Appendix D

Pakistan

Pakistan's housing finance-to-GDP ratio is below 1 percent. The ratio in developed countries is 50–70 percent, and 7 percent in India. In spite of active and robust financial sector reforms led by the State Bank of Pakistan [SBP] in the recent decade, the unwieldy land administration environment, unprecedented rises in land prices, and inadequate mortgage lender experience with lower-income housing have prevented the market from advancing in the provision of housing and housing finance solutions. Pakistan is facing unprecedented challenges of acute housing shortages, unhealthy living conditions, and nonexistent or dilapidated infrastructure across the country.

*Housing shortages stood at an estimated 7.57 million units in 2009—6 million of which are concentrated in the lower-middle-income and low-income population groups, which the market is incapable of servicing currently. Housing stock is composed mostly of nonpermanent dwellings—about 40 percent of houses are semi-*pucca *(semipermanent) houses, generally without planned sanitation or a sewerage system. Thirty-nine percent are* kutcha *(temporary) houses with minimal water supply and either sanitation or drainage services. Only 21 percent of houses are modern brick constructions. Private developers are relatively dynamic, but have focused exclusively on the upper-income population, constrained by developer industry fragmentation, unorganized brokers, the lack of developer finance, an unstructured framework for property development, skewed tenant laws, poor master planning, problematic zoning restrictions, unreliable utility connections, and impractical building codes. There is little research on local, viable, low-cost housing solutions in the country. The quality of construction is grossly compromised by high prices for construction material. The secondary market is active, but nontransparent and speculative.*

Currently, there are 25 commercial banks offering mortgage finance in Pakistan. The state-owned House Building Finance Corporation (HBFC) is the only institution that caters to the financing needs of middle- and low-income groups in the country. Only

1–2 percent of all housing transactions are processed through housing finance credit lines; the remaining, mostly lower-income, clients are funded by personal savings and informal borrowing. More than two thirds of its population falls below the mortgage affordability threshold of PRs 200,000. The microfinance market has a very limited outreach in Pakistan, at barely 2 percent of the population. Microfinancing for housing is even more limited. Growth is brisk, however, starting from a small base. Combined efforts of nongovernmental organizations (NGOs) and the government have proved inadequate to address the low-income housing and housing finance gaps.

The role of private banks has grown significantly over the years, and they now hold 46 percent of outstanding mortgages—though the HBFC still handles 77 percent of mortgage clients by number. Mortgage terms are typical for the region, though unaffordable for lower-income groups. The industry performance has suffered from global conditions, with a rising nonperforming portfolio above those of neighboring countries. Commercial banks have remained very conservative in their limited exposure to housing finance, and Islamic mortgage lending has not fulfilled its considerable potential in servicing lower-income borrowers in the housing finance sector. In spite of the small share of housing finance in banks' portfolios, those loans cause exposure to credit risk, as well as liquidity risk from the term-maturity mismatch, given short-term deposits and long-term lending. Credit risk is being managed by increasingly better client information, but will take on renewed importance as the market moves down the income scale. Interest rate risk is borne by the borrower because banks do not offer fixed-rate instruments.

The palpable shift from public to private housing finance provision was achieved as a result of aggressive and enabling policy measures. The Financial Institutions (Recovery of Finances) Ordinance, 2001, established a new nonjudicial procedure for recovering secured claims. The National Housing Policy was published the same year. The regime of mortgage lending was liberalized and strengthened by lifting various regulatory restrictions. An appropriate prudential framework for housing finance was designed. Credit information services were introduced. The SBP constituted the Housing Advisory Group in 2002 to analyze existing housing and housing finance policies and to address key challenges, and it created a special department focused on promoting market-based credit in housing finance. Further measures included fiscal incentives in 2003–04 and several government mega-housing projects in big cities to increase the housing supply.

Important regulatory weaknesses remain, creating continued uncertainty on property and housing finance transactions. An inefficient legal framework; fragmented ownership and titling procedures; inefficient land information systems; inaccessible, unused government land; high stamp duties and registration fees; a weak tax framework; and ineffective land dispute mechanisms dampen the willingness of banks to increase their mortgage portfolios. In Karachi, more than 17 different agencies are responsible for land titling and registration. Stamp duties and registration fees can go up to 9 percent in some provinces. Land registration is manual, nontransparent, and cumbersome, with several possibly applicable legal regimes. As a result, most deals are made for cash and without official title documents. The recovery, foreclosures, and eviction framework from 2001 has certain legal weaknesses, but its biggest challenge is the reluctance of courts to apply it in practice.

Overhauling housing development regulations; providing infrastructure for residential development; improving the reliability of land administration, records, and titling; streamlining property taxes; rewriting urban rent laws; enforcing foreclosure laws; and promoting long-term funding will boost the overall demand for and supply of mortgage finance. And, in the medium to long term, those efforts will address the supply of serviced land. New financing mechanisms including real estate investment trusts, municipal bonds, and a secondary mortgage facility would help deepen the housing finance market. An overhaul of the HBFC and innovative instruments would promote microborrowing and first-time purchases.

Overview

With a population of more than 167 million people (as of May 2009), Pakistan is the sixth most populous country in the world; and has the third-largest Muslim population after Indonesia and India. The country is riddled with problems of terrorism and lagging rural regions, with a poverty rate of 24 percent and access to any type of formal finance at barely 14 percent. With inflation at 12.0 percent in fiscal 2007/08 and projected to rise to 20.8 in fiscal 2008/09, and with an unstable macroeconomy, GDP growth slowed from 6.8 percent in fiscal 2006/07 to 4.1 percent in fiscal 2007/08. Projection for fiscal 2008/09 is 2.5 percent.[1] The high poverty level is coupled with an inequitable income distribution, lack of basic infrastructure, substandard living conditions and erosion of basic health and educational facilities—particularly for low-income groups.

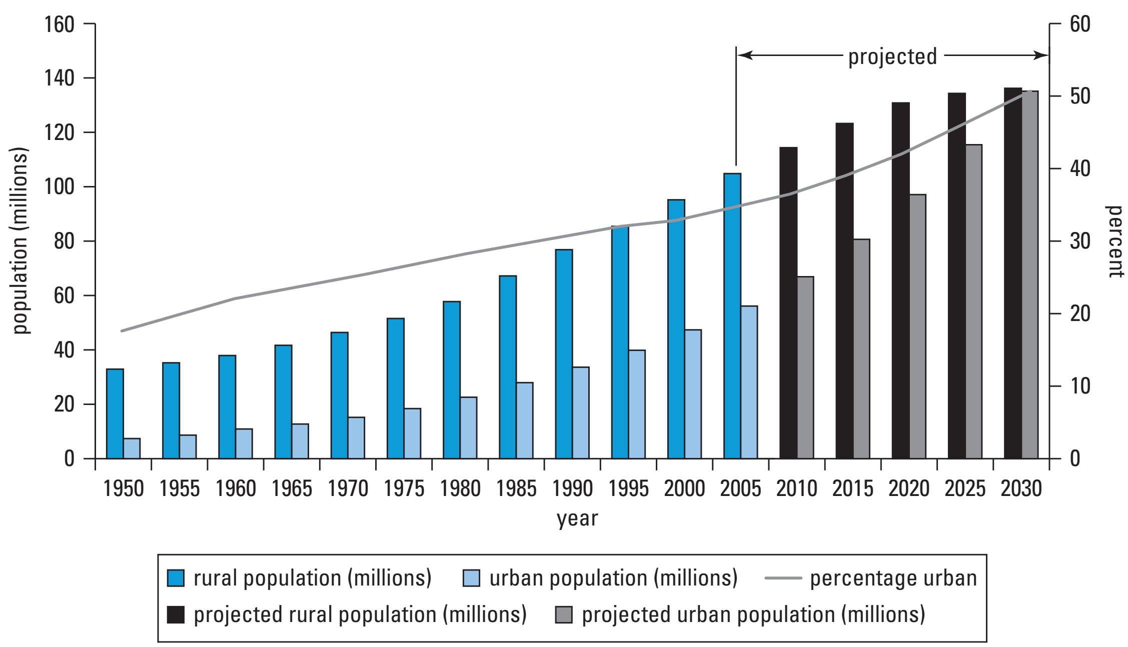
Despite hectic government measures, economic indicators are showing downward trends. A turbulent political situation, law and order instability, global supply shocks—the oil, food, and financial crises—and a softening of external demand have adversely affected key macroeconomic fundamentals. Given low population growth rates, however, per capita income has grown at an average annual rate above 13.0 percent during the last five years. Total investment declined to 19.7 percent of GDP in fiscal 2008/09, from its peak level of 22.9 percent in fiscal 2006/07; and is expected to experience further decline in 2010.

In recent years, Pakistan has undertaken major financial sector reforms that have resulted in a more efficient banking system. During the global financial crisis, the Pakistan banking system was relatively resilient because it has had an expanding asset base fueled by healthy deposits and equity growth. In spite of the worsening macroeconomic environment, the banking system appears to be generally well capitalized, profitable, and liquid. Consumer lending has taken off in recent years, with banks expanding aggressively into consumer, automobile, and housing loans. At the same time access to finance remains limited. Currently, less than 14 percent of the population uses formal financial services, compared with 32 percent in Bangladesh, 48 percent in India, and 59 percent in Sri Lanka. Microfinance institutions and microfinance banks are the formal providers of finance to poor households and microenterprises, whereas commercial banks are the source of credit and finance to small and medium enterprises. In Pakistan, 1.7 million people use the microfinance sector—this is about 1 percent of the population and about 2 percent of adults—because the country has the lowest outreach in the region (except for Afghanistan). Operational and financial sustainability of microfinance institutions is also the lowest in the region. Similarly, access to finance for small and medium enterprises is low on an absolute and comparative basis. The percentage of such enterprises with bank loans in Pakistan is 7 percent, compared with 32 percent in Bangladesh and 33 percent in India.

Macroeconomic instability has had an adverse impact on financial system performance and growth. The heightened credit risk resulted in a significant increase in nonperforming loans and associated asset quality indicators. Furthermore, the slowdown in the economy dampened the growth rate of the banking system. During the first quarter of 2009, the asset base of the banking system passively grew by 1.6 percent. The net loan portfolio declined by 5.6 percent over the same quarter, while investments in government paper increased by 20 percent. Bank deposits remained stagnant, and banks had to resort to interbank borrowing to finance the marginal increase in their asset base (SBP 2009).

The urban share of the total population is already high at 37 percent, and is projected to rise to 50 percent by 2030 (figure D.1). Annual city growth rates are high, ranging between 3.8 percent and 5.5 percent in the late 1990s. Karachi is said to be growing at 6.0 percent annually, requiring the city to accommodate 700,000 new residents each year. Pakistan now has nine urban centers close to or

Figure D.1 Urban and Rural Populations in Pakistan, 1950–2030



Source: UN-HABITAT 2008.

exceeding 1 million people. High urbanization considerably contributes to chronic housing shortages.

Pakistan is facing unprecedented challenges of acute housing shortages, unhealthy living conditions, and nonexistent or dilapidated infrastructure across the country. More than 50 percent of the urban population lives in slum areas. The lack of affordable housing is pervasive because of the exorbitant markup of interest rates, high real estate prices, and eroding incomes of middle- and low-income groups. The average national occupancy rate per dwelling is above six; density per room is 3.5 people, compared with the international standard of 1.1 per room. The mortgage-to-GDP ratio is below 1 percent. Currently there are 25 commercial banks offering mortgage finance in Pakistan. The HBFC is the only state-owned corporation that caters to the financing needs of middle- and low-income groups. The housing market has also witnessed an increasing participation in housing finance by Islamic banks since 2007.

High economic growth and remittances have produced escalating real estate prices and a high ratio of urban property prices to purchasing power that is typical for densely populated cities, such as Mumbai and Hong Kong, China. The twin problems of supply shortages and escalating prices underscore the underdevelopment and undercapitalization of the housing sector. 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 in the 2000s, in response to government policies and increased bank interest in retail lending, mortgage finance in 2007 was still less than 1.0 percent of GDP. The government has taken numerous steps to encourage development of a more stable and vibrant housing sector. The Financial Institutions (Recovery of Finances) Ordinance, 2001, established a new (nonjudicial) procedure for recovering secured claims. The regime of mortgage lending was liberalized and strengthened by lifting various regulatory restrictions. An appropriate prudential framework was designed. Credit information services were introduced. The Housing Advisory Group was appointed in 2002 to iron out housing sector–related issues. A Development Finance Group was created within the SBP, with enhanced focus for creating an enabling environment to facilitate intermediation of market-based/high-priority credit (which included housing finance as a key area). The 2001 National Housing Policy was published. Finally, fiscal incentives were granted in the federal budget of fiscal 2003/04 to facilitate mortgagors and banks.

The greatest challenges that the housing and housing finance sectors are facing at the moment are the inefficiency of the overall regulatory regime, including land and titling procedures; a poor regulatory framework for housing and real estate; and the lack of an organized database and key information on the housing and housing finance sectors. Other challenges include insufficient developed land and exorbitant land and housing finance prices; housing shortages; maturity mismatch and liquidity risk in mortgage lending; poor government success in addressing low-income housing needs; and lack of commercially viable housing microfinance lending.

Housing Demand

Housing shortages have increased from 4.33 million units in 1998 (the latest census) to an estimated 7.57 million units in 2009 (table D.1). The factors responsible for substantial increase in the housing backlog are generic population growth, year-on-year short supply, and depletion of existing stocks. The yearly new housing units needed because of population growth is 0.7 million, whereas the addition to the existing stock is only 0.3 million a year. Considering depletion of stock at 1 percent or 0.2 million units a year, the new addition would practically have no impact on existing stock.

Figure D.2 presents a breakdown by income group of various aspects of Pakistan's housing finance industry. The high- and very-high-income brackets, with annual earnings of more than PRs 51,000, represent the top 5 percent of the Pakistani population that is serviced by commercial banks. These people can afford a mortgage above PRs 2.5 million.[2] This is the sole group that can be sustainably serviced on a commercial basis, given current financial development and mortgage know-how in Pakistan. The market can address this demand in spite of high land prices, scarce developed land, and low capacity for housing units supply because the segment can afford a considerable amount in mortgage (commensurate with property prices) and because of the modest size of the segment (estimated at a little over 1 million households).

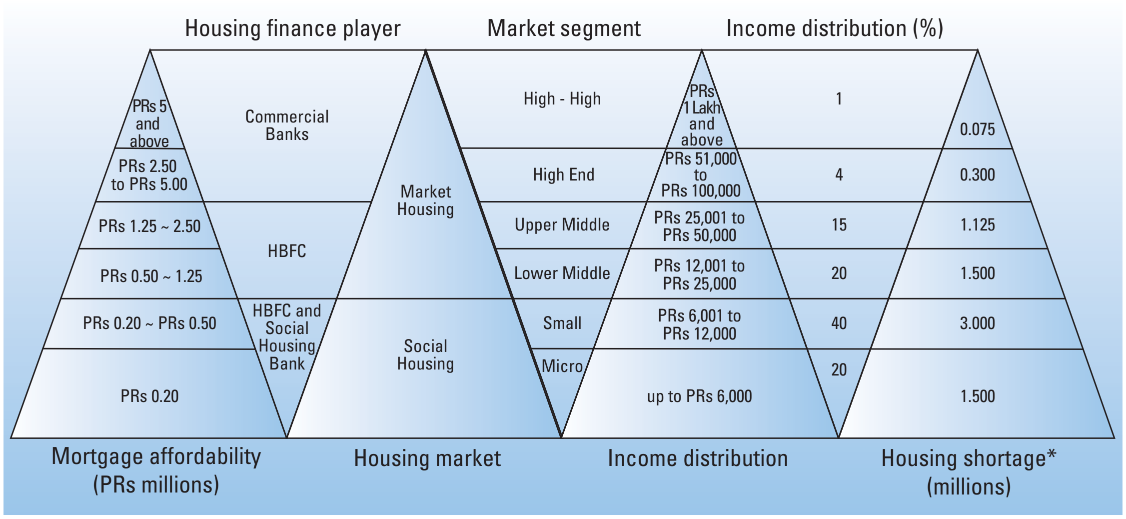
For the upper-middle- and lower-middle-income groups, incomes range from PRs 12,000 to PRs 50,000; and together they represent 35 percent of the population in the country. These groups are serviced by the HBFC, and the mortgage level they can afford falls in the range of PRs 0.5–2.5 million. The housing shortage estimates for this middle-income group of about 8.1 million households is 2.6 million units. This income group, although currently not serviced by commercial banks, could be

Table D.1 Basic Housing Indicators for Pakistan, 1998 and 2009

Description	1998	2009 (estimated)
Total housing (units)	19.30 million	20.48 million
Housing backlog (units)	4.33 million	7.57 million
New housing need resulting from population growth (units)	0.30 million	1.28 million
Annual depletion of housing stock	1%	1%
Total population	132.2 million	167.0 million
Urban population	32.5% of population	37% of population
Annual growth rate of housing demand in urban areas	8%	8%
Urban housing units	32.30%	32.20%
Average household size	6.0 people	6.6 people

Sources: Pakistan's 1998 national census; authors' estimates.

Figure D.2 Segmentation of the Housing Market by Income Group



Source: Rizvi 2007.

Note: Housing shortage is estimated from the total existing backlog of 7.3 million, proportionately, to the population shares for each income bracket. However, actual shortage is much higher in low-income segments than in higher-income segments.

profitably addressed by the market if there were better technology, more competition, a level playing field, and further financial development within a stable macroeconomy.

The lowest two income segments making up two thirds of the population cannot be profitably provided with a dwelling or a mortgage at this stage, and require recourse to some sort of subsidy. The group with income of PRs 6,000–12,000, representing 40 percent of the population, can afford a mortgage of PRs 0.2–0.5 million. These roughly 9.3 million households are exposed to an estimated housing shortage of 3 million units. The lowest 20 percent, with incomes below PRs 6,000 (roughly 4.6 million households), can afford nothing above PRs 200,000; and they face a housing shortage of 1.5 million units.

As a result, lower-income groups expand into illegal habitats and squatter settlements (*katchi abadis*) in major cities. These are pockets of unregulated tracts of land scattered throughout the landscape of large cities; and over the years, they have sprouted to fulfill the housing needs of the low-income stratum of the society. Because property ownership in these shantytowns is devoid of a legal title, housing finance from the formal credit system could not trickle to these areas. Moreover, as a result of their unregulated nature, *katchi abadis* are a cause of revenue slippages for the government on a continuous basis. More than half of the major cities (like Faisalabad, Karachi, Lahore, and Peshawar) have *katchi abadis*. Karachi alone has 600–800 such settlements, sheltering about 7.6 million people (or 1 million households, as of 2005) out of the total city population of 15.1 million people. Singh province, which comprises Karachi as well as Hyderabad, has 1,300 *katchi abadis* overall, located on 24,300 acres of government-owned land and 1,700 acres of privately owned land (table D.2). The situation is also difficult in Punjab, with 902 *katchi abadis*.

Table D.2 Details of *Katchi Abadis* in Pakistan, by Province, 2008

Province	*Katchi Abadis* (number)	Government Owned (number)	Privately Owned (number)	Total Area (acres)
Balochistan	55	2,826	0	2,826
North-West Frontier	65	1,509	3,434.03	4,943
Punjab	902	8,875	501.16	9,376
Sindh	1,300	24,300	1,700.38	26,000
Total	2,322	3,7510	5,635.60	43,145

Source: HBFC country report, 2008.

