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Policy and Institutional Study of Housing Finance in Pakistan

Volumes 1&2

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for the:

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The views expressed herein are those of the author and do not necessarily reflect those of the Office of Housing and Urban Programs

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POLICY AND INSTITUTIONAL STUDY OF HOUSING FINANCE IN PAKISTAN

Table of Contents

CURRENCY EQUIVALENTS

Currency Unit	=	Rupee (Rs)
Rs 1.00	=	US $0.057
US $1.00	=	Rs 17.5 (April 1988)

MEASURES AND EQUIVALENTS

m	=	meter (3.28 feet)
m^2	=	10.775 square feet
ha	=	hectare (2.47 acres = 10,000 square meters)
marla	=	225 square feet (20.91 square meters) in some areas 1 marla = 272 square feet (25.3 square meters)

GOVERNMENT OF PAKISTAN
FISCAL YEAR

July 1 to June 30

PRINCIPAL ABBREVIATIONS AND ACRONYMS

ADB	-	Asian Development Bank
ADBP	-	Agricultural Development Bank of Pakistan
ADP	-	Annual Development Program
BEL	-	Bankers Equity Ltd.
DA	-	Development Authority
DKA	-	Department of Katchi Abadies
FMHW	-	Federal Ministry of Housing and Works
GOP	-	Government of Pakistan
HBFC	-	House Building Finance Corporation
KDA	-	Karachi Development Authority
LDA	-	Lahore Development Authority
MCB	-	Muslim Commercial Bank
NCB	-	Nationalized Commercial Bank
NCCC	-	National Credit Consultative Committee
NHA	-	National Housing Authority
PLS	-	Profit and Loss Sharing
SBP	-	State Bank of Pakistan

EXECUTIVE SUMMARY

Introduction

A World Bank Mission to review the shelter sector in Pakistan in December 1987 concluded that one of the constraints to an effectively functioning housing sector is credit. The review found that less than 20% of the housing units constructed in Pakistan are financed from formal sources with most financing coming from savings, sale of assets and informal borrowings. Liquidation of assets is probably at a high opportunity cost and borrowing on the informal market is at very high rates of interest.

Furthermore, formal housing finance to the extent that it exists comes almost entirely from the House Building Finance Corporation (HBFC), a wholly government-owned institution which makes subsidized loans to a group of borrowers only partially and loosely targetted toward lower income levels. HBFC, in turn, gets its financing entirely through loans from the State Bank of Pakistan (SBP), the government central bank, and raises no resources in the market place.

Based on discussions between the USAID Mission in Pakistan and the Government of Pakistan (GOP) it was decided to do a more detailed study of housing finance in Pakistan focussing on government policies and the institutional make-up of the sector.

The objective of the Housing Finance Policy Study is to identify and explore approaches that should be followed in order to develop a dynamic, market oriented housing finance system. The intent is to find ways that the GOP could shift some of the financial burden of housing production from government financing to private financing where it could be more easily carried. This is consistent with the objectives of the Seventh Development Plan which states that the mobilization of resources for development should be shifted from the government budget to the private sector. The State Bank which provides a yearly allocation of funds in the form of a loan to the HBFC has indicated that HBFC must begin to look for other means to raise resources. The Seventh Plan also indicates that consideration be given to the establishment of a private savings and loan or building society system.

There are two additional factors, interrelated to those mentioned above, which have a major bearing on the operation of the housing finance system. One is that the government controls the amount and cost of credit for housing that can be issued by depository institutions so that the amount of housing credits that could be extended by the nationalized commercial banks, even if they were so disposed, is so severely limited as to be almost negligible.

The second is the launching by the government of its One Million Houses Program to deal with shelter for the shelterless. This program was launched during the latter part of 1987 and envisioned construction of some 75,000 nucleus houses during 1988 financed on a grant basis through a religious based fund for the poor, 35,000 nucleus houses in both urban and rural areas financed through return free loans, i.e., principal only repaid, 20,000 return free loans to upgrade houses in rural areas and another 10,000 loans through HBFC. Because of the heavy subsidies involved, this program will clearly impact on the development of housing finance institutions which attempt to operate on a market basis.

The Study Team has identified a number of constraints to developing a private housing finance system and made a series of recommendations to address these constraints. The basis and underlying factors which have influenced these recommendations are set forth briefly in the following summary.

The Economy

The economy of Pakistan is in a strong long term uptrend. Over the past 20 years GNP grew at a 6.2% real annual rate but population is also growing rapidly; 3.1% annually. On net, per capital income rose by 80% over the past 20 years. GNP per household is now about Rs 37,000 per year (equivalent to about $2115). These trends imply a high and rapidly growing demand for formal housing finance and the need to meet this demand through the private sector.

Deficit financing has been growing with much of the burden borne by an expansion of credit to the government by the State Bank. But so far inflation has been kept to reasonable levels by close control of private credit expansion.

The CPI rose at a 9.1% annual rate over the past 20 years although only at a 6.5% rate since 1980-81 but there are some concerns that inflation may trend upward in the future. Since Pakistan has no indexation system for financial instruments, to raise money from the private sector will require rates of return i.e. interest rates, to be positive at a level to more than cover inflation.

The Financial Sector

These are currently 22 commercial banks in Pakistan of which 17 are foreign-owned. The remaining five are all government-owned and are known as the nationalized commercial banks (NCBs). In addition there are a number of government-owned specialized banks and non-bank financial institutions (NBFs) of which the House Building Finance Corporation is one.

The NCBs have developed an extensive system of branches (some 7,000) in Pakistan reaching throughout the population. They offer a wide variety of deposit, checking and savings accounts ranging up to 5 year term accounts. In June 1987 there were some 15 million personal accounts, about the same as the number of families. Although many of these accounts are small, together they account for 1/2 of all deposits in the banking system. Lack of competition has resulted in the NCB's falling short as innovators on the lending side over the past 10 years.

People can also deposit money in accounts outside the commercial banking system e.g. the NBFI's, government savings schemes, mutual funds, stocks and contractual savings schemes such as life insurance and pension funds. There is a feeling that there is a large untapped pool of savings. One manifestation has been the rapid growth of unregulated finance companies offering extraordinary rates of return; many of them unscrupulous in their dealings.

There is also substantial "black" money in the system, money outside the formal and legal framework, arising out of such things as the dope trade and gun running but including corruption and tax avoidance. Much of this money has moved into land speculation but there have been attempts to tap into this by issuing bearer bonds.

There is little if any formal consumer credit. One conclusion of all of the above is that the household financial sector is capable of increased mobilization of funds on both the deposit and credit side.

Since 1972 both aggregate credit expansion and sectoral allocation have been set by the government to control monetary expansion and to conform to development objectives. This has been carried out through the National Credit Consultative Committee. The NCCC is staffed by the Ministry of Planning but has as members representatives of the federal and provincial governments, the Pakistan Banking Council, the six major government development finance institutions (including HBFC) and representatives of the private sector. The Chairman is the Governor of the State Bank. Within this context, individual banks are given ceilings on credit to the private sector by the SBP and annual funding of each DFI is set.

There is no way to determine the cost of capital due to the highly regulated and segmented nature of the financial markets. There is no auction or secondary market for government securities; no form of credit which is in ready supply at market driven prices. There are many pots of money tapped at costs determined by regulation and administration and related to the tight credit controls.

Therefore, banks have no incentive to maximize deposits at competitive rates nor to seek outlets for funds. The rate of return on loans is also restricted to keep credit affordable and to remove price as a major consideration in allocating scarce funds.

Banks must hold high reserves, much of it in short term government debt at a below market rate of 6%. In fact, savings deposits pay the equivalent of 7%. At the same time, the government pays up to 15% on its various national savings schemes which clearly influences the levels of rates of return on longer term loans and deposits.

Thus, the rate of return that a private housing finance institution would likely have to pay for funds would be in the range of 9-10% for 3-6 month term deposits, 12% for one year deposits and up to 15% for longer term deposits. This is similar to rates being offered by the National Development Finance Corporation.

If the financial system is to meet the potential demand for formal sector housing finace there must be steps taken toward a competitive market place for housing funds with greater market determination of rates of return on deposits and loans. But this would also have to be accompanied by changes in the allocation of credit and greater competition in other finacial markets.

Finally, it should be pointed out that Pakistan has operated under Islamic banking concepts since 1985 and the HBFC has used such principles since 1979 whereby the cost of HBFC loans to borrowers has been computed on the basis of imputed rents. These principles do not really alter the fact that money will have to be raised and loaned out based on market principles.

The Housing Sector

The growth in real incomes and in population, estimated at 106 million in 1987 of which some 32% lives in urban areas, has resulted in enormous growth in housing production. Household formation has been running at about 450,000 p.a. in recent years. This, along with the replacement to the existing stock, indicates the gross flow of units into the stock may have been on the order of 500,000. However, some of this is probably accounted for through sub-dividing existing units; others through converting buildings from non-residential use. Therefore, the number of new units actually constructed in more likely to be in the

400-450,000 range. Official documents referring to housing production cite much lower figures but this may be because such figures refer primarily to urban housing or only housing built with formal permits.

However, the large number of new units which appear to have been constructed doesn't mean there is no problem; only that households have managed to form at a rapid rate. There is, in fact, a wide-spread perception that there are serious housing problems, particularly among lower income families.

Among other things, this has manifested itself in the formation of katchi abadies (illegal housing settlements) which, although their expansion has slowed down, may contain as much as 20% of the urban population (37% of the population of Karachi is estimated to live in katchi abadies). The rapid rise in land prices has also added to the problem and land (and even vacant houses) is seen as a place to invest money for speculation.

As indicated above, formal housing finance in Pakistan is directly controlled by the government both in quantity of credit available (SBP allocations to HBFC and credit limitations on commercial banks) and in the terms of the loans. The effect is that there is really very little formal housing finance. The government arrives at its credit allocation based on its estimate of total projected investment in housing and assumes 66% will be self-financed. HBFC is funded by SBP to provide about 25% of the total housing investment.

The actual net cash provided to HBFC is based on HBFC loan recoveries less amounts owed to government and the State Bank for previously borrowed funds. Under this methodology HBFC has no incentive to seek other sources of funds but, in any event, because of the below market nature of its returns as well as poor recovery record, it has no options but to borrow.

In fact, the share of housing investment provided by HBFC under the above method is probably much less than what is implied. First, the government's estimate of total construction expenses is probably low as indicated earlier. Second, the estimate does not include anything for upgrading or anything for land. In addition, there are transactions related to existing houses. Thus, formal credit available to finance housing investments may be even less than 20% figure.

Therefore, from either the perspective of the average household or the aggregate economic perspective, formal housing finance is having little impact at present.

Out of the 400,000 new housing units being constructed each year, perhaps 100,000 are in urban areas. HBFC provides financing for only 20-25,000 of these units. The typical recipient of an HBFC loan will have to finance 2/3 of the cost of the house from other sources. First, HBFC finances none of the land costs which run about 1/3 of total house costs. Second, HBFC finances a maximum of Rs 90 per square foot with construction now averaging between Rs 150-200 per square foot. The exception is local development authority projects with a low cost of land.

Since HBFC is presumably funded by the SBP to provide some 25% of the cost of estimated new housing construction it appears inconsistent that only some 5-6% of new home owners get loans from HBFC and their financing for construction amounts to only some 50% of the cost. One obvious answer is that HBFC-funded housing must be much more expensive than the average new dwelling unit. The other is that the estimate of the cost of new housing construction excludes the large amount of self-constructed housing in rural areas.

In conclusion, it would appear that housing finance along with serviced land, both of which are scarce and expensive, are twin blockages on the supply side of housing. It is likely that the impact of the rise of land cost on housing consumption has been compounded by the lack of housing finance. In fact, as noted, HBFC does not finance land costs at all. In addition, the fixed amount that HBFC will finance per square foot of housing construction h[illegible] been changed for some time. Thus, increases in the cost of land and construction must be fully self-financed by households. When these cost increases exceed the rate of income growth, very high costs are imposed on potential home buyers.

Government Policies and Programs in Housing

Up until now there has been no stated government policy with respect to housing or housing finance and, in fact, up until last year the government generally had not accorded housing a high priority relative to other aspects of economic development. This has been reflected in the limited allocation of credit for housing. The Study Team was informed that a draft housing policy statement had been prepared but was not able to review it.

However, the institution of the government's program to make land available to low income families, i.e., the Seven Marla Program for rural areas and the Three Marla Program for urban areas, followed last year by the major One Million Houses Program of Shelter for the Shelterless (described earlier) appears to mark a significant change in government priorities. The latter program has included the creation of a new agency, the National Housing Authority, to administer it.

The programs clearly reflect a special concern for improving the housing opportunities of low income families. Without passing judgment on the likely effectiveness of the programs to achieve their goals, it is worth noting that a significant percentage of the housing will be provided either on a grant basis or as a long term return free loan. The close identification of the latter with the government and the income characteristics of the recipients make repayment at least questionable. Whatever the other effects of the programs, their financing characteristics are not conducive to the development of a private, market rate housing finance system capable of achieving high recovery rates.

Finally the government now has underway a major katchi abadie upgrading program which, among other things, will establish legal tenure. To the extent that the program does clarify and establish title, it will expand further the demand for formal sector housing finance, both for improvement and for resale.

Housing Production

Most housing is either self-constructed or built by the owner acting, in effect, as the general contractor. A variation of the latter is when groups of individuals form a cooperative for the purpose of building their houses. Resources are pooled to buy land and a contractor engaged to build the houses. It enables individuals to accomplish what would be more difficult than operating alone, particulaly obtaining land.

Only in Karacchi, Lahore and some other large cities are there private developers who construct housing for sale or act as general contractors for individuals. The major reasons that developers are not more prevalent relate to the lack of construction financing (discussed below) and the difficulty of assembling land for large scale development. Most formal sector urban land development is undertaken directly by the municipal urban development authorities. Since much land is owned by the government and obtaining required approvals is difficult, there is limited capacity for private development.

In addition, the windfall nature of the allocation by lottery of developed land by the municipal development authorities (most public land is developed and sold at prices substantially below market) make it difficult for developers to compete. However, in some cases, e.g. Surjani Town by the Karachi Development Authority, some areas are allocated to developers who must build within KDA specifications.

Rental Housing

According to the 1980 Pakistan census 78% of all housing units were owner-occupied. Even in urban areas, owner-occupied units amounted to 68% of the total, higher than in most developed countries. This high ownership rate, while undoubtedly reflecting a strong desire to own one's home, is also due to the difficulties faced by landlords in raising rents because of rent controls and the apparently great difficulties encountered in evicting tenants for non-payment or other reasons stemming from strong tenant protection laws and cumbersome procedures.
The result is very few new multi-family rental units on the market with some available units being held empty with the owners looking only to price appreciation. In addition, some serviced land is held vacant until the owner is prepared to build and occupy it or sell it.

The impact is perhaps greatest on lower income families who, because of the lack of formal housing finance or, when it is available, the high down payment requirements, find themselves unable to obtain standard housing. With more favorable rental laws and the availability of finance for rental housing, private investors, who can better bear the risks of developing and owing housing, might be prepared to do so.

The Current Housing Finance System

As stated earlier, less than 20% of all investment in new housing in Pakistan is financed through formal sector institutions or mechanisms much of which is associated with high down payments. Much of the new investment includes not only housing units self-financed or financed by money lenders in squatter and slum areas but also standard housing financed by individuals through savings, sale of assets or informal borrowing.

In addition to HBFC, formal finance is provided by the commercial banks and direct employer loans including government loans to civil servants. Up to now the government has used HBFC as its means to contribute to housing finance but with the advent of the Shelter for the Shelterless Program and the creation of the National Housing Authority, it will play a more direct role in the provision of housing finance.

HBFC is supervised and regulated by the MOF and the commercial banks by the SBP. Although policy control of HBFC is exercised through its Board, which includes the MOF and SBP, little direct supervision is exercised. If the housing finance system is to be expanded and broadened to include private participants, it is clear that a strong regulatory-supervisory framework would have to be established.

This appears to be recognized by government which has been enforced by growing problems with unregulated private finance companies over the past year, many of them based on real estate endeavors. The companies have been able to attract a significant amount of deposits from a broad spectrum of the population and some have closed up within a short period of time and made off with the deposits. The result has been a special set of regulations issued by the government setting forth the terms and conditions for the operation of legal, supervised investment finance companies. Although applications have been received none have been approved yet (several had been approved by September 1988) pending supervisory arrangements. The intent, however, was not that these institutions would engage in mortgage finance but would, rather, facilitate the development of financial and capital markets and the mobilization of savings.

The provision of long term housing finance seems to be regarded universally by the banking community in Pakistan as too risky to enter. It is not the legality of the mortgage instrument itself, nor is it the value of the underlying real estate which is increasing at a rapid rate. Rather, it is the difficulty in pursuing delinquent borrowers which can result in high costs to the lender.

House Building Finance Corporation

HBFC can be characterized as an institution struggling to remain solvent, relying totally on government loan resources to operate and which it must repay, lending with a sliding structure of returns on its loans that is far below market and faced with high delinquencies.

HBFC now receives all of its new lending resources except for repayments and some fees through a yearly allocation of funds from the State Bank. It lends through the Profit and Loss Sharing (PLS) mechanism at a range of returns from around 6-3/4 percent to 15 percent, an average return which is below what it would have to pay for funds in the market. Since it also repays SBP on the PLS basis, it is technically profitable although the return to SBP is around 4% or less, far below the marginal cost of money to government.

However, HBFC has a high percentage of delinquent loans on which it books accrued interest in developing its income statement and balance sheet. Thus, the profits on which it bases its repayments to SBP are really illusory. In fact, what happens is that SBP's yearly loan allocation of funds to HBFC is effectively reduced by the amount HBFC owes SBP from its "profits," "profits" which on a cash flow basis have not actually been received. The result is that HBFC's available lending resources, already limited because of the overall allocation from SBP, are further reduced. This situation will be exacerbated in the next few years as large balloon payments of principal on ten year SBP loans start to become due.

Finally, HBFC is carrying on its books, as assets, earlier loans made under government-sponsored programs such as those to flood victims and loans to borrowers in Bangladesh on which no payments at all are being received nor have been for some time. The amount outstanding on these questionable loans exceeds HBFC's capitalization, giving it a negative net worth. Thus, it is technically bankrupt. When this is coupled with the high rate of delinquencies on its regular loan portfolio and the cash flow problems that will be caused as larger SBP loans become due, HBFC's financial picture is bleak.

However, as an institution with over Rs 12 billion in stated assets and as the only institution providing any substantial amount of housing finance, it is unlikely that the government will abolish it or allow it to fail. In fact, our review of HBFC indicates that it is making substantial improvement in its management and operations; among other things it is instituting new collection procedures which appear to be resulting in improvements; it is developing improved accounting procedures and management reporting systems; and it is focusing its efforts more on lower income borrowers.

New Institutions

Despite the drawbacks to the private sector set forth above, there have recently been two efforts initiated to provide long term housing finance through private institutions. One, a joint proposal by a private industrial conglomerate and the National Investment Trust, a government open end mutual fund, was, in April 1988, still at an initial feasibility study stage. The other, being proposed by the Pakistan Industrial Credit and Investment Corporation, is also in a development stage. Both would have to get government approval and would presumably be affected by the new investment company regulations.

Construction Finance

Short-term construction (bridge) financing for housing projects is completely unavailable from formal financial institutions, thus limiting and slowing down the process of housing production. At present most new housing in Pakistan is built by individuals who own a plot of land and engage the services of a builder to construct the house. If they are fortunate enough to obtain a loan from HBFC, which, as stated earlier, is limited to Rs 90 per sq. ft. of floor area against actual construction costs of some Rs 150, they do not receive their first disbursement until after the house is at foundation level and the second, and final, disbursement when the roof is on. Thus, even individuals who receive an HBFC loan usually self-finance as much as 50% of the cost of the construction plus the full price of the land. HBFC finances a part of the construction but charges no return on its loan until one year after the initial disbursement. This arrangement is unsatisfactory both from the borrower's standpoint (very high cost of self-financing which limits the number of people who can afford this) and HBFC's standpoint (no return on money disbursed for one year).

If urban housing production is to expand to a level which would begin to meet demands, there will have to be more housing projects built by developers. Currently there are a limited number of apartment units being offered below Rs 150,000 but, for the most part, such developers are building only in Karachi and to some degree in Lahore. Here again the burden for up-front money by the buyer is significant. Because of a lack of construction financing buyers are asked to pay a deposit with their application and make periodic payments during construction supplemented by some HBFC disbursements if, as stated above, they are fortunate enough to get such a loan. Sometimes this may not even be known until they have paid in a significant amount.

With regard to purchase of land and other up front costs, a developer, if he has insufficient funds to cover all of this, must pay up to <u>5% per month</u> to borrow in the informal market. Commercial banks, who would normally provide such short-term financing in many countries, are not permitted to do so in Pakistan. Moreover, they have indicated they are not interested in lending for this purpose. They cite the riskiness of such projects, here again indicating that it is too difficult to proceed against defaulters and take over the project.

Yet some developers have indicated that if such financing were available and its cost built into the price of the house unit, and if this were coupled with the availability of long term financing for the buyer, they could increase the production of housing units significantly and cut the time to complete a project by one half.

Summary of Constraints to an Effective Housing Finance System

The Study Team has caategorized four major constraints to developing an effectively functioning housing finance system to achieve the GOP's objective to rely increasingly on the private sector to provide the resources for housing.

A. Viability of the Market

It is unlikely that there will be any significant flow of resources from the private sector into long term residential housing finance until the private sector perceives this as a viable financial market.

There is no doubt that the provision of housing finance is recognized as a potentially huge market. It is also recognized that the underlying security for a loan to finance a house, i.e. the mortgage on the house, is essentially a good one, particularly in view of the appreciating value of real estate.

But, almost universally, members of the financial community, both public and private, said lending long term for housing was too risky and that the dangers of significant delinquencies and the ability to collect in a timely way made this an unattractive proposition.

