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PAKISTAN HOUSING FINANCE
TRAINING REPORT

SHELTER RESOURCE MOBILIZATION PROGRAM (391-0507)

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Prepared for
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PAKISTAN HOUSING FINANCE TRAINING REPORT

Introduction:

1. As part of the Shelter Resource Mobilization Programme (SRMP) and under the IQC contract no. 391-0507-1-001780-00 with the 21st Century Consultancy & Management Services, USAID/PAK issued work order dated February 11, 1991 assigning Dr. F.A. Rabbani Economic Specialist to prepare a report evaluating housing finance training needs in Pakistan and making recommendations and proposals for the emphasis and direction of such training.

Background:

2. Dr. Rabbani participated in the international seminar on "Effective Housing Finance" held in Bangkok, Thailand from January 2-12 1991 organized by Fels Center of Government, University of Pennsylvania, the Government Housing Bank of Thailand (GHB) and USAID/RHUDO. The seminar was attended by 50 officials from India, Indonesia, Pakistan, Philippines and Thailand. Wharton Professor Jack M. Guttentag and Mr. Marshall Dennis of National Mortgage Institute (USA) were the lead speakers. The case studies of Thailand and India were presented by Mr. Sindhijai Tanphipat, Managing Director GHB and Mr. Nasser Munjee, Chief Economist of Housing Development Finance Corporation (HDFC), Bombay, respectively.

3. Synopses of the topics covered in the seminar along with an evaluation of relevance and applicability of subject matter, materials and training techniques to housing finance training in Pakistan are at Annexure I. The last session of the Seminar was devoted to seminar's contents, material and techniques in the context of topics discussed; and the identification of the topics that were considered most important and critical from the point of view of each country and areas which require urgent attention for designing and conducting training and assistance.

4. The Pakistani participants considered the following five topics discussed in the seminar as most important from their point of view:

   a) Legal aspects of housing finance, titles, liens, and foreclosures.
   b) Institutional building blocs-role of an overview agency.
   c) Loan processing, underwriting, servicing, foreclosure.
   d) Low income targeting, and
   e) Resource mobilization - financial and human.

5. The participants were highly appreciative of the contents and materials of topics covered and the techniques used in

conducting the seminar and considered these as quite effectivr. It had certainly advanced the understanding of the institutional building blocks of the Housing Finance System (HFS): their role and functions in developing primary and secondary mortgage markets and their interaction with overall financial sector, The seminar was not only instrumental in updating their knowledge about effective operational and management strategies in housing finance institutions but also in identifying areas which need immediate attention for education and training.

6. Dr. Rabbani during his stay in Bangkok discussed with key faculty members of the seminar, RHUDO officials, participants from other countries generally and with participants from Pakistan particularly both individually and in groups, the areas of housing finance requiring training in Pakistan. List of persons with whom subject was discussed is at Annexure II.

7. It was the unanimous view of the participants from Pakistan and RHUDO officials with whom the subject was discussed that as Pakistan has almost no experience of operating a market oriented housing finance system, there is significant and urgent need to create an awareness among the policy makers in the government and its agencies, financiers and bankers, business leaders of the country about the need of effective housing finance system, how it functions on commercial lines and contributes to economic and social growth. Simultaneously, attention has to be focused on training of officials of institutions which will start operating in this field and GOP agencies who will oversee and regulate the system.

Major Training Issues of Policy Nature:

A. Myth of high risk:

8. Awareness/appreciation of HFS in the formal housing finance sector is almost non-existent in Pakistan. Government owned House Building Finance Corporation (HBFC) which undertakes mortgage lending works as an arm of government and has no market orientation. In fact one of the main factor for non-emergence of an effective housing financial system in Pakistan has been the subsidized lending by HBFC: primitive underwriting , processing and servicing procedures, and high delinquency rate with almost no foreclosure of mortgages. The commercial banks treat it as a high risk venture and accord it very low priority and confine their home lending operations to their own employees.

The above has resulted in a culture which is alien to an effective housing finance system. Housing Finance by the Government agencies is largely treated by borrowers as a social welfare activity, whose loans need not be paid back.

The government also did not treat it as a productive sector, and hence no practical steps were taken to make housing finance as an integral part of the overall financial and credit structure. As a result of studies undertaken by international financial institutions for reforming and restructuring the financial system and the lead taken by USAID to foster a market oriented housing finance system in Pakistan during the last three years, there is a growing awareness particularly in the government that essential steps have to be taken to create an enabling environment for market based housing finance system, and mobilization of domestic savings.

One important step taken by the Government is to issue a notification on 24th December, 1990 laying down the regulatory framework and establishing a supervising body which shall oversee the working of the housing finance institutions - Annexure III. The government has permitted floatation of a private sector housing finance company sponsored by PICIC with participation of foreign financial institutions and local private sector. It has restricted release of funds to government owned HBFC and have asked them to raise their funds from the market and undertake administrative and financial restructuring.

B. <u>Understanding of housing finance institutions and their functions:</u>

9. The roles and functions of agencies and institutions which are commonly referred to as institutional building blocks of housing finance system have to be properly understood so that an effective HFS is installed.

Functions
- provide loan instruments according to needs of borrowers.
- provide facilities of origination, servicing, closure and savings.
- mobilize savings/funds from foreign aid giving agencies/financial institutions and local financial market, insurance and provident funds.
- allocate credit between borrowers of different affordibility and areas and between residential and other sectors.

Institutions
- Depository: such as specialized housing finance lenders, commercial banks, savings banks, credit and cooperative societies, savings and loan associations, leasing companies.
- life insurance companies and pension funds.
- for secondary market: i) deposit insurers

		and mortgage insurers for loss and cash flows.
	ii)	mortgage companies and brokers.
	iii)	conduits for insurance backed securities.
	iv)	investment companies.
- Central institution to act as	i)	regulatory body.
	ii)	overview agency
	iii)	lender to housing finance institutions.

10. It is recognized that in the development of housing finance system in Pakistan all the above functions would have to be provided by the mix of specialized and generalized housing finance institutions. It is an interlinked complex of all the institutions. These however, can be categorized into the following:

- central institution: an overview agency which has to ensure that titles, liens are clear, foreclosures are speedy and swift; ground rules are observed by all concerned and obstacles removed in effective working os the HFS.
- housing finance lenders: mobilization of savings and performing the function of origination, so that marketable and serviceable mortgage documents are prepared, marketed and serviced.
- insurance companies: playing the role as deposit insurer and mortgage loss and cash flow insurers.

C. <u>Ingredients of regulatory framework:</u>

11. The following essential features of regulatory system need attention:

a) Legal aspects - clarity of title of land, liens, mortgage deeds, tenancy laws particularly about fixation of rent and eviction of tenants.
b) speed and certainty of foreclosure.
c) entry rules - minimum conditions for entry, loan capital ratio; liquidity and capital reserve requirements; tangible core capital; disclosure and closure requirements. The legal framework would also include licensing to private housing companies, regulation of such companies, reviewing the working and audit system, creation of public confidence in such institutions, by ensuring adequate debt recovery

mechanism, and mortgage insurance.