The province comprises the cities of Faisalabad, Gujranwala, Islamabad, Lahore, Multan, and Rawalpindi, all with populations exceeding 1 million.

Housing Supply

Pakistan is facing unprecedented challenges of acute housing shortages, unhealthy living conditions, and nonexistent or dilapidated infrastructure.

Current State of Housing

About one third of available housing units are urban, and the remainder is rural. Ownership in the country is at approximately 81 percent of dwellings, with about 9 percent of households living rent-free and 11 percent renting. Roughly 40 percent of houses are semi-*pucca* (permanent) houses, mostly without planned sanitation or a sewerage system; 39 percent are *kutcha* (temporary) houses with minimal water supply and sanitation or drainage services; and 21 percent are modern brick constructions. In addition to rising land prices, the costs of construction materials have been increasing considerably, particularly those of cement and iron. Unavailability of developed land, coupled with the high prices of construction materials, has compounded the problem of housing shortages in Pakistan. Private developers are relatively dynamic and have been engaging in considerable activity, including large infrastructure projects. Their supply of housing has exclusively targeted the upper-income population. Unavailability of requisite bulk developer financing from commercial banks is another big hurdle in the way of housing supply in the country. The government has initiated some low-income housing projects; but these efforts have been vastly inadequate, relative to need. The brisk pace of activities in housing and high-rise building construction, along with large public sector spending on physical infrastructure and ongoing reconstruction activities in earthquake-affected areas, have contributed to the sharp pickup in construction value added. Construction has been growing at an average annual rate of 10.2 percent over the last five years.

Although the construction sector has only a 2.3 percent share in GDP, its share of the employed labor force was disproportionately large, at 7 percent.

Development of Housing Stock

The current land development framework is highly inefficient and acts as a critical bottleneck to the availability of developed land on the market.

Procuring Land for Development. The land administration 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.

Accordingly, developers are confined to procuring scarce developed urban land through the government. Landowning government agencies (such as city governments) auction plots, which then give rise to speculative secondary trading until they are purchased by the highest-value client. This speculative element considerably impairs affordability of subsequent developments on auctioned land, so the real estate naturally is placed with only the highest-income groups. This can be remedied by transforming the land auctions into government contract awards for completed housing projects, thereby making it less attractive for the speculators to bid. Moreover, such an undertaking would increase the supply of constructed housing units rather than that of plots (which usually remain vacant even many years after auction). In sum, the institutional framework for identifying, acquiring, and servicing land that is available for construction and subsequently selling the constructed housing units is underdeveloped. Some of the factors causing this shortcoming are poor master planning, governance issues at national and local levels, multiple institutions and administrative procedures, problematic zoning restrictions, unreliable utility connections, and restrictive building codes.

National and local master plans are either inadequate or poorly enforced, and this has led to inefficient allocation of land and uncontrolled urban development. The root cause is the lack of clear responsibility among a multitude of government institutions (such as in Lahore, where responsibility is shared among the land development authority, the city district government, 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 opens opportunities for land mafias to have valuable inside information about future infrastructure developments or to influence such plans so that mafia land increases in value.

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.

Increasing the supply of land has been problematic in Pakistan. 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 challenging. 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. According to a Foreign Investment Advisory Services administrative barrier study, it takes an average of 135 days to acquire land from the government. Private land can be acquired in 63 days, but even this is not a good-practice benchmark.

Despite imposition of a nonutilization penalty on plots, construction on a significant number of residential plots—auctioned to the private sector by the various public sector landowning authorities—has not been initiated because of the allottees' tendency to reap speculative gains.

The present land allocation policy encourages horizontal development, which adds to the land scarcity problem. At present, only a small portion of land is allocated for high-rise buildings: for example, in Karachi only 5 percent of the land is earmarked for apartment buildings, but 55 percent is assigned for individual houses. Because land is a major component of the total building cost, imbalances created under the present land allocation policy, among other things, have led to a real asset price spiral in the urban centers of Pakistan.

Various landowning agencies currently release public land to the end users in an unplanned and inadequate manner. The quantity of auctioned land falls short of quenching the demand for housing facilities. Because a limited number of plots are offered through these public auctions, speculative gains abound. Speculators in large numbers participate in the auction process, which breeds "file-culture." Because of the gross involvement of the speculators, genuine recipients are able to purchase a piece of land only at a much higher price through the secondary market. At present, various government agencies (such as City District Government Karachi) are enjoying the status of a natural land bank; they release public land to the private sector on a recurring basis but in a haphazard manner, devoid of any medium-to-long-term strategic focus.

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 most (including farmers)—it is made problematic by the 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 (specifically, 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 resold their land long ago and moved on. The government is slowly regularizing these cases. (Less than 200 cases have been reviewed so far.)

Overly 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 1.0:1.5 (floor areas less than 1.5 are low density; plot ratios above 5.0 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 the number of stories. Their legal status has been pending for many years because the developers are well connected or no longer around. (There are 300 such buildings in Karachi alone.)

Poor incentives and governance within government-controlled companies (especially a problem in power and gas) typically can delay large-scale construction projects by as much as a year. Some developers are relying on gas-powered, self-generation power plants as an alternate and viable source of electric power. Poorly targeted subsidized pricing, widespread theft, 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 estimates that 40 percent of water is lost through mechanical failure and theft.

By far, the scarcity of developed lands at prices that are affordable to other than the highest-income groups is the biggest challenge for policy makers and the housing sector. Housing shortages and exorbitant real estate prices fundamentally are two by-products of developed land shortages in the country. Though land itself is not scarce, there is an acute dearth of serviced land along with the attendant residential infrastructure. In fact, the government already has devised a land policy to make developed lands available throughout the country, through the National Housing Authority. The policy provides for urban and rural settlements for housing developments that reduce the concentration of metropolitan and major urban centers, and that enhance land availability through such innovative measures as land banking on a continuous basis to cater to longer-term needs.[3] Further, the aim is to amend the land acquisition laws to make provision for a unified, transparent, and market value–oriented system that will minimize litigation. A comprehensive land information system would be created, including inventory and land classification, geographic information system mapping, settlement patterns, land values, land availability, and other data. The policy provides for federal and provincial funding for infrastructure, amenities, and other developments in the planned housing development areas, with the responsibility and cost fully shouldered by public utility agencies, not the developer. Integrated development would be promoted, optimizing land use and mandating the preparation of master structural plans. For all its redeeming features, this policy has not been implemented as yet.

Low-Cost Construction Technologies. Developers use conventional construction technologies with gradual introduction of recent improvements for residential and commercial construction. Few initiatives exist in low-cost housing development, and all of these are indigenous. No serious attempt has been made to have technical collaboration with a globally acknowledged, low-cost construction technology provider. These local initiatives include the use of prefabricated materials technology (such as prefabricated slabs, roofs, pillars, and so forth). The primary gain of the prefab material technology is the cost reduction resulting from production economies of scale and reduced labor costs. An alternative—the "8x8 construction technology" (also known as movable housing technology)—has been tried on a very limited scale. Under the 8x8 technology, all dimensions of the house are eight feet and the structure is placed over a movable frame with wheels fixed on the bottom at the four corners. To promote development of low-cost construction technologies and materials, the HBFC in 2006 set up a Center for Promotion of Low-Cost Housing, in association with NED University of Engineering and Technology (Karachi). However, this useful undertaking lost momentum after 2008. That leaves the country with no existing platform to evaluate, certify, and introduce the internationally proven low-cost housing technologies capable of matching local requirements. There is a need in Pakistan to initiate low-cost construction pilot projects on the pattern of four such projects implemented in India.

The Developer Industry. The emergence of an active and competitive building industry is constrained by industry fragmentation, unorganized brokers, the lack of developer finance, an unstructured framework for property development, and skewed tenant laws. 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. The majority of real estate builders and developers are organized as sole proprietorships or partnerships, with limited capital and informal corporate governance structures. Without using a strong regulatory authority to enforce building standards, the quality of housing still leaves much to be desired.

The unstructured and unsupervised nature of real estate brokers is also a significant constraint to the provision of housing and housing finance. Only appraisers have professional conduct requirements that were established by the SBP and the Pakistan Banks' Association. 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 because the market is dominated by cash transactions and lacks transparency, and because no systematic information is available. Risk assessment and portfolio valuation are fragile as well—another factor prompting lenders' extreme caution.

The 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. Their reluctance, in turn, makes finance scarce and constrains the supply of housing.

Developer Financing. At present, there is little external bank financing for property development. Land for a housing project is usually owned by many interconnected companies with complex relationships, understandings, and arrangements that are hard to assess. Further, transparency and accountability are not easily practiced in the presence of such complex ownership arrangements. Historically, the real estate business has been booking driven; in the recent past, however, the paradigm has shifted and now the main concern regarding the provision of funding to real estate builders and developers is that financing generated through the general public may not be sufficient to complete and hand over a housing project/scheme in accordance with the booking schedule. Therefore, there is a need to figure out the modus operandi for financing arrangements for builders and developers through the formal banking system that is viable, acceptable, and sustainable.

Developer Associations. The All Pakistan Contractor Association (APCA) was created in 1998, under the Companies Ordinance 1984; and is affiliated with the Federation of Pakistan Chambers of Commerce and Industry as an "A" class association.[4] APCA's efforts to address the problems facing the construction industry have met with substantial success. On the initiative of APCA, the construction sector has been recognized as an industry in official government classification, entitling the sector to fiscal incentives, special treatment, and other benefits. That also helped association members win a number of government housing projects throughout the country. APCA was instrumental in drafting the National Housing Policy for low-income groups. Finally, APCA achieved duty-free status for imported construction machinery.

ABAD, created in 1972, is a national-level representative organization under the Companies Ordinance 1984, affiliated with the Federation of Pakistan Chambers of Commerce and Industry.[5] Its mission is to unify and streamline the construction activities of the private sector; to promote the housing industry; to provide assistance to the government in formulating housing policy and explore the potential for large-scale public projects for private implementation; to coordinate housing stakeholders; and to support capacity-building, awareness, and training efforts. ABAD has made a valuable contribution in the formulation of the National Housing Policy and the Sindh Building Control Ordinance. It has also supported the enhancement of the role of the HBFC.

Rental Regulations. Tenant laws further increase the riskiness of investment in rental property, resulting in a very small rental market. (Private banks refuse to finance developments destined for the rental market.) The letter of the law is highly skewed in favor of tenants because eviction is very difficult. Relevant laws act as an impediment to the provision of housing finance aimed at generating rental incomes. Consequently, large shares of land-related disputes are tenant related. This issue disproportionately affects the middle and lower classes for whom renting is the only way 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 significantly more developed (constituting 40 percent of the market, versus 20 percent in Lahore). The recent increase in rental taxes (Finance Act 2008; the prior tax was 5 percent) is considerably decreasing transparency in the leasing environment.[6]

There is no single statute that governs the landlord and tenant relationship; instead, each state has its own governing statute, and most of them are outdated. Although the law was designed to protect both the landlord and the tenant, implementation has been fraught with poor governance and delays in enforcement. Specifically, a rent case takes about 24–42 months in the Court of the Rent Controller; about 8–10 months before the Appellate Court (district judge); and when a second appeal or a revision is entered before the High Court, it takes approximately seven to eight years before the final disposition. The position and powers of a Rent Controllers—basically, a civil judge—have become a major source of corruption and delays in the settlement of cases relating to tenancy. It is significant to note that nearly 40 percent of the total pending cases in the courts of law relate to land disputes; those relating to tenancy are roughly 23 percent.

Construction Costs. The quality of construction is grossly compromised by high prices for construction materials. There are no formal data available on housing construction costs, and those vary considerably with the quality and luxury level of the construction plans and with the location of the property. Nonetheless, a casual regional comparison makes it plain that construction costs in Pakistan are much higher than those in Bangladesh, India, and Sri Lanka. An interview with the developers puts current estimates at PRs 800–1,000 per square foot for low-cost housing, PRs 1,400–1,600 per square foot for middle-cost housing, and PRs 2,200–3,000 per square foot for high-end housing.

Construction Quality and Enforcement of Construction Standards. Following the 2005 earthquake in the northern areas of Pakistan, building codes were redrafted in 2007 to include seismic provisions, with the technical support of the National Engineering Services Pakistan (Pvt.) Ltd. The 2007 seismic provision of the building code serves two purposes. First, for each *tehsil* (the smallest administrative unit in a province) of the country, it defines the earthquake level for which buildings must be designed. Second, it provides codified procedures and guidelines for planning, design, analysis, and detail of building structures. The topics covered include site considerations, soil and foundations, general structural design requirements, reinforced concrete buildings, structural steel buildings, masonry buildings, architectural elements, and mechanical and electrical systems. Effective implementation of this code can lead to significant improvements in the seismic safety of buildings in the country. Compliance levels remain low, however.

The Secondary Property Market. Real estate in Pakistan has an active secondary market; but it suffers from certain limitations including lack of transparency, price speculation, and sales involving legally imperfect documentation. Real estate brokers are neither licensed nor registered. More than 80 percent of the mortgage finance being done by the commercial banks is for secondary market transactions.

Housing Finance

Overall, consumer lending in general, and housing finance in particular, are growing. Banks, once conservative consumer-loan lenders, are now aggressively expanding into consumer loans (including those for housing). The share of commercial banks involved in housing finance grew from 10 percent in 2003 to 79 percent in 2009. 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.

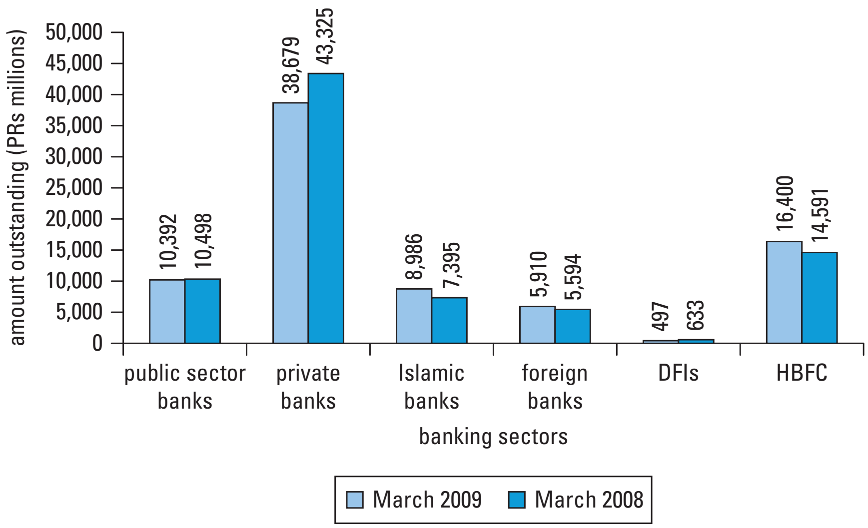
Currently, 25 commercial banks offer mortgage finance in Pakistan. The state-owned HBFC is the only institution that caters to the financing needs of middle- and low-income groups. Although the entry of commercial banks in the housing mortgage market has occurred relatively late (in 2007, with the consumer boom), its evolution has remained promising. The market has also witnessed an increasing participation in housing finance by Islamic banks since 2007 (annexes D3 and D4).[7] Other sources of long-term funds include provident funds, various organizations, builder's credit, and friends and family.

Although the current legal and macroeconomic environment is increasingly conducive to 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 the urban working class that is most in need of mortgage financing. Primarily, banks are constrained in their lending by the lack of long-term, fixed-rate funding that would enable them 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—a practice that increases the risk for lenders and restricts the menu of long-term mortgage products that can make housing more affordable. The current cost of short-term liabilities is significantly lower than the average markup charged by the banks on housing loans, so it yields a huge spread for the banks. However, this practice is creating asset-liability mismatching that may not be sustainable over the long term.

Even if long-term funds were immediately available, however, the volume of mortgages would be restrained by broader challenges facing the sector as a whole—challenges for which public intervention is required. The weak property rights and land development framework, the embryonic property development framework, and the emerging building industry pose significant problems for Pakistan's nascent mortgage finance market.

The Housing Finance Market. On March 31, 2009, the total outstanding finance of all banks and development finance institutions (DFIs), including the HBFC, stood at PRs 80.87 billion; private banks had a significant lead, with PRs 38.6 billion—a

Figure D.3 Housing Finance Outstanding Loans, March 31, 2008 and 2009



Source: SBP 2009.

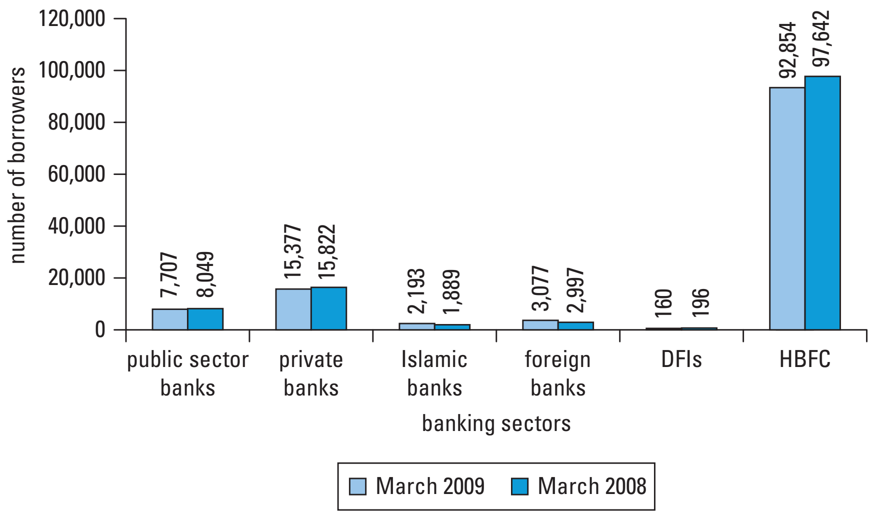
48 percent share in the total housing finance sector. Compared with the quarter ended March 31, 2008 (figure D.3), outstanding loans of all commercial banks and DFIs increased by 1.3 percent by March 31, 2009. Islamic banks have an 11 percent share in total outstanding loans with PRs 8.98 billion, followed by public sector banks with PRs 10.39 million (13 percent) and foreign banks with PRs 5.91 billion (7.3 percent). The cumulative outstanding loans of the HBFC stood at PRs 16.40 billion as of March 31, 2009, showing a 20 percent share in the overall stock of outstanding loans.

In 2009, Islamic banks showed the highest growth, at 21.5 percent. The HBFC's outstanding lending grew by 12.3 percent. In contrast, private banks' lending decreased by 10.9 percent, while public sector and foreign bank lending remained virtually unchanged.

During the quarter ended March 31, 2009, the banks and DFIs extended loans to 712 borrowers (compared with 3,673 borrowers served during the same quarter in the previous year). The HBFC served 46.6 percent of the total borrowers by extending finance to 332 borrowers during the quarter.

