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ABSTRACT

There is presently no organized private sector mortgage lending in Pakistan. The only systematic program of mortgage lending in Pakistan is currently being conducted by the Housing Building Finance Corporation which is essentially controlled by the Ministry of Finance. The country's Seventh Development Plan (effective FY88) announces a policy of shifting responsibility for development from the government to the private sector. The Plan also indicates the desirability of establishing a private housing finance system. Existing studies show that a major impediment to the establishment of a private sector housing finance system is the absence of a viable means for recovery of debts through a workable mortgage foreclosure procedure. This report explores the country's current lending practices, a revision of Pakistan's mortgage foreclosure scheme, and elements of a restructured foreclosure system.

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**REVISION OF PAKISTAN'S
MORTGAGE FORECLOSURE
LAWS**

August 1990

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**Prepared for:
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Office of Housing and Urban Programs
Washington, DC**

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1.0 INTRODUCTION

1.1 Current Lending Practices

The only systematic program of mortgage lending in Pakistan is currently being conducted by the House Building Finance Corporation ("HBFC"), established in 1952 under an Act of Parliament. There is presently no organized private sector mortgage lending. HBFC itself is an undertaking of the Government of Pakistan ("GOP") and is essentially controlled by the Ministry of Finance, gets its financing from the government central bank, the State Bank of Pakistan ("SBP"), and raises no resources in the market place.

The Seventh Development Plan (effective in the fiscal year commencing July 1, 1988) contains two elements which bear on housing finance. First, it announces a policy of shifting an increasing share of the responsibility for development from the government to the private sector. Second, the Plan indicates the desirability of establishing a private housing finance system.

Virtually every paper which has been written on the subject suggests that a major impediment to the establishment of a private sector housing finance system is the absence of a viable means for recovery of debts through a workable mortgage foreclosure procedure.¹ Foreclosure in Pakistan currently

¹See, e.g., USL International, Pakistan: Policy and Institutional Study of Housing Finance, May 1988, for the Office of Housing and Urban Programs, U.S. Agency for International Development; USAID, Pakistan Shelter Resource Mobilization Program, May 1989.

takes anywhere from 10-15 years, if pursued under the mortgage provisions of the Transfer of Property Act of 1882 and Order 34 of the Civil Procedure Code, 1906. HBFC appears to have been effective in getting loans out to borrowers, but extraordinarily deficient in servicing and collecting delinquent loans. By either an accounting or economic value measure it is, as a consequence, insolvent.

It appears that some of the nationalized commercial banks do engage in a small amount of mortgage lending, limited to their own employees and to employees of companies which, in effect, guarantee their employees' obligation by agreeing to deduct from paychecks any amounts necessary to cure delinquencies. That sort of arrangement, of course, eliminates the need for a debt recovery scheme. It also eliminates from consideration for a loan anyone who is not employed in the formal sector of the economy or who cannot pledge as security for the loan easy-to-liquidate security (i.e., insurance policies, jewelry, etc.).

Interviews with HBFC and SBP officials and with officers of several of the five nationalized commercial banks suggest a pervasive sense that no lender closely identified with the government can afford the political price likely to be paid for taking a borrower's home to enforce a debt. One officer of a foreign-owned private bank indicated an eagerness to set up an affiliated housing finance company ("HFC") as soon as the legal framework was in place, but felt strongly that a workable debt enforcement

scheme, with foreclosure as the ultimate penalty, was a sine qua non to attracting private capital into such a business.

On the other side of the ledger, one high Ministry of Finance official felt that the HBFC experience with defaulting borrowers was aberrational, attributable to poor servicing and a conviction on the part of borrowers that because HBFC was the government it did not need to be paid back. In his view, once private lenders enter the picture and the government retreats, traditional Pakistani notions of honor and duty will prompt borrowers to keep their loans current. This is a point on which private investors, particularly the foreign-owned banks that will seek to tap and repatriate the savings of overseas Pakistanis, may require no small amount of convincing.

A Secondary Market

In interviews, some attention was also focused on the need to generate additional capital for a housing finance system. Currently, the SBP sets credit ceilings for various sectors of the economy and limits the nationalized commercial banks' lending practices accordingly. Housing is regarded as a "non productive" sector of the economy (i.e., it produces nothing for export and thus generates no hard currency) and therefore little credit is allocated to it. Accordingly, there appears to be growing interest in looking toward the development of a secondary mortgage market as a useful way to attract private, or perhaps better stated, discretionary, capital into the system.

For a secondary mortgage market to function efficiently, however, there must be a high degree of standardization of mortgage instruments, lending and servicing procedures, and underwriting and appraisal practices. Also required are negotiability of the mortgage notes (so that the buyer of the mortgage note acquires it free of any defenses which the maker may have), a system of registration of mortgages unburdened by exorbitant stamp duties, and finally, a legal matrix within which foreclosure and liquidation of the security can be completed cheaply, fairly and quickly. For reasons which are explained below, the prospects for achieving negotiability and mortgage registration in the immediate future are remote. The development of a true secondary market may have to abide those events.

It is also useful to ask whether is there a viable market for mortgages originated by HFCs given the returns available on other investments in the Pakistan capital markets? If not, sellers will be strongly tempted, perhaps required, to offer attractive returns by deeply discounting those mortgages. This is not a circumstance that will contribute to keeping loans to ultimate borrowers at the lowest rates possible.