12. The regulatory framework has been notified by M/o Finance and the State Bank of Pakistan has been designated as an overseeing agency. The private and public sector firms need to have a dynamic interaction with the government and its agencies who will regulate and supervise their operations. This is the stage, when the existing regulatory framework and charter of overseeing agency should be discussed, so that improvements and modifications are made, and foundations laid for development of both primary and secondary mortgage markets.

D. Functions of an overview system:

13. The role of overview agency is basically promotional. In order to be effective it should perform the following functions:

a) prepare a blue print, framework for housing finance and lay down the objectives,

b) serve as a think tank; provide expertise and serve as source of information/training,

c) design different types of savings schemes and mortgage instruments according to needs, affordibility, priorities of different sectors and sections of society with different mark ups,

d) plan the development of secondary mortgage market through
   - safety of deposits and cash flow payments by involvement of insurance companies,
   - standardization of documents to develop mortgage lending on national basis,,
   - development of mortgage securities, bonds, acting as conduit,
   - encourage establishment of savings and loan associations, banks, cooperatives, mortgage companies along with paraphernalia of brokers, and

e) coordination/lobbying with GOP and foreign financing agencies on behalf of housing finance institutions.

14. There is need for understanding, cooperation and dynamic interaction between the Government agencies who will regulate, oversee and facilitate the working of housing finance system viz Ministry of Law, Ministry of Housing and Works on the one hand and housing finance institutions on the other.

E. Development of secondary market:

15. The insurance companies will play a pivotal role in establishing the secondary market in mortgages by insuring loss and cash flows after the servicing of loan has become

effective and delinquency rate reduced to a minimum. Development of secondary market is not only necessary for mobilization of savings but also to create an equilibrium in demand for and supply of housing stock.

16. In the scenario of Pakistan's financial structure, and the environmental pollution that exists, inhibiting growth of HFS, the central agency regulating and supervising the functioning of housing finance institutions, would play the key role in establishing a primary market. Once the success of primary market functioning is demonstrated, mainly through mobilization of savings/funds; efficient origination and servicing and delinquencies rate are reduced to minimum say with 3% range as has happened in India and Thailand, insurance covers for loss and cash flow would be forthcoming which shall lay the foundation of secondary mortgage market.

Major Training Issues of Housing Finance Institutions:

17. Effective housing finance system has to develop a market oriented financial sector rather than just work as a means to meet shelter goals. The emphasis has to be on i) mobilization of savings ii) designing of mortgage instruments according to needs and affordibility iii) techniques for low income lending and iv) loan processing, underwriting, servicing and closure.

A. Mobilization of savings:

18. The deposit base can be widened by encouraging new saving habits. Savings for residential investment have served as a catalyst for the growth of the economy. In the U.S. families allocate as much as half of their income to saving and poor generally higher proportion than the rich. Home linked savings schemes, community mortgage programmes, non mortgage lending programmes, involvement of guarantor to improve affordibility; using NGOs and cooperative societies as intermediary, development of thrift societies, would make a tremendous impact on encouraging savings habits. The availability of houses can be ensured through short term credit to builder. It is the availability of credit for immediate purchase, construction, upgradation of existing shelter facility which plays the key role in developing saving habits and mobilization of resources for housing finance.

B. Designing of mortgage instruments:

19. Mortgages are instruments of contract between mortgagor and mortgagee. In developing countries, institutions which have savings such as commercial banks, insurance companies, provident fund holders do not invest in mortgages because of high risks and legal restrictions imposed by central bank. If

the mortgages become marketable and liquid, the secondary market can develop. This is possible if loss and cash insurance backed mortgages with reliable servicing are offered. This will necessitate that

a) Mortgage instruments are designed, adjusted, modified in accordance with the affordibility of different class of group of mortgagors such as
i) upper and middle income
ii) low income; and below poverty line
iii) salaried income
iv) self employed
v) professionals
vi) elderly people/ex servicemen/Ret. Govt. servants

b) The mortgage instruments have to take care not only of anticipated inflation but also risk of changes in interest rates. This means designing of variable interest rate mortgages.

20. In Pakistan, where primary market is being established, consideration should be given to the benefits and contributions of support system of mortgage market such as mortgage insurance, insurance backed securities, bond market and other liquidity enhancement mechanism. The priority however, has to be for capability and capacity enhancement in readiness for the home mortgage finance requirements.

C. <u>Low income targeting:</u>

21. The group below 50% of the median income and above the poverty line - Rs. 2000 to 6000 per month per household according to some surveys may be categorized as low income group. This is the largest group which has been paid little attention and requires immediate targeting by the HFS. In their case lending instruments need adaptation somewhat on the following lines:

a) financial institutions charge all or bulk of their fixed costs to loans advanced to middle and upper income groups and only variable costs charged to low income mortgages,

b) in the initial period only mark up is charged,

c) to salaried group if the employer guarantees,

d) non mortgage loans to enterprises if employer agrees or to societies if society guarantees, and

e) non mortgage lending to individuals on the guarantee of the group.

D. <u>Loan processing/underwriting/servicing/.....</u>

22. This is heart of the lending process. Those who process well are the most efficient lenders and have the lowest delinquency rate. Underwriting mortgage loans involves reviewing a collection of documents and through the art of observation and deduction, making a decision regarding the grant of loan. The maxim is that each application has to be examined on its merit and techniques are learnt only by doing. Some of the critical steps are:

a) Loan application has to be filled by the lender/processor and signature of the loanee obtained after filling in the application. This is the most important document. A check list for processing the loan is prepared. Additional documents are asked for; lender and borrower set a time table for the process.

b) Verification of the information in respect of borrower.

c) Determining ability and willingness to repay: here amount and type of income of applicant, probability of that income continuing, credit history, financial resources, assets and value of collaterals, is crucial.

d) Examination, verification of title to property/land; determining market value of property.

23. Servicing or loan administration is one of the most critical function as it may take only weeks to process the loan but loan may have to be serviced for 15 to 30 years. Efficient servicing plays key role in the development of secondary mortgage market. The functions involved are:

a) Collection of principals and interest and other charges on collateral such as taxes, insurance etc.
b) Calculation of pay offs; escrow analysis.
c) Delinquency management and foreclosure.
d) Provision of annual statements.

Servicing is an area that can produce a lot of expense but also generate considerable revenue as in U.S.; the most important element being collection where speed of communication is critical.

<u>The Areas of Housing Finance Requiring Training:</u>

24. In the light of above policy and operational issues faced in Pakistan, following areas in the domain of housing finance need education and training:

A. Role of housing - Housing as the lead sector in socio-economic development.

- Housing Finance in the Region.

B. Housing Finance
- Effective Housing Finance Systems and Functions.
- Essential first steps
    - Regulatory framework
    - Overview Agency
    - Legal aspects - Titles, liens, foreclosures, tenancy laws.

C. Resource Mobilization
- Home linked savings schemes.
- Special savings schemes.
- Community mortgage programmes and non mortgage lending as instruments of savings.
- Development of thrift societies, cooperatives.
- Role of NGOs in stimulating savings.
- Development of secondary market in mortgages.
- Workable system of mortgage insurance.

