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HOUSING DEVELOPMENT AND ITS FINANCING
DEBT RECOVERY MECHANISMS
AND
MORTGAGE FORECLOSURE LAWS

DRAFT REPORT NO. 03

DRAFT LEGISLATION

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210, R.S.M. Square, Shaheed-e-Millat Road, P.O. Box: 2010, Karachi-75350, Pakistan
Ph: (21) 449133 & 34, Telex 25727 BMS PK. & 24104 ACB PK. Fax: (21) 438710

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For Amendment and Improvement of Debt Recovery Mechanisms and Mortgage Foreclosure Laws in Pakistan

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INTRODUCTION:

01.01 For the past ten years, the Government of Pakistan has been stressing the need and trying to promote increased participation of the private sector in housing finance. But the commercial banks and the DFIs have been least interested in this activity due to high risks involved in recovery of long term housing loans advanced against mortgage of property. Commercial banks find it more profitable to advance short term loans involving higher turnover and lesser risk in repayment. The unsatisfactory performance of the HBFC has also contributed to this sentiment although it is common knowledge that HBFC is a public sector agency and its employees are inefficient and dishonest. The State Bank of Pakistan has also not been enthusiastic in this sector and has not accorded any priority to housing loans while setting credit ceilings for commercial banks. And in fact all along there has been an absence of a proper legal framework for establishment of housing finance companies (HFCs) in the private sector.

01.02 It was only in December, 1990, when, on the recommendations of the National Seminar on Housing held in August, 1990, the Ministry of Finance issued an SRO

providing a legal framework for the setting up of HFCs. Two months later another SRO was issued inviting applications for permission to set up HFCs. About two dozen applications were received but permission was initially given to only Citibank and PICIC to set up subsidiaries. Later another four permissions have been granted but none of them has started functioning so far. And the main reason for this slow progress is the fear of not being able to recover the long term mortgage loans. About 20,000 cases are pending in civil courts and banking tribunals for recovery of bank/DFI loans. These cases have been filed by banks and DFIs and about two billion rupees of these institutions are reported to be stuck up in these loans. Some of the cases are pending for over ten years. The financial institutions face the following constraints due to delays in recovery of loans:

(i) Loss of income by way of stoppage of interest/markup.

(ii) Decrease in the intrinsic value of money as the cases are decided after many years.

(iii) Reducing the ability of the institutions in expending credit facilities.

(iv) Loans for housing finance are long term - 15 to 20 years duration and the security is landed property where sale/foreclosure is problematic.

01.03 An English Judge of the Primary Council had once remarked that in the sub-continent the problems of the litigant start after obtaining a decree in his favour. The defendant/borrower adopts all types of delaying tactics; courts are overworked and grant adjournments without costs; there are delays in service of process as the court bailiffs connive with the defendants; anyone with an interest in the mortgaged property including the tenant is required and/or entitled to be joined in the legal proceedings; borrowers give had cheques which are dishonoured for lack of funds. All this delay occurs because the borrower/defendant is fully aware of the position that under the present legal system/mechanism, he can always effect a compromise and/or pay up the dues anytime before sale of the mortgaged property. The Transfer of Property Act is an old and antiquated law and proceedings under the Civil Procedure Code are slow and exploitable by the defendant. The right of foreclosure has been virtually eliminated under the T. P. Act although technically a provision is there: this is because the bias of equity provides protection to the mortgagor's right of redemption. The special powers in the HBFC and IDBP Acts are also not adequate as intervention of court is about always required and the district judges usually come to the rescue of the defendants and allow them fresh time to pay the outstanding dues in instalments. Banks and DFIs have generally not resorted to make use of Section 69 of the T. P. Act which allows the mortgagee in certain cases to

sell the property without the intervention of courts. This is because the agreements between the lending institutions and the borrowers do not include these special provisions and secondly because it is not possible under the present laws to have the house vacated without the execution of a court decree and a house without vacant possession does not attract buyers.

01.04 In addition to the aforesaid legal problems, there are some other constraints also: The records kept by the Land Revenue Department or the Development Authorities are not conclusive proof of title to land; transfer fee and stamp duties are exporbitantly high under the Registration Act and the Stamp Duties Act; lack of compulsory system of land registration leads to fraudulant and multiple sales; there are no set rules of evaluation of property and there are no licensed evaluators; registration of mortgage is subject to very high stamp duties. There are also problems of land registration, transfer and title which need to be adequately resolved if an effective housing finance system is to be promoted in the private sector.

