its operations. The present management team has been in place for three years and it has plans to "corporatize" the entity, which will give it some flexibility. HBFC, under the new management, has achieved reasonable progress in straightening out its accounts, reassessing its provisioning level, and subjecting its nonperforming loan monitoring and provisioning to prudential regulations. Moreover, it has increased its arrears recovery actions, started repaying the below-market-rate SBP credit lines, and begun distributing dividends to its shareholders. It is thus on the right track and in process of becoming a normal player —although it specializes in the low end of the bankable households spectrum and in Islamic housing finance products.

Unlike the commercial banks, HBFC has a larger proportion of its loan portfolio in construction loans (81.01 percent as at March 2006), followed by outright purchases (13.78 percent) and renovations (5.21 percent). Having been in the housing business longer than the private banks, it has a more mature overall loan portfolio growth rate of 1.09 percent (Table 2.4).

[2] See "A Housing Finance System for Pakistan – Issues and Options," World Bank, May 2002.

Table 2.4 Housing Finance in Pakistan (Amount in PRs million) Performance of HBFC Since March 2003	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06
Net Outstanding as on				
Housing Loans Outstanding	**18,023.00**	**18,427.68**	**20,582.59**	**19,084.82**
Increase/(Decrease)		404.68	2,154.91	(1,497.77)
Percentage Increase/(Decrease)		2.25%	11.69%	-7.28%
Number of Housing Loans	150,071	145,744	140,317	113,696
Increase/(Decrease)	-	(4,327)	(5,427)	(26,621)
Percentage Increase/(Decrease)	-	-2.88%	-3.72%	-18.97%
Average Loan Size	0.120	0.126	0.147	0.168
Construction Loans	**16,831.00**	**16,391.73**	**17,042.24**	**15,460.85**
Increase/(Decrease)	-	(439.27)	650.51	(1,581.40)
Percentage Increase/(Decrease)	-	-2.61%	3.97%	-9.28%
Number of Construction Loans Outstanding	141,114	135,017	127,008	99,734
Increase/(Decrease)	-	(6,097.00)	(8,009.00)	(27,274.00)
Percentage Increase/(Decrease)	-	-4.32%	-5.93%	-21.47%
Average Loan Size	0.119	0.121	0.134	0.155
As a Percentage of Total Housing Loans	93.39%	88.95%	82.80%	81.01%
Outright Purchase Loans	**1,192.00**	**1,650.80**	**2,311.63**	**2,629.74**
Increase/(Decrease)	-	458.80	660.82	318.12
Percentage Increase/(Decrease)	-	38.49%	40.03%	13.76%
Total Number of Outright Purchase Loans Outstanding	8,957	9,490	9,914	9,125
Increase/(Decrease)	-	533.00	424.00	(789.00)
Percentage Increase/(Decrease)	-	5.95%	4.47%	-7.96%
Average Loan Size	0.133	0.174	0.233	0.288
As a Percentage of Total Housing Loans	6.61%	8.96%	11.23%	13.78%
Renovation Loans	**-**	**385.15**	**1,228.73**	**994.23**
Increase/(Decrease)	-	385.15	843.57	(234.49)
Percentage Increase/(Decrease)	-	N/A	219.02%	-19.08%
Total Number of Renovation Loans Outstanding	-	1,237	3,395	4,837
Increase/(Decrease)	-	1,237.00	2,158.00	1,442.00
Percentage Increase/(Decrease)	-	N/A	174.45%	42.47%
Average Loan Size	N/A	0.311	0.362	0.206
As a Percentage of Total Housing Loans	0.00%	2.09%	5.97%	5.21%
Cumulative Gross Disbursements up to the Quarter Ended				
Disbursements	**30,063.00**	**31,974.36**	**34,446.20**	**36,517.92**
Increase/(Decrease)	-	1,911.36	2,471.85	2,071.72
Percentage Increase/(Decrease)	-	6.36%	7.73%	6.01%
Number of Loans Disbursed	414,592	421,734	429,131	433,790
Increase/(Decrease)	-	7,142	7,397	4,659
Percentage Increase/(Decrease)	-	1.72%	1.75%	1.09%
Construction Loans	**28,381.00**	**29,462.50**	**30,646.55**	**31,641.41**
Increase/(Decrease)	-	1,081.50	1,184.05	994.86
Percentage Increase/(Decrease)	-	3.81%	4.02%	3.25%
Number of Construction Loans Disbursed	395,104	399,535	403,367	406,242
Increase/(Decrease)	-	4,431	3,832	2,875
Percentage Increase/(Decrease)	-	1.12%	0.96%	0.71%
Outright Purchase Loans	**1,682.00**	**2,228.38**	**2,966.69**	**3,561.72**
Increase/(Decrease)	-	546.38	738.31	595.03
Percentage Increase/(Decrease)	-	32.48%	33.13%	20.06%
Number of Outright Purchase Loans Disbursed	19,488	20,962	22,325	23,406
Increase/(Decrease)	-	1,474	1,363	1,081
Percentage Increase/(Decrease)	-	7.56%	6.50%	4.84%
Renovation Loans	**-**	**283.48**	**832.96**	**1,314.80**
Increase/(Decrease)	-	283.48	549.48	481.84
Percentage Increase/(Decrease)	-	N/A	193.83%	57.85%
Number of Renovation Loans Disbursed	-	1,237	3,439	5,218
Increase/(Decrease)	-	1,237	2,202	1,779
Percentage Increase/(Decrease)	-	N/A	178.01%	51.73%

Source: SBP

2.3 Conclusion

Overall, consumer lending in general, and housing finance in particular, is growing. From being conservative consumer-loan lenders in general, banks that offered credit cards only to wealthy clients are now aggressively expanding into consumer loans, including housing loans. Each bank is investing resources and skills to attract market share from targeted segments of the market. In this relatively new product development phase, the market is open for larger portfolios and for more institutions to enter the market.

While the current legal and macroeconomic environment is increasingly conducive for the growth of the housing finance market, financial institutions in general have yet to provide home financing to a great majority of the population, especially to the urban working class that is in most need of mortgage financing. Primarily, banks are constrained in their lending due to a lack of long-term, fixed-rate funding, which would enable banks to increase the volume and tenure of their housing portfolios. Thus they have continued to rely on short-term deposits to fund long-term loans, which increases the risk for lenders and in turn restricts the menu of long-term mortgage products to increase affordability. The current cost of short-term liabilities is around 2.57 percent, and as depicted in Table 2.2 above, the average markup charged by banks on housing loans hovers in the vicinity of 11 percent, therefore yielding a spread of 8 to 9 percent to the banks. However, this practice is creating asset-liability mismatching, which may not be sustainable in the long term.