D. Mortgage instruments
- General characteristics of mortgages.
- Types of mortgages - Fixed rate payment graduated payment, adjustable rate linked to inflation and changes in interest rate.
- Mathematics of Housing Finance.

E. Processing, Underwriting, Servicing of Loans
- Determining ability and willingness to pay
- Determining affordibility
- Underwriting
- Delinquency management

F. Low income targeting
- Strategy
- Determining affordibility
- Designing mortgage and non mortgage instruments
- Induction of NGOs, cooperatives

G. Human Resource Development
- Job classification
- Recruitment, discipline
- Appraisal, career planning
- Management practices

- Management development
- Training and information system
- Public relations and customer service
- Monitoring and evaluation of training

H. Case studies
- success stories of India and Thailand highlighting
- role of regulatory, overview agencies and central bank
- designing of saving and lending instruments
- underwriting and servicing of mortgages
- low income targeting
- human resource development

<u>The Target Group</u>

25. The following groups should be targeted for education and training immediately:

A. Chief Executives of local and foreign commercial banks, DFIs, emerging housing finance institutions, insurance, leasing, Modaraba, Mutual Fund companies. Chamber of Commerce and Industry, Stock Exchanges; Association of Builders and Developers, individual business leaders, top financiers and bankers of the country, senior policy personnel of regulatory & supervisory institutions - State Bank of Pakistan; senior public officials of the Government in the M/o Finance, Planning, Housing; Commerce, Law.

The group would need an extensive analysis of the 'Effective Housing Finance System' - the policy issues facing the development of commercially viable market oriented housing finance system in the context of socio-economic advancement of the country.

B. Senior and middle level managers of HBFC, emerging housing finance institutions, commercial banks, State Bank of Pakistan and trainers of training institutes of financial institutions. An indepth analysis of the institutional and managerial aspects of housing finance, its linkage and role in the overall financial framework would be required. For this group innovative techniques in product development and product launching in the fields of lending and resource mobilization would be explained. A dynamic interaction of housing finance managers with public officials in charge of implementing housing policies having a direct impact on housing finance system, is considered most opportune.

C. Middle and frontline professionals of emerging housing finance institutions, commercial banks, HBFC. A workshop on 'credit evaluation and loan servicing needs' to be organized for this group. This would be the first course among the series of courses planned for human resource training, once the housing finance institutions start operations in Pakistan.

Outline of Human Resources Training Plan:

26. A smart responsive organization is a shared wisdom and perspective of a texturized competence that shapes the behavior of individual practitioners. Scientific management of human resources in a housing finance institution where the HFS is being established or is in the initial stages of development, would first call for

a) Definition of Premises/Objectives:
The objective of the organization should be clearly defined. Specific objectives of different arms of the organization should be laid down in the light of goals of the organization. Specific objectives should be such as can be appraised.

b) Vision of Management:
The culture of the organization and individual's behavior depends on Management vision. Coordination and team building ability commitment, initiative and effort, competence, track knowledge, analytical ability, entrepreneurial skills to drive ideas of the management play a key role in making the organization dynamic and vibrant.

Creation of an environment for change, timing for change is critical. Their insistence on higher standards and perfection makes the organization market leader.

c) Value System:
Which is geared to
- i) needs of customers
- ii) integrity of purpose is foremost; performance is secondary
- iii) commitment
- iv) learning by doing - tolerance for accepting mistakes, learning through errors
- v) feedback - asking for feed back - internal from staff and external from clients.

d) Business Oriented Recruitment Policy:
Recruitment should be purely on merit and according to needs. The officials should be:
- i) result oriented,
- ii) able to work easily with variety of people

particularly with difficult clients,
iii) capable of taking challenges,
iv) willing to take risk and responsibility,
v) desirous to seeking better performance and creating new opportunities,
vi) blessed with leadership quality,
vii) able to develop and push ideas,
viii) able to work under stress.

e) Incentive Policy:
The main elements of incentive policy of a dynamic organization and particularly a housing finance institution are:

i) for junior executives	- promote them when they are able to shoulder higher responsibilities - reward them for accuracy in underwriting, for services when loans do not go default and promoting business turnover
ii) for middle management	- incentives should be provided when their section exceeds the goals
iii) for senior management	- incentives when division contributes to the culture of the organization and exceeds the goals
iv) for chief executives	- incentives provided when company exceeds the goals, new opportunities of business are created, timely action taken to meet the challenges and enforcing changes.

f) Performance Appraisal:
The performance appraisal system should be open as it tends to analysis of training needs. Self appraisal by individuals and communication of appraisal by countersigning offices to individuals is important for his assimilation in the culture of the organization.

g) Training:
i) for junior frontline staff:
It is better to have young staff fresh from university which is not conditioned to experience. They should

be trained for six months in mortgage lending, credit appraisal, determining willingness and ability to pay, mortgage instruments suitability and affordibility.

ii) for middle management level:
The staff would mainly be drawn from commercial banks and should be real technical people responsible for processing/supervising/data control. Short courses for training at Institute of Bankers/Training institute of State Bank of Pakistan should be designed and conducted.

<u>Housing Finance Training Plan</u>

A. <u>Seminars and Workshops during 1991</u>

27. Following seminars and workshops should be arranged during 1991:

a) <u>Seminar on 'Housing Finance Management and Managerial Effectiveness'</u>

Inauguration	- Governor State Bank of Pakistan
Date	- July/August 1991
Duration	- 15 days
Venue	- Islamabad/Murree; similar seminars to be organized at Karachi, Lahore, Faisalabad, Multan, Peshawar, Quetta at a later stage.
Participation	- Group B - paragraph 25
Objective	- Enhancing the skill in product launching in the fields of lending and resource mobilization.

Topics	- Essentials of Effective Housing Finance System.
	- Overview Agency
	- Legal Aspects - titles, liens, foreclosures, eviction of occupants; court procedures
	- Resource Mobilization
	  - special saving schemes
	  - development of secondary market
	  - mortgage insurance
	- Mortgage instruments
	  - Designing of fixed rate; graduated adjustable mortgages

- Mathematics of Housing Finance
- Processing, underwriting and servicing of loans
  - determining affordibility
  - delinquency management
- Low income targeting
- Human Resource Development
- Case Studies

Faculty

- Jack M. Guttentag		USA
- Marshall Dennis		USA
- Kitti Patpongpibul		Thailand
- Nasser Munjee		India
- Earl Kessler	RHUDO	Bangkok
- Barbara Foster	RHUDO	Bangkok
- Jon Wegge	USAID/PAK	Islamabad
- Aneeq Khawar	City Bank	Karachi
- Executive Director	State Bank of Pakistan	Karachi
- Director Banking Control Dept	State Bank of Pakistan	Karachi
- Nessar Ahmad	Managing Director Crescent Bank	Karachi
- F.A. Rabbani	Twenty First Century	Karachi
- Hafeez Pasha	Director Applied School of Economics University of Karachi	
- Z.D. Farooqi	Consultant and Assoc. Training Specialist Twenty First Century	

Methodology - Lectures, case presentations, individual and group studies and exercises, group presentation and analysis; instrumentation exercises, role plays and video interactive feedback.