Although indicating that the mortgage instrument was sound, the majority of opinions was that the procedures for pursuing delinquent borrowers and, if need be, actually foreclosing on a property, were too cumbersome and lengthy.

It should be pointed out that the problem of delinquent borrowers is apparently a problem across the board in the financial sector, not just in housing. However, housing loans, because of their long term nature and the fact that you may have to deal with a social problem, i.e. a person's house, are currently perceived of as especially unattractive. Adding to this is the image that HBFC has conveyed, one of an institution struggling with many delinquencies with major advertisements in newspapers warning delinquent borrowers.

The two initiatives currently being developed in the private sector to create private or mostly private housing finance institutions have special interests behind them. One has the backing of the International Finance Corporation, the World Bank's private sector arm, and the Pakistan Industrial Credit and Investment Corporation and the other is being generated by the Chairman of the Dawood Group, who has long been interested in helping to finance housing, in conjunction with the National Investment Trust.

Finally, HBFC, which provides almost all of the formal housing credit in the country, makes loans which have a range of returns, depending on location, size of loan and income, starting as low as 6 3/4 percent and to some degree, there is a concern by some that housing finance should be provided at even lower rates.

This is inconsistent with attracting private funds into long-term housing finance. Private institutions would have to pay a rate of return to attract funds which, when added to their cost of operations including a return, would require them to lend at a significantly higher rate than HBFC's current rates. Indications are that the demand is there to do this and in such a way that it would be affordable to a large percentage of the population. But this cannot occur if a government institution is providing credit to a limited number of middle class borrowers at a subsidized rate.

The conclusion is that unless private investors see the provision of long-term housing finance as a viable financial market, i.e., that the loans provide a reasonably safe investment and a sufficient return such that funds can be mobilized to carry out the activity, then private interests will not move into the creation of private housing finance institutions.

B. Need for Regulatory/Supervisory Framework

There is no effective regulatory/supervisory framework to govern the establishment of new institutions whose primary business would be the making of long term housing loans.

Currently the financial sector is faced with a crisis in the proliferation of finance companies offering investors impossibley high rates of return supposedly growing out of activities which are not clearly defined. Many savers have apparently lost substantial amounts of money. A number of the companies have indicated their proposed returns are based on real estate ventures of one sort or another.

The government now has under consideration a set of regulations and licensing procedures to govern the setting up of investment companies. The lack of such regulations pertaining to private housing finance institutions is an impediment to their creation. That is, for the private sector to invest in setting up legitimate institutions for housing finance, they would have to feel that the public would have confidence. Without a strong regulatory framework and given the association of real estate with many of the recent scandals related to finance companies, that confidence would be lacking.

Concomitant with the need for a strong regulatory framework is the need for comprehensive follow-up supervision. That is, there needs to be an assurance that the firms that enter the field are indeed carrying out their activities in a way that is consistent with government objectives to provide finance to housing at an adequate level, in an effective manner and on a reasonable basis. Such direct supervision is now lacking even with HBFC, a government organization. It is also reportedly a matter of some concern across the board in the financial sector.

C Role of the House Building Finance Corporation

HBFC, as it is currently operating, tends to deter the development of a private housing finance system, is a drain on government resources and will soon no longer be financially viable.

HBFC is widely perceived by the public and in financial circles as an institution with too few funds to lend, that is saddled with high delinquencies, and is lending at subsidized rates below what the market could support. At the same time it is operating at substantial cost to government. It can be concluded that the current circumstances of HBFC as a housing lender do not present an attractive picture to private investors which might consider entering the field.

D. Construction Finance

A final factor bears heavily on the climate that would attract private investment into housing finance and is a necessary ingredient to a housing finance system. That involves construction finance. For long term lenders for housing to operate, there must exist the wherewithal for the construction of the housing to be financed, either developer-built housing, the probably long run solution, or housing built by individuals. Such financing is now lacking and must be handled by the individuals or developer from their own funds (HBFC provides a type of limited construction finance to individuals) or at high cost from informal sources. The commercial banks would be the logical source of such short term financing but for reasons enumerated earlier do not provide it.

Recommendations

After identifying the key elements which must be addressed to make the housing finance system more effective and to induce an expanded role for the private sector, recommendations to achieve this flow logically.

A. If lending for housing is to be perceived as a safe investment and one that can attract private sector endeavors, proceedings against delinquent borrowers and defaulters must be made more expeditious. It is recognized that this is a problem in other areas of lending. However, security for housing loans has its own unique characteristics.

The government should appoint a committee/commission to recommend specifically how proceedings against delinquent or defaulting borrowers for housing loans can be streamlined such that lenders will indeed lend with confidence. People must understand that if they receive a loan to finance their house and they do not pay, they will lose that house. This recommendation is made with the understanding that there will always be special cases where the borrower has unavoidable problems and that the lender needs to make exceptional provisions.

The other major area that must be dealt with to induce private interests to enter the housing finance field relates to the return on the loans and the cost of mobilizing resources. Lenders will have to pay for their funds and to this must be added the administrative costs. Right now, as pointed out earlier, HBFC's return on its loans is below the cost of raising funds in the market. HBFC should be required to increase to a market level the cost of those loans for which the private sector might compete. Otherwise it will discourage private lenders from entering the field or at the least reduce their scope.

B. The regulations about to be issued by the government for investment companies should be modified to include companies or institutions that could raise resources and lend long-term for housing. Alternatively, a special set of regulations should be developed for housing finance institutions. As they now stand, the investment company regulations are broad enough to encompass at least the basic provisions that would apply to housing finance institutions.

However, the nature of housing finance is sufficiently different to require at least certain specific regulations/licensing procedures to provide adequate safeguards to the public and the financial sector and to control entry of only reputable firms into the field. If a private housing finance system is to develop, it must have a clear set of guidelines and a regulatory framework in which it can operate. The government must then develop a strong and effective supervisory system to protect depositors, investors and borrowers and to ensure the continuity of the system. It would appear that this supervision could best be carried out by the State Bank as part of an expanded supervisory role for all financial institutions by the SBP which we understand is under consideration.

Finally, because of the long term nature of mortgage loan assets, and the probably shorter term nature of the liabilities which will finance these assets, there is a need for a liquidity facility to be available to private housing finance institutions. This facility should probably be within the supervisory framework suggested above i.e. the SBP.

C. HBFC - There are a number of alternative directions in which HBFC could go and which are being discussed: (1) It could become a completely market-oriented institution; (2) It could create a market-based subsidiary or division within HBFC while continuing to carry on its existing operations; (3) It eventually could become the regulatory/licensing/supervisory agency for private housing finance institutions including the provision of liquidity to such a system; (4) It also could take on the servicing of government programs such as the "Shelter for the Shelterless" program; and (5) All or a combination of these functions.

There is a need by government to clearly spell out the precise role that HBFC should play in an efficiently functioning housing finance system. The Asian Development Bank has embarked on a comprehensive and detailed study of HBFC which should provide recommendations on this.

However, based on a preliminary review growing out of this study the following suggestions are made with regard to HBFC:

- To put HBFC on a sound financial footing, HBFC should be allowed to write-off those loans which are clearly non-performing and which are not expected to be collected. To offset the write-off of these loans which are now carried as assets, it either should have certain of its government or SBP loans forgiven or it should have a new infusion of capital.

- There will always be a need for a government housing finance institution to implement government programs and deal with income levels below that where the private sector could operate profitably and, therefore, would probably not operate. This is a role that HBFC could play but it should do this in an effective and efficient manner. Over the long run it should not compete against private sector institutions. That is, consistent with announced government objectives, HBFC should not operate in areas that can be adequately addressed by the private sector.

- If the government does proceed to take the steps necessary to create a private housing finance system there would obviously be a transition period between such steps and the actual creation of new institutions During that period HBFC needs to perform on terms which could be profitably emulated by the private sector in those market segments where HBFC will phase out its operations. In other words, rates of return should be raised and the full extent of existing recovery procedures should be exercised.

D. The need to provide construction financing as a part of any effectively functioning housing finance system is difficult to deal with. Obviously, the government could direct the nationalized commercial banks to make a certain amount of finance available for this purpose. However, this would require a reallocation of credit ceilings.

Possibly a non-bank financial institution such as a new type of investment company could pursue such lending. Properly done, construction loans can be quite profitable at a reasonable rate.

There is clearly a need to create linkages between commercial banks, developers and housing finance companies to provide the structure for a complete housing finance system.

Conclusion

It is recognized that to implement some of the recommendations above requires specialized expertise. Where the GOP feels that such short term expertise could be useful, e.g. to draft specific regulations that would pertain to specialized housing finances institutions, this expertise should be made available.

The potential market for private housing finance institutions in Pakistan is huge. The need for an effectively functioning government supplement to private housing finance for the lowest income groups is also great. Together such an institutional framework could help significantly to meet the continually growing housing needs of Pakistan. The Study Team believes the implementation of the recommendations in this report can facilitate creation of such a framework.

I. INTRODUCTION AND BACKGROUND

A. Factors Affecting Housing Finance

There are four interelated factors which have a major bearing on the provision of housing finance in Pakistan and, hence, affect any recommendations to improve the system.

The first of these is the launching by the government of its One Million Houses Program to deal with shelter for the shelterless. The second factor is that estimates indicate that only 20% or less of the investment in new houses is financed through the formal sector. The third is that the government currently controls the amount and cost of credit for housing. The final factor concerns the government's increasing interest in expanding privatization efforts and has two closely related components. One is that the provision of formal housing finance is currently dominated by one institution, the government-owned House Building Finance Corporation (HBFC), a $700 million institution which gets its new resources entirely through an annual loan allocation from the central bank. The other is that the government is giving serious consideration to reducing the flow of its resources that have been allocated to parastatal institutions, including the HBFC, and setting up a framework to facilitate the development of a private housing finance system.

B. The Government's One Million Houses Program

This program was developed in 1987. Implementation of the first phase of the program started during the latter part of 1987 and was to continue throughout 1988. A new National Housing Authority was created to manage the program at the Federal level. The first phase envisions an ambitious effort to construct 150,000 housing units during the course of the year with details for all following years not yet developed. Funding for the first phase has been identified as follows:

1. 75,000 nucleus (core) houses will be built and provided as a grant to the Mustahqueen (the very poor) financed from the Zakat Fund, a religious-based fund for the poor. Organizationally there are about 37,500 local Zakat Committees in Pakistan and each one will select two Mustahqueen by ballot. The houses will be built in clusters on 2-3 marla plots in urban areas but on 7 marla plots in rural areas. The houses are expected to cost Rs 25,000 each for a total of Rs 2 billion.

2. Rs 400 million will be spent on the construction of 20,000 nucleus houses, also at an estimated cost of Rs 25,000 per house, to be provided to shelterless families in rural areas. Each beneficiary, to be selected by ballot, would have to make a Rs 5000 down payment and the remaining Rs 20,000 would be repaid over 20 years on a return free basis.

3. Rs 200 million will be used for upgrading 20,000 houses of eligible beneficiaries in rural areas by making available loans of Rs 10,000 to be repaid over 20 years on a return free basis.

4. Rs 150 million to provide loans of Rs 10,000 to eligible beneficiaries in urban areas to construct 15,000 nucleus houses. The remaining cost of the house and the land would be paid by the beneficiary. The loan would be repaid over 15 years on a return free basis.

Items 2,3 and 4 above will be financed from the Special Development Program.

5. HBFC would provide financing for 20,000 loans of Rs 10,000 each to beneficiaries in urban areas through streamlined procedures. HBFC will make the loans on its regular profit sharing basis and repayments will be in accordance with standard procedures.

That component of the 1988 program assigned to the HBFC constitutes only some 13% of the total program. However, it will have to be absorbed within HBFC's regular lending program and will impact on how HBFC will allocate and process its normal applications. But of even greater importance, the program as now constituted involves the provision of substantial subsidies in the financing of housing, in some cases outright grants and in others no interest loans. Although the beneficiaries being targeted for the government's programs are presumably shelterless, e.g. doubled-up, and at very low income levels, the existance of a major government program which is highly subsidized may have significant indirect impacts on efforts to develop a privately-oriented housing finance system at market rates. First, if, as is likely, the loans under the various subprograms are not vigorously collected, attitudes toward repayment of conventional loans will be undermined. Secondly, the tremendous gap between probable market rates (over 15%) and the zero rate of return on most of these loans may encourage feelings that market rates are "exhorbitant".

C. The Seventh Development Plan

The Seventh Development Plan becomes effective in the fiscal year commencing July 1, 1988.

There are two elements within the Plan which have a direct bearing on housing finance. One is that it is the policy of the government to shift an increasing share of the financing of development from government resources to the private sector. Among other things the State Bank of Pakistan which has provided below market financing to government-owned Development Finance Institutions (DFI's), of which HBFC is one, has indicated that these institutions will have to increasingly mobilize resources in the market place.

The second is that the Plan document indicates the desirability of considering the establishment of a private housing finance system similar to building societies or savings and loan associations. While the Plan does not spell out this proposal in detail it does indicate the general desirability of proceeding along such lines.

D. Other Donor Involvement

At the request of the Government of Pakistan (GOP), a World Bank mission visited Pakistan in early December 1987 to review the shelter sector and to assess the housing programs being developed by the government. Specifically, these programs are included in the One Million Homes Program for the Shelterless described in Section IB above.

In an Aide Memoire provided to the government at the conclusion of the mission (the draft final report was circulated in July 1988) the Bank identified land and the provision of infrastructure as the major problems confronting the housing sector. At the same time the Aide Memoire indicated that less than 20% of the housing units constructed in Pakistan are financed from the formal sector, the remainder being financed at high opportunity cost from savings, sale of assets, and informal borrowings. Further, that most formal housing finance comes from the HBFC at less than the opportunity cost of funds and is poorly targetted to those who would have the greatest need for subsidized credit. It concludes that HBFC should evolve toward being a more market oriented institution and that it should be possible to develop an overall system oriented toward the market.

Concomitant with its efforts in the shelter sector the World Bank is also developing a program to strengthen and develop the financial sector. Among other things, financial sector institutions in general are plagued by two problems which also have a specific bearing on the provision of housing finance through the private sector. One concerns the ability to successfully pursue delinquent borrowers and the resulting high delinquencies in financial institutions' portfolios and the other concerns the regulatory/supervisory framework which governs financial institutions. Both of these factors will be dealt with in more detail in following sections.

Finally, it should be noted that the Asian Development Bank is contemplating a program of major assistance to Pakistan in the shelter sector. In this connection it is doing a substantial study of HBFC including a detailed examination of its operations in the context of the current housing finance situation in Pakistan. Thus, that study will be complementary to the broader considerations of policy and institutional issues dealt with in the AID study and, relative to HBFC, a follow on to some of the problems identified.

E. The Context for the AID-Financed Housing Finance Study and Its Objectives

The AID Program in Pakistan, among other things, supports efforts by the government to increase the involvement of the private sector in development and seeks to provide assistance to strengthen the overall financial system. Consequently, the opportunity to assist in the development of a private housing finance sector is consistent with both of the above interests.

In this context, the USAID provided one consultant to the World Bank Shelter Mission in December. Following presentation of the World Bank Aide Memoire to the GOP at the conclusion of the mission, USAID and the head of AID's Regional Housing and Urban Development Office for Asia had follow-up discussions with the GOP. With the provision of credit identified as one of the constraints to an improved shelter sector as well as the need to improve HBFC's operations, USAID and the government agreed that AID undertake a more detailed study of housing finance in Pakistan focussing on government policies and the institutional framework affecting housing finance.

The objective of the Study is to identify and explore innovative approaches that could lead to the development of a dynamic, market-oriented housing finance system. The intent is to find ways that the GOP could shift a part of the financial burden of housing production from government resources to the private capital markets where it could be more easily carried.

The Study was carried out by a team of three housing finance analysts with field work conducted between March 26 - April 14, 1988. The Team visited Islamabad and Karachi for meetings with key government officials in the Ministries of Finance and Planning, the National Housing Authority and the State Bank of Pakistan. In addition, the Team carried out a review of the House Building Finance Corporation which included visits to zonal offices.

The Team also met with the Chairman of the Pakistan Banking Council, officials of four of the Nationalized Commercial Banks, and top officials in the National Development Finance Corporation, Bankers Equity Limited and the National Investment Trust. In the private sector discussions were held with various companies with an interest in housing finance including the Pakistan Industrial Credit and Investment Corporation. On the land and development side the team met with the Karachi and Lahore Development Authorities and the leadership of the Association of Builders and Developers, the latter very much concerned with the availability of credit for potential purchasers of housing.

The Team also met with some members of the World Bank's mission reviewing the overall financial sector. It has also reviewed the background work done by the Asian Development Bank preparatory to the major study it is doing of HBFC.

Finally, it has reviewed the current measures and policies of the GOP which have a bearing on housing finance including the draft of the Seventh Plan, the new regulations governing investment companies and an expressed desire for reforms within the banking sector.

F. Brief Description of the Terms of Reference

Following is a summary of the specific areas which are covered by the Study.

1. The current state of the housing finance system and its implications for the provision of shelter.

2. The key policies and programs of the GOP affecting the housing finance system.

3. A summary of the macroeconomic environment, especially the finance sector, affecting the housing finance system.

4. An identification of the current and potential providers of housing finance, both public and private, formal and informal, with a further identification of current and potential resource flows, the terms for mobilization of resources and lending and the needs of developers and purchasers of housing for financing.

5. An analysis of the structure by which the housing finance system is and would be controlled.

6. The legal and regulatory framework that applies to housing finance.

Based on the above analysis the Team has identified constraints to the development of an expanded housing finance system and identified a set of recommendations to deal with these constraints.

The complete terms of referrence is contained in Annex A.

It should be noted that this report should be read in conjunction with the two World Bank reports cited earlier, i.e. the Shelter Sector Review and the Financial Sector Review. Those reports were important sources of background for this study but no attempt was made in this study to repeat the comprehensive information covered in, say, the banking sector in the Financial Sector Review even though it is an important consideration in housing finance.

II. THE MACROECONOMIC ENVIRONMENT

This section reviews the performance of the Pakistan economy, particularly with respect to the growth in real income, the rate of inflation, the public finances, and the performance of the financial system. The trends in these economic forces imply a high and rapidly growing demand for formal housing finance and the need to meet this demand through the private sector.

A. Economic Trends

The economy of Pakistan is in a strong, long-term uptrend, associated with industrialization and modernization of agriculture and boosted until recently by growing remittances from nationals working abroad. Over the twenty years from 1966-67 to 1986-87, real GNP rose at a 6.2 percent annual rate. At the same time, the population was also growing rapidly, at a rate of 3.1 percent. On net, per capita real incomes rose by 80 percent over the last twenty years. Since the average household size increased by nearly 20 percent as well, GNP per household more than doubled to about Rs 37,000 per year, or about $2,150 at the current exchange rate.

The signs of this economic growth are everywhere in Pakistan. Cars and motorscooters are relatively numerous in the cities, school attendance and literacy are up sharply, basic nutritional needs are generally met, and life expectancy at birth and other measures of the quality of life have increased substantially. In fact, due to the apparent growth in the unreported sector relative to the reported sectors, actual growth has probably outstripped that measured by the official statistics. Thus, expanding educational, employment, and consumption opportunities for most, but not all, have been hallmarks of the Pakistan economy.

Inflation has also been a constant feature of the economy. Over the period 1966-67 to 1986-87, the Consumer Price Index rose by 570 percent, or at a compound rate of 9.1 percent. In comparison to other economies, particularly in developing countries, this is a reasonably moderate rate of inflation. Moreover, inflation has averaged only 6.5 percent since 1980-81. Thus, the economy is not racked by the problems of triple digit inflation, but neither has it adapted to inflation through extensive use of indexed or adjustable contracts. In addition, due to the current high level of the Government deficit, there is some evidence, and even greater expectations, that inflation will trend upwards in the near future.

B. Trends in Public Finance

The status of governmental budgets is important in a country where (1) Government investment in infrastructure and other types of capital are essential to continuing growth, and (2) financing government budget deficits is one of the major tasks of the financial system. Table II.1 shows total governmental expenditures as a percent of GNP, broken out into recurrent and investment (development) expenses. Financing for these expenditures is also indicated.

Table II.1
Government Financing As a Percent of GDP

	1980/81	1984/85	
1986/87Revenues:		16.9	
16.5	16.8		
Taxes	14.0	13.0	13.2
Expenditures:	22.9	24.9	26.3
Current Expenditures:	14.5	18.2	19.1
Interest	2.1	3.4	4.0
Development Expenditures:	8.4	6.7	7.2
Deficit:	5.3	7.8	9.0
External Financing	2.8	1.1	1.9
Domestic Financing	2.4	6.7	7.1
Bank	0.8	4.0	2.0
Non-bank	1.6	2.7	5.1

Source: State Bank of Pakistan

As is evident, the burden of deficit financing has been growing significantly. Notably, most of the increase has been financed through high rate non-bank borrowing, mostly in the form of various medium-term certificates. Much of the burden, though, has been borne by the expansion of credit to the government by the State Bank. Despite this, overall monetary expansion and, thus, inflation, has been kept at a moderate pace by permitting private credit to expand only at a controlled pace.

Taxation as a source of Government financing has been particularly weak. Overall, tax revenues have stagnated at around 13 or 14 percent of GDP. This is despite an allegedly progressive income tax system which is unindexed for inflation. The immediate reasons for this inelasticity of taxes with respect to GDP are (1) the heavy reliance on import duties, (2) the flat tax on corporations, which pay the bulk of the income taxes, and (3) the totally porous nature of the income tax reporting system. Not only are large portions of the economy (such as agriculture) exempt from taxation, but evasion among the taxable sectors is so pervasive that the recent report of the National Tax Reform Commission concluded that only those corporations (e.g., foreign or governmental) and persons (e.g., salaried employees) who could not hide their incomes paid taxes. Moreover, the typical salaried employee, and particularly a higher income employee, receives nontaxable fringes that may exceed his taxable salary.

In this context of massive tax avoidance and already excessive reliance on import duties, the ability to reduce deficits on the revence side of the budget is limited. Thus, there is increasing pressure to reduce direct or indirect burdens on the government, including the funding of the housing finance system and other governmental financial institutions that is currently borne by the State Bank.