Yet, even if long-term funds were immediately available, the volume of mortgages would be restrained by broader challenges facing the sector as a whole and for which public intervention is required. The weak property rights and land development framework; embryonic property development framework; and emerging building industry pose significant problems for Pakistan's nascent mortgage finance market. This paper discusses these constraints in Section 3, and Section 4 offers a modest range of reform options for strengthening property rights and the land development process, developing the property development framework, organizing the building industry, and, broadly, facilitating the overall growth of the housing finance market.

3. KEY CONSTRAINTS TO HOUSING SECTOR DEVELOPMENT

3.0 Introduction

The government of Pakistan is committed to long-term housing sector development reforms. This is evident in its drafting of the **National Housing Policy (NHP)-2001** and subsequent efforts to enact critical legislation that reduces regulatory complexities and streamlines its legal environment. The current macroeconomic conditions along with the focus of the government to deepen capital markets also facilitate further growth in the housing sector.

Although deliberate efforts are being made by the government and other stakeholders to increase housing supply and improve the overall conditions in the housing market, there still remains an acute and severe 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.

This section summarizes the constraints facing the housing sector in Pakistan using three principal themes—the weak property rights and inadequate land development framework, the embryonic property development framework, and the emerging building industry. The purpose of the section is to identify those factors in the macro- and microeconomic environment that are holding back a more aggressive growth of the housing finance sector. The section is by no means exhaustive in its listing of these factors. Its intention is only to highlight primarily those for which external public intervention is required in prompting corrective action.

3.1 Weak property rights and inadequate land development framework

The property development industry suffers from low public confidence. A history of scams, financial weaknesses, and the absence of clear, uniform, and fair business practices have tarnished its credibility. Financial institutions are reluctant to provide construction finance, and individuals are reluctant to apply for mortgages. There is a strong need to strengthen the property titling/land administrative procedures, including the overhaul of the legal provisions, the standardization of processes, and computerization, which will not only bring efficiency gains, but also drastically improve security. Presently, the system is adversely plagued by the following factors:

- *Inefficient legal framework* – The current land development framework is highly inefficient and acts as a critical bottleneck to the availability of developed land in the market. Within the public agencies, for example, the effective reorientation of staff from a direct state provision of housing toward a more market-oriented approach has yet to take place. The current land development authority system requires that the development agencies acquire land, develop it, and then sell it to the public. This process is plagued with legal and administrative burdens, which increase the costs and time for delivery and reduce the availability of developed land. The development authorities are also faced with a lack of adequate funding to finance this cumbersome process, which also impedes their ability to meet demands of the market.

- *Fragmented land ownership and titling* – In Pakistan, the basic regulatory framework for land registration and transfer is sound; however, the process by which land is acquired and registered is extremely nontransparent, and cumbersome. Typically, Patwaris manually maintain 15 separate books of land registries to which nobody else has access. Even though it is mandatory, property registration is also neglected because procedures are costly.

To avoid excessive stamp duties and registration fees, a large proportion of transactions are not recorded. Further, while land titling is a provincial responsibility and some variances are expected amongst the four provinces, even within a province land titling and registration practices are fragmented. An acute example of this problem is the situation in Karachi, where over 17 different agencies are responsible for land titling and registration.

- *Inefficient land information systems* – It is hard to verify land ownership and transfers for large parts of the country, especially when transactions are recorded manually and are predominantly cash based. Better ways to collect and disseminate data are required to improve efficiency and minimize fraud and financial abuse. Computerized information and registration systems, property and ownership databases, effective title regularization processes and cadastral surveying, and an Land Information Service (LIS) will increase transparency and creditor rights enforcement. Almost 80 percent of transactions, valuations, and so forth are done between the parties in cash and without any transparent verifiable public document. This means that only 10 to 20 percent of property transactions are registered with the authorities. In Pakistan, there exists a strong and rampant informal land transfer system that ranges from oral commitments to disputable land allotment letters, to collateral assurances through powers of attorney, which operate outside of the formal land registration systems. Consequently, record-keeping is incomplete and unreliable, and multiple sales of the same property with related ownership disputes are commonplace. This state of affairs, combined with very weak law enforcement, enables illegal activities by well-connected land mafias and short-lived opportunistic developers. These unethical practices make title search or record certification nearly impossible.

- *Unused government land* – According to the Association of Builders and Developers (ABAD), the government of Pakistan directly controls 40 percent of the land, and acquiring the land from the government is problematic. Therefore, a large share of the land directly controlled by the government is not being used for productive or strategic purposes, and the remainder is leased to the private sector. The Foreign Investment Advisory Services (FIAS) administrative barrier study has found that it takes, on average, 135 days to acquire land from the government in Pakistan. Private land can be acquired in 63 days, but even this is not a good practice benchmark.

- *High stamp duty/registration fees for conveyance and mortgage deeds* – Despite the NHP-2001 call for a nationwide reduction in duties and fees to an average of 0 percent and 1 percent for mortgage and conveyance deeds, respectively, the provincial governments (despite being signatories to NHP-2001) have not responded to this call. The lowest rates are in Punjab at 3.5 percent (conveyance deed stamp duty and registration fee of 2 percent and 1 percent of the value, respectively; and mortgage deed stamp duty and mortgage deed registration fee of 0.25 percent each).

Table 3.1 Provincial transaction costs

Province	**Registration fee**		**Stamp duty**		**Total**
	Conveyance	**Mortgage**	**Conveyance**	**Mortgage**	
Punjab	1%	0.25%	2%	0.25%	3.5%
Sindh	1%	1%	3% (also add 1.5% CDGK tax in Karachi)	Ad valorem PRs 2,500 for loan from PRs 1 to PRs 10m	5% + PRs 2,500
Balochistan	1%	1%	5%	2%	9%
NWFP	0.5%	0.5%	3%	4%	8%

Source: Tarin and Javid, 2006

Among the four provinces, Punjab generates the highest revenues from stamps (PRs 7.5 billion; FY05–06), sale of stamps (PRs 6.31 billion), and registration fees (PRs 1.8 billion). Balochistan generates the lowest revenues from stamps and registration fees, which are only PRs 160.5 million (FY05–06) and PRs 17 million, respectively. For Sindh, stamps account for PRs 3.81 billion (FY04–05), but sale of stamps yields only PRs 1.94 billion; whereas, revenues from registration fees stand at PRs 0.5 billion. For North-West Frontier Province (NWFP), stamps and registration fees yield PRs 240 million (FY04–05) and PRs 40 million in revenues, respectively. Thus, Punjab collects 61 percent of the total revenue generated in lieu of stamps by the four provincial governments.