But whether the concern is with facilitating a primary or a secondary mortgage market, a functioning foreclosure system is critical. Failing that, there will be an increasing reliance on personal guarantees, and on an underwriting process at the origination level which largely disregards the value of the security

property and relies almost wholly on borrowers' credit worthiness and on devices such as the assignment of life insurance policies, personal guarantees and pledges of personal property, such as jewelry. In a nation where so many people rely successfully on income from the informal sector, such an unbalanced underwriting process discriminates against otherwise worthy borrowers.

In short, for a system of HFCs to grow and prosper and effectively address Pakistan's housing deficit, a number of structural problems must be solved. Foremost among them, at least in the initial stages, is the establishment of a fast, efficient way to prompt ultimate borrowers to repay their loans in a timely fashion, either by foreclosing on the mortgage or by some other device which achieves the same result.

Current Foreclosure Practices

Mortgage lending is a seamless web. Central to the entire process is a mortgage foreclosure procedure that works. As currently structured, Pakistan's does not. Because all mortgages must be foreclosed through judicial process, and because the court system is sclerotic,² if the traditional process is relied

²The court system is grossly understaffed. The author was provided with a court calendar for October 29, 1989. It shows the Chief Justice of the High Court for Sind (which includes Karachi) with 105 matters on his calendar for the day. No judge confronted with a docket of that magnitude could fairly be expected to resist with any enthusiasm litigants' and lawyers' desire for delay.

upon, it can take anywhere from eight to fifteen years to obtain a foreclosure decree and get it enforced.

Order No. 34 of the Civil Procedure Code, which governs court procedures in foreclosures, is an invitation to delay because it requires joinder in the proceeding of anyone with an interest in the mortgaged property. This, in turn, encourages borrowers to transfer interests to third parties for the sole purpose of delay.

Once the multitude of allowable appeals have been dealt with, there is the problem of enforcing the decree, which can be complicated by matters as varied as corruption on the part of the court officers charged with responsibility for conducting a foreclosure sale, to impediments to getting the property vacated. The balance of this report is devoted to an examination of how the foreclosure law might be changed so that it does work.

2.0 REVISION OF PAKISTAN'S MORTGAGE FORECLOSURE SCHEME

Chapter IV, Sections 58-104, Transfer of Property Act of 1882 (hereinafter "1882 Act"), sets out the entire substantive body of Pakistan immovable property mortgage law. Last amended in 1929, it reflects ancient concepts of English mortgage law largely developed during the reign of Henry II, gifted to India by the Raj, and adopted virtually en haec verba by Pakistan upon Partition. While the basic principle (a mortgage is a pledge of an interest in property made to secure the performance of an obligation) would be left intact, the 1882 Act should be

uprooted, discarded and replaced by a comprehensive real property conveyancing statute embodying modern principles of secured real property transaction law. But not now.

In the nearly 25 interviews conducted for the preparation of this report, it was made clear, first, that repeal of the 1882 Act and wholesale reform would likely require years, and second, that if the public policy goals reflected in the Seventh Development Plan are to be brought within reach, a fast, fair, and inexpensive procedure must be implemented immediately. Accordingly, this report proposes that, as a first step, procedures and devices available in scattered sections of current Pakistan law be integrated into a single ordinance and access to that integrated remedial procedure be afforded to HFCs. As a second step, using the experience gained in the administration of those amendments, an official body charged with law revision responsibilities, should constitute a drafting committee to prepare a replacement for the 1882 Act.

2.1 An Interim Measure

2.1.1 The Enforcement Scheme

The Banking Tribunals Ordinance, 1984, established what appears to be a fast, efficient scheme to permit banking companies to recover debts. Under Section 6, the initiation of an action by a banking company triggers the issuance of a notice requiring the debtor to show cause within ten days why the relief

sought against him should not be granted. If the debtor fails to respond, or if the Tribunal rejects his reply, a decree is entered in favor of the bank. The Tribunal can, however, set the decree aside, for good cause, upon the debtor's application within 30 days of the decree's entry.

Tribunals are required to dispose of these matters within 90 days. Failing that, the debtor is supposed to deposit with the Tribunal cash or other security at least in the amount of any missed installments (Section 6(6)).

The debtor's right of appeal to the High Court is conditioned upon the deposit of the total amount of any missed installments with the Tribunal. Other than by way of appeal, no other court can do anything which would oust, or interfere with, a Banking Tribunal's jurisdiction (Section 10).

Once a decree is final, the Tribunal can order execution in accordance with the Code of Civil Procedure, and can order that the debtor be held in civil prison. Where the bank that was awarded the decree actually holds property belonging to a debtor, once a decree is final, it can sell the property to satisfy the decree. It is not clear from Section 11(3) of the Ordinance whether a bank which holds a deed to real property as security for a loan (in effect, an equitable mortgage) is regarded as "hold[ing]" property belonging to the debtor.³ The decree can

³Section 11(3) also grants to a debtor the right to purchase or redeem his property prior to its being sold, and the bank is required to notify the debtor to this effect.

also be executed by the Collector of Land Revenue as an arrear of land revenue.