C. The Evolution of the Financial System

The financial system has come very far in a short time, but it is only at the brink of certain key reforms which are essential for its further evolution and for the further development of housing finance.

There are twenty-two commercial banks, seventeen of which are foreign-owned. All five domestic banks have been government-owned since 1974, but previous to that time there had been twelve private commercial banks. Prior to nationalization, the banks were not aggressive in seeking deposits or in lending. In fact, the real level of deposits had been stagnant. Since nationalization, these banks have built an extensive system of branches (seven thousand in total) and offer a wide variety of deposits, from checking and savings accounts to five years or longer term deposits. As of June 1987, there were over fifteen million personal accounts, about the same number as there were households in Pakistan. Most of these accounts were quite small; over 90 percent were under Rs 10,000. In fact, there were only 61,500 personal accounts in total with more than Rs 100,000.

Such personal accounts, although small, constitute nearly half of all deposits in the banking system. Overall, the banking system reaches throughout the population, familiarizing the bulk of small savers with deposit-taking institutions. However, it has been relatively moribund as an innovator, because of a lack of competition and also tight ceilings on lending. Moreover, rates of return offered on deposits have been below those available elsewhere and often negative after accounting for inflation and the Zakat tax of 2.5 percent.

The last ten years have seen the creation or expansion of many other forms of financial assets available to individuals other than bank demand and time deposits. These include time deposits with certain Non-Bank Financial Institutions (NBFI), an extensive array of National Savings Schemes (NSS), post office passbook savings, some closed-end and open-end mutual funds invested in stocks, direct investment in stocks, and contractual savings scheme such as life insurance and provident funds. The NSS alone exceed in magnitude the personal deposits in the commercial banks.

Despite the large number of formal sector outlets for financial savings, there is a general feeling that there remains a large untapped potential for financial intermediation. The most recent evidence of this has been the rapid growth of unregulated finance companies. Some of the growth has been at the expense of formal financial assets and has been because of the extraordinary rates of return offered, but the general consensus is that these schemes are also simply attracting a portion of a huge pool of "black money" in Pakistan.

Money becomes "black" when it is generated through illegal activities (drugs, weapons, bribes, kickbacks) or through legal activities which go unreported in order to evade income taxes. The latter can include even the capital gains on the sale of a house, although capital gains themselves are not taxed. Sale prices are systematically under-reported in order to reduce transfer taxes and future property taxes or to hide an infusion of black money into the initial construction of the house. However, anecdotal information suggests that a large portion of black money derives from illegal activities, including the widespread selling of favors in a heavily regulated and government-controlled economy. It is also generally reported that black money has been growing relative to the overall economy. Further evidence of the importance of the black assets is the offering of bearer bonds by the Water and Power Development Authority (WAPDA), and bearer Certificates of Investments by Bankers Equity Limited (BEL). Most discussions of the potential of new financial assets presume that depositor anonimity will have to be offered.

On the liability side of the ledger for the household financial sector, households have a very small menu of formal consumer credit. Commercial banks are restricted in their consumer lending. Only 10 percent of the outstanding advances by the commercial banks were for "personal" uses in 1987, although undoubtedly some consumer lending is disguised as business finance. Much of the consumer finance may actually be simply loans to employees of the bank, since such reported loans nearly equal the personal advances.

In conclusion, the household financial sector appears to be capable of increased mobilization of funds on both the deposit side and the credit side. In fact, the general availability of housing credit potentially would free up a huge amount of wealth currently in illiquid physical asset (houses) which could be held instead in the form of liquid financial assets. This would permit households to better arrange their asset portfolios and encourage further financial deepening of the economy.

D. The Credit Allocation Process

Since 1972, both the aggregate credit expansion and the pattern of credit allocation across sectors has been controlled to conform to the country's development objectives. The ultimate controlling body in the government is the Ministry of Finance. However, the subsequent work of creating specific allocations within the context of government-determined priorities is performed by the National Credit Consultative Committee (NCCC), assisted by two related groups, the Agricultural Credit Advisory Council, and the Industrial Credit Advisory Council. Staffing for these groups is drawn from the Ministry of Planning.

The NCCC has representatives from the Federal and Provincial Governments, the State Bank, the Pakistan Banking Council (PBC), the six major development finance institutions (including HBFC), and the private sector (representatives from the Chamber of Commerce). The Chairman is the Governor of the State Bank.

The NCCC was necessitated by the decision in 1972 to control monetary expansion through credit ceilings, as well as the desire to better control the allocation of credit. Thus, the first step in creating a national credit plan each year is to determine a rate of growth in the monetary aggregates and overall credit that is consistent with a targeted growth in real income and a low-to-moderate inflation rate. They key variable is the level of M2, which consists of currency and demand and time deposits with banks. It does not include longer term deposits in the National Savings Schemes or the nonbank financial institutions such as NDFC. Thus, the monetary authorities are not concerned with the growth of relatively illiquid deposits collected by a nonbank financial institution lending to housing or other areas, whereas they do constrain the growth on conventional bank deposits.

The allocation of the permitted expansion of credit by major sector is determined with reference to objectives in the current five-year plan and the Annual Development Plan (ADP). First the credit needs of the government and public enterprise sectors are netted out, taking account of expected receipts from all of the sources, including nonbanking sources of financing. Notably, the ceilings on credit to government and enterprises are placed on the borrowers to choose a bank to borrow from and some reason for banks to compete with respect to service.

Individual banks themselves are given ceilings on credit for the private sector, apparently by the State Bank itself (not the NCCC). These ceilings are based on each bank's share of total domestic deposits and its foreign currency deposits.

The funding of each Development Finance Institution (DFI) by the State Bank is also determined by the NCCC. It appears that expected funding from non-government sources is netted out in fixing the State Bank's contribution. Thus, there is little incentive to seek outside funding unless the State Bank's contribution was reduced to zero, or is channeled only to certain segmented lines of credit.

In addition to the establishment of overall ceilings for credit, detailed ceilings and sometimes minimums are set for different types of economic activity. Extensive analysis is performed by the Planning Division of the potential for private investment in each sector and the need for further credit is determined, within the context of the Annual Development Plan. In most sectors, this exercise involves complex estimations of flows from many sources, including foreign currency loans, DFI financing, self-financing, equity contributions, etc.

E. The Cost of Capital

Financial markets in Pakistan are so highly regulated and segmented currently that a "cost of capital" cannot really be defined. There is no form of credit which is in ready supply at a market-driven price. Instead, there are many pots of money which can be tapped for certain amounts for certain purposes, generally at a cost determined by regulation or other administrative mechanism.

One of the most important reasons for this situation is the existence of tight controls on overall formal sector credit and on the sectoral allocation of credit. Because of these controls, banks do not have an incentive to maximize deposits at competitive rates, nor to seek outlets for funds. Similarly, rates of return required on loans are also restricted to keep credit "affordable" and to remove price as a major consideration in allocating scarce funds.

Another barrier to deriving the cost of capital is the absence of an auction or secondary market for short-term government debt, which could yield a benchmark, risk-free rate of return against which other rates could be based. Currently, short-term government debt is sold to the commercial banks for holding as reserves at the rate of 6 percent, a rate which appears to be lower than "market". In fact, savings deposits at commercial banks (non-PLS basis) earn nearly 7 percent.

The levels of rates of return on longer term loans and deposits seem to be influenced heavily by the fixed rates offered by the government for deposits under various national savings schemes (NSS). The most popular of these are the Khaas deposit accounts with a three-year term which pay a compound rate of return of 13.44 percent if held to maturity. Moreover, this return is free of income tax and of the Zakat tax levied for Islamic charitable purposes. Even one year Defense Savings Certificates pay 12.0 percent. These rates have been fixed at these levels since 1981, despite the tremendous variation in inflation and other economic considerations over the period.

Although the rates of return on the NSS are administratively determined, they may not be out of line with what is being required to mobilize the massive increase in domestic funds needed to finance expanding government deficits. The expansion in the deficit has probably both raised real rates of return and also raised expectations of inflation. If this is the case, then the rates of return required to raise funds for a private housing finance entity, even one with government backing, would have to be in the range of 9-10 percent for term deposits of three-to-six months, 12 percent for one year, and up to 15 percent for longer-term deposits. These are similar to rates being offered by the National Development Finance Corporation under its deposit schemes. Of course, any reduction in Government deficit financing needs or in inflation expectations could reduce these rates, as long as competing rates on NSS were also lowered. Even these rates are not fully competitive with the NSS, since they presumably would be subject to the Zakat tax. However, aggressive marketing of the deposit schemes could compensate for the unfavorable comparison as could the availability of the deposits in bearer form.

F. Government Policies Toward Financial Intermediation

If the financial system is to meet the potential demand for formal sector housing finance, steps must be taken toward a competitive market place for housing funds. This would involve, among other things, greater market determination of rates of return on deposits and loans. However, freer competition for funds by housing lenders implies a longer term breakdown in the administered allocation of credit for other sectors and, thus, could only be part of a major change in government policies with respect to greater competition in other financial markets.

Currently, all formal financing is directly or indirectly controlled by the government. Banks are given maximums for certain types of lending and minimums for certain favored loans. The rates of return on some loans are fixed at low levels. On other loans, rates of return are much closer to a hypothetical market rate, but are still limited, apparently to a maximum of 15 percent. The rates of return on deposits are not limited, but are determined by the restricted returns on lending. They are further limited by the high liquid reserve requirement of 30 percent. Thus, the flexibility of the banks in mobilizing funds is severely limited.

The flexibility of the government in raising funds has not been as limited. Thus, it has been spectacularly successful at increasing the nonbank lending to itself. However, the mechanisms chosen to accomplish this have not encouraged the further development of competitive financial markets. The major form of such borrowing has been through the National Savings Schemes, with certificates and notes marketed at high, administratively fixed rates of return. The rates of return on the various debt instruments are not systematically related to their characteristics with respect to their maturity, tax treatment, and depositor anonymity. Nor are there any market forces to assure such consistency.

Such competition as there is with the government in deposit taking is by some of the government-related Non Bank Financial Institutions (NBFI). For example, Bankers Equity Limited offers Certificates of Investment with various maturities. They are in bearer form, and are thus theoretically tradeable. The rates of return are based on the PLS system, with returns gradated according to the maturity of the certificate. The certificates are not tax free, nor are the returns as high as on the NSS. Yet, BEL is successful in raising deposits by offering better service to depositors.

The general tenor of the deposit raising activity of BEL and the report of strong excess demand to borrow at the current maximum official bank rate of 15 percent, confirms the potential for private financial intermediaries. Creation of private financial intermediaries has been announced by the government, but as yet no applications to initiate such firms have been approved. It was suggested to the Study Team that the primary purpose of such intermediaries would be as a secondary market for government debt. This is still far from general purpose private financial intermediation, but is a big step toward market determination of rates of return. Such market rates of return would be very useful in setting other rates, even if the other rates are administered.

G. Islamic Banking

Islamic banking, or non-interest based banking became widely adopted in Pakistan in early 1985. HBFC, however, instituted the practice in 1979.

It is applicable to both the asset and liability side of banking. That is, savings and deposit rates are based on the profitability of the financial institution and those instruments with a longer term share in the profits at a greater percentage. There are a variety of lending mechanisms e.g. lending with a service charge, lending on a mark-up basis, lease financing, musharika (where one party invests funds and the other contributes managerial skills), etc.

With regard to housing finance, the lender, HBFC, makes funds available to the borrower or partner. In addition to repayment of principal, the borrower pays a share of the imputed rental of the dwelling based on the percentage that his loan represents to the total value. As a loan is paid down, the percentage share of the imputed rent that the borrower would pay would obviously go down.

This payment of part of the imputed rental would represent the return to the lender on the use of its funds.

III SUMMARY OF THE HOUSING SECTOR

A. Housing Production and Conditions

The growth in real incomes and the growth in population has meant that an enormous amount of housing is being built in Pakistan. Presumably, the growth in housing units has at least matched that of households, or about 450,000 per year recently. Other units have been added to replace losses to the stock and to permit the occurrence of a normal level of vacancies. Thus, the gross flow of units into the stock may have been closer to 500,000. However, some of those units were probably provided by subdividing existing units, e.g., renting out part of a single family home, or by converting from nonresidential use. Thus, a guess as to the number of units constructed each year would still be about 400-450,000. In addition, many units have been upgraded, often substantially. (Note: Official documents referring to housing production quote much lower production of units. Presumably they are referring to urban housing only. Otherwise we cannot explain the discrepancy.)

Such prodigious production does not mean that there are no housing problems, only that households have managed to form at a rapid rate. In fact, there is a widespread perception of serious housing problems, particularly among lower income groups. This perception seems to be based on the large shortfall in formal sector housing production relative to household growth and an apparent rise in persons per room.

Since no data are available on the quantity or quality of annual housing production, or on short-term trends in housing conditions, the nature and magnitude of these housing problems are hard to specify. Census data for 1961 and 1981 suggests that there has been a trend toward both households and housing units getting larger (see Table III-1). These data have been quoted as showing an increase in crowding, with persons per room rising from 3.3 to 3.5. However, the World Bank has adjusted the data for the fact that the 1981 Census no longer considered kitchens to be a room, and found that the growth in room count had kept up with the growth in household size. In fact, in urban areas, persons per room fell sharply from 3.1 to 2.6. This was offset by the rise from 3.3 to 3.6 in rural areas.

Table III-1

Household Size and Unit Size

Year	ALL	URBAN	RURAL
		Persons per Household	
1961	5.51	5.84	5.41
1981	6.52	6.71	6.44
		Persons per Room	
1961	3.3	3.1	3.3
1981 - Unadjusted	3.5	3.2	3.6
1981 - Adjusted	3.3	2.6	3.6
		Rooms per unit/household	
1961	1.7	1.8	1.6
1981 - Unadjusted	1.9	2.2	1.8
1981 - Adjusted	2.0	2.6	1.8

Source: 1961 and 1932 Census of Housing, Census of Population.
taken from World Bank report

Thus, it appears that the increases in real incomes have permitted a significant expansion in housing unit size, and, in some cases, a net decrease in persons per room. The 90 percent increase in income per capita over the same period (1961-1981) should have led to a greater decrease in persons per room if not offset by other factors. One major factor is that the price of developed land has shot up, pushing up the real cost of housing by all accounts (the Housing Price Index does not reflect this since it is rooted in housing construction costs).

The increase could be due to slowness in developing land. Some evidence on this in the urban sector is the number of lots produced by city development authorities, and the growth of the informal sector in land development, i.e., katchi abadies. Evidence is that plot production has been at a high level. However, there are clearly many developed plots which remain unused and there is annecdotal information that the rate of nonuse is rising as vacant land has been an evermore popular haven for black money. On the other hand, growth of katchi abadies seems to have slowed, although this could be because of a shortage of suitable locations.

An equally likely source of the major increase in land costs has been the rapid growth of the population in general, and in particular the urban population. In cities throughout the world, the rapid growth in the population of a city and the expectation of further growth leads to higher land prices, as the premium for accessible and desirable locations expands in the face of growing demand. Thus, it is entirely possible that the long-term rise in land costs in Pakistan is primarily related to the strong expectations that the urban areas are growing toward very large sizes and the further expectation that real incomes will continue to expand. For both of these reasons, it is perfectly reasonable that land price advance.

The population growth has not been as rapid in rural areas: however, rural housing markets have not benefitted from the activities of formal land development authorities. There seems to be a general view that it is very difficult to expand housing in rural land markets because of the few number of landowners and the lack of interest in selling land. On the other hand, it is not clear that land costs would be a major factor discouraging growth in housing consumption.

B. Katchi Abadies

Katchi abadies are illegal squatter settlements concentrated in the larger cities in which most residents do not have established tenure rights. A 1985 survey cited by the World Bank in its report indicates that some 5.5 million people lived in 2302 katchi abadies which were surveyed, 87% on state-owned land. The province of Sind had most of the katchi abadie dwellers, 3.4 million, and of these, most were in Karachi. An earlier survey put the katchi abadie population of Karachi at 37% of Karachi's total population and it is estimated that about 20% of the total urban population lives in katchi abadies.

The characteristics of katchi abadies do not differ from that of squatter settlements the world over; illegal occupation of land, housing of generally low quality, infrastructure that trails considerably behind the growth of the community as a whole, and poor community facilities such as schools, health clinics, etc. What does characterize many of the katchi abadies in Karachi, however, is that employment levels appear reasonably good.

Another characteristic which bears on how katchi abadies can be developed, particularly in mobilizing community self help efforts is that much of their growth results from in-migration of people from other provinces and Bangladesh. This has resulted in a diversity of ethnic groups who tend to congregate together with their own values so that any attempt to develop the communities must take these divisions very carefully into account.

A final characteristic of katchi abadies in Karachi, particularly the newer and larger ones, which bears on how to deal with the problem, is that professional land encroachers have actually developed the land in many cases. People paid for the right of possession of a plot of land; that is, there were informal sales of land even though it was not legally accounted for or registered. These professional "land grabbers" would illegally take over an area in an undeveloped section of Karachi, presumably on the outskirts. Such groups actually carried out a type of unofficial urban planning, marked out plots and "sold" them to "squatters". They would lay out streets and in come cases they even left some land in an area for public purposes, thus making their development more desirable. Some groups probably even hired urban planners to plan such communities.

When a group acquired an area in this manner it would sell the initial plots in a sort of scattered way throughout the area. The first buyers were obviously hesitant to lay out much money for a plot with no infrastructure, no people. So the "sellers" provided plots to these original inhabitants for a very cheap price, almost free, because they wanted to get people in. As families began to move in, the "group" would then pressure the Karachi Water and Sewer Board (KWSB) to provide water.

The next step was to get the Karachi Municipal Corporation (KMC) to put in some access roads.

The result is that the prices of the plots increase, some times dramatically, as the demand for residency increases. The "land grabbers" continue to fill in the area until there is a small settlement. Incremental development continues to occur with sales of plots in phases, mutually supportive, and prices continuing to go up.

The last step is to develop some land as commercial areas and this is when "regularization" comes in; i.e., KMC is approached to "regularize" the area legally and designate some areas as commercial which were held by the "land grabbers".

In some katchi abadies the original squatters paid as little as Rs 10 per plot; today the price can go over Rs 15,000 per plot! Who could pay these prices? Some families have had members who worked in the Middle East. They return and want to stay in the same area. Or there were remittances. Employment in many katchi abadies is fairly high. Therefore, there are some good houses. There is also probably some turn over of occupied plots but it is probably not common. Say a man gets one of the early plots in an area at a low cost, then needs money to, say, marry-off a daughter. He might sell his house for a good profit and try to move further out. There is also incremental house building as the squatters find jobs (or because of Middle East earnings cited above).

This pattern of development of katchi abadies suggests: (1) the need for more formal sector private land and housing development; and (2) the capability of the private sector to pursue such development. Such development, as well as the regularization and upgrading of housing in current katchi abadies, would greatly benefit from expanded housing finance.

C. Housing Finance

Formal housing finance is directly controlled by the government both in quantity of credit available and in terms of the loans. To arrive at credit allocation it estimates total projected investment in private housing and assumes that 66 percent of that amount will be self-financed. In addition, construction expenditures and loans for staff housing by the government, the Central Bank, and the commercial banks are estimated and netted out to arrive at a gross lending level for HBFC. (Loans by private employers for housing are not included.) Such lending totals about 8 percent.

The annual cash contribution of the State Bank to HBFC is further derived by accounting for projected recoveries on existing loans, any other sources or needs for funds and any amount due to the State Bank on previous loans by the State Bank. It appears that the gross loan by the State Bank is based on projected net needs for loanable funds, assuming two-thirds self-financing. Thus HBFC is funded by the SBP to provide about one-fourth of gross formation of owner-occupied housing with another 8% provided as indicated above.

As an aside, it should be pointed out that the actual financing share for housing provided by the HBFC is much less than the above would indicate. The base number that is used by the government is the estimate of total construction expenses for new houses in the coming year. As argued above, this estimate is probably a low one, and, in addition, it does not include anything for upgrading of existing homes. Of course, from the point of view of the households buying housing, the price of land should also be included. In addition, since many households purchase existing homes, the financing needs for such purchases should also be accounted for. In this case, it is likely that the overall amount of credit available for housing purchases is on the order of 10 percent of that provided by self-financing. Moreover, most formal lending is used for homes of above average costs, since (1) it is primarily urban, and (2) it is solely for new housing. Thus, while most homes are totally self-financed, most of those receiving HBFC financing are still over one-half self-financed.

In 1986-87, estimated gross investment in private dwellings was about Rs 8 billion. If 66 percent of that is self-financed, then that leaves Rs2.7 billion to be financed through the formal sector. If government and bank lending to employees, plus a credit allocation of Rs 190 million to commercial banks are accounted for, it is quite reasonable to conclude that a gross funding level of about Rs 2 billion would be appropriate for HBFC. This determination implied a net cash contribution by the State Bank of Rs 1.45 billion. Any variation in actual recoveries is born by HBFC. Notably, past loans by the State Bank are essentially forgiven as they come due since the figure for net cash availale is the target.

Under this methodology, HBFC has no incentive to seek other sources of funds. Because of the below market nature of its returns, as well as its poor recovery record, HBFC has no other options than to borrow from the State Bank anyway. However, it is a major concern whether any additional housing lending by a new institution would be netted out by HBFC's funding. In this case, only once such institution's lending came to exceed the current lending by HBFC would total housing finance be expanded. Moreover, if the new institution financed resales of housing, the gross amount of housing finance required would have to be refigured.

From either the perspective of the average household or from the aggregate economic perspective, such formal finance is hardly making a difference. HBFC originates about 20 to 25 thousand loans each year, in contrast to the average of at least 400,000 new housing units being constructed. This is not surprising since the majority of new households are in rural areas, which are largely unserved by HBFC.