- *Weak tax framework and enforcement environment* – Property tax is the main source of local government revenues in most good-practice countries. In Pakistan, property tax revenues have fallen way short of local government financing needs—they have been barely increasing in real terms despite a marked increase in construction activities and a tripling in property prices. One of the key reasons is that property tax is based on rents, which are controlled. Other reasons include poor enforcement and coverage. Many of the cities have neither the latest master plans for construction nor the revenues for implementation. It is estimated that the new Integrated Master Plan of Lahore requires $1 billion a year for infrastructure development; however, the revenues of the local government enable an investment of only $0.1 billion. Another major enforcement constraint is the prevalence of cash transactions, in which it is often easier to conceal the true sales price or understate the taxable property development income. The reported under-invoicing of construction inputs further understates the scale of property development projects—therefore abetting the loss of revenue to the government.

- *Ineffective land dispute resolution mechanisms* – Courts have a huge backlog of land-related disputes that take years to resolve—more than 40 percent of all court disputes are land related, and accordingly there are more than a million land-related disputes pending resolution. The court proceedings drag on for years due to the aforementioned backlog, thereby enabling illegal activities of the land mafias and short-lived opportunistic developers to flourish. Dispute resolution mechanisms need to be improved for persuading financial institutions to increase lending to the housing sector. For example, within the judiciary, even though the new foreclosure law permits the repossession of property from defaulters without resorting to a court of law, some lower courts have granted stay-orders when financial institutions have attempted to utilize the new recovery law. Until lenders are confident that they can enforce their rights to collateral, they will remain reluctant to invest.

3.2 Embryonic property development framework

The institutional framework for identifying, acquiring, and servicing land available for construction and subsequently selling the constructed housing units is underdeveloped. The property development process is constrained by many factors, which , include (but are not limited to) the following:

- *Poor master planning and governance issues at national and local government levels* – National and local master plans are either inadequate or poorly enforced, which has led to inefficient allocation of land and uncontrolled urban development. The root cause is the lack of clear responsibility between a multitude of government institutions (e.g., in the case of Lahore between the land development authority, the city district government of Lahore, and the Tehsil municipal administrations), as well as a mismatch between expenditure and revenue responsibilities. The lack of transparency and accountability in the planning process also gives opportunities to land mafias to have valuable inside information as to future infrastructure developments or to be able to influence such plans so that its land increases in value.

- *Multiple institutions and administrative procedures* – The number of institutions and registration procedures required to execute property transactions needs to be reduced. Multiple institutions and procedural differences between and within states create market distortions and inefficiencies in the property development market. The distortions result in improper registrations and a culture favoring informal property transactions—an obstacle to effective liens and asset securitization.

- *Problematic zoning restrictions* –Although the conversion of rural land into urban land at the town periphery is a key means of increasing the supply of land, and one that should benefit the lower classes the most (including farmers), it is made problematic by ill-inspired interventions of local and provincial governments. The government of Karachi, for example, has put a ban on the conversion of Barani land around Karachi following malpractices (converted land made available with the intention of developing social housing ended up being used for more profitable commercial ventures). The Sindh government has also cancelled the validity of 5,000 land allotments around Karachi—but the original culprits have long resold their land and moved on. The government is slowly regularizing these cases (only 170 cases have been reviewed so far).

- *Restrictive building codes* – Over-restrictive building codes and laws on subdivision limit the efficient use of urban land and increase the price to consumers, especially in high land price zones. Lahore, for example, has a restrictive floor/area ratio of 1:1.5 (floor areas below 1.5 are low density; Plot ratios above 5 are very high density). The trouble with such a low ratio is that the city cannot accommodate enough population to provide adequate demand or funding for the appropriate infrastructure. Similar issues prevail in Karachi, which has a very low limit on the height of apartment buildings. Furthermore, a large share of the city buildings cannot be put on the secondary market or used as collateral because their developers did not respect the limit on number of stories. Their legal status has been pending for many years while the developers are well connected or no longer around (there are 300 hundred such buildings in Karachi alone).

- *Unreliable utility connections* – Poor incentives and governance within government-controlled companies (especially a problem in power and gas) can typically delay large-scale construction projects by a year. Some developers are relying on gas-powered, self-generation power plants as an alternative and viable source of electric power. Poorly targeted subsidized pricing, widespread thefts, and expensive mechanical failures considerably reduce the incentives and financial capacity of government-owned utility companies to connect new housing developments; for example, the Water and Sanitation Authority (WASA)estimates that 40 percent of water is lost due to mechanical failures and thefts.

One of the key results of the weak land development process is a high speculative behavior that has plagued the market and has resulted in exorbitant land prices. This phenomenon is primarily a result of three key factors: (i) the shortage of developed (serviced) land in the market; (ii) increased liquidity for investment purposes after 9/11 due to an increase in the remittances and above-average economic growth; and (iii) lack of alternative—especially productive—investment opportunities.

3.3 Emerging building industry

An active and competitive building industry is required to sustain an affordable supply of housing. Such a market can be encouraged by the elimination of regulatory barriers to entry, breaking up of monopolies, facilitation of equal access of small firms and inputs, removal of constraints to the development and use of local building materials, and construction methods. There remain, however, constraints that restrict the emergence of an active and competitive building industry, namely:

- *Fragmented building industry* – The majority of real estate builders and developers are organized as sole proprietorships or partnerships with limited capital and informal**[[ok?]]** corporate governance structures. Without using a strong regulatory authority to enforce building standards, the quality of housing still leaves much to be desired.

- *Unorganized real estate agencies* – 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 Pakistan Banks' Association (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.

