Pakistan housing finance sector, challenges and opportunities

Honorable fellow delegates,

I feel immense pleasure and honored to participate in this workshop on Housing Finance in South Asia and presenting Pakistan’s experience in the housing finance sector, the challenges it faces and the opportunities it offers.

2. According to the UN-Habitat, half of humanity now lives in cities, and that the urban population will increase to 60% within next two decades. Developing world with highest growth rate of urban population absorbs on an average about 5 million new urban residents every month and thus accounts for 95 per cent of the world’s urban population growth. Urban growth is a result of a combination of factors namely geographical location, natural population growth, rural-to-urban migration, infrastructure development, national policies, corporate strategies and other major political, social and economic forces. Therefore, the need for the government as also financial institutions to respond adequately and timely to this resultant increase in demand perhaps has never been more critical. The ability of financial institutions to meet this demand in turn hinges on the overall institutional and regulatory framework of a country relating to housing and financing the housing needs.

A geographical positioning of Pakistan can be seen in Slide 2

General statistics about Pakistan is tabulated in Slide 3

3. Pakistan like other developing countries faces a critical shortage of housing units. According to conservative estimates, there is already a backlog of more than 6 million housing units which is growing approximately by about 300,000 units every year. This backlog, together with inadequate housing facilities has been affecting quality of life of the general public especially the urban working class in Pakistan. Average national occupancy rate per dwelling in Pakistan is over 6 whereas per room density is 3.5 persons as compared to the international standard of 1.1 per room. The shortage of housing facilities is more acute in urban cities and towns where more than half of the population lives in slums or in irregular settlements.
Actual and projected trend of urbanization in Pakistan is presented in Slide 4

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

5. In Pakistan the rising land prices and rapid urbanization has become a challenge for increasing number of households. Recent studies indicate that lack of finance from a formal source is primarily a supply problem. In Pakistan most of the housing finance is arranged through personal resources. The formal financial sector caters to only 1 to 2 percent of all housing transactions in the country, whereas the informal lending also caters up to 10% of such transactions, though the informal sector is poorly regulated, particularly in respect to consumer protection. Presently, the formal financial sector provides housing support through two major sources namely the Government owned House Building Finance Corporation (HBFC) and commercial banks. The private sector housing finance companies also caters to a negligible consumer base. Before I elaborate more on the role of commercial banks in housing finance in Pakistan let me share with you, in brief, both the situation and the response of the government of Pakistan in enhancing the housing facilities in Pakistan.

6. The development of housing sector in Pakistan has been constraint primarily on account of three main issues viz. (i) weak property rights and inadequate land development framework (ii) the embryonic property development framework and (iii) the emerging but poorly regulated building industry. I believe that these constraints are not unique to Pakistan as other development economies also faced them albeit to a varying degree, during the process of development of their housing sector.

7. In Pakistan unfortunately the property development industry suffers from low public confidence. Financial weaknesses and the absence of clear, uniform and fair business practices have affected its credibility contributing to the reluctance of financial institutions in providing development and construction finance. There is a strong need to strengthen the property titling and land administrative procedures including improvements of the legal provisions, standardization of processes, and computerization of all relevant revenue record this paradigm shift in addition to bringing efficiency gains will also drastically improve titling of the under lying security that can enhance the financing by the formal sector or the weakness in the existing legal framework also impedes the financing opportunities of the
formal financial sector. Though the Financial Institution Recovery Ordinance, 2001 empowers the financial institutions to foreclose and get registered a mortgage property without recourse to the court of law, but, lack of full implementation of the recovery law in its letter and spirit, dilute, its effectiveness in protection of rights of the respective parties, i.e., the financial institutions, mortgagors, landlords and tenants, thus needing a major improvement.

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

9. The increase in property tax revenues has not been equating to the rise in construction activities and 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. The institutional framework for identifying, acquiring, and servicing land available for construction and subsequently selling the constructed housing units is underdeveloped. Thus in the said issues affect the property development process.

10. National and local master plans for town planning and housing facilities are either inadequate or poorly enforced, which has led to inefficient allocation of land and uncontrolled urban development. Lack of transparency and accountability in the planning process also 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 value of its land increases. Over-restrictive building codes and laws on subdivision limit the efficient use of urban land and increase the price to consumers, especially in zones having relatively higher prices of lands in high land price zones. Moreover, the large scale projects often get delayed due to failure of utility companies to connect new housing developments in time. An active and competitive building industry is required to sustain an affordable supply of housing. Such a market can be encouraged by elimination of regulatory barriers to entry, breaking up of monopolies, facilitation of equal access to small firms.