The total number of housing finance borrowers as of March 31, 2009, was 121,368 (down from 126,595 on March 31, 2008), a 4.1 percent decrease (figure D.4). That decline masks a growth in the clientele of foreign and Islamic banks (by 286 percent and 16 percent, respectively), compensated by a decline in the number of borrowers served by private banks, public sector banks, the HBFC, and other DFIs (declines of 14.6 percent, 2.0 percent, 5.0 percent, and 18.0 percent, respectively). No disbursements were made by DFIs during the quarter ended March 31, 2009. Average loan size for the HBFC is PRs 1.08 million, compared with those of private sector banks (PRs 2.29 million), public sector banks (PRs 1.75 million), and foreign banks (PRs 2.68 million). Surprisingly, Islamic banks have not played any role in middle-income home financing; their average loan size remains high at PRs 3.7 million.

Figure D.4 Number of Housing Finance Borrowers with Outstanding Loans, March 31, 2008 and 2009



Source: SBP 2009.

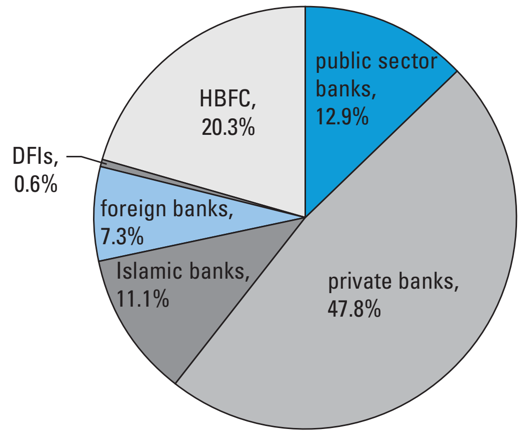
Private banks vastly dominate the housing finance market when outstanding loan balances are considered; however, the HBFC remains the largest lender by number of clients, serving some 71 percent of housing finance borrowers (figure D.5). The overall market share of commercial banks (excluding DFIs) remained around 81 percent between March 2008 and March 20009, with rapid growth in the market share of Islamic banks compensating for a decrease in private bank share. The market share of the HBFC has risen from 17.8 percent to 20.3 percent (not accounting for nonperforming loans).

Housing finance sector products range from loans for home purchase or renovation to financing for construction (figure D.6). The most popular product by far, with an outstanding portfolio of PRs 47.6 billion and a share of 59 percent, is the home purchase loan. Construction loans stand at PRs 23.8 billion (29 percent share), and renovation lending is at PRs 9.39 billion (12 percent of total).[8] In a nascent market, the dominant share of home purchase loans with smaller exposure to construction and renovation loans is not surprising. The need for verifiable collateral for the loan makes construction loans more difficult to finance; renovation loans tend to be smaller, of shorter maturity, and with lower profit margins for the banking institution. In 2009, financing for construction increased by 6.0 percent, while outright purchase and renovation loans decreased by 4.0 percent and 7.3 percent, respectively. Private banks have taken a lead in financing for construction and outright purchase, with 41.5 percent and 55.4 percent shares in the respective sectors. Public sector banks enjoy the greatest share in the renovation sector—25 percent.

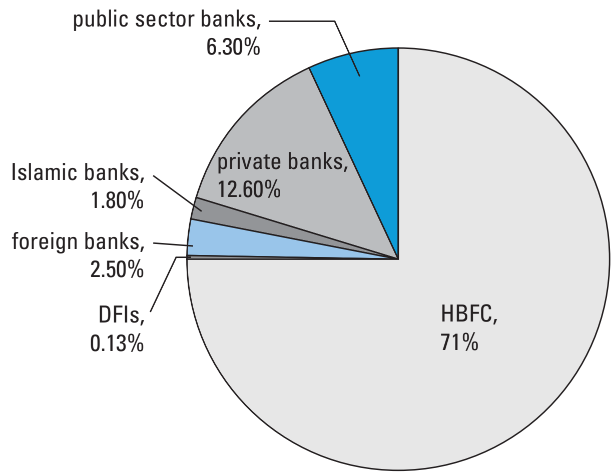
The overall weighted average interest rate in the housing finance market for the quarter ended March 2009 was estimated to be 15.42 percent—up 2 percentage

Figure D.5 Market Shares of Housing Finance Lenders, March 31, 2009

a. by outstanding portfolio



b. by number of borrowers

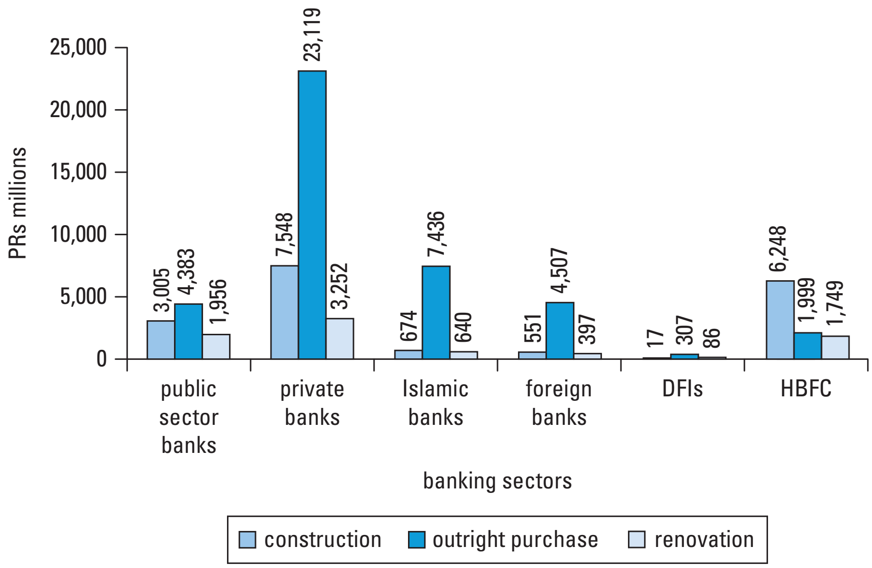


Source: SBP 2009.

points from March 2008 (table D.3). This underlines higher markups for Islamic and foreign banks (average interest rates of 17.8 percent and 17.5 percent, respectively), and more competitive pricing for public and private sector banks and the HBFC (15.0 percent, 14.6 percent, and 11.9 percent, respectively). Average maturity periods have declined marginally, from 13.2 years to 12.5 years in March 2009. DFIs and the HBFC extend loans with considerably longer maturities than those extended by commercial banks—14.5 years (DFIs) and 15.2 years (HBFC)—and so do Islamic banks (14.9 years). Public, private, and foreign banks offer home loans for 10.6, 11.9, and 12.0 years, respectively, on average.

The loan-to-value ratios declined progressively over 2009 (down to an average of 53 percent for the housing finance market) as a result of increased caution and the impact of the global financial crisis (table D.4). Loan-to-value ratios remain high at

Figure D.6 Mortgage Products Offered by Housing Finance Lenders, 2009



Source: SBP 2009.

Table D.3 Interest Rates and Maturities in the Housing Finance Sector

Finance Institution	Weighted Average Interest Rate (%) March 2009	December 2008	September 2008	June 2008	March 2008	Average Maturity Period (years) March 2009	December 2008	September 2008	June 2008	March 2008
Public sector banks	14.96	14.30	13.33	13.13	12.78	10.6	10.8	9.4	11.1	11.0
Private banks	14.55	13.34	13.61	12.94	12.75	11.9	11.9	11.9	12.1	12.5
Islamic banks	17.81	18.23	14.86	13.22	13.84	14.9	15.3	15.0	16.6	16.6
Foreign banks	17.53	16.89	15.05	14.67	14.40	12.0	11.8	9.1	12.5	14.5
All banks	15.52	14.57	13.94	13.23	13.10	12.3	12.1	11.6	12.7	12.7
DFIs	17.60	16.84	16.01	14.84	13.68	14.5	14.7	12.4	14.7	14.8
All banks and DFIs	15.60	14.65	14.02	13.29	13.12	12.4	12.2	11.6	12.8	13.0
HBFC	11.88	11.35	13.71	13.71	13.71	15.2	15.1	15.1	16.7	16.7
Total	15.42	14.40	13.97	13.45	13.42	12.5	12.4	11.8	12.9	13.2

Source: SBP 2009.

public banks (above 60 percent), followed by the HBFC, private banks, and Islamic banks (roughly 56 percent). The ratios evince a far more cautious approach by foreign banks (with a average loan-to-value ratio around 36 percent). Average processing time has remained at just over 25 days for the housing finance industry overall,

Table D.4 Loan-to-Value Ratios and Loan Processing Times

Finance Institution	Average Loan-to-Value Ratio (%) March 2009	December 2008	September 2008	June 2008	March 2008	Average Time for Loan Processing (days) March 2009	December 2008	September 2008	June 2008	March 2008
Public sector banks	60.5	63.1	58.3	63.7	58.2	31.7	38	38.6	39.2	38.0
Private banks	55.3	40.3	52.7	57.9	56.8	22.8	22	22.8	22.6	22.8
Islamic banks	55.3	39.8	56.7	59.1	55.9	30.4	36.9	33.6	21.5	20.9
Foreign banks	36.1	41.9	36.5	59.8	58.9	22.5	23.6	18.8	23.8	23.8
All banks	53.0	44.0	52.4	58.9	56.5	25.3	26.3	25.7	24.5	24.7
DFIs	43.1	44.2	49.1	45.4	47.5	30.0	30.0	30.0	30.0	30.0
All banks and DFIs	52.6	44.0	52.3	58.3	56.5	25.5	26.4	25.9	24.7	24.9
HBFC	55.8	67.5	55.0	55.0	55.0	30.0	30.0	30.0	30.0	30.0
Total	52.8	44.7	52.3	58.1	56.5	25.7	26.6	26.1	25	25.17

Source: SBP 2009.

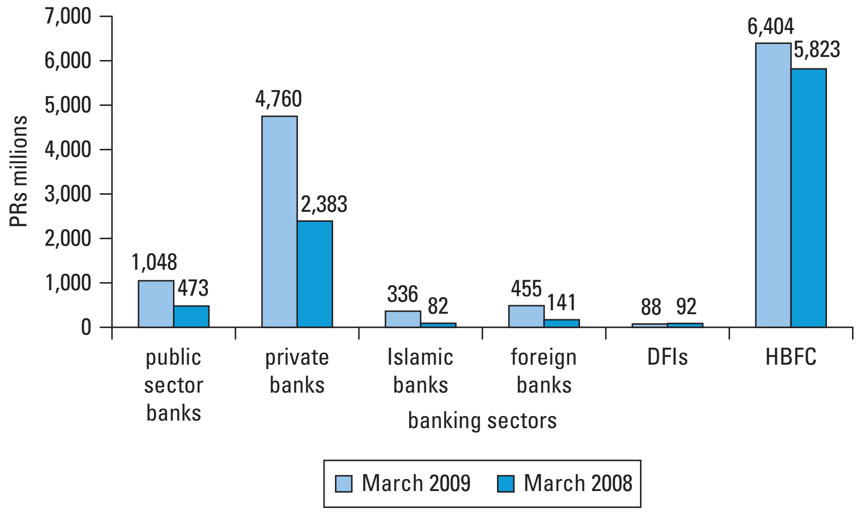
with private and foreign banks showing much more efficient processing and the HBFC being the slowest in loan administration. Foreclosure activities intensified considerably at the HBFC in 2009, whereas public banks remained unable or unwilling to collect the collateral of delinquent borrowers.

Efficiency and Performance of the Mortgage Finance Industry

Macroeconomic instability in Pakistan has had an adverse impact on financial system performance and growth, including in the housing finance sector. Accordingly, housing finance nonperforming loans had increased to PRs 13.09 billion by the end of March 2009—a 45 percent increase over the previous quarter (figure D.7). Nonperforming loans as a percentage of total loans outstanding for the entire housing finance sector (commercial banks and DFIs) are reported to be 16.2 percent. Commercial banks (excluding DFIs) collectively have nonperforming loans constituting 10.3 percent of their total outstanding portfolios. The HBFC reports nonperformers to be 39 percent of their total loans outstanding, whereas other DFIs stand at 17.1 percent.

A 300 percent increase in nonperforming loans has been witnessed among Islamic banks (from PRs 88 million to PRs 336 million); that number is followed by an increase of 121 percent among public sector banks (from PRs 0.47 billion to PRs 1.50 billion). For foreign banks, such loans have increased from PRs 141 million to PRs 445 million—a 222 percent increase. Private banks have reported an increase

Figure D.7 Nonperforming Loans in the Housing Finance Sector, 2009



Source: SBP 2009.

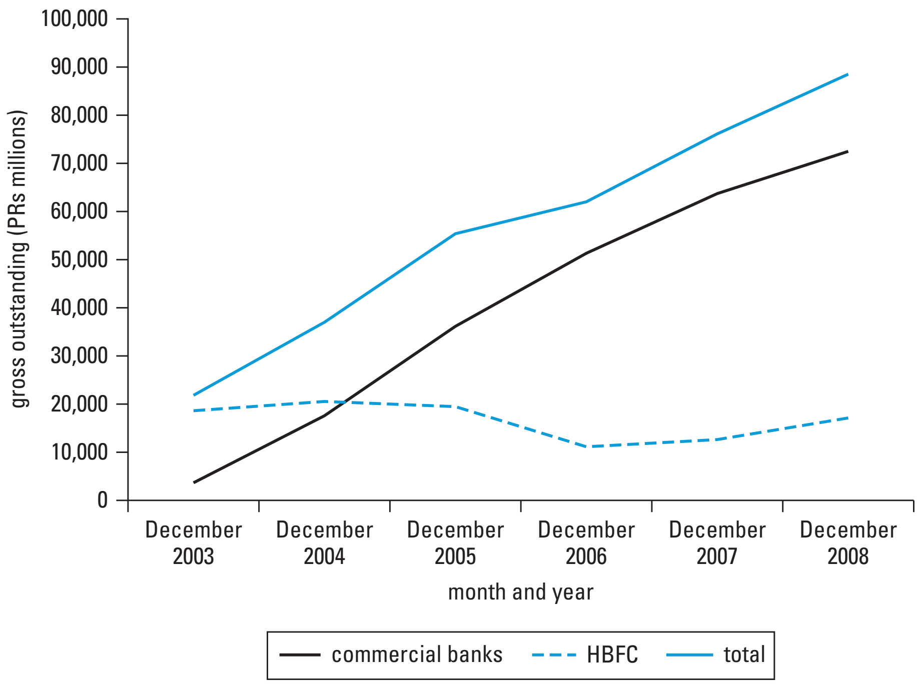
to PRs 4.76 billion (or 99 percent over the year), and the HBFC has reported an increase of 45 percent during the year (from PRs 5.8 billion to PRs 6.4 billion).

Pakistan HBFC

Historically, housing finance had been provided exclusively by the government-owned HBFC, established in 1952, because banks were not allowed to provide housing finance. From 1952 to 1972, the HBFC disbursed loans only to homeowners for construction of homes in urban areas. During this period, the HBFC's disbursement activities were quite modest, averaging PRs 18 million annually. In 1972, the HBFC's mandate was expanded to housing projects, finance to housing authorities and housing corporations, and rehabilitation loans; and it was permitted to undertake real estate development projects. Following this expansion of scope, its volume of originations increased significantly, averaging around Rs 500 million annually between 1972 and 1979. In the 1980s and 1990s, the HBFC was averaging around Rs 1.5 billion in annual disbursements/originations. Since fiscal 2002/03, the corporation has maintained a good pace in growth, and it disbursed PRs 4 billion in the last financial year.

The HBFC is active in low- and middle-income housing finance. Commercial banks entered the mortgage finance business in 2002-03, with a business focus only on the upper-middle portion and the high end of the housing finance market. With their entry, the need for an institution to serve the low-and middle-income segments became more obvious, and the HBFC was and is the only institution responding to that need. The HBFC's outstanding portfolio has been hovering in the vicinity of PRs 16–20 billion for the last few years, in contrast to the fast portfolio growth of

Figure D.8 Commercial Banks Versus the HBFC—Outstanding Portfolios' Historical Trends, 2003–08



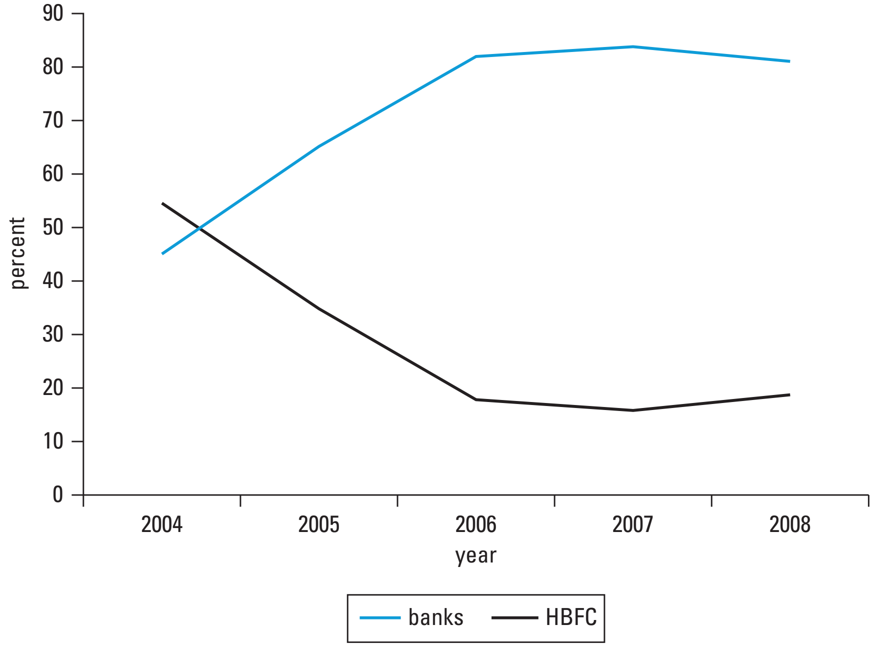
Source: SBP 2008b.

commercial banks (over PRs 70 billion in 2008; figure D.8). Similarly, banks have outperformed the HBFC in terms of market share, as the HBFC's share fell from 50 percent in 2004 to less than 20 percent in 2008 (figure D.9). Conversely, commercial banks have taken a considerable lead—from virtually nothing in 2003, to just under 50 percent in 2004, and to 80 percent in 2008.

During 2005–07, the HBFC (with technical assistance from the International Finance Corporation) availed the advisory services of the Canadian Mortgage Housing Company to carry out a diagnostic study of the HBFC and make recommendations for upgrading and reforming its operations, work environment, preparation of manuals, and computerization. The study also developed a business plan for the HBFC to make it a commercially viable and self-sustainable corporate entity. By the end of 2007, the HBFC had undergone a comprehensive reform program. That year, it was converted into a corporate entity under Companies Ordinance 1984, and thus was removed from the State Charter of 1952. Its financial restructuring and privatization were to follow, and they are ongoing.