- *Lack of developer finance* – Absence of sound governance structure within the housing developer industry creates major deficiencies 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 finance and constrains the supply of housing.

- *Skewed tenant laws* –Tenant laws, by and large, make investment in rental property a very risky operation, resulting in a very small rental market (private banks refuse to finance developments destined for the rental market). Tenant laws are highly skewed in favor of tenants, as once housing units are rented out it is very difficult to evict the tenants. These laws, therefore, act as an impediment to the provision of housing finance aimed at generating rental incomes. Consequently, a large share of land-related disputes are tenant related. This issue disproportionately affects the middle and lower classes for which renting is the only option to move out of the slums, especially in the current high-price environment. This issue also affects the retail sector, especially the development of professionally managed shopping malls. Tenant laws in Islamabad are more appropriate and the rental market is as a result significantly more developed (40 percent of the market versus 20 percent in Lahore).

3.4 Conclusion

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

4. POLICY AND STRATEGY OPTIONS

4.0 Introduction

There is no single master blueprint for the development of housing finance markets. Much depends on the political and socioeconomic history of the country and the current government's commitment to implementing market-oriented housing reforms.

Accordingly, the modest policy recommendations and options in this section are premised on the fact that a market-based system of housing finance provides real economic benefits and positively impacts savings, investment, output, and employment. However, it is reiterated that the primary purpose of the reforms is to change the underlying housing development structure from an "all-equity-financed late home ownership" structure to a "leveraged early home ownership" structure.

Following years of sustained dialogue with various stakeholders in Pakistan, there is general consensus on the principal constraints to the development of housing finance in the country. The constraints detailed in the previous section suggest that the challenge for the country lies in undertaking the following:

- Strengthening the legal and regulatory framework for housing finance;
- Supporting the institutional reforms for property acquisitions and transactions;
- Supporting the institutional reforms for financing property development; and
- Introducing new housing development and finance-related products and services.

While the options in this section are listed and discussed as distinct reforms, it is highly recommended that they be implemented as part of an overall programmatic development policy reform process that will adopt short-term, medium-term, and long-term approaches to reforms in this economically significant, yet still underperforming sector. Such a process would involve an integrated framework of reforms, linked to Pakistan's overall economic reforms. Within this framework the reforms would be implemented in a series of operations, with monitorable indicators of progress and triggers for moving from one operation to the next.

The key objective of adopting such an approach would be to ensure nationwide support for the reforms, complementary reform effects, and most important, linking the reforms to the intended outcomes of more affordable housing for all—a process essential for securing the requisite political support for reforms. Because of Pakistan's federal structure, a mechanism for ensuring the consistent implementation of reforms across the provinces is a necessity. Laws, rules, procedures, documentation, and taxes are best rationalized to preserve the sanctity of a commercially viable national housing market.

4.1 Strengthening the legal and regulatory framework for housing finance

A strong housing market requires an effective legal and regulatory framework that instills confidence in the property rights of buyers and sellers and facilitates efficient and verifiable property transactions. Coupled with fragmented land ownership and title registries, and inefficient land information systems, a weak legal and regulatory framework hinders the development of a sound housing finance market. Legal and regulatory reforms are a drawn-out process that requires government persistence and strong political will. But these reforms need to start somewhere, and the following are three areas with a potential for high-impact outcomes.

Regulating land and housing development

An important rationale for external regulation is to ensure that there is an appropriate balance between the costs and benefits of land and housing development. Regulations need to be established in a way that ensures the population equitably benefits rather than being penalized for housing development. To accomplish this, audits need to identify key housing legislation and regulations; to establish their impacts on housing demand, supply, and prices; and to set priorities for regulatory reforms. Affordable housing standards should not compromise environmental, health, and safety concerns. For example, areas of the current legal and regulatory framework that could benefit from regulations include (i) revising urban land use and building regulations to promote efficient land usage and reasonable construction costs; and (ii) improving the design and enforcement of housing codes and standards.

Tax rationalization program

An in-depth tax rationalization program needs to be implemented in order to develop a taxation scheme that promotes economic behavior consistent with the overall long-term economic policy objectives. There needs to be a reorientation of the government's taxation role in land-related transactions. In line with the spirit of the NHP-2001, efforts need to be made to rationalize and standardize the rates of stamp duty and registration fees across the four provinces and the federal capital. Further, by automating the tax collection system, the government will further strengthen the revenue collection process. Housing tax revenues need to be directed toward managing the land management system in a commercially sustainable manner, which allows the government to fulfill its social responsibilities toward middle- and low-income households, and good regulatory governance responsibilities for the entire sector.

Ensure an appropriate prudential environment

In the banking sector, calls have been made for regulatory adjustments that would make it easier for financial institutions to invest in housing assets. It would be particularly advisable to adjust the prudential regime to reflect the low risk associated with secured housing lending—through the risk-weighting of the loans for capital adequacy requirements. Rather than imposing quantitative ceilings, the prudential regime could provide for asset/liability matching, which is critical for long-term loans because they are rate sensitive. Special attention should be given to ensure uniform treatment of all lenders, regardless of the regulator. Investment should be made in a wider-ranging credit information system—in the private sector—to include positive data on retail lending.

4.2 Supporting the institutional reforms for property acquisitions and transactions

An effective housing market depends on efficient and reliable property transactions. Buyers and sellers need to be able to verify and confirm their rights to title with the appropriate third-party authorities. Inordinate delays in verifying ownership, cases of fraud, and failure to secure legal redress undermine the confidence required for a vibrant housing market.

To achieve such an environment, the property registration system in Pakistan needs to be overhauled, especially for banks to gain greater confidence in loan documentation. Improvement in this system is particularly important for the secondary mortgage market, which requires due diligence procedures to ascertain the security of underlying claims. This will be possible on a large scale only if the mechanisms for determining this security are standardized and efficiently done.

Specifically, the overhaul of the current systems should include coordinating land usage planning policies, coordinating titling and land administration, building internal technical capacity, and integrating the land registration and information systems nationally. Currently, there is no institutionalized policy framework or mechanism to determine the criteria and frequency of government land disposals, especially within and around major cities. And related to this, the policies and procedures for ensuring that the land is appropriately serviced with infrastructure / utilities should be made more effective and transparent.