Among the 100,000 or so new units being constructed in urban areas, about 20 to 25 percent of the purchasers are receiving HBFC loans. Since HBFC funding is supposed to be about one-quarter of the aggregate expenditures on the construction of new housing, one might expect that the concentration of such funding around a relatively few households would imply generous funding for them. Even so, it appears that the typical recipient of HBFC funds must treat them as solely supplementary to other sources of financing. First, land must be financed separately, since HBFC loans do not apply to land. Of course, if land is purchased directly from a development authority at its below market price, this is not a major problem. Otherwise, though, land costs appear to be about one-third of total house costs.

Second, formal sector construction costs are a minimum of Rs 150 a square foot. Even the stripped down houses in Surjani Town, a Karachi Development Authority (KDA) development on the outskirts of Karachi cost Rs 130 per incremental square foot. In contrast, HBFC funds only Rs 90 a square foot. Thus, by the very nature of HBFC funding constraints, only about one-third of the cost of a new home can be formally financed (half of the construction costs and none of the land).

This analysis accords with casual observation. A typical HBFC loan is for Rs 70,000-80,000 to a middle class household that is buying a house costing about Rs 200,000-250,000. The 70 percent financing provided at Surjani Town in Karachi is the rare exception, solely due to the low cost of land and of construction. For most HBFC borrowers, while the loan provides the last 30 percent or so of needed financing, the first 70 percent must be obtained from other sources. Of course, those who are buying an existing house are not eligible for any HBFC financing.

How can it be that HBFC is funded by government at 25 percent of estimated new housing construction, yet only 5-7 percent of new home buyers get loans, and those receive only 50 percent or so of the construction costs of their new homes? Obviously, HBFC-funded housing must be much more expensive than the cost of the average new dwelling unit. This is true by rural house price levels, and it is probably true in comparison to an average urban house price, including informal sector construction. As an educated guess, HBFC is funding about half the construction costs for about half of the middle-class buyers of standard formal sector new housing in urban areas.

As an aside, it should be noted that the estimates of annual investment in the ownership of dwellings included in the GNP calculations, and on which HBFC's funding is based, is clearly significantly less than the amount of new housing that is being constructed. The likely source of the bulk of this differential is the large amount of self-constructed housing in rural areas that does not enter into GNP. This may explain the discrepancy between the estimated 1.3 percent of GNP spent on new housing construction in Pakistan and the 3.5 percent reported in the United States where the household growth rate is about the same. In addition, though, the overall investment in residential construction may be underestimating the amount of upgrading that is going on, much of which may also be self-constructed, too. Despite the fact that much of the housing activity in the country includes self-constructing labor, there is a need for financing the building materials and such financing could also foster a greater growth in construction specialists, rather than the current emphasis on doing-it-yourself.

In conclusion, there appear to be twin blockages on the supply side of housing. First, land is scarce and expensive. To a great extent, this is due to the tremendous pressures of population expansion and the long-term expectation that cities, such as Karachi, will be growing both rapidly and extremely large. However, it may also be due to an inability by development authorities to keep up with the demand for serviced plots and to the use of vacant lots as an investment medium.

Second, housing finance is scarce and expensive with most housing self-financed at high opportunity costs in terms of foregoing consumption or investment in other opportunities. Here the blockage appears to be one of a shortage of institutional, legal, and economic infrastructure for financial intermediation towards housing. These factors are slowing down the improvement in housing that should be accompanying the expansion of real incomes.

It is likely that the impact of the rise in land costs on housing consumption has been compounded by this lack of housing finance. In fact, what housing finance that is available through HBFC does not cover land costs at all. In addition, HBFC has a fixed amount that it will finance per square foot of covered area, an amount that has not been changed for some time. Thus, increases in the cost of land and construction must be fully self-financed by households. Increases in the amount to be financed that exceeds the rate of growth of income imposes very high costs on potential home buyers.

D. Government Policies and Programs In Housing

The Government of Pakistan up until last year generally had not accorded housing a high priority, relative to other aspects of economic development. Reflecting this priority has been the very limited amounts of credit which have been allocated to the housing sector.

However, the governments Five-Point Program includes several components for housing for very low-income households. These include (1) the Seven Marla (rural) and Three Marla (urban) programs for giving small plots to low income households and (2) the Shelter for the Shelterless Program, which has encompassed the construction and granting of completed nucleus housing and the provision of interest-free loans for housing improvements or new construction, as well as the provision of regular loans by HBFC on an expedited basis for new construction. Additional efforts in the proposal stage include relatively small low-cost loans for upgrading or new construction.

All of these programs reflect a special concern for improving the housing opportunities of the low income. There are a number of shortcomings to the programs that need not be reviewed here. But what is notable is that although many of the loans are provided on a loan basis, albeit return free, the close identification of the loans with the government, as well as the income characteristics of the recipients, make repayment unlikely. Whatever the other effects of these programs, they generally are not conducive to the development of a private, market rate housing finance system capable of achieving high recovery rates.

Another on-going effort to improve housing conditions is the Katchi Abadi Upgrading Program. Upgrading usually involves the establishment of legal tenure, as well as the provision of municipal services. The World Bank and the Asia Development Bank have financed major katchi abadi upgrade programs. The government's Five-Point Program has made upgrading a priority also, and established a National Katchi Abadi Directorate in the Ministry of Housing and Works. To the extent that such programs clarify and establish title, they will expand further the demand for formal sector housing finance, both for improvement and for resale.

Despite these significant programs aimed at improving housing and public services among the poor, there is no stated policy with respect to housing or housing finance in general, or even about housing for low-income households. The Study Team was informed that there is a draft of such a policy statement, but was unable to obtain a copy of it. Of particular interest is whether the policy statement goes beyond the needs of the poor to comment on the perceived housing crisis among lower middle class households.

It is notable that a new government agency, the National Housing Authority (NHA), has been created to implement the Shelter for the Shelterless Program. It is primarily an administrative and design body for overseeing the Shelterless Program. The responsibilities of the NHA could be expanded to other housing related activities, including such activities as land development or determining housing development standards. However, since the NHA appears to have little or no expertise in housing finance, it has apparently had no role to date in discussions relative to creating or supervising a private housing finance system. In fact, it is problematic how well it will oversee the recovery of interest-free "loans" made under the Shelterless Program. (Subsequent to the completion of the report it was indicated that the Habib Bank, one of the NCB's, would handle collections.)

E. Land Development and Infrastructure

Most formal sector urban land development is undertaken directly by the municipal urban development authorities or in conjunction with house building societies (discussed below). There appears to be limited capacity for extensive private development, partly because so much land is owned by the government and partly because of the difficulty of financing and obtaining extensive required approvals. Thus, formal land development is subject to all of the inefficiencies and inappropriate design and pricing policies often associated with government operations. (At the other extreme are the katchi abadi developments, through which the private sector expeditiously provides large amounts of poorly serviced land.)

The development process itself appears to be fraught with delays and uncertainties, partly associated with a chronic lack of funds. The installation of road and water capacity is not always well coordinated with development plans. Moreover, the supply of developed plots is completely unresponsive in the shortrun to swings in the demand for housing.

However, there is an interesting feature of urban land markets that is quite important for urban housing markets. At any moment, there are a large number of plots which are serviced, but not built on. Presumably, they are being held as an investment. Such widespread speculative holding of land is rational in urban areas that are rapidly growing, such that future uses of land will be more highly valued than current uses. It also may be economically rational if vacant land is a more liquid investment than a house. This situation will tend to occur when, as is the case, it is much more difficult to finance the full cost of a house and land, than just the land itself or when it is difficult to use the land for rental housing.

Since is is economically rational to hold land vacant when these conditions obtain, and since the conditions do hold, there is a large amount of vacant developed land. Improving the housing finance system and the private rental market will go far toward solving this problem. Alternately, policies such as charging property taxes on the market value of the land would raise the carrying costs and promote more rapid utilization. On the positive side, though, it must be recognized that the supply of developed land can be drawn into the market (at least the middle class market) at some price and, thus, serves as a buffer stock to meet fluctuations in the demand for developed land, fluctuations which could not be met through the cumbersome mechanism of the development authorities.

Another notable feature of land development in Pakistan is the windfall nature of the allocation of developed land. Most public land that is developed is sold at prices substantially below the market price. Generally, allotment is through a lottery. However, in some cases, such as the Surjani Town development in Karachi, the land is allocated only after a house has been put on it. In this case, the below-market nature of the pricing was handled on a first-come, first-served basis.

This kind of pricing is partially defensible in the case of seeking subsidized housing for low-income households. But it applies to middle-income housing, as well. In this case, the loss of the potential for additional revenue for further development activities is simply painful to observe.

F. Housing Construction

One of the few components of the housing system currently run on a competitive basis is that of actually building homes. In most of Pakistan, home building is not as highly developed an industry as in the industrialized countries. Most housing is either self-constructed or built by the owner acting as a general contractor. Only in Karachi, Lahore, and some of the other large cities, are there private developers who construct housing for sale, or act as general contractors for individuals.

Many of these private developers belong to the Association of Builders and Developers (ABAD), headquartered in Karachi. Currently, there are 102 members of ABAD. ABAD estimates that there is a potential for about 250 members based on its knowledge of the number of developers and builders operating in Pakistan. This can be contrasted with the 45,000 builder members of the National Association of Home Builders in the United States, where housing production is no more than three times the amount in Pakistan, but where most of the production is done by general contractors.

Probably the major reasons that developers are not more prevalent is the lack of construction financing and the difficulty of assembling land for large-scale private development. As discussed below, developers must rely on HBFC loans and on staged pay-ins on presold homes for most construction financing. For land development, only black money at exorbitant rates is available. Similarly, individuals building on their own plot tend to do so only over long periods of time, as they accumulate their required savings.

Greater prevalence of construction finance and permanent financing would expedite construction of housing, both by developers and individuals. It would permit the sale of land by development authorities to developers at competitive rates (given whatever constraints the authority imposed on the use of the land) and the rapid completion of development schemes. It would also foster the use by individuals of general contractors specializing in housing construction.

G. House Building Cooperatives

Housing cooperatives are an important contributor to the housing sector but their role is in the acquisition and development of land and building of houses, rather than in housing finance. A brief report from 1985 indicates there were at that time some 1478 active house building cooperative societies operating throughout Pakistan, with the great majority (1042) in Sind province with over 470,000 members.

Karachi has been a center for house building cooperative activities. Large areas of the developed part of the city are known by the names of the house building cooperatives that originally developed them, such as "Karachi Administration Co-operative Housing Society," "Defense Officers Co-operative Housing Society", and the "Public Employees Co-operative Housing Society". The names indicate that employment is a strong factor in the establishment of the cooperatives. There does not appear to be any practical limitation to the subsequent sale of these units to individuals who are not employed by the original employer. If the USAID employees group is any example, and its statutes were taken from standard models, the usual requirement is for some affiliation only during the formation stage of the cooperative.

In Pakistan, house building cooperatives are formed by people who want to obtain their own houses, but who do not have the land and the approvals for a housing project. The groups receive recognition from the government and are able to collect money from their members regularly as they pool their resources to buy and develop land. The cooperatives apparently do not obtain any financing other than the monthly contributions from their members, so the process can take many years before houses are built and occupied.

Once there is enough money to begin the project, the cooperative may contract with a builder to start construction. The members must contribute their own resources to build their own houses, but the cooperative structure seems to allow this process to move at an easier pace. In any case, the land and houses are not held by the cooperative for all the members. Once the houses are completed there is no longer any reason to continue the cooperative, except to make additional improvements to the area, such as sidewalks, green areas, and other amenities outside the building lots of the members.

The Team talked with members of the housing cooperative composed of employees of the USAID mission in Islamabad and it is useful to describe its activities by way of example. This cooperative was formed several years ago as a vehicle to allow local employees to acquire and develop land in Islamabad where they could build their own houses. It seems that an earlier cooperative had been formed by local employees of the US mission, including some at USAID, but that cooperative was restrictive in its membership. The great need for housing made it possible for more than one house building cooperative to be formed from this relatively small employment base. The USAID employees group has over 200 members and meets regularly.

At this time the cooperative is looking for a suitable site in either Islamabad or Rawalpindi. The bureaucratic difficulties these groups encounter is demonstrated by a problem now facing this group. It is organized in the Islamabad district, in which it has found that property values are perhaps too high for its members to afford. The property values in Rawalpindi are more affordable, but the cooperative will have to change its registration, at least, in order to purchase land there because it can only legally operate in the district in which it is organized.

The Federal Bank for Cooperatives (FBC) channels government funds to agricultural cooperatives throughout the country. Housing cooperatives do not play any part in the lending program of the FBC.

H. <u>The Rental Housing Sector</u>

The Pakistan census reports that, in 1980, 78% of all housing units were owner occupied, another 8% were rented for cash, and 14% were rented out at no cash price. Even in urban areas, where owner occupancy is less common, 68% of all units were owner occupied, a greater share than in most developed countries. We were told that this dominance of owner occupancy reflects the difficulties faced by landlords in raising rents in the context of rent controls and evicting tenants for nonpayment or other reasons, due to strong tenant protection laws. The greater problem seems to be that of eviction proceedings. Indeed, eviction cases seem to take 8 to 10 years, longer than foreclosure cases.

Aapparently most of the rental stock is older, with relatively few new multifamily units being rented. We heard of many units sitting empty rather than being rented out and thereby perhaps becoming no longer available for the personal use by the owner.

These difficulties in enforcing rental contracts have significant ramifications for the housing situation in Pakistan. Not only are units sitting vacant, but serviced land is vacant because it cannot be used for housing until the owner is prepared to occupy it himself.

There are also important ramifications for housing finance. Whereas in the United States, households at the lower income levels have feasible housing options other than owning, in Pakistan they commonly must seek owner occupancy. This means that a broad, effective housing finance system must attempt to serve all income levels.

Instead, it would be economically more sensible to have private investors who can better bear the risks and financial burdens of developing and owning housing to provide rental housing. This would require the creation of a private finance system for rental housing as well as for owner occupied housing. The system would have to differ in a number of important ways including underwriting standards, from the financing for owner occupancy. However, such a rental housing finance system is probably not viable or needed until the basic difficulties of tenant/landlord relations are acted upon.

IV THE CURRENT HOUSING FINANCE SYSTEM

A. Introduction

According to official estimates, as stated earlier, less than 20% of all investment in new housing in Pakistan is financed through formal sector institutions or mechanisms. The remainder, financed outside the formal system, includes not only housing units self-financed or financed by money lenders in squatter and slum areas but also standard housing, some of it very expensive, financed by individuals through savings, sale of jewelry or informal borrowing.

The formal financing is dominated by the House Building Finance Corporation (HBFC) which probably supplies about 80%. Most of the rest comes from commercial banks (10%) or employers (10%), including the government, but data is practically non-existent on the latter.

Up to now the government has used the HBFC as its means to contribute to the financing of housing. However, with the advent of the Shelter for the Shelterless Program, the government may play a role in directly financing housing loans through the National Housing Authority.

B. Controls and Policies Affecting Housing Finance

1. Regulation and Supervision

a. The Government Framework

According to the World Bank Financial Sector Review, the commercial banks and the specialized banks e.g. Agricultural Development Bank of Pakistan, are supervised and regulated by the SBP under the Banking Act but the Non-Bank Financial Institutions (NBFIs), which include HBFC, are supervised and regulated by the MOF. With nationalization in 1974, the Pakistan Banking Council (PBC) was created as a government organization to look after the interests of the five nationalized commercial banks (NCBs) and to perform certain supervisory functions with regard to these institutions as well.

Supervision of the banks grows out of regulations contained in the Banking Act, the SBP's Credit Control Manual or specific instructions issued by SBP. With regard to NBFIs, SBP issues some regulations but the regulatory framework is set-up by the MOF, although each of the NBFI's is governed by the statute by which it was established.

With regard to the possible creation of new institutions that would engage in lending for residential housing, the key organizational units in government are the sections under the Joint Secretary for Internal Finance, the Joint Secretary for Investment, which deals with capital issues and the SBP.

b. Regulation and Supervision of Housing Finance

HBFC is governed by the House Building Finance Corporation Act of 1952 which establishes the regulatory framework under which it operates. Direct supervisory responsibility rests with the MOF and the MOF, represented by the Joint Secretary for Internal Finance, is a board member of HBFC.

In fact, little direct supervision of HBFC is actually exercised and this is true not just of HBFC but other NBFIs as well, apparently because of staff limitations. For instance, the audit of HBFC's books for the fiscal year ending 6-30-86 has yet to be finalized because of unresolved issues (see section on HBFC) and there is no formal management reporting system by HBFC to MOF. MOF does exercise an indirect supervision and overview of HBFC by virtue of its position on the board. Such indirect supervision is also carried out by SBP, also by virtue of its board membership but also because it is the source of HBFC's resources each year through a new loan. There is one major unresolved issue which seems to result from this lack of direct focus on HBFC; that is, HBFC is technically insolvent if its nonperforming loans were to be written off (see again, section on HBFC).

With regard to commercial banks, as stated above, the SBP carries out supervision and, in the case of the nationalized commercial banks, which are the only commercial banks which can lend for housing, the PBC also exercises certain supervisory functions. Lending for housing is such a small part of the NCB's activities, however, that the degree of supervision for this is probably not even a factor.

There has been some discussion of extending to the SBP the supervisory responsibility for all financial institutions, presumably growing out of the World Bank's work in the financial sector. There appears to be a real need for some modification to the existing system if HBFC is a representative example.

c. The Private Finance Company Problem

Over the past year private investment companies have sprung up in Pakistan promising returns of anywhere from 3% to as high as 8% or more per month. Apparently they have been able to attract a significant amount of rupees from thousands of Pakistanis including pensioners, white collar workers, government civil servants, people working in the Gulf but also including people from lower income levels. Some of the companies have closed up within a short period and made off with the savings of some of their investors. Some of these companies credited the promised returns or actually paid them out for a few months out of new investments but then simply closed their doors and disappeared with the money.

The government has begun to take some actions. The SBP filed criminal complaints against 26 companies in February for violation of the Banking Companies Ordinance and the MOF is now engaged in an active campaign against such companies. But in many cases the actions are too late to prevent people from losing their savings. The

SBP can actually take action only if the Banking Companies Ordinance has been violated but cannot do anything if the companies are simply bilking the public or even violating corporate law.

Apparently one approach is that the companies claim they are not taking deposits from individuals but instead are taking loans from them or issuing shares on a profit and loss sharing basis. Nor are they advertising for deposits but are receiving the loans by way of word of mouth. The companies range from small and medium-sized companies throughout the large cities to large ones with a number of branches. To compound the problem, there are some legitimate finance companies which do pay regular returns, some of them for a number of years. The recent surge in such types of finance companies follows not too far behind a similar scandal in 1979 when almost 200 unauthorized companies, some created by well known figures, defrauded the public.

How can these companies attract such large resources? Disaffection with dealing with the bureaucracy of government savings schemes, the low rates of return on savings and term deposits at banks (the NCB's, in any event, are actually "shedding" deposits i.e. discouraging accounts because of credit limitations by the SBP), the parallel or black economy where significant amounts of money are looking for outlets outside the formal system and the rapid run-up in real estate values which many of the finance companies purport to cash in on.

Partly to counteract these companies, the MOF, through the Controller of Capital Issues, issued Statutory Notifications in July 1987 setting forth the terms and conditions for the operation of legal, supervised investment finance companies. These are a special set of regulations different from the Companies Ordinance. It followed an announcement some two years ago by the government that it would allow such companies to be created locally. Such companies in the first instance must be registered as a public limited company under the Companies Ordinance. The government then solicited applications with a cut off of 11-30-87. Forty three applications were received, all of which are still pending. (Note: Several had been approved by September 1988.)

There are very stringent requirements for these companies e.g. they must have Rs 100 million of paid-up capital at the time of the application cut off; the top management people have to be specifically identified. An opinion expressed at the central bank was that these institutions are like investment banks, not institutions who would engage in mortgage lending.

d. The Impact of New Regulations on Housing Finance

In discussing these regulations with the Joint Secretary for Investment in the MOF (who is also the Controller of Capital Issues - CCI) the Team was told that when the new regulations were being framed it was specifically felt that the companies should not go into housing finance.

The Controller of Capital Issues is now in the process of screening applicants against the criteria set forth in the regulations. One reason cited for the delay is that the supervisory machinery is not yet in place and government is waiting until that is done.

Although the new regulations do not appear to restrict companies from investing in real estate, the CCI said the registrar would not, at the present time, license a company that proposed to engage in real estate financing. Companies organized under the Companies Act are not regulated very strictly. But if a company is involved in financing there are certain areas like the debt-equity ratio and others where it is regulated closely. There is also a strong feeling that adequate safeguards be provided for the public.

The main objectives of the new regulations for investment finance companies included facilitating the development of financial and capital markets, development of a secondary market and mobilization of savings Also, to induce such firms to engage in long term lending for industrial financing. The thinking, however, was that it would be inappropriate for these companies to go into specialized lending for real estate, despite the fact that there is now no corporate framework which permits funds to be raised and then flow into housing. The Companies Act does not permit real estate investments.

Another financing vehicle, the modaraba, is an Islamic financing concept which can legally be used to finance any endeavor; it doesn't exclude real estate. A modaraba is an agreement where one party invests funds and the other party puts in managerial efforts or skill to carry on a business. It may be for a specific or multiple purpose and may have a specified time period or be open ended. The partner who furnishes the management must put in a 10% share of the modaraba. Profit is shared in an agreed ratio and the modaraba certificates are transferable. Modarabas must be registerd under the Modaraba Ordinance of 1980.

In practice, however, the government is not approving any new moderabas to finance real estate. In a successful and well known modaraba formed by Grindlays Bank in 1987 to carry out the leasing business, Grindlays

Bank and one of its subsidiaries took up 20% of the paid up capital of Rs 100 million, the public took 72% and the National Investment Trust took 8%, the capital being denominated in certificates with a par value of Rs 10. Real estate activities were specifically excluded.

The Controller of Capital Issues has the power to issue rules for organizations operating under the Companies Act. In theory rules and regulations could be developed for housing finance companies. The CCI stressed that there has been no model of a housing finance institution developed yet. To get approval for private housing finance institutions would require a specific policy decision by "government". As stated, the new regulations by implication exclude housing finance. Although the new Seventh Plan (and the Sixth as well) has expressed the broad objectives of fostering the creation of savings and loan associations, there have never been specific proposals developed.