On paper, at least, the Banking Tribunals Ordinance appears to be everything a creditor could conceivably want by way of an arsenal of remedies. Practice, however, appears to be a long step from what the Ordinance provides. In interviews, advocates and lenders complain that in difficult cases, Tribunal judges simply disregard the Ordinance's injunction to get the matter done with in 90 days. Cases apparently go on for years.

Part of the problem may be that Tribunal judges are required either to be qualified to be judges or actually to have served as judges. By its nature, training or experience as a judge is poor conditioning for expeditious action. They also complain that vacancies on Banking Tribunals go unfilled for long periods, sometimes for years. One advocate cited as an example the government's failure to appoint a replacement for the vacancy created by the resignation or retirement of the chief judge of the Tribunal that has jurisdiction over matters that arise in Karachi.

Execution of decrees appears to be a much larger problem than the language of the Ordinance suggests it should be. The process for execution set out in the Code of Civil Procedure is archaic, time consuming, and subject to challenge and frustration.

Advocates with experience representing lenders say that one of the major problems associated with sale of the security pro-

perty is that few prospective purchaser are willing to bid on a property that is occupied by the debtor or by the debtor's tenant at the time of sale. Clearly, where a prospective purchaser can look forward to immediate possession, the chances for the sale yielding a price close to market value are materially enhanced. This benefits both the lender, who can look forward to having its obligation satisfied in full, and the borrower, whose chances for recovery of some portion of his equity (the difference between the sale price and the amount of the obligation) are substantially increased.

This, of course, is the point where the public policy concerns with establishing a viable debt recovery scheme as a prerequisite to a properly functioning mortgage lending program may collide with social and cultural traditions and values. It is thus the point at which it is appropriate to ask whether there is a word for "foreclosure" in Urdu, in Punjabi, in Sindhi or in Pushto.

If that overarching issue can be resolved, it makes sense to amend current law to provide a summary process of eviction that would be readily available to a purchaser at a foreclosure sale. What would have an even more beneficial effect on the price yielded at the foreclosure sale would be a summary eviction process that would be available to the lender immediately prior to the sale.

The Banking Tribunals Ordinance appears to have been designed more with recovery of obligations from trade debtors in

mind than mortgage obligations. In the typical mortgage default, the factual issues are usually simple and straightforward: Is there a debt and did the debtor make the payments when due.

Because the issues are so simple, utilization of a power of sale mortgage should be considered. Under this arrangement, the mortgage instrument itself would empower the lender to direct a trustee to sell the mortgaged property at auction upon the debtor's default. The sale itself would be preceded by a notice to the debtor of the default, a period during the default could be cured by payment of the missed installments, and an opportunity on the debtor's part to invoke a hearing at which an impartial officer would decide any disputed factual issues.

It may be possible to amend the Banking Tribunals Ordinance to establish such a procedure. The Tribunals themselves would provide the forum for the adjudication of the simple factual disputes, but the burden of invoking its processes would be upon the debtor, not the lender. And to insure that debtors do not frivolously invoke a hearing when in fact there are no valid defenses, they could be required to post the amount of any missed installments as the price of admission to the Tribunal.

If the Tribunals are thought to be too burdened with commercial debt cases, or too slow, Collectors of land revenue or officers of the SBP in each province or district could be empowered to act as hearing officers, with the debtor having a one-time right of appeal on issues resolved against him, perhaps to the High Court. The Collectors, with some additional compensation

out of the proceeds of sale, or the SBP province or district officers could also be empowered, as trustees with fiduciary duties to both parties, to conduct the sale and take whatever steps are necessary to vacate the security property.

This enforcement approach is in many respect similar to what India has provided in the State Financial Corporations Act (63 of 1951), under which secured loans are made to small business enterprises. Recently, the Kerala High Court decided a case, K. Surendranathan v. Kerala Financial Corp., AIR 1988 Kerala 330, in which a borrower whose property had been taken under the Financial Corporation's possession remedy challenged it as "harsh, and capable of arbitrary exercise and thus violative of Article 14 of the Constitution."⁴ He also claimed that the unfettered discretion given the Corporation to pick and choose among remedies was illegal.

The court rejected the claim of arbitrariness, pointing out that the composition of the Corporation's board, its purposes, the necessity to avoid the problems presented by prolonged court delays and a variety of other provisions provided the requisite guidance for the informed and reasonable exercise by the Corporation of choice among the remedies.

⁴Article 14 of the Indian Constitution provides:

The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.

In closing, however, the court cautioned that even where the provisions of a statute are not arbitrary, the exercise of the power granted by it can be. It noted that here, the Board had not acted "vindictively or arbitrarily," that the borrower was informed of the action to be taken against him and given an opportunity to bring his account current, and that he did not.

In another case relevant here, Ramchandra v. Collector, Nagpur, 1970 Mh.L.J. 116, the High Court set aside an auction sale conducted by the Collector to recover a debt to a Cooperative Land Development Bank pursuant to the Maharashtra Co-operative Societies Act, 1960. Under that procedure the Collector of land revenue conducted the sale of the security property based on a certificate issued by the Cooperative Land Development Bank. After reviewing the statute, the court held that notice to the borrower and an opportunity to be heard were required before any certificate stating the amount due could be issued and acted upon. It reached that conclusion by applying what it characterized as three fundamental rules of natural justice:

1. No one shall be a Judge in his own case.
2. No decision shall be given against a party without affording him a reasonable hearing.
3. Quasi-judicial enquiries must be held in good faith, without bias and not arbitrarily.

