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BUSINESS PLANNING AT HOUSING FINANCE COMPANIES

REPORT 5
(Draft)

PREPARED FOR USAID'S SHELTER RESOURCE MOBILIZATION PROGRAM

Management & Financial Applications (Private) Limited
Flat# 9, Block 13-E, Qadoos Plaza, Markaz F/7, Islamabad. Ph.# 818125-826265, Fax# 826265

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A

EXECUTIVE SUMMARY

B

I. EXECUTIVE SUMMARY

This report compiles into a single volume four separate reports on business planning procedures at the seven recently licensed private Housing Finance Companies (HFCs). The HFCs that are the subject of these reports are:

* Citibank Housing Finance Company Limited
* Empire Housing Finance Company Limited
* Interfund Housing Finance Company Limited
* International Housing Finance Company Limited
* Jaffer Brothers Housing Finance Company Limited
* National Housing Finance Company Limited
* Olympic Housing Finance Company Limited

The objectives of the four reports that have been consolidated here are as follows:

* Report 1 deals with the perceptions of the HFCs about the present business, policy, and legal environment in which they are expected to operate. It also presents their suggestions as to what they consider are essential policy changes to bring about an appropriate enabling environment. Finally, Report 1 presents our observations about the key factors likely to impact, whether for better or worse, HFC operations over the next five years.

* Report 2 reviews the status of start-up business planning at each of the seven HFCs and presents our assessment of the present state of their readiness to begin operations and the likely time frame within which each may be expected to do so.

* Report 3 focuses on key issues -- market segments, product lines, marketing strategy, etc. -- that HFCs must address when preparing a business plan. This Report also includes our business plan for a 'model' HFC that is reflected in a set of base case financial projections supplemented by 'what if' analysis that takes into account plausible departures from the base case set of assumptions.

* Report 4 identifies the appropriate organization and management team required to start and operate a HFC over the first five years. This Report also covers the training and technical assistance requirements of the model HFC.

We first summarize the major findings of the four reports and then indicate our recommendations for the implementation of macroeconomic, fiscal, institutional, and legal policies to facilitate the business of the HFCs.

A. Report 1

Our discussions with the HFCs indicate that there are five main areas of concern in the current regulatory and legal environment. These are: (1) absence of a proper system of title recording and verification;(2) high level of transactions taxes (stamp duty, registration charges) on title transfer and high mortgage registration fees for non-banking companies creating incentives for undervaluation of property by owners and/or adoption of transfer methods that have legal lacunae; (3) high costs of funding the deposit base with correspondingly high rates of mark-up to be charged on mortgage loans that make the product unaffordable for the vast majority of the population; (4) doubts about their ability to enforce foreclosure in case of borrower default; and (5) the grouping of HFCs with other NBFIs under the prudential regulations administered by the State Bank of Pakistan (SBP).

Further, in response to our questionnaire circulated among the HFCs (to which six of the seven HFCs responded in writing) the following institutional and fiscal measures were indicated as also being essential for HFCs to operate successfully:

Policy	Number indicating as priority
Permission to operate passbook savings accounts	5
Deductibility of mortgage mark-up from taxable income	2
Access to refinancing facilities through an apex bank	2
Access to inter-bank funds	1

Four of our six respondents had an opinion about the future state of the economy (the other two being silent on the matter). Three HFCs are optimistic about growth prospects. On the other hand, an equal number believes that inflation rates and government's fiscal deficits are heading upwards.

The prevalent feeling among the HFCs is that the present environment is not conducive to the development of the housing finance business, and, unless the Government of Pakistan (GOP) implements appropriate policy changes, the HFCs will face serious difficulties in launching their operations.

The final section of the Report presents our own assessment of the business environment facing HFCs which is that it will be one that is fraught with difficulty unless the GOP allows for at least the major stumbling blocks identified by the HFCs to be removed. Even if the policy environment is made easier, we envisage that only three or four HFCs will be able to weather the difficult times expected in the next five years.

B. Report 2

The business planning procedures adopted by each of the HFCs have been reviewed in terms of four key areas: (1) Market Analysis; (2) Resource Mobilization; (3) Organization and Management; and (4) Financial Forecasting.

Citibank

Citibank is the only HFC that has started operations so far. It is focusing on the salaried and self-employed business person with a minimum monthly net income of Rs. 10,500 and on recognized developers with a successful track record. The minimum loan amount for individuals is Rs. 300,000 with a maximum of Rs. 2 million. These loans will have a tenor of 15 years, a loan to value ratio of 60 per cent and a mark-up of 20% for self-construction and 22% (including 2% excise levy) for purchase of ready property.

Citibank expects to have a public flotation of Rs. 50 million by December 1994. It expects the cost of deposit mobilization to be in the vicinity of 16%.

While Citibank has no doubt prepared a financial forecast this was not disclosed to us for understandable reasons. It is the most well informed of the HFCs in the matter of the GOP and SBP regulations. It is also likely to be the most successful given its strengths in management and organization.

Empire Housing Finance Company

Empire intends to lend to both individuals as well as developers. Individual borrowers will be expected to have a monthly gross income of Rs. 15,000-Rs. 20,000. However, the bulk of Empire's lending will be targeted to developers for the commercial property market which it believes is more lucrative and relatively underserved compared to the market for individual mortgages. They expect to charge a mark-up of between 18-22 per cent.

Empire expects to raise funds from term deposits of one to three months with an average cost of 14 per cent yearly and from sale of one month bankers' acceptances at an average cost of 12 per cent.

At present only two senior executives have been recruited. However, a recruitment plan has been prepared for the next two years.

In sum, Empire is focusing on a high risk strategy but has the management and institutional strengths to sustain profitable operations in this business.

Interfund Housing Finance Company

Interfund is a member of a highly successful Pakistani financial services group that boasts of two modarabas and a leasing company in addition to the HFC.

This HFC plans to target the mass of middle income home borrowers, ie, those with even as low a monthly net income as Rs.

6,000. It intends to develop a whole host of mortgage products to take into account the needs of all its borrowers including a loan for which repayment levels are tied to the varying income level of the borrower. The minimum and maximum loan size expected is Rs. 200,000 and Rs. 1.5 million, respectively. The average loan tenor is likely to be 10 years and the mark-up 20 per cent.

In addition to the equity, Interfund projects its additional funding requirements to be met from passbook deposits (40 per cent), local and international institution credit lines (40 per cent) and term deposits with a maturity ranging from 30 days to 5 years (20 per cent). The annual cost of funds is expected to range from 11 per cent for passbook savings, 12 to 17 per cent for term deposits, 15 per cent for international agency credit lines, and 18 per cent for local financial institutions line of credit.

The organization structure comprises of three departments: (1) Finance; (2) Credit and Monitoring; and (3) Investment. Only a Chief Executive and two Group Executives have been engaged so far.

Because of its strong management team and well conceived business plan, we expect this HFC to be among the top three to emerge within the next five years.

International Housing Finance Company

The sponsoring shareholders of this HFC are renowned institutions: Pakistan Industrial Credit and Investment Corporation (PICIC) (25 per cent), Commonwealth Development Corporation (15 per cent), International Finance Corporation (10 per cent) and CresBank (10 per cent).

International's target client is the salaried employee of the multinational and large Pakistani organizations that have already set up some concessional home loan schemes for its employees. It also envisages developers as an indispensable part of its target market.

The nature of the product line and the minimum and maximum loan amounts have not been decided yet. The rate of mark-up is expected to be about 23 per cent.

No indication of the sources and maturity of deposits were available at the time of our visit. However, International will have access to lines of credit from its institutional shareholders at 'market' rates.

The organization will have three departments: (1) Personnel, Administration, Legal, and Corporate Affairs; (2) Finance, Accounts, and Treasury; and (3) Marketing and Credit Evaluation.

International's strong linkages with top flight institutions give it a decided edge in comparison to the other HFCs with the exception of Citibank. With its strong management team in place, including an expatriate seconded by the Commonwealth Development

Corporation, we expect it to be among the leaders of this business.

Jaffer Brothers Housing Finance Company
Jaffer Brothers are still in the process of thinking through their strategy for housing finance. They have the same target customer in mind as do almost all other HFCs which is the employed salary earner. They are also aiming at companies with employer sponsored housing projects and plan to bridge finance developers.

Because the responses we received on our questionnaire was extremely sketchy, we have no information about this HFCs resource mobilization plans or about its organization structure.

Jaffer Brothers' current business planning procedures (or lack of them) indicate that they have serious doubts about the viability of this business.

National Housing Finance Company
National is also focusing on salaried individuals with reputable firms. The estimate we got about the size of the potential market was 10-20 million which indicates their optimism about the potential of this business provided certain policy reforms referred to in the first report are implemented.

National intends to provide different types of mortgages including adjustable rate mortgages. The minimum loan amount envisaged is Rs. 100,000 and the maximum Rs. 1.5 million. The loan tenor will range from 10 to 15 years with an expected mark-up of 23 per cent.

The funds mobilization plan relies on issuance of Certificates of Investment (COIs) and on term deposits. The cost of funds to be mobilized is estimated at about 15 per cent.

The organization structure reveals that there will be three departments: Construction and Technical, Legal and Finance, and Banking. Each of the departments will be headed by a Director (with the Chief Executive doubling as the Director Banking).

In general, we find that National does not have any strong rationale for this business other than the Directors' background in the construction industry. Hence we also have doubts about their commitment to remaining in this business as the business environment is expected to prove unfavorable.

Olympic Estate Finance Company
Olympic has the salaried population earning between Rs. 10,000 and Rs. 15,000 in its sights. Developers are also part of the target market.

Olympic intends to offer adjustable rate mortgages at a mark-up between 16-22 per cent. The minimum loan amount offered will be Rs. 50,000 and the maximum Rs. 1 million. The tenor of the loan is expected to be 7 years.

The cost of deposit mobilization is expected to range between 12-15 per cent although no indication is given about the mode of raising the necessary funds.

No organization chart has been prepared and neither have any key professional staff been recruited especially for the housing finance company by the parent organization.

Our overall impression is that Olympic is marking time to watch developments in the economic environment facing HFCs before making any decisions about market entry.

C. Report 3

(1) Background issues:

Before preparing its own business plan a HFC must develop an understanding of certain background issues. The background issues important enough to merit inclusion in Report 3 are: (i) Identification of target market (s); (ii) product line; (iii) product attributes; (iv) distribution channels; (v) resource mobilization; (vi) liquidity management; (vii) personnel; (viii) lending procedures; and (ix) legal environment.

(i) Target market (s): The market study conducted by EDC (Pvt) Limited on behalf of the Shelter Resource Mobilization Program (SRMP) includes data on the basis of which we can generate estimates of credit demand among high income groups (those earning more than Rs. 15,000 monthly). The estimate ranges between Rs. 350 million to Rs. 1.2 billion yearly with a best estimate of Rs. 430 million. This market is growing in nominal terms at between 11-15 per cent yearly.

The market can be segmented by different variables on the basis of which we can say that the HFC customer will be developers with a solid business reputation and resident and non-resident individuals. In general, the individual borrower will be: employed with a reputable company (preferably one that has a home loan scheme of its own); between the ages of 30-45 years; and earning at least Rs. 15,000 per month gross.

(ii) Product line: There are at least six possible loan products that an HFC can offer. These are: (i) loan for purchase of ready property; (ii) loan for self-construction; (iii) loan for home improvement and/or extension; (iv) loan for land purchase; (v) bridge loan to individuals; and (vi) bridge loan to developers.

(iii) Product attributes: The loan amount to individuals can vary between Rs. 0.2 million to Rs. 1.5 million while that to developers can range between a minimum of Rs. 5 million to a maximum of Rs. 20 million.

The recommended loan tenor is 15 years whereas the recommended maximum for the loan to value ratio is 60 per cent. As to the mark-up charged, it is not likely that in Pakistan's current financial sector environment anything less than a mark-up of 22 per

cent will be feasible.

(iv) Distribution channels: The HFC is expected to conduct its operations out of the main office for the first three years or so until sustained profitability is achieved and certain policy changes, particularly one allowing it to mobilize passbook savings, are introduced.

(v) Resource mobilization: In addition to equity and retained earnings the HFC will raise resources through: (i) term deposits; (ii) short and long term loans from commercial banks and DFIs; and (iii) international lines of credit.

The term deposit schemes of National Development Finance Corporation (NDFC) are particularly noteworthy in view of their phenomenal success in mobilizing deposits. These schemes include the <u>Standard Certificate of Deposit</u> with a maturity from 7 days to 5 years and rates of return between 6 per cent and 15 per cent, the <u>Monthly Income Certificate</u> with a maturity between 3 months and 5 years and profit rates between 6 per cent and 14 per cent, and the <u>Golden Certificate of Deposit</u> with a maturity of one to five years and a rate of return ranging between 12 per cent and 17 per cent. Needless to say, the HFC will have to be rates comparable to this and/or offer some incentive such as the prospect of a house loan to attract deposits.

For short and long term borrowings from commercial banks and/or DFIs, the cost is estimated at 18 per cent per annum given the current market conditions.

International lines of credit can offer attractive margins on lending so the HFC should explore the prospect of funding from international agencies such as the Asian Development Bank.

(vi) Liquidity management: A weekly, monthly, quarterly, and annual cash flow forecast is essential to guard against any shortfalls in liquidity.

To comply with prudential regulations for investment in government securities equivalent to 15 per cent of its deposit liabilities, the HFC will have two major instruments -- Treasury Bills of 6 months maturity and Federal Investment Bonds of 3, 5, and 10 years maturity -- to choose from. Treasury Bills yield less than Federal Investment Bonds but they have the advantage of greater liquidity and are less exposed to the risk of losses in capital value should short term interest rates increase further. In the currently uncertain economic environment, we are recommending that HFCs hold Treasury Bills.

(vii) Personnel: The HFC will be structured into three divisions: the Operations Division, the Finance and Accounts Division, and the Human Resources Division. The positions that have been identified are: (a) Chief Executive; (b) General Manager, Operations; (c) General Manager, Finance; (d) General Manager, Human Resources; (e)

Marketing Manager; (f) Loan Processor; (g) Technical Manager; (h) Manager Recoveries; (i) Manager Accounts and MIS; (j) Manager Treasury; (k) Manager Deposit Mobilization; (l) Internal Auditor; and (m) Legal Advisor.

Detailed position descriptions are given in Report 4.

(viii) Lending procedures: The HFC will set certain conditions precedent to a loan agreement including negotiating an agreement from the employer for a salary deduction, borrower's ability to arrange for life insurance, borrower's willingness to pay a loan processing fee and a commitment fee. Several negative covenants must also be adhered to by the borrower.

(ix) Legal environment: There are two particular legal issues that are going to confront HFCs on a daily basis. These are: (a) title verification; and (b) mortgage registration.

Because of the multiplicity of title documents and outmoded methods of recording titles to property, the procedure for title verification is time consuming and error prone. Further, owing to deliberate avoidance of high transactions taxes (stamp duties/registration charges) the great majority of transactions in open plots are undertaken on basis of transfer of allotment of lands coupled with powers of attorney. This process creates legal problems in verifying the title of the mortgagor in case: the donor of the power dies before the eventual registration by the purchaser or his nominee; or if the power is badly drafted so as not to contain the requisite powers required for the transfer of the land; or if the power of attorney allows the attorney to appoint sub-attorneys one of which may die effecting a break in the chain of attorneys which creates a legal lacuna in the transfer of the property.

In light of the above problems of verification and until the GOP provides policy remedies, the HFC is advised to secure additional indemnities and guarantees to safeguard its interest.

The registration of a mortgage is expensive as a mortgage deed is required to be stamped under the provisions of the Stamp Act. The rate of stamp duty, in cases where the possession is also transferred to the mortgagee, varies from 4% in Balochistan to 10% for property with a value over Rs. 350,000 in Punjab. This provides an incentive for the mortgagors to prevail upon the mortgagees to obtain the mortgage by deposit of title deeds rather than by registered mortgage deed. However, while certain provisions of the law appeared to suggest that only by a registered mortgage deed could adequate security be obtained by a financial institution, this was changed with an amendment in the Finance Act of 1986 which did away with the distinction between a mortgage created by a mortgage deed and mortgage by deposit of title deeds of property where the mortgagee is the Federal Government or Provincial Government or a 'banking company' as defined by the Banking Tribunals Ordinance. However, since HFCs are not

classified as banking companies this amendment does not cover them. In other words, they need the umbrella of being classified as banking companies to avoid the expensive route of mortgage registration rather than the simpler equitable mortgage procedure.

