

Guidelines for Financing to Housing Builders/Developers

Contents

Preamble	1
1. Eligibility Criteria	1
2. Documents Relating to Financial Standing	2
3. Documents Relating To Property/Project.....	2
4. Assessment of Builders'/Developers' Projects	2
5. Valuation.....	3
6. Legal Opinion	3
7. Collateral Arrangements.....	3
8. Leverage Ratio	3
9. Escrow Account.....	3
10. Insurance/Takaful	4
11. Other Arrangements.....	4

Guidelines For Financing to Housing Builders/Developers

Preamble

Shelter is one of the important human needs that have multiple effects on the society and economy. It can be witnessed through the fact that during the period of recession, developed countries boosted their economies through spending on housing sector. More or less 40 industries are allied with the housing/construction sector. Pakistan is facing rapid urbanization due to which the need for housing in urban areas is increasing rapidly.

One of the ways of improving capitalization of the housing sector is the provision of housing loans, thereby leveraging home ownership. The State Bank of Pakistan (SBP) in consultation with the stakeholders has taken a number of initiatives to promote housing finance but still it has to go a long way to address the challenges being faced by the sector.

These initiatives, besides bringing overall improvements, resulted in a larger lending exposure of commercial banks/DFIs during 2003-04 to 2008. However, some fundamental aspects of a fully functioning market-driven housing finance sector remain to be addressed before achieving a balanced and sustainable growth of the housing finance market in Pakistan.

One of the areas required to be taken care of is, the availability of institutional finance facility to credit worthy builders/developers engaged in housing projects. Based on an analysis of the mechanisms being adopted by central banks and regulatory authorities in the region and world, below-given guidelines have been developed. It is hoped that through supply of bank finance, builders/developers would be able to increase the supply of affordable housing units. For effectively executing such financing transactions, banks/DFIs are encouraged to provide financing to Housing Builders/ Developers for which banks/DFIs may establish specialized unit. Further, banks/DFIs are advised to adhere to applicable Prudential Regulations for Corporate/Commercial Banking.

1. Eligibility Criteria

- Builder/Developer/team should possess a valid builder/developer license from building control authority, where applicable
- Builder/Developer must have at-least 3 years experience with good track record
- There should be a clear and marketable title to the land, free of encumbrances, charges and liens on which the project will be built in case it is offered as equity of the builders/sponsors
- Copies of documents required to be submitted with application:
 - i) Registration certificate of the firm/company
 - ii) Memorandum and Articles of Association/Partnership Deed/Business Charter (in case of Sole Proprietorship)
 - iii) List of the technical staff
 - iv) Pakistan Engineering Council certificate and experience certificates

- v) List of recently completed projects (if any), alongwith copies of Completion Certificates submitted to concerned authorities
- vi) Any other document(s) required by the bank/DFI

2. Documents Relating to Financial Standing

Banks/DFIs may obtain the following documents from Builders/Developers:

- Three years' financial statements duly audited by a practicing Chartered Accountant or Cost and Management Accountant in case where the exposure of a banks/DFIs does not exceed Rs 100 million, for analysis and record.
- In case the financing amount exceeds Rs. 100 million then the latest financial statements shall be audited by SBP approved panel of auditors in the following manner:

Financing Amount	Auditors Category
Above Rs. 100 Million upto Rs. 500 Million	'B'
Above Rs. 500 Million	'A'

- Income Tax Assessment Order/Acknowledged copy of Income Tax Returns submitted by the firm/company for the last three years
- Bankers' confidential reports on financial credibility of firm/company and its directors/sponsors

3. Documents Relating To Property/Project

Banks/DFIs may obtain the following documents from Builders/Developers:

- Property Documents & Documents concerning ownership of land
- Concept plan
- Approved building plan
- Permission to Mortgage
- Non-encumbrance certificate
- NOC for construction/sale of the housing units from the concerned authority
- A predefined list of contractors & subcontractors
- Permission from relevant authorities i.e. Civil Aviation Authority, federal and provincial Environmental Protecting Agencies (EPA) etc
- Any other documents relating to title/ownership of the project

4. Assessment of Builders'/Developers' Projects

- A project should be capable of generating sufficient cash flows to repay its debt.
- Banks/DFIs shall get the technical feasibility report independently reviewed by an engineering firm of repute registered with concerned authority such as Pakistan Engineering Council etc.
- Financial Feasibility Report of the proposed project, endorsed by a reputed Auditing Firm which shall contain information on the Project's anticipated economic conditions, capital investment, financial projections and projected completion time.
- Banks/DFIs should review the financial and other relevant documents submitted by the builder/developers as part of their risk-assessment process. Banks/DFIs should critically evaluate the possibility of various risks and their possible impact on the viability of the project and hedge

identified and potential risks by initiating necessary measures as per their credit and risk management policies.