Reducing the regulatory and bureaucratic complexity of the property ownership process is a key element to promoting a more vibrant and sustainable housing sector. Policy makers should constantly analyze the public sector institutions that are involved in the housing sector and make every attempt to eliminate redundancies and inconsistencies among the various institutions and the policies they implement. This requires a significant commitment on the government's part, but it is critical for the future growth of this sector.

A well-coordinated institutional framework will make it possible for the government, with its limited resources, to manage the housing sector in a manner that provides adequate and affordable housing for all. Most countries need an institutional mechanism to oversee the performance of the sector as a whole and coordinate the major public agencies that influence housing sector performance. Pakistan may not be an exception.

In seeking to strengthen the institutional framework, mechanisms should be devised to

- Provide periodic census and survey activities, including collecting, analyzing, interpreting, and publishing data on the performance of the housing sector, particularly concerning its outcomes for the poor;
- Provide an institutional framework for generating long-term plans for housing sector development in conjunction with the central planning agencies—Ministry of Finance, Ministry of Housing, and SBP;
- Provide an ongoing forum for participation of the private sector, NGOs, community-based organizations, and the general public in housing policy formulation at both the national and municipal levels;
- Systematically and periodically review the effects of regulations on housing and initiate regulatory reforms; and
- Influence decision makers in housing-related agencies and local counterpart institutions to improve housing sector performance.

Coordination of titling and land administration

A key challenge is coordinating the titling and land administration process. At present there are several land-owning and record-keeping agencies within the same urban areas, with little coordination and weak links. Each agency applies heterogeneous registration procedures and offers very different degrees of security. Problems are most acute in big urban cities with a multitude of land development authorities, for example, in Karachi, which has 17 such land development authorities. Generally only a few of these agencies are reliable registrars, and the lack of resources has led the Board of Revenues to abdicate some of its core responsibilities (such as records of rights and land).

Specific steps to strengthen the titling and recording system include

- Computerizing land registers;
- Creating real estate transaction databases linked to the registration entries;
- Drastically lowering the effective burden of registration fees/stamp duties;
- Adjusting the legal context to consider only formally registered transfers as generally binding and link registration to the authentication of deeds;
- Reforming the operating conditions of the development agencies; that is, creating a uniform framework of registration standards, instituting a supervising and monitoring system of these agencies, designing quality control norms, and providing incentives for efficiency;
- Inaugurating special procedures for regularizing (at the lowered tax rate) the stocks of unrecorded properties or those left without clear titles with a provision to include explicit criteria for the validation of rights and rules for dispute resolution; and
- Establishing dispute resolution mechanisms to deal with the many disputed properties pending resolution by the courts of law.

Integrate the land registration and information systems nationally

As part of the process of improving the land management system, the land registration information system needs to be strengthened. Building on short-term initiatives to streamline and computerize the administrative bureaucracy responsible for the land titling and registration systems, efforts should be made to integrate all the provincial systems and interagency systems with one another. This initiative would provide policy makers with a better understanding of the housing situation on the national level and would prevent variations in the level of sophistication between the provinces. It would be useful, in particular regarding standards, procedures, and IT systems, to launch a pilot program in a high-priority area that could then be replicated. Some of these actions will probably have to be taken at the national level, or in coordination with the provincial governments, especially tax and legal issues and institution of uniform standards. Regularization actions, however, should be carried out selectively, in order to prioritize regional areas depending on the shortage of housing and the state of the local land or development agencies.

Providing infrastructure for residential land development

It is clear that the current convoluted approach that has been adopted by the development authorities is creating artificial shortages of serviced land to the public; this in turn contributes to the high cost of land that effectively makes land ownership prohibitive for the middle class. Infrastructure agencies should devote greater attention to providing utilities and infrastructure rather than focusing on land ownership and resale. Funding for such a model should come from the public credit markets, as such an undertaking may yield a number of direct benefits, namely, increased land availability, deepening of the credit markets, and required institutional reforms to make the development authorities more efficient.

Any such strategy should also include a program that would provide adequate infrastructure to the squatter settlements. In addition, whenever possible, programs for regularizing tenure should go hand in hand with infrastructure improvement in slum and squatter settlements, and should seek to recover costs.

Specific steps to providing infrastructure include the following:

- The agencies responsible for provision of residential infrastructure (roads, drainage, water, sewerage, and electricity) should focus less on narrow physical objectives and more on opening up urban land for residential development;
- There should be greater coordination in planning and possibly joint acquisition of rights of way, joint financing, and joint cost recovery;

- Infrastructure agencies should review the impact of various regulations on the performance of the housing sector and propose new legislation to improve sector performance;
- Existing communities should be encouraged to participate in the process of planning and building of infrastructure projects, to ensure accountability and smooth implementation;
- Cost recovery mechanisms should be improved and opportunities for privatizing infrastructure provision and maintenance should be sought.

Consistent with the long-term policy objectives in achieving greater economic growth through the housing market, efforts should be made to help develop a sound and vibrant home construction industry. The government should seek to create greater competition in the building industry by eliminating regulatory barriers to entry, breaking up monopolies where present, facilitating equal access of small firms to markets and inputs, removing constraints to the development and use of local building materials and construction methods, and reducing trade barriers that apply to housing inputs.

4.3 Supporting the institutional reforms for financing property development

Increasing the level of financing to the housing sector requires a double-edged approach: increasing the financing going into the construction of housing, and increasing the available financing for mortgages. To achieve these twin objectives, it is recommended that the government continue its efforts to introduce real estate investment trusts (REITS), encourage the issuance of municipal bonds, and create a secondary mortgage market.

Real Estate Investment Trusts

The government could help increase the volume of financing available to the real estate business through the introduction of real estate investment trusts (REITs), a company or trust that uses the pooled capital of many investors to purchase and manage rental property (an equity REIT) and/or mortgage loans (mortgage REIT). Designed to be traded on stock exchanges, REITs allow small investors to invest in the real estate sector in the same way they buy company stock. To increase their attractiveness, REITs are usually granted special tax considerations. Rather than own properties directly, REITs offer investors liquidity, which traditional real estate cannot. Second, REITs enable sharing in nonresidential properties as well, such as hotels, malls, and other commercial or industrial properties. Third, there is usually no minimum investment requirement with REITs, which encourages small savers to invest in REITs and reaps higher returns compared with alternatives such as bank deposits and National Savings Schemes (NSS)..