No proper enquiry having been held to determine the propri-

ety of the claimed default, the auction sale was set aside and the property restored to the borrower.

There are several important lessons to be drawn from these cases:

First, the court in the Kerala Financial Corp. case relied heavily on the fact that the choice among the remedies was being made by the Corporation itself under the guidance of statutory purposes and goals. This factor could be taken into account by providing, either through Ordinance or Notification, authority in the HFCs themselves to invoke the power of sale foreclosure remedy pursuant to a statutory framework, or perhaps it could be provided that the remedy would only be invoked upon application to the regulator of HFCs, the SBP.

Consideration should thus be given to (1) reviewing the Ordinances and Notifications defining the authority of the SBP for conformity with the language relied on by the court in the Kerala case with respect to duties, powers and purposes and amending where necessary; and (2) developing additional statutory language for the those enactments which would establish a simple procedure under which the HFCs could apply to the SBP for permission to invoke either of the remedies. (Presumably no SBP action would be necessary for an HFC to use the procedure established under the Banking Tribunals Ordinance, so long as it is made clear that HFCs have access to that process.) As an alternative

to describing the power of sale procedure in detail in an Ordinance or Notification, it might be possible (assuming that Pakistan administrative law principles permit) to add language to SBP's rulemaking authority under the Notification establishing its regulatory authority over HFCs giving it explicit authority to formulate rules under which it would act on requests from HFCs to invoke summary remedies.

Second, part of the learning of the Ramchandra case is that requirements for notice to borrowers that action is to be taken against them will have to be provided. The notice requirement should not be particularly troublesome. The statute (or, if administrative law principles permit, a regulation) could provide something along the following lines:

Section __. Notice of intention to collect amounts due shall be given to a borrower by a writing, substantially in the form set forth below, in English and in the language of the borrower, sent to him by [registered] and ordinary mail at his last known address and affixed prominently to the property which secures the loan to the borrower.

NOTICE OF INTENT TO COLLECT

You are in danger of losing your property. Please read this notice carefully and observe the time

limits. If you do not understand this notice,
contact a lawyer.

You are in default on your loan because you
have not made your payments for [dates] in
the amounts of Rs _____ each. _____

Unless you take one of the steps
described in this Notice the law permits us
to sell your property at auction [or turn the
matter over to the Collector who will sell
your property at auction] in four months.
You may be able to prevent this if you:

(1) Pay the installments now due. If you pay all
the instalments now due, you can prevent the sale of
your property. You have the right to make up all the
missed installments any time up to five days before the
public sale. However, if you wait until we have begun
advertising the sale, the law requires that you reim-
burse us for all expenses incurred.

(2) Disagree with our claim that you are in
default. If you have a defense to our claim that you
are in default for the reasons(s) stated in this
Notice, you are entitled to a hearing. You should

contact us at once so that we can arrange for a hearing at which you can present your defenses.

(3) Attempt to sell your property. The law provides you with a three-month period of time (beginning with the receipt of this Notice) in which to sell your home privately. If you decide that you want to do this, we will assist you by providing the title documents to your buyer. After deducting the amount that you owe us on your loan and the costs of this collection effort, we will pay the balance to you.

If you do not understand this Notice, you are advised to call the undersigned and to contact a lawyer.

[Name of HFC]

by _____

Tel:

Third, the Ramchandra decision also requires a hearing before an impartial trier of the facts at which the borrower has an opportunity to present his defenses. Under this standard it is clear that an officer or agent of an HFC could not function as a hearing officer. The next choice appears to be someone named

by the SBP, or perhaps Collectors of land revenue, or other officers appointed on a district, or province-by-province basis, by the SBP (assuming it would be considered sufficiently disinterested) pursuant to regulations, or by the State governments, to conduct very simple hearings and render brief written summaries of the proceedings and findings, sufficient to support either the holding of an auction sale by the appropriate officer. Failing that, there is the possibility of utilizing the Banking Tribunals both to conduct the hearing and to oversee the auction sales.

2.1.2 The Security Transaction

The Transfer of Property Act of 1882 specifies no less than six different types of mortgages, some of which have not been heard from in hundreds of years and others of which can only be utilized in specified cities and by persons of specified national and religious origin. Section 58. When broad-scale revision is undertaken, the possibility of dropping the term "mortgage" and substituting for it "security interest" should be considered. The classification problem would thus be eliminated.

While there appears to have been some relief from this problem, the provinces have imposed documentary stamp duties at a rate so high as to be confiscatory. The result -- which serves neither the provinces' interest in raising revenue, nor the cadastre system's interest being able to maintain records of titles and encumbrances -- is that documents identified as

mortgage-related in most developed countries have not been entered into or registered in Pakistan. Loans on immovable property are secured by depositing the deeds with lenders, thus creating equitable mortgages. With no effective system of registering documents which reflect an encumbrance on property, it is difficult to understand how, short of hand-to-hand combat, priorities are established among competing lien holders.