It would appear that specific legislation covering housing finance is needed with a specific mandate from government. This should be followed by a strong regulatory framework and supervision.

Where would the impetus come from to develop such regulations and who would supervise? This is clearly a key issue. One approach would be that the National Housing Authority, as the agency likely to be responsible for housing policy, should sponsor the idea of creating private housing finance institutions. There is a view that you need to have "housing interests" behind the idea. Another possibility to develop the conceptual framework is the Ministry of Planning which has been responsible for putting forth the original concept of savings and loans in the Plan. This way you could back up the proposal with the objectives of the Plan. It would appear, however, that the development of detailed regulations would have to come from the MOF/SBP and that the supervisory apparatus would rest in the SBP.

2. Legal Issues

There is almost universal agreement in the financial sector that long term lending for residential housing is not a good business to get into because of the high delinquencies that will arise among borrowers and the inability to pursue these delinquencies in a timely manner. Hence, it is unlikely that private entrepreneurs will seek to start up or engage in the business of mortgage lending and that even if they were they could not raise substantial resources from those institutions or individuals with long term funds.

This is in spite of the fact that real estate as an investment is considered sound and represents good collateral particularly with the rapid escalation in real estate prices. In addition, the mortgage document itself is considered legally sound.

The problem is that pursuing delinquent borrowers through threats of foreclosure or the actual act of foreclosure is apparently a long drawn out process with many procedural roadblocks. This is not restricted to mortgage loans but is a problem throughout the banking sector. The government recognized this as long ago as 1979 when it passed the Banking Companies (Recovery of Loans) Ordinance and, more recently, established Special Banking Tribunals as part of Islamization to deal with delinquent borrowers. But a shortage of judges and lawyers expert in commercial matters and the complicated procedures have prevented much improvement. One comment directed toward housing finance was that it was one thing to foreclose on a company's assets and yet another to take a person's home.

The problem is compounded by the fact that the predominant lender for housing, HBFC, has substantial delinquencies (see later section). It has recently been running a series of advertisements in the newspapers warning delinquent borrowers on actions HBFC will take if accounts are not brought up to date. The image to the public is one of an institution struggling with its delinquencies. Although there is some recognition that HBFC, as a government institution, is perceived by many of its borrowers as one where nonpayment will be tolerated, it is not the image of a business that attracts private investors. The situation may be worsened if loans made under the Shelterless Program are not vigorously collected.

One other legal requirement cited as having an adverse impact on housing finance, at least as it affects affordability and market, is the stamp tax on real estate transactions. This currently is set at 8% of the transaction price and has been described as an inhibiting factor on real estate sales.

C. The Institutional Make-up of Formalized Housing Finance

1. Introduction

As stated earlier, Pakistan's formal housing finance system is dominated by the House Building Finance Corporation (HBFC) which is providing some Rs 1.2 billion per year in new financing for 20 - 25,000 units. This contrasts with commercial banks who will provide only Rs 190 million in residential housing finance in 1987-88 with additional amounts coming from employers for their employees and the government for civil servants.

2. House Building Finance Corporation

(Because of its dominance in housing finance, a more detailed and self-contained examination of HBFC is provided in Volume II of the report.)

a. General Background

HBFC is an independent financial institution established in 1952 by act of Parliament with its share capital fully subscribed by the Federal government and the State Bank. HBFC is governed by a Board of Directors that has eight members. It includes the Managing Director and representatives of the Ministry of Finance, Ministry of Housing and Works, the provincial Governments of Punjab, Sind, North West Frontier Province and Baluchistan and the SBP. The Managing Director, who is appointed by the Federal Government, is the Chairman and Chief Executive. HBFC has its head office located in Karachi and has wide country coverage with seven zonal offices and 58 district offices located throughout the country.

The primary objective of HBFC is to provide long term loans to people to finance the construction of their own house. Included in its activities have been special programs responding to unique situations such as loans to many families who had lost their homes in floods and loans to families who had migrated from India and Bangladesh. More recently, it is to participate as a lender in the Shelter for the Shelterless program by introducing special procedures for processing loan applications expeditiously as well as somewhat less stringent criteria in evaluating borrowers.

HBFC adopted an Islamic banking approach to its operations in 1979 when it was first introduced in Pakistan. Since that time its lending has been on the Profit and Loss Sharing (PLS) system as well as its borrowings from the State Bank of Pakistan.

b. <u>Source of Funds</u>

HBFC currently gets all of its new funds as an annual loan from the State Bank of Pakistan which it must repay in a balloon payment at the end of ten years. Although in theory it can take deposits and borrow money or issue bonds on the market, it does not do so because the market cost of funds would not permit it to continue its current lending charges. It repays SBP on the PLS basis, i.e. out of its earnings after deducting operating costs. The return to SBP has averaged only about 2-4%.

As described earlier, the annual loan amount from the SBP is determined by the National Credit Consultative Council which meets every two months. For FY 1987-88 starting July 1 HBFC was allocated Rs 1,850 million from SBP but because of what it owed SBP it received only Rs 1,450. Because of delays in releasing funds, HBFC usually does not get its funds until around October. To supplement these funds HBFC also utilizes repayments from its loan portfolio.

HBFC top management is actively examining ways to begin to raise funds on the market. SBP has indicated that it wants to significantly cut back on its provision of resources to government-owned financial institutions. To put the cost of funds in some perspective, commercial banks are now (April 1988) paying 11.7% to 13.5% on 3 to 5 year deposits, respectively. The government through its National Savings Schemes has a program referred to as Khas deposits which are savings certificates paying 15% p.a. but if held for three years pay 17% p.a. (although the return on such forms of savings is reduced by imposition of Zakat tax). Finally, the Water and Power Development Authority (WAPDA) began selling 5 year bearer bonds in denominations as low as Rs 1000 in December 1987 paying 13.5% p.a. payable semi-annually which are exempt from income tax and with no Zakat deduction.

It, thus, can be seen that with a maximum equivalent lending rate of about 15% (the highest rate of return it charges on a scale of different loans) HBFC cannot currently raise funds in the market and operate without incurring a loss. The main areas it is considering are in developing some sort of home-linked deposit scheme and looking at institutional borrowing. It will, however, have to re-examine its lending terms if it is to have any chance of success in this area.

The major liabilities of HBFC are the loans made to it by the government over the years. The oldest loans are interest bearing loans made up to July 1979. The vast majority of the HBFC's liabilities are owed to the SBP, which loaned to HBFC at 8% per annum interest up to July 1979, and under PLS since then with the introduction of Islamic banking in Pakistan. The PLS "investments" require annual payments to the SBP based on HBFC's accrued "profits" with repayment of the principal as a single balloon payment at the end of ten years. The principal amounts coming due in the next few years will increase each year, from Rs 400 million in FY 1988 to Rs 853 million in RY 1991. After that the balloon payments will increase dramatically to Rs 1,239 million in FY 1992, and remain at that level for several years.

The PLS profit "sharing" arrangement has resulted in the transfer of practically all of the HBFC's pre-tax profit to the SBP every year. In this regard the poor quality of the HBFC's "investment" portfolio, and the lack of write-offs to reduce net assets to some reasonable level, has tended to force the HBFC to transfer large amounts of cash to SBP as "shared" profits based on accrued (but only partially received) income. This imbalance has now caused a cash crunch at HBFC which will only get worse as it tries to keep up its lending operation while also keeping up to date with its payments to the SBP.

c. Lending Operations

(1) Terms and Procedures

HBFC lends for a term of 15 years. Prior to July 1, 1979 HBFC's lending was done on a regular interest bearing basis with interest and rates ranging from 5% to over 12% and for terms sometimes exceeding 15 years. Subsequent to that time HBFC has carried out its lending under Islamic banking principles called variously Profit and Loss Sharing (PLS) or Rent Sharing Scheme (RSS). Borrowers are referred to as partners.

Repayments start one year after HBFC makes its first disbursement. HBFC does not charge any "shared profit" during this period. The rationale is that the borrower is not deriving any benefit during the construction period; neither rent nor the benefit of living in the house. Therefore, there is no "profit" for HBFC to share in.

In theory, on a "shared profit" loan with, say, 180 monthly installments (15 years), part of the payment goes to reduce the loan and part is the "shared-profit" with HBFC which relates to imputed rental income. But as a loan is repaid the borrower's share of the imputed rental goes up and HBFC's down. Therefore, more of a payment goes to reduce the loan amount (same as in a level payment mortgage). When the imputed rental values for an area of a city are high, HBFC should and does charge more profits. HBFC has simplified its system starting July 1, 1987.

The maximum "profit" is 15%, the lowest is 6%, depending on the size of the loan, the size of the unit, the location of the property, and the income of the borrower. HBFC has had this worked out actuarally so that, starting with FY 1988, the 180 installments are equal. The new system should increase HBFC's profits significantly as it becomes a greater portion of its portfolio (financial operations are computerized by IBM installed on July 1, 1987). Earlier, HBFC was nowhere near market, averaging around 8% on its loans.

Anyone wanting to build his own house or buy a new house from a developer can apply to HBFC for a loan. The maximum loan was increased in FY 1988 from Rs 150,000 to Rs 200,000. However, in March 1988 it was abruptly dropped back to Rs 100,000 so that more loans could be made with the available funds but it's not clear if this change is permanent. The maximum size of a unit in terms of covered area is 2250 sq ft.

HBFC will provide financing up to a maximum of Rs 90 per sq. ft. The borrower must come up with the rest. For example: HBFC will provide a loan for up to Rs 90,000 for a 1000 sq. ft. house. Construction costs, which vary, are based on different standards and range from Rs 100-125 per sq. ft. up to Rs 300 per sq. ft. or more.

A borrower must have land with clear title for an application to be considered; he must also have house plans approved by the local authority and cost estimates. HBFC makes two disbursements; 40% of the loan amount when the house reaches foundation level and the remaining 60% when the borrower gets the roof on.

A borrower must also have the capacity to repay the loan and proof of income is required. HBFC accepts 50% of a person's income toward repayment of a loan which is clearly on the high side.

An individual can get only one loan in a lifetime but a loan can be transferred to the purchaser of a house i.e. an assumable mortgage. A loan must be for a new house either constructed by an individual or built by a developer. One cannot get a loan from HBFC to finance an existing house. The intent is that HBFC fosters the production of new houses.

HBFC provides no construction or bridging finance for developers. For a developer-built apartment project loans are provided to individuals on a similar basis to individual houses.

(2) <u>Loan Servicing</u>

Old (interest bearing) loans are serviced by Habib Bank; new loans by the Muslim Commercial Bank (MCB). Under the new simplified procedures, if a borrower falls behind MCB will notify and request him to pay. If the account continues to be behind, MCB will notify HBFC and HBFC will pursue.

In theory, HBFC can eventually foreclose if a borrower doesn't pay but there are many factors that enter the picture. As a government agency, there are political, social and economic considerations and these all affect recoveries. If HBFC foreclosed and sold a house it would obviously get very bad publicity. Instead, HBFC tries pressuring a delinquent borrower, issues a notice, sends someone to try and collect, shows him an attachment order, etc.

(3) Lending Activity

Since its inception in 1952 up until June 30, 1979 HBFC made almost 80,000 loans totalling about Rs 2 billion (this was the point at which HBFC began to make profit sharing loans). Subsequent to that point HBFC has made an additional approximately 150,000 loans totalling almost Rs 10 billion.

Although HBFC does not assign quotas or levels to zonal offices, it now gives priority to loan applications from Baluchistan and the North West Frontier Province to spur housing developing in these two provinces. In an attempt to finance more low cost housing, HBFC also gives priority to loans up to Rs 60,000 and the branches have been instructed to give first priority to all such loans. HBFC has not developed any statistics as yet on the incomes of its borrowers (it obviously could be derived from a search of the files) nor on the total cost of housing that is getting financed. It only maintains statistics on size of loans.

(4) Comments on HBFC's Loan and "Investment" Portfolio

A review of HBFC internal reports shows an enormous problem with past due loans and "investments". The situation cannot be stated precisely due to a lack of easily obtainable records within the accounting system. The Study Team, however, developed some information by reviewing the most recent information relating to transactions for each of the 58 district offices compiled by the head office. The result is shown in Volume II.

The HBFC prepares a past due report every six months. This summary report lists the total amounts past due, including interest or "rent", and accrued late charges. The HBFC does not prepare a report showing a comparison of the payments actually received with the past due status of the accounts for which payments are received. Such a comparison would allow management to make a meaningful analysis of the quality of its loan and "investment" portfolio.

There is no system to classify the loans and "investments" according to their repayment history. There is no policy that requires HBFC to stop accruing interest or "rent" after some reasonable time period if payments are not received. According to HBFC management, no loan or "investment" has ever been specifically written off, although in 1985 for the first time a provision for doubtful accounts was included in the amount of Rs 3 million against the interest bearing loans. This provision was increased by Rs 13 million in FY 1986, and by an additional Rs 30 million in 1987. This is an indication that management is aware of the problem. However, these provisions were not against specific loans, and the outside auditors were still unable to give an opinion as to the adequacy or otherwise of the provisions, due to the deficiencies of the accounting system.

Overall, it is apparent that HBFC should evaluate its portfolio against some standard of recoverability. Such an evaluation would certainly require that a large portion of the portfolio be written off as being uncollectible. Of course, any abrupt write-off of assets without a corresponding restructuring of liabilities would result in the bankruptcy, on paper, of the HBFC. Once the questionable assets are written down, any subsequent collections from them would immediately increase net income. However, as a practical matter the HBFC's liabilities greatly exceed the real value of the assets, so the HBFC should be considered bankrupt, anyway. The real question is how to proceed with the restructuring, rather than whether a restructuring is needed.

d. Financial Performance

Although the stated balances in the financial statements give the appearance of good financial health, a review of the auditor's notes and opinion in the FY 1986 statements reveals several areas of major concern.

One of the most significant accounting practices being followed by the HBFC which impacts on its financial statements is to accrue interest or rental income on all loans or "investments" without regard to their repayment history. The underlying theory seems to be that the HBFC, through its first mortgage claim to the property, has legal access to the supporting property values even if the payments are not made on time. Under more ideal conditions the full value of any past due payments would be realized by the active threat of foreclosure, which would tend to encourage defaulters to pay up or face the loss of their property. Unfortunately, the HBFC has been unable to effectively carry out the foreclosure threat and has built up a huge level of past due accounts.

The HBFC appears to be treated as a real estate or financial institution rather than a bank in the accounting treatment of its financial assets. It continues to accrue interest and rental income when the payments may be three, five, or even more than twelve years past due. Generally, a bank would stop accruals after three months past due, and would back out accrued interest and start to write off the loan or investment after six months or so, depending on the situation. In contrast, the Survey Team discovered in its discussions with HBFC management that the institution has apparently never placed any regular loan or investment on non-accrual (other than certain refugee loans dating back to Partition), has never backed out unpaid accrued interest, has never written off a single loan or investment, and has never foreclosed on a loan.

This practice has had the effect of overstating the profit attained each year, even if one assumes that all the past due principal could be recovered some time in the future, and one only discounted the past due interest or "rental" income. The HBFC has paid income tax to the government on this questionable income, and the HBFC has shared with the SBP almost all of the "profit". These transfers to government have been in the form of cash payments made during the course of each fiscal year. The Survey Team was unable to determine the accumulated amounts of income taxes paid, but the accumulated "profits" shared with the SBP will amount to Rs 1,610 million (at least $93 million) by the end of the present fiscal year.

e. Conclusion and Assessment of the Future

With the government looking to shift more of its programs to the private sector and with the SBP indicating that it will reduce or eliminate its subsidized lending to government financial institutions, there is a very real question as to where HBFC goes from here; what is the role it will play in any new housing finance system designed to attract private interests.

While HBFC's operations can undoubtedly be improved, it is already taking steps which have resulted in improvements in accounting, collections and organization. It has, however, without doubt been afflicted with the problems that plague specialized government financial institutions in many countries. It has had to participate in lending for government programs e.g. flood victims, using resources it has obtained on a loan basis from government where its likelihood of recovery was dim. It's lending rates (or rate of return relative to PLS) are far below what it would cost to raise resources in the market. It's high rate of delinquencies, while perhpas due in part to its own inefficiencies, are heavily influenced by the system of foreclosures and by the sometimes political implications of collecting.

The end result is an institution that is technically bankrupt, has a problem with its public image and is facing the possibility of having to seek its funds on the market (pretty much an impossibility unless the government were to provide a 100% guaranty).

Where does HBFC go from here? As a $700 million institution it is unlikely that government will allow it to fail. A number of possibilities for HBFC have been discussed or put forth.

To participate in and foster the development of a private housing finance industry, HBFC could set up a wholly-owned subsidiary which would operate at market levels or set up a department within HBFC to do the same thing. This could be done while gradually putting its existing portfolio in order. As part of this exercise, HBFC should be allowed to write-off all loans that are no longer repaying and are deemed uncollectible and it should be recapitalized to reflect this loss of assets.

HBFC could be reconstituted as the agency that will license, regulate and supervise a new private housing finance industry and provide wholesale funding to that industry. Here again, it would eventually have to dispose of its existing assets.

It could become the financing agency for all government-supported housing programs, those that because of the nature of the beneficiaries e.g. the Shelter for the Shelterless Program, would provide some level of subsidy to the lowest income families. But in such a scenario subsidies should be recognized and provided up front and not in the way HBFC is forced to operate currently.

Or, finally, HBFC could in theory do all of these things. What needs to be done is that the government clearly set out the role that it wants HBFC to play and then make possible the financing of that role.

It is the conclusion of this study that HBFC in the long run should not do what the private sector can do and therefore shouldn't compete with the private sector. However, there is always the need for a government housing bank to provide financing for an income level that the private sector will not seek to reach, at least initially. But this need should be met as efficiently and in the most cost effective way possible and subsidies, such as are provided, be focussed on the most needy.

Since the Asian Development Bank is going to finance a major study of HBFC and its operations in the very near future this report will not go further than the conclusions outlined above so as not to preclude the eventual recommendations of that study.

3. Commercial Banks

Only the five nationalized commercial banks can lend for housing and the government's credit controls limit this to a relatively small amount. Funds allocated by the National Credit Consultative Committee in 1987-88 to the five NCBs for housing credit amounted to only Rs 190 million. Each bank is allotted a separate ceiling.

To put this in perspective, the allocation to Habib Bank was Rs 69.5 million for 1987-88. As of December 1987 Habib's outstanding balance on mortgages was Rs 249 million and in 1986-87 it disbursed Rs 71 million. This compares with total advances outstanding by Habib of Rs 50 billion. Thus, housing credit is insignificant in this picture.

Habib also makes housing mortgage loans to its employees (see next section for more details on terms). According to Habib, such lending does not come under credit ceilings for housing, (in fact, the total amount outstanding for employee loans quoted by Habib was much higher than for its general housing credits) but does come under its overall credit ceilings. However, one of the other NCBs indicated employee loans do come under housing credit limitations.

It's also not clear whether the credit ceiling is just that, a ceiling, or a mandated target as well. This is what one of the NCBs indicated as well as that a certain percentage was targetted for military personnel. In any event the total for commercial banks represents a very small percentage of housing finance requirements.

The commercial banks lend for higher amounts than does HBFC with a range of from Rs 150,000 to Rs 300,000, presumably to reach the next level up from HBFC. However, as stated in the previous section, HBFC increased its maximum rate to Rs 200,000 earlier in FY 1987-88 so that there was an overlap but recently dropped it back to Rs 100,000 which leaves a gap. Habib's terms are for repayment over 15 years with a loan to value of 60% requiring a high down payment. The commercial banks recently dropped the PLS formula for their housing loans because it was too complicated. Apparently clients were disputing the method of calculation i.e. investment vs. land area and area of house.

The banks now lend on a mark-up basis of 13% p.a. based on a reducing balance method and equal payments over the life of the loan. The 13% rate is somewhat misleading, however. In calculating the repayments for a Rs 300,000 loan for 15 years with a mark-up of 13%, the monthly payments come to Rs 3643.75 after a one year grace period. (See Annex B) The annual percentage rate, calculated as interest for this loan, turns out to be 9.73%. Thus, the banks are quoting a "mark-up" rate considerable in excess of the equivalent interest rate, one which is certainly not an attractive rate to investors in Pakistan at this time.

In the view of commercial bankers with whom the Team discussed lending for housing, the universal view was that it was too risky, given the delinquency problems and the inability to pursue the delinquent borrowers, to attract private investors into the business.

4. <u>Employer-Financed Housing and Allowances</u>

Many employers offer some form of assistance to employees to obtain housing. The Federal Government and the provincial governments make house building advances to employees who have at least ten years of service. The maximum loan is equivalent to 36 month's pay and repayment is normally over twenty years. Loans are interest feee to all non-gazetted civil servants; they carry market rates for higher level officers (14% in 1983). About Rs 60 million was reportedly disbursed for such housing loans in 1983/84.

paid off in the allotted time with profits because the developer was able to sell out. However, the project wasn't completed or the units sold. This was the first and last time funds were raised in the stock market for housing development through the modaraba concept.

BEL feels that using the concept of a modaraba for housing development could be successfully sold now. People are ready to subscribe to such a deal. However, given the recent experience with finance companies there is a question as to whether government would approve real estate as something to be financed with a modaraba at this time.

With regard to land development and purchase, here again there is no formal financing provided by financial institutions. A developer must finance through his own resources or seek financing through informal borrowing. Modaraba financing, described above, would presumably, however, also extend to the purchase and development of land as part of the project.

The Karachi Development Authority (KDA) which had developed some 300,000 plots by 1982 in the Karachi area does provide some financing for individuals who are allocated plots (developers who are allocated blocks of plots by KDA must pay cash to the KDA). Every applicant must make a down payment of 10% with his application. After the successful applicants have been selected (it is done by ballot or lottery), they must make an additional payment of 40% for a total down payment of 50%. (The unsuccessful applicants have their original deposits returned.) KDA then finances the remainder in two equal annual installments. Whether other development authorities such as the Lahore Development Authority or the Capital Development Authority in Islamabad provide such financing was not ascertained.