(2) Business plan:
The business plan for a 'model' HFC takes into account the fact that the market is not overly large, that funds mobilization will be expensive, and that developers will be an important avenue for lending.

The base case financial projection gives the following outcome:

Year	Loans Disbursed (Rs. mil.)	Net Income (Rs. mil.)	Return on Equity (%)	Debt to equity
1	62	-1.54	-3.1	1.31
2	136	-6.67	-6.7	1.51
3	136	7.85	7.9	2.11
4	136	11.80	11.8	2.22
5	136	23.28	23.3	1.98

Under the set of assumptions used in our financial plan the HFC will only start to make profits once it has booked about Rs. 242 million in loans. This business volume is reached in the first quarter of the third year of operations.

D. Report 4
As indicated in Report 3, the organization of a 'model' HFC will have three divisions -- Operations, Finance and Accounts, and Human Resources.

The key positions in the organization -- that are expected to be filled over a period of a year so as not to add unduly to the HFCs cost structure -- are:

(i) Chief Executive: He will be the chief operating officer. Reports to the Board of Directors.

(ii) General Manager, Operations: Will have overall responsibility for the Operations Division; will also prepare operating plans and budgets. Reports to the Chief Executive.

(iii)Marketing Manager: Will spearhead the organization's marketing activity. Reports to the General Manager, Operations.

(iv) Loan Processor: Primary responsibility will be to underwrite and process the loan from application through closing. Reports to General Manager, Operations.

(v) Technical Manager: Primary responsibility is to visit construction site and prepare report for use in package by loan processor. Reports to General Manager, Operations.

(vi) Manager Recoveries: Will be responsible for keeping track of loan cycle from date of disbursement. Reports to General Manager, Operations.

(vii) General Manager, Finance: Will set financial policies for the HFC in light of Board's guidelines and will supervise accounting operations. Reports to the Chief Executive.

(viii) Manager Accounts and MIS: Will design and maintain a computerized accounting and MIS. Reports to the General Manager Finance.

(ix) Manager Treasury: Will be primarily responsible for enuring that sufficient funds at some predetermined cost are available for the budgeted operations of the HFC. Reports to the General Manager Finance.

(x) Manager Deposit Mobilization: Will spearhead the deposit mobilization drive by the HFC. Reports to the General Manager Finance.

(xi) General Manager Human Resources: Will have primary responsibility for the selection, recruitment, and training of HFC personnel. Reports to the Chief Executive.

(xii)Internal Auditor: Will check on the accounting and other procedures prescribed by the Board and management's adherence to them. Reports to the Chief Executive.

(xiii)Legal Advisor: Will be a legal consultant to the HFC on a case to case basis. Reports to the Chief Executive.

The training needs of the HFC will be particularly acute in the following areas: (a) loan processing; (b) property appraisal; (c) MIS and systems development; and (d) loan recoveries.

The short term training strategy relies on a combination of technical assistance and short period training programs. For short term reasonably priced technical assistance the HFCs can pool their resources and approach an American organization that sends retired executives abroad, International Executive Service Corps (IESC) or its British equivalent, British Executive Service Overseas. In addition, by becoming affiliated to the 'Asian Coalition of Housing Finance Institutions' it can also network with experts from other Asian countries and send executives for two-three weeks training at the Housing Development Finance Corporation of India (HDFC). The courses at HDFC are of high quality according to the feedback we received from participants in previous courses. Moreover, the total costs of attending an HDFC training program are highly reasonable.

When it has become clear just how many HFCs are likely to stay in this business, which is to say after a three to four year period, the HFCs can pool their resources and est. 'ish a training

institute -- the Center for Housing Finance -- that will tend to their specialized requirements. The costs of this institute should be borne equally by all participating institutions.

The SRMP can play an important facilitating role in identifying training programs and bringing in expatriate consultants for short periods both to train HFC executives on the job and to conduct training of trainers.

E. Recommendations

The viability of several of the HFCs is presently doubtful and the objective of affordable housing for the majority of the country's families will remain unattainable unless some major structural reforms of the macroeconomic, fiscal, institutional, and legal environment are undertaken.

(i) Macroeconomic measures: At the macroeconomic level it would be desirable for the GOP to trim its fiscal deficit and provide incentives for saving through the tax system so that the available pool of savings is increased and the cost of funds mobilization by HFCs reduced. Further, HFCs should be allowed to tap savings through passbook savings accounts which will provide them with a steady stream of relatively low cost funds.

(ii) Fiscal incentives: Certain fiscal incentives are also necessary to help lower the cost of funds and make HFC loans affordable to the middle classes of this country. Among these we would suggest that mortgage mark-up be made tax deductible for income tax computation purposes, that repayment of principal amount of loan upto Rs. 10,000 yearly be made tax deductible, that yearly income of upto Rs. 10,000 on deposit with HFCs be exempt from income tax, that the 2% excise levy be repealed on all HFC lending, and that HFCs be given a five year corporate tax holiday.

At present, to avoid stamp duty on conveyancing either property is not obtained in a manner which provides a clear title to the owner of the property who is seeking the HFC financing or the property is undervalued in the official documentation. Both these problems manifest themselves in increased processing costs at the stage of the review of the application for HFC financing in order to provide optimum security to the HFC and yet to provide as much financing as possible looking at the actual value of the property involved. Thus stamp duties and registration charges should be brought at par with those applicable to banking companies or the HFCs should be declared banking companies for purposes of stamp duty and mortgage registration. (Citibank's suggestion that the definition of customer of a banking company should be expanded to include both borrower and seller of property should be accepted as otherwise the transactions costs will still be applicable on the seller.)

(iii) Institutional measures: Instead of lumping the HFCs with other Non Bank Financial Institutions (NBFI) under the NBFI regulations, as is currently the case, the State Bank of Pakistan should recognize their importance and issue a separate set of

regulations for HFCs. This will highlight their needs and problems to the SBP supervisors in a realistic light.

Also, HFCs either need to have a apex bank as 'lender of last resort' or should be allowed access to the inter-bank market where they can arrange to meet their liquidity needs from other banks at short notice and/or can participate in repo transactions with the SBP.

The apex bank solution is a long term option which may not be feasible at present if it is to be funded largely by the HFCs themselves. However, access to the inter-bank market and the SBP's repo window will help not only the HFCs liquidity position but will send a tremendous signal of confidence to the depositor public at large that the HFCs are reckoned as mainstream institutions by the SBP thereby removing the stigma that may have carried over to them from the collapse in the past of deposit taking private sector organizations.

One regulation that is an unnecessary administrative encumbrance and should be dispensed with is the present NBFI requirement that 5 per cent of all loans be under Rs.125,000. This is an unrealistic imposition on the HFCs given the cost of their product and their target market.

(iv) Legal framework:
(a) Title standardization and verification
Major long term reforms are required to simplify and standardize the system of title recording and verification. What is required is a complete overhaul of the system, a task that may appear difficult but one that is necessary. Thus we recommend that each parcel of land throughout the territory of Pakistan be mapped and identified as belonging to a particular person or authority. The hierarchy of ownership in such property should also be established. Thus as of any given target date (say, January 1, 2000) all properties in Pakistan would bear a number which would show the owner of that property, any encumbrances on that property and, if relevant, any existing dispute in relation to the title of such property. With the computerization of records, the task though daunting is not impossible of achievement. (Similar doubts were expressed about the feasibility of undertaking the task of issuing National Identity Cards to millions of resident and non-resident Pakistanis when the idea was first mooted in the early 1970s.)

The positive results of the computerization of title records would manifest themselves in the certainty as to title of land, disclosure of the wealth of persons holding the land under 'benami' transactions, unearthing of hidden sources of income and elimination of transactions costs with respect to title verification.

To achieve the desired goal of standardization of titles to property and to make the system so efficient as to eliminate

transactions costs would require widespread amendments in the legal framework pertaining to the land. Owing to the power which is derived from the control over land, the implementation of this policy will face immense resistance from vested interests. However, if the power to control the disposal or utilization of land is left with the authorities, as is currently the case, then the resistance would be greatly diluted as the authorities would merely provide the data to a centrally administered agency which would enable such agency to standardize the title to all property situated within the jurisdiction of such authority. Hence we recommend that the various development authorities, municipal councils, housing societies, cooperative societies, revenue boards, military estate office, cantonment board, and government functionaries vested with the power to control allotment, lease, or sale of property rights be obliged under the law to provide the requisite information to the centrally administered data bank entrusted with the task of compiling the computerized records. This would enable the entire land record of Pakistan to be eventually computerized without there being any need for a change in the legal framework pertaining to the manner of disposal of such property.

The manner in which the information pertaining to the title is provided would require substantial discussion between the various authorities concerned in order to ensure full cooperation from them. The concept of public hearing of objections prior to the finalization of records, as undertaken in various developed societies, and expeditious disposal of such objections would ensure the authenticity and veracity of the record once created.

The law pertaining to the transfer of property or creating any encumbrance or charge on any property, should also be changed once the title records are computerized, such that all property borne on such records can be transferred or encumbered in the same manner irrespective of the location of the authority granting the rights to the said property.

(b) Mortgage registration: The mortgage registration procedure should be made as simple as the verification of title to property. Once all the data with regard to the ownership of property in Pakistan are collated and laws are introduced for the simplification and standardization of the procedures for property transfer, laws should concurrently be introduced for the manner in which mortgage, charges, or encumbrances are to be recorded. A simple inquiry giving a computer the number of the property should reveal not only the details as to the title of the property but also details as to any encumbrances in respect of such property. Again, though the task appears daunting, once the data are collated the task of listing all charges and encumbrances in respect of such property can be easily accomplished. The investment in collating such information and creating the data base pertaining to the encumbrances on each parcel of property in Pakistan would be more than adequately recompensed by the efficiency with which the system pertaining to housing finance would be able to be operated. The

reduced risk of security being depreciated or defrauded would be reflected in the reduction of transactions costs and higher turnover of HFC financed property transactions.

To avoid confusion, the law pertaining to mortgages should be amended to clearly provide the rights and obligations of the mortgagees and the mortgagors in respect of mortgaged property. Instead of different forms of mortgages, the charges register should be able to clearly inform the proposed mortgagee of all encumbrances and charges existing on the property.

(c) Debt recovery and foreclosure: In the event of default by the borrower, the HFC will encash the security. Where their primary security is fraught with uncertainties or the manner of enforcing such securities is riddled with delays, the HFC would not be willing to increase its transactions risks under the present set up. Laws need to be amended in order to ensure that the HFC is not only provided the right to sell the mortgaged property without recourse to a court of law but also that it may obtain a summary order of possession. Ability to sell immoveable property, be it residential or commercial, without the ability to have the property evacuated and to transfer vacant possession to the purchaser of such property would not enable HFCs to achieve the optimum value of such mortgaged property. In order to ensure that HFCs are able to maximize the amount recoverable from such mortgaged property, they must be given legal powers to obtain immediate physical possession of the mortgaged property through a summary procedure.

REPORT 1

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INTRODUCTION

I. INTRODUCTION

The objective of this report is to describe how the seven leading housing finance companies (HFCs) view the present business, policy, and legal environment. The seven companies that are covered are:

* Citibank Housing Finance Company Limited
* Empire Housing Finance Company Limited
* Interfund Housing Finance Company Limited
* International Housing Finance Company Limited
* Jaffer Brothers Housing Finance Company Limited
* National Housing Finance Company Limited
* Olympic Housing Finance Company Limited.

The seven HFCs are in various states of readiness. Thus only three of the seven companies have thus far been incorporated while only one has begun operations.

The methodology for meeting the study objectives entailed a combination of personal interviews by the MFA team of key personnel of the HFCs (in most cases the Chief Executive) as well as written responses to our questionnaire (Appendix 1). Six of the seven companies have responded in writing to our questionnaire whereas the seventh promised to submit its questionnaire later as it was updating its original feasibility study at the time of our visit.

The remainder of this report is divided into sections that cover the following four issues:

1. HFC perceptions about the current regulatory and legal environment directly affecting their operations.

2. HFC perceptions about the constituent elements of an appropriate enabling environment for housing finance and what policy changes should be brought about by the Government of Pakistan to create this environment.

3. Our overall assessment of the degree of optimism or pessimism about present and expected business conditions exhibited by the participants in this industry.

4. Our assessment of the key factors likely to impact, whether adversely or favorably, the HFCs over the next five years.

CURRENT REGULATORY AND LEGAL ENVIRONMENT

II. CURRENT REGULATORY AND LEGAL ENVIRONMENT

Our discussions with all seven of the HFCs reveal that the major areas of concern in the legal and regulatory environment currently in place are the following:

1. Title verification.
2. Title transfer and mortgage registration costs.
3. Funding costs.
4. Foreclosure in the event of borrower default.
5. Non-Bank Financial Institution (NBFI) Regulations.

The institution that is most knowledgeable on each of these areas is Citibank as they are presently the only institution to have opened their doors for business and are confronting these problems head on.

1. Title verification

A key condition for success in the housing finance business is clear evidence that the potential borrower is the actual owner of the property that is to be offered for security to the lending institution and that the legal system recognizes this claim of ownership. Unfortunately, under the present system of multiple sources of title claims the lender cannot be absolutely certain that title vests in the claimant and that this can be transferred to the HFC clear of all third party claims. The situation prevalent in Lahore is indicative of the type of problems encountered.

In Lahore there are three main methods of acquiring title to property. First, in the high income localities of Defence and Canal the allotment letter constitutes evidence of ownership notwithstanding that it is not a valid legal title. This letter can be obtained at significantly lower cost than if the owner were to register a legal title which would entail a 8.5 per cent to 10 per cent stamp duty levied on the value of the property by the Punjab Government as also a 2.5 per cent corporation fee by the Lahore Development Authority (LDA). Thus while the allotment letter confers ownership so far as transactions with third parties are concerned, it does not constitute valid legal title to the property and is not therefore acceptable to an HFC as a title document. Second, in the area falling under the jurisdiction of the LDA the majority of transactions are conducted through the open transfer letter whereby the sales agreement coupled with the power of attorney in favor of the buyer constitutes proof of ownership. In this type of case, it is not unusual to find that the current owner is last in a line of several previous owners and that the registered owner is indeed not traceable or lacks little incentive to transfer title according to the legal procedure. Third, there is the oral gift which is valid as per the Islamic procedure but requires significant effort in bringing witnesses together etc. and may therefore not be feasible for the HFC to cope with because of the significant transaction and time costs involved.

On the other hand, the situation in Karachi is apparently not as confusing as in Lahore. According to our information, the titling problem is acute mainly in the case of apartment blocks where title is not transferred to buyer and he either gets a sub-lease from the developer or a simple allotment. A similar problem of incomplete title transfer appears to hold in case of Karachi's cooperative housing societies.

In view of the above the HFCs consider the present system of title registration unsatisfactory. Unless some reforms are undertaken to standardize the titling procedure and to reduce or eliminate the high level of transactions taxes that give rise to anomalies militating against title registration, the HFCs are apprehensive not only that the total size of the market for mortgage loans will be restricted but that they will have limited or no recourse to the property in case of borrowers' default.

2. <u>Title transfer and title registration charges</u>
The high rate of transactions taxes are a deterrent to would be borrowers as indicated by the fact that four of our six respondents rated high transactions taxes as one of the three most pressing areas for reform.

Currently the following charges are applicable to transfer of property by potential customers of the HFCs:

	(% of property value)	
	Lahore	Karachi
Stamp duty on transfer	8.5-10	9
Registration charges	2.5	1
Capital Value Tax	5	5
Property transfer fee	-	Varies by locality according to plot size

The mortgage registration charges are also fairly onerous for non-banking financial institutions. These include the following:

Stamp duty on mortgage document (% of loan amount)	3
Registration of mortgage (% of loan amount)	1
Mortgage redemption charge (% of loan and mark-up)	1

Customers of commercial banks have an advantage in so far as they only have to pay 1% stamp duty on a transfer of title transaction and 1% stamp duty on a mortgage document. That is why Citibank would like to see the definition of customer expanded to encompass not only the borrower but also the seller of the property to the HFC. Thus, with the change in definition of the customer, the transfer of property title in favor of Citibank will take place at a much lower cost. (At the same time the HFC will have automatic

access to the Banking Tribunal rather than having to apply for special access through the Ministry of Finance.)