These are problems that deserve urgent attention if an even modestly sophisticated mortgage finance system, primary and secondary, is to mature in Pakistan. But it is not a problem addressed by any of the pending Ordinances or Notifications, nor can it be. Resolution will have to await a much broader effort at fiscal and law reform.

The suggestions offered here provide a speedy enforcement mechanism. Its selective and effective use in a relative handful of situations should provide an example which will promote prompt payment by many more borrowers than those against whom it is actually used.

The next step is a systematic and comprehensive revision of the laws which have an impact on immovable property financing, beginning with the documentation, carrying through registration, and including foreclosure. Below, we offer some statutory language, together with comments, that might be useful as a starting point.

3.0 ELEMENTS OF A RESTRUCTURED FORECLOSURE SYSTEM

Section 101. Title. This Act shall be known and may be cited as the Residential Mortgage Foreclosure Act.

Section 102. Scope. This Act applies to any transaction, regardless of its form, which is intended to create a security interest in property which is the principal residence of its owner, or which is intended to create a security interest in owner-occupied real estate which is used for farming or related purposes, including but not limited to a mortgage, deed of trust, security deed, contract for deed, land sale contract, and any other consensual lien or title retention contract intended as security for an obligation.

Comment

This section embraces all transactions in which the parties intend to create a security interest in real estate covered by the Act. It therefore excludes those security interests created by operation of law, and depends solely on the parties' intent. It operates in disregard of the distinction between "lien theory" and "title theory" and covers a transaction whether the title to the collateral is in the secured creditor or in the debtor. The listing of traditional security devices is illustrative, and it is the parties' intent in transacting, not the manner in which they choose to label the transaction, that is determinative.

Coverage is limited to owner-occupied properties used primarily for residential and farms simply because the drafter has no knowledge of how other immovable property secured transactions operate in Pakistan. Most of the principles reflected here could be made applicable to non-residential and non-farm transactions as well.

Section 103. Purposes; Rules of Construction. This Act shall be liberally construed and applied to promote its underlying purposes and policies, which are:

- (1) to modernize the law governing residential and farm mortgage transactions;
- (2) to protect borrowers against practices which may cause unreasonable risk and loss to them;
- (3) to provide certain and equitable procedures whereby secured creditors may protect their security interest and realize their obligations from the proceeds of the collateral of debts; and
- (4) to ensure stability and marketability of title.

Comment

This Act should be construed in accordance with its underlying purposes and policies, and each section should be read as

narrowly or as broadly as possible to conform to those purposes and policies.

Among the goals of the Act is to extend modern consumer protections to an area of law which has been largely neglected. While the Act limits the freedom of the parties to contract, it does not jeopardize the fundamental right of the secured creditor to protect the security property and to satisfy the debt. The procedures made available balance the secured creditor's interest in repayment of the debt with the debtor's interest in protecting and realizing his equity.

Section 104. Waiver. The provisions of this Act shall not be waived and any agreement to waive them or covenant not to rely upon them shall be void.

Comment

Even though many persons covered by this Act could "knowingly, freely, and intelligently" waive its protections, the endless litigation which permissive waivers could generate would thwart the Act's purpose of stability and marketability of title; hence a blanket prohibition on waivers is imposed.

Section 105. Supplemental General Principles of Law Applicable. The principles of law and equity including the law relative to capacity to contract, marshalling of assets, subrogation, estop-

pel, fraud, misrepresentation, duress, coercion, mistake, unconscionability, bankruptcy, or other validating or invalidating cause, supplement this Act unless displaced by particular provisions of it.

Comment

This Act displaces existing law only as stated by specific sections and by reasonable implication therefrom. The listing is intended to be illustrative of the fact that, except as expressly modified herein, common law rights remain intact.

Section 106. Construction Against Implied Repeal. This Act is intended as a unified coverage of its subject matter. No part of it may be construed to be impliedly repealed by subsequent legislation if that can be reasonably avoided.

Comment

Acts which are of a uniform, permanent and comprehensive nature should not be subject to easy repeal by implication.

Section 107. Severability. If any provisions of this Act or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of the Act which can be given effect without the invalid provision

or application, and to this end the provisions of this Act are severable.

Comment

This is severability language frequently used in model acts in the United States.

Section 108. Definitions. In this Act:

(1) "Debtor" means the person who owes payment or other performance of the obligation secured, but if the debtor and the owner of real estate are not the same person, the term means the owner of real estate in any provision of this Act dealing with the collateral, the obligor in any provision dealing with the obligation, and the term may include both where the circumstances so require.

(2) "Default" means the nonperformance of a duty arising under a security agreement.,

(3) "Forbear" means refraining from foreclosing on the security agreement even though the debtor is in default.

(4) "Secured creditor" means a lender, seller, or other person in whose favor there is a security interest.

(5) A "security agreement" means a writing that creates or provides for a security interest in real estate.

(6) "Security interest" means an interest in an owner-occupied, one- to four-unit residential dwelling or farming operation which secures payment or performance of an obligation.