b) Workshops on 'Credit Evaluation and Loan Servicing'

Inauguration	- Dy. Governor, State Bank of Pakistan
Date	- May/June; September/October; December
Venue	- At places where housing finance institutions intend to start operations during 1991-92.
Participation	- Group C - paragraph 25
Objective	- Understanding techniques of effective credit appraisal and loan recoveries.
Topics	- Loan processing - determining ability and willingness to repay - underwriting and closing - servicing - delinquency management and foreclosure

Faculty

- Satish Mehta - Chief of operations HDFC, Bombay
- Jamaree Saveta Chinda - Chief Personnel GHB, Thailand
- Vice President, City Bank, Karachi
- Principal, Training Institute, State Bank of Pakistan, Karachi
- Secretary, Institute of Bankers, Karachi
- Associate Training Specialist 21st Century Consultancy & Management

Methodology	- Lectures, case presentation, individual and group studies and exercises, group presentation and analysis; instrumentation exercises, role plays and video interaction feedback; one to one exchange with faculty and among participants.

A detailed design of the seminars and workshops would be prepared once the proposal is approved.

B. Symposia on key areas of housing finance:

28. Symposia on the following five subjects may be organized to develop an advanced understanding and appreciation of the following critical areas of housing finance by the firms which will start of housing finance operations and agencies of the Federal; Provincial and local governments/agencies which will

oversee, regulate and facilitate the operation of the emerging housing finance system. These symposia may be organized in 1992.

a. Role of an overview agency
b. Loan processing, underwriting, servicing and foreclosure
c. Resource mobilization - financial and human
d. Low income targeting
e. Development of secondary market in mortgages - role of insurance companies.

29. Lead speakers from Pakistan and abroad as indicated for Seminar on 'Housing Finance Management and Managerial Effectiveness' - paragraph 27(b) and participants from Group B- mentioned in paragraph 25 would be invited. In addition to the participants of Group B senior public officials of Provincial Governments, local bodies from departments of Finance, Housing, Town Planning, Building Control, Rent Control, should be invited. An interaction of these public official and housing finance mangers would be ensured. Each symposium would cover basically,

a) essential elements of the particular subject in effective housing finance system.
b) How it works in advanced HFS say in US and how it operates in developing countries particularly in the Asian region?
c) What is the mechanism available in Pakistan? and
d) What improvements, amendments should be made to make it effective in Pakistan's environment?

A set of recommendations would be put up at the end of each symposium. Designs of these symposia would be prepared in mid 1991.

C. <u>Inservice training in foreign institutes</u>

30. The year 1991 should hopefully see start of market oriented housing finance operations in Pakistan. A few new institutions are planned to be set up and some of the existing institutions would start these operations. Basically officials forming Group B - paragraph 25 would need inservice training of two weeks to four weeks in the concerned institutes and agencies of United States, India and Thailand. The officials constituting Group A - paragraph 25 should be considered for short term exposure in the relevant institutes of these countries.

The details of these programmes would be worked out in consultation with Overview Agency.

D. <u>Training of trainers in housing finance and inclusion of courses in curriculum of Institute of Bankers/Training Institutes.</u>

31. State Bank of Pakistan, commercial banks, DFI's have their specialized training institutes for frontline staff and middle level managers. In addition Institute of Bankers, conducts courses leading to diploma in banking, which is considered as an essential qualification for promotion. Directors/Principals of these institutes would initially upgrade their understanding of HFS by attending seminar on 'Housing Finance Management and Managerial Effectiveness' proposed in paragraph 27(b) and attending Symposia proposed in paragraph 28. In addition some of these trainers would gain an advanced understanding through short visits and during inservice training at foreign institutes as proposed in paragraph 30. It is understood that HDFC Bombay is organizing a training programme for trainers during 1991. A few trainers from Pakistan selected by the Overview Agency should attend this programme. The desirability of organizing a separate programme for Pakistani trainers in Pakistan would be examined in the light of the above programmes.

E. <u>Inclusion of courses on housing finance in the curriculum</u>

32. Courses on housing finance particularly the areas identified in paragraph 24 above, should be included in diploma courses conducted by Institute of Bankers and training institutes of State Bank of Pakistan, commercial banks and DFI's. Efforts would also be made to include the subjects on Housing Finance in the courses of business administration conducted by specialized institutes of business administration of Pakistan. In this connection, the Overview Agency would finalize the strategy with the assistance of Twenty First Century Consultancy and Management Services, if considered necessary.

<u>Promotional Campaign</u>

33. It is considered essential that a promotional campaign to create an enabling environment for the start of market oriented housing finance operations is prepared and launched in advance of or at the most concurrently with the Training Plan. This would enhance the effectiveness of the two programs, assist in better understanding of the HFS and highlight the need and urgency of establishing the system and management of human resources on scientific lines. The promotional plan should have the following basic components:

A) <u>Seminars and Workshops on 'Effective Housing Finance System'</u>:

34. As demonstrated while discussing major training issues of policy nature in the field of housing finance in Pakistan in paragraphs 8 and 9 above, the key issue is the myth that housing finance is a high risk venture and not commercially viable unless subsidized by the government. It is felt that a seminar on effective housing finance system should herald the promotional campaign, followed by workshops on the same subjects at regional levels in leading business centers/cities of Pakistan. An outline of the seminar to be held at national level is given below:

Inauguration	-	Prime Minister of Pakistan/Finance Minister
Date	-	Third week of April 1991.
Duration	-	Three/four days
Venue	-	Karachi/Islamabad
Participation	-	Group A - paragraph 25
Objective	-	To expose the myth that housing finance is a high risk venture
Topics	-	Housing as a lead sector
	-	Housing Finance System - institutional building blocks
	-	resource Mobilization
	-	Low income targeting
	-	Success stories of GHB Thailand and HDFC Bombay.
Faculty	-	Marshall W. Deniss of REMOC Associates
	-	Sindhijai Thanphiphat M.D. GHB Thailand
	-	Earl Kessler - RHUDO, Bangkok
	-	Michael Lee - RHUDO, Bangkok
	-	Deepak Satwalekar - HDFC, Bombay or Naseer Munjee - HDFC, Bombay
	-	Qazi Alimullah - Economic Consultant M/o Finance, GOP
	-	Aftab Ahmad Khan - Former Secretary M/o Finance
	-	F.A. Rabbani - Former Chairman HBFC and M.D. Twenty First Century Consultancy
Methodology	-	Lectures, Presentations, Case studies with video interactive feedback, one to one exchange with Faculty and among participants.