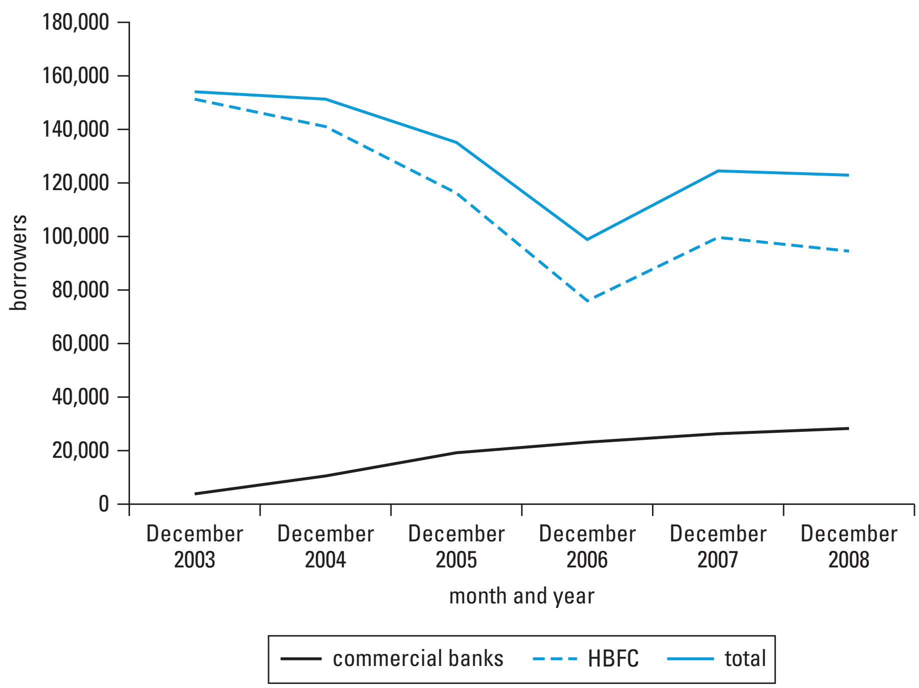
In terms of numbers of borrowers, the HBFC has shown negative growth over the years, while commercial banks have shown consistently positive growth (figure D.10). Although the total number of HBFC borrowers is still on the higher side, having the lowest average loan size makes its overall market share not commensurate with its high number of borrowers.

Figure D.9 Competition between Banks and the HBFC—Market Shares, 2004–08



Source: SBP 2008b.

Figure D.10 Commercial Banks Versus the HBFC—Number of Borrowers, 2003–08



Source: SBP 2008b.

Table D.5 Concentration in the Mortgage Market, 2003–07

Year (June)	Total Amount Outstanding (PRs millions)	Total Number of Banks/ DFIs	80% Share (PRs millions)	Number of Banks/ DFIs with 80% Share	Concentration (%)	Herfindahl Concentration Index
2003	2,372.3	14	1,898	3	21	0.259
2004	8,267.4	22	6,614	6	27	0.132
2005	26,699.2	24	21,359	10	42	0.095
2006	43,839.2	29	35,071	10	34	0.087
2007	57,541.8	29	46,033	9	31	0.094

Source: SBP.

Note: This analysis is conducted only on commercial banks and DFIs; the HBFC is excluded.

Commercial Bank Lending[9]

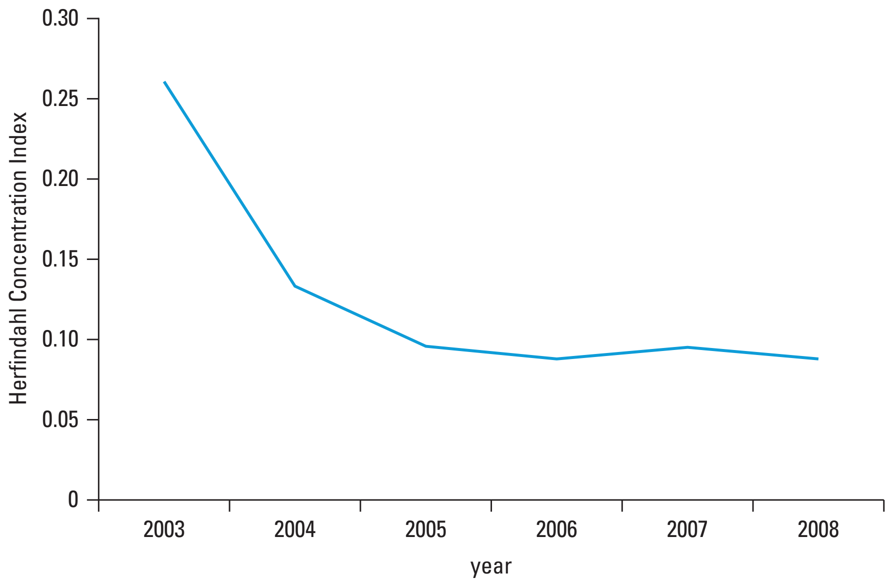
The mortgage market at inception can easily be characterized as concentrated. With the exception of the HBFC, only 3 of 14 commercial banks extended the bulk (80 percent) of housing loans during fiscal 2003/04 (table D.5). As more banks entered the mortgage market, the concentration of banks lessened somewhat: the number of banks participating increased from 24 to 29 during 2006, as Islamic banks entered the banking sector. In 2009, nine banks held an 80 percent share.

The Herfindahl Concentration Index for the Pakistani banking sector—a measure of the size of firms in relation to the industry in which they operate and an indicator of the amount of competition among them—has experienced a progressive improvement (figure D.11). The index, computed for five years, shows that competition in Pakistan among commercial banks and DFIs (excluding the HBFC) actually increased over time, with the index falling from 0.259 (highly concentrated) in 2003 to 0.132, 0.095, 0.087, and 0.094 in 2004, 2005, 2006, and 2007, respectively. The mortgage market, although in its embryonic stage, enjoys a fair degree of competition. This calls for a cautionary attitude to portfolio quality, however. Desire to capture competitive market share can obscure good lending practices and build up bad loans.

Table D.6 lists banks and DFIs (excluding the HBFC) that loan portfolios exceeding PRs 1 billion in the housing finance market. These institutions collectively constitute 80 percent of the housing finance market. There is also a clear mix of local, public, and foreign banks, with Bank Alfalah, National Bank of Pakistan, and Standard Chartered Bank being the top three dominating the market.

Overall, statistics suggest that banks remain very cautious in their lending strategy to the housing sector. Housing-related risk is presently manageable because of the relatively small size of the housing finance portfolio. The limited exposure enables banks to manage liquidity risk by leveraging their stable deposit bases, but this is not sustainable in the long term because bank deposits have relatively short

Figure D.11 Herfindahl Concentration Index for the Banking Sector



Source: Kamran Shehzad, deputy governor of the SBP, at a 2009 workshop on housing finance in South Asia, Karachi.

maturities (that is, the bulk of a 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 for deposits with large nationalized banks. As a result, banks are currently forced to restrict their housing loans to relatively shorter maturities.

In part, the banks' cautious approach to lending is because they are still attracting the requisite expertise and resources to exploit this business area and manage its associated risks. The requisite expertise to undertake housing finance transactions has yet to become widely available among market players in the financial system, in related institutions and industries, and 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 using market mechanisms and actively mobilizing private sector resources for investment in housing. Some bankers remain focused on making large loans to the manufacturing/industrial sector, and they do not understand the centralization/standardization/portfolio approach that is required for consumer finance.

Specialized Mortgage Finance

In Pakistan, the HBFC is the only specialized housing finance institution that provides loans for middle- and low-income housing. In the past, some other housing finance companies were established—namely, Asian Housing Finance Limited,

Table D.6 Banks and DFIs with Housing Finance Portfolios Exceeding PRs 1 Billion, March 31, 2008

Bank	Amount (PRs millions)	Number of Loans Outstanding	Market Share (%)	Weighted Average Markup	Average Maturity Period (years)
Bank Alfalah Ltd.	10,559	4,644	15.9	12.50	10.6
National Bank of Pakistan	8,513	5,370	12.8	12.45	16.2
Standard Chartered Bank	7,210	1,764	10.9	13.38	12.2
United Bank Ltd.	5,513	1,212	8.3	13.68	15.8
Faysal Bank	5,364	1,079	8.1	13.90	14.9
Askari Bank	4,251	1,517	6.4	11.33	12.8
MCB	3,799	914	5.7	12.00	15.0
ABN AMRO	3,610	1,211	5.5	14.80	18.8
Meezan Bank	3,372	1,285	5.1	13.70	14.1
Dubai Islamic Bank	3,287	467	5.0	13.75	16.5
Habib Bank Ltd.	2,463	1,633	3.7	13.33	13.3
Citibank	1,753	718	2.6	15.67	13.0
NIB	1,406	1,209	2.1	13.00	11.1
Bank of Punjab	1,222	1,349	1.8	12.02	9.2
Other banks	4,059	2,361	6.1	n.a.	n.a.
Total (excluding HBFC)	66,380	26,733	100.0	n.a.	n.a.
Total outstanding mortgage debt	76,719	124,358	n.a.	n.a.	n.a.

Source: SBP.

Note: n.a. = not applicable.

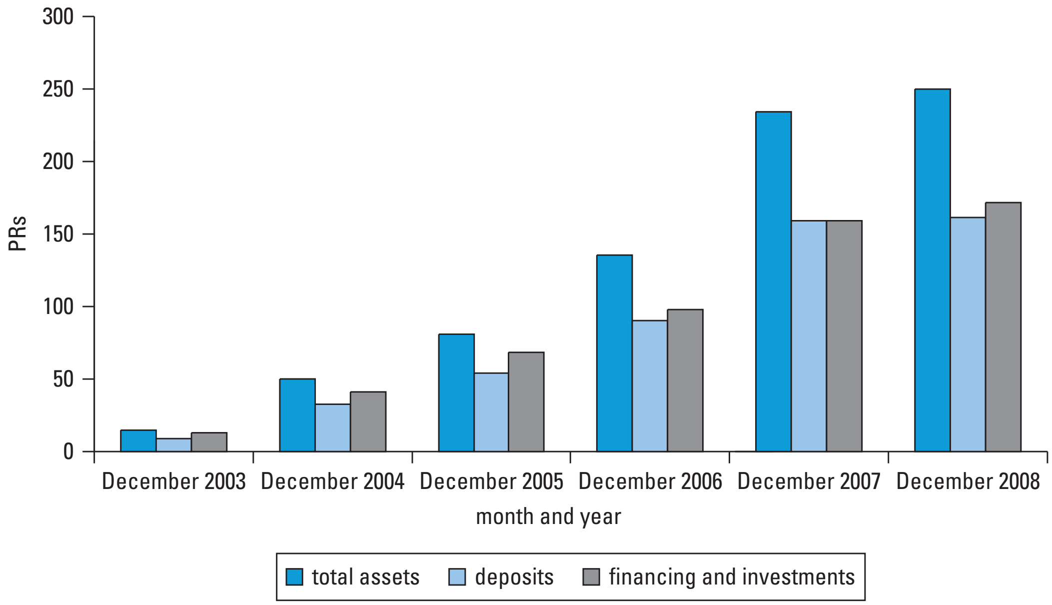
Citibank Housing Finance Company, and International Housing Finance Limited. These specialized firms could not compete in the market, primarily because long-term funds were not available at attractive rates. Gradually, they moved out of the business. Because the SBP is now working to set up a long-term liquidity institution (Pakistan Mortgage Refinance Company) with technical and possibly financial assistance from the World Bank Group, it is expected that the market may see the emergence of some more specialized housing finance companies.

Islamic Mortgage Finance

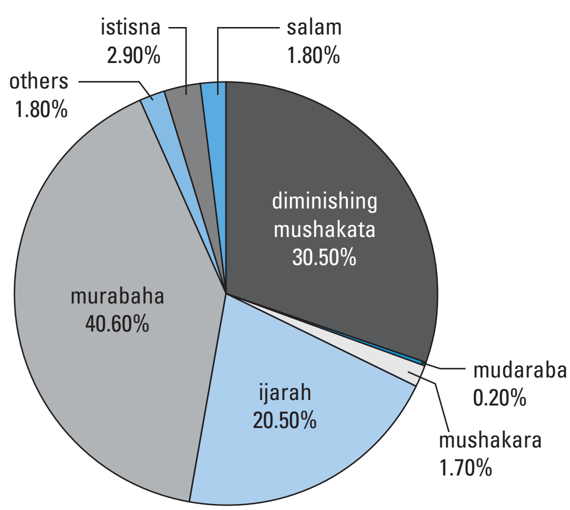
Islamic banking in Pakistan is growing substantially and has massive untapped potential. In housing finance, specifically, loans increased from 1,675 in December 2007 to 2,144 in March 2009—in monetary terms, from PRs 6.0 billion to PRs 8.7 billion (43 percent). But there is a need to introduce more *Shar'ia*-compliant products to satisfy customers' varied needs. Islamic banking remained resilient during the 2008 global crisis, despite negative shocks and pressure on the rupee experienced by the banking sector in October 2008. The portfolios of Islamic banks are performing better than those of conventional banks in terms of nonperforming loans.

Figure D.12 Growth in Islamic Assets, Deposits, Financing, and Investment

a. Islamic banking, 2003–08



b. mode of financing, December 2008



Source: SBP 2008b.

Islamic assets, deposits, financing, and investment have shown increasing growth trends over the past several years (figure D.12). The number of branches of Islamic banking institutions has crossed the 500 mark, and Islamic banking grew at a yearly average of 37 percent. The respective shares of Islamic banking assets and deposits are 4.9 percent and 4.8 percent of the banking sector. On the face of it, these figures look modest; but given the short time frame and other countries' experiences, the growth has been significant (SBP 2008). Islamic housing finance is growing very fast (121 percent over 2008) because of new entrants and because of increased consumer preferences for Islamic banking.

One of the most popular housing products in Islamic finance is diminishing *musharakah,* a declining-balance/shared-equity partnership. With this product, both parties share the risks and obligations related to the property. Ownership of the property is divided into equal units and is purchased regularly by the customer. Under this arrangement, leasing and selling contracts must be conducted separately. The main steps involved in diminishing *musharakah* require the consumer to select a house and obtain approval for financing. The financier and consumer then jointly buy the house and obtain joint-ownership title through a *musharakah* agreement. The consumer leases the house from the financier, and eventually buys out the financier's equity, getting sole title to the property.

Prudential Framework for Housing Finance, and Recent Policies

Commercial banks and DFIs in Pakistan are regulated by the SBP under the Banking Companies Ordinance 1962. Furthermore, banks and DFIs engage in housing finance under the auspices of prudential regulations. The promulgated prudential regulations provide specific rules for banks and DFIs engaging in housing finance activity. To encourage those institutions to increase their investments in the housing and construction sector, the SBP has issued the following new regulations for housing loans (box D1):

- Banks and DFIs are required to determine the housing finance lending limit, in both urban and rural areas, in accordance with their internal credit policy, client creditworthiness, and borrowers' loan repayment capacity.
- Banks and DFIs are required to ensure that the total monthly amortization payments of consumer loans, including housing loans, do not exceed 50 percent of the net disposable income of the prospective borrower.
- Banks and DFIs may originate a housing loan at a debt-to-equity ratio of 85:15 for up to 20 years.
- The maximum housing finance limit of PRs 10 million per owner or owning group has been removed.
- To curb speculation, banks and DFIs are not allowed to provide housing finance purely for the purchase of land plots.
- Banks and DFIs are allowed to provide housing loans amounting to no more than 10 percent of their net advances.
- Banks and DFIs are encouraged to develop floating-rate housing finance products.
- A housing unit financed by a bank or a DFI should be mortgaged in favor of the bank/DFI by way of an equitable or registered mortgage.

Box D.1 The Central Bank's Prudential Regulations

Following are the up-to-date prudential regulations for housing finance (part of the consumer finance prudential regulations) pertaining to banks and DFIs. They are taken from the SBP Web site, http://www.sbp.org.pk/.

Regulation R-15

Banks/DFIs shall determine the housing finance limit, both in urban and rural areas, in accordance with their internal credit policy and the 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 shall ensure that the total monthly amortization payments of consumer loans, inclusive of a housing loan, should not exceed 50 percent of the net disposable income of the prospective borrower.

Banks/DFIs will not allow housing finance purely for the purchase of land/plots; rather, such financing would be extended for the purchase of land/plot and for construction on it. Accordingly, the sanctioned loan limit—assessed on the basis of a borrower's repayment capacity, the value of the land/plot, and the cost of construction on it—should be disbursed in tranches; that is, up to a maximum of 50 percent of the loan limit can be disbursed for the purchase of land/plot, and the remaining amount can be disbursed for construction on the land/plot. Furthermore, the lending bank/DFI will take a realistic construction schedule from the borrower before allowing disbursement of the initial loan limit for the purchase of the land/plot.

Banks/DFIs may allow housing finance facility for construction of houses against the security of land/plot already owned by their customers. However, the lending bank/DFI will ensure that the loan amount is used strictly for construction and that the loan is disbursed in tranches according to the construction schedule.

Loans against the security of existing land/plot, or for the purchase of a new piece of land/plot, for commercial and industrial purposes may be allowed. But such loans will be treated as commercial loans, covered either under prudential regulations for corporate/commercial banking or prudential regulations for small and medium enterprise financing.

Banks/DFIs may allow housing loans in rural areas, provided all relevant guidelines and regulations on the subject are complied with by them.

Regulation R-16

The housing finance facility shall be provided at a maximum debt-equity ratio of 85:15.

Regulation R-17

Banks/DFIs may extend mortgage loans for housing up to any tenure defined in the bank's/DFI's duly approved credit policy, keeping in view the maturities profile of their assets and liabilities.

Regulation R-18

The house financed by the bank/DFI shall be mortgaged in bank's/DFI's favor by way of an equitable or a registered mortgage.

(*Continued*)

Box D.1 The Central Bank's Prudential Regulations (*continued*)

Regulation R-19

Banks/DFIs shall either engage professional expertise or arrange sufficient training for their concerned officials to evaluate the property, assess the genuineness and integrity of the title documents, and so forth.

Table DD.1 Mortgage Loan Classification

Classification	Definition	Interest Treatment	Provisioning
Substandard	Where markup/ interest or principal is overdue by 90 days or more from the due date	Unrealized markup/ interest to be kept in Memorandum Account and not credited to Income Account, except when realized in cash; unrealized markup/ interest already taken to income account to be reversed and kept in Memorandum Account	Provision of 10% (25% from December 31, 2006) of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a court of law and adjusted forced sale value of mortgaged/ pledged assets, as valued by valuers on the approved panel of the Pakistan Banks' Association.
Doubtful	Where markup/interest or principal is overdue by 180 days or more from the due date	As above	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a court of law and adjusted forced sale value of mortgaged/ pledged assets, as valued by valuers on the approved panel of the Pakistan Banks' Association.
Loss	Where markup/interest or principal is overdue by one year or more from the due date	As above	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a court of law and adjusted forced sale value of mortgaged/pledged assets, as valued by valuers on the approved panel of the Pakistan Banks' Association.

Source: Authors' compilation.

(*Continued*)

Box D.1 ***(continued)***

It may be noted, however, that the requirements for full-scope and desktop evaluation (under R-8 and R-11 of Prudential Regulations for Corporate/Commercial Banking and Small And Medium Enterprise Financing, respectively) will not be applicable to housing finance.

Regulation R-20

The bank's/DFI's management should put in place a mechanism to monitor conditions in the real estate market (or other product market) on at least a quarterly basis to ensure that its policies are aligned with current market conditions.

Regulation R-21

Banks/DFIs are encouraged to develop floating-rate products for extending housing finance, thereby managing interest rate risk to avoid its adverse effects. Banks/DFIs are also encouraged to develop an in-house system to stress-test their housing portfolio against adverse movements in interest rates and maturity mismatches.