The Securities and Exchange Commission of Pakistan (SECP) has been working toward the establishment of REITs in the country. In December 2005, draft legislation was sent to the Ministry of Finance for vetting by the Ministry of Law. It has been proposed that REIT companies must have at least 70 percent of their assets invested in real restate with a minimum paid-up capital of PRs 50 million. To ensure that the REITs are held by a broad population, it has also been proposed that the REIT fund be held by at least 100 people, and 5 of whom cannot hold more than 50 percent of the assets. The feasibility of these proposals is being discussed.

However, there is a general consensus among the policy makers in Pakistan that, if properly regulated and supervised, REITs would yield a multitude of benefits for the promotion and development of the housing sector. REITs provide an alternative source for raising capital and therefore would help in increasing the liquidity of the real estate market. At the same time, the institution and proper functioning of REITs is expected to improve the governance structures of real estate companies in the industry, especially with regard to transparency and credibility.

Municipal bonds

Institutional reforms on housing have to involve municipalities, which control access to land as well as the development of local infrastructure. Municipalities often cite their weak financial condition as a key constraint. At times, their only reliable source of revenue is taxation, and property tax is the only major tax. Accordingly, municipal governments have increased the property tax rate on the premise that this will yield more tax revenues; however, the empirical evidence suggests the contrary.

A major step toward improving the availability of financial resources for infrastructure development is encouraging the issuance of municipal bonds (after appropriate governance and management reforms within the municipality).

In developed economies, municipal bonds are issued by a state, city, or local governments, or their agencies, to raise funds for building schools, highways, hospitals, and sewer systems, as well as many other similar projects that benefit the general public. In order to make investment in municipal bonds attractive, the interest income is often exempt from the national and local income tax and from the income tax of the state in which they are issued.

It is significant to elaborate that for investors, tax-exempt municipal bonds are a popular type of investment because they offer a wide range of benefits, including the following:

- Attractive current income free from federal and, in some cases, state and local taxes;
- High degree of safety with regard to payment of interest and repayment of principal;
- Predictable stream of income;
- Wide range of choices to fit in with investment objectives with regard to investment quality, maturity, choice of issuer, type of bond, and geographical location; and
- Marketability in the event the investor has to sell before maturity.

In addition to administrative reforms to ensure that bond revenues are used for the purpose they are intended, the issuance of municipal bonds also requires legislative changes. Currently, Section 120 of the Provincial Local Government Ordinance 2001 specifically prohibits local governments from incurring debt.

Secondary mortgage facility

The ultimate objective of developing mortgage finance is to create a secondary market that would help the market take off through a refinancing structure, which would not only alleviate the liquidity risk incurred by the primary lenders, but would also promote sound practices and standards in the lending activity through its refinancing requirements and have an overall catalytic effect on the development of the lending activity. Such a structure could be seen as a first step toward a true secondary mortgage market in Pakistan.

In the medium term, the establishment of a secondary mortgage facility could become viable once primary originations reach a critical mass. This would be a way to provide external credit enhancement at lower cost than if such enhancement were arranged on an individual basis. In the initial stage, a liquidity facility could be structured for lending against a bank's mortgage portfolio, with recourse to the lender, like CAGAMAS[3] in Malaysia. In such a case, the second-tier institution acts as a credit enhancer of the originating bank itself, rather than the loan portfolios, by issuing bonds that are its own general obligation.

In Pakistan, a secondary mortgage company needs to be established to purchase mortgage loans from mortgage originators (commercial banks and housing finance companies), with full recourse to the primary lenders at a fixed or floating rate initially up to a period of 10 years. At the same time, the securities of the company could be eligible as liquid assets and subjected to concessional risk weights, i.e., 10 to 20 percent compared with a 50 percent risk weight for housing loans. Further, the State Bank of Pakistan could support a repo market by accepting mortgage securities as collateral in its repo transactions. Finally, the government could provide incentives to investors by exempting mortgage security interest from taxes (subject to appropriate fiscal considerations).

An alternative is to set up an institution that would issue bonds against securitized paper, with the originating bank taking the first credit losses while multilateral and local institutions would underwrite the mezzanine and senior tranches.

A key element in proposing a set of reforms for the secondary market is one of sequencing. A secondary market depends on the existence of a strong primary market in which mortgages are regarded as attractive assets with good and well-documented performance. A major prerequisite is a strong legal infrastructure supporting the registration, enforcement, and eventual pledging or sale of mortgage loans. Finally, it is difficult, although not impossible, for a secondary market to lead to capital market development. The existence of a robust bond market is an important precursor to secondary market development. To be sustainable, the secondary markets should be run as a profitable entity. However, such structures generally benefit from some kind of institutional support during the first years of their operation, if only for legal reasons (restrictions to bond issues by a newly created or an unlisted entity, for instance), but above all to help establish credibility of the entity and speed up the acclimation process among investors, thus avoiding the premium that a totally new issuer would normally pay.

4.4 Introducing new housing development and finance-related products and services

Improving the operational capacity of the industry, improving the reliability of the land records, and improving the availability of long-term funds will improve the overall demand for and supply of mortgage finance, and in the medium- to long-term address the supply of serviced land. However, in the face of pressure to address the housing finance needs of specific communities, the government may wish to consider some of the programs that have been implemented recently in other countries for micro borrowers and first-time buyers.

Micro-housing finance

In October 2005, Mexico took a Development Policy Loan for Affordable Housing and Urban Poverty Reduction. This loan enabled the Mexican Federal Mortgage Corporation to approve approximately US$14 million for a pilot project to provide microfinance for home improvements through two to three nonbank financial institutions, which have been Mexico’s main sources of private home lending. The pilot was set up for one year, after which the Federal Mortgage Corporation is mandated to decide whether to expand its portfolio in this area. The pilot started with one of the three nonbank financial institutions that the Federal Mortgage Corporation considers as market leaders and that have a core interest in the target group for microfinance products.

3 Cagamas Berhad is the National Mortgage Corporation in Malaysia. Cagamas is the major issuer of asset-backed securities.

While microfinance institutions (MFIs) in Pakistan continue to focus on credit delivery of loans for agriculture, livestock, trading, and consumption, a few are beginning to diversify and innovations have begun in enterprise loans and housing finance. In Pakistan, the government may wish to begin with the strongest players as a way of reducing risk and getting to know the market and to help in adapting the selected financial institutions' internal systems and designing their database on mortgage risk assessment. While reaching scale would not be a central objective of the pilot, efforts should be made to reach a scale sufficient to test the adequacy of the systems used to analyze and monitor the institutional system (of the financial institution) developed for lower-end borrowers. In time, other banks may consider investing in this end of the market.