B) <u>Communication/audio-visual promotional plan</u>:

35. The following action program in the field of communication/audio-visual needs immediate consideration:

a) Collect literature on the policy environment and the success stories of HOusing Bank of Thailand; Housing Development Finance Corporation India; Shelter programs of Sri Lanka and the Philippines; building societies of U.K.; and Savings and Loan Associations, mortgage banks, primary and secondary mortgage markets of U.S.A.

b) Prepare policy paper on the extent and magnitude of shelter problems in Pakistan, prevailing policy environment, changes envisaged in the legal framework, rules and regulations recently announced for regulating and supervising the operations of housing finance companies; incentive package considered necessary for emerging housing finance institutions.

c) Prepare materials to serve as background material on areas of housing finance detailed in paragraph 24 above for writing of articles, brochures, by leading economists, economic journalists, financiers, bankers, builders and architects, social scientists, community developers etc.

d) Compile an annotated list/directory of potential private sector support group of investors and arrange workshops on HFS and SRO governing the establishment and operation of housing finance institutions in all major cities of Pakistan.

e) Create a favorable climate for market based housing finance system by:
   i) publication of material prepared as per (iii) above in leading local dailies and journals and dispatch them to the support groups as discussed in (iv) above.
   ii) prepare films and other audio-visual aid material based on (iii) above
   iii) arrange group discussion of opinion builders on Radio and TV.

f) Evaluate the result of publication, publicity, seminar and design nation wide extension program to promote market based housing finance system and institutions.

36. <u>Recommended Strategy</u>:

a) A Housing Finance Consultant may be appointed immediately in the State Bank of Pakistan who should

i) liaise with both the licensing authority and monitoring/overview agency envisaged in SRO-1356(I)/90, and
ii) assist these agencies in formulating policies in accordance with the principles discussed in paragraphs 11 and 13 of the Report.

b) Promotional campaign should precede the launching of Training Plan.

c) A seminar on 'Effective Housing Finance System' at national level should be held by end of April 1991 to expose the 'myth of high risk' and generate interest in the setting up of housing finance institutions - paragraph 34 of the Report.

d) Housing Finance Consultant of State Bank of Pakistan should ensure finalization of the actions to be taken under the SRO by licensing authority and overview agency by end of April 1991.

e) Literature should be prepared and publicized explaining the licensing procedure, supervisory and regulatory functions of the monitoring/overview agency.

f) Workshops should be held at regional level in all major business centers/cities of Pakistan explaining the HFS and SRO - reference paragraph 34 of the Report.

g) Communication/audio-visual promotional plan should be launched simultaneously as discussed in paragraph 35 of the Report.

h) Annotated list/directory of potential private sector support group of investors should be finalized.

i) Housing Finance Consultant of State Bank of Pakistan should determine training needs of emerging housing finance institutions and finalize Training Plan detailed in paragraphs 27-33 of the Report.

ANNEXURES

ANNEXURE "I"
Synopses of Topics covered in the Seminar on 'Effective Housing Finance'

An international seminar on Effective Housing Finance was held at Bangkok from January 7, 1991, to January 12, 1991 organised by Fels Centre of Government, University of Pennsylvania; The Government Housing Bank of Thailand and Regional Housing and Urban Development Office of USAID. It was attended by 50 officials from India, Indonesia, Nepal, Pakistan, Philippines and Thailand. The main speakers of seminar were JACK M. Guttentag, Professor of Finance, Wharton School, University of Pennsylvania, Marshall W. Dennis of REMOC Associates, The case studies of Thailand and India were presented by Sidhijai Tanphiphat, Managing Director Government Housing Bank Thailand, and Mr. Nasser Munjee, Chief Economist of House Development Finance Corporation (HDFC) Bombay, respectively. The seminar was designed so that participants could

a) develop a more advanced understanding of institutions that comprise a housing finance system and increase their appreciation of alternative ways of delivering housing finance,

b) update their knowledge about effective operational and management strategies in housing finance institutions,

c) interact with their colleagues, sharing critical experiences in operating housing finance institutions with special emphasis on resource mobilisation and mortgage loan instruments and

d) orient themselves to the dynamic interaction of housing finance institutions with the overal financial sector and see the relationship between the policy issues and effective institutional performance.

Topics covered:
The main topics discussed in the seminar were:

01. Housing and the economy and housing finance in the region.
02. Housing finance systems and functions.
03. Legal aspects of housing finance, titles, liens and foreclosures and role of an overview agency.
04. Resource mobilisation.
05. Loan processing/underwriting; servicing/foreclosures.

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06. Mortgage loan instruments.
07. Low income targeting.
08. Case studies, housing finnace in India, Thailand.
09. Management of human resources, training needs.

1. **<u>Housing and the Economy</u>:**

Shelter is a basic human need and effective housing finance system is the primary instrument in mobilising savings to meet this need. Families allocate about half of their income to housing and poor generally a higher proportion than the rich. (Mayo, Stephen & others - shelter strategies for urban poor in developing countries - World Bank Research Observer, July 1986). Construction of new houses has formed 50% of private investment in the US over the past 10 years. Housing represents 15 to 20% of GDP and provide 6% of emplyment in US.

The income multiplier for housing investment in a number of countries including Pakistan has been estimated to be about two. (Katsura; Harold - Economic effects of housing investment-Urban Institute 1984). In US however, the ripple effect is six because of sophisticated secondary market. Around 35% of total credit of capital markets is drawn by the housing sector in US. Effective housing finance system does not exist in the Asian Region. Primary mortgage markets have been successfully established in India and Thailand. They are being established in the Philippines and Sri Lanka, while in Pakistan, essential first steps are being taken to establish the system.

2. <u>Housing Finance System</u>:

Housing is basically a private sector activity and most of it in the Asian region is undertaken by private informal sector. Everyone saves but few save well. When finanial intermediation is low, savings cannot be put to their most productive use. For the design and implementation of an effective formal housing finance system, following key issues need consideration, so that strong and sustainable financial institutions are established:

a) In a developing country a mix of specialised institutions and generalised system as in Thailand would be preferable. The institutions that comprise the housing finance system are specialised institutions dealing in originating, servicing and closing of mortgages

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both in public and private sectors, government banks, private savings and loan associations, savings banks, insurance companies, commercial banks, credit unions.

b) There should be a "level playing field" for all participants. A regulatory framework is essential to lay down uniform ground rules for all. There is also need to have an overview system, so that performance is monitored, observation of ground rules is supervised in such a way that it encourages new entrants and facilitates the operation of those in the field rather than strangulate their working-long term support for institutional development should be the goal.

c) Steps should be taken to develop secondary markets alongwith the primary market to make the system sustainable. To develop secondary morgage markets, governmetn backed insurance companies can play pivotal role by guaranteeing deposits and cash flows so that mortgage companies, and brokers, and investment companies start playing their role.

d) Resource mobilisation is undertaken competitively from the general public. Prices should reflect real costs. This means that financial and social goals should remain separate at least in the short and medium term.

e) Efficient ways of chanelling government subsidy to low income group have to be clearly devised. Mortgages should be designed to increase affordibility of this group.

f) An effective system for underwriting and servicing of loans have to be designed so that defaults are minimal and need for foreclosures arise only in extreme cases.

The function of the system would thus be to mobilise savings, provide loan instruments and servicing facility and allocate credit to all fairly under the market mechanism. In United States, the government through the mortgage and deposit insurance, provided the stimulus to the economy in World War II period and now housing sector accounts for 55% of total credit of capital markets. S&L provide 30 to 40% of total loans

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and commercial banks 10 to 15%. As a result, housing finance sector contributes 15 to 20% of GNP and 6% of employment.