Comment

The terms chosen have no common law or statutory roots in order to avoid the implication that existing law referable to any of the numerous terms now used to describe secured transactions in real estate is applicable. Thus, the relationship of "mortgagor-mortgagee," "grantor-debtor," "settlor-debtor," or "purchaser-seller" -- terms which describe the participants in a "mortgage" or "deed of trust" -- becomes "secured creditor-debtor" to describe the participants in a "security agreement," if the "security interest" is in a residential dwelling or farm.

The term "security agreement" can include a purchase money mortgage in favor of a commercial creditor and does not alter existing law pertaining to its priority over certain categories of claimants.

Section 109. Notice of Intent to Foreclose. A secured creditor may seek to foreclose on the security interest which is the subject of a security agreement by mailing to the debtor by [registered] and regular mail and by posting prominently on the security property a Notice of Intent to Foreclose, in English and in the language of the debtor, in substantially the following form:

NOTICE OF INTENT TO FORECLOSE

You are in danger of losing your property. Please read the enclosed carefully and observe the time limits. If you do not understand this notice, contact a lawyer.

You are in default on your security agreement no. _____
because [reason(s) for and underlying facts of claimed default]

Unless you take one of the steps described in this Notice the law permits us to hold a public sale of your home in four months. You may be able to prevent this if you:

1. Pay the installments now due. If you pay all the installments now due, you can prevent the sale of your home. You have the right to make up all the missed installments any time up to five days before the public sale. However, if you wait until we have begun advertising the sale, the law requires that you reimburse us for all expenses incurred.

(2) Disagree with our claim that you are in default. If you have a defense to our claim that you are in default for the reasons(s) stated in this Notice, you are entitled to a court hearing. You should contact a lawyer at once so that you can file a lawsuit within thirty days.

(3) Attempt to sell your home on the private real estate market. The law provides you with a three-month period of time (beginning with the receipt of this Notice) in which to sell your home privately. If you use the services of a real estate broker,

or other sales techniques, it is more likely that you will obtain a higher price for your home than we will be able to if we are forced to sell it at a public auction. You are urged to take this opportunity to minimize your losses.

If you do not understand this Notice, you are advised to contact a lawyer.

Comment

The creditor may trigger the foreclosure process by mailing a Notice of Intent to Foreclose to the debtor. No attempt is made to impose restrictions on when the Notice may be mailed, or what constitutes a default. As a practical matter, if, as it usually will be, the claimed default is failure to make a payment, the creditor will not possess the administrative capability to issue a notice until one month after the date of the last payment. The grounds for default may be determined by reference to the security agreement, and traditional remedies are available for unconscionable terms.

The main purpose of the Notice is to explain to the debtor the options the law provides -- private sale, the opportunity to be heard in court on a contractual defense, and cure and reinstatement rights -- and to point out the time limits on the exercise of the various options.

The Notice must be written in a manner substantially equivalent to the one provided. Both the Notice and its attachment must be written in plain and understandable English and in the language of the debtor.

Section 110. Opportunity to Raise Contractual Defenses.

(1) The debtor may assert any judicially cognizable defense to the claim of the existence of a valid obligation or to the creditor's claim of default by filing a [civil action] seeking an injunction within one month of receipt of the Notice of Intent to Foreclose.

(2) The prevailing party shall be entitled to court costs and reasonable attorney's fees.

Comment

While the overall purpose of the Act is to permit a power of sale to be exercised within a reasonable period of time, and to avoid a judicial foreclosure proceeding in every instance -- and its attendant costs in terms of time and money -- this section affords a debtor with a contractual defense a reasonable opportunity to be heard. Court costs and attorneys' fees are automatically awarded to the prevailing party to encourage meritorious defenses and to discourage dilatory defenses.

Section 111. Cure and Reinstatement Rights. A debtor in default shall have the right to cure and reinstate the security agreement any time until five days before the date of the public sale, provided that the debtor reimburse the creditor for any expenses the creditor has incurred in satisfying the requirements of Section __ of this Act.

Comment

This section establishes a mandatory time period within which the secured creditor must accept a debtor's offer to pay all of the monthly payments then due, as well as any expenses incurred by the creditor in advertising the property for sale. The right to cure and reinstatement is extinguished five days before the date of public sale in order to avoid chilling competitive bidding at the sale. If it is believed that permitting cure and reinstatement until that time may not avoid depressing the sale price, an earlier time may be set. It is important, however, in order to avoid disputes over whether an offer to cure was timely, to set an easily calculated date after which the right is cut off.

It may also be appropriate to limit the number of times a debtor may cure and reinstate after the creditor has set the 30-day public sale advertisement period in motion. Even though the debtor is required to reimburse the creditor for expenses incurred, direct and indirect, including newspaper advertising

fees, fees for, the production of appraisal reports, labor, and overhead, some indirect costs are incapable of measurement and it may be unfair to sanction the unlimited exercise of cure and reinstatement rights.

Section 112. Private Sale by the Debtor. All debtors covered by this Act shall have three months from the date of receipt of the Notice of Intent to Foreclose to sell the real estate which is the subject of the security agreement. The real estate shall be deemed to be sold if, at the end of the three- or six-month period, title has not been transferred but all the following conditions have been met:

- (1) all contingencies have been satisfied;
- (2) the amount of the prospective buyer's deposit on the real estate is at least equal to the amount necessary to permit the debtor to cure and reinstate the security agreement as of the date of final closing; and
- (3) the debtor and prospective buyer have agreed in writing that, in the event title is not transferred to the buyer, the secured creditor shall be entitled to that portion of the deposit which is necessary to permit the debtor to cure and reinstate the security agreement.