5. Valuation

- Banks/DFIs will get the value of the plot and the project assessed from PBA approved well reputed valuers as per following criteria.

Financing Amount	No. of Valuations Required
Above Rs. 50 Million upto Rs. 100 Million	At least by 1 Valuer
Above Rs. 100 Million upto Rs. 500 Million	At least by 2 Valuers
Above Rs. 500 Million	At least by 3 Valuers

6. Legal Opinion

- Legal opinion of the well reputed law firm on project and property documentations be sought.

7. Collateral Arrangements

- Mortgage of Plot (on which construction is to be made) may be created in favor of Bank/DFI. Further, bank/DFI may mark its lien on Project Escrow Account or any other collateral;
- Lien/mortgage may also be created over movable/immovable assets of the project firm/company;
- In case of foreign builders/developers, bank guarantees may also be obtained.
- Any other security acceptable to banks/DFIs

8. Leverage Ratio

- Leverage ratio may be observed by banks/DFIs as per their policy and risk assessment in line with SBP PRs for Corporate/ Commercial Banking.

9. Escrow Account

- In order to monitor non-diversion of bank funds, an account be opened, operated by the builder/developer and bank/DFI under escrow banking arrangements to ensure that funds are not diverted to the detriment of lender(s).
- In case of syndicate financing, Financial Institutions and Builder Developer, with mutual consent, have to declare which bank shall maintain the escrow account.
- All project-related transactions including disbursement to the contractors/sub-contractors and collection of money on account of booking of flats, housing units and shops etc., subsequent installments from the allottees and withdrawals for the construction of the project under pre-agreed terms will be made through this account.
- All payments should be made through crossed cheques.
- The Escrow Account shall not be changed/shifted to other bank during the financing tenure without consent of all lenders.

10. Insurance/Takaful

- Banks/DFIs, while taking an exposure on builders/developers project, shall ensure that the builder/developer has obtained, or made arrangement to obtain, valid and enforceable comprehensive insurance/takaful coverage (Contractor's All Risk Insurance Policy) for potential risks associated with the project.
- Assignment of all insurance policies in the bank's/DFI's name.

11. Other Arrangements

- On the basis of the information provided by the builder an amount may be sanctioned for the project for a period of upto 5 years. Banks/DFIs may also grant moratorium period, to the builders/developers, in repayment, as per policy/product approved by the Board.
- Once the project gets formal approval and the said plot is mortgaged with the bank/DFI, amounts may be released to the builders/developers, as per agreed schedule in accordance with the construction schedule, through escrow account maintained with the concerned bank/DFI.
- Banks/DFIs may obtain e-CIB of Directors and Sponsors of the company to monitor overall exposure and financial health of the entity.
- Banks/DFIs shall establish a mechanism for regular monitoring during construction phase to ensure proper utilization of the finance. For this purpose, proper scrutiny/audit shall be undertaken of the Project Account(s), Project Escrow Account and any other accounts deemed necessary for the operation of the Project. This activity may be carried out by banks'/DFIs' own staff or through outsourcing. Moreover, compliance of financial covenants and periodical inspection of the project at least once in six months during construction phase shall also be carried out.
- During construction phase, banks/DFIs should monitor project's progress through periodical review by technical consultant. The scope of technical consultant should include assessment of actual progress of the project against the scheduled progress and agreed milestones, review of status of construction and identification of bottlenecks arising or likely to arise in the project completion. All draw-downs should be linked with certification by technical consultant.
- As the primary source of repayment is through cash flows from down payment and installment by individual purchasers, banks/DFIs need to secure the loan by obtaining an assignment of project receivables.
- To ensure the protection of lien/mortgage on assets of the business entity, banks/DFIs will register their lien/mortgage with the Registrar of Companies, so that the security is not mortgaged with any other lending institution for further financing.
- At the time of approving/releasing the financing amount, builders/developers should be advised to strictly follow the by-laws/building rules and approved plan.