Regulation R-22

Mortgage loans shall be classified and provided for in the manner described in table DD.1.

There is a need to revamp exiting prudential regulations in line with the industry requirements. Specifically, it is expedient to introduce a comprehensive set of housing finance guidelines to boost the housing finance sector in Pakistan. These guidelines should be focused on key facets of the housing finance sector and should provide the necessary details and guidance to all key stakeholder to conduct prudent and supportive housing activities. The SBP is in the process of reviewing existing prudential regulations in order to launch a comprehensive set of housing finance guidelines and the much-needed mortgage finance–specific prudential regulations in the coming year.

Recent Regulatory Policies on Housing Finance

The government of Pakistan has taken active policy measures and practical initiatives to provide an enabling framework for housing and housing finance. The Financial Institutions (Recovery of Finances) Ordinance, 2001, established a new (nonjudicial) procedure for recovering secured claims. The National Housing Policy was published the same year (table D7). The regime of mortgage lending was liberalized and

Table D.7 Action Plan of the 2001 National Housing Policy, Implementation Status

Policy Measures/Action Required	Implementation Status (update)
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-to-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 policies and the creditworthiness and loan repayment capacity of the borrowers. While determining creditworthiness and repayment capacity, 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.
All commercial banks shall be motivated to advance loans for housing and housing projects by earmarking a substantial percentage of their loan portfolios.	The maximum exposure of banks/DFIs to housing finance has been enhanced from 5 percent 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 to undertake financing of housing projects.
Financial institutions and housing financial institutions 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. Moreover, the minimum credit rating for banks/DFIs to make direct investment and for taking exposure (that is, undertaking lending and reverse repo) against listed and unlisted asset-backed securities for mortgage/construction/developer finance is reduced from "A" to "A–" (or equivalent).
Housing refinance window shall be set up at the SBP for long-term funds from multilateral agencies.	The Finance Division approved the final scheme for setting up a housing refinance window at the SBP, with the loans amounting to PRs 450 million from multilateral institutions for low-cost housing. Under the scheme, the SBP is acting only as an agent of the government of Pakistan for providing funding facility to housing finance companies. The scheme was circulated accordingly by the SBP in October 2001; however, housing finance companies failed to fulfill conditions under the scheme, so the funds have not been used. It is important to note that, in accordance with the instructions of the Finance Division on March 30, 1995, the loan under the housing refinance window of PRs 450 million was credited to the government of Pakistan. Therefore, utilization of the aforesaid amount requires permission from the government.
Housing finance institutions shall be encouraged to promote savings and provide microloans for low-income groups through NGOs and community-based organizations.	The Microfinance Institutions Ordinance allows MFBs/MFIs to take deposits and to appoint agents, such as NGOs, to undertake activities that are essential for proper discharge of their functions (these functions include 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

Table D.7 (*continued*)

Policy Measures/Action Required	Implementation Status (update)
	finance. Although housing finance companies are regulated by the SECP, the HBFC comes under the regulatory purview of the SBP. Moreover, in accordance with Section 21 of the HBFC Act of 1952, the SBP has intimated to the Finance Division that the HBFC can undertake issuance of certificates of investments and float long-term bonds. At the same time, the SBP has already advised the government of Pakistan to declare special-purpose vehicles as financial institutions under the 2001 Recovery Ordinance, and to grant the HBFC permission to institute asset securitization through special-purpose vehicles.
HBFC and other financial institutions shall formulate packages of preferential/concessional rates, with an affordable system of installments for repayment, to provide affordable credit to low-income groups.	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 different strata of society. Although the banks have increased their exposure to housing finance since March 2003, banks/DFIs are facing a number of critical impediments to providing housing finance to the general public. These impediments include, among other things, lack of 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 monthly incomes because there are no mechanisms/documentation for determining the monthly incomes of low-income groups, and most low-income dwellings are situated in shantytowns and irregular settlements without legal/clear title documents. The aforementioned major constraints are not only impeding countrywide growth and development of housing finance to the general public; but also holding back the trickle-down of housing loans to the low-income groups for whom the cost of financial intermediation is higher than that for high- and middle-income groups.
Foreclosure laws shall be introduced to ensure effective recovery of loans and advances from the defaulters.	According to Section 15 (sale of mortgaged property) of the Financial Institutions (Recovery of Finances) Ordinance (promulgated by the government of Pakistan on August 30, 2001), 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 the secured sum has been fully paid or the mortgagor has deposited cash in the banking court. The foregoing provision gives more powers and remedies to the lending institutions, which suggests that foreclosure laws have been strengthened and would help improve the recovery process of financial institutions' defaulted loans.

Source: 2001 National Housing Policy, Pakistan Ministry of Housing and Works.

Note: MFB = microfinance bank; MFI = microfinance institution; SECP = Securities and Exchange Commission of Pakistan.

strengthened by lifting various regulatory restrictions. An appropriate prudential framework for housing finance was designed, and credit information services were introduced.

The SBP took a vanguard position for providing the institutional arrangements and reforms to housing finance, to support the shift of housing funding from government to the banking system. Since 2002, with an objective of enhancing access to market-based housing finance, the SBP has been playing a facilitating role in association with private and public sector stakeholders (1) to increase the number of channels through which housing finance can be provided to the general public in the marketplace, (2) to enhance the general public's ability to afford housing finance products and services, and (3) to improve the service quality of housing finance. As part of this effort, the SBP constituted the Housing Advisory Group in 2002 to conduct a thorough analysis of existing housing and housing finance policies and conditions and to formulate a concrete strategy to address key challenges (table D8). The group's specific activities have included providing assistance in developing long-term funding/liquidity mechanism for housing, conducting capacity-building programs on housing issues for the banking and financial system, monitoring the flow of credit by banks and DFIs in the areas of infrastructure and housing finance, and analyzing emerging trends and developments in the housing and housing finance industries.

The Housing Advisory Group, through its first set of recommendations, emphasized the following actions: liberalization of the credit regime; provision of fiscal incentives to mortgagors and mortgagee financial institutions, streamlining of data related to banks' and DFIs' housing finance portfolios, reduction of the SBP's minimum threshold of loans on which information is collected by the Credit Information Bureau (CIB), implementation of foreclosure laws, and other essential measures. The implementation of these recommendations and the keen interest of all public and private sector stakeholders resulted in significant growth in housing finance lending by banks and DFIs.

The SBP established a separate department—the Infrastructure and Housing Finance Department—under the Development Finance Group of the SBP, and charged it with creating an enabling environment to facilitate intermediation of market-based credit in housing finance. In the federal budget for fiscal 2003/04, fiscal incentives were granted to facilitate mortgagors and banks. The government further initiated several mega-housing projects in big cities to increase the housing supply (see the "Government Housing Programs" section below).

The Housing Advisory Group has placed particular emphasis on the need for a well-structured and efficient legal framework and property development process. Therefore, there is a need not only to reform the present procedures and practices of the real estate sector, but also to have a supportive institutional framework for enhancing the general public's access to housing finance. The group has taken a long-term view of expanding the scope and outreach of housing finance by focusing on a few key, broad-based areas. An overhaul of the legal and regulatory framework for housing is required, coupled with the institutional reform of property

Table D.8 Housing Advisory Group Recommendations

Recommendation	Action Plan	Implementing Agency
Reforming legal framework affecting foreclosure, transfer, tenancy, rent control, and acquisition of immovable property	A) Implementing Recovery Ordinance 2001 B) Amending Recovery Ordinance 2001 C) Establishing an electronic public registry D) Transferring property only through a registered instrument E) Rewriting urban rent laws F) Amending the Land Acquisition Act	• Ministry of Law, Justice, and Human Rights • Provincial governments
Rationalizing transaction costs	A) Rationalizing the cost of stamp duty and registration fee on conveyance and mortgage deeds B) Rationalizing commercialization fee C) Automating land records and improving the tax collection system	• Provincial governments • City district governments
Establishing an integrated, nationwide system of land registration information	A) Streamlining the role of the public sector B) Promoting area-specific private sector initiatives C) Building the capacity of the existing system	• National Reconstruction Bureau • National Database and Registration Authority • Provincial governments • City district governments • Landowning agencies • Central Board of Revenue • Central Depository Company
Increasing supply of land for affordable housing	A) Private sector using existing allotted land B) Reforming *katchi abadis* C) Pursuing vertical land allotment policy to diversify D) Government auctioning existing land E) Creating city-based land banks and satellite towns F) Amending the Land Acquisition Act	• City district governments • Landowning agencies • Provincial governments • Ministry of Law, Justice, and Human Rights
Structuring and streamlining large-scale developer finance	A) Registering real estate builders and developers with ABAD B) Introducing credit rating C) Government schemes on completed housing/project basis D) Encouraging real estate investment trusts E) Encouraging joint ventures with foreign developers	• City district governments • Landowning agencies • Association of Builders and Developers • Financial institutions • Pakistan Banks' Association • Credit rating companies

(*Continued*)

Table D.8 Housing Advisory Group Recommendations (*continued*)

Recommendation	Action Plan	Implementing Agency
	F) Simplifying the documentation required by banks G) Standardizing valuation methodologies	• Mortgage Bankers Association
Providing housing finance for affordable and low-cost/low-income housing facilities	A) Developing innovative solutions B) Establishing anonymous and self-regulating structures (Condominium Act) C) Amending the Land Acquisition Act	• Financial institutions, such as housing finance companies, microfinance banks, and NGOs • Ministry of Law, Justice, and Human Rights • Provincial governments • City district governments
Promoting and developing real estate investment trusts	A) Disseminating real estate investment trust rules B) Amending Rent Control Laws C) Rationalizing transaction costs D) Establishing anonymous and self-regulating structures (Condominium Act) E) Establishing a tax framework for real estate investment trusts	• Ministry of Finance • Ministry of Law, Justice, and Human Rights • Securities and Exchange Commission of Pakistan • Provincial governments • Islamabad Capital Territory
Providing long-term funding for housing loans	A) Establishing a mortgage refinance company	• Ministry of Finance • SBP • Securities and Exchange Commission of Pakistan • International financial institutions • Primary mortgage lenders
Developing housing market information systems	A) Upgrading Web sites of primary mortgage lenders B) Mortgage Bankers Association supporting a dedicated Web site for the housing market information system C) Setting up a housing observatory	• Pakistan Bureau of Statistics • Mortgage Bankers Association • Primary mortgage lenders
Developing a mortgage banking industry	A) Building the capacity of the Mortgage Bankers Association	• Mortgage Bankers Association • Primary mortgage lenders • Various private sector players, such as real estate builders and developers, real estate brokers, insurance companies, and pension and provident funds

Source: Authors' compilation.

acquisitions and transactions, the establishment of an integrated nationwide land registration information system, and the creation of a housing market information system. The framework for financing large-scale property development should be structured and streamlined,; new products and services related to housing development and finance are needed, including real estate investment trusts (REITs); there should be enhanced provision of long-term funding for housing loans; and active development of the mortgage banking industry should be encouraged. In the area of low-income housing, increased supply of land for affordable housing is essential, as is provision of housing finance for affordable and low-cost/low-income housing facilities.

Homeowners' Insurance

To secure the housing loans against loss of property or life, the insurance companies provide property insurance and life insurance. Mortgage insurance and title insurance are not currently available in the market. The lack of mortgage credit insurance facilities seems to result from two sources: the risky mortgage industry milieu and regulatory compulsions on one side, and borrowers' inability to provide documented evidence of income and ability to repay on the other side.

Risk Management

In Pakistan, banks are in the gradual process of implementing Basel II; and nonbank institutions must establish policies, procedures, and practices to define risks, stipulate responsibilities, specify security requirements, design internal controls, and ensure compliance.[10] In spite of the small share of housing finance in banks' portfolios, those loans cause exposure to credit risk, and to liquidity risk resulting from the term-maturity mismatch (given short-term deposits and long-term lending). Credit risk is being managed by gathering increasingly better client information (see the "Credit Information" section below), as well as by limiting mortgage finance to top-income clients. The issue will take on renewed importance as the market moves down the income scale, requiring innovative products and approaches to mitigate credit risk. At present, banks are mitigating interest rate risk by offering adjustable-rate mortgages through which the interest rate risk is borne by the borrower. Floating-rate mortgages, however, lower the affordability of mortgage finance for middle- and lower-income borrowers—especially given a volatile environment with high interest rates. This could further translate into a credit risk in a rising-interest-rate scenario so as not only to restrain housing demand, but also to pose a systemic risk.

Financing long-term mortgages with short term funds is not sustainable, and eventually would lead to a credit crunch and instability in the financial system. The lack of a viable funding structure for housing loans greatly constrains the activity of housing finance companies, and of the HBFC specifically. Smaller housing finance institutions operating mostly in the private sector are unable to raise long-term funds. This creates a situation in which they are forced to lend for shorter terms, all the while bearing an exposure to their mismatched maturity positions. Commercial banks actively engaged in providing mortgage financing are better able to cope with the liquidity risk, relying on demand and time liabilities; and are able to benefit from higher yields. However, this poorly mitigated exposure creates interest rate risk and maturity mismatches, and will prove increasingly costly in a tightening prudential regulatory environment.

At present, the option of going for outright securitization is remote because of information asymmetries and cost constraints. The capital markets and market-based funding sources have not yet developed for long-term instruments of finance. In a promising recent development, the HBFC went to the market for funding for the first time, floating a six-year s*ukuk*[11] at an attractive rate. For most private financial institutions, however, this would be difficult. A viable option, contemplated by policy makers in Pakistan, is establishing a refinance facility that could provide liquidity to the financial institutions with recourse. Challenges in creating such a structured funding mechanism include the low volume of long-term mortgage loans, compared with the total deposit base of all banks; the general use of cost-efficient funding for housing through demand and time liabilities; and the broad spread between weighted average cost of deposits and price of housing loans.

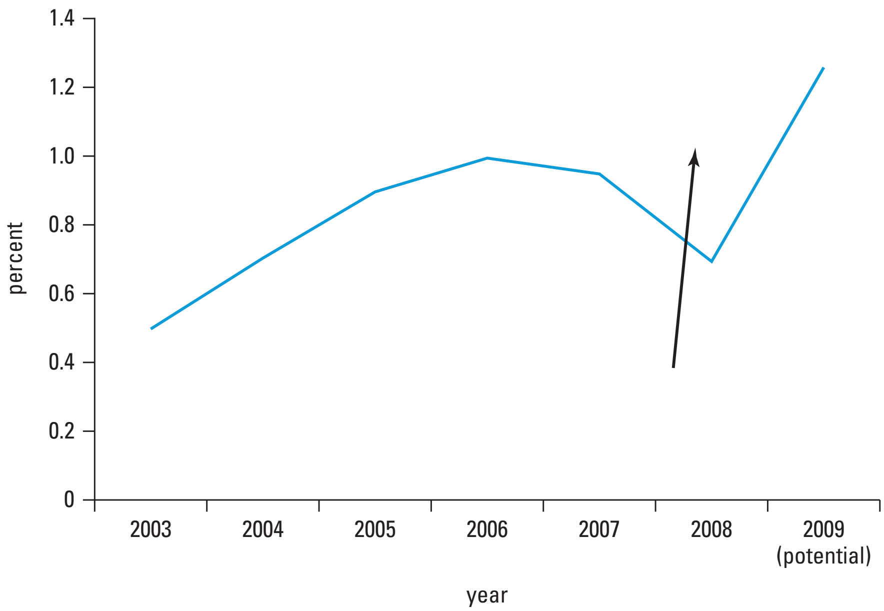
The refinance facility would help in providing fixed-rate mortgages, improving the liquidity of the financial system, and enabling banks and housing finance companies to prudently match the maturity profile of their assets and liabilities. It also would facilitate development of a private debt market and open up investment opportunities for long-term institutional investors (such as pension and provident funds) and insurance companies, which are looking for better returns on their investment portfolios. The facility, in turn, would serve as a preparatory step in developing a secondary mortgage market in Pakistan. More important, setting up a mortgage refinance company would act as an “equalizer” in a present environment where banks with large balance sheets have an advantage over medium-size banks and housing finance companies when originating and funding housing loans. When a mortgage refinance company is established, medium-size banks and housing finance companies would be in a position to compete with the big commercial banks on the bases of price, product features, and service quality—thereby improving the competitiveness of the housing finance market and increasing the outreach of housing finance, especially to the low- and middle-income groups.

Growth Potential of the Mortgage Debt Industry

Figure D.13 shows the historical mortgage debt-to-GDP ratio in Pakistan. The ratio has risen only slightly from 0.49 percent since 2003, reaching its peak at 0.98 percent during 2006 and following a decreasing trend through 2008. This highlights the huge untapped potential of the market.

Projecting future effective demand for housing finance for 2009, it is clear that there is demand 470,000 housing units in urban Pakistan alone (table D.9). If one

Figure D.13 Debt-to-GDP Ratio, 2003–09



Source: Authors' calculations based on GDP and economy data from the SBP.

Table D.9 Estimated Urban Mortgage Potential, 2009

Urban housing needs (units)	470,000
At average cost of PRs 1.0 million/unit	PRs 470 billion
Mortgage finance potential at 35% of urban housing needs	PRs 165 billion (1.26% of GDP)[a]

Sources: Pakistan's 1998 national census; authors' calculations.

a. Taking GDP at PRs 13,065 billion for fiscal 2007/08 (or $167.5 billion, where $1 = PRs 78).

housing unit costs, on average, PRs 1 million, then total construction cost will be PRs 470 billion for the needed units. Assuming only 35 percent of the units are paid for through mortgage finance, there will be a requirement of PRs 165 billion in financing (1.26 percent of GDP). The effective potential demand for housing financing is even greater beyond 2009.

Low-Income and Microfinance Housing

Low-cost and low-income housing is, by far, the most neglected area of housing and housing finance in Pakistan.

Challenges for the Development of Low-Income Housing Finance

The lack of finance is primarily a supply problem. Only 1–2 percent of all housing transactions in Pakistan are processed through housing finance credit lines; the rest are funded via personal savings and informal borrowing. Key constraints to housing are poor people's lack of financing capacity and a low penetration of housing finance, especially in the poorest segments of the population.

In turn, the high and ever-increasing supply gap has yielded a very high room density—that is, 3.5 people per room. That density is alarming when compared with the international standard of 1.1 per room. The majority of commercial banks' loans are focused on the high-income group in major cities. The HBFC remains the only institution catering to groups lower down on the income scale: its average loan size is PRs 860,000, compared with PRs 2.35 million among commercial banks. Nonetheless, most HBFC loans are focused on the middle-, not lower-, income groups.

National per capita income is around PRs 7,300 a month, and the minimum wage is PRs 6,000 a month. More than two thirds of the country's population fall below the mortgage affordability threshold (that is, PRs 200,000). This, coupled with the massive backlog of housing (7.57 million units), has led to a situation in which nearly three quarters of the population is unable to access the services of the housing and housing finance sectors.