Another area of concern includes the applicability of Capital Value Tax on income tax assesses who are supposedly exempt but in fact may be liable as the government has included all residential land transactions of more than 240 square yards liable for this tax. According to our information the CVT is currently being collected (on the basis of the declared value of the property by the transferee) on all land transactions regardless of the tax paying status of the parties involved in the transaction.

The high transactions taxes have had one notable effect. According to Citibank the market for ready property has been 'killed' by the onerous stamp duty, registration charges, etc. on transfer of title. They are therefore focusing on the 'under construction' borrower segment where the borrower has clear title to the land and does not have to incur heavy stamp duty and registration charges. However, the concern here is the lag between the time of sanction of loan and complete disbursement which in the case of some developer sponsored projects may take up to two years; this would mean a slow build up of the loan portfolio and foregone earnings while they have to pay for the cost of deposit mobilization. (On the other hand, some of the HFCs are targeting the developers themselves rather than the latter's individual customers indicating that they would prefer a quick turnaround in the entire loan cycle because of their high risk aversion.)

One of the responses by Citibank to the high stamp duty is to allow the title to remain with the borrower in the case of an under construction loan but to execute an equitable mortgage in which the title deeds are deposited with the HFC. The agreement between Citibank and the borrower is to indicate the market value of the land and the property as well as the mortgage agreement between both parties. The impression we received was that this solution was accepted only as a second best compromise after much debate within Citibank's ranks. (Another HFC also indicated that it would settle for equitable mortgages after it began its operations.)

3. Funding costs

A low cost and reliable deposit base has been mentioned as the most important key success factor by three of the seven companies covered.

The HFCs believe that their funding costs will range between 12%-17% p.a. depending on the maturity of the funds mobilized. The consensus estimate of the average cost of funds is 15% -- similar to what leasing companies are currently paying for raising funds from the market. (All participants appear to recognize that the Government's borrowing in the capital market sets a floor on the cost of funds for the private sector.)

Based on the cost of funds the mark-up proposed or expected to be charged the borrower is as follows:

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Company	Mark-up proposed (% p.a.)
Citibank	20-22
Empire	18-22
Interfund	18-22
International	23
Jaffer Brothers	N.A.
National	23
Olympic	16-22

Citibank's rates include a 2% excise levy that it charges on ready property bought from, say, developers. On the other hand, the excise duty exemption applies to loans for self-construction by borrowers who qualify for the lower 20% mark-up rate.

None of the HFCs we spoke to seems to think this an 'affordable' rate of mark-up, particularly in light of the sluggish real estate market where the vacancy rate of newly constructed residential property -- particularly in Karachi -- is high. Consequently, the need felt for incentives such as mark-up deduction from taxable income to bring down the after-tax cost to the borrower or to attract long term funds available with pension/provident funds and insurance companies.

Despite their reservations about the high cost to the borrower only three companies have seriously thought about the implications for their market strategy and whether they can or cannot compete under these conditions. The other four appear to believe that there is a potentially large market for their services and, implicitly, that the Government will somehow come through with its concessions to the HFCs making the product affordable to the bulk of the middle class households.

4. Foreclosure in the event of borrower default

HFC opinion about the importance of foreclosure as a factor conducive to success was about evenly divided. Three of the companies we interviewed rated this as among the three most important key success factors on which the success of the HFCs hinges. The other four did not rate it as among the most important of the issues.

Even among those who rated this as a key issue the consensus was that the laws on the books and access to Banking Tribunals were adequate. The problem lay in enforcing the rulings handed down by the judicial bodies because of the general belief that the law could be circumvented whether by fair means or foul.

The four HFCs that did not rate this an important matter felt that proper appraisal of the borrower would preempt the foreclosure issue. Since a house is an 'emotional' investment (as one of our discussants put it) a person with a reputable background would not like to get involved in litigation that may also mean the loss of what is his most precious asset.

5. Non-Bank Financial Institution (NBFI) Regulations

One particular rule under the NBFI regulation does hurt HFCs profitability directly. This is the requirement that at least 15% of HFC liabilities should be invested in government securities. Since the return on treasury bills is around 12%-13% whereas the cost of mobilizing funds is 15%-16%, several HFCs indicated that the ultimate cost of lending would increase by about one percentage point as losses would have to be recouped through their normal business operations.

(If the HFCs are allowed to operate in the inter-bank market, however, then the possibility of arbitrage does open up as the Treasury Bills could be used by the HFC in a repo transaction whereby they agree to repurchase the security on a future date at sale price plus mark-up meanwhile using the borrowed funds to lend short term to, say, developers. In general, the inter-bank rates have been much lower than the lending rates charged to prime borrowers.)

Specific reporting requirements imposed by the SBP and the Ministry of Finance on all NBFIs were not a priority concern right now as none of the HFCs excepting one has been faced with the minutiae of operational reporting requirements. However, at least three HFCs did underline the importance of having a separate set of regulations concerned exclusively with HFCs as their business procedures and problems were different from other NBFIs with which they are currently grouped by the State Bank of Pakistan.

Overall the HFCs are well informed about the prudential requirements excepting in two areas: (i) Leasing/Hire purchase regulations; and (ii) Small Loans.

(i) Leasing/Hire Purchase: There is some uncertainty about whether HFCs can enter the leasing business. Although S.R.O. 1356(I)/90 does expressly contain a clause envisaging the leasing of buildings, one of the HFCs we spoke to pointed out that leasing of buildings is not allowed under the leasing laws. On the other hand, another HFC indicated that leasing was a permissible mode under the Islamic system of finance and that regulations pertaining to leasing companies were not applicable to HFCs who were therefore competent to enter into leasing/hire purchase arrangements for real estate as per their own statutory rules.

This issue will become clearer when more HFCs come into operation. Our opinion is that leasing is permissible but whether HFCs will enter this business depends on considerations of future tax liability and the possibility of losing access to Banking Tribunals in case a lease arrangement is deemed to fall outside the ambit of the latter's jurisdiction.

Presently four of our six respondents intend to engage in leasing/hire purchase of buildings. A fifth HFC would like to do so but is not sure whether it can under the law. Only one HFC categorically stated that it would not enter into lease/hire

purchase transactions.

(ii) Small loans: The NBFIs regulation that 5% of all loans be under Rs. 125,000 per borrower appears to be part of the small print that has escaped the attention of almost all HFCs save one. This issue will crop up later and prove to be a big administrative headache if not tackled now. Only one HFC is aware of the difficulty of meeting this statutory requirement given that the loan product currently on offer is designed only for a narrow target market.

PERCEPTIONS ON GOVERNMENT POLICIES

III. PERCEPTIONS ON GOVERNMENT POLICIES

The Shelter Resource Mobilization Program has been very useful in raising awareness among all the HFCs about the necessary policy environment if housing finance is to flourish. All HFCs are aware of at least some features of policies in other countries that provide incentives for home ownership through long term loans. Obviously enough, all HFCs want as many incentives as possible and are confident that with necessary changes in the enabling environment they will have a viable business.

A. Institutional changes and microeconomic policies

The response to our questionnaire indicated that the following are the most important institutional and/or company level changes that would have a long term positive impact on the development of housing finance institutions in this country.

Policy	Number indicating as priority
Permission to operate passbook savings accounts	5
Deductibility of mortgage mark-up from taxable income	2
Access to refinancing facilities through an apex bank	2
Access to inter-bank funds	1

1. Permission to operate passbook savings accounts

The current rules only allow HFCs to mobilize deposits of not less than 30 days maturity which means that they are prevented from tapping the bulk of low cost retail deposits that commercial banks traditionally depend on to lower their funding costs. Virtually all the HFCs recognize that if the government allows them to operate a passbook scheme they would in time garner a substantial share of all funds placed in saving accounts with financial institutions. However, only one gave us its assessment of how much this source of funding would cost: 11% per annum. This is significantly higher than the 6%-8% cost that commercial banks have to pay for PLS type deposits and appears to indicate that this HFC is canny enough to perceive that public depositors will demand a premium from HFCs till such time that they have an established track record.

One HFC clearly indicated that it would operate multiple branches if the rules regarding deposit mobilization were relaxed. It appeared confident that it could muster substantial deposits through the passbook scheme. Others were not as sure whether just a change in the rules would be enough as the HFCs would have to surmount the loss of public confidence in all Pakistani private sector financial institutions in the wake of a series of financial scandals culminating with the cooperatives. (The representative of

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one HFC came up with the curious suggestion that by renaming the HFCs 'banks' the confidence gap would somehow be overcome; he did not spell out though how the name change, per se, would be helpful although the implication was that since all 'Finance Companies' were considered disreputable organizations by the public as they had been bilked by similarly named organizations in the past, a name change would be good for the HFCs image.)

At least two of the HFCs who endorsed the passbook scheme saw in it the seeds of a program to mobilize contractual savings as it would be quite simple to have,say, different colored passbooks for different classes of savers while the record keeping costs would not vary much, if at all.

2. Deductibility of mortgage mark-up

Two HFC saw complete deductibility of mortgage mark-up from taxable income as one of three key areas of reform as it would permit a very reliable class of borrower -- the salaried employee -- to lower his borrowing cost. One of these two HFCs also viewed this to be a useful way for the government to widen its tax net as many borrowers, not normally expected to declare taxable income, would then declare income so as to take advantage of the tax deduction for the duration of the loan but would afterwards be included among the list of tax payers.

The majority of respondents rated this as a low priority measure perhaps because they believed its applicability would be limited to a very narrow segment of the population. This may be due to, in our opinion, a mistaken perception that the number of tax assesses is less than what is actually the case. (A figure mentioned by one HFC was that there are only 14,000 income tax assesses whereas according to our information the actual number is about 1.1 million.)

3. Access to refinancing facilities through an apex bank

Two of the HFC indicated this as being among their three key areas in which they would like some changes introduced. In general, those HFCs that were already part of a financial conglomerate did not view the need for an apex bank as key perhaps because they could count on support from their affiliated concerns in case of need.

As to the preferred mode of organization, the majority indicated that the State Bank should have the lead responsibility in arranging refinance facilities in addition to a expansion in its supervisory and regulatory responsibilities. This probably reflects an underlying assumption that if the State Bank were to shoulder this role, the need for expensive capital subscriptions by the HFCs themselves would be obviated. In other words, this would be a lower cost option than if a new private organization were to be set up and managed by the HFCs themselves at a time that they are themselves trying to get to grips with a new business.

One HFC believed that HBFC should take on the refinancing role and

withdraw or reduce its presence in direct financing activities.

4. Access to inter-bank funds
Only one HFC rated access to inter-bank funds as among the three most important changes that should be effected.

The HFCs are more concerned about their core funding activities through deposit mobilization and see the inter-bank market as a useful adjunct in helping to lower the cost of funds mobilization as well as to manage their liquidity requirements.

The concern expressed by the regulatory authority about mismatched asset and liability maturities should inter-bank funds be deployed for long term house lending is misplaced, according to one HFC, because the inter-bank market is a self-policing one where all participants know each other and enforcement of market discipline is extreme. In other words, the chances of an HFC that has been granted access by the players backing out of an inter-bank commitment is remote. Which is not to say that it cannot happen, though. Another HFC hinted as much when it pointed to the need for access to inter-bank deposits as part of a package of deregulation for the financial sector including lender of last resort facilities and permission to issue bank guarantees for securitization purposes.

5. Permission to mobilize foreign exchange deposits
One HFC was confident about its ability to mobilize foreign currency deposits. This reflected its enthusiasm for the low interest rates on foreign currencies prevalent in the international markets to which even when the foreign exchange risk cover levied by the SBP was added meant a cost of funds of about 7% or something less than half the cost of funds mobilization from domestic channels alone.

This may be an overly optimistic assessment of the situation as this source of funding can just as easily be withdrawn depending on the depositor's perception of the politico-economic situation in the country.

6. Corporate taxation
Only one HFC rated exemption from corporate tax for five years as an important enough incentive.

Since the emphasis by HFCs is on concessions to be provided the borrower to generate the initial momentum for the business, corporate taxation becomes only relevant when there are profits to distribute.

B. Macroeconomic policies
Only four of the six respondents who responded in writing to our questionnaire had an opinion on the macroeconomic environment expected to prevail over the next five years. (This appears on the surface to indicate a serious flaw in the planning procedure in at least two of the HFCs if they have not even seriously thought about

the business environment in which they will be operating.)

The HFCs are generally optimistic about the economy in terms of its growth prospects as indicated by the fact that three HFCs' estimate of annual GDP growth in the next five years ranged from a low of 5% to a high of 10%. The fourth HFC did not venture to give its estimate about future growth prospects.

The opinion on expected inflation and budgetary deficits was evenly split with two HFCs expecting increases in budgetary deficits and attendant inflation of over 10% per annum whereas the other two expected the budgetary deficit to taper off along with an ensuing drop in the inflation rate to within the range of 7%-10%.

Only one of the HFCs expected a lower budgetary deficit and inflation rate to translate into a decrease in the mark-up rate on mortgages whereas the other HFC with an optimistic assessment of inflation rates and budget deficits nevertheless felt that concurrent financial sector deregulation meant higher cost deposits and correspondingly higher mark-up on lending. Two other HFCs with an expectation of higher budget deficits and inflation were consistent in their expectation that these macroeconomic imbalances, allied to increasing deregulation of the financial sector, would result in higher cost funding.

HFC ASSESSMENT OF FUTURE PROSPECTS

IV. HFC ASSESSMENT OF FUTURE PROSPECTS

The pervasive feeling among the HFCs we met with is that the current environment is not conducive to development of the housing finance business and, unless the government introduces policy changes of the kind referred to in the previous two sections, the HFCs will face serious difficulties in sustaining their operations.

In general, opinion was divided about whether the GOP was serious about developing the appropriate housing finance institutional and other policy mechanisms. At least two companies held that the Executive Committee of the National Housing Authority which was mandated to take stock of the problems confronting HFCs did not have an adequate appreciation of the problems confronting the private sector HFCs as their priorities were short term rather than long term in outlook. Further, as responsibility for setting the ground rules was distributed among various bodies such as the Corporate Law Authority, the Internal Finance Wing of the Ministry of Finance, and the State Bank of Pakistan, decision making tended to get bogged down as decision making by committee was an extremely slow process that resulted in delayed and, therefore, costly outcomes. In this regard, the respondents were glad that the SRMP had mooted the idea of a trade association that would project the HFC viewpoint on a common platform but would like to see the concurrent emergence of recognizable pressure points within the government on which they can focus their attention. Hence the need expressed for a separate set of NBFI regulations governing the operations of the HFCs.

One HFC was optimistic enough to believe that the government could not remain oblivious to their plight as why would they have sanctioned their establishment in the first instance? Another seemed to believe that as a negotiating strategy if the HFCs asked for the maximum support (e.g., the demand that GOP should channel low cost housing finance loans through the HFCs instead of using HBFC for this purpose), they would get at least some of the other changes.

Overall, we came away with the impression that only three HFCs would begin operations 'no matter what', as they were committed to entering and remaining in this business. Three HFCs, while sounding cautiously optimistic, would probably watch from the sidelines and wait to see how the leaders in their industry fared. One HFC was least committed to enter this business and would only do so if the most favorable scenario prevailed (which included, inter alia, access to low cost funds to be provided by the government.)

CONSULTANT'S ASSESSMENT

V. CONSULTANT'S ASSESSMENT

Our own assessment of the business environment facing the HFCs is that it will be difficult for the HFCs to operate profitably in this environment unless some policy changes are introduced to reduce the onerous level of transactions taxes. This includes stamp duties and registration charges on title transfer as well as the fees associated with registering a mortgage. With necessary reductions in stamp duties, etc., the environment will become competitive.

Our understanding of the business environment has been arrived at after talking to both the HFCs themselves as well as the officials entrusted with developing policies. We believe that policy changes to be introduced in the next five years will be limited to the following two measures:

1. Reduction in stamp duties and HFC eligibility to be classified as a banking company for mortgage registration purposes.

2. Permission to operate passbook savings accounts.

With these two changes we expect that the environment will become manageable for some, if not all, HFCs. We envisage that only three or four HFCs at most will survive in the resulting business environment over the next five years. Our reasons are based on the following:

1. Market size will be restricted by the cost of the product. Only a limited segment of the salaried population will be able to afford the mortgage product as currently priced even if up front transactions costs on a mortgage are reduced significantly. This implies that there will be spare lending capacity among the HFCs.