3. **Regultory framework/Legal aspects:**
The essential elements are:

a) clear title to land/property,

b) speed and certainty of closure; loan processing should be completed within shortest possible time and applicant informed.

c) entry rules - minimum conditions for entry, loan capital ratio, and management

d) portfolio restriction - products that can be financed,

e) liquidity requirement - capital / reserve requirement,

f) disclosure requirement - true condition of the value of core capital is critical, and

g) foreclosure - speed and and certainty is important in acquiring title and eviction of occupant. Foreclosure time should not exceed 3 to 6 months from the date of filing the case in court. Issues of facts should not be appealable as in US.

4. **Overview system/agency:**
At the start it should be a government agency/central bank/specialised bank as in India which could develop on some such lines as the Federal House Loan Bank System of USA. This agency would raise funds through capital market and provide credit support to housing finance institutions when required. It should be basically a promotional agency. Some of the main functions are

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a) prepare a blue print/frame work for housing finance-laying down the objectives,

b) serve as a think tank; provide expertise and serve as source of information/training,

c) design different type of mortgage instruments wih varying mark ups according to needs, priorities of different sectors and sections of the society,

d) plan the development of secondary mortgage market through:
safety of deposits - Government backed deposit insurance shceme
- insurance of cash flow payment.
- standardisation of documents for underwriting to develop national mortgage lending
- encouragement of mortgage, securities, bonds - can act as conduit by purchasing mortgages, creating securities and selling them.
- encouragement of savings and investment banks, companies, associations and mortgage companies alongith paraphernalia of brokers

e) coordination/lobbying with the Government and foreign financing agencies on behalf of housing finance institutions.

5 **Resource mobilisation:**
The primary objective of "Effective Housing Fiance System" is to develop a market oriented financial sector rather than as a means to meet shelter goals. The deposit base has to be widened and new saving habits encouraged. Savings for residential investment can serve as an engine of growth. Families allocate as much as half of their income to housing, the poor generally higher proportion than the rich according to a number of World Bank studies on housing demand. In the absence of sound housing finance system, savings

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find their way in conspicuous consumption, festivities and 'luxury' durables. The main disincentive to save by the low income group and poor is the non-availability of credit for immediate purchase, construction, upgradaing of shelter facilities. The way out is marketing of home linked savings scheme; development of community mortgage programmes as in the Philippines; short term loans to builders; non mortgage lending programes as is done by Gremin Bank, Bangladesh; involvement of guarantors to improve affordibility as is done by HDFC, Bombay; using NGOs and cooperative societies as intermediaries; development of thrift societies as in Sri Lanka. Insurance of deposits plays a major role in encouraging saving in in societies where unscrupulous thrift societies have shaken the confidence of public.

6 **Loan Processing/Underwiting/Servicing/Closure:**

This is the heart of the lending process. Those who process well are the most efficient lenders and have the smallest delinquency rate. Underwriting mortgage loans involves reviewing a collection of documents and through the art of observation and deduction making a decision regarding the grant of loan. The maxim is that each application has to be examined on its merit and techniques are learnt by doing. The key factors are:

a) preparatation of loan applications; loan application has to be filled by the lender/ processor and signature of the loanee obtained after filling in the application. This is the most important document. Acheck list for processing the loan is prepared. Additional documents are asked for and borrower is given a time table for this purpose,

b) verification of the information in respect of borrowers, co-borrowers/guarantor,

c) determination of ability and willingness to repay; here amount and type of the income of applicant, probability of that income continuing, credit history, financial resources/assets and value of collaterals would facilitate in reaching an informed decision,

d) examination and verifacation of title to property/ land; assessment of value of property/ collateral, its condition and marketability is important,

e) determination of best mortgage instrument/ product for the applicant in the light of his affordibility, and

f) servicing - efficient servicing is one of the most critical function as it may take only weeks to process the loan but loan may have to be serviced for 15 to 30 years. Here, the functions involved are:

- collection of principal and interest and other charges on collatteral such as taxes, insurance etc.
- calculation of pay offs; escrow analysis
- delinquency management and foreclosure
- provision of annual statements

Efficient servicing plays a major role in the development of secondary mortgage market. It is an area that can produce a lot of expense but also can generate considerable revenue as in U.S. The most important element is collection, where speed of communication is critical. Normally first nice letter should be sent either immediately after the due date of payment or within 15 days. The second letter should be sent after 30 days indicating the risk and the third letter after 60 days giving notice that if no contact is made within 15 days mortgage will be handed over for foreclosre. In cases where payment is overdue for 90 days, matter should be reported to credit bureau/guarantor.

7. **Low Income Targeting:**

The group below 50% of median income and above the poverty line consititutes the low income group. The group below poverty line does not have sufficient income even to meet nutritional needs. According to some studies in India and Pakstan, the urban group below poverty line would be having an income of less than Rs.2000/- pm per household and would need subsidised lending. The low income group, however, has to be targeted commercially with varying mortgage instruments. Cost of servicing the loans to this group are high as loan amount depending on affordibility is low. The volume of business is high and the advantage of high turn over can be exploited if servicing is made efficient and effective. A number of studies have shown that poor households have greater willingness to pay and delinquences are less.

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It would be necessary to undertake community based operation through NGOs, cooperatives and formation of group to meet the challenge of providing shelter to this group. Special mortgage instruments shall be needed to meet the requirements of this group. Following action programme needs consideration:

a) financial institutions charge their fixed costs to loans advanced to middle and upper income group and only variable costs charged to low income gruop mortgages,

b) in the initial period, only interest be charged and say after one to three years principal is deducted,

c) mortgages be adapted to needs of various low income groups as is done by Gujrat Rural Housing Corporation in India and under Community Mortgage Programmes in the Philippines,

d) non mortgage loans advanced to enterprises for housing their employees if the employer guarantees or to societies if society guarantees,

e) non mortgage loans advanced to enterprises for housing their employees if the employer guarantees or to members of societies if society guarantees, and

f) non mortgage lending on the guarantee of the group like Gremin Bank of Bangladesh.

To meet the needs of those who are below poverty line, governemnt should consider outright grants preferably in kind on the basis of incremental development. The personal touch, and human approach would work wonders in this sector.

8. Mortgage Instruments and Development of Secondary Market:

Mortgages are instruments of contract. In developing countries, institutions such as commercial banks, provident funds, insurance trusts/companies which have savings, do not invest in mortgages because of

a) high risks and uncertainy involvedin time consuming process of foreclosure and evicting and

b) legal restrictions imposed by the central bank. Government agency can offer mortgage backed securities to these unwilling investors if they become members as is done in the United States by Federal Home Loans Banking Association. This necessitates reliable servicing, loss and cash insurance and uniform documentation. A secondary mortgage market is developed simultaneously with primary market and pool of funds is available if investor could be protected. The mortgages can be made marketable and liquid if they can be sold without loss of value. This in turn is possible with mortgage backed securities having insurance of cash flows. Savings get a boost if mortgage instruments attractive for households are designed and marketed.