However, it must be recognized that this channel for delivering housing finance, at best, may remain small. As of June 2005 the microfinance network served only 718,000 borrowers and held US$99 million in total loans outstanding, covering less than 12 percent of the potential market in terms of the estimated possible outreach of six million.

Young first-time home buyers

In 2002, the Latvian government started implementing a project aimed at young people who were unable to afford housing, and households living in denationalized buildings that did not have the finances to purchase their apartments and were facing precipitous rent increases. Many, even those young families that had incomes sufficient to meet banking criteria for borrowing, did not have the usual necessary down payment of 30 to 40 percent of the price. Therefore, under the project, the government provided guarantees to the qualifying young home buyers, which enabled the banks to lower the down payment required on qualified properties. Loans were disbursed by the private commercial banks on market terms for purchasing or undertaking capital improvements of housing units; underwriting, administration, and foreclosure risks for up to 70 percent of house value were the responsibility of the eligible lenders. The government provided a guarantee for the portion of the loan exceeding the amount provided by the bank in accordance with the standard loan to value (LTV) ratio of 70 percent. The minimum required participation by the sub-borrower was 10 percent. Such a guarantee was valid until the LTV ratio dropped to 70 percent. The guarantee was effective only after foreclosure and recovery of the debt, and it was designed to cover the bank losses up to an amount equal to 20 percent of the initial sales price.

The key challenge for initiating such housing finance programs is securing long-term funding to finance them. The first option could be to let banks secure their funding through their own individual issues. The instruments could either be Terms Finance Certificates (TFCs) or securitization, on or off balance sheet. There are obstacles to the use of both tools: individual financing requirements will stay low in a first phase, hence generating illiquidity premiums. Public offerings of TFCs are restricted to listed companies; the market is far from being ready for securitization, despite available regulation for trusts and special purpose vehicles.[4] Alternatively, the financing can be of different types: it could take the guise of capital sponsorship (idea of "seed" capital), a debt guarantee or a backup line of credit provided by the Government of Pakistan or SBP, or simply by the benefiting institutions, which would give a mutualized structure to the scheme.

These various options are not exclusive of each other—in the United States, the Federal Home Loan Bank system enjoys both the support of its members and a quasi-government guarantee; in Malaysia and Jordan, the share capital of the secondary market facilities is held by lending institutions and the

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[4] Securitization requires a developed primary market, if only for cost efficiency considerations, trustworthy property collateralization, credit enhancement tools, specific prudential and accounting regulations, reliable historical information on credit and prepayment risks, and option pricing capabilities among investors.

central bank. Supporting tools, that is, either a guarantee or a standby line, could be implemented only during an initial phase, until the structure acquires full autonomy and maturity, and a sunset provision may be stipulated from the beginning. Otherwise, the institutional support could not only make the risk-mitigation scheme built in the structure meaningless, but also could easily turn into a market distortion factor.

4.5 Conclusion

Despite the growing economic and social importance that development economists are attributing to housing finance, it remains largely underdeveloped in Pakistan. Private mortgages remain small and unaffordable, and are provided by only a limited number of depository institutions. Housing finance is expensive and still rationed in favor of higher-income populations.

This study discussed the present state of the housing finance market in Pakistan against the background of the sustained fundamental constraints that continue to hold back the sector's growth. But it also argued that the housing finance constraints are not insurmountable. Policy makers, in collaboration with the private sector, can strengthen property rights and the land development process, develop the property development framework, support the building industry, facilitate the development of the primary and secondary housing finance market, and introduce useful targeted housing finance programs.

A fundamental challenge, however, is developing the institutional framework for managing the housing sector, including the property titling/land administrative procedures, the overhaul of the legal provisions, and the standardization of processes and computerization, which will not only bring efficiency gains, but also drastically improve the level of confidence in property transactions overall.

The overhaul of registration systems is also a prerequisite of the development of mortgage lending on a large scale and is likely to have additional benefits such as facilitating the upgrade of slums, tax collection, and the overall marketability of properties. Because of the federal structure in Pakistan, these reforms must be undertaken by the provincial governments.

As all of these reforms are being implemented, a sectorwide capacity program will be required. It is important that all stakeholders, including policy makers, financial institutions, private sector developers, regulators, and consumers become more aware of the detailed aspects of housing policy. Such capacity-building processes should include strengthening the governance structures and business orientation of the housing development authorities, property market developers, and related institutions. Currently, some developers generate much mistrust and suspicion among both individual buyers and potential financiers because of weak governance structures and practices.

The capacity-building methodology could be based on a "training the trainers" principle and the transfer of best practices and know-how from foreign, experienced institutions. Targeted training and conferences, particularly for decision makers, could help facilitate a better understanding of the issues and the responsibilities of each group of stakeholders in the housing market. It would also promote a more coordinated effort in accomplishing long-term objectives. It may be stressed that the existence of an intersectoral working group on housing finance, already used for the design of NHP-2001, could be instrumental in preparing measures and monitoring implementation.

Specifically for the banking sector, banks currently are constrained in expanding the outreach of housing finance because they don't have enough staff with the expertise to undertake housing finance for origination of housing loans in the primary mortgage market. Banks' in-house capabilities for undertaking housing loans should be developed so that any systemic crises due to their ill-prepared entry to housing finance may be mitigated. Technical training should be provided on the processes of originating, servicing, managing risk, and funding mortgage portfolios. Such training should be aimed at bankers, developers, real estate brokers, appraisers, lawyers, and regulatory and supervisory staff of the State Bank of Pakistan, Ministry of Finance, and Ministry of Housing and Works. The training could include specialized topics such as the handling of borrowers with no documented incomes, developer finance, public-private partnerships and real estate project assessment, and Islamic finance products.

Specific steps to develop training may include the following:

- Needs assessment for developing vocational skills should be conducted, for instance, by the Banking Association and other professional associations;
- Depending on its outcome, inducements could be considered to speed up and organize training programs on a large scale;
- Strategic advisory services could be envisaged, with the view to making bank management aware of the role housing finance can play in the soundness and growth of their institution.