2. Economies of scope will favor those companies that combine house loans with loans for other consumer needs as this way they will be able to spread their overheads and be able to price their products more competitively. Similarly, some HFCs will benefit from the presence of an already tried and tested accounting system and MIS in affiliated financial concerns that could be easily tailored to meet the needs of the home lending operation. In this way, they will be able to reduce their learning costs relative to others.

3. There will be intense competition for the deposit base among all types of financial institutions as financial markets become further deregulated with private sector institutions taking the lead. In the absence of a brand name or an established track record for the sponsors, several of the HFCs will not be able to break into the market for deposits particularly with the legacy of the cooperatives and the defunct finance companies still

fresh in the minds of the depositor public. Thus the scale of the operations, and therefore the profitability of several HFCs, will be severely restricted by their inability to leverage their capital base.

4. As almost all the HFCs have indicated their intention of providing bridging loans to developers, this will result in some concentration of the asset portfolio with attendant business risk. It is not inconceivable that defaults on one or two developer loans could significantly erode the capital base of an HFC and cause a run on its deposits thereby curtailing its activities further and casting doubt on its viability.

5. Because of our belief that Karachi offers a bigger pool of potential borrowers and has fewer of the titling problems that are evident in Lahore, those HFCs focusing on Karachi should perform relatively better than their Lahore counterparts.

REPORT 2

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INTRODUCTION

I. INTRODUCTION

The primary objective of this report is to assess the state of business planning at each of the seven HFCs that were awarded Letters of Intent by the Government of Pakistan. These HFCs are:

* Citibank Housing Finance Company Limited
* Empire Housing Finance Company Limited
* Interfund Housing Finance Company Limited
* International Housing Finance Company Limited
* Jaffer Brothers Housing Finance Company Limited
* National Housing Finance Company Limited
* Olympic Housing Finance Company Limited.

Only three of the seven companies have incorporated so far and, of these, only one has started operations.

The methodology for meeting the objectives of this report consists of a combination of personal interviews by the MFA team and an analysis of written replies received in response to the questionnaire we distributed among all seven HFCs (Appendix 1). Six of the seven companies responded in writing to our questionnaire whereas the seventh indicated that it would reply later as it is now in the process of updating its feasibility study.

The remainder of this report reviews the business planning process at each of the seven companies in terms of the following areas that are at the heart of a business plan for a newly formed financial institution:

1. Market Analysis
2. Resource Mobilization
3. Organization and Management
4. Financial Forecasting.

A sub-section also focuses on the general level of HFC knowledge and attitude vis-a-vis State Bank of Pakistan and financial policy regulations.

In the final section we present our own assessment of the state of preparedness of each of the HFCs and the time it will take for each to launch operations (with the exception of course of Citibank that has already opened for business).

It is perhaps fair to point out that some of the material presented here is based on our piecing together of incomplete information as we believe that in several instances, for understandable reasons, the HFCs may have been reluctant to disclose the complete repertoire of their business strategy.

CITIBANK HOUSING FINANCE COMPANY

II. CITIBANK HOUSING FINANCE COMPANY

Citibank Housing Finance Company (CHFC) started operations in December 1992 and has since received more than 5000 inquiries in response to its two advertisements in the press. However, only some 30 applications had been received as of mid-March 1993; further, no loans had been booked.

A. Market Analysis

1. Market size: No estimate was available about the potential value of the market for housing and/or commercial loans.

In fairness to CHFC, they did indicate that they had approached the SRMP to conduct a study to cover this very area but, because of certain procedural delays at USAID, had then advanced its own funds as a form of bridge financing to a firm of consultants that was later selected to undertake the market survey by the SRMP. However, the preliminary results of this survey had come in after the start of their operations; as such, these could not be factored into their strategic market plan.

2. Market segments: No estimates were available for the potential number of borrowers whether by income levels or by geographic area, etc.

However, the market segment that CHFC is focusing on is the salaried and self-employed professional and the businessman with a minimum monthly net income of Rs. 10,542 (based on the minimum loan amount and loan conditions announced by Citibank). Certain ethnic groups known for the high level of their per capita net worth are also being targeted. These include the Chinotis, Ismailis, and the Memons.

The applicant may or may not keep records for tax purposes but CHFC reserves the right to scrutinise the financial status of the potential borrower.

Recognized developers with a successful track record will also be used as a conduit for loans to individuals although the percentage breakdown between direct loans to individuals and through developers has not been worked out yet.

3. Competition: CHFC is aware that if anybody can succeed in this market, it can. By coming into the market first it has not only signalled its resolve to succeed in the housing finance field but may also be able to skim off the best clientele before the competition is ready with their own operations. On the other hand, there are dangers in this strategy as, given the difficulties of the regulatory and legal environment, the first entrant incurs substantial learning costs that others may avoid at a later stage.

For the smaller sized loans at the lower end of its target market, CHFC anticipates competition both from HBFC and from the commercial banks.

4. Market positioning: CHFC intends to provide adjustable rate mortgages mainly to individual borrowers. No indication is available as to how often the mortgage rates are to be adjusted but presumably the loan agreement will contain a provision for the possibility of a revision in the rate of mark-up in case there is a drastic change in financial market conditions.

The minimum loan amount envisaged is Rs. 300,000 (entailing a monthly installment of Rs. 5,271 for a person whose minimum monthly income should be at least Rs.10,542) whereas the maximum loan amount is Rs. 2,000,000 (entailing a monthly installment of Rs. 35,140 for an eligible borrower with a minimum monthly income of Rs. 70,280). The loans will have a tenor of 15 years and a loan to value ratio of 60% for residential property. No loans for commercial property are envisaged. Further, CHFC does not intend to enter into leasing/hire purchase arrangements.

The mark-up for the loan has been fixed at 20% for self-construction and 22% for purchase of ready property as a 2% excise levy must be added in accordance with GOP regulations.

The promotion strategy depends on periodic advertisements in the leading English newspapers. These advertisements coupled with word of mouth publicity are expected to generate sufficient interest in the product.

The initial thrust is at the Lahore market where CHFC has started its operations. Over the next five years it intends to set up branches at Karachi, Rawalpindi/Islamabad, Faisalabad, Sialkot, Multan, Hyderabad, Peshawar, and Gujranwala -- in other words, all major urban centers in the country.

5. Market share: As indicated earlier, no estimate is available for the total potential annual demand for housing loans. An alternative way of arriving at a rough approximation of this value is to get an estimate of the value of the business generated by CHFC and its corresponding market share; these two pieces of information could then be used to extrapolate the total market size. However, CHFC did not indicate that it had any such estimate of market share. They did, however, give us an estimate of 400 loans that they expected to book in the first year. Since the average loan size is expected to be Rs. 700,000 this implies a total loan portfolio of Rs. 280,000,000 by the end of the first year or a leverage ratio of liabilities to equity of around 2:1.

B. <u>Resource Mobilization</u>

1. Equity: The Rs. 100 million has already been subscribed. A loss of Rs. 7 million was incurred when the equity in foreign currency had first to be converted into Pak Rupees to comply with the requirements of the licensing authorities and then reconverted into dollars for hedging purposes.

A public flotation of 50 per cent of the shareholder's capital -- Rs. 50 million -- is expected before December 1994.

2. Deposits: Based on our projection of the value of loans booked in the first year of operations, an estimate of funds mobilization for the first year of operations is Rs. 200 million. However, we are not in a position to make any judgements either of the maturities or of the type of financial instrument.

CHFC's estimate of the weighted cost of mobilizing deposits is 16%. This would cover the opportunity cost to the depositor of foregoing alterative return schemes and takes into account both the deduction of zakat and the withholding tax on profit of 10%.

C. Organization and Management

1. Organization structure: We understand that the Managing Director also devotes at least some time to other businesses in Citibank's consumer banking portfolio. In other words, CHFCs costs are being shared with other businesses in the corporate portfolio.

From the response to our questionnaire we can infer that at present the stress is on developing a strong marketing organization as the key personnel recruited so far all have experience in marketing/sales and the MBA as a basic educational qualification. There is a marketing director to whom two regional sales managers report. The following personnel have been recruited:

Position	Qualification	Experience(years)
Marketing Director	MBA	8
Regional Sales Manager - North	MBA	6
Regional Sales Manager - South	MBA	7

In addition to the key managers above, three employees report to the marketing director while there are 6 sales persons reporting to the Regional Sales Manger (North) and 3 to the Regional Sales Manager (South).

2. Recruitment and staffing plan: No recruitment and staffing plan has been prepared.

It appears that Citibank is using the concept of a 'one window' consumer banking operation with some costs such as accounting, MIS, personnel, and internal audit shared over its different consumer businesses. This is a reasonable approach in so far as the strategy is to provide all the consumer's needs -- from convenient foreign exchange deposit facilities to car loans to house loans -- under the one roof of a financial supermarket.

D. Financial Forecast

With the information available from Citibank including number of loans booked, average size of loan, estimate of provision for bad loans (1%), the raw data with which to develop a financial forecast

are there. Citibank has no doubt developed a financial forecast to which we are not privy but we can assert with a great deal of confidence that, owing to the unanticipated difficulties besetting the operations of all HFCs, such a forecast is no doubt being revised often.

E. <u>Knowledge and attitude towards State Bank and financial policy regulations</u>

CHFC is the most well informed of all the HFCs about the existing State Bank and financial policy regulations. The main changes in the existing financial policy regulations that CHFC would like to see implemented are:

1. HFCs to have freedom to operate passbook savings accounts.

2. HFCs should have access to inter-bank market on the same terms as commercial banks.

3. CHFC to be allowed to raise foreign currency deposits to fund housing loans.

4. All loans for housing should be exempt from the 2% excise levy.

5. The GOP should come out with a clear statement that registered taxpayers are exempt from the Capital Value tax.

6. The requirement that 5% of all loans should be under Rs. 125,000 be waived.

7. The number of Banking Tribunals should be increased to ensure that cases are decided within 90 days.

8. There should be no restriction on branch location.

9. The mandatory reserves that are to be retained within the business should be a tax deductible expense.

10. Information about individuals seeking housing loans should be encompassed in the data bank at the Credit Bureau established by the SBP.

11. Bad loans that are in conformity with the SBP prudential regulations should be a tax deductible expense. Currently the tax authorities only allow those bad loans as a deductible expense that have been decided in a court of law or if the debtor has been declared bankrupt.

12. HFCs should be allowed to issue tax free financial instruments to lower the cost of their funds.

13. The leverage ratio of deposits to equity for HFCs in Pakistan should be brought at par with that of commercial banks, ie, 17 to 1 after two years of experience instead of the presently permitted 10 to 1.

14. HFCs should be allowed to offer differentiated mark-up rates with the rate varying directly with the size of deposit.

15. SBP should issue a separate set of prudential regulations that take into account the special circumstances of the HFCs rather than banding them with other Non Bank Financial Institutions (NBFIs) as at present.

F. Observations based on SWOT analysis

Our analysis of Strengths, Weaknesses, Opportunities, and Threats (SWOT) relevant to CHFC is presented below.

* Strengths
  - Already known clientele belonging to the target market segment that keep forex accounts, or use credit cards issued by the bank.
  - Worldwide experience in housing finance means a reservoir of management skills and systems are available to draw on in case of need
  - Brand name will attract depositors
  - Parent organization has financial wherewithal to back organization through any initial loss phase
  - Ability to recruit best available staff because of reputation

* Weaknesses
  - Inadequate understanding of the size of the market segment focused on
  - Parent may not have patience to wait for housing finance policy reforms to be implemented

* Opportunities
  - Rising GDP and per capita incomes
  - Low rate of owner occupation of housing in country
  - Limited capital requirement for entry into business

* Threats
  - Higher budget deficits and inflation are likely
  - High cost of product because of funding and transactions cost may

mean limited market potential

- Legal title to property is not clear cut for mortgage purposes in many instances
- Deposit mobilization potential may fail to materialize if GOP does not signal approval of passbook savings type schemes
- Several other HFCs in market may mean intense competition particularly if market potential is limited.

Among all the HFCs, CHFC has the most sophisticated business plan based on the concept of a one stop consumer banking operation in Pakistan similar to its operations internationally. It is the organization most likely to be successful given its numerous strengths in management and organization. As the business environment becomes more hospitable, as we expect it will, CHFC will emerge as the market leader in the upper income market segment.

EMPIRE HOUSING FINANCE COMPANY

III. EMPIRE HOUSING FINANCE COMPANY

Empire Housing Finance Company (EHFC) has not yet finalized the membership of its Board of Directors. This issue is expected to be resolved soon; incorporation of the company, however, is expected to take a minimum of 6 to 8 months after which they will complete share subscription and launch operations.

A. Market Analysis

1. Market size: No estimate was forthcoming about the total size of the market for housing loans. However, we were told that "the number [of potential borrowers] will be large and their requirements cannot be met by the HFCs recently allowed to operate".

2. Market segmentation: No estimates were available for the potential number of borrowers, whether individuals or companies, in different categories.

EHFC intends to focus on both individuals and developers. In the case of individuals they will target salaried professionals, about 40 years of age, with a gross income of between Rs.15,000 to Rs. 20,000 per month. They will also lend to medium and small construction companies.

3. Competition: EHFC believes that the market for housing loans is large enough to accommodate all existing participants as well as new HFCs that have not yet appeared on the scene. Hence they have not given this aspect of their business plan much thought.

Further, they do not view either the HBFC or Commercial Banks as competitors. HBFC, they believe, is going to evolve into a refinancing agency whereas the commercial banks have other, relatively more attractive, avenues for using their funds.

4. Market positioning: The bulk of EHFC's loans (60%) will be earmarked for commercial property as this is perceived to be a potentially lucrative source of short term business and one that is managed relatively easily.

As yet, EHFC has not decided on the type of mortgage, whether it is to be fixed or adjustable etc., and on the loan amount and tenor. They envisage a loan to value ratio of 70 per cent for both residential property and non-residential property (indicating here their non-awareness of the prudential regulation which allows a maximum loan of 60 per cent of the property cost in case of non-residential property).

The mark-up on the loans is expected to range from 18% to 22%.

Management is uncertain as to whether leasing/hire purchase is permitted under the prudential rules and will consider this mode of financing should it be deemed permissible.

The initial geographic focus is on Karachi but later EHFC intends to set up branches at Lahore, Rawalpindi, Faisalabad, Peshawar, Quetta, Hyderabad, Sukkur, Multan, and Mirpur. In short, EHFC is positioning itself as a nation wide company.

5. Market share: No estimate of market share was available. However, management has prepared a two year financial forecast which indicates the value of the loan portfolio expected. In the first year after start of operations, EHFC expects to lend Rs. 130 million of which the amount lent for commercial property is projected at Rs. 78 million (60 per cent of the total) and the amount projected for residential loans at Rs. 52 million (40 per cent of the total). In the second year, total loans to be disbursed are estimated at Rs. 170 million of which Rs. 102 million (60 per cent) is projected for commercial property whereas loans for residential property are projected at Rs. 68 million (40 per cent).

B. <u>Resource Mobilization</u>
1. Equity: Sponsor's equity subscription of Rs. 50 million is expected to take another 6-8 months to accomplish. The public subscription for Rs. 50 million will be undertaken about 6 months after the start of operations.

2. Deposits: EHFC projects a total deposit base of Rs. 50 million in the first year of which Rs. 40 million is expected to be raised from term deposits of 1-3 months with an average cost of 14 per cent a year and Rs. 10 million through sale of one month bank acceptances with an average cost of 12 per cent a year.

In the second year the quantum of funds to be raised from term deposits and bank acceptances is projected at Rs. 75 million and Rs. 15 million, respectively.

(When bank acceptances are mentioned as a source of funds, there is the question of who would buy trade bills endorsed by a fledgling HFC. Thus this source of funds has to be clearly identified in a proper business plan.)

C. <u>Organization and Management</u>
1. Organization Structure: The company has developed an organization chart but we were not given an opportunity to study it in detail.

At present only two senior executives, one of whom is the Chief Executive of the company, have been recruited. Both are commercial bankers, each having about 20-25 years experience in commercial banking.

2. Recruitment and staffing plan: A recruitment plan has been prepared for the next two years. Similarly, a job description manual has also been developed. However, both these documents seem to be at a tentative stage as EHFC is tackling its internal management issues first. The current chief executive may hand over

charge to the other senior banking professional we met as the former has been assigned as head of the group affiliated commercial bank which will be starting operations soon.

D. Financial Forecast

A two year financial forecast has been prepared but we were not given details.