E. <u>The Financing of Government Programs</u>

Section I B outlines the Government's Shelter for the Shelterless Program. As described, the funding of the Program for the most part will come from either the Zakat Fund or from the government budget. That part which will be administered by HBFC will come directly from HBFC resources. Prior to the advent of this program, the government was not engaged in financing housing per se (as opposed to the various programs to provide developed sites through the municipal development authorities or the Three Marla and Seven Marla Programs to provide land in urban and rural areas respectively). Special government housing programs, when the need arose such as housing for flood relief victims, was done through HBFC. To the extent that government contributed finances for housing, then, it did so by subsidizing the lending of HBFC.

The Works Division within the Ministry of Housing and Works does construct housing for civil servants (as opposed to housing loans to civil servants which is discussed in Section IV 3 above) but the financing for such housing is contained in individual ministry budgets.

However, under the new One Million Homes Program the government will be providing housing loans directly for three elements under Phase One of the Program, i.e. that phase which was scheduled for completion by the end of 1988. A brief description of the financing under this program follows:

1. 20,000 loans of Rs 20,000 each for nucleus houses in rural areas costing Rs 25,000 where the beneficiary must make a Rs 5,000 down payment and own the land. Repayment is over 20 years on a return free basis.

2. 20,000 loans of Rs 10,000 each for upgrading houses in rural areas. Repayment is also over 20 years on a return free basis.

3. 15,000 loans of Rs 10,000 each for nucleus houses in urban areas. The remaining cost including land would have to be provided by the beneficiary. Repayment is over 15 years on a return free basis.

Starting in FY 89 and over the next three fiscal years the government proposes to provide loans of Rs 15,000 to 100,000 beneficiaries each year for either a new nucleus house or upgrading an existing house. A revised estimate of the cost of a nucleus house is Rs 30,000 so the remainder of the cost will have to be borne by the beneficiary. The proposed family income of the beneficiaries should not exceed Rs 1150 per month (presumably this will be adjusted in succeeding years), the proposed rate of return on the loan is 6% and the repayment period is 22 1/2 years.

Funds for the program will be allocated from the Federal Government to the account of the Secretary of the Provincial Housing Department (who will also be an ex-officio Deputy Director General of the NHA). The National Housing Officer in each district (DNHO) will invite applications after the Provincial Housing Secretary has sub-allocated funds by district. The DNHO will review the applications in accordance with established criteria, including income level. After approval by the District Housing Committee, beneficiaries will be selected by ballot under the supervision of the Deputy Commissioner.

Disbursements, to be made in three installments, and recoveries will be handled by the Agriculture Development Bank of Pakistan in rural areas and by one of the nationalized commercial banks in urban areas. The National Housing office in each district will be responsible for recoveries under the loans and will maintain the loan records. Title will not pass for new houses until the loan is paid off.

F. Informal Financing of Housing

Since the formal housing finance system finances only 20% or less of housing investments in Pakistan, it is useful to take a brief look at how the remainder of the financing is carried out although there has been no previous study of this nor does any kind of data exist. Informal financing of housing can be categorized into two classes; financing for standard housing on land that is legally owned and financing for slum housing, either in very poor areas or on illegally-occupied squatter land.

1. Standard Housing

This can range from very modest housing for low income families to very expensive housing and involve either new housing where neither HBFC or commercial bank financing is available, either because these institutions have no money to lend or because the amount being sought exceeds their limits. Note that in any event, the low LTV in HBFC-commercial bank loans requires a significant amount of self financing and financing of resale housing must come entirely from outside the formal system.

It is generally assumed that such financing comes from the savings of families, from the sale of assets or from informal borrowing. For needs beyond what a family can raise through its own savings or from sale of assets, it can turn to informal borrowing. If the family can get a "friendly" loan, i.e. from a relative or a friend, the going rate may range from 2-4% per month. If the buyer has to turn to a black money lender, the rate will be 5% per month! Such financing can obviously only be afforded for very short periods (essentially bridge loans) by higher income families and points up the difficulties that lack of long term credit from formal institutions causes. Annex E contains an expample of how one lower income family financed its house.

2. Squatter/Slum Housing

There is a definite need for credit in a katchie abadie community if people are to upgrade their living conditions; i.e. to pay a development charge eventually, to pay for sanitation and to pay for improving their house or to build a new one. The speed of implementation of community upgrading programs would appear to be directly related to the availability, or absence, of credit. The average household (in most families, however, only the male works) income is such that to expect a family to be able to pay a large lump sum is not realistic. It's one thing for community development projects to motivate the people; it's another thing to get the money.

Access to any type of formal credit, even short term, for incremental building appears to be non-existent. The banks apparently feel that there is not enough potential business in katchi abadie areas to open up branches on a wide basis. Thus, it's not just housing that suffers from lack of credit. A man starting up a small business in, say, building materials, has no place to get a loan. The piece of land he might want to acquire would have no legal basis; therefore, no bank would get involved. The result is that there are probably money lenders charging the same kind of rates, or higher, described above for informal lending for standard housing i.e. 4-5% per month, but for very small short-term loans; otherwise they couldn't be repaid.

Since katchie abadies make up such a significant percentage of the largest cities e.g. Karachi and Lahore are the major examples, and some of the housing in these areas is quite substantial, it can be assumed that some level of informal lending through money lenders has occurred. The degree of organization described earlier would clearly indicate this.

According to an Asian Development Bank report, Catholic Social Services (CSS) set up a revolving fund for resettlement of low-income families in 1980 to provide relocation assistance to families evicted from their homes by urban development projects in Karachi katchie abadis. CSS makes loans of Rs 6,000 to be repaid monthly over 30 months without interest. Selected beneficiaries are organized into members. Beneficiaries must be destitute, but also have title to a house plot, usually provided by government. The loan can only be used for house construction. The intent is to use the Rs 6,000 to build a simple one-room core house, with most of the work done by family members. A CSS social worker is assigned to each group to assist with various problems and monitor disbursements and repayments. CSS's target is to assist 200 families each year. The problem, of course, is that such a program must, by definition, be very limited in scope because it has to rely on donations to keep going.

In conclusion, there is a great need for credit in the katchie abadies if the overall katchie abadie program of government is to succeed. Whether the home improvement portion of the One Million Homes Program will address this area isn't known.

A more detailed treatment of this aspect wasn't possible in this particular study because of time limitations and the focus on constraints facing the establishment of a formal private housing finance system. It is an area that requires attention, however.

V. THE DEVELOPMENT OF AN EXPANDED HOUSING FINANCE SYSTEM

A. Constraints to an Effective Housing Finance System

The Team has identified what it feels to be four major constraints to achieving the GOP's objectives of an effectively functioning housing finance system which can rely increasingly on the private sector to provide the resources.

1. Viability of the Market

It is unlikely that there will be any significant flow of resources from the private sector into long term residential housing finance until the private sector perceives this as a viable financial market.

There is no doubt that the provision of housing finance is recognized as a potentially huge market. It is also recognized that the underlying security for a loan to finance a house, i.e. the mortgage on the house, is a good one particularly in view of the appreciating value of real estate.

But, almost universally, members of the financial community, both public and private, said lending long term for housing was too risky and that the dangers of significant delinquencies and the ability to collect in a timely way made this an unattractive proposition.

Although indicating that the mortgage instrument was sound, the majority of opinions was that the procedures for pursuing delinquent borrowers and, if need be, actually foreclosing on a property, were too cumbersome and lengthy.

It should be pointed out that the problem of delinquent borrowers is apparently a problem across the board in the financial sector, not just in housing. However, housing loans, because of their long term nature and the fact that you may have to deal with a social problem, i.e. a person's house, are currently perceived of as especially unattractive. Adding to this is the image that HBFC has conveyed, one of an institution struggling with many delinquencies with major advertisements in newspapers warning delinquent borrowers.

There are, however, two initiatives currently being developed in the private sector to create private or mostly private housing finance institutions. One has the backing of the International Finance Corporation, the World Bank's private sector arm, and PICIC and the other is being generated by the Dawood Group in conjunction with the National Investment Trust. Both of these proposals, however, have special interests behind them.

Finally, HBFC, which provides almost all of the formal housing credit in the country, makes loans which have a range of returns, depending on location, size of loan and income, starting as low as 6 3/4 percent, and to some degree, there is a concern that housing finance should be provided at even lower rates.

This is inconsistent with attracting private funds into long-term housing finance. Private institutions would have to pay a rate of return to attract funds which, when added to their cost of operations including a return, would require them to lend at a significantly higher rate than HBFC's current rates. Indications are that the demand is there to do this and in such a way that it would be affordable to a large percentage of the population. But this cannot occur if a government institution is providing credit to a limited number of middle class borrowers at a subsidized rate.

Conclusion - Unless private investors see the provision of long-term housing finance as a v'able financial market, i.e., that the loans provide a reasonably safe investment and a sufficient return such that funds can be mobilized to carry out the activity, then private interests will not move into the creation of private housing finance institutions.

2. Need for Regulatory/Supervisory Framework

There is no effective regulatory/supervisory framework to govern the establishment of new institutions whose primary business would be the making of long term housing loans.

Currently the financial sector is faced with a crisis in the proliferation of finance companies offering investors impossibley high rates of return supposedly growing out of activities which are not clearly defined. These companies have apparently bilked many people out of substantial amounts of money. Many of the companies have indicated their proposed returns are based on real estate ventures of one sort or another.

The government now has under consideration a set of regulations and licensing procedures to govern the setting up of investment companies. The lack of such regulations pertaining to private housing finance institutions is an impediment to their creation. That is, for the private sector to invest in setting up legitimate institutions for housing finance, they would have to feel that the public would have confidence. Without a strong regulatory framework and given the association of real estate with many of the recent finance companies' scandals, that confidence would be lacking.

Concomitant with the need for a strong regulatory framework is the need for comprehensive follow-up supervision. That is, there needs to be an assurance that the firms that enter the field are indeed carrying out their activities in a way that is consistent with government objectives to provide finance to housing at an adequate level, in an effective manner and on a reasonable basis. Such direct supervision is now lacking even with HBFC, a government organization. It is also reportedly a matter of some concern across the board in the financial sector.

3. Role of the House Building Finance Corporation

HBFC, as it is currently functioning, tends to deter the development of a private housing finance system, is a drain on government resources and will soon no longer be financially viable.

HBFC now receives all of its new lending resources except for repayments and some fees through a yearly allocation of funds from the State Bank. It lends through the Profit and Loss Sharing (PLS) mechanism at a range of returns starting as low as 6-3/4 percent, all of which are below what it would have to pay for funds in the market. Since it also repays SBP on the PLS basis, it is technically profitable although the return to SBP is around 4% or less, far below the marginal cost of money to government.

However, HBFC has a high percentage of delinquent loans on which it books accrued interest in developing its income statement and balance sheet. Thus, the profits on which it bases its repayments to SBP are really illusory. In fact, what happens is that SBP's yearly loan allocation of funds to HBFC is effectively reduced by the amount HBFC owes SBP from its "profits", "profits" which on a cash flow basis have not actually been received. The result is that HBFC's available lending resources, already limited because of the overall allocation from SBP, are further reduced. This situation will be exacerbated in the next few years as larger balloon payments of principal on ten year SBP loans start to become due.

Finally, HBFC is carrying on its books as assets, earlier loans made under government-sponsored programs such as those to flood victims and loans to borrowers in Bangladesh on which no payments at all are being received nor have been for some time. The amount outstanding on these questionable loans exceeds HBFC's capitalization giving it a negative net worth. Thus, it is technically bankrupt. When this is coupled with the high rate of delinquencies on its regular loan portfolio and the cash flow problems that will be caused as larger SBP loans become due, HBFC's financial picture is bleak.

However, as an institution with over Rs 12 billion in stated assets and as the only institution providing any substantial amount of housing finance, it is unlikely that the government will abolish it or allow it to fail. In fact, our review of HBFC indicates that it is making substantial improvement in its management and operations: among other things it is instituting new collection procedures which appear to be resulting in improvements; it is developing improved accounting procedures and management reporting systems; and it is focussing its efforts more on lower income borrowers.

Nevertheless, HBFC is widely perceived by the public and in financial circles as an institution with too few funds to lend, that is inefficient with high delinquencies, and is lending at subsidized rates below what the market could support. At the same time it is operating at substantial cost to government.

Conclusion: The current circumstances of HBFC as a housing lender do not present an attractive picture to private investors which might consider entering the field.

4. Construction Finance

Short-term construction (bridge) financing for housing projects is completely unavailable from formal financial institutions, thus limiting and slowing down the process of housing production. At present most new housing in Pakistan is built by individuals who own a plot of land and engage the services of a builder to construct the house. If they are fortunate enough to obtain a loan from HBFC, which is limited to Rs. 90 per sq. ft. of floor area, they do not receive their first disbursement until after the house is at foundation level and the second, and final, disbursement when the roof is on. Thus, even individuals who receive an HBFC loan usually self-finance as much as 50% of the cost of the construction plus the full price of the land. HBFC finances a part of the construction but charges no return on its loan until one year after the initial disbursement. This arrangement is unsatisfactory both from the borrower's standpoint (very high cost of self-financing which limits the number of people who can afford this) and the lender's standpoint (no return on money disbursed for one year).

If urban housing production is to expand to a level which would begin to meet demands, thre will have to be more housing projects built by developers. Currently there are apartment units being offered below Rs. 150,000 but, for the most part, such developers are building only in Karachi and to some degree in Lahore. Here again the burden for up-front money by the buyer is significant. Because of a lack of construction financing buyers are asked to pay a deposit with their application and make periodic payments during construction supplemented by some HBFC disbursements if, as stated above, they are fortunate enough to get such a loan. Sometimes this may not even be known until they have paid in a significant amount.

With regard to purchase of land and other up front costs, a developer, if he has insufficient funds to cover all of this, must pay up to 5% per month to borrown in the informal market. Commercial banks, who would normally provide such short-term financing in many countries are not permitted to do so in Pakistan. Moreover, they have indicated they are not interested in lending for this purpose. They cite the riskiness of such projects, here again indicating it is too difficult to proceed against defaulters and take over the project.

Yet some developers have indicated that if such financing were available and its cost built into the price of the housing unit, and if this were coupled with the availability of long term financing for the buyer, they could increase the production of housing units significantly and cut the time to complete a project by one half.

B. Recommendations

After identifying the key elements which must be addressed to make the housing finance system more effective and to induce an expanded role for the private sector, recommendations to achieve this flow logically.

1. The Market

If lending for housing is to be perceived as a safe investment and one that can attract private sector endeavors, proceedings against delinquent borrowers and defaulters must be made more expeditious. It is recognized that this is a problem in other areas of lending. However, security for housing loans has its own unique characteristics.

The government should appoint a committee/commission to recommend specifically how proceedings against delinquent or defaulting borrowers for housing loans can be streamlined such that lenders will indeed lend with confidence. People must understand that if they receive a loan to finance their house and they do not pay, they will lose that house. This recommendation is made with the understanding that there will always be special cases where the borrower has unavoidable problems and that the lender needs to make exceptional provisions.

The other major area that must be dealt with to induce private interests to enter the housing finance field relates to the return on the loans and the cost of mobilizing resources. Lenders will have to pay for their funds and to this must be added the administrative costs. Right now, as pointed out earlier, HBFC's return on its loans is below the cost of raising funds in the market. HBFC should be required to increase to a market level the cost of those loans for which the private sector might compete. Otherwise it will discourage private lenders from entering the field or at the least reduce their scope.

2. Regulation/Supervision

Alternatively, a special set of regulations should be developed for housing finance institutions. As they now stand, the investment company regulations are broad enough to encompass at least the basic provisions that would apply to housing finance institutions.

However, the nature of housing finance is sufficiently different to require at least certain specific regulations/licensing procedures to provide adequate safeguards to the public and the financial sector and to control entry of only reputable firms into the field. If a private housing finance system is to develop, it must have a clear set of guidelines and a regulatory framework in which it can operate. The government must then develop a strong and effective supervisory system to protect depositors, investors and borrowers and to ensure the continuity of the system. It would appear that this supervision could best be carried out by the State Bank as part of an expanded supervisory role for all financial institutions by the SBP which we understand is under consideration.

Finally, because of the long term nature of mortgage loan assets, and the probably shorter term nature of the liabilities which will finance these assets, there is a need for a liquidity facility to be available to private housing finance institutions. This facility should probably be within the supervisory framework suggested above i.e. the SBP.

3. HBFC

There are a number of alternative directions in which HBFC could go and which are being discussed: (1) It could become a completly market-oriented institution; (2) It could create a market-based subsidiary or division within HBFC while continuing to carry on its existing operations; (3) It eventually could become the regulatory/ licensing/supervisory agency for private housing institutions including the provision of liquidity to such a system; (4) It also could take on the servicing of government programs such as the "Shelter for the Shelterless" program; (5) All or a combination of these functions.

There is a need by government to clearly spell out the precise role that HBFC should play in an efficiently functioning housing finance system. The Asian Development Bank is about to embark on a comprehensive and detailed study of HBFC which should provide recommendations on this.

However, based on a preliminary review growing out of this study the following suggestions are made with regard to HBFC:

- To put HBFC on a sound financial footing, HBFC should be allowed to write-off those loans which are clearly non-performing and which are not expected to be collected. To offset the write-off of these loans which are now carried as assets, it either should have certain of its government or SBP loans forgiven or it should have a new infusion of capital.

- There will always be a need for a government housing finance institution to implement government programs and deal with income levels below that where the private sector could operate profitably and, therefore, would probably not operate. This is a role that HBFC could play but it should do this in an effective and efficient manner. Over the long run it should not compete against private sector institutions. That is, consistent with announced government objectives, HBFC should not operate in areas that can be adequately addressed by the private sector.

- If the government does proceed to take the steps necessary to create a private housing finance system there would obviously be a transition period between such steps and the actual creation of new institutions During that period HBFC needs to perform on terms which could be profitably emulated by the private sector in those market segments where HBFC will phase out its operations. In other words, rates of return should be raised and the full extent of existing recovery procedures should be exercised.

4. <u>Construction Financing</u>

Obviously, the government could direct the nationalized commercial banks to make a certain amount of finance available for this purpose. However, this would require a reallocation of credit ceilings.

Possibly a non-bank financial institution such as a new type of investment company could pursue such lending. Properly done, construction loans can be quite profitable at a reasonable rate.

There is clearly a need to create linkages between commercial banks, developers and housing finance companies to provide the structure for a complete housing finance system.

<u>Conclusion</u>

It is recognized that to implement some of the recommendations above requires specialized expertise. Where the GOP feels that such short term expertise could be useful, e.g. to draft specific regulations that would pertain to specialized housing finances institutions, this expertise should be made available.

The potential market for private housing finance institutions in Pakistan is huge. The need for an effectively functioning government supplement to private housing finance for the lowest income groups is also great. Together such an institutional framework could help significantly to meet the continually growing housing needs of Pakistan. The Study Team believes the implementation of the recommendations in this report can facilitate creation of such a framework.

POLICY AND INSTITUTIONAL

STUDY OF HOUSING FINANCE

IN PAKISTAN

VOLUME II

HOUSE BUILDING FINANCE CORPORATION

108

POLICY AND INSTITUTIONAL STUDY
OF HOUSING FINANCE IN PAKISTAN

VOLUME II
HOUSE BUILDING FINANCE CORPORATION
Table of Contents

Note: This study was done in April 1988. Events in Pakistan and with HBFC have resulted in some changes to the information provided herein

Annexes to Volume II

1. HBFC 1987-88 Approved Investment Budget
2. GOP Loans to HBFC 1972-1979
3. SBP Loans to HBFC 1974-1988
4. HBFC Disbursements 1981-1987 by Year and Area of Country
5. HBFC Loans Approved 1982-1987 by Year and Loan Amount
6. HBFC Collections of Interest Bearing Accounts July 1986 - Feb. 1988
7. HBFC Collections of Investment (PLS) Accounts July 1986 - June 1987
8. HBFC Balance Sheets 1985 and 1986
9. HBFC Profit and Loss Account 1985 and 1986
10. Cash Flow July 1986 - June 1987
11. Loan Terms and Locations April 1988

HOUSE BUILDING FINANCE CORPORATION

I. Introduction

Pakistan's formal housing finance system is dominated by the House Building Finance Corporation (HBFC) which is providing some Rs 1.2 billion per year in new financing for 20 - 25,000 units. This contrasts with commercial banks who will provide only Rs 190 million in residential housing finance in 1987-88 with additional amounts coming from employers for their employees and the government for civil servants.

II. Establishment and Objectives

HBFC is an independent financial institution established in 1952 by act of Parliament with its share capital fully subscribed by the government. The primary objective of HBFC is to provide long term loans to people to finance the construction of their own house.

Included in its activities have been special programs responding to unique situations such as loans to families who had lost their homes in floods and loans to families who had migrated from India and Bangladesh. More recently, it is to participate as a lender in the Shelter for the Shelterless program by introducing special procedures for processing loan applications expeditiously as well as somewhat less stringent criteria in evaluating borrowers.

HBFC adopted an Islamic banking approach to its operations in 1979 when it was first introduced in Pakistan. Since that time its lending has been on the Profit and Loss Sharing (PLS) system as well as its borrowings from the State Bank of Pakistan.

III. Capitalization and Ownership

The Act establishing HBFC authorizes share capital of Rs 200 million all of which has been fully subscribed and paid-up. The Federal Government holds 62.5% of the shares (Rs 125 million) and the State Bank of Pakistan holds the remaining 37.5% (Rs 75 million).

HBFC is governed by a Board of Directors that has eight members. It includes the Managing Director and representatives of the Ministry of Finance, Ministry of Housing and Works, the provincial Governments of Punjab, Sind, North West Frontier Province and Baluchistan and the SBP. The Managing Director, who is appointed by the Federal Government, is the Chairman and Chief Executive.