02. India has the same laws and mortgage debt recovery mechanism as in Pakistan. Indian courts are also overloaded with cases pending for over ten years; the defendants in India also adopt delaying tactics; their land title and registration system is the same. India is experiencing many of our problems but at the same time they have taken a leap forward and made substantial

progress towards the establishment of a strong housing finance industry in the private sector. Banks in India have to invest 1.5% of their incremental deposits in housing and have set up HFCs as their subsidiaries. The HFCs in India tend to be selective in lending and over-securitize the loans; they monitor the recovery process very closely - many of them with computer aided systems. But despite all their efforts many HFCs in India are facing problems in recovery of mortgage loans because they too do not have the power to sell the house and have it vacated without prolonged and frustrating litigation.

03. A Study of Malaysia revealed that all the commercial banks have to invest 5% of their assets in low and medium cost housing. They operate as HFCs. Besides there are several large and small building societies in the private sector, providing long term loans for housing against mortgage of property. The legal mechanism in Malaysia is far better that in India and Pakistan. They have well defined legislation to regulate the working of HFCs. Laws have also been framed for the licensing and control of housing developers. The evaluators are licensed; purchase and sale agreement has been standardised; land record system has been overhauled with the result that title to land is clear. The developer has to open and maintain an account with a bank or HFC: the bank's bridge loan to the developer as well as the down payments made by the house buyers are deposited in this account which is operated by the

bank/HFC and not by the developer and in this way the unscrupulous developers are kept under strict watch and control and not allowed to play with the bank loans or the money paid by the buyers. The mortgage loan recovery law and the legal mechanism is helpful, quick and responsive with the result that it is possible to secure vacant possession, sell the mortgaged house and thereby recover the dues within one to two years. In Malaysia also the HFCs appraise and scrutise the loan applications properly and closely monitor the computer aided loan recovery process.

04. A study of the situation prevalent in Sri Lanka indicated that they have no HFCs in the private sector but their lending institutions in the public sector like the HDFC, the State Mortgage and Investment Bank and the National Savings Bank are well organised in grant of housing loans against mortgage of land/house. Laws in Sri Lanka have been amended so that every HFC/commercial bank has the legal authority to physically take over possession of the mortgaged property and sell it. The property evaluators are licensed. The lending institutions in Sri Lanka are allowed to buy the property under auction at the upset price which is fixed in advance.

DRAFT LEGISLATION:

04.01 The above analysis of the current ineffectiveness of Pakistani laws and mechanism in effecting recovery of

loans advanced against mortgage of property and the study of the improved situation in Malaysia and Sri Lanka and the progress made in India, calls for an urgent action to bring about necessary improvement in our laws and systems also in order to promote the housing finance industry in the private sector in Pakistan.

04.02 The present Report deals with the legislative measures suggested in Report No. 2 which have been discussed in the preceding paragraphs also. However, it is important to note, that the following two aspects are not proposed to be dealt with:

(i) legal difficulties arising from the deficiencies in the system of title and registration of land. This subject in the present context calls for a detailed study and major legislative changes since what is required is a wholesale reformation of the system of land record and registration in Pakistan. Therefore, minor legislative changes in the present set-up will not be appropriate and may in fact further confound an already perplexing situation. In our view appropriate care, prudence and vigilance on the part of Housing Finance Companies would be adequate safeguard pending the comprehensive legislative changes required for introduction of a proper and effective land to title and registration system in Pakistan.

(ii) changes in service of process for purposes of execution as suggested in Report No. 2 have, on a closer examination been found to be unnecessary since Section 11 of the Banking Tribunals Ordinance, 1984, envisages that the Banking Tribunal shall immediately pass an order for execution of the decree on the written or oral application of the Decree-holder. It would thus appear that the Banking Tribunal is competent to pass orders for execution of the decree without serving any notice on the defendants.

04.03 It may be noted here that the State Bank of Pakistan has already notified that the HFCs will be treated as banking companies and be entitled to take their cases to the Banking Tribunals.

PROPOSED DRAFT OF LEGISLATION

05.01 The proposed Legislation seeks to implement the following:

(i) granting the HFCs a right to foreclose in case of default by the mortgagee. Coupled with this right is the right to obtain vacant possession of the mortgaged property on passing of a decree for foreclosure alongwith the right to evict any tenants or squatters in occupation of the mortgaged property without recourse to the Courts. Police assistance may also be availed for this purpose.

(ii) power to sell without intervention of the Court and to obtain vacant possession including the right to evict tenants or squatters without resource to Courts. Police assistance may also be availed for this purpose.