E. Knowledge and attitude towards State Bank and financial policy regulations

EHFC was not completely 'au fait' with all aspects of the prudential regulations. Thus they were not aware of the 60 per cent ceiling on the loan to value ratio for non-residential property. Similarly, they were not sure about the permissibility of leasing/hire purchase. They also appeared to believe that the percentage of profits that is to be retained within the business depends entirely on the discretion of the Board rather than being, to some extent, within the purview of the prudential regulations .

Their recommendations for changes in the existing regulations include the following:

1. HFCs to be allowed access to the inter-bank market.

2. HFCs to be allowed to operate passbook savings schemes.

3. HFCs to be given access to 'low cost funds similar to export refinancing facilities' from the State Bank of Pakistan or an apex refinancing agency.

4. HFCs to be allowed access to funds from international agencies against a GOP guarantee of repayment and for which the SBP should provide forward exchange cover.

5. HFCs to be permitted to call themselves banks.

F. Observations based on SWOT analysis

The following comments are pertinent:

* Strengths
    - Good institutional knowledge of real estate market
    - Sponsors have adequate financial resources to sustain a period of loss
    - Key staff have extensive experience in financial institutions

* Weaknesses
    - Have no real long term plan for this business
    - Brand name will take time to develop

* Opportunities
  - Infrastructure construction boom in country means more business for target construction companies
  - As construction has been declared an 'industry', the organized construction sector will grow in importance

* Threats
  - There will be greater business risk with greater concentration of the loan portfolio
  - Deposit mobilization may take time and effort
  - Commercial banks may seize opportunities in construction with increasing deregulation of financial sector
  - There may be fewer soundly managed developer owned construction companies than anticipated by EHFC.

EHFC is focusing on a market niche that other HFCs are not emphasizing as much. This is a higher risk strategy but with commensurately higher returns; there is also the side benefit that management monitoring and control costs associated with a commercial project oriented loan portfolio are going to be lower than for a HFC with a broader based clientele. On the whole, our assessment is that EHFC is realistic enough about its own relative strengths and has the institutional capacity to weather the difficult times ahead.

INTERFUND HOUSING FINANCE COMPANY

IV. INTERFUND HOUSING FINANCE COMPANY

Interfund Housing Finance Limited (IHFL) is a member company of a financial services group that currently manages two modarabas and a leasing company. The company will be incorporated by May/June 1993 after which the sponsor's share subscription will be completed.

A. Market Analysis

1. Market size: IHFL's estimate of the total potential number of borrowers in Pakistan is 4 million. Between 0.2 to 0.4 million overseas Pakistanis are also potential borrowers.

2. Market segments: All individuals with a minimum income level of Rs. 6,000 per month, of which there are about 4 million in the country, are potential borrowers. Also, developers with a successful track record are a potential target market for HFCs.

IHFL intends to focus on the middle class salaried employee or the small businessman, 30-40 years old, with a minimum monthly net salary of Rs. 6,000. About 20 per cent of the loan portfolio will be accounted for by loans to developers who will channel these funds to individual borrower customers.

3. Competition: IHFL anticipates tough competition both from other HFCs and from the HBFC. However, unlike Citibank, its focus is on the middle class rather than the upper income borrower. Consequently, it may be shielded from competition to some extent.

4. Market positioning: In response to our question about the type of mortgage to be offered, IHFL indicated that it would develop a product line comprising of all types of mortgages including fixed rate and adjustable rate mortgages. They also intend to offer a special mortgage in which the repayment amount will be linked to the income of the borrower such that repayments in earlier years when the borrower's income is relatively low will be less than in later years when income levels are higher.

The minimum loan amount envisaged is Rs. 200,000 and the maximum Rs. 1.5 million with an 'average' loan size of about Rs. 0.5 million. The loan tenor is expected to be 10 years with a mark up rate of 20 per cent giving a monthly installment on the average loan of about Rs. 10,500. The maximum loan to value ratio for residential property has been set at 70 per cent.

In the beginning IHFL will concentrate on the three major housing markets in the country, namely, Karachi, Lahore and Islamabad. Apart from the head office, a branch office will also be established at Karachi and at the following locations in the first five years of operations: Faisalabad, Hyderabad, Multan, Gujranwala, Peshawar, Quetta, and Sukkur.

5. Market share: No estimate for market share is available but IHFL projects the following number and value of loans booked for each of

the five years following start up:

Year	No. of loans	Value of loans (Rs. mil.)
1	300	143
2	450	492
3	500	1,198
4	550	853
5	700	1,138

B. Resource Mobilization

1. Equity: Sponsor's equity is expected to be paid up by June 1993. The public flotation is expected in the second year of operations.

2. Deposits: IHFL projects the following quantum of funds to be mobilized during the first five years of operations:

Year	Funds mobilized (Rs. mil.)
1	180
2	700
3	1,050
4	1,300
5	1,750

According to the projections made, 40 per cent of total funds for each of the five years are to be raised from passbook deposits, 40 per cent from local and international financial institution credit lines and 20 per cent from term deposits with a maturity ranging from 30 days to 5 years.

The annual cost of funds is expected to range from 11 per cent for passbook savings, 12 per cent to 17 per cent for term deposits, 15 per cent for international agency credit lines and 18 per cent for local financial institution lines of credit.

C. Organization and Management

1. Organization Structure: Three departments have been delineated: (1) Finance; (2) Credit and Monitoring; and (3) Investment.

We were not able to determine whether the organization structure as presently designed is in its final form or whether new functional departments are to be added. Neither was it possible to ascertain which of the above departments is to be located at the branch office and which in the head office although the response to the questionnaire indicates that the Credit and Monitoring Department will be centralized at Head Office.

Presently only a Chief Executive and two group executives have been deployed by IHFL. Support staff from other group companies are also being used. Details of experience and qualifications of key personnel were not revealed.

2. Recruitment and staffing plan: According to the response to our questionnaire, the following recruitment plan is proposed:.

Department	(Staff to be recruited) Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
(Finance, Accounts, Credit)	3	-	-	-	-
(Branch mgr.)	-	1	2	3	4
Credit & monitoring	5	2	4	6	6
Finance	4	1	2	4	5
Investment	3	1	-	4	1

D. Financial forecast

IHFL has prepared a five year financial forecast from which we were able to approximate their profitability. Their projections appear to indicate pre-tax profits of about Rs. 14 million, Rs.45 million, Rs. 160 million, Rs. 70 million, and Rs. 92 million in years one through five after the start of operations.

E. Knowledge and attitude towards State Bank and financial policy regulations

The sponsors of IHFL, because of their considerable prior experience in the financial sector, are well informed about the prudential regulations. However, they recommend the following policy changes:

1. Permission to operate passbook savings scheme.
2. Waiver of requirement for HFCs to lend to small borrowers (ie, the waiver from the rule that 5 per cent of all loans be under Rs. 125,000).

F. Observations based on SWOT analysis

* Strengths
    - Professional management attuned to financial sector environment in Pakistan
    - Long term commitment to housing finance business
    - Ability to share overheads with other businesses in portfolio
* Weaknesses
    - May be overambitious about starting business at several locations at once
    - Middle class target market may not be able to afford the cost

of the product such that market strategy may be misconceived

- Delay in start up may mean others get to target market first

* <u>Opportunities</u>
  - Rising percentage of middle class families in total population

* <u>Threats</u>
  - Passbook savings may not be permitted thereby endangering deposit base
  - Higher inflation may mean little or no ability to save among the middle classes thereby eroding their ability to repay loan.

IHFL has prepared itself for the difficult times ahead. As a member of a group which is pressing ahead on several fronts in the financial sector, it is better positioned relative to several of the other HFCs.

INTERNATIONAL HOUSING FINANCE COMPANY

V. INTERNATIONAL HOUSING FINANCE COMPANY

International Housing Finance Limited (IHF) has recently completed its incorporation and share subscription. This HFC has been sponsored in the main by the Pakistan Industrial Credit and Investment Corporation (PICIC) and has enlisted some sterling names among its major shareholders including the International Finance Corporation (IFC) that holds 10 per cent, and the Commonwealth Development Corporation (CDC) that owns 15 per cent of the shareholding.

IHF has not returned the questionnaire we handed them because many of the assumptions they had made in their original feasibility study -- conducted in 1989/90 -- had become outdated. As such, they were in the process of reorganizing their strategy for housing finance and were not in a position to provide written responses at the time of our visit. Consequently, the following description of their business plan is based on our understanding gained through personal interviews.

A. Market Analysis

1. Market size: IHF is confident that there is a large market for house loans as otherwise their international shareholders would not have committed to participate in this venture.

2. Market segments: No numbers about the different possible classes of borrowers were provided.

IHF's target client is the salaried employee of the multinational and large Pakistani organizations that have already set up some concessional housing schemes for their employees. IHF's loans will top up the loan limits of these target organizations and offer an appropriate choice of loan amount and cost to the borrower. Indeed, many companies will be induced to liberalize their loaning facilities as they learn about IHF's mortgage schemes.

3. Competition: IHF believes that it has an edge over other HFCs (excepting Citibank) because of its links to international financing agencies that will generate public confidence in its soundness as a financial institution. Hence it is positive that it will be among the top two or three in the housing finance field.

4. Market positioning: The exact 'product line' in terms of whether IHF will offer a fixed or variable rate mortgage and the minimum and maximum amounts that are to be offered has not been determined yet. The rate of mark-up is expected to be around 23 per cent.

IHF management believes that no HFC will be able to survive unless it also caters to the funding needs of developers. Hence they will also provide bridge finance to developers which will subsequently be rolled over into long term loans to house purchasers. The debt to equity ratio for bridging loans will be 70:30.

The modalities of leasing property are currently being reviewed by

their legal advisor. IHF would like to assess the tax implications of leasing on the profitability of its operations before making any decisions in this area.

The initial focus will be on the Karachi market which offers the maximum potential clientele of the type that IHF seeks to target.

B. Resource Mobilization

1. Equity: The Rs. 50 million of sponsors' equity has been subscribed. The major institutional shareholders other than the IFC and CDC are PICIC (25%) and CresBank (10%). The remaining equity will be offered to the public within two years.

2. Deposits: No estimate of funds raised from depositors and/or other corporate institutions is available. However, IHF will have access to lines of credit from its institutional shareholders at yet to be determined 'market' rates.

C. Organization and Management

1. Organization Structure: The Managing Director of IHF envisages the following three departments for IHF:

(i) Personnel, Administration, Legal and Corporate Affairs; (ii) Finance, Accounts, and Treasury; (iii) Marketing and Credit Evaluation.

The following key executives had been recruited as of the date of the consultant's visit:

Position	Qualification	Experience
Chairman	Ph.D	Former chairman, HBFC and retired government servant
Managing Director	MBA	30 years experience of DFIs and commercial banks

In addition to the above, the Chief Operating Officer has been identified, a U.K. national who qualified as a chartered accountant. This person will be seconded by the CDC for a period of 2-3 years and will be taking up his assignment with IHF shortly. Further, certain other middle level executives have been selected and will be invited to join the organization shortly.

2. Recruitment and staffing Plan: We are not aware of any such plan having been prepared.

D. Financial Forecast

No forecast indicating the financial feasibility of IHF was available.

E. Knowledge and attitude towards State Bank and financial policy regulations

With the current Chairman of IHF having been associated with the evolution of the prudential regulations governing HFCs as well as being a consultant to the SRMP, IHF is among the best informed of

the HFCs in the regulatory and prudential reporting areas.

They did not indicate the need for any major changes in the financial policy regulations other than the desire to see the operation of a refinancing agency as a 'lender of last resort' to the HFCs.

F. Observations based on SWOT analysis

* Strengths
    - Strong international technical and financial support
    - Experienced and capable management
    - Ability to recruit capable staff
    - Long term view of business
* Weaknesses
    - May be pulled in different directions by different objectives of shareholders
    - Organization culture may be governed by public sector norm of major shareholder
    - Have not developed a strategy for deposit mobilization (at least one that we are aware of)

* Opportunities
    - Rising aspirations for home ownership
    - Rising GDP and per capita incomes

* Threats
    - Other HFCs targeting the same market segments
    - High cost of product may mean very limited demand.

IHF is likely to succeed but it will be disadvantaged in comparison to Citibank in attracting clients from the same market segment, as the latter offers several different consumer finance services under one roof and has superior brand recognition.

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JAFFER BROTHERS HOUSING FINANCE COMPANY

VI. JAFFER BROTHERS HOUSING FINANCE COMPANY

Jaffer Brothers Housing Finance Company (JBHFC) is being advised by a firm of chartered accountants, Khalid Majid Husain Shah Rahman, and is still very much in the pre-incorporation stage with incorporation not likely before June 30, 1993.

The response to our questionnaire by their consultants was extremely sketchy with nothing substantive in most of the responses other than the repetition of the words 'not available'.

A. Market Analysis

1. Market size: JBHFC's consultants estimate the total market for housing loans as being in the vicinity of Rs. 25 billion per annum -- not far off from the Rs. 15-20 billion that HBFC has estimated for inclusion in its corporate strategy.

2. Market segments: The division of the Rs. 25 billion among different categories was not specified. JBHFC, like almost everyone else, wants to target the professionals in the market. They also have in mind collective housing projects which are employer sponsored and for which collateral can be arranged. On the other hand, they have left open the possibility of bridge financing of developers.

3. Competition: This HFC is one that has decided to watch from the sidelines to see how others fare in the market before making any decision on market entry.

4. Market positioning: No information about the mortgage product was available. Neither was any information about the geographic distribution of branch offices.

B. Resource Mobilization

1. Equity: The sponsor's equity is expected to be subscribed by end-June 1993. No indication was made about the date of the public flotation.

2. Deposits: No figures were available about deposit mobilization targets or about the liabilities to equity ratio.

C. Organization and Management

1. Organization structure: It is doubtful whether anything other than lip service has been paid to the concept of an organization structure thus far. Certainly no full time executives have been recruited which is some indication of this HFCs lack of interest and/or belief in the attractiveness of the market for housing finance.

2. Recruitment and staffing: No information offered.

D. Financial Forecast

We understand that JBHFC has prepared a business plan, which must necessarily include a financial forecast, but the contents of

this business plan were not revealed to us.

E. Knowledge and attitude about State Bank and financial policy regulations

The consultants are well informed about the prudential regulations both in this country and abroad. They recommend certain changes in these regulations to make it easier for HFCs to operate. These recommendations are:

1. Wide ranging reforms of financial sector to be effected including HFCs being permitted access to inter-bank market, HFCs being allowed to give bank guarantees for securitization purposes, and HFCs having recourse to a lender of last resort in case of need.

2. The apex refinancing agency should be allowed to issue bonds on behalf of the HFCs.

3. Pension schemes and provident funds should be permitted to invest in HFCs.

F. Observations based on SWOT analysis

Strengths

- Too early to tell if JBHFC possesses any advantages in this business

Weaknesses

- No real commitment to business
- Too dependent on consultants who have only a limited interest in steering business
- Delayed start-up could mean 'missing the bus' if business picks up following reforms in policy

Opportunities

- Karachi market offers growth opportunities for housing development
- Rising aspiration for home ownership among professional classes

Threats

- Lack of brand name may mean losing out on deposit mobilization
- Intense competition likely as other HFCs offer more or less the same product in the same market segment.

JBHFC's current business planning procedure indicates that they harbor serious doubts about the viability of this business.

NATIONAL HOUSING FINANCE COMPANY

VII. NATIONAL HOUSING FINANCE COMPANY

The National Housing Finance Company (NHFC) was incorporated in January 1993 and is currently seeking approval for a change in the list of their shareholder directors from the Internal Finance Wing, Ministry of Finance.

A. Market Analysis

1. Market size: According to NHFC, there are between 10-20 million salaried individuals who are potential borrowers from the HFCs. Further, there are another 2-3 million high net worth individuals who are also potential borrowers. (No indication was provided whether there is any overlap between the two groups.)

2. Market segments: The over 10 million potential borrowers are in the middle class; however, no data were provided about the minimum monthly income level of this class of potential borrowers.

NHFC is targeting salaried individuals with reputable firms. Their stress would be on lending to individuals with a steady employment record and a history of stable earnings (generally in the 'higher income' bracket).

3. Competition: NHFC is aware that Citibank's is going to be the dominant presence in the housing market particularly in Lahore. Hence it is making a cautious entry into the market as they are aware that even Citibank is experiencing unanticipated difficulties in the present regulatory and legal environment.