The present "retail" approach to providing affordable housing facilities has failed to address the burgeoning gap between housing unit demand and supply. Several factors impede the success of a market solution. First, the legal framework is not conducive to large-scale access to housing finance ("Mortgage Market Infrastructure [Regulatory Framework]" section). Property titling in low-income areas is comparatively more difficult because a representative of a mortgagee finance institution must visit at least five different offices to verify title documents. Documentation is poor because the level of illiteracy is high. The procedure is bureaucratic and characterized by weak governance. Land records are not computerized, so it is a challenge for mortgagee institutions to ascertain who holds true title to the property at the time of loan origination. It is also problematic to foreclose on property subsequent to loan delinquency.

Second, the recent speculative wave in real estate has further exacerbated the situation because land prices have skyrocketed, thereby eroding the general public's ability to afford housing (especially low-income groups).

Third, rental markets are not extended to lower-income groups because of the poor profitability of house rentals. High interest rates and low rental prices create a disparity between rental income and mortgage costs, thereby discouraging investors from placing their funds in rental properties. Generous tenancy laws worsen the situation. Providing fiscal incentives, implementing recovery laws, and instituting investor-friendly tenancy laws could improve the prospects of constructing housing units, especially for low-income groups.

Fourth, the intermediation costs of providing housing loans to low-income groups are higher than those for middle- and upper-income groups because the loan sizes are smaller, the incidence of circumstantial defaults is higher, and there is a negative propensity to save. Income stability is an issue for low-income groups, and the risk of losing the income-generating source in the longer term is compounded. This is especially true, given that the main income earner is rarely insured for accident, prolonged illness, or death. Documented verification of income is also difficult because most low-income people are informally employed.

Fifth, low-cost housing construction is not a viable proposition in the current legal and economic framework. Initiation and successful closure of low-income residential projects are also marked with barriers to site permits, environmental clearance, and the lack of infrastructure and utilities connections.

The Microfinance Market and Informal Housing Lending

The microfinance market has a very limited outreach in Pakistan: barely 2 percent of the population. Microlending for housing is even more limited. Growth is brisk, however, starting from a small base. The number of active borrowers at microfinance banks stood at 564,892 in the quarter ended September 2008, increasing by 26 percent over the preceding year. The number of branches was 252, up 36 percent over the previous year. Similarly, the number of depositors rose to 254,381 by December 2008. The market is concentrated, with the central role being played by the two largest microfinance banks (SBP 2008a). Extending this overview to all microfinance institutions, table D.10 shows 1.8 million microloan borrowers, 2.0 million depositors, and 2.1 million holders of microinsurance policies.

Although most microfinance institutions in Pakistan 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. Still, housing represents a negligible proportion of microfinance borrowing. Housing finance companies and microfinance institutions, alongside NGOs, need to take the lead in initiating housing projects for low-income groups, with autonomous and self-regulating structures within their jurisdictions/boundaries, and perhaps calling on the experiences and lessons of successful cases (such as India's low-income housing models).

Table D.10 Microfinance Industry at a Glance

	Microcredit		Microsavings		Microinsurance	
	Active Borrowers (n)	Value (PRs millions)	Active Savers (n)	Value (PRs millions)	Policyholders (n)	Sum Insured (PRs millions)
2008, Q4	1,732,879	18,752	1,876,802	5,419	2,241,552	34,340
2009, Q1	1,751,111	19,252	2,043,774	5,882	2,128,493	31,232
Change (net)	18,232	500	166,972	463	−113,059	−3,108
Change (%)	1	3	9	9	−5	−9

Source: MicroWATCH, first quarter 2009.

NGO Programs in Housing and Housing-Related Social Services

NGOs, in collaboration with governments and other stakeholders, can play a pivotal role in accelerating the process of economic development, socioeconomic change, and improvement in the society to produce a sustainable livelihood and overall prosperity. Historically, low-cost housing in Pakistan has been the realm of NGOs, the government, or the informal sector. Because of the heavy capital requirements and the level of skill involved in scaling up in the housing sector, NGOs have not gained much ground in this regard. A few initiatives from Saiban and from Aga Khan Planning and Building Services are the only visible steps in this direction.

Saiban is an internationally recognized NGO that provides urban squatters with access to plots of developed land at affordable rates (Rahman and Hassan 2009). In December 2005, the NGO received Acumen Fund financing of $302,500 to launch a low-income housing development. The selected location was 20 acres of flat and arid land, a 40-minute drive (20 kilometers) from Lahore. The project involved the construction of 500 homes. The model provides secure residential tenure and public utilities in areas where squatters normally would have no access to legal property. The Saiban approach directly addresses a severe livelihood challenge for lower-income groups—those earning between PRs 5,000 and PRs 15,000 a month. Saiban offers the possibility of legal entitlement to land, giving the poor an important piece of economic collateral—an asset for a population with no access to capital for economic growth. The project, named Khuda-ki-Basti-4 (“God’s Own Settlement”), is a good example of success in providing low-income housing on market principles (see box D.2). [12]

Aga Khan Planning and Building Services, established in 1980, is an independent executive body with the mandate to plan and implement infrastructure and technology–related development initiatives to improve peoples’ living conditions.[13] The NGO assists local communities of the Northern Areas, Punjab, North-West Frontier Province, and Sindh in such development program areas as habitat risk reduction, energy-efficient building and construction improvement, water supply and sanitation, and natural resources conservation. The organization takes an integrated, community-based approach to sustainable development; and its development programs address not only the immediate needs of clean water, adequate sanitation, and safe housing, but also the overall impact that these initiatives have on economic, social, and environmental sustainability. Capable, proficient, vibrant, and self-reliant community-based organizations underpin all developmental interventions. Poverty alleviation, environmental sustainability, gender equality, and economic regeneration serve as cornerstones of these initiatives.

Government Housing Programs

Over the years, the role of government in the housing sector has evolved from that of predominant provider to that of a facilitator of the housing sector. The share of housing in public sector programs has decreased progressively, from 10.9 percent in the 1960s to 5.9 percent in the 1990s. The government’s Medium-Term Development Framework envisages only PRs 30 billion out of a total of PRs 950 billion of

Box D.2 Low-Income Housing Initiatives in Pakistan

There are several low-cost housing projects that can be studied and replicated across the country, using an improved approach and technology.

The first government housing project, implemented in 1959–60, was the *Korangi Landhi Township* in Karachi, built under the supervision of Gen. Azam Khan. The project was completed within a record time of six months. The settlement scheme is globally acknowledged as one of the best housing solutions to rehabilitate squatters and the poor. The cost of a house, including the land, was a token PRs 35, payable in three installments.

The *Sujrani Town* low-cost housing project in Karachi was developed in 1970 by the now-defunct Karachi Development Authority, exclusively for low- and middle-income groups. With 47,736 residential plots, the project catered to the housing needs of approximately 800,000 people. The complex consisted of one- and two-room houses with toilet, bath, and kitchen. Units were built by construction companies whose designs were found suitable and economical. The total cost of a house of 80 square yards was between PRs 45,000 and PRs 80,000. Additionally, the HBFC provided housing finance of up to PRs 20,000–36,000. The scheme was self-financing, and all development work was done on a breakeven basis. It took more than 15 years following construction to provide transport, utilities, health, and education services and facilities to the locality.

The *Khuda-ki-Basti Incremental Housing Project* in Karachi is ongoing, and is located in Phase-III of Taiser Town. Through this project, plots are provided by Saiban, an NGO, to homeless and poorly sheltered groups. The price of a plot of 80 square yards (including all development charges) is modest, at PRs 37,000. A prospective homeowner is required to provide a very low up-front deposit of PRs 4,000 to become eligible for a plot, and must prove his or her destitute housing situation. Until that is accomplished, the applicant is allotted a plot to start the construction work; and Saiban provides a temporary shelter. Upon completion, the plot is leased in the name of the applicant.

The *Taiser Town* low-cost housing scheme in Karachi is a future joint project of the City District Government Karachi and a U.S.-based private company. The plan is to construct earthquake-resistant, low-cost housing on a breakeven basis to provide affordable living facilities. The plots are 80 square yards. The city government would help prospective homeowners get affordable loans from the HBFC or other banks. The project involves building times of less than a month for each house, at an estimated cost of PRs 600 per square foot.

Khuda-ki-Basti-4 in Lahore is a 20-acre colony with 12 blocks and 460 houses. The project was initiated in June 2006, construction work started in September 2006, and the first families had moved in by February 2007. Each house is 816 square feet, and costs PRs 80,000. The downpayment is PRs 40,000, with the balance paid in monthly installments of PRs 1,000. The implicit interest rate amounts to 12–13 percent. The HBFC will provide 70 percent of the funding, with Saiban providing the balance of housing finance.

Heritage Homes in Lahore is a project of 2,500 housing units launched by the private developer M/s Sehar Associates (Pvt.) Ltd. The project, conceptualized as a "sustainable neighborhood," was marketed as respectable living at affordable prices. The plots are 100 square yards, and cost PRs 690,000. Prospective homeowners are required to live in the project for a minimum of five years.

Source: Rizvi 2007.

public sector investment to go toward housing during the period 2005–10. This low share is attributed to the government's resolve to play a facilitating/regulating role in accordance with the 2001 National Housing Policy.

However, recent preoccupations with the increasing housing shortage for middle- and lower-income groups has moved the government to action, on a public-private partnership basis. In the fiscal 2007/08 budget, the government committed to making 250,000 low-cost housing units available over the next five years. The Ministry of Finance entrusted the HBFC with the preparation of a road map for implementing 250,000 housing units for middle- and low-income groups, and the HBFC is doing that now.

Ministry of Housing and Works. The Ministry of Housing and Works is responsible for housing improvements and construction (along with other public agencies, including the National Housing Authority, the Pakistan Housing Authority, the Pakistan Public Works Department, the Federal Government Employees Housing Foundation, National Construction Ltd., and the Estate Office). The ministry is responsible for acquiring and developing sites and constructing and maintaining federal government buildings. It is actively involved in coordinating civil works, budget, fixation and recovery of rents from government-owned/hired and government-requisitioned buildings. Its activities include managing federal lodges; handling matters related to federal government lands; issuing licenses to various cooperative housing societies in Karachi (except those under the different ministries); administering to officers belonging to the engineering group; and registering with the Housing Authority, National Construction Ltd., and the Federal Government Employees Housing Foundation. Since 2008, the Ministry of Housing and Works has undertaken the planning of a mega-scale housing project (known as "Housing for All") to address the acute shortage of housing units. Under the plan, 1 million low-cost houses will be constructed throughout the country. The scheme calls for units with two rooms plus a bath, and includes quotas for federal government employees and a 5 percent quota for the employees of print and electronic media. Satellite towns will be built in various cities throughout the country, on a total cumulative area of 70,000 acres of land. For example, one of the low-cost housing schemes, planned to launch in Sindh, involves 300 acres in Karachi and 10 acres each in the towns of Bin Qasim, Gadap, and Kemari. According to the HBFC, the government has earmarked PRs 10 billion as a revolving fund for this initiative. A government committee has been entrusted with the tasks of coordinating the scheme with the provision of affordable mortgage financing or easy-installment financial plans for the middle- and lower-middle groups, and ensuring housing for government employees on or before their retirements.

National Housing Authority. The National Housing Authority was established in 1987 with the primary objectives of preparing short- and long-term programs and policy guidelines and mobilizing financing resources for the development of housing for low-income groups. It was subsequently attached as a department to the Ministry of Housing and Works.

Pakistan Housing Authority. The Pakistan Housing Authority was established under a cabinet resolution in May 1999 to provide shelter to low-income groups, the poor, and the needy. The scheme was thoroughly reviewed later that year, resulting in the 2000 approval of 18 commercially viable and marketable projects. The projects involved 4,476 housing units in four major urban centers of the country (Islamabad, Karachi, Lahore, and Peshawar), at an estimated total cost of PRs 5 billion. The Pakistan Housing Authority is also undertaking housing projects based on plot ownership for the officers of the federally constituted occupational groups and for low-paid federal government employees.

Federal Government Employees Housing Foundation. The Federal Government Employees Housing Foundation was established in 1989 to achieve the following objectives:

- to formulate policies, programs, and projects for providing shelter to serving and retired federal government employees and their dependents;
- to initiate, launch, sponsor, and implement housing projects on an ownership basis for federal government employees in Islamabad, the provincial capitals, and other major cities of Pakistan;
- to undertake redevelopment of FG Housing Estates to increase housing stock and improve the living and environmental conditions; and
- to do whatever is incidental or conducive to attaining any or all of the above objectives.

Pakistan Public Works Department. The objectives of the Public Works Department are to provide offices and residential accommodations for federal government employees, and to overcome the backlog of millions of square feet of office space and housing units presently located in rented office buildings and privately owned residences (within budgetary provisions of the federal government).

The Estate Office. The Estate Office, a department attached to the Ministry of Housing and Works, was established in 1947 at Karachi. The government inherited certain units of housing property at the time of independence, and the primary objective for establishing this department was to allot these housing units to the federal government officers and staff then posted at Karachi (at that time, the capital). The business of the department is being carried out under Pakistan Allocation Rules, 1993. The important functions are summarized here:

- provision of government accommodations to the federal government officers or officials in basic pay scales 1 to 22;
- provision of government accommodations to the ministers, minister of state, advisers, and other authorities, under the rules;
- assessment of rents for privately hired/requisitioned houses, with the help of the Public Works Department and the Finance Division;

- maintenance of general waiting lists of federal government workers in basic pay scales 1 to 22;
- ejection of unauthorized occupants from government accommodations;
- maintenance of payment records (cash books, ledgers, checkbooks, and so forth) for privately rented houses and buildings; and
- maintenance of records for house rent charges recovered from the federal government workers who are provided with government or privately rented houses.

In implementing "Housing for All," the Pakistan Housing Authority outsourced construction to a number of competitively selected contractors from Canada, China, Egypt, Germany, Malaysia, the United Arab Emirates, and the United States. These contractors have also invested their own equity up to 80 percent in the venture. Outside of this program, and following its experience, contracts have been concluded with counterparts from Indonesia, the Islamic Republic of Iran, the Republic of Korea, Indonesia, and Malaysia for he construction of other housing projects in such towns as Hyderabad, Quetta, Rawalpindi, Sukkur. These initiatives are part of a 10-year construction plan that relies on foreign direct investment coupled with a policy and investment framework friendly to foreign construction ventures. Examples of other housing initiatives are offered in box D.2.

Regulatory Framework and Mortgage Market Infrastructure

Several aspects of the way the legal system operates at present generate pervasive uncertainty about property transactions in Pakistan. An inefficient legal framework, fragmented ownership and titling procedures, inefficient land information systems, inaccessible and unused government land, high stamp duties and registration fees, a weak tax framework, 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 regulations, 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.

Land Registration and Administration, and Land Titling

The present system of land records is fragmented: it is administered by various landowning agencies at the provincial, district, and city government levels and by autonomous land development authorities (box D3).[14] Even within a province,

Box D.3 Land Titling System Description and Shortcomings

The land titling system in Pakistan is rendered ineffective by several problems, including the lack of a sole land allotment authority/agency of the country/city, no coordination among different recordkeeping agencies, divergent recordkeeping systems and methods at different departments, and manual documentation without safety and security of records. The system for ascertaining the chains of titles is cumbersome and lengthy. The lack of transparency and the incentives for graft provoke the avoidance of official land registration. The various land allotment agencies working in different cities use divergent procedures, rules, and documents (detailed in table DD.2). The main bottlenecks involve title validity, encumbrances, and title informality.

Title Validity

Under the land registration system, lenders have developed policies and procedures regarding title validity. The chain of title relating to any given property is ascertained by the series of documents through which the property has been transferred from one buyer to another. To verify the chain of title, borrowers are required to provide a number of (original) title documents for each transfer relating to the property from the time the property was conveyed by the government. Title verification is then performed solely on the basis of the gathered documentation; the subregistrar does not undertake an independent search to confirm the chain of title. The complexity of this process can cause a lender to deny financing to genuine borrowers. Lenders are further challenged in verifying title with respect to authorities and corporations, because of the nonstandard system of title documentation in these cases; and they are driven to employ specialized lawyers (which raises their costs).

Encumbrances

There is no practical and realistic system to ascertain encumbrances on land/property. Mortgage deeds are registered; however, the information is not properly maintained, and lenders have resorted to requiring that the original title be deposited with them until the loan is repaid in full. This precludes property financing in cases where the original title documents are not available to the owner.

Title Informality

Informal/unregistered land is also prevalent, mainly in smaller cities and on the outskirts of major cities such as Karachi and Lahore. Informal title to these lands has passed for generations without any conveyance document being registered. In these cases, property rights are transferred through bills of sale, powers of attorney, and other such informal documents. Informality has been further exacerbated by urbanization, with squatters usually taking up unused government or corporate lands. Over time, the inhabitants without formal title do perceive an entitlement to the land, and they invest considerable resources in housing and better living conditions.

(*Continued*)

Box D.3 Land Titling System Description and Shortcomings (*continued*)

Table DD.2 Land Allotment Agencies' Locations, Procedures, Rules, and Documents

Agency	Location	Procedures, Rules, and Documents
Urban areas	Lahore, Rawalpindi	Sale deed
	Abbottabad, Faisalabad, Multa, Rahim Yar Khan	Registered sale deed
	Quetta	Fard
	Hyderabad, Sukkur	Permanent transfer deed
	Islamabad	Allotment letter/sale deed
	Jhelum	Sale deed/gift deed
	Bahawalpur, Muzaffargarh	Sale deed/Sanad/gift deed
	Dera Ghazi Khan, Vehari	Registered sale deed/gift deed/ registered partition deed and permanent transfer deed
Government schemes (urban area private)	Lahore	Sale deed/registered sale agreement
	Karachi, Sukkur	Lease deed
	Jhelum, Multan, Rahim Yar Khan	Registered allotment order
	Dera Ghazi Khan, Rawalpindi, Vehar	Registered sale agreement/ allotment order
	Bahawalpur	Registered allotment order/sale agreement
	Muzaffargarh	Original allotment order
Defense Housing Authority	Lahore	Transfer letter
	Karachi	Sublicense
Evacuee property	Karachi, Lahore	Permanent transfer deed/provisional transfer deed
	Rawalpindi	Permanent transfer deed
Cantonment board and development authorities (urban area)	Faisalabad	Sale agreement/lease deed/ allotment order
	Quetta	Registered final transfer deed
	Hyderabad, Jhelum, Rawalpindi	Lease deed
	Karachi, Sukkur	Sublease/lease
	Multan	Lease deed extract from the Land Register
Municipal committee	Quetta	Lease deed
	Rahim Yar Khan	Agreement for sale
Rural areas	Hyderabad, Sukkur	Ownership certificate
Freehold properties	Bahawalpur, Bannu, Dear Ismail Khan, Gilgit, Kohat, Mardan, Peshawar, Swat	Mutation

Source: Authors' compilation.

land titling and registration practices are fragmented. An acute example of this problem is the situation in Karachi, where more than 17 different agencies are responsible for the process. Registration is at a comparable level of efficiency in the region as a whole—although it compared poorly with best-performing countries like Georgia and Saudi Arabia, where registration takes two procedures, two or three days, and carries either no cost (Saudi Arabia) or the minimal cost of 0.02 percent of property value (Georgia). In Pakistan, six procedures are necessary, it takes 50 days, and it costs 5.29 percent of property value to complete the registration (World Bank 2008a). Elsewhere in the region: in India, five procedures completed in 44 days at a cost of 7.43 percent of the property value; in Sri Lanka, eight procedures involving 83 days at a cost of 5.11 percent. The 2001 National Housing Policy in Pakistan calls for a nationwide reduction in stamp duties and registration fees to an average of 0.0 percent and 1.0 percent for mortgage and conveyance deeds, respectively. The provincial governments have not implemented this policy, however, and are charging between 3.5 percent and 9.0 percent in levies. As can be seen in table D.11, both registration fees and stamp duties are considerably above these suggested benchmarks. There are other levies on property, such as the commercialization fee on the purchase of properties that are converted to commercial use. This fee is considerable—20 percent in Punjab, for example.[15] The logistics costs incurred by the customer to access the land transaction document are also not negligible (table D.12). By some estimates, the time delays involved, appropriately monetized, amount to $140 (in Punjab); and could be reduced to $25 with the establishment of an automated land record system (SBP 2007).