11. In Pakistan only “property valuers” have professional conduct requirements that were established by SBP and the Pakistan Banks’ Association (PBA), whereas majority of real estate builders and developers are working as sole proprietorships or partnerships with
limited capital and informal corporate governance structures. Absence of sound governance structure within the housing developer industry creates lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in future. The unstructured and unsupervised nature of business of real estate brokers/agencies, which could serve as a natural arrangers for the provision of financial services, is also a significant constraint to the provision of housing and housing finance. Consequently, it is difficult for financial institutions to verify the character, capital, and capacity of potential clients. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders’ extreme caution for transaction initiated by these venture. As a result, financial institutions are reluctant to enter this market, which in turn causes scarcity of finance and constraints the supply of housing. In the absence of the formal arrangements between the housing developers/real estate agents etc; and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner. Without using a strong regulatory authority to enforce corporate governance and allied standards for this stratum of business entrepreneurship, the quality of availability of housing facilities across population spectrum will not be improved. Above all tenancy laws are skewed in favor of tenants and therefore also act as an impediment to the provision of housing finance aimed at generating rental incomes.

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

13. Despite all the above impediments that exist in the housing sector of Pakistan the government of Pakistan has shown its commitment to long-term housing sector development reforms. It has recognized Housing and Construction as an industry and a priority sector of the economy. It also announced National Housing Policy (NHP) in 2001 with a focus on evolving an enabling strategy aiming at resource mobilization, development of a housing finance system, provision of incentives through tax rationalization and enforcement of effective foreclosure laws. Although dedicated and focused efforts are being made by the Government 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 accounts for a substantial part of the population. There is also a significant level of commitment required on the part of the Government as well all
stakeholders to constantly analyze the issues in the housing sector and make efforts to eliminate redundancies and inconsistencies among these institutions. To strengthen the institutional framework following steps are essential:

i. Generation of long-term plans for housing sector development in conjunction with the central planning agencies.

ii. Participation of the private sector, NGOs, community-based organizations, and consumer protection group in housing policy formulation at national and provincial levels and municipal levels;

iii. Conducting studies on impact assessment of regulations on housing & initiatives concerning development of housing facilities in the country.

14. While sharing all the above constraints and challenges, which may paint a pessimistic picture, I see this forum as an opportunity to share those challenges with a view to identify common issues in our region so we all can join hands in an effort to learn with each other’s experiences and adopt proven strategic initiatives. Notwithstanding the weak infrastructure and allied facilities concerning housing finance in Pakistan fact remains that our mortgage market continued to develop albeit at a slow pace initially with more concentration in large cities prior to last decade. The House Building Finance Corporation (HBFC) a Government owned specialized housing institution was historically providing housing finance to lower or average income group since 1952. In 1994, the Government decided that HBFC should operate as a market-oriented financial institution. Commercial banks though providing mortgage loans on a much selected basis entered the mortgage business during 2002 in a structured way and registered their share in the housing finance system. The majority of commercial banks’ loans has been or are being extended to middle and high income group particularly major cities. As more banks entered the mortgage market, the share of HBFC in terms of value reduced from 90% in 2003 to 19% during 2008 though it remained the only institution that continues to cater mainly to the lower-middle and low-income groups, and enjoys the largest customer base. This is evident from the fact that the average loan size of HBFC is reported to be Rs. 860,000, (US $ 10,750) where as the average loan size of commercial banks is reported at Rs. 2.35 million (US$29,375). Although the entry of the housing mortgage market of Pakistan was a delayed, but its evolution has remained promising. It has also witnessed an increasing participation in housing finance by Islamic banks since 2007.

A historical trend of housing finance in Pakistan is presented in Slide 5 and 6.

15. The total housing finance portfolio reported by banks and Development Finance institutions (DFIs) as on December 31, 2008 was Rs. 88.2 billion, (US$1.10 billion) witnessing a growth of 59% over the last three years. However, the mortgage debt to GDP ratio is less than even 1% as compare to 5% in India, 18% in Malaysia and 15% in China. The total number of
borrowers at the end of December 2008 just exceeds 123,000. In absolute numbers HBFC accounts for more than 75% of these borrowers, due to its wider customer base, but in terms of finances majority share in overall housing finance portfolio rests with commercial banks as already stated.

**Competiveness of banking sector in Pakistan in the context of housing finance is illustrated in Slide 7.**

**Explanation of Slide 7:** the Herfindahl concentration index is a measure of the size of firms in relation to the industry and an indicator of the amount of competition among them. The index computed for 5 years shows that competition in Pakistan among commercial banks & DFIs has in fact increased over time, with the index falling from 0.259 which was highly concentrated in 2003 to 0.132, 0.095, 0.087 and 0.094 during, 2004, 2005, 2006 and 2007, respectively. The reduction in index signifies more diversification and high level of competitiveness. 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.