4. Market positioning: NHFC intends to provide different types of mortgages including adjustable rate mortgages. The minimum loan amount envisaged is Rs. 100,000 and the maximum Rs.1.5 million. The average loan size expected is Rs. 300,000. The loan tenor will range from 10 to 15 years with an expected mark-up of 23 per cent.

The target clientele will be readily accessible through NHFC's affiliated developer firm -- the Developers Group -- who, according to the Director we met, have customers constantly inquiring from them about the availability of financing for house purchase.

NHFC plans to focus on Northern Pakistan initially with offices envisaged at Lahore, Islamabad, Faisalabad, Peshawar, and Multan and only at a later stage will they set up branch offices at cities located in the southern part of the country such as Karachi, Quetta, and Hyderabad.

5. Market share: No estimates of the likely market share were given. The amount of loaning expected to be undertaken will range from Rs. 84 million in the first year to Rs. 117 million in the fifth year of operations. (While giving the financial projection, the assumption is that there will be a 70:30 division between housing and commercial building. This is, however, contradicted by a separate response elsewhere in the questionnaire where the percentage of loans to be allocated to commercial buildings is

indicated as only 10 per cent.)

No direct estimate of the number of loans booked was given although using the figure for average loan size as a divisor, an estimate that ranges from 280 loans in the first year to about 400 in the fifth year of operations may be made.

B. Resource Mobilization

1. Equity: The sponsor's equity will be in place within 6-7 months after some procedural matters have been cleared with the Internal Finance Wing, Ministry of Finance.

The public flotation is expected to occur one year after the start of operations.

2. Deposits: An estimated Rs. 100 million is expected to be raised through Certificates of Investment (COIs) in the second year of operations. Thereafter Rs. 100 million is to be raised through term deposit saving schemes every year giving a steadily rising liability to equity ratio that increases from 2 in the second year of operations to about 5 in the fifth year and reaches 9.4 in the tenth year of operations.

The gross cost of funds mobilized is estimated at 14.5 per cent.

C. Organization and Management

1. Organization structure: NHFC is the only HFC that actually gave us a copy of its organization chart. The organization chart reveals that there is to be an executive Chairman of the Board assisted by a Chief Executive who will double as the Director, Banking.

There will be three departments: Construction and Technical, Legal and Finance, and Banking. Each department will be headed by a Director.

The only key executive as yet having joined the company full time is the Chairman of the company, a retired commercial banker.

2. Recruitment and staffing plan: No recruitment and staffing plan has been prepared.

D. Financial Forecast

Some financial projections over a 10 year period have been provided. These indicate a Return on Equity of between 12 per cent and 18 per cent over the ten year horizon.

E. Knowledge and Attitude towards State Bank and financial policy regulations

NHFC did not give the impression of being particularly knowledgeable about the prudential regulations. Questions related to these regulations were not responded to in our questionnaire completed by them.

The main changes in the financial policy regulations that they suggest are:

1. Permission to operate passbook savings schemes.

2. Access to refinancing facilities through an apex bank for HFCs.

F. Observations based on SWOT Analysis

* Strengths
  - Detailed knowledge of construction business
  - Have ready clientele through developer affiliate

* Weaknesses
  - Inadequate top management time devoted to this business
  - No independent strategy developed; instead more 'playing it by ear'
  - May be overoptimistic about market size

* Opportunities
  - Construction of houses will increase with population and income increases

* Threats
  - Product may turn out to be unaffordable for market segment targeted
  - Delayed start-up may mean lost opportunity of grabbing market share and establishing market presence.

NHFC does not appear to have any strong rationale about being in this business other than the Directors' background in the construction industry. We have doubts about the management's commitment to staying in this business in case the policy environment is not deemed favorable.

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OLYMPIC ESTATE FINANCE COMPANY

VIII. OLYMPIC ESTATE FINANCE COMPANY

Olympic Estate Finance Company (OEFC) envisages incorporation within the next 6-8 months. Indeed, their Chairman made it plain that their future plans depended on 'positive' changes in the policy environment which, at present, made it difficult for any HFC to achieve financial viability.

A. Market Analysis

1. Market size: No quantitative estimates were given although the management is confident that there are a large number of potential borrowers.

2. Market segments: No market segmentation was done for the market as a whole.

OEFC intends to focus on persons with monthly gross earnings of between Rs. 10,000 to Rs. 15,000. Also, developers with a successful track record are to be targeted.

3. Competition: OEFC is realistic about its relative strengths and weaknesses and acknowledges difficulties in competing for business with the better known names even though the market segment focused on is at the lower end compared to, say, NHFC.

Under the present business conditions, it is unlikely they will venture into this market with anything other than a token presence.

4. Market positioning: OEFC intends to offer adjustable rate mortgages at a mark-up between 16 - 22 per cent. The minimum loan amount offered will be Rs. 50,000 and the maximum Rs. 1 million. The tenor of the loan is expected to be 7 years with an average repayment installment of Rs. 6,000 to Rs. 7,000.

The total quantum of loans will be distributed about evenly between loans for commercial property and loans to individuals for house purchase/improvement.

OEFC has indicated that they will establish a presence at the following locations in addition to their head office at Lahore: Faisalabad, Rawalpindi/Islamabad, Multan, Gujranwala, Karachi, Hyderabad, Peshawar, and Quetta.

5. Market share: No estimates about market share were provided. However, the number of loans expected to be booked in the five years after the start of operations is as follows:

Year	Loans booked
1	100
2	200
3	400
4	600
5	600

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B. Resource Mobilization

1. Equity: Sponsor's equity of Rs. 50 million will be paid in after incorporation within the next 6-8 months. The date for the public flotation for the other Rs. 50 million has not been given.

2. Deposits: A rough and ready estimate of the quantum of liabilities expected to be raised by OEFC is provided although no indication is given about the different financing modes. As to the cost of resource mobilization, their somewhat optimistic assessment is that this will range between 12 to 15 per cent.

C. Organization and Management

1. Organization structure: No organization chart has been prepared and neither have any key professional staff been recruited. Two positions have apparently been created, that of Vice President and Assistant Vice President, but we are not sure of the degree of their involvement with the housing finance side of the business as they may be more concerned with affiliated businesses in the same business group. In any case, the experience of these two executives may not be pertinent to the core needs of a HFC (and we are only surmising here based on our discussions with one of the gentlemen in question) which would require more experience in the management of financial institutions.

2. Recruitment and staffing plan: No recruitment and staffing plan has been prepared.

D. Financial Forecast

The information that we were given indicates that it is unlikely that OEFC has prepared a financial forecast.

E. Knowledge and attitude towards State Bank and financial policy regulations

If Citibank is the best informed about the SBP's prudential regulations then OEFC is probably the least well informed. We find that not much home work has been done by this HFC in regard to any of the business planning procedures, least of all a study of the regulations (as indicated by the vague responses on this matter in our questionnaire).

One major suggestion that we received from OEFC was that the GOP should arrange some concessional lines of credit for housing to be routed through the private HFCs. (According to them, HBFC does not have the efficiency of the private sector HFCs and therefore does not merit such credit lines.)

F. Observations based on SWOT analysis

* Strengths
  - Good knowledge of construction sector

* Weaknesses
  - Obvious lack of commitment
  - 'Ad hoc' management structure

in place

- Lack of financial institution expertise
- Lack of name recognition will present hurdles in mobilizing deposits

* Opportunities
  - Growth in construction sector and aspirations for home ownership
* Threats
  - There may be too many players competing for customers and deposits in a small market
  - Deregulation of financial markets may mean only those who have the institutional capacity to absorb temporary stresses in fast changing markets will survive.

In general, OEFC is likely to make a market entry only if the business environment changes drastically. For the time being, it will mark time and watch developments before making any major business commitments.

ASSESSMENT

IX. ASSESSMENT

Our own assessment of the business planning at the HFCs is that there are certain companies that have taken to pursuing planning procedures aggressively, the most obvious among them being Citibank which really is the leader since it has already started operations. Following closely on Citibank's heels are Interfund and International, both of which have very strong management teams on board. Also in the running is Empire which has prepared two year forecasts of the major business plan elements. Jaffer Brothers has, we understand, prepared a business plan on the basis of which it has decided to delay its entry in the housing finance business (we were not, however, given any details about this plan).

National and Olympic have, we find, decided to watch from the sidelines before chalking out a definitive business plan. An alternative, and more sympathetic, interpretation might be that they would like to be certain that there are not going to be any major changes in government policies before getting involved in any serious business planning exercise which may have to be revised frequently.

REPORT 3

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INTRODUCTION

I. INTRODUCTION

The purpose of this report is to develop a model business plan that will be useful to the Housing Finance Companies (HFCs) in drawing up their own business plans. The report is divided into two main parts. The first part explores the key issues that must be addressed by any HFC when developing its business plan. The second part fleshes out the financial implications of a business plan adopted by a 'model' HFC in light of the key background issues.

It should be noted that the discussion of substantive issues is based mainly on our understanding of the business environment gained from discussions with all the HFCs as well as from research generated by other technical assistance activities undertaken under the aegis of the Shelter Resource Mobilization Program (SRMP). In other words, no additional research has been undertaken specifically for this report. However, we have dwelt at some length -- and perhaps longer than strictly required -- on the legal environment conditioning the operations of the HFCs in Pakistan because this has been a source of some concern to the companies themselves. Moreover, the legal areas focused on are of direct practical concern to a HFC that needs guidance on mortgage registration procedures and on how to verify titles to property in Pakistan.

Before getting into the details of the various issues, perhaps some indication of why the HFCs need to prepare a formal business plan is necessary as, thus far, only two or three HFCs have given serious thought to business planning procedures. The attitude among the skeptics in the HFCs is rooted in the assumption that since the future is so uncertain, why bother to prepare a plan that is bound to be overtaken by events anyway? Our response is that it is precisely because the future is uncertain that companies ought to prepare a plan which can and should be revised if events not previously anticipated render the initial plan obsolete.

At bottom, the whole purpose of a formalized plan is to impart a sense of direction to the company. In the absence of such a plan, the HFC has few indicators to measure its relative performance or to tell it where it is heading or indeed whether it is heading in the right direction. As an old saw puts it: " If you don't know where you are going you are likely to get lost".

BACKGROUND ISSUES

II. BACKGROUND ISSUES

There are certain critical questions that an HFC must attempt to answer before it can develop a business plan which may then be translated into a set of realistic financial projections. Chief among these are:

* What is our target market?
* What kind of marketing strategy do we pursue given that we have identified the target market?
* How do we raise funds and at what likely cost?
* What kind of staff do we want to recruit given the requirements of the business we are in?
* How should a HFC manage its liquidity in view of the fact that there is no 'lender of last resort' that we may turn to?
* What kind of legal environment will we be operating in and how can we adapt our operations to this environment?

In addition to the broad questions of a strategic nature listed above, there are also the 'nuts and bolts' operational matters such as credit evaluation of loan applicants, conditions to be fulfilled before loan disbursement, and kinds of insurance required to indemnify the HFC against risk of damage to the property or the untimely demise of the borrower. These areas will also be covered in this report since one of its purposes is also to illustrate some of the important operational issues that an HFC must address.

A. Identification of Target Market (s)

The market study conducted by EDC (Pvt) Limited on behalf of the SRMP estimates the total addition to the housing stock each year by upper income groups (defined as those earning Rs. 8000 or more monthly) as about 5000 units in the three cities of interest to the HFCs, namely, Karachi, Lahore, and Rawalpindi/Islamabad. (This figure is derived from the Housing Census of 1980 and the study's authors rightly point to the need for updating it.) Elsewhere in the same study, the findings of a sample survey indicate that the average cost of land and house acquisition is estimated at Rs. 1.07 million by the 103 respondents (of the 301 in the entire sample) who are resident in the three cities but who do not currently own a house or apartment and would like to purchase or construct one if financing were made available. Although the 103 respondents include 37 respondents earning below Rs. 10,000 per month whose aspirations about the type of house may not strictly match that of higher income groups (Rs. 15,000 plus per month), we can nonetheless use the Rs. 1.07 million acquisition cost as a conservative estimate of the average cost of a house desired by higher income groups in the cities under focus. Assuming that only about 1000 units -- instead of the 5000 which include units constructed by even those earning less than Rs. 15,000 monthly -- are built by those whose earnings exceed the threshold level, the annual investment in the housing stock by upper income groups is estimated at Rs. 1.07 billion.

With the estimate of total annual investment in housing at hand and employing the EDC sample survey finding that the desired loan to value ratio of those aspiring for home ownership from institutional sources is 40 per cent, the annual credit demand is estimated at about Rs. 430 million yearly. This market is growing in nominal terms at about 11-15 per cent yearly which means that the total market for housing credit will be about Rs. 700 million in 1997-98.

Obviously the size of the market for housing credit will depend on the assumptions made. In Tables 1 and 2 in Appendix 2, we have conducted sensitivity tests on the range of the value of the total market under two scenarios: (1) that the loan to value ratio demanded by borrowers varies from 35% to 80%, house prices vary between Rs. 1 and Rs. 1.5 million, and the number of units constructed by high income groups is 1000 yearly (Table 1); and (2) that the number of units constructed each year by high income groups range from a low of 1000 units to a high of 1500 units, house prices range between Rs. 1 and Rs. 1.5 million, and that the standard loan to value ratio demanded is the one uncovered in the EDC survey, ie, 40% (Table 2).

Tables 1 and 2 indicate that under the range of assumptions adopted the total size of the market for HFC credit lies between Rs. 350 million to Rs. 1.2 billion yearly. Given the sensitivity of the market size to the loan to value proportion, some judgment about this ratio is essential. We feel that the EDC survey findings putting this at 40 per cent 'feels' right in terms of what most people in the target group can afford to borrow given the average cost of a house. Thus the Rs. 430 million annual credit demand estimate referred to earlier is a fairly good approximation of the total annual credit demand in the three cities under focus. In other words, while this is a significant market, it is not an overwhelming one and may not be large enough for all seven HFCs to operate in. (Incidentally, we do not accept the EDC assumption that HBFC will have preferential access to this market because it provides subsidized credit. The State Bank of Pakistan has made it clear to HBFC that it must raise its resources on commercial terms and therefore it must compete on the same basis as all other HFCs.)

Market segmentation

We have already segmented the market by income level as the cost of the product will of paramount importance to most borrowers. Here we review some other segmenting variables.

(1) Geographic segmentation: The EDC study reveals Karachi to account for about 50 per cent of the total market for high income housing, Lahore for 35 per cent and Rawalpindi/Islamabad for the residual 15 per cent. This means that the Karachi market merits particular attention particularly in light of the EDC finding that apartment dwelling is mainly a Karachi phenomenon and that these apartments are bought mostly from developers -- an important part of the target market.

Another important geographic division is between resident and non-

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resident Pakistanis. Various surveys have documented that overseas Pakistanis invest a significant fraction of their earnings in property. This can be an important segment of business provided the HFC can devise appropriate programs to market their loan products to this segment. (Currently the SBP has permitted HFCs to grant Rupee loans for purchase of residential apartments, plots, and bungalows to Pakistani nationals who are working outside Pakistan and who do not own immovable property outside Pakistan. This loan may be worth up to 90 per cent of the value of the house to be purchased/constructed subject to the condition that the loan would be liquidated by the borrower through remittances from abroad in foreign exchange through normal banking channels or by accretions to the borrowers' foreign currency accounts here.)

(2) Segmentation between institutional and individual borrowers: An important target market for the HFCs will be the builders/developers. The right selection of developers is key in enabling the HFCs to include even those segments of the housing market that they might otherwise avoid -- such as middle income households -- because the collateral and other repayment requirements will be met by the developer substituting his repayment capacity for that of the individual low to middle income borrower. One advantage of a larger loan is proportionately lower administrative costs. Thus through the medium of the developer the HFC can expand the scale of its operations.

(3) Segmentation between commercial and residential lending: The risk averse HFC is well advised to stay away from lending for commercial projects the returns on which ebb and flow with the stage of the business cycle. On the other hand, returns for commercial lending would be much higher to compensate for the additional risk compared to lending for residential property.

(4) Segmentation of the market for individual house loans: We have already segmented the entire market for housing loans by income levels so that only individuals earning more than Rs. 15,000 monthly (gross) are eligible borrowers. However, there are other variables in addition to income that the HFC can use to identify its likely customers.

Age of the individual is important as a borrower whose income is high enough and is rising regularly is expected to find it easier to repay compared to a retired person past his peak earnings phase. Thus individuals between 30-45 years are likely to be promising candidates for house loans as they are in the growth stages of their careers and are also likely to have saved enough by this time for the equity portion of the house to be acquired.