IV. Organization and Staffing

HBFC has its head office located in Karachi with seven zonal offices and 58 district offices located throughout the country. The head office has four primary organizational units; a Finance Department and three divisions, Operations, Engineering and Administration; the divisions headed by Executive Directors. As of June 30, 1987 HBFC had a total staff of 1421 of whom 253 were officers. HBFC uses both the Habib Bank and the Muslim Commercial Bank to provide for some of the servicing functions for its loan.

V. Source of Funds

HBFC currently gets all of its new funds as an annual loan from the State Bank of Pakistan which it must repay in a balloon payment at the end of ten years. Although in theory it can take deposits and borrow money or issue bonds on the market, it does not do so because the market cost of funds would not permit it to continue its current lending charges. It repays SBP on the PLS basis, i.e. out of its earnings after deducting operating costs. The return to SBP has averaged only about 2-4%.

The annual loan amount from the SBP is determined by the National Credit Consultative Council which meets every two months. For FY 1987-88 starting July 1 HBFC was allocated Rs 1,850 million from SBP but because of what it owed SBP it received only Rs 1,450. Because of delays in releasing funds, HBFC usually does not get its funds until around October. To supplement these funds HBFC also utilizes repayments from its loan portfolio. (Annex 1 shows HBFC's Investment Budget for 1987-88).

HBFC top management is actively examining ways to begin to raise funds on the market. SBP has indicated that it wants to significantly cut back on its provision of resources to government-owned financial institutions. To put the cost of funds in some perspective, commercial banks are now (April 1988) paying 11.7% to 13.5% on 3 to 5 year deposits, respectively. The government through its National Savings Schemes has a program referred to as Khas deposits which are savings certificates paying 15% p.a. but if held for three years pay 17% p.a. (although the return on such forms of savings is reduced by imposition of Zakat tax). Finally, the Water and Power Development Authority (WAPDA) began selling 5 year bearer bonds in denominations as low as Rs 1000 in December 1987 paying 13.5% p.a. payable semi-annually which are exempt from income tax and with no Zakat deduction.

It, thus, can be seen that with a maximum equivalent lending rate of about 15% (the highest effective rate of return it charges on a scale of different loans) HBFC cannot currently raise funds in the market and operate without incurring a loss. The main areas it is considering are in developing some sort of home-linked deposit scheme and looking at institutional borrowing. It will, however, have to re-examine its lending terms if it is to have any chance of success in this area.

The major liabilities of HBFC are the loans made to it by the government over the years. The oldest loans are the interest bearing loans made up to July 1979. The vast majority of the HBFC's liabilities are owed to the SBP, which loaned at 8% per annum interest up to July 1979, and under PLS since then with the introduction of Islamic banking. (See Annexes 2 and 3 for a list of the outstanding loans and PLS "investments" from the government and SBP). The PLS "investments" require annual payments to the SBP based on HBFC's accrued "profits" with repayment of the principal as a single balloon payment at the end of ten years. As shown in Annex 3, the principal amounts coming due in the next few years will increase each year, from Rs 400 million in FY 1988 to Rs 450 million next year, Rs 650 million in FY 1990, and Rs 853 million in RY 1991. After that the balloon payments will increase dramatically to Rs 1,239 million in FY 1992, and remain at that level for several years.

The PLS profit "sharing" arrangement has resulted in the transfer of practically all of the HBFC's pre-tax profit to the SBP every year. In this regard the poor quality of the HBFC's loan and "investment" portfolio, and the lack of write-offs to reduce net assets to some reasonable value, has tended to force the HBFC to transfer large amounts of cash to SBP as "shared" profits based on accrued (but only partially received) income. This imbalance has now caused a cash crunch at HBFC which will only get worse as it tries to keep up its lending operation while also keeping up to date with its payments to the SBP.

The details of how this works are worth describing. In fiscal year 1988 the SBP's loan allocation to HBFC was Rs 1,850 million of which only Rs 1,450 million was provided. The difference of Rs 400 million was withheld in FY 1988 for the first time to cover the maturing balloon payment. The HBFC now will owe the SPB Rs 1,850 million from the 1988 loan which will have to be repaid in ten years as a balloon payment. However, the basis for calculating shared profit will be the full Rs 1,850 million. This rescheduling of debt may allow the HBFC to continue to operate for a while, but will not help its financial situation unless the profit "sharing" arrangement is adjusted to properly reflect the real profit or loss generated by the HBFC's loan and "investment" portfolio. This "sharing" should include write-offs on both sides of the balance sheet, perhaps with the conversion of some of the debt to equity as an interim step.

VI. Lending Operations

A. Terms and Procedures

HBFC lends for a term of 15 years. Prior to July 1, 1979 HBFC's lending was done on a regular interest bearing basis with interest rates ranging from 5% to over 12% and for terms sometimes exceeding 15 years. Subsequent to that time HBFC has carried out its lending under Islamic banking principles called variously Profit and Loss Sharing (PLS) or Rent Sharing Scheme (RSS). Borrowers are referred to as partners.

Repayments start one year after HBFC makes its first disbursement. HBFC does not charge any "shared profit' during this period. The rationale is that the borrower is not deriving any benefit during the construction period; neither rent nor the benefit of living in the house. Therefore, there is no "profit" for HBFC to share in.

In theory, on a "shared profit" loan with, say, 180 monthly installments (15 years), part of the payment goes to reduce the loan and part is the "shared-profit" with HBFC which relates to imputed rental income. But as a loan is repaid the borrower's share of the imputed rental goes up and HBFC's down. Therefore, more of a payment goes to reduce the loan amount (same as in a level payment mortgage). When the imputed rental values for an area of a city are high, HBFC should and does charge more profits.

HBFC simplified its system starting July 1, 1987. The old style PLS "investments" were extended over 15 year periods at net level rental return rates that were reset every three years based on surveyed rental return rates for some 500 areas throughout Pakistan. Also, after every three years the rate at which the principal was repaid was adjusted according to a prearranged schedule requiring increased level principal payments, with a result that every three years the "partners'" monthly payments would be increased.

The new simplified scheme incorporates significant changes from the old style PLS scheme, one of which is to eliminate the annual survey. It incorporates a built-in 5% annual increase in the rental rate while maintaining the same level monthly payment throughout the life of the loan.

The maximum effective "profit" is 15%, the lowest is 6%, depending on the size of the loan, the size of the unit, the location of the property, and the income of the borrower. (See Annex 11 for a complete listing of the ranges of the rates, demonstrations of the "effective" rates, and the accepted locations.). HBFC has had this worked out actuarally so that, starting with fiscal year 1988, the 180 installments are equal. The new system should increase HBFC's profits significantly as it becomes a greater portion of its portfolio (financial operations are computerized by IBM installed on July 1, 1987). Earlier, HBFC was nowhere near market, averaging around 8% on its loans.

Anyone wanting to build his own house or buy a new house from a developer can apply to HBFC for a loan. The maximum loan was increased in fiscal year 1988 from Rs 150,000 to Rs 200,000. However, in March 1988 it was abruptly dropped back to Rs 100,000 so that more loans could be made with the available funds but it's not clear if this change is permanent. The maximum size of a unit in terms of covered area is 2250 sq ft.

HBFC will provide financing up to a maximum of Rs 90 per sq. ft. The borrower must come up with the rest. For example: HBFC will provide a loan for up to Rs 90,000 for a 1000 sq. ft. house. To put this in the perspective of what a borrower might have to pay it is necessary to look at the different classifications of construction which are based on different standards. Class A construction costs around Rs 300 per sq. ft. or more; Class C would average Rs 100-125 per sq ft; Class B somewhere in between. Thus, in the above example, a Class A house would cost, say Rs 300,000, HBFC would finance Rs 90,000 and the borrower would have to pay Rs 210,000 from his own resources.

A borrower must have land with clear title for an application to be considered. He must also get a certificate of non-encumbrance; that is, there must be no loans or liens against the land. He must also have house plans approved by the local authority e.g. Karachi Development Authority, and cost estimates. HBFC makes two disbursements; 40% of the loan amount when the house reaches foundation level and the remaining 60% when the borrower gets the roof on. A borrower must also have the capacity to repay the loan and proof of income is required. HBFC accepts 50% of a person's income toward repayment of a loan which is clearly on the high side.

There is no minimum size loan nor is there a maximum cost house that a borrower can finance. However, the maximum is really controlled by HBFC's loan maximum i.e. Rs 200,000 which is derived from the maximum 2250 sq. ft. size house that HBFC will finance. That is, somebody in theory could spend Rs 1000 per sq. ft. but they wouldn't do this on a house that was only 2250 sq. ft. And that is what is intended; to limit the type of housing that HBFC will finance. HBFC's largest number of loans is in the Rs 60,000 range.

An individual can get only one loan in a lifetime but a loan can be transferred to the purchaser of a house i.e. an assumable mortgage. A loan must be for a new house, either constructed by an individual or built by a developer. One cannot get a loan from HBFC to finance an existing house. The intent is that HBFC fosters the production of new houses.

HBFC provides no construction or bridging finance for developers. For a developer-built apartment project it works as follows: The developer advertises the project (condo apartment) and invites people to "join". HBFC is approached and appraises the project, then reviews the developer's reputation and financial condition. HBFC then works out loans for the individual borrowers. The developer must have completed the "structure" before HBFC disburses any money. It is usually 18 months before the second installment. Work up to completion of the structure is financed by deposits of buyers and the developer's own resources.

B. Loan Servicing

Old (interest bearing) loans are serviced by Habib Bank; new loans by the Muslim Commercial Bank (MCB). Previously the borrower got a payment book and made payment in person to the MCB. A new more simplified system of collections has been launched. A borrower must open an account with MCB. On disbursements HBFC sends a check directly to the account, not to the borrower. On repayments there is no deposit book but the borrower must always keep at least one payment in his account at MCB. When the payment is due MCB sends it to HBFC i.e. it debits the borrower and credits HBFC.

Under the new simplified procedures, if a borrower falls behind MCB will notify and request him to pay. If the account continues to be behind, MCB will notify HBFC and HBFC will pursue.

In theory, HBFC can eventually foreclose if a borrower doesn't pay but there are many factors that enter the picture. As a government agency, there are political, social and economic considerations and these all affect recoveries. If HBFC foreclosed and sold a house it would obviously get very bad publicity. Instead, HBFC tries pressuring a delinquent borrower, issues a notice, sends someone to try and collect, shows him an attachment order, etc.

Another change introduced by HBFC under its new simplified PLS scheme is mortgage life insurance for the "partner". The HBFC is not able to effectively collect or foreclose on a family which loses its principal salary earner. The new scheme includes a life insurance policy which will pay off the HBFC upon the death of the "partner" or the guarantor, if the guarantor's income was used to qualify the "partner" for the original investment. The level premium is included in the monthly installment, in addition to the payment of principal and imputed rent. (The life insurance premium is not included when the HBFC determines the ability of the "partner" to carry the level monthly payment.) The HBFC considers the life insurance policy to be a very popular enhancement to its program.

C. Lending Activity

Since its inception in 1952 up until June 30, 1979 HBFC made almost 80,000 loans totalling about Rs 2 billion (this was the point at which HBFC began to make profit sharing loans). Subsequent to that point until April 1988 HBFC made an additional approximately 150,000 loans totalling almost Rs 10 billion.

In addition to its regular lending schemes described in the previous section, HBFC has undertaken special programs for the government: Rs 450 million for some 270,000 flood victims and Rs 20 million for about 5000 migrants from Bangladesh. HBFC's participation in the new Program for the Shelterless will be such a special program.

Although HBFC does not assign quotas or levels to zonal offices, it now gives priority to loan applications from Baluchistan and the North West Frontier Province to spur housing developing in these two provinces and in this regard approved two new zonal offices at Quetta and Peshawar, respectively (see Annex 4 for a breakdown of lending by area of country). In an attempt to finance more low cost housing, HBFC also gives priority to loans up to Rs 60,000. In processing loan applications the branches have been instructed to give first priority to all loans up to Rs 60,000.

(Annex 5 provides information on numbers of loans and disbursements since 1982-83 in three categories: up to Rs 60,000, Rs 60,000 - 100,000 and Rs 100,000 - 150,000. As pointed out earlier, FY 1987-88 ws the first year for loans up to Rs 200,000 although by March 1988 the maximum loan had been reduced to Rs 100,000.)

However, despite priorities for lower cost housing as a policy, HBFC does no advertising; it simply processes applications that are received. This is undoubtedly due to a demand that far exceeds the supply of funds. HBFC has not developed any statistics as yet on the incomes of its borrowers (it obviously could be derived from a search of the files) nor on the total cost of housing that is getting financed. It only maintains statistics on size of loans.

D. Comments on HBFC's Loan and "Investment" Portfolio

As described, HBFC has two basic types of housing loans or "investments" on its books; one type being the conventional fixed interest rate level payment mortgage loans made prior to June 30, 1979 and the other being the profit and loss sharing "investment" made under Islamic banking methods.

As of June 30, 1987 there were still 56,351 of the conventional loans on the books with an aggregate balance of Rs 2,015.2 million including principal, accrued interest, and late charges.

At the end of FY 1987, there were 147,736 PLS "investments" of the original type with a book value of Rs 9,415 million including principal, accrued "rent", and late charges. There were another 25,497 simplified scheme "investments" that were extended between July 1987 and February 1988 in the amount of Rs 1,854.3 million of which Rs 1,069.2 million had been disbursed as of 29 February 1988.

A review of HBFC internal reports shows an enormous problem with past due loans and "investments". The situation cannot be stated precisely due to a lack of easily obtainable records within the accounting system. The magnitude of the problem is demonstrated with the collection histories of the 56,351 interest bearing accounts and the 147,736 PLS accounts. The HBFC does not prepare global reports showing the number of payments received each month from the major types of accounts. The Study Team, however, developed such information by reviewing the most recent information relating to transactions for each of the 58 district offices compiled by the head office. The results is shown in Annexes 6 and 7, which summarize the gross payments received for the 20 months ending in February 1988 for the interest bearing accounts (Annex 6) and the 12 months ending in June 1987 for the PLS accounts (Annex 7).

Despite its limitations, the information shown in Annexes 6 and 7 is rather startling. Of the 56,356 interest bearing loans on its books, the HBFC received an average of only 16,956 payments per month over the twenty months ending February 1988 or 30% of the payments expected. The situation appears to have deteriorated somewhat recently since an average of only 13,444 payments were received each month during the period September 1937 - February 1988, or 24% of the payments that might be expected. Even so, the average amount of cash received over the 20 months, as well as over the last six months of the period, was about Rs 16 million ($920,000). There was no way of knowing how much could have been expected to be received, nor was there an attribution between interest, principal, and late charges, although these should be available somewhere in the system.

The PLS accounts seem to be in somewhat better shape than the interest bearing accounts, but they are only marginally better. During the 12 months of FY 1987 shown in Annex 7, the HBFC received an average of 59,800 payments per month on its 147,736 PLS accounts, or 40% of the payments that should have been received if the accounts were all good. During the last six months payments were received from an average of 60,521 accounts, or 41%. The exact percentage may be slightly higher because many investments extended during the year do not require payments until after 12 months. However, the collection history for the PLS scheme would still be less than 50%.

According to the HBFC, they are currently receiving around 100,000 payments per month of both types, so it may be possible that some 85,000 of those payments would be coming from the PLS schemes. This could mean that about 58% of those accounts are paying, if one assumes that about 15,000 of the interest bearing accounts continue to pay.

The HBFC prepares a past due report every six months. This summary report lists the total amounts past due, including interest or "rent", and accrued late charges. The HBFC does not prepare a report showing a comparison of the payments actually received with the past due status of the accounts for which payments are received. Such a comparison would allow management to make a meaningful analysis of the quality of its loan and "investment" portfolio.

There is no system to classify the loans and "investments" according to their repayment history. There is no policy that requires HBFC to stop accruing interest or "rent" after some reasonable time period if payments are not received. According to HBFC management, no loan or "investment" has ever been specifically written off, although in 1985 for the first time a provision for doubtful accounts of Rs 3 million was included against the interest bearing loans. This provision was increased by Rs 13 million in FY 1986, and by an additional Rs 30 million in 1987. This is an indication that management is aware of the problem. However these provisions were not against specific loans, and the outside auditors were still unable to give an opinion as to the adequacy of the provisions, due to the deficiencies of the accounting system.

Overall, it is apparent that HBFC should evaluate its portfolio against some standard of recoverability Such an evaluation would certainly require that a significant portion of the portfolio be written off as being uncollectible. Of course, any abrupt write-off of assets without a corresponding restructuring of liabilities would result in the bankruptcy, on paper, of the HBFC. Once the questionable assets are written down, any subsequent collections from them would immediately increase net income. However, as a practical matter the HBFC's liabilities greatly exceed the real value of the assets, so the HBFC could be considered technically bankrupt. The real question is how to proceed with the restructuring, rather than whether a restructuring is needed.

VII. Financial Performance

HBFC does not set a target for receipt of applications or approval of loans because of the limited financial allocation of funds from SBP. In FY 1985-86 (July 1-June 30) HBFC was allocated Rs 1,400 million by the National Credit Consultative Council which was fully used within the first seven months of the year. HBFC stopped taking applications at this point and ceased disbursing any more funds through 6-30-86.

It could not start again until it had received is allocation for FY 1986-87 which amounted to Rs 1,833 million. These funds, in turn, were used up by January 1987. As noted in the financial statements and investment budget, HBFC disbursements have exceeded the funds allocated by SBP by using its own resources.

The same situation is prevailing in the current fiscal year. (See Annex 1 which is the approved HBFC Investment Budget for 1987-88.) The problem is further compounded in that HBFC does not receive its allocation until September/October which means it can not really begin its fiscal year operations until this point.

A. Review of HBFC Balance Sheets & Income Statements

The latest audited statements available (as of April 1988) are for FY 1986. The complete financial statements for FY 1987 had not yet been prepared, although the outside auditor is now conducting its financial accounting audit of HBFC for FY 1987. During the stay in Pakistan of the Study Team, HBFC's financial general manager had his staff prepare a preliminary and unaudited balance sheet and income statement for FY 1987, with stress on the preliminary and unreviewed status. These statements, when compared with the last audited statements, are useful in approximating the changes in the HBFC's financial position over the past two years.

Highlights of the statements for the most recent two years are as follows:

As of FY 1987 the HBFC had total assets of Rs 12,238.6 million, which is the equivalent of US $699 million [See Annexes 8 and 9 for the FY 1986 and FY 1987 Financial Statements.] The single most significant change in assets during FY 1987 was the increase of Rs 2,235.9 million in the HBFC's PLS "investments." These asset changes were balanced by changes in the liabilities in the form of PLS loans from the State Bank of Pakistan and the "bank" holding account, which is a transitory account pending the final disposition of the funds from SBP. The other major liability change was the increase in the share of profit payable to the SBP.

The income statement for FY 1987 shows that income from PLS loans provided an increasing portion of gross income compared with the interest bearing loans. This is natural since all lending has been on a PLS basis since 1979, and PLS loans thus comprise an increasing share of assets. The increase in financial gross income was not matched by a corresponding increase in operating expenses, resulting in increased gross profit for the year. This gross profit was almost completely eliminated by increased taxes payable to the government and the transfer of almost all profit to the SBP as its "share" under the profit sharing loans from it to the HBFC.

Although the stated balances in the financial statements give the appearance of good financial health, a review of the auditor's notes and opinion in the FY 1986 statements reveals several areas of major concern. To begin with, the auditor was unable to reconcile the disbursements and collections accounts, and the related accounts showing the amounts due from the borrowers. There were seven major items of concern to the auditor, ranging from doubtful recoveries on the flood loans and doubtful accounts in Bangladesh, to the lack of consistency in the basis of recording interest on the flood loans, to a general statement citing the ineffectiveness of the HBFC's accounting procedures. These resulted in seven "qualifications" to the audit.

The internally prepared financial statements for FY 1987 had not been subjected to any outside review as of the time of this Study and they are based on the audited FY 1986 statements. Therefore, the lack of any major changes in the provisions for adjustment indicate no major changes in accounting procedures have taken place. However, there have been a series of adjustments to make the system more manageable, including the acquisition of an IBM System 36 minicomputer to automate the accounting system, introduction of the new simplified PLS loan scheme to replace the one used since 1979, and the opening of more zonal offices.

One of the most significant accounting practices being followed by the HBFC which impacts on its financial statements is to accrue interest or rental income on all loans or "investments" without regard to their repayment history. The underlying theory seems to be that the HBFC, through its first mortgage claim to the property, has legal access to the supporting property values even if the payments are not made on time. Under more ideal conditions the full value of any past due payments would be realized by the active threat of foreclosure, which would tend to encourage defaulters to pay up or face the loss of their property. Unfortunately, the HBFC has been unable to effectively carry out the foreclosure threat and has built up a huge level of past due accounts.

These past due accounts do not appear directly under that heading on the balance sheet, but rather are included in the amounts shown as loans or investments, according to the accounting convention mentioned above. The computer department of HBFC prepares a report on the past due amounts every four to six months. These reports are not reconciled with the accounting system, but are close approximations of the real situation.

There are apparently no generally accepted accounting practices in Pakistan to deal with th application of Islamic banking. This broad issue is beyond the scope of the present study, other than to include it as a matter that must be resolved and that definitely affects the prospects of opening housing finance to private market forces. This lack of standards makes it difficult to readily evaluate the quality of the assets and liabilities of the HBFC, or any other institution, for that matter.

The HBFC appears to be treated as a real estate or financial institution rather than a bank in the accounting treatment of its financial assets. It continues to accrue interest and rental income when the payments may be three, five, or even more than twelve years past due. Generally, a bank would stop accruals after three months past due, and would back out accrued interest and start to write off the loan or investment after six months or so, depending on the situation. In contrast, the Survey Team discovered in its discussions with HBFC management that the institution has apparently never placed any regular loan or investment on non-accrual (other than certain refugee loans dating back to Partition), has never backed out unpaid accrued interest, has never written off a single loan or investment, and has never foreclosed on a loan.