In US, mortgage securities like pass through securities of mortgage pool, isuring/ guaranteeing payment of principal and interest and mortgage bonds inssued against collateral of mortgages have played a significant role in development of secondary market. Standard mortgages were introduced during depression of 1930s. Mortgages are long term upto 30 years and fully amortised, preferably of equal monthly instalments and with single fixed rate, with built-in provision for inflation. The equation of interest rate on mortgage is $i = (1+r)(1+p) - 1$ where

i is interest rate on mortage
r is prevailing interest rate
p expected inflation rate

Mortgage instruments have to take care not only of anticipated inflation but also of risks of changes in interest rates, and hence variable interest rate mortgages may be designed. Another element is capital appreciation which may be absorbed by issuing appreciation mortgages/certificates. In U.S out of every four loans originated, three are sold in secondary market; out of these three, two find their way in mortgage backed security market.

The mortgage instruments have to be designed for different groups of people such as:

a) below median income
b) salaried
c) elderly peoples
d) professional
e) self employed
f) ex servicemen/veterans/retired government servants

The developing countries which are in the process of setting up a primary market, should examine very carefully the benefits and contribution of support systems of secondary mortgage market such as mortgage insurance, insurance backed securities, bond market and other liquidity enchancement mechanism. Step by step approach may be followed. The priority should be for capability and capacity enhancement in readiness for the home mortgage finance requirements.

9. **HOUSING FINANCE IN THAILAND AND INDIA**

Government Housing Bank of Thailand (GHB) was established in 1953 under the Ministry of Finance. Since 1984, GHB competes with other savings institutions in resource mobilisation from general public through attractive returns to deposits and by offering innovative saving instruments. It has demonstrated that home loans are commercially viable with the result that all major financial institutions particulary commercial banks have entered the housing finance market since 1987. In 1990, commercial banks accounted for 70% of loans to housing seetor as against 17% of GHB. Mortgage loans consituted 7.18% of total loans in the formal sector in 1989 as against 4.93% in 1986.

The performance of GHB has been remarkable. GHB continues to work as market leader. As of Sept. 1990, there were 80,000 borrowers; total loans were $ 1.0 billion; total assets $ 1.2 billion with deposits of $ 865 million. It was offering interest rates of 11.5% to 13.5% while lending at adjustable rates from 13.5% to 15% Net profit was 8% twice the level of average of 1986 and 1987. The slums which constitued 24% dwelling in 1974 were halved by 1988. Deposits now constitute 85% of total GHB funds as a result of marketing attractive deposit instruments. Availability of home loans is now taken for grandted and consumers have started shopping for the best deals rather than accept what is offered.

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The central bank of Thailand played a key role in encouraging commercial banks to participate in mortgage lending.

a) It granted capital adequacy concession to house mortgage credits; only 80% of home mortgages of $ 16000 and less are regarded as risk assets, which must be covered by a capital adqequacy ratio of 8% and

b) allowed home mortgage interest expenses, deductible from income tax.

In India annual gross capital formation in housing was about Rs.310 billion in 1980s compared with 1100 billion in 1990. The commulative contribution of formal institutional flows for housing finance at the beginning of 1980's was almost Rs.120 billion mainly from the public sector financial institutions and commercial banks. Housing Development Finance Corporation (HDFC) which was established in 1976 as a private sector entity, contributed only Rs.10.50 billion during the first five years of its existence. Once HDFC demonstrated that housing finance is affordable, recoverable and profitable, public policy interest followed and funds started flowing in the sector. In 1990, flow of net credit by way of housing finance increased to nearly Rs.200 billion on an annual basis specialised housing finance institutions contributing 25% of the total.

HDFC dominates the component attributable to specialised housing finance institutions. HDFC has been instrumental in widening the institutional base for housing finance. The basic philosophy of HDFC management is "learning by doing". Loan approvals and disbursals in the year ending March 1990 increased by 36% and 44% respectively over te previous year - 78% of loans were for individual home owenership. The dividend in 1990 was 20% as agaist 18.67 percent during the preceding year. HDFC has internationalised its training operations through Centre for Housing Finance in Lonavla. Intensive training work\shops are conducted for its own staff, other institutions and for trainers of training colleges of commercial banks. The Government has set up a National Housing Bank in 1988 to function as an apex bank. It works as an overseeing agency ad is responsible for developing a healthy self sustaining housing finance system, integrating it with general financial system, and mobilising savings specifically linked to housing.

10. **Management of Human Resources and Training Needs:** A smart responsive organisation is a shared wisdom and perspective of a texturised competance that shapes the behaviour of individual practitioners. Scientific management of human resources in a housing finance institution where the HFS is being established or is in the initial stages of development, would call for

a) definition of premises/objectives:
The objectives of the organisatin should be clearly defined. Specific objectives of different arms of the organisation should be laid down in the light of goals of the organisation. Specific objectives should be such as can be appraised.

b) Vision of Management: The culture of the organisation and individuals's behaviour depends on Management's vision. Coordinatin and team building ability, commitment, initiative and effort, competence, track knowledge, analytical ability, enterpreneurial skills to drive ideas of the management play a key role in making the organisation dynamic and vibrant. Creation of an enviroment for change, timing, for change is critical. Their insistence on higher standards and perfection. makes the organisation market leader.

c) Value system, which is geared to
 i) needs of customers
 ii) integrity of purpose is foremost; performance is secondary.
 iii) commitment
 iv) learning by doing - tolerance for accepting mistakes, learning through errors.
 v) feed back - asking for feed back-internal from staff and external from clients.

d) Busineess oriented Recruitment Policy:
Recruitment should be purely on merit and according to needs. The officials should be
 i) result oriented.
 ii) able to work easily with variety of people particulary with difficult clients,
 iii) capable of taking challenges,

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iv) willing to take risk and reponsibility,
v) desirous to seeking better performance and creating new opportunities,
vi) blessed with leadership quality,
vii) able to develop and push ideas,
viii) able to work under stress.

e) Training:

i) For junior frontline staff:
it is better to have young staff fresh from University which is not conditioned with experience. They should be trained for six months in mortgage lending, credit appraisal, determining willingness and ability to pay, mortgage instrument suitability and affordibility.

ii) For middle management level:
The staff would mainly be drawn from commercial banks and should be real technical people responsible for processing/supervising data control. Short courses for training at training institutes of central bank commerical banks should be designed and conducted.

f. Incentive policy
The main elements of incentive policy of a dynamic organisation and particularly an emerging housing finance institution are:

i) for junior executives - promote them when they are able to shoulder higher responsibilities.

- reward them for accuracy in underwriting of mortgages, for services when loans do not go in default and for promoting business turn over.

ii) for middle management - incentives are to be provided when their section exceeds the goals.

iii) for senior management - incentives should be provided when their division contributes to the culture of the organisation and exceeds the goals.

iv) for Chief Executive - incentives only when company exceeds the goals, new opportunities created, and timely action taken for meeting challenges and enforcing necessary changes.

g. <u>Performance appraisal</u>

There should be an open appraisal system. Appraisal should lead to identification of training needs. Self appraial by individuals is important to determine the potential for learning. Comments of the countersigning officer should be communicated to the individual soliciting his observations.