Occupation is important because of the additional comfort that is offered by an employer's guarantee. Thus those with steady incomes and an employer willing to deduct regular amounts from the paycheck are more credit worthy than those with high but erratic incomes (self-employed professionals of all types and small business persons are examples of the latter).

Among company employees, the HFC can try to top up the employer sponsored housing loans so that the employee has more flexibility in his selection of a home. Thus companies with home loan schemes of their own should be actively sought out by the HFC.

Profile of borrower
We may now summarize the profile of our borrower. This will be either developers with an established track record in the housing field or individuals. In the case of individuals they will be resident or non-resident Pakistanis between 30-45 years, employed with a reputable company (in the case of residents preferably with a home loan scheme of its own) and earning at least Rs. 15,000 per month.

The developers will be mainly Karachi based where most of the apartment construction takes place. In the early years, the HFC should lend mainly against residential property. Only after it has developed sufficient financial depth should it enter the market for commercial property.

B. Product line
The EDC sample survey findings, some of which have been referred to in the previous section, reveal that the preference for buying ready property among respondents outweighed that for self-construction by a ratio of two to one. Thus one obvious product is the loan to individuals at fixed mark-up for purchase of ready property, whether a bungalow or an apartment. A second is the loan for self-construction.

A third product is the loan for either home improvements and/or home extensions (The EDC survey finds only a marginal demand for this type of loan, however, possibly because the market for rented property is not well developed in this country.)

A fourth product is indicated by the semi-structured interviews of potential HFC customers, bankers, developers, etc, by the EDC study team. This is the loan for land purchase for later construction which the EDC focus group discussants thought would be more affordable than loans for purchase of ready property or for self-construction.

A fifth product is the developer loan that could either take the form of a bridge loan for short periods or could be rolled over into a longer term loan, with recourse, for individual purchasers of property. This is a very important product for the fledgling HFCs as it expands the potential size of their market at a stroke, and if appropriate niche marketing is done, should not cannibalize their market of loans for individuals.

The developer loan also suggests the possibility of co-financing between the HFC and, say, a life insurance company with the latter taking on the loan on to its own books after the bridging period of up to a year financed by the HFC. (Indeed, with the regulations allowing HFCs to manage mortgage investments as agents the

possibility of the HFC generating fee-based income through insurance companies and other long term lenders opens up but this type of sophisticated management function is for the later stages in the HFCs life cycle.)

A sixth possible product is one that is part of the Housing Development Corporation of India (HDFC) menu. This is the short term bridging loan to an individual, whereby the individual borrower approaches HDFC for a short term bridging loan to construct/purchase a house which shall be repaid after the sale of his existing unit. In effect, the HDFC funds are substituting for the borrower's own funds pending the sale of the latter's property. This product is aimed at those who do not wish to take on debt for long periods and will be a useful adjunct in the HFCs product line to attract business from those who are averse to the idea of being in debt if they can afford to avoid it. However, it is not likely to be a priority in the HFC's product line in Pakistan till after their teething problems have been overcome.

C. <u>Product attributes</u>
A new HFC must tailor its products to the requirements of the market. The key concerns for customers, as also for the HFC, will be the minimum and maximum loan amounts, the tenor (term), the loan to value ratio and, of course, the price (mark-up rate).

1. Loan amount: There is no hard and fast rule but depending on the value of the property and the income of the borrower, this may vary between Rs. 0.2 million to Rs. 1.5 million. The HFC would do well to remember that small loans take up as much administrative time as large loans and therefore are relatively more expensive to administer. On the other hand, smaller loans allow for a larger client base and thus for portfolio diversification. Further, the HFCs could use the developer as an intermediary in tapping the smaller housing loans market thereby cutting its administrative costs while at the same time complying with the regulation that 5% of all HFC loans given must be under Rs. 125,000 per borrower.

For short term bridging loans to developers the loan amount may vary from Rs. 5 million to a ceiling of Rs. 20 million -- the ceiling taking into account the NBFI regulation relating to the single borrower limit of 20 per cent of the HFCs equity.

2. Loan tenor: The HFC should keep in mind that a longer tenor will make the loan affordable to a wider range of clients. Further, the fact that HBFC is a potential competitor and offers a tenor of 15-20 years on its loans will be a consideration in potential borrowers' mind. Of course, the fact that Citibank is already in the market and offers a tenor of 15 years will also constrain the HFCs ability to offer loans with terms shorter than this. We therefore recommend that the HFC treat this as a standard for their own lending.

The loan repayment should start the month following the final disbursement. Grace periods and the like are not recommended as

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the earlier the borrower gets into the habit of regular repayment the easier it is for him to understand the implications for his lifestyle of taking on a fixed obligation.

In certain instances where the borrower has the potential to earn larger amounts in the future and could therefore service a much larger loan than if only his current income were taken into account, the HFC may design a loan program with gradually increasing repayments. This feature may therefore be used in some particularly deserving cases.

A significant proportion of borrowers may decide to prepay their loan, ie, repay the balance of the principal amount with the accrued mark-up earlier than the loan's tenor. In a market where interest rates can fluctuate both up and down this can cause some loss of income to a HFC particularly as borrowers usually prepay when interest rates are down depriving the lender of the expected higher stream of income compelling them to lend for less remunerative opportunities. In Pakistan, lower mark-up rates are not expected to occur in the foreseeable future mainly because of enormous governmental fiscal deficits and the country's low savings rate. Nonetheless, with the deregulation and liberalization of financial markets there is a possibility that it might happen. That is why the loan agreement should include some provision for a prepayment penalty charge.

3. Loan to value ratio: This will depend to some extent on borrowers preference but must not exceed 80 percent for residential property as per the prudential regulations. We feel that a 60:40 loan to value ratio is a balanced one from the viewpoint of both the borrower as it ensures an adequate stake for him in the property and the HFC which has to ensure adequate safeguards against any possible decline in the value of the collateral (Property prices have been known to decline even in Pakistan as those who bought property in Karachi in the mid-80s can testify).

4. Mark-up rate: This is one area in which the HFCs will be driven by environmental factors, in particular, the cost of mobilizing debt and equity funds. In Pakistan today, it is not likely that a HFC will charge anything less than 22 per cent mark-up if it is to operate profitably. The reasons will become clearer in the section below relating to resource mobilization by HFCs.

Although almost all the HFCs we met indicated that they would charge adjustable mark-ups, this was probably an indication that they would avoid getting into a situation like the American S&Ls who were caught in a rate squeeze between rising cost of deposits and flat earnings on outstanding loans. (Also, the fixed mark-up may seem too much like interest which is antithetical to Islamic financial principles.) In other words, they viewed this as a mechanism for rate increases in case their cost of funds increased significantly.

The HFC can and should protect its interests in the event that

capital market conditions change significantly by inserting a clause in the loan agreement empowering it to change the rate of mark-up if it deems this necessary. After all, one of the contributing factor to the S & L failure in the U.S.A. was the fact that they had locked into long term lower rate lending commitments but had to pay higher rates on their deposits in line with changes in money market conditions. The power of discretionary rate change must be used sparingly, however, as it may lead to unnecessary friction with the borrower and litigation as a consequence.

D. Distribution channels

Although branch locations may be necessary to mobilize deposits, the HFC will find it uneconomic in the beginning to set up branch locations particularly as passbook savings are not permitted as yet. We therefore recommend that operations be conducted out of the main office in the first two years or so and as business volume picks up it should expand its presence through branches. The number of branches to be opened will depend on the business volume but is unlikely to exceed two or three in a major city like Karachi.

Because of the centralized operations of the HFC in the early years, it becomes essential to have a credible promotion strategy that makes the public aware both of the HFCs loan products and its deposit schemes. Regular media advertising, attractively designed brochures in both English and Urdu, and a courteous staff at the end of several telephone lines will go a long way in building the image of the institution with the public and therefore in attracting business.

To reach overseas Pakistanis, we suggest that the HFC tie up with Community Welfare Attaches and Commercial Counsellors in Pakistan's embassies in countries with a large Pakistani origin migrant or worker population.

E. Resource Mobilization

The HFC will generate resources through the following sources: (1) Equity; (2) Term deposits; (3) Short and long term loans from commercial banks and DFIs; (4) International lines of credit; and (5) Retained earnings.

(1) Equity: The sponsors' equity of Rs. 50 million will be supplemented by a public issue of Rs. 50 million within the first two years of operations. We expect the public issue to take place in the second year of operations after the HFC has established its credentials in the market.

(2) Term deposits: Passbook savings are not permitted as the GOP probably fears that they will encroach directly on the commercial banks deposit base. However, the HFCs have one distinct advantage in attracting savers and this is the possibility of linking term saving with the ability to get a long term mortgage loan. This facility will, however, be restricted to those saving a minimum amount of at least Rs. 100,000 over a five year period with the

HFC. Provided that the borrower otherwise meets the eligibility requirements of the HFC, the loan amount will then be a multiple of up to four times of the amount saved or the upper limit on individual loans, whichever is less. The mark-up rate will be a percentage point or so below the normal lending rate to make it attractive for depositors.

As for the form of the deposit schemes, any HFC in Pakistan would be well advised to study and replicate the National Development Finance Corporation's (NDFC) deposit schemes. According to NDFC's balance sheet at end-1991, it had generated a phenomenal Rs. 15.3 billion in deposits as of that date (on a total asset base of Rs. 24.7 billion).

The following NDFC deposit schemes are of particular relevance to a HFC:

(a) The Standard Certificate of Deposit: This scheme allows for funds to be invested for fixed periods ranging from 7 days to 5 years. Profit is paid at the time of maturity. However, in case of SCD's of over one year maturity, profit may be paid on a six monthly basis. The most recent profit rates declared by NDFC under this scheme are:

Minimum deposit period	Profit rate per annum
7 days	6.0%
1 month	7.0%
3 months	10.0%
6 months	11.5%
1 year	12.5%
2 years	13.0%
3 years	13.5%
4 years	14.5%
5 years	15.0%

Source: Bulletin, State Bank of Pakistan, April 1993

With the proviso that the HFC will operate schemes of one month or more when it undertakes a similar scheme, it will have to pay somewhat higher profit rates if it wants to compete with the likes of NDFC and other entrenched deposit-taking institutions. In this regard, the rates of return announced by a leading investment bank are relevant:

Period	Rate of profit per annum
1 month	11.0%
2 months	12.0%
3 months	12.0%
6 months	12.5%
1 year	13.0%
2 years	14.0%

No instruments of over 2 years maturity are indicated

Source: First International Investment Bank brochure, April 1993.

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Keeping the above returns in view, we expect that the HFC will have to offer close to 16% per annum profit on its own CDs with a maturity of 5 years.

(b) Monthly Income Certificate: The NDFC's Monthly Income Certificates (MICs) are of five years maturity with profits payable monthly. The minimum amount required to be invested is Rs. 10,000 while the monthly payment starts from the end of the first month of the deposit. For illustrative purposes the payment schedule under this scheme is given below.

Principal Amount (Rs.)	Monthly Return (Rs.)
10,000	116
25,000	291
50,000	583
100,000	1,166
500,000	5,830

Source: Bulletin State Bank of Pakistan, April 1993

The expected profit rates payable at maturity or on premature encashment are as follows:

Period	Expected profit per annum
3 months	6.0%
6 months	8.0%
12 months	10.0%
24 months	11.0%
30 months	11.5%
36 months	12.0%
42 months	12.5%
48 months	13.0%
5 years	14.0%

Source: NDFC Annual Report 1991

No profit is paid if the certificate is encashed before three months and if this is encashed between scheduled dates of payment, a lower profit rate is paid.

The HFCs can also use this scheme but the profit rates paid to attract depositors will be at least a percentage point or two higher.

(c) Golden Certificate of Deposit: The Golden Certificate of Deposit (GCD) is of five years maturity. However, funds can be withdrawn at any time before five years in accordance with the applicable rates. No profit is payable if the certificate is encashed before one year. The rate of profit under this scheme is as follows:

Period	Rate of return per annum
1 year	12%
2 years	13%
3 years	14%

4 years	15%
5 years	17%

Source: Bulletin State Bank of Pakistan, April 1993

The GCD scheme is the kind of scheme that is most apt for the contractual savings type arrangement. Thus the HFC can lay down minimum deposit requirements of Rs. 20,000 that should be added to yearly such that the total amount cumulates to over Rs. 100,000 in five years if the depositor is to be eligible for a loan. Those who fail to reach this threshold can be given the option of switching over to another scheme of 10 years for which the minimum cumulated amount is Rs. 250,000.

The scheme should be marketed under a catchy name (as the HDFC is doing with its 'Home Loan Account') and with some attention grabbing features (eg, the rate of return may be partly tied to an index of house prices). The target depositor (s) should be young married couples in their mid to late 20s who are just starting to save for their first house so that by the time they are in their mid-30s the equity portion of the house loan has been provided for through this contractual scheme.

The rates of profit on the HFCs variant of the GCD can be about the same as the NDFC's as the prospect of a house loan will be an added inducement for the depositor.

The three schemes described above, namely, the Standard Certificate of Deposit, the Monthly Income Certificate, and the Golden Certificate of Deposit accounted for about 50 per cent of NDFCs total deposits at end-1991. Their success has spawned a host of imitations under the label of 'Certificates of Investment' (COIs) that are currently sponsored by several DFIs. Further, the HDFC in India is operating schemes of the same kind very successfully.

The cost to NDFC of its deposit scheme was, on average, 11.03% in 1991 (NDFC Annual Report). For a new HFC which has still to establish its reputation in the market -- Citibank being an exception because of its worldwide reputation -- deposit mobilization will not cost anything less than 15 per cent per annum. This is of course our judgment but takes into account the returns on myriad other governmental and semi-governmental financial instruments currently being marketed such as WAPDA bonds, Civil Aviation Authority bonds, etc. (These instruments are not described here as they have already been covered in the ANZ Grindlays Capital Markets Study commissioned by the SRMP.)

(3) Short and long term loans from commercial banks and DFIs: HFCs are not permitted to access the inter-bank market. (With the current tight liquidity condition whereby the call rate has reached 14 per cent and the credit ceiling rate ranges between 20-25 per cent this may be a dubious privilege. How this came about is because of an amalgam of reasons such as changes in the liquidity ratio for scheduled banks, bank lending for yellow cabs, poor loan

recovery etc.) They must therefor arrange access to running finance (overdrafts or lines of credit) in times of tight liquidity resulting from greater than expected loans booked and/or deposit withdrawals. Such credit lines are expensive. Currently, Habib Bank Limited charges mark-up at 17.5 per cent while the National Bank of Pakistan charges 18.6 per cent on running finance (not including the 2 per cent excise duty).

For longer term loans, the HFCs can make arrangements either with the commercial banks or with the DFIs. These funds can, but need not be, more expensive than running finance charges. Thus NDFC charges between 15.695-18.0 per cent per annum on local currency term loans (State Bank of Pakistan Annual Report, 1991-92). Similarly, Bankers Equity Limited (BEL) is currently charging 18.25 per cent on local currency term loans. Thus with some shopping around the HFC can cut its borrowing costs.

Overall, we feel that the borrowing cost to HFCs will approximate about 18 per cent per annum on a mixture of running finance and term loans similar to what leasing companies and Modarabas are paying the commercial banks for financial accommodation.

(4) International lines of credit: International agencies such as the World Bank and the Asian Development Bank are keen to promote housing finance institutions in developing countries. However, they are skeptical about the ability of public sector housing finance agencies (such as HBFC) to deliver the goods. This is where the HFCs may step in and explore the possibility of gaining access to funds disbursed by the private sector window at the ADB just as some leasing institutions have done without the GOP being involved as a guarantor. (The World Bank does not, of course, lend without government guarantee so the HFC may explore possibilities with its private sector arm, the IFC. However, the IFC is likely to watch the results of one of the HFCs that it holds equity in, International Housing Finance Limited, before making any further commitments about funding housing finance activities.)

It is important to underline that access to foreign currency lines currently offer attractive margins even after he exchange risk cover fee has been paid. Thus several foreign commercial banks earned margins of over 10 per cent from local currency lending against their foreign currency deposits because of the current low interest rates prevalent in the Eurocurrency markets. This is why Citibank was keen on the GOP granting it permission to raise foreign currency deposits. However, while private foreign currency deposits offer wider spreads they are also more volatile and tend to flee a country at the first hint of trouble. This is why we are recommending that the HFC instead approach the international lending agencies that have a longer term perspective on developing countries notwithstanding that the rates they charge are significantly higher.