If no sale within the definition of this section has occurred upon the expiration of the three-month period, the

creditor may conduct a public sale in accordance with the procedures set forth in Section ____.

Comment

This section grants all debtors who have received a Notice of Intent to Foreclose three months in which to attempt a private sale of the property. One of the least satisfactory aspects of present mortgage foreclosure procedures is the method of sale. Sale by public auction -- even if it is conducted in the commercially reasonable fashion required by this Act -- is inherently inferior to a private sale in a true market setting. While the three-month limitation does not simulate a true market model, it should give most debtors a reasonable opportunity to recover their equity.

It is likely, however, that the debtor may have a buyer but that the transaction will not be closed at the end of the three-month period. This section draws a line between transactions which are still contingent upon the happening of some future event, such as the ability to obtain financing, and transactions where all contingencies have been satisfied and it is likely that the sale will be completed. As a protection for the creditor against the possibility that closing does not occur, two other conditions must be met by the end of the three months: (1) the deposit given by the prospective buyer must be sufficient to cover all missed payments due to the creditor at the end of the three-month period; and (2) the debtor and buyer must agree in

writing that if closing does not take place, the creditor is entitled to that portion of the security deposit necessary to cure and reinstate the debtor. If the three conditions are met, the creditor is precluded from commencing the public sale procedures because he is adequately protected.

This section operates to the clear advantage of both debtor and creditor and, if extensively utilized, could dramatically reduce both parties' losses associated with traditional foreclosure. It is to the creditor's advantage to urge its use in the Notice of Intent to Foreclose and to provide assistance to debtors on the best methods of promoting a private sale.

It should be noted that the opportunity to effect a private sale is automatically granted any debtor who receives a Notice of Intent to Foreclose, and the three months begin running regardless of whatever other options the debtor elects.

Section 113. Public Sale by the Secured Creditor. Whenever a public sale by the creditor is authorized by this Act, the sale must be preceded by good faith efforts to publicize as broadly as possible that the following sale procedures will be utilized:

(1) inspection of the premises at any reasonable time during the thirty-day advertisement period will be permitted;

(2) [appraisal reports] and all other reports customarily furnished prospective buyers will be furnished upon request;

(3) written bids may be submitted prior to the date of the sale;

(4) on acceptance of a written or oral bid, the bidder must deposit 10 percent or more of the bid price in cash, or letter of credit or bank obligation and complete the transaction within five weeks; and

(5) if the successful bidder fails to make the deposit at the time of acceptance of the bid or fails to pay the balance of the price, the real estate may be resold subject to the provisions of this section. A defaulting bidder is liable on his bid which may be specifically enforced against him or, at the option of the creditor, the deposit may be retained or recovered. Any sums retained or recovered shall be applied in the same manner as the proceeds of a completed sale.

Comment

This section prescribes public sale procedures which may be instituted whenever the debtor has failed to sell privately. An independent trustee, public or otherwise, with express fiduciary responsibilities to both creditor and debtor was not believed to be necessary because the sale requirements will afford sufficient protection of both parties' interests.

The purpose of this section is to avoid the artificially depressed sales price that public auctions of foreclosed proper-

ties can produce. Thus, an effort to generate as much buyer interest as possible is required.

Section 114. Application of Proceeds from Sale. The proceeds from a sale shall be applied in the following order:

- (1) the expenses of a public sale, including direct and indirect expenses incurred pursuant to Section _____;
- (2) the reasonable expenses of securing possession before sale; holding, maintaining, and preparing the real estate for sale, including taxes, insurance, and reasonable attorney's fees;
- (3) the satisfaction of the indebtedness secured;
- (4) the satisfaction in the order of priority of subordinate security interests of record; and
- (5) remittance of any excess to the debtor.

Comment

This is the typical manner in which proceeds of a sale are applied, except, under this Act, the expenses of a public sale may be greater because of the efforts necessary to obtain the highest possible sale price.

Section 115. Effect of Disposition; Right of Redemption
Repealed. Upon payment by the purchaser at a public or private

sale, a deed shall be executed to the purchaser reciting the facts that the sale was conducted in accordance with the requirements of this Act, which recital shall be prima facie evidence of such compliance and conclusive evidence thereof in favor of bona fide purchasers.

The deed executed to the purchaser shall convey the interest in the real estate which the debtor had the power to convey, free of the security interest under which the sale occurred and any subordinate interests of record.

After sale as provided for in this Act, no person shall have any right by statute or otherwise to redeem from the sale.

Comment

This section makes clear that a purchaser under either method of sale takes free of interests of the debtor and all subordinate parties by requiring a recital of these facts in the deed. The weight accorded such a recital eliminates a rigorous examination by the purchaser to determine whether the details of the statutory requirements were met and further assures that the sale price will more properly reflect the real market value of the property.

In addition, this section prohibits post-sale redemption, a right generally accorded by statute, because of its depressant

effect on sale price due to the inability of the buyer to receive full and effective title immediately.