This practice has had the effect of overstating the profit attained each year, even if one assumes that all the past due principal could be recovered some time in the future, and one only discounted the past due interest or "rental" income. The HBFC has paid income tax to the government on this questionable income, and the HBFC has shared with the SBP almost all of the "profit". These transfers to government have been in the form of cash payments made during the course of each fiscal year. The Survey Team was unable to determine the accumulated amounts of income taxes paid, but the accumulated "profits" shared with the SBP will amount to Rs 1,610 million (at least $93 million) by the end of the present fiscal year.

B. Asset/Liability Management

A goal of all viable financial institutions is to achieve a proper balance between interest bearing liabilities and interest earning assets so that enough income is generated to cover all operating expenses and still meet the net return on investment targets set by management. The proper balance must be achieved between interest rate differentials, (the "spread"), as well as matching the maturities of the assets and liabilities as closely as possible. Mismatches of maturities should be reduced wherever possible, and proper adjustments made to assure that all liabilities are supported by properly matched assets at all times. The HBFC has not achieved any kind of balance between its assets and liabilities.

The old interest bearing loans from the government were approximately matched with interest bearing loans the HBFC made to its borrowers. The maturities were similar but not exactly matched, with the government loans requiring level semi-annual payments of principal while the borrowers were required to make increasing principal payments each month. The interest rates for these assets were apparently about the same as on the liabilities, although there may have been a negative spread to the HBFC. (There was no summary available of the loans to borrowers. The Survey Team reviewed extensive lists of loans made over the years which appeared to show the interest rates charged were less than the interest rates to be paid to the government. However, it was not possible to verify this while in the field.)

The interest rates on the early SBP loans made prior to the PLS era also appear to be similar to the rates charged to the borrowers. Here, however, there is a basic mismatch of maturities. The loans from SBP were repayable as a balloon payment at the end of ten years, while the loans made to individual borrowers were to be repaid over 15 years. Even under the best of conditions these housing loans would only have repaid about half of their principal at the end of the ten years when the SBP had to be repaid.

The mismatch in repayment histories of these matched assets and liabilities is demonstrated in the balance sheet of 30 June 1987 which shows interest bearing loan assets of Rs 2,015.2 million while the comparable liabilities owed to the government as of 31 December 1987 (Annex 2) totalled Rs 121.5 million. These assets and liabilities would have been about equal if the borrowers had paid as agreed. As it is, the HBFC paid the government as agreed, but still carries the borrowers' loans on its books, most of which have matured long ago. The provisions for doubtful accounts initiated in the last few years applies only to these interest bearing loans.

The repayment terms on the later SBP "investments" to the HBFC were mismatched in terms of rate, in that the "rent" charged the "partner" had no relation whatsoever with the cost of funds to the HBFC.

Rather, the "rent" was set based on a survey of housing costs commissioned every year by the HBFC. The amount of "profit" to be shared with the SBP was determined without regard for the repayment history of the portfolio that was funded by this source of funds, resulting in a consistent overstatement of profit when the HBFC's "partners" defaulted on the "investments". As was shown above, there have been no write-offs or other direct adjustments to the PLS portfolio to reflect is true value.

The PLS "investments" are also mismatched in terms of maturities in the same way as the early SBP loans to the HBFC. The "investments" with the "partners" are made over 15 years with fairly level repayment of principal, while the SBP "investments" in the HBFC are payable in balloon payments after ten years. There was never any way the process would work out, and the present cash crunch was probably inevitable, or at least would occur as soon as the SBP cut back its net budget allotment to the HBFC.

C. Cash Flow Projections

The HBFC prepares a cash budget at the beginning of every fiscal year, in which all sources and amounts of cash are identified, and all cash expenses are estimated. (See Annex 10 for the cash flow for FY ending 6/30/87).

The largest sources of cash are the allocations from the SBP and collections from borrowers and "partners". The largest application or use of cash are the disbursements on new houses and payments to the SBP. The present situation is that HBFC has some doubts as to future levels of support from SBP, while collections from borrowers and "partners" has not been up to expectations.

On the applications side, the repayments to the SBP and the regular administrative and operating expenses have been treated as fixed, with any residual cash being made available for new "investments". HBFC prepared a mid-year cash forecast as of 25 March 1988 with the intention to try and stretch the cash resources of HBFC through the remainder of the current fiscal year. The result was reduction in the amount of disbursements for new "investments" from the originally planned level of Rs 2,143 million to Rs 1,629.8 million. However, the level of commitments did not appear to change, indicating the unfunded commitments would be expected to be funded from next year's cash budget and allocation. It was not at all clear how or whether these cash projections would reconcile with the actual performance during the year.

VIII. Conclusion and Assessment of the Future

With the government looking to shift more of its programs to the private sector and with the SBP indicating that it will reduce or eliminate its subsidized lending to government financial institutions, there is a very real question as to where HBFC goes from here; what is the role it will play in any new housing finance system designed to attract private interests.

While HBFC's operations can undoubtedly be improved, it is already taking steps which have resulted in improvements in accounting, collections and organization. It has, however, without doubt been afflicted with the problems that plague specialized government financial institutions in many countries. It has had to participate in lending for government programs, e.g., flood victims, using resources it has obtained on a loan basis from government where its likelihood of recovery was dim. Its lending rates (or rate of return relative to PLS) are far below what it would cost to raise resources in the market. Its high rate of delinquencies, while perhaps due in part to its own inefficiencies, are heavily influenced by the system of foreclosures and by the sometimes political implications of collecting.

The end result is an institution that is technically bankrupt, has a problem with its public image and is facing the possibility of having to seek its funds on the market (pretty much an impossibility unless the government were to provide a 100% guaranty).

Where does HBFC go from here? As a $700 million institution it is unlikely that government will allow it to fail. A number of possibilities for HBFC have been discussed or put forth.

To participate in and foster the development of a private housing finance industry, HBFC could set up a wholly-owned subsidiary which would operate at market levels or set up a department within HBFC to do the same thing. This could be done while gradually putting its existing portfolio in order. As part of this exercise, HBFC should be allowed to write-off all loans that are no longer repaying and are deemed uncollectible and it should be recapitalized to reflect this loss of assets.

HBFC could be reconstituted as the agency that will license, regulate and supervise a new private housing finance industry and provide wholesale funding to that industry. Here again, it would eventually have to dispose of its existing assets.

It could become the financing agency for all government-supported housing programs, those that because of the nature of the beneficiaries, e.g., the Shelter for the Shelterless Program, would provide some level of subsidy to the lowest income families. But in such a scenario subsidies should be recognized and provided up front and not in the way HBFC is forced to operate currently.

Or, finally, HBFC could in theory do all of these things. What needs to be done is that the government clearly set out the role that it wants HBFC to play and then make possible the financing of that role.

It is the conclusion of this study that HBFC in the long run should not do what the private sector can do and therefore shouldn't compete with the private sector. However, there is always the need for a government housing bank to provide financing for an income level that the private sector will not seek to reach, at least initially. But this need should be met as efficiently and in the most cost effective way possible and subsidies, such as are provided, be focussed on the most needy.

Since the Asian Development Bank is going to finance a major study of HBFC and its operations in the very near future this report will not go further than the conclusion outlined above so as not to preclude the eventual recommendations of that study.

Annex I

HOUSE BUILDING FINANCE CORPORATION
1987-88 APPROVED INVESTMENT BUDGET
(thousands of Rupees)

FUNDS AVAILABILITY	
Carryover from last year	52,341
State Bank of Pakistan credit line	1,450,000
Recovery of Principal from borrowers/partners	743,600
Flood subsidy from Govt of Pakistan	1,500
Faisal Town installments from house purchasers	67,000
Staff loans recovery of principal	600
Brought forward from Administrative Budget	471,760
Sale proceeds of HBFC House Islamabad	165,000
TOTAL:	2,951,801

UTILIZATION OF BUDGET:	
Disbursement under Rent Sharing Scheme (RSS)	1,943,000
Payment of prinicpal to SBP	400,000
Payment of interest of interest bearing scheme to SBP	52,545
Payment of principal to Govt of Pakistan	35,000
Payment of interest to Govt of Pakistan	12,304
Payment of RSS Sharing of profit to SBP	433,400
Insurance Fund	500
Carryover to next budget	75,052
TOTAL:	2,951,801

Annex 2

HOUSE BUILDING FINANCE CORPORATION
HEAD OFFICE KARACHI
GOP Loans

	Yearwise sanction	Rate of Interest	Repayment made upto 31.12.87	Balance of Principal as on 31.12.1987
1972-73	10,000,000	8.25%	9,666,663	333,337
1973-74	42,500,000	9.25%	41,083,322	1,416,678
1973-74	57,500,000	9.25%	51,749,998	5,750,012
1974-75	100,000,000	10.25%	83,333,350	16,666,650
1975-76	100,000,000	10.50%	76,666,682	23,333,318
1976-77	80,000,000	10.75%	55,999,986	24,000,014
1977-78	44,643,000	10.75%	29,761,980	14,881,020
1977-78	20,357,000	11.75%	13,571,340	6,785,660
1978-79	35,240,057	12.50%	21,144,060	14,095,997
1978-79	32,759,943	12.50%	18,563,932	14,196,011
	523,000,000		401,541,303	121,458,697

1. All loans are payable in 15 years in bi-annual instalments.

2. All these loans pertain to interest bearing scheme.

136

Annex 3

HOUSE BUILDING FINANCE CORPORATION
FINANCE DEPT. HEAD OFFICE, KARACHI

LOANS FROM THE STATE BANK OF PAKISTAN

Year of sanction	Credit Line Nos.	Amount Sanctioned	Remarks
1974-75	I to III	265,000,000	Paid
1975-76	IV	300,000,000	Paid
1976-77	V to VI	420,000,000	Paid
1977-78	VII to XII	400,000,000	Partial paid Rs.250M upto 30.3.88
1978-79	XIII to XVII	450,000,000	
1979-80	XVIII to XXV	650,000,000	Partial paid in C.L. No. 18 & 19
1980-81	XXVI to XXXII	853,328,000	Partial paid in C. L. No. 31
1981-82	XXXIII to XXXVIII	1239,000,000	
1982-83	XXXIX to XLII	1100,000,000	
1983-84	XLIII to XLIV	1050,000,000	
1984-85	XLV to XLVI	1365,000,000	
1985-86	XLVII to XLVIII	1400,000,000	
1986-87	XLIX	1833,000,000	Partially paid in C. Line No. 48
1987-88	L	1850,000,000	
		13175,328,000	
Less payment of C.L. 1 to X		1235,000,000	
		11940,328,000.00	
Less payment partially paid in Credit Line 31 & 48		44,481,466.64	
		11895,846,533.36	

1. All above credit lines are payable after 10 years of its year of sanction

2. Credit Line No. 1 XIX carry 8% interest rate i.e. 2% below bank rate and belong to interest bearing scheme

3. Credit Line 20 onwards relatds to Profit sharing scheme

HOUSE BUILDING FIN, ,E CORPORATION
HEAD OFFICE KARACHI.

(RS. IN MILLION)

DISBURSEMENT YEAR WISE AND ZONE WISE

YEARS.	TOTAL.	KARACHI.	HYDERABAD.	QUETTA.	MULTAN.	LAHORE.	ISLAMABAD.	PESHAWAR.
1981-82	1344.70	506.00	120.43	13.19	142.56	228.15	233.73	100.64
1982-83	1150.30	384.73	122.67	15.40	98.38	119.92	136.40	272.80
1983-84	1385.00	393.90	213.30	27.00	141.21	234.19	245.19	130.21
1984-85	1300.71	329.32	176.70	17.90	146.21	259.18	230.54	140.86
1985-86	1314.00	382.41	184.04	10.50	130.41	228.38	244.74	133.52
1986-87	2020.93	582.03	200.84	15.61	241.05	353.61	399.66	228.13
TOTAL:	8515.64	2578.39	1017.98	99.60	899.82	1423.43	1490.26	1006.16

YEARS.	SOUTHEREN REGION	NORTHERN REGION	TOTAL.
1981-82	639.62	705.08	1344.70
1982-83	522.80	627.50	1150.30
1983-84	634.20	750.80	1385.00
1984-85	523.92	766.79	1300.71
1985-86	576.95	737.05	1314.80
1986-87	798.48	1222.45	2020.93
TOTAL:-	3695.97	4819.67	8515.64

Annex 4

HOUSE BUILDING FINANCE CORPORATION

HEAD OFFICE KARACHI

(RS. IN MILLION)

CATEGORYWISE INVESTMENT APPROVED

YEAR	UPTO RS.60,000		RS.61,000 TO RS.100,000		RS.101,000 TO RS.150,000/-		T O T A L	
	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT
1982:83	8032	360.70	6791	559.70	2936	345.20	17759	1265.60
1983:84	10032	481.60	10825	899.60	2499	304.20	23356	1685.40
1984:85	7854	385.52	8982	735.37	2452	335.48	19288	1456.37
1985:86	9689	454.52	8256	685.63	3024	403.96	20969	1544.11
1986;87	6119	283.13	6029	504.46	3000	381.08	15148	1168.63
	41726	1965.47	40883	3384.76	13911	1769.88	96520	7120.11

Annex 5

171

Annex 6

HOUSE BUILDING FINANCE CORPORATION
HEAD OFFICE KARACHI

COMPUTER DIVISION

COLLECTION STATEMENT OF INTREST BEARING SCHEME
FOR THE PERIOD FROM JULY,86 TO FEBRUARY,88

PERIOD	AMOUNT(Rs)	AMOUNT(In Million)	NO OF TRANS.
July,86	1,64,67,496.04	16.467	12557
Aug, 86	1,02,68,303.57	10.268	11278
Sept,86	2,03,46,124.24	20.346	32176
Oct, 86	1,35,79,398.57	13.579	11888
Nov, 86	1,41,04,301.69	14.104	13888
Dec, 86	1,62,88,844.54	16.289	30568
Jan, 87	1,68,36,454.53	16.836	18673
Feb, 87	1,58,64,532.32	15.864	15274
Mar, 87	1,50,10,987.85	15.011	22455
Apri,87	1,68,26,314.40	16.826	16755
May, 87	1,37,38,460.90	13.738	22168
June,87	2,47,34,235.68	24.734	17641
July,87	1,76,77,158.90	17.677	18902
Aug, 87	1,33,73,499.01	13.373	11929
Sept,87	1,48,85,199.25	14.885	12558
Oct, 87	1.59,27,750.84	15.928	13316
Nov, 87	1,50,36,582.35	15.036	13515
Dec, 87	2.13,98,556.41	21.398	17345
Jan, 88	1,29,74,525.02	12.974	12577
Feb, 88	1,56,17,011.54	15.617	11355

Annex 7

HOUSE BUILDING FINANCE CORPORATION
HEAD OFFICE KARACHI

COMPUTER DIVISION

COLLECION STATEMENT OF INVESTMENT SCHEME
FOR THE YEAR 1986 - 87

PERIOD	AMOUNT(Rs)	AMOUNT(In Million)	NOS OF TRANS
July,86	5,63,26,102.30	56.326	59901
Aug,86	4,74,73,124.00	47.473	53782
Sept,86	5,10,01,901.18	51.002	53815
Oct,86	5,36,93,068.00	53.693	55581
Nov,86	3,80,78,572.50	38.079	57908
Dec,86	6,81,36,224.12	68.136	73496
Jan,87	5,44,09,524.30	54.409	54811
Feb,87	5,42,74,015.90	54.274	53362
Mar,87	6,24,29,657.51	62.430	60851
Apr,87	5,89,99,450.75	58.999	59706
May,87	4,89,16,774.50	48.917	60876
Jun,87	7,78,08,833.90	77.809	73520
Total	67,15,47,248.96	671.547	

IBRAHIM, SHAIKH & CO.
CHARTERED ACCOUNTANTS

SIDAT HYDE[illegible] & CO.
CHARTERED ACCOUNTANTS

HOUSE BUILDING FINANCE CORPORATION

BALANCE SHEET AS ON 30 JUNE 1986

CAPITAL AND LIABILITIES	NOTE	1986 Rupees	1985 Rupees
CAPITAL			
Authorised			
40 shares of Rs.5,000,000/- each		200,000,000	200,000,000
Issued, subscribed and paid-up	3	200,000,000	200,000,000
RESERVES AND SURPLUS	4	37,024,192	41,770,918
LOANS	5	9,088,999,041	8,067,413,054
LOAN FROM INTERNATIONAL DEVELOPMENT ASSOCIATION	10.1	100,000,000	100,000,000
OTHER LIABILITIES AND PROVISIONS			
Accrued interest	6	160,768,060	184,819,633
Creditors and provisions	7	12,462,252	10,875,838
Taxation - net		20,001,995	14,499,813
Share of profit payable to State Bank of Pakistan	8	442,247,600	382,068,119
		635,479,907	592,263,403
CONTINGENCIES AND COMMITMENTS	9	-	-
		10,061,503,140	9,001,447,375
P.R.R.F.C. (LIABILITIES)	21	19,627,601	19,627,601

PROPERTY AND ASSETS	NOTE	1986 Rupees	1985 Rupees
CASH AND BANK BALANCES	10	99,002,641	73,833,931
BANK ACCOUNTS	11	35,563,976	(1,256,976)
INVESTMENTS - Unquoted	12	11,100,000	11,100,000
INVESTMENT UNDER RENT SHARING SCHEME		7,178,121,017	6,089,983,059
LOANS - Secured	14	2,084,537,233	2,212,479,961
LOAN - Lahore Development Authority	10.1	94,000,000	94,000,000
OTHER ASSETS			
Work-in-progress - housing projects	15	75,702,101	86,170,036
Advances, deposits and prepayments	16	63,972,399	48,039,934
Accrued interest	17	6,587,049	5,245,973
Stock of stationery and forms		306,176	290,059
		146,567,725	139,746,002
FIXED CAPITAL EXPENDITURE			
Fixed Assets - at book value	18	19,796,518	20,407,769
Capital Work-in-progress	19	127,599,904	101,926,503
		147,396,422	122,334,272
NET ASSETS IN BANGLADESH	20	265,214,126	259,227,126
		10,061,503,140	9,001,447,375
P.R.R.F.C. (ASSETS)	21	19,627,601	19,627,601

AUDITORS' REPORT ANNEXED

The annexed notes form an integral part of the accounts.

DIRECTOR

DIRECTOR

Annex 8

Annex 9

IBRAHIM, SHAIKH & CO.
CHARTERED ACCOUNTANTS

SIDAT HYDER ASLAM & CO
CHARTERED ACCOUNTANTS

HOUSE BUILDING FINANCE CORPORATION

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30 JUNE 1986

	NOTE	1986 Rupees	1985 Rupees
INCOME			
Interest	22	160,817,555	178,376,655
Share in rental income		313,692,155	245,693,332
Other income	23	53,024,265	42,706,312
		527,533,975	466,776,299
EXPENDITURE			
Interest and bank charges	24	144,750,943	170,712,286
Establishment expenses	25	47,188,205	43,475,016
Rent, rates, taxes and insurance		4,188,914	4,802,699
Postage, telephone and telegram		1,213,212	1,240,254
Printing and stationery		1,366,721	1,767,154
Legal and professional charges		780,652	686,925
Audit fee		30,000	30,000
Depreciation and repairs to fixed assets		3,211,951	3,006,200
Provision for doubtful receivables		13,000,000	3,000,000
Other expenses	26	2,997,185	3,821,140
		218,727,783	232,541,674
		308,806,192	234,234,625
SHARE OF PROFIT PAYABLE TO STATE BANK OF PAKISTAN	27	308,050,736	234,196,864
NET PROFIT BEFORE TAXATION		755,456	37,761
PROVISION FOR TAXATION			
Current		5,502,182	1,518,880
Prior years		-	13,204,690
		5,502,182	14,723,570
LOSS AFTER TAXATION		(4,746,726)	(14,685,809)
UNAPPROPRIATED PROFIT BROUGHT FORWARD		14,797,815	29,483,624
UNAPPROPRIATED PROFIT CARRIED FORWARD		10,051,089	14,797,815

The annexed notes form an integral part of the accounts.

HOUSE BUILDING FINANCE CORPORATION

Annex 10

(RS. IN MILLION)

CASH FLOW AS ON 30-6-1987

		1-7-1986 TO 30-6-1987
A-	FUND RESOURCES	
	Opening balance	207.225
	Receipt from State Bank	1833.000
	Recovery/Collections	933.913
	Sale Proceeds of Faisal Town & Misc	12.403
		2986.541
B-	FUNDS UTILISATION:	
	Disbursement	2022.93
	Payment to State Bank	420.000
	Debt Servicing	50.356
	Interest on State Bank loans	82.433
	Establishment Exp including refundable advances	92.648
	Project Expenses	10.984
	Share payable to State Bank	250.796
	Advance income tax	2.500
		2932.647
	BALANCE AS ON 30-6-1987:	53.894

Annex 11-1

Housing Finance Study - HBFC

Table 1: Accepted locations for HBFC housing loans & "investments"
20-Apr-88

Assumptions:
1. Not all types of "investments" are available in all locations.
2. See Table 2 for maximum amounts and return rates.
3. Income groups are neighborhoods in the listed cities.
4. Numbers indicate how many rental return rates are offered within each income group

Source: Analysis of HBFC documents

	Houses				Apartments			
Income groups ->	Lower	Lower-Middle	Middle	Upper	Lower	Lower-Middle	Middle	Upper
Localities:								
Islamabad				2X				2X
Rawalpindi	4X	4X	4X	2X				
Lahore	4X	4X	4X	2X	3X		3X	3X
Faisalabad		4X	4X	2X				
Multan	4X	4X	4X	2X				
Karachi	4X	4X	4X	2X	3X	3X	3X	3X
Hyderabad	4X	4X	4X	2X		2X		
Peshawar		4X	4X	2X				
Quetta		4X	4X	2X				
Dist. towns Punjab	4X	4X						
Dist. towns Sind	4X	4X				2X	(Sukkur)	
Dist. towns NWFP	4X	4X						
Dist. towns Baluch.	4X							
Northern Areas	4X							
Azad-Kashmir	4X							
Rural Areas Non-RCC Houses	2X							