The property tax framework is weak. Property tax is the main source of local government revenues in most good-practice countries, but property tax revenues in Pakistan have fallen way short of local government financing needs; they barely have been 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

Table D.11. Cost Structure of Land Titling and Registration, 2009

	Registration Fee (%)		Stamp Duty (%)		
Province	Conveyance	Mortgage	Conveyance	Mortgage	Total (%)
Balochistan	1.00	1.00	5.0	2.00	9.00
North-West Frontier	0.50	0.50	3.0	4.00	8.00
Punjab	1.00	0.25	2.0	0.25	3.50
Sindh	1.00	1.00	3.0 (plus 1.5 tax in Karachi)	Ad valorem PRs 2,500 for a loan of PRs 10 million or more	5.00 plus PRs 2,500

Source: Land registration and titling regulations.

Table D.12. Average Per-Land-Record Cost to the Customer

Rupees

Scenario	Direct Transaction Costs, Including Graft	Opportunity Costs	Total	
Without LRIS project	7,427	181	1,144	8,571
With LRIS project	641	32	841	1,514
Difference	–6,786	–149	–303	–7,057

Source: World Bank's project appraisal document on a proposed credit (SDR 30.35 million; US$45.65 million equivalent) to Pakistan for a Punjab land records management and information systems project, December 21, 2006.

Note: LRIS = land registration information system; SDR = Special Drawing Right.

coverage. Many of the cities have neither the latest master plans for construction nor the revenues for implementation. 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.

There is a general consensus among fiscal experts and economists that revenue collection in lieu of property transactions is a function of documentation, valuation, collection efficiency, and overall economic activity. The Punjab government's "White Paper 2003-2004"[16] also acknowledges the effect of rate reduction, improvements in administration, and stable economic conditions on revenue collection in lieu of stamp duties and registration fees. It is significant to emphasize that, after decreasing rates in fiscal 2003/04, the Punjab government experienced an increase in revenues. In spite of charging the lowest property levies, Punjab generates the highest revenues from stamp duty (PRs 7.50 billion in fiscal 2005/06), sale of stamps (PRs 6.31 billion), and registration fees (PRs 1.80 billion).[17] The issue of property tax revenue achieves strengthened significance because this category forms the single largest source of provincial tax receipts (for example, 29.12 percent in Punjab). Moreover, registration fees are the third-largest revenue source (6.98 percent in Punjab).[18]

The basic regulatory framework for land registration and transfer is sound, but nontransparent and cumbersome. Typically, *patwaris*[19] manually maintain 15 separate books of land registries to which nobody else has access. Poor recordkeeping is pervasive. Issuances more than one property title document for the same plot are not uncommon. Land records are not a, and have numerous errors and omissions. Because of the costs involved in property registration procedures, many transactions are not recorded. Computerized information and registration systems, property and ownership databases, effective title regularization processes and cadastral surveying, and a land information service will increase transparency and the enforcement of creditor rights. The lack of an efficient, transparent, and reliable system for ascertaining who holds authentic titles to properties has forced banks to maintain a "negative list," thereby impeding access to housing finance in a number of urban localities within the urban centers.

This situation is further aggravated by the law, which allows a claim of proprietary interest in real estate based on an unregistered sale deed, instead of mandating full registration. This leads to fraudulent claims and much litigation. Another major source of litigation is claims to title on the basis of an oral gift under Islamic law.[20] The absence of an effective dispute mechanism compounds the problem. Courts have a considerable backlog of land-related disputes that take years to resolve. More than 40 percent of all court cases are related to land—that number exceeds 1 million.

The weaknesses of the present land records in tandem with high transaction costs have led to exchanges of property on a cash basis and without any transparent and legally acceptable title documents in a majority of property transactions. The less-than-satisfactory state of real estate registration has not only deprived the property owners of an effective legal title, but is also a major cause of leaks in revenue collection because stamp duty and registration fees on property transactions are not paid.

Taking the directives of the Ministry of Housing and Works, the governments of Punjab and Sindh have already started projects to develop computer-aided, accountable, equitable, and secure land record management systems. These will secure the title of land by improving clarity and efficiency, controlling errors and fraud, and decreasing the transaction costs. In Punjab, work is under way in three districts—Gujrat, Lahore, and Rahim Yar Khan. Completion of the effort in an initial 18 districts is planned for no later than 2011, and projects will be completed in another 14 districts by 2013. The government of Sindh launched a pilot project in 2003–04 to computerize the revenue records in five districts—Hyderabad, Khairpur, Larkana, Mirpurkhas, and Sukkur. This was scaled up to the entire province in 2007–08. The computerization and establishment of a land administration and revenue management information system, at an estimated cost of PRs 921.812 million, will be finished in four years.

The Support to Devolution Reforms in Balochistan developed a comprehensive model for land record computerization in Balochistan. The pilot test results (Mauza of District Loralai) proved that the model is user friendly; Urdu language–enabled; and offers many key features including live map generation, automatic error checking, and automated data processing. The Balochistan Land Record Management Information System was shared with the revenue department of the government of Balochistan, and a detailed training on surveying was provided for the staff of the revenue department.

A nationwide land registration information system (LRIS) would be the ultimate goal, based on future similar projects instituted throughout the country. Implementing agencies of nationwide LRIS include the National Reconstruction Bureau, the National Database and Registration Authority, provincial governments, city and district governments, landowning agencies, the Central Board of Revenue, and the Central Depository Company. However, to expedite implementation there is also a need to encourage private sector–led initiatives to build the capacity of existing automated property transaction–related systems.

Capacity of Real Estate Professionals

In Pakistan, "property valuers" have professional conduct requirements established by the SBP and the Pakistan Banks' Association.[21] The majority of real estate builders and developers do not have strong governance and disclosure standards, and that makes it difficult for financial institutions to assess them. The business of real estate brokers/agencies is unstructured and unsupervised as well.

Property valuers are approved by the Pakistan Banks' Association; and they must undergo professional training in evaluating the property, assessing the genuineness and integrity of the title documents, and adequately performing all aspects of their work. Nevertheless, the lack of transparency in real estate valuation is a major bottleneck. The present valuation methodologies are primitive and not standardized, and that leads to different valuers offering different proxy market price estimates for the same property. This is especially crucial for the promotion and development of REITs. Pursuant to launching the REIT product in February 2008, the Securities and Exchange Commission of Pakistan took major steps to promote the implementation of international best practices in the field of valuation, focusing particularly on Malaysia's experience. The commission has also applied for membership in the International Valuation Standards Committee—an organization responsible for setting worldwide standards for property valuations. And the commission is presently an associate member of the Asian Public Real Estate Association.

Constraints for Women

In Pakistan, there are no constraints or limitations on a woman's right to own assets, run a business, or hold a title in her own name. At the higher levels of income, there is no apparent gender-based credit rationing. In fact, there is a specific bank for women entrepreneurs—First Women's Bank Limited. However, lower-income groups, located mostly in rural areas, show considerable gender disparities regarding all forms of financing. These disparities exist for both cultural and informality reasons.

Foreclosure and Eviction

Recovery, foreclosure, and eviction laws in Pakistan are based mainly on the 2001 Financial Institutions (Recovery of Finances) Ordinance (sections 15[2] and 19[3]). The process empowers financial institutions to foreclose on a mortgage property without recourse to the court of law. The law is not being applied, however. Some lower courts have granted stay-orders when financial institutions have tried to use the ordinance. Until lenders are confident that they can enforce their rights to collateral, they will remain reluctant to invest. Initial steps in implementing the law were taken by the Balochistan High Court in 2006, when it passed a judgment defending the right of a financial institution to foreclose. This precedent has been replicated successfully enough for recovery laws to be used more frequently.

The ordinance also has weaknesses in the letter of the law. The foreclosed property auction, for example, does not require the prior objective valuation of the property, to set a reserve price. This often leads to recourse to a court of law, and adds to the cost and delay of the procedure. In addition, surveyors and property valuers lack credibility in the absence of a trusted systematic transparency mechanism for the evaluation and certification and strict enforcement of professional ethics and standards. The ordinance also does not provide for adequately broad publicity/advertisement of the proposed sale by the foreclosing financial institution. Advertising in provincial newspapers alone is not likely to inspire judicial confidence. The law should provide for national and, in appropriate cases, international advertising.[22] Poor notice is also given on attached properties that are subject to sale—typically, the notice is affixed near the plot location and it may be damaged or removed. This exposes potential buyers to the risk of paying in full for an attached property, and is the cause for numerous lawsuits. The ordinance compounds the problem by voiding property sales made after the banking court issues an order against the debtor, even if the execution of the foreclosure has not been requested at the time of the property sale. At present, there is no public registry of debtors against whom judgments passed by banking courts remain unsatisfied. Consequently, a purchaser can find his or her title challenged by a financial institution, even if the property was neither mortgaged nor attached at the time of the purchase.

Credit Information

The CIB was established by the SBP in December 1992.[23] The scope and activities of the CIB are governed under provisions of the Banking Companies Ordinance 1962.[24] The scope and administration of the CIB database were enhanced in April 2006 when credit information was transferred on an electronic platform, improving the speed, reliability, and security of data. The key features of eCIB include consumer and corporate reports and data input formats; records of credit inquiries made by the financial institutions; and consumer credit and default histories. The system provides for online amendments and interim updates, and comes with a Web-based help desk and online technical support to the financial institutions.

At present, only those banks and financial institutions that are either regulated by the Securities and Exchange Commission of Pakistan or the SBP have access to the eCIB database. The information there is being exchanged on a reciprocity basis; and every financial institution is required to submit its entire body of borrower records, irrespective of any limit to the CIB database. The member-institutions can access only limited information from the CIB database, however—for example, they do not know which financial institution is the source of the credit information about any given borrower. Individuals and corporate entities are not entitled to obtain their own credit information reports. The onus of correct reporting lies with the reporting financial institutions.

Consumer credit and default histories over the preceding 12 months are reported for all individuals and sole proprietors served by the participating financial institutions. Partnership concerns and corporate entities (both listed and unlisted) receive a unique borrower code, against which member-institutions report outstanding liabilities (fund and nonfund based); position of overdues; and details of litigation, write-offs, recoveries, and rescheduling and restructuring. The financial institutions are not allowed to use credit reports for marketing their financial products, and are bound not to divulge information to a third party.

There are also three privately owned and managed credit bureaus in Pakistan—namely, Datacheck (Pvt.) Limited, News-VIS Credit Information Systems, and ICIL/PakBizInfo. These firms recently started operations, and mainly gather data on the credit histories of exiting borrowers. The information is obtained from various banks, utility companies, credit card issuers, and so forth. It is updated regularly and passed on to banks on demand. The information includes both positive and negative details on consumer credit. However, these credit bureaus remain less reliable and are less widely used than the CIB. The private services will become more useful when they have databases with longer credit histories.

Policy Options for Improving the Framework for Housing Finance

Housing finance is a fundamental pillar that supports development of the economy because the housing and construction sectors are labor intensive and have both backward and forward links with more than 40 industries. In most developed countries, housing finance is one of the main economic drivers and its share of the GDP may rise above 50 percent; in developing countries such as Thailand, however, its share is about 15 percent. Eliminating housing shortages enables lower-income groups to improve their living standards, accumulate assets, create livelihoods, and boost their savings. Vibrant housing and housing finance sectors can adequately accommodate population growth and urbanization pressures, thus minimizing slum problems.

Reforming the real estate sector is a prerequisite for broadening and deepening housing finance. The Housing Advisory Group at the SBP has issued a detailed report on better enabling the housing and housing finance sectors. The following key recommendations are included there:

1. reform the legal framework affecting foreclosure, transfer, tenancy, rent control, and acquisition of immovable property;
2. rationalize transaction costs in real estate transactions;
3. establish an integrated, nationwide land registration information system;
4. increase the supply of land for affordable housing;
5. structure and streamline large-scale developer finance;
6. provide housing finance for affordable and low-cost/low-income housing facilities;
7. promote and develop REITs;
8. provide long-term funding for housing loans through the creation of a mortgage refinance company;
9. develop a housing market information system; and
10. develop the mortgage banking industry.

Those recommended policy actions are discussed below in greater detail. Successful reform in these areas holds the promise of developed housing and housing finance sectors, and an improved housing situation the population—especially for lower-income groups. Action also promises the economic benefits of housing and housing finance development: increased savings, investment, output, and employment.

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 landownership and title registries, and with inefficient land information systems, a weak legal and regulatory framework hinders the development of a sound housing finance market. The following section discusses the overhaul of the land administration and property taxation systems. The "Housing Development Regulations" section tackles the rules, building codes, and regulations placed on property developers, as well as housing finance prudential rules and faithful application of the existing foreclosure regime. As a first step, policy makers should provide an institutional framework for generating long-term plans for housing sector development in conjunction with the central planning agencies—the Ministry of Finance, Ministry of Housing and Works, and the SBP. This process should be conducted with the participation of the private sector, NGOs, community-based organizations, and the general public at both national and municipal levels.

Regulating Land Administration, Titling, Property Transfer, the Land Registry, and Property Taxes

To support a vibrant housing market, the property registration system in Pakistan needs to be overhauled, especially if banks are 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-use 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 and 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. Public sector institutions that are involved in the housing sector should not have redundancies and inconsistencies among their functions and they policies they implement. 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 people.

A key challenge is coordinating the titling and land administration process. Computerization is essential. Real estate transaction databases need to be linked to the registration entries. Specific steps to strengthen the titling and recording system include amending the land acquisition acts and the urban rent laws. The legal context should only consider formally registered transfers as generally binding, and should link registration to the authentication of deeds. A uniform framework of registration standards is required, instituting a system for supervising and monitoring development agencies, designing quality control norms, and providing incentives for efficiency. Special procedures would be required to regularize (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. Finally, and very important, effective dispute resolution mechanisms are required 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 LRIS 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 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 degree of sophistication between the provinces. It would be useful—particularly regarding standards, procedures, and information technology systems—to launch a pilot program in a high-priority area that could then be replicated elsewhere. Some of these actions probably will have to be taken at the national level or in coordination with the provincial governments (especially tax and legal issues and the institution of uniform standards). Regularization actions, however, should be carried out selectively to prioritize regional areas according to their shortages of housing and the state of the local land or development agencies.

A properly planned and efficient LRIS would not only secure the interest of mortgagee financial institutions and investors (in the case of mortgage-backed securities), but would also help in consolidating a decentralized real property rights system that could help the general public in numerous ways, could lead to one-stop title documentation, and increase property registration—thereby enabling provincial governments to realize the revenue-generating potential of property transactions. Implementing an LRIS would help increase the outreach of housing loans and decrease the loan processing time for mortgagee financial institutions.

To institute a nationwide LRIS within the next five to seven years, a three-pronged strategy is required. It should involve both public and private sectors. The three pillars of the strategy should be these:

- *Streamlining the role of the public sector*—Implementing the LRIS in 102 districts (27 in Balochistan, 23 in North-West Frontier Province, 30 in Punjab, and 22 in Sindh) and 8 city districts (5 in Punjab and one each in Balochistan, North-West

Frontier, and Sindh) requires streamlining coordination among the National Database and Registration Authority, the National Reconstruction Bureau, and the respective district/city governments. At the same time, the eventual nationwide integration of the LRIS requires standardization of the system across districts/cities; and under this public sector–led initiative, priority should be accorded to instituting the LRIS in rural and low-income urban areas so that residents may receive credit from the formal financial system.

- *Promoting area-specific private sector initiatives in cities*—In the more affluent urban localities of major cities (Pakistan Employees Cooperative Housing Society neighborhood in Karachi, Gulbarg in Lahore), private sector organizations such as the Central Depository Company may be willing to automate land records. Therefore, these small-scale private sector initiatives need to be encouraged because they would act as a catalyst in automating the property database in the country.
- *Building the capacity of the existing system*—To take advantage of the ongoing public or private sector initiatives relating to automation of property transactions, it is important to build their capacity. In this regard, a good example is the initiative of the Central Board of Revenue in automating land records in 18 Karachi towns. This initiative could be upgraded to an LRIS by enlarging its scope and scale.

To weed out malpractice in the sale of attached properties, an electronic public registry should be created forthwith. All people obtaining attachment orders or decrees would then be legally obligated to make a filing of fact concerning the attachment or the decree with the electronic public registry. Failure to do so should make the attachment or decree ineffective against any right acquired by a subsequent purchaser of property. The details of the public registry can be worked out. The registry may either be attached to the existing offices of the registrars of documents or be set up as an independent institution.

Transfer Property Only through a Registered Instrument. No proprietary interest should be recognized unless the property has been registered. Initially, the recommendation contained in this paragraph may be effective only with respect to urban areas.[25] Evidence of an oral gift should appear as a written memorandum attested by a judicial officer.[26] A filing of acknowledgment of an oral gift with the electronic registry may also be stipulated. Finally, claims of *benami* (absentee) ownership should not be recognized by law.[27]

Rewrite Urban Rent Laws. The Rent Control Act should be repealed, if that is politically feasible. Repeal would eliminate the special status accorded to landlord-tenant relationships. Contracts between landlords and tenants would be treated as normal contracts; and dispute resolution could be instituted at higher tiers of the judiciary, thereby not only expediting the settlement process but also helping weed out inefficiencies created at the level of the rent controller. At a minimum, the urban rent laws should be amended to equilibrate the rights of landlords and tenants. In the case of a verbal lease, the landlord can evict the tenant within six months of notice, without any default by the tenant. Written leases should be encouraged. The landlord should not be able to evict on grounds of personal need when a written lease exists. A Urban rent laws should clearly state that written lease agreements containing a term less than 12 months may be registered at the option of either the landlord or the tenant.[28]

Implement a Tax Rationalization Program. An in-depth tax rationalization program needs to be implemented to develop a taxation scheme that promotes economic behavior consistent with the overall long-term economic policy objectives. There should be a reorientation of the government's taxation role in land-related transactions. In line with the spirit of the 2001 National Housing Policy, efforts need to be made to rationalize and standardize the rates of stamp duties and registration fees across the four provinces and the federal capital. Furthermore, by automating the tax collection system, the government will strengthen the revenue collection process.