[If felt appropriate for public policy reasons:]Section ____.

Anti-deficiency Judgment. No debtor covered by this Act shall be liable for a deficiency judgment if the proceeds of the sale of the secured property fail to satisfy the outstanding debt.

Comment

The primary argument in favor of a blanket prohibition against deficiency judgments is that in making the loan, the secured creditor has, by the very nature of the loan, agreed to look to the security property and not to the personal credit of the debtor for satisfaction of the debt. Even if the creditor did implicitly look to both the security property and the debtor's personal credit in making a decision to loan, anti-deficiency judgment legislation will force the creditor to look solely to the security, thus fostering prudent lending policies.

The real impact of anti-deficiency legislation will be on the second and third mortgage holder. In the United States, banks and savings and loan institutions, the bulk of the industry making first mortgages, have not utilized their authority to seek a personal judgment against a debtor when the proceeds of the judicial sale fail to satisfy the debt. Those lenders who are inclined to seek deficiency judgments, the second and third

mortgage holders, will be discouraged from over-mortgaging a home by anti-deficiency judgment legislation.

Section ____ . Foreclosure by Judicial Proceeding.

(a) Any real estate security interest may be foreclosed in a judicial proceeding that directs a judicial sale of the real estate that is subject to the security interest.

(b) In his initial pleading the secured creditor shall state facts showing that the notice of intention to foreclose was properly given.

(c) Process shall be served on all persons whose interest is to be cut off by the judicial sale. If the court finds that the debtor is in default and that the creditor has properly given notice of intention to foreclose, it shall enter judgment for the amount due with costs and order the sale of the real estate. The judgment also shall specify the official, secured creditor, the debtor, or other person authorized to conduct the sale. Unless otherwise specified in the judgment, the sale shall be conducted in accordance with Section ____ of this Act.

(d) The person conducting the sale must seek potential buyers and bidders through means of communication reasonable for the type of real estate involved, even though there has been or will be notice by publication for the purpose of service of process or informing persons having a claim to the property.

(e) The judgment shall direct the person conducting the sale to make a report to the court. If it appears to the court that justice has been done, it shall confirm the sale.

(f) If the sale is confirmed the person conducting it shall execute an instrument of conveyance under Section ____.

(g) If possession the property is wrongfully withheld after confirmation of the sale, the court may compel delivery of possession to the person entitled thereto by order directing the appropriate official to effect delivery of possession.

Comment

This section prescribes the procedure for foreclosure by judicial sale. It makes applicable to such a proceeding the rules of civil procedure. Subsection (b) states certain rules of pleading necessary to make operative rights given elsewhere in the Act. Subsection (c) calls for entering a judgment for the amount adjudged to be due and then prescribes how the court official is to conduct the sale. Subsection (d) repeats for judicial sales the requirement for exercise of power of sale, that the official or other person conducting the sale use some means other than publication of a legal notice to find buyers. If a judicial sale is held, subsection (e) requires that the sale details be presented to the court for confirmation. Subsection (f) states the formalities of the instrument of conveyance when the sale is conducted by the court. Finally, subsection (g)

enables the court to put the purchaser in possession where possession is wrongfully withheld after confirmation of the sale.

Section ____ . Commencement of Judicial Foreclosure Proceedings When Waste or Abandonment is Alleged.

(a) Whenever a secured creditor has reason to believe that the debtor is committing waste or has abandoned the security property, and as a consequence there is a threatened inadequacy of the security to meet the outstanding debt, a complaint setting forth the facts relating to such acts and seeking a foreclosure order and the right to be placed in immediate possession may be filed. The complaint shall be served in the manner required by law on the debtor and on holders of all subordinate security interests of record.

(b) A preliminary hearing on the complaint shall be held within 5 days of service of the complaint and if the court is satisfied that the allegations of waste or abandonment have been proven are credited, the secured creditor shall be placed in immediate possession. A foreclosure order authorizing sale of the security property in accordance with Section ____ shall be automatically entered within 21 days after the date of the preliminary hearing unless the debtor asserts claims or defenses to the default prior to the expiration of the 21-day period.

Comment

This section provides as a matter of law that an act of waste or abandonment which threatens to decrease the value of the security property is grounds for foreclosure and establishes an expedited and what may be a summary hearing procedure to place the creditor in possession of the property prior to sale. However, there must be actual or threatened inadequacy of the security property to meet the outstanding debt to ensure that the extraordinary relief granted is necessary to the creditor's repayment.

There is a 21-day delay between the time the creditor is placed in possession and the date of entry of a foreclosure decree authorizing a public sale in order to prevent an unjust summary termination of the debtor's interests. The debtor may have a defense to the default which led to abandonment, or may have appeared to have abandoned the property when in fact he was merely temporarily absent. The five day period before the preliminary hearing may not be sufficient time to raise the first defense properly; and in the latter case, where the court is in doubt, the creditor may be placed in possession pending entry of a foreclosure decree.

We express our appreciation to the Ministry of Finance of the Government of Pakistan for inviting us to assist in the development of a housing finance system. The purpose of this paper is to suggest ways in which current Pakistan mortgage foreclosure procedures might be revised to function more efficiently and effectively. The following persons were consulted in the course of preparing this report:

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