In developing "tailor-made" training courses, it would be important to engage foreign trainers who have experience with housing finance in developing countries, and who could provide "academic" and "hands-on" training so that banks may learn efficient ways of doing mortgage business. Additionally, foreign training trips to countries in the region, e.g., Malaysia, Thailand, Singapore, India, could show trainees case studies of ongoing/actual housing finance projects in these countries. Among the regional countries, Malaysia provides the most relevant housing finance system for study and adaptation in Pakistan.

As with all reforms, however, training is only a supportive component. Success is determined by the adequacy of resources committed to the reforms, the consistency and follow-up of implementation actions, and the level of political will associated with the reforms.

Annex A

Action Plan of NHP-2001 Implementation Status	
Policy Measures/Action Required	Implementation Status (update)
3.2.1.a) Financial institutions shall be encouraged to give mortgage loans for housing purposes at market rates.	The regulatory regime for the provision of housing finance by banks/DFIs to a cross-section of the population has been greatly liberalized. Accordingly, the maximum debt-equity ratio for housing loans has been increased from 70:30 to 85:15, and the maximum loan tenure for housing finance has been increased from 15 years to 20 years. Moreover, as of March 19, 2005, the maximum per party limit of PRs 10 million in respect to housing finance was removed and banks/DFIs have been allowed to determine the housing finance limit in accordance with their internal credit policy, creditworthiness, and loan repayment capacity of the borrowers. At the same time, while determining the creditworthiness and repayment capacity of the prospective borrower, banks/DFIs are required to ensure that the total monthly amortization payments of consumer loans, inclusive of housing loan, should not exceed 50 percent of the net disposable income of the prospective borrower.
3.2.1.b) All commercial banks shall be motivated to advance loans for housing and housing projects by earmarking a substantial percentage of their loan portfolio.	The maximum exposure of banks/DFIs to housing finance has been enhanced from 5 to 10 percent of their net advances; however, it is up to banks to decide if and when they plan to offer housing finance to various strata of society and undertake financing of housing projects.
3.2.1.c) Financial institutions and housing financial institutions (HFIs) shall be encouraged to float long-term bonds at market rates.	Banks/DFIs are allowed to securitize mortgage/construction/developer finance through special purpose vehicles (SPVs). Moreover, the minimum credit rating for banks/DFIs to make direct investment and for taking exposure (i.e., undertaking lending and reverse repo) against listed and unlisted ABSfor mortgage/construction/developer finance is reduced from "A" to "A- (or equivalent)."
3.2.1.d) Housing refinance window shall be set up at the State Bank of Pakistan for long-term funds from multilateral agencies.	The Finance Division approved the final scheme for setting up a housing refinance window (HRW) at SBP with the loans amounting to PRs 450 million from multilateral institutions for low-cost housing. Under the scheme, SBP is only acting as an agent of the GOP for providing funding facility to housing finance companies (HFCs). The scheme was accordingly circulated by SBP in October 2001; however, HFCs failed to fulfill conditions under the scheme, so the funds have not been used. It is important to note that as per the instructions of the Finance Division on March 30, 1995, the loan under HRW of PRs 450 million was credited to the GOP. Therefore, utilization of aforesaid amount requires permission from the government.
3.2.1.f) Housing finance institutions shall be encouraged to promote savings and provide micro loans for low-income groups through community organizations, NGOs, and CBOs**[[pls. spell out]]**.	The Microfinance Institutions (MFIs) Ordinance allows MFBs/MFIs to take deposits and to appoint agents, such as NGOs, for undertaking activities essential for proper discharge of their functions, which among other things, includes savings mobilization and provision of credit to the marginalized strata of the society. Therefore, in the realm of microfinance, MFBs are allowed to develop products that not only help mobilize savings but also have a link with the provision of housing finance. Although HFCs are regulated by SECP, HBFC comes under the regulatory purview of SBP. Moreover, in accordance with Section 21 of the HBFC Act of 1952, SBP has intimated to the Finance Division that HBFC can undertake issuance of Certificates of Investments and float long-term bonds. At the same time, SBP has already advised GOP to declare SPV as a financial institution under the Recovery Ordinance, 2001, and to grant permission to HBFC for instituting asset securitization through SPV.
3.2.2.c) HBFC and other financial institutions shall formulate packages of	The regulatory regime has been liberalized for the promotion and development of a market-based housing finance system in the country, and it is up to banks to decide if and when they plan to offer housing finance to

preferential/concessional rates with an affordable system of installments for repayment to provide affordable credit to low-income groups.	different strata of society. Although since March 2003 the banks have increased their exposure to housing finance, banks/DFIs are facing a number of critical impediments to providing housing finance to the general public. These impediments include lack of, among other things, proper property titling; a land registration information system; and implementation of foreclosure laws. Moreover, in the case of low-income groups, the impediments are further compounded by difficulties in ascertaining the monthly incomes because there are no mechanisms/documentation for determining the monthly incomes of low-income groups and most of the low-income dwellings are situated in shantytowns and irregular settlements without legal/clear title documents. The aforementioned major constraints are not only impeding the growth and development of housing finance in the country to the general public, but also holding back the trickle-down of housing loans to the low-income groups, for which the cost of financial intermediation is also higher than that for high- and middle-income groups.
3.2.3.a) Foreclosure laws shall be introduced to ensure effective recovery of loans and advances from the defaulters.	According to Section 15 of the Finance Institutions (Recovery of Finances) Ordinance 2001, which has been promulgated by the government of Pakistan on August 30, 2001, (the sale of mortgage property) whereby after service of notice of demand by a financial institution, all the powers of the mortgagor with respect to recovery of rents and profits from the final mortgage property stand transferred to the financial institution. Accordingly, under the provisions of Section 15(4), the financial institution after expiry of final notice can sell the mortgaged property or any part thereof by public auction and appropriate the proceeds thereof toward total or partial satisfaction of the outstanding mortgaged money without intervention of any court. In doing so, neither the banking court nor the high court shall grant an injunction restraining the sale or proposed sale of mortgaged property unless courts are satisfied that no mortgage was created or sum secured has been fully paid or mortgagor has deposited cash in the banking court. The foregoing provision provides more powers and remedies for the lending institutions, which suggest that foreclosure laws have been strengthened and would help in improving the recovery process of defaulted loans of financial institutions.