EVALUATION OF THE SEMINAR

The design of the seminar and the contents, materials and techniques were very effective in achieving its objectives. The interaction of the participants with lead speakers and with their coleagues was very forceful. The presentation of case studies helped in appreciation of the housing finance system in action in the Asian region. The reading material helped in preparing background for a better understanding of alternate ways of delivering housing finance. The techniques used in stimulating interest and participation through interaction of the faculty members and participants with questions and answers session during presentation, were very effective. The last session of the seminar which was devoted to evaluation of the seminar was a clear proof of the fact that every participant was wiser at the end of the seminar and had developed an advanced understanding of the housing finance system and its institutions.

It was however, felt that if more time could be devoted to presentation and discussion of case studies of Thailand and India and particularly to designing of savings and lending schemes for low income groups, training techniques for front line staff and human resource development, the success stories of India & Thailand would have had greater impact.
In this connection video taped materials prepared at HDFC Centre, Lonavala, India, if presented, perhaps would have been very informative and useful.

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A N N E X U R E "I I"

List of Persons contacted

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O T H E R S

Kitti Patpongpibul

ANNEXURE "III"

GOVERNMENT OF PAKISTAN
FINANCE DIVISION
(INTERNAL FINANCE WING)

Islamabad, the 24th December, 1990.

NOTIFICATION

S.R.O. 1356 (I)/90. In exercise of the powers conforred by sub-sections (4) and (4A) of Section 3 of the Capital Issues (Continuance of Control) Act, 1947, (XIX of 1947), The Federal Government is pleased to direct that all consents and permissions in respect of a company engaged in the business of housing finance for issue of capital, for making public offer or taking any other action under sub-section (2) or sub-section (3) of the said section shall be subject to the following conditions, namely:-

1. Definitions:- In this notification, unless there is anything repugnant in the subject or context.

(a) "company" means a company incorporated under a law for the time being in force

(b) "business of housing finance" means a business described under Clause 0;

(c) "housing finance company" means a company licenced to do business under this Notification;

(d) "borrower" includes any customer of a company under any of the forms of non-interest based modes of financing prescribed by the State Bank of Pakistan from time to time and shall also include a hirer or lessee where financing.

2. Commencement of operation

(a) A housing finance company (HFC) shall commence business and operations only after it has been registered and issued a licence under this notification by the Federal Government.

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(b) An HFC proposing to commence its business of housing finance shall make an application to the Federal Government, in the manner notified by the Federal Government in the official Gazette, with a declaration that it complies with all the terms, conditions and requirements of this notification and shall comply with all that is required of a housing finance company in the conduct of such business.

3. <u>Share Capital</u>

A housing finance company shall not be permitted to issue capital unless it:-

(a) is incorporated as a public limited company under the law for the time being in force;

(b) has a minimum paid up capital of one hundred million rupees and has been listed on the Stock Exchanges of Pakistan; and

(c) has clearly and concisely stated its financing and investment policy in its memorandum and articles of association.

4. <u>Qualification of Directors etc.</u>

No person shall be elected or appointed as a director, an officer or an employee of a housing finance company who

(a) has been convicted of an offence involving fraud, breach of trust or moral turpitude; or

(b) has been adjudged as insolvent, or has suspended payment of his debts or has compounded with his creditors.

5. <u>Terms and conditions of operation</u>

A housing finance company shall operate under the following conditions namely:

(a) the company shall extend loans on commercial terms to the following extents of the total cost.

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(i) in the case of residential property 80%
(ii) in the case of non-residential property 60%
(iii) for additions, alterations or improvements in existing property 60%

(b) the ratio of equity to liabilities for the first two years shall be one to seven; thereafter, it shall not be more than one to ten;

(c) foreign participation shall require specific approval of the Federal Government; and

(d) no finance will be provided for purchase of land.

6. Bar on purchase or sale by beneficial owners

A housing finance company shall not, without the prior approval in writing of the Federal Government, purchase anything from, or sell anything to, any director, officer, employee of the company or from or to a person who either individually or in concert with close relatives beneficially owns ten per cent or more either of the equity or other securities with voting rights, if any, issued by such housing finance company.

7. Monitoring and regulation

For purposes of monitoring and regulation, a housing finance company shall be treated as non-banking financial institution and be subject to same monitoring and regulation arrangements as may be prescribed by the Government for other non-banking financial institution.

8. Functions of housing finance company

The following shall be the functions of the housing finance companies, namely:-

(a) mobilisation of long term savings exclusively for housing investment;

(b) to provide long term finance for the purpose of constructing, purchasing or making any additions, alterations or improvement to or in any property;

(c) leasing and renting on hire purchase of buildings for residential and commercial purposes;

(d) establishing and managing housing schemes;

(e) carrying out surveys and valuations of land and properties;

(f) arranging for the provision of insurance of pledged property;

(g) managing mortgage investments as agents;

(h) management of projects, public or private sector, in the housing and urban development sectors;

(i) making loans and advances for house building to individuals, projects and housing companies;

(j) Raising their funds, in addition to share capital from:-

(i) commercial paper, term finance certificates and deposits of not less than thirty days maturity duly approved by the Government;

(ii) floating and managing Modarabas;

(iii) foreign debentures both short and long term;

(iv) issuance of redeemable capital (Participation Term Certificates or Term Finance Certificates, etc.);

(v) lines of credit;

(vi) re-discount facilities; and

(vii) advancing loans on mark up to other housing finance companies.

9. Rate of mark up and fees

A housing finance company will charge mark up rate on its loans in accordance with the prevailing, rates provided that, where disbursement is held up by the company for any reasons, the commitment fee charged shall not exceed one per cent of the un-disbursed balance.

10. Insurance coverage

A housing finance company shall

(a) obtain sufficient insurance coverage on its own or on its clients' benefit against any losses that may be incurred as a result of employees' fraud or gross negligence; and

(b) ensure that properties being financed by it are covered by adequate fire and casualty insurance.

11. Bar to certain transactions

No housing finance company shall

(a) grant a loan to any employee, officer, director or a shareholder having a beneficial ownership including that of close relatives of more than 100% in the paid up capital of the housing finance company whether directly or indirectly (through their close relatives, companies controlled by them, affiliates, subsidiaries, or by way of acting in concert with others);

(b) transfer ownership of controlling shares, merge with, acquire or take over any other housing finance company unless it has obtained the prior approval of the Federal Government in writing to the scheme of such merger, acquisition or take over; or

(c) employ as a broker, directly or indirectly, any of its directors, officers or employees, or a person who beneficially owns whether individually or in association with close relatives ten per cent or more either of the equity or other securities with voting rights, if any, issued by the housing finance company.

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12. <u>Penalties</u>:-

(a) Without prejudice to an action and punishment under section 13 of the Act, in case of contravention of any provision of this notification the Federal Government may cancel the registration or licence of the housing finance company after issuing a show cause notice and giving such company an opportunity of being heard or pass another order deemed appropriate by the Federal Government.

(b) Upon cancellation of the registration or licence, the functions and carrying on the business of housing finance company shall cease and the Federal Government may move the Court for a winding up order in respect of the company.

(M. ZAFAR IQBAL)

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