16. Presently, the current overall weighted average interest rate is hovering around 14.40%, with maturity periods being a little over 12 years, on an average. In case of financing by banks the Loan to Value ratio has recently witnessed a decline and was 45% during the last quarter of 2008, as against maximum permitted level of up to 85%. The bank’s share in the housing market would have increased at a much higher pace, however lack of long-term fixed-rate funding to them has proved an impediment for them in increasing the volume and tenure of their housing portfolios. Their continued reliance on short-term deposits to fund long-term loans has increased the risk which in turn has restricted the variety of floating/fixed rate long-term mortgage products. This has been affecting the affordability of the mortgage finance by the end users, especially with the floating rate products in a high interest volatile environment. The current cost of short-term liabilities, raised by the banks, is low as against average markup charged by the banks on housing loan. Thus yielding a huge spread to the banks. However, this practice is increasing the asset-liability mismatching which may not be sustainable in the long term. Therefore it is felt that despite rapid retail credit expansion that took place in an increasingly sophisticated and highly profitable banking sector, banks have yet to explore full potential of the housing finance sector.

**Achievements and key initiatives taken by State Bank of Pakistan is presented in Slide 8 and 9.**

17. Let me also assure you that State Bank of Pakistan being the central bank of the country is fully cognizant of all issues and constraints and therefore besides establishing a dedicated Infrastructure and Housing Finance Department, it has already embarked on a number of key initiatives to strengthen the market based housing finance mechanism, which
are as under:

- SBP established a Housing Advisory Group (HAG). The HAG was established with an intention to conduct a thorough analysis on the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations stressing on the need to enhance access of financial services for the development of housing sector. SBP had already disseminated the recommendations to the concerned stakeholders and is also in the process of initiating measures for establishment of secondary mortgage market. Some of the recommendations are given below;
  
  i. Reforming Legal Framework Affecting Foreclosure, Transfer, Tenancy, Rent Control and Acquisition of Immovable Property.
  ii. Rationalization of transaction costs.
  iii. Establishing an integrated nationwide land registration information system
  iv. Increasing supply of land for affordable housing.
  v. Structuring and streamlining large scale developer’s finance.
  vi. Provision of housing finance for affordable and low cost/income housing facilities.
  vii. Promotion and development of real estate investment trusts (REITs)
  viii. Provision of long term funding for housing loans.
  ix. Developing housing market information system.
  x. Capacity building of the mortgage banking industry in Pakistan.

- SBP and World Bank have agreed to work together for implantation of key recommendations of HAG and bring a financing environment conducive to growth of housing sector. This will involve restructuring of HBFC by removing inefficiencies and strengthening the nation’s oldest housing bank.

- The establishment of Mortgage Refinance Company (MRC) is also on the common agenda of SBP and World Bank and will be initiated to explore fixed rate or hybrid models of mortgages, improve liquidity of the financial system and enable banks and housing finance companies to prudently match maturity profile of their assets and liabilities. MRC will give special attention to the provision of low cost housing finance so that a low-income stratum of the population is not excluded from housing finance services.

- Efforts are being made with the assistance of WB in establishment of an observatory for real estate market and capacity building of professionals engaged in housing finance through housing experts. The observatory for real estate market will be established with the intention of minimizing information asymmetries that currently plague the system.

- Realizing the fact that housing finance be institutionalized simultaneous efforts to develop human capital will also be ensured. A Cooperation Agreement was signed between
International Finance Corporation, and SBP to launch a housing finance training program in Pakistan. The training covered all aspects of housing finance from product development, loan marketing/distribution and origination to loan underwriting, servicing and risk management. Till date, approximately 200 bankers from over 20 banks have been trained in the mortgage business.

- A series of dialogues on promotion of housing finance in Pakistan have also 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 system/management.

- The objectives of the province of Punjab Land Records Management and Information Systems Project are to improve the land records service delivery of the Province of Punjab, contributing to long-lasting security and more efficient operation of land markets. The Project will upgrade the land records management system for Punjab Province by revising current business processes and associated legislation and regulations, establishing Service Centers where land records will be maintained and available to the public in digital form and establishing linkages between the land records system and the system for registration of deeds. In fact the project has already begun to see success in some parts of Punjab used as pilot regions. Once this project reaches its completion this can be used as a model for replication in other regions of the country.

- In 2008 the Securities and Exchange Commission of Pakistan introduced the real estate investment trusts (REITS). This initiative will benefit housing sector in two ways; first it will increase financing going into construction of housing and increasing the flow of financing for mortgages.

- Strengthening of credit information bureau by upgrading it to e-CIB

18. To sum up, 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. However, it does give comfort that strategic measures to address key impediments and challenges have been initiated and a roadmap has been set for further direction.

19. In the end I would wish to thank WB-IFC, panel speakers and the audience. I leave with an expectation that this forum will help create a synergy between the South Asian countries and help initiate a common strategic direction for a cause common to all of us.

Thank you.