(iii) expeditious proceedings in the Banking Tribunal have been sought to be strengthened by minimizing adjournments and allowing adjournments only on imposition of high costs.

(iv) issuance of cheques which are dishonoured later on, to be made a criminal offence to deter mortgagees from adopting such tactics.

06. THE PROPOSED DRAFT LEGISLATION

Draft is appended herewith as ANNEX "A"

PROCEDURE FOR THE PROMULGATION OF THE PROPOSED LAW

07.01 The final draft of the proposed law should be handed over to the Ministry of Finance since that is the Ministry dealing with regulations and control of HFCs.

07.02 The Minister for Finance will take the draft of the proposed law to the Cabinet for approval.

07.03 After the Cabinet has approved it in principle, the draft will be sent to the Ministry of Justice for legal vetting.

07.04 The Ministry of Justice may effect some changes without altering the policy contained in the proposed draft. Thereafter it will be the responsibility of the Minister for Finance to introduce it in the National Assembly as a Bill. However, the Minister will have to give a written notice to the Secretary of the Assembly, before introducing the Bill, for his intention to do so.

07.05 The Secretary of the National Assembly will then have the Bill published in the Gazette of Pakistan whereupon it will stand referred to the concerned Standing Committee. However, reference to the Standing Committee can be dispensed with if the Assembly agrees.

07.06 Seven days after the receipt of the Bill from the Standing Committee, it will be set down, with modifications if any recommended by the said Committee, on the Orders of the Day for a day meant for Government business.

07.07 On the said day, the Bill may be referred to a select Committee if necessary. In any case that will be the first day on which the principles of the Bill and its general provisions will be discussed without going into the details. This is called the first reading of the Bill.

07.08 After the first reading of the Bill, it will be open to the members of the Assembly to move amendments.

07.09 If no amendments are moved, the Minister-in-charge can ask the Assembly to pass the Bill straight-away.

07.10 In case there are amendments to be dealt with, a thorough discussion on the amendments will follow.

07.11 Thereafter the Bill will be read clause by clause and the preamble and the title of the proposed law will also be discussed separately. This is called the second reading of the Bill.

07.12 After the second reading, the proceedings will be adjourned to a later day for final consideration.

07.13 On that day, the third and final reading of the Bill will take place but no further amendments of substance will be allowed. The Bill will be discussed generally and arguments will be addressed only either in support, or for the rejection, of the Bill. The details are not supposed to be discussed.

07.14 When the Bill is passed it will be transmitted to the Senate for concurrence.

07.15 The Senate may within 90 days either pass it with or without amendments or reject it.

07.16 If the Bill is passed by the Senate without amendments, it will be presented to the President for assent.

07.17 If it is neither passed nor rejected within 90 days, or is passed with amendments, the National Assembly may ask for it to be considered in a joint sitting of the two Houses of Parliament.

08. If a request that the Bill be considered in a joint sitting is made by the National Assembly, the President shall summon a joint sitting.

09. The joint sitting may pass the Bill, with or without amendments, by the votes of the majority of the total membership of the two Houses. Thereafter it will presented to the President for assent.

10. The President is supposed to assent to a Bill within thirty days of its presentation to him. On his assent, the Bill becomes law and is called an Act of Parliament.

11. However the President may return the Bill to the Parliament for reconsideration which, in this particular case is very unlikely.

Annex "A"

Act No._____of 1992

The Housing Companies Act 1992.

An Act to provide for the establishment of Housing Finance Companies.

Whereas it is expedient to provide for the effective working and regulation of Housing Finance Companies in Pakistan and to amend certain laws for the purposes thereof.

It is hereby enacted as follows:

Short title, extent and commencement.

(1) This Act may be called the Housing Finance Companies Act, 1992.

(2) It shall extend to whole of Pakistan.

(3) It shall come into force at once.

02. Definitions:

In this Act, unless there is anything repugnant in the subject or context:

(1) "Tribunal" means Banking Tribunal established under section 4 of the Banking Tribunals Ordinance, 1984 (Ordinance No. LVII of 1984) as amended from time to time.

(2) "Housing Finance Company" means a Company duly registered and licensed by the Federal Government under the provisions of this Act.

(3) "Rules" means rules made under this Act.

03. Application of other laws not barred:

The provisions of th is Act shall be in addition to and not, save as hereinafter expressly provided, in derogation of other laws for the time being in force.

04. Registration and licensing of Housing Finance Companies:

The Federal Government may by rules lay down terms, conditions and requirements for the registration and licensing of Housing Finance Companies.