Stamp duties and registration fees need to be lowered. Keeping in view the positive implications of rate reduction on documentation of property transactions and subsequently on provincial revenue receipts, the provincial governments should adopt the National Housing Policy in both letter and spirit by reducing transaction costs on residential properties in accord with the housing policy covenants—that is, for conveyance and mortgage deeds, the aggregate rate of stamp duty and registration fee should be decreased to 1 percent and 0 percent, respectively. The commercialization fee should be rationalized as well. The present high transaction costs create an incentive to record transactions at a price much below market value (the D.C. Rate) because there exists a substantial disparity between the actual transaction prices and those recorded for tax purposes. This disparity puts corporate entities such as REITs at a serious disadvantage because these entities are required to disclose the actual purchase price (and pay fees based on it rather than on the D.C. Rate). Therefore, to encourage corporate entities in the construction sector, it is proposed that commercialization fees should be reduced to 10 percent.

Instituting automated land records, in tandem with rate rationalization and improving the revenue collection system, has the potential to encourage documentation of property transitions by reducing the direct transaction and opportunity costs, and would have a positive impact on the provincial governments' revenue collections. Moreover, housing tax revenues need to be directed toward managing the land management system in a commercially sustainable manner that enables the government to fulfill its social responsibilities toward middle- and low-income households, and its good regulatory governance responsibilities to the entire sector.

Housing Development Regulations

The current convoluted approach of development authorities is creating artificial shortages of serviced land for the public; this contributes, in turn, to the high cost of land that effectively makes landownership impossible for the middle class.

Provide Infrastructure for Residential Land Development. In view of the rising prices of land, the government of Pakistan needs to develop land and satellite towns on the outskirts of the cities. These should be adequately serviced with residential infrastructure such as water, electricity, sewerage, schools, clinics, transport service, and road networks. Data are available on availability of large pieces of land at the disposal of federal and provincial governments. In obtaining land for low-cost housing, preference would be given to those government lands that have lain idle for many decades. The land would be purchased at an official rate. Through this method, the government can directly share its subscription, so the land would be available at far cheaper rates than the market rates. Once developed, these plots could accommodate pro-poor housing projects under public-private partnership arrangements.

Infrastructure agencies should devote greater attention to providing utilities and infrastructure rather than to focusing on landownership and resale. Funding for such a model should come from the public credit markets because 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 to provide adequate infrastructure to 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 providing 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.
- A clear statutory scheme for land acquisition for private housing schemes should be included in the land acquisition acts in force in the provinces and the capital territory.
- The fee for nonutilization of land should be raised, especially in areas where infrastructure has been provided, so that speculation in land is avoided and construction is expanded.

Develop a Home Construction Industry and Financing. 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. There is a need for a strong regulatory authority to enforce building standards to improve the quality of housing.

Banks may be encouraged to establish business relationships with developers on the basis of past performance and the commercial and financial viability of the real estate projects, thereby making the credit rating of projects a viable alternative to credit rating of developers. However, where appropriate and possible, the credit rating of a builder should also be encouraged. It is important for a developer to be registered with ABAD, both to facilitate the builder's credit access to the formal financial system and as a tool to ensure builder compliance with the ABAD code of conduct. For streamlining the provision of credit to developers, documentation should be simplified and a standard set of documents should be instituted with the mutual consent of ABAD and the Pakistan Banks' Association.

A REIT is an alternate model of developing real estate, and is more transparent and structured than the traditional real estate development process in Pakistan. Therefore, institution of REITs should be encouraged in both letter and spirit. To modernize and increase capitalization of the real estate sector, it is important that joint ventures with foreign developers be encouraged. Among other things, this would encourage the transfer of technology and management know-how.

Promote Low-Cost Technologies. The industry of low-cost housing technology and materials should be strongly promoted, including through incentives. Bulk purchasing and reduced taxes can be a right mix of policies. The government should invite some international best-practice providers of low-cost housing technology and should facilitate technology transfer through joint ventures. These experts can also help in capacity building and trainings.

There are many low-cost housing construction technologies being marketed by various international and local vendors. But there is no existing platform to evaluate and certify which technologies are internationally proven low-cost housing technologies and which ones would satisfy local requirements. Technologies may also need some indigenization. The Center for Promotion of Low-Cost Housing should be encouraged to pick up its activities anew, with a focus on research and promotion of low-cost construction materials and technologies. More coordination is required among construction/development industries, builders, architecture/design firms, and government agencies to promote affordable housing for the low- and middle-income population.

Organize Real Estate Agencies. The unstructured and unsupervised nature of real estate brokers is a significant constraint to the provision of housing and housing finance. Only property valuers have professional conduct requirements (established by the SBP and the Pakistan Banks' Association). The real estate agencies, which could be natural brokers or arrangers of financial services, remain unorganized and insufficiently supervised. The protection of individual purchasers remains limited because the market is dominated by cash transactions and lacks transparency and because no systematic information is available. Risk assessment and portfolio valuation are also fragile—another factor prompting lenders' extreme caution.

The Pakistan Securities and Exchange Commission (in collaboration with the SBP) should assist the valuation profession to create an institute that would create a system of examinations, license valuers, and implement international best practices and standards. To standardize the valuation process, therefore, the Pakistan Banks' Association or the Mortgage Bankers Association needs to screen the various valuation methods that are used internationally, and adopt the one that best fits Pakistan's circumstances. To provide for an effective mechanism for sale by mortgagee financial institutions without the intervention of the court, the law should require that SBP-approved surveyors fix a reserve price. For such surveyors to have credibility, the SBP or other reputable trade body/association should establish a mechanism for evaluating and certifying property valuers.

Supporting 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 financing available for mortgages. To achieve these twin objectives, it is recommended that the government continue its efforts to introduce REITs, encourage the issuance of municipal bonds, and create a secondary mortgage market. Two other important policy focus areas are the creation of a housing observatory and an appropriate prudential environment for mortgage lenders. Finally, it is very important that the foreclosure law be adopted in practice if housing finance is to extend to the average consumer.

As an interim measure, and as indicated by some recent experiences, raising medium-term funds (by floating debt papers of five to seven years) could be a good beginning for housing finance institutions. A recent example is the HBFC, which has successfully floated a six-year *sukuk* at a very attractive rate. Another option for raising long-term funds would be to issue several medium-term (five-year) debt floats in succession, thereby raising funds for 15–20 years.

As Pakistan extends housing finance to middle- and low-income segments of the population, the demand for long-term, fixed-rate mortgages increases because the low-income segment is hardly able to withstand the dynamics of interest rate volatility. A refinancing facility would go a long way toward lowering financial institutions' cost to issue such instruments.

Apply the Foreclosure Law in Practice. Judge training and capacity building should be conducted throughout the country, especially in lower courts, to instill there the spirit of the foreclosure law. The decision made by the Balochistan High Court in 2006 in defense of the right of a financial institution to foreclose could be successfully replicated throughout the country to expedite implementation of the recovery laws.

The 2001 Financial Institutions (Recovery of Finances) Ordinance could also be amended to iron out some remaining weaknesses. Objective valuation to set a reserve price for a property prior to auction should be mandated. Certification and higher standards should be instituted for surveyors (with higher penalties for breach of standards) to promote credible valuations. Auction notices and the general transparency of the process should be improved. The issue of property sales made after the banking court issues an order against the debtor should be clarified, in conjunction with other laws, to minimize title challenges.

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. The per-party limit of PRs 10 million and maximum 10 percent ceiling of housing finance with respect to a financial institution's total credit portfolio of have been waived recently by the SBP. 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.

Create a Housing Observatory. A housing observatory should be created to provide periodic census and survey activities, including collecting, analyzing, interpreting, and publishing data on the performance of the housing sector. The database would also address the issue of complete and reliable data not being available to stakeholders, consumers, and the housing industry to help facilitate property purchases, investments, or financing decisions. The housing observatory may include some or all of the following:

- *housing supply information (formal and informal)*—new construction and sales, vacancies, quality and condition of property, prices, and dwelling characteristics;
- *housing demand data*—demographic trends and housing needs, characteristics of occupants of the existing stock (crowding indicators), affordability (availability of income indicators are of paramount importance of this), and buyer's intentions;
- *housing finance data*—sensitivity of monetary indicators to the residential and commercial property exposures of lenders and investors (for example, inflation

rates, interest rates), fiscal indicators and degree of reliance on housing-related developments (for example, property taxes, construction industry contribution to GDP and employment), lending volumes by category of financial institution; loan characteristics (loan-to-value ratios, debt service ratios, prices, locations, borrowers, and so forth);

- *construction inputs*—production capacity; prices, quality, and availability of materials, labor, and land.

The Pakistan government has shown commitment to establishing a housing observatory. The effort is led by the SBP. In the meantime, after consulting the Pakistan Banks' Association, the SBP plans to launch a dedicated Web site for housing information systems and to require primary mortgage lenders to upgrade their Web sites.

Introduce REITs. The government could help increase the volume of financing available to the real estate business through the introduction of 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 (a mortgage REIT). Designed to be traded on stock exchanges, REITs enable 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 offer. Second, REITs enable sharing in nonresidential properties, such as hotels, malls, and other commercial or industrial properties. Third, there is usually no minimum investment requirement, and that encourages small savers to invest in REITs and reap higher returns than would be possible with bank deposits and national savings schemes.

The Securities and Exchange Commission of Pakistan has been working to establish 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 minimum paid-up capital of PRs 50 million. To ensure that the REITs are held by a broad population, it also has been proposed that the REIT fund be held by at least 100 people, and that no 5 of them may hold more than 50 percent of the assets. The feasibility of these proposals is being discussed.

However, there is a general consensus among policy makers in Pakistan that, if properly regulated and supervised, REITs would yield a multitude of benefits for promoting and developing the housing sector. Because REITs provide an alternative source for raising capital, they would help increase 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.

Encourage Issuance of Municipal Bonds. Institutional reforms in 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, 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 state, city, or local governments (or their agencies) to raise funds for building schools, highways, hospitals, sewer systems, and other similar projects that benefit the general public. To make investment in municipal bonds attractive, the interest income is often exempt from national and local income taxes and from income tax levied by the state in which the bonds 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 of federal and (in some cases) state and local taxes;
- a high degree of safety with regard to payment of interest and repayment of principal;
- a predictable stream of income;
- a broad array of choices to fit investment objectives regarding investment quality, maturity, choice of issuer, type of bond, and geographic 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 their intended purpose, 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.

Create a 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 lending activity through its refinancing requirements and have an overall catalytic effect on the development of lending activity. Such a structure could be seen as a first step toward a true secondary mortgage market in Pakistan.

A secondary mortgage facility is a financial institution designed to support long-term lending activities by primary mortgage lenders. Its core function is to act as an intermediary between mortgage lenders and the bond market, with the objective of providing long-term funds at better rates and under better terms and conditions than lenders might be able to obtain if acting alone (Hassler and Walley 2007). The need for such an institution arises because of the mismatch between the liabilities and the assets of mortgage lenders. The facility would help financial institutions issue lower-cost, fixed-rate mortgages.

In the medium term, establishing a secondary mortgage facility could become viable when primary originations reach critical mass. This would be a way to provide external credit enhancement at a lower cost than would be possible 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[29] 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, that is, 10–20 percent, compared with a 50 percent risk weight for housing loans. Further, the SBP 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 (for instance, restrictions to bond issues by a newly created or an unlisted entity). Such support is vital in helping establish the entity's credibility and speed up the acclimation process among investors, thus avoiding the premium that a totally new issuer would normally pay.

Introducing New Housing Development and Finance–Related Products and Services

Overhauling the operational capacity of the industry, improving the reliability of the land records, and promoting long-term funding will boost the overall demand for and supply of mortgage finance and, in the medium to long terms, will address the supply of serviced land. In the face of pressure to address the housing finance needs of specific communities, however, the government may wish to consider some of the programs for microborrowers and first-time buyers that recently have been implemented in other countries.

While microfinance institutions 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. The government may wish to begin with the strongest players as a way of reducing risk, getting to know the market, and helping adapt the selected financial institutions' internal systems and design their mortgage risk assessment databases. Although reaching scale would not be a central objective of a pilot project, 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, at best, this channel for delivering housing finance may remain small. As of June 2005, the microfinance network served only 718,000 borrowers and held $99 million in total loans outstanding, covering less than 12 percent of the potential market in terms of an estimated possible outreach to 6 million.

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 term finance certificates 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, thus generating illiquidity premiums. Public offerings of term finance certificates are restricted to listed companies; the market is far from being ready for securitization, despite available regulation for trusts and special-purpose vehicles.[30] Alternatively, the financing can be of different types: it could take the form of capital sponsorship (the idea of "seed" capital), a debt guarantee or backup line of credit provided by the government of Pakistan, the SBP, or 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 Jordan and Malaysia, the share capital of the secondary market facilities is held by lending institutions and the central bank. Supporting tools—either a guarantee or a standby line of credit—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 make the risk-mitigation scheme built into the structure meaningless, and could easily turn into a market distortion factor.

Some proposed solutions to improve housing supply for low-income groups are as follows (Rizvi 2007). Mega-housing projects should be initiated in each province. Policy makers should create a land supply at low prices. The model for microlending for housing (Progressive Housing) should be implemented in every province, and construction sites should be located as near as possible to the developed cities so that the infrastructure for the new settlements can be created easily and cost effectively.

Policies should enable the supply of low-cost microlending and microfinance for housing. The design, layout, and construction materials should be standardized. Tax incentives on construction materials could be provided for low-cost housing projects. Financing at low cost must be made available through smart subsidies. Cross-subsidization should be considered, possibly via an infrastructure and development fund dedicated to affordable housing developments. Prominent organizations having expertise in low-cost housing techniques and models could be used for technical assistance and capacity building on affordable housing solutions. Foreign direct investment in the construction sector should be encouraged. Finally, fiscal incentives for builders, banks, and developers should be considered for promoting low-cost housing schemes.

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. Policy makers, in collaboration with the private sector, can strengthen property rights and the land administration process, strengthen the property development framework, support the building industry, facilitate the growth of the primary and secondary housing finance markets, 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 administration procedures, an overhaul of the legal provisions, and the standardization of processes and computerization that will not only bring efficiency gains, but also drastically improve the overall level of confidence in property transactions.

The overhaul of registration systems is also a prerequisite to establishing mortgage lending on a large scale; and it is likely to have additional benefits, such as facilitating the upgrading of slums, improving tax collection, and enhancing 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-building 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 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 experienced foreign 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. They 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 the 2001 National Housing Policy) could be instrumental in preparing measures and monitoring implementation.

Specifically for the banking sector, banks currently are constrained in expanding their housing finance outreach because they do not 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 to mitigate any systemic crises arising from their ill-prepared entry into housing finance. More technical training should be provided on the processes of originating loans, servicing loans, managing risk, and funding mortgage portfolios. Such training should be aimed at bankers; developers; real estate brokers; appraisers; lawyers; and regulatory and supervisory staffs of the SBP, the Ministry of Finance, and the 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:

- Periodical needs assessment for developing vocational skills should be conducted, for instance, by the Pakistan Banks' Association and other professional organizations.
- Depending on training outcomes, inducements could be considered to speed up and organize training programs on a large scale.
- Strategic advisory services could be devised, with the view to making bank management aware of the role that housing finance can play in the soundness and growth of their institutions.

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 both "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 (for example, India, Malaysia, Singapore, or Thailand) could show trainees case studies of ongoing and actual housing finance projects. 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.

Notes

1. Data presented here are from JS Global Capital Limited, Pakistan, July 2009.
2. The figure also notes that this income segment is experiencing at most a housing shortage of 375,000 units. (There is a bias in this calculation, because the housing shortage out of the total backlog is assumed proportionate to the share of population in each income bracket; more realistically, the housing shortage for this income bracket is negligible.)
3. Information is available at http://www.pakistan.gov.pk/divisions.
4. Information is available at http://www.apca.org.pk.
5. Information is available at http://abad.com.pk.
6. Information comes from the Securities and Exchange Commission of Pakistan, Internal and External Communications Unit, July 2008.
7. Information is from the SBP housing finance reviews of 2007 and December 2008.
8. These figures are presented net of nonperforming loans, which accounts for the difference in total outstanding amounts when compared with figure D.4.
9. This section is adapted from World Bank (2008b).
10. This information comes from Kamran Shehzad, deputy governor of the SBP, in a speech at a 2009 workshop on housing finance in South Asia, Karachi.
11. A *sukuk* is a *Shar'ia*-compliant financial instrument, similar to a bond in non-Islamic finance.
12. Khuda-ki-Basti-4 in Lahore is a variation on the original Khuda-ki-Basti model of incremental housing for the poor in Karachi. The Khuda-ki-Basti-4 Lahore model uses a more commercial approach than does the original Karachi model.
13. Information is available at http://www.akdn.org/default.asp.
14. Kemal (2008) delves in considerable detail into various issues, including corruption in titling and registration process; and gives some suggestions for improving the situation.
15. The rate is levied on historical value, not the market value of the property. In the city of Karachi, the commercialization fee is levied by the City District Government Karachi on a per-square-foot basis. A proposal is in the offing to increase the commercialization fee up to three times so as to reflect the increase in prices of real estate during the last three or four years.
16. This annual provincial budget report is available at http://www.punjab-prmp.gov.pk/Evidences-2009/2.4%20WhitePaper2009-10.pdf.
17. Balochistan generates the lowest revenues from stamps and registration fees: PRs 160.5 million (fiscal 2005/06) and PRs 17 million, respectively. For Sindh, stamps account for PRs 3.81 billion (fiscal 2004/05), but sale of stamps yields only PRs 1.94 billion; revenues from registration fees total PRs 0.5 billion. For North-West Frontier Province, stamps and registration fees yield PRs 240 million (fiscal 2004/05) and PRs 40 million in revenues, respectively.
18. The second major source is land revenue.
19. *Patwaris* hold and maintain the land records in revenue offices. Any land document, including mutations and "fard" (a part of revenue records), is prepared initially by a *patwari;* it is then verified and signed by the *gardawar* (supervisor of the *patwari*) and presented to the subregistrar for final signature.
20. Although an oral gift of immovable property under Islamic law commands widespread juristic acceptance, the courts often have insisted on rigorous evidence of such gift having been made. Yet another feature of the law that adds to the uncertainty of ownership rights is the acceptance of the concept of *benami* ownership. This acceptance leads to the claim that the ostensible owner of a property is, in fact, not the real or beneficial owner. Such a claim inevitably results in involved litigation, with the so-called real owner seeking to avoid the transactions entered into with the ostensible owner.
21. This information is taken mainly from a 2008 press release issued by the Internal and External Communications Unit of Pakistan's Securities and Exchange Commission.

22. Another weakness of the law is that the tenant rights with respect to the landlord in default currently do not transfer to the creditor institution holding a mortgage over the leased property; rather, they require court interpretation. The law gives the Banking Court the power to terminate a bona fide lease on reasonable terms, and that undermines the sanctity of contractual engagements.
23. Much of the information in this section is based on material available at the SBP Web site, http://www.sbp.org.pk/.
24. Section 25(A) vests with the SBP the power to call for credit information in such a manner as it may deem necessary, and to make such information available to any banking company.
25. Section 53-A, Transfer of Property Act, 1882.
26. Amending the Transfer of Property Act and/or the Qanun-e-Shahadat Order, 1984.
27. Amending the Transfer of Property Act, 1882.
28. Lease agreements with a term of 12 months or more already are subject to this requirement (section 17, Registration Act, 1908).
29. Cagamas Berhad, the national mortgage corporation in Malaysia, is the major issuer of asset-backed securities.
30. 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.

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