05. Right to foreclosure:

(1) Notwithstanding anything contained in section 67 of the Transfer of Property Act 1882 (Act IV of 1882) a Housing Finance Company in its capacity as a mortgagee shall have, at any time after the mortgaged money has become due to it, and before a decree has been made for the redemption of the mortgaged property, or mortgaged money has been paid or deposited, a right to obtain from the Tribunal a decree that mortgagor shall be absolutely debarred of his right to redeem the property.

(2) The Tribunal shall not grant a decree for foreclosure where the mortgagor satisfies the Court that there has been a fundamental change of circumstances beyond his control on account of which he has not been able to make payments of money due to the Housing Finance Company.

In a case where the court is so dissuaded from passing a decree for foreclosure it shall in the alternative pass a decree for sale of the mortgaged property so that the Housing Finance Company may recover its dues from the proceeds thereof.

(3) On obtaining a decree of foreclosure, the Housing Finance Company shall be entitled, notwithstanding any thing to the contrary contained in any law for the time being in force, to obtain vacant possession of the mortgaged property and for that purpose, if required, have the mortgagor (or mortgagors) as the case may be, as well as any person who may be in occupation, of all or any part thereof, evicted with the assistance of Police.

(4) The remedy available to a Housing Finance Company under this section shall be in addition to any other remedy available to it under the law for the time being in force.

06. <u>Power to sell</u>:

(1) Notwithstanding anything to the contrary contained in any other law for the time being in force, a Housing Finance Company or any person acting on its behalf, shall, subject to the provisions of this section, have the power to sell or concur in selling the mortgaged property, or any part thereof in default of payment of the mortgaged money, without intervention of the Tribunal.

(2) The power under sub-section (1) shall not be exercised unless and until a notice in writing requiring payment of the outstanding dues under the mortgage has been served on the mortgagor, or one of the several mortgagors, and default has been made in payment of the said amount, or of any part thereof, for 2 months after such service.

(3) When a sale has been made in exercise of power under this section, the title of purchaser shall not be impeachable on the ground that no case had arisen to authorise the sale or that due notice was not given or that power was otherwise improperly or irregularly exercised; but any person damnified by an unauthorised, improper or irregular person shall have his remedy in damages against the Housing Finance Company exercising the power.

(4) Notwithstanding anything to the contrary contained in any other law for the time being in force, the purchaser of the mortgaged property shall be entitled to obtain vacant possession of the mortgaged property purchased by him and for that purpose, if required have the mortgagor or mortgagors as the case may be, as well as all other persons who may be in occupation thereof or any part thereof, evicted with the assistance of Police.

(5) The money which is received by the Housing Finance Company arising from the sale after discharge of prior encumbrances, if any, to which the sale is not made subject, or after payment into Court under section 57 of the Transfer of Property Act 1882 of a sum to meet any prior encumbrance, shall be held by it to be applied as follows:-

(i) firstly in payment of all costs, charges and expenses properly incurred by it as incidental to the sale or any attempted sale; and

(ii) secondly, in discharge of all outstanding amounts due under the mortgage; and

(iii) thirdly, the residue of the money so received shall be paid to the person

17

entitled to the mortgaged property, or authorised to give receipts for the proceeds of the sale thereof.

07. <u>Amendment of the Banking Tribunals Ordinance, 1984 (LVIII of 1984):</u>

(1) In section 6 after sub-section (5) the following new sub-section shall be inserted, namely:

"(5A) As far as possible, no adjournment shall be granted by the Banking Tribunal except for reasons to be recorded in writing and any adjournment granted shall be subject to heavy cost.

(2) In section 7 after sub-section (1) the following new sub-section shall be inserted, namely:

"(1-A) If a cheque issued by a person towards payment of his liability to the Housing Finance Company, is dishonoured for any reason whatsoever that person shall be deemed to have committed a criminal offence punishable with an imprisonment of 2 years and a fine equal to twice the amount for which the cheque was issued, or both".

08. Indemnity:

No suit, prosecution or other proceeding shall lie against the Federal Government or a Provincial Government or any officer of the Federal Government or of a Provincial Government for anything in good faith done or intended to be done in pursuance of this Act or the rules made thereunder.

09. Power to make Rules:

The Federal Government may by, notification in the official Gazette make Rules to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

10. Removal of Difficulties:

If any difficulty arises in giving effect to any provision of this Act, the Federal Government may, by notification in the official Gazette, make such order not inconsistent with the Provisions of this Act as may appear to it to be necessary for the purpose of removing any difficulty.