(5) Retained earnings: In accordance with the prudential regulations governing operations of NBFIs the HFC will credit to

its reserves at least 20 per cent of its after tax profits till such time as reserves equal the amount of the paid-up capital. Thereafter a sum of at least 5 per cent of after tax profits must be thus credited.

F. Liquidity Management

Liquidity management for HFCs will mean allocating its assets in such a way that it will have adequate liquidity to meet maturing obligations while maximizing its investment income. To some extent the HFCs liquidity management policy is already determined by the NBFI prudential regulations under which all HFCs must keep at least 15 per cent of their liabilities (this does not include borrowings from financial institutions) in government securities.

The government securities of relevance to HFCs are: (1) Treasury Bills (TBs); and (2) Federal Investment Bonds (FIBs).

(1) Treasury Bills: These are zero coupon instruments with a 6 month maturity. Auctions of TBs take place every fortnight and the auction is open to individuals and corporate bodies. The bid must be made to the SBP through a primary dealer (commercial banks, DFIs, National Savings Centers, and selected members of the Stock Exchanges).

In the last two months or so TBs have yielded between 12.5 and 13 per cent reflecting the overall tight credit situation.

(2) Federal Investment Bonds: FIBs are of three different maturities, namely, 3 years, 5 years, and 10 years carrying an annual rate of return of 13%, 14%, and 15%, respectively, payable biannually. These bonds are not redeemable before maturity; however, there is a secondary market where they may be sold at the prevailing price.

As to the choice between these two instruments the HFC has to balance the higher returns on the FIBs with the risk that there may be a capital loss should it need to liquidate these bonds for any reason (The SBP repo facility for 10 years FIBs at 16% is only open to the scheduled banks and selected DFIs).

In Pakistan's current environment in which the financial sector has been liberalized without appropriate reforms of the macroeconomic environment there is every likelihood that short term interest rates will go up in the near to medium term. Because of this likelihood we recommend that the HFC hold TBs. (These securities can be used as collateral should the need arise through appropriate short term repos with private commercial banks between weekly reporting dates to the SBP although whether this would violate any prudential regulation would have to be reviewed.)

As a guarantee against liquidity shortfalls -- news of which can spread immediately leading to a disastrous effect on depositor confidence -- we recommend that the HFC arrange a ready line of credit with a commercial bank. This can help smooth out the humps

in cash flows.

As a matter of policy the HFC should regularly prepare weekly, monthly, quarterly, and annual cash flow forecasts. This will provide indications about seasonal highs and lows in cash flow which will enable it to approach its bank well in advance of the moment that it actually needs to borrow.

G. Key personnel

A key success factor in this business is competent and trained staff. Owing to the fact that only one housing finance agency, HBFC, has so far been operational in Pakistan -- and that too in the public sector -- there is a serious shortage of experienced staff. Further, those with the relevant experience in banking will require premium salaries in view of the expansion in the number of financial institutions of all stripes in the last two years. (The new commercial banks, investment banks, and leasing companies are all competing for staff from the same pool of qualified manpower.)

The organization structure and the staff requirements along with job descriptions are the subject of another Report in the present assignment. Here we describe briefly the positions to be filled by the HFC.

(1) Chief Executive: Will be the operating head of the company. Reports to the Board of Directors.

(2) General Manager, Operations: The HFC will be divided into three divisions one of which will be the Operations Division. The G.M. Operations will be responsible for the performance of his division. Reports to the Chief Executive.

(3) Marketing Manager: Responsible for marketing of loan originations. Reports to the G.M. Operations.

(4) Loan Processor: Responsible for underwriting and processing the loan from application to closing. Reports to G.M. Operations.

(5) Technical Manager: Primary responsibility is to check construction progress at site so that loan disbursements may be made accordingly. Reports to G.M. Operations.

(6) Manager Recoveries: Will keep track of loan from date of disbursement. Reports to G.M. Operations.

(7) General Manager, Finance: The General Manager, Finance will be responsible for setting financial policies for the HFC in light of the Board's decisions and for supervising accounting operations. Reports to the Chief Executive.

(8) Manager Accounts and MIS: Will design and maintain the HFCs accounting system. Reports to G.M. Finance.

(9) Manager Treasury: Primarily responsible for liquidity

management encompassing disposition of short term assets and agreement with financial institutions for financial accommodation at reasonable cost.

(10) Manager Deposit Mobilization: Will be the person spearheading the deposit mobilization drive. Reports to G.M. Finance.

(11)General Manager, Human Resources: Will be responsible for selection, recruitment, and training of manpower suitable to the HFCs medium and long term requirements. Reports to the Chief Executive.

(12)Internal Auditor: The Internal Audit function is a statutory requirement under the NBFI regulations. The Internal Auditor will report directly to the Chief Executive.

(13)Legal Advisor: The Legal Advisor will not be a full time employee but rather will be engaged as a consultant whenever the need arises. Will report to the Chief Executive.

Since staff will be expensive to hire and maintain we recommend that the HFC stagger its hiring over at least a year or more after the start-up stage so that staff costs are contained in the early phase of slow business. A suggested recruitment schedule is given in Appendix 3.

H. <u>Lending procedures</u>
The HFC will keep the following criteria in mind when evaluating loan applications:

1. The prospective borrower must have been gainfully employed for the last two years with a reputable firm preferably one that has a home loan scheme of its own. In case the applicant is self-employed, he must provide proof of income for the last three years (e.g., tax returns). Overseas Pakistanis will get their employment status verified by a senior official of the Pakistani embassy and must corroborate this with tax returns, and/or social security payments, and/or bank statements for the last two years.

2. Developers must have successful operating histories of at least five years.

3. The individual borrower must be able to arrange for life insurance with the lender as beneficiary. Alternatively, if he is covered under a company sponsored Group Life Insurance/Accident Insurance Scheme he will assign the benefits admissible under the policy to the HFC with the condition that in case of his death or disability any excess benefits after payment of the loan amount outstanding shall revert to his heirs.

The borrower must also be able to arrange for fire and damage insurance to protect the property mortgaged against unforeseen hazards.

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4. The individual salaried borrower and his employer must agree to salary deductions at source equal to the monthly loan repayment and insurance premium. The employer must also agree to seek clearance from the HFC before paying any amount out of the provident fund and/or gratuity to the employee in case he resigns or is dismissed.

Further, the borrower and company must both agree to notify the HFC of any change in the former's employment status within seven days of any such change.

5. The size of the loan will be an amount whose monthly repayment over 15 years, along with any other prior debts incurred by the borrower, does not exceed 30-35 per cent of the borrowers' monthly gross income. In instances where the joint family income is higher and other earning members are willing to sign the agreement as co-borrowers or where an individual is expected to climb the earnings ladder rapidly, this ceiling may be waived.

6. The borrower must be willing to pay a 1/2 per cent processing fee to the HFC and in case the application is unsuccessful the HFC will only charge Rs. 1000 and refund the balance amount to the applicant.

The borrower must also agree to pay the HFC a commitment fee equal to 1 per cent of the amount sanctioned but not drawn after disbursement has been approved by the HFC.

7. There are also certain negative covenants that the borrower must agree to in the loan agreement. Chief among these are:

(a) The borrower must not let out or otherwise part with the possession of the property or any part thereof.

(b) The borrower shall not sell, lease, surrender or otherwise alienate the property or any part thereof.

(c) The borrower shall not enter into any agreement or arrangement with any person or institution for the use, occupation, or disposal of the property or any part thereof during the pendency of the loan.

(d) The borrower shall not amalgamate or merge his property with any other adjacent property nor shall he create any other right of way or any other easement on the property.

(e) The borrower shall not stand surety for anybody or guarantee the repayment of any loan or the purchase price of any asset.

(f) The borrower will not leave the country for an extended period without full repayment of the loan amount outstanding in favor of the HFC including accrued mark-up and prepayment charges.

I. <u>Legal Environment</u>

There are two particular legal issues that the HFC will be confronted with daily at the time of reviewing a loan application and after loan sanction. These are: (1) verification of title to property that is proposed to be mortgaged; and (2) the mortgage registration process itself. Here we present an extended discussion of these two issues from the legal standpoint as we feel that the successful resolution of these issues will be vital to the successful operation of HFCs in Pakistan.

(1) Title verification: In Pakistan there are at least six kinds of title documents in existence:

(i) Leases granted by the President of Pakistan or other authorized government authorities;

(ii) Subleases granted by various housing societies which have been granted leases by the President of Pakistan or other authority;

(iii)Rural properties, title whereof is established through chain of sale deeds and other transfer documents, like gifts, inheritance certificates etc., evidenced by entry in the Records of Rights maintained by the Revenue Department;

(iv) Share certificates along with subleases of Cooperative Housing Societies in respect of flats constructed on a single plot of land;

(v) Original title documents in the name of another party with sale agreement and power of attorney in the name of actual holder; and

(vi) Allotment letters.

In cities like Karachi and Lahore, and more so in smaller cities and towns, the procedure for verification of title to property is extremely time (and therefore cost) consuming. As leased land can only be transferred by conveyance deeds, which are registered with the Sub-Registrar appointed under the Registration Act, 1908, within the territorial jurisdiction of which such property is situated, it is required to go through the registers to search for any entry in respect of such property. An application to such effect is required to be made to the relevant Sub-Registrar for being granted a search certificate, which would list all the entries in respect of such property in the registers of the Sub-Registrar, which have been made for the period of time for which the search is required to be undertaken. Owing to the fact that the registers are not computerized, it takes only the onerous physical task of going through the hundreds of volumes of the Registrar's record to locate any entry in respect of any particular property. Such work, being conducted by semi-literate, low paid employees is oftentimes inaccurate. Thus even though an entry may have been made with regard to a property many years ago to create a defect in the title documents of the present holder of the title documents, such defect may not be brought out in the search

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certificate issued by the Sub-Registrar. The consequence of such inept method of verification is that reliance cannot be placed on such certificate alone and, instead, various other safeguards including indemnities, guarantees, and other securities are required to be obtained for the purpose of securing repayment of mortgaged moneys.

Where the property is situated in any of the housing societies, the records of the housing societies are, prima facie, evidence of the title of the person registered in its records as being the owner. However, if in the meanwhile the property has been sold and the new owner has not obtained mutation of the records of the housing society, such lack of mutation would not disentitle him to claim to be the real owner of the property. As such, checking of records of housing societies can only be supplemental means of verifying the title of any mortgagor but cannot be said to be the best legal method of verifying the title of the mortgagor.

In respect of immovable property belonging to a member of a cooperative society, the verification of title is much simpler. According to the regulations used by cooperative housing societies no person can own property within the cooperative society unless he is a member thereof. The register of members is conclusive proof of the membership of the person registered as member of the society. It is, usually in the case of apartments and block of flats, the practice of cooperative societies to merely issue share certificates to its member and give therewith a certificate of occupancy pertaining to a particular apartment or flat. The verification of title to such apartment or flat then becomes simple as one does not need to check the records of any office but obtain the certificate of verification from the relevant officer of the cooperative society. If such share certificate is coupled with the sub-lease of a specific undivided portion which represents the area of the apartment to the total area of the land on which all the apartments are constructed, then verification of the transfer of such leased rights in the undivided portion of the land would require to be obtained through the offices of the Sub-Registrar of the area within which the land is situated.

The most difficult case for verification which arises is the land that is situated adjacent to developed urban areas but is yet agricultural land such has not to be included in the areas taken over by a development authority, be it the Karachi Development Authority, the Lahore Development Authority, or the Hyderabad Development Authority. In all these cases, the records of the Board of Revenue serve as prima facie proof of the title of the land. However, such land is mostly beset by confusing "sanads" (grants), "bainamas" (sale deeds), "halafnamas" (affidavits), family settlements, and judicial orders pertaining to devolution of inherited rights. Each local area has its own tradition with regard to the manner in which such documents are drafted, often in the vernacular. It requires substantial familiarization with the local terminology in order to appreciate the legal impact of a document presented as being a title document. As a natural

corollary to the haphazard manner in which the records are maintained, opportunities present themselves to corrupt officials to create documents which would show ownership of one plot of land in the name of two or even three individuals. Documents are also prepared which show the land being held in the name of persons other than the actual owner, and fictitious transfers are recorded without the real owner being aware of the same.

The Revenue Authorities cloaked with authority to record transfers of such land do not require strict compliance with the legal requirements of the Registration Act and the Stamp Act. This causes legal complications as under the Registration Act immoveable property can only be transferred under an instrument in writing registered with the relevant Sub-Registrar. Under the Stamp Act such instrument in writing cannot be adduced in evidence or relied upon unless it bears the proper stamps. Though non-compliance with such mandatory requirements of the Registration Act and the Stamp Act should render the title to millions of acres defective in law, in practice such defects are ignored and legal requirements give way to practical reality.

Allotment orders are contractual documents which do not, of themselves, create any proprietary rights to any plot of land. It is often said that an allotment letter is not a document of title and cannot, therefore, be subject of a mortgage by deposit of title deeds. However, recent judicial pronouncements seem to have given to allotment letters which are coupled with possession of specific pieces of land, the manifestation and legal purport of title documents. Verification of such title documents is simple as one need only examine the record of the authority issuing such allotment order. However, corrupt practices in such authorities, be it the KDA, LDA, or various other housing societies in Karachi and Lahore, have resulted in the dilution of the accuracy of such verification. Thus in the mid-1980s a spate of cases came to light regarding double allotment of plots in the Defence Housing Society at Karachi. Such double allotments resulted in substantial litigation which affected the value of the land as uncertainty as to the title holding of any person purporting to be the owner of the land spread like wild fire in the property market. People became hesitant to undertake property transactions due to their inability in ensuring that there was only one allotment letter in respect of the property sought to be sold. Resort was made to prominent advertisements in the Press and indemnities of all sorts were obtained from the seller to protect the purchaser or mortgagee against defect in title of the seller or the mortgagor, as the case may be. Such indemnities are of limited practical importance as the purchaser/mortgagee would still be out of pocket if the real owner is able to establish that the seller/mortgagor did not have the requisite title to the property. By then it is too late as the seller/mortgagor would have disappeared with the funds of the innocent purchaser/mortgagee.

Due to deliberate avoidance of transaction costs (stamp duties/registration charges) the great majority of transactions in

open plots are undertaken on the basis of transfer of allotment of lands. Such transfers are often coupled with power of attorneys in order to even obviate the necessity to pay the minimal transfer fee payable to the housing society issuing such allotment of land.

The existence of power of attorney, whether it be in the case of leased properties or for properties being transferred on the basis of allotment letters, creates various problems in verifying the title of the mortgagor. As a consequence of the exorbitant stamp duties being charged for conveyances. transactions of transfer of title are being undertaken more on the basis of sale agreements coupled with power attorneys than on the basis of registered conveyance deeds. Such powers of attorney cause the following legal problems:

a) If the donor of the Power dies prior to the eventual registration in the name of the purchaser or his nominee, the property legally reverts to the legal heirs of the person who owns the legal title to such property. As a consequence litigation is always the only way of clarifying the entitlement to such land.

b) At times it has happened that the power of attorney is badly drafted so as not to contain the requisite powers required for the transfer of the land to the beneficial owner, who has paid the transfer fee and entire sale consideration. When the transferor (donor of the power) is no longer available to execute the requisite documents to effectuate the transfer, declaratory suit filed in the Court having jurisdiction in respect of such land seems to be the only way of ensuring compliance with such transfer formalities.

c) It sometimes happens that the power of attorney allows the attorney to appoint sub-attorneys. In such case a chain of attorneys is established. If anyone of such special attorneys dies the chain is broken with the result that the subsequent transfer or auctions in respect of such property would become defective. Often it is not possible to track down all the attorneys (special attorneys) in respect of any plot of land and unscrupulous persons may exploit such legal lacuna of a breach in the chain, to provide worthless securities to financial institutions. For example D may present documents of title to a bank on the basis of a power of attorney granted by A to B, B to C, C to D knowing full well that at that moment B was dead and A was a co-conspirator; once the moneys have been duly disbursed to D, D would disappear; A would then enter the picture and inform the Bank that the mortgage is void in view of the fact that his attorney through whom D derived the power to mortgage the property died prior to the exercise of such power and as such the property of A could not have been mortgaged by D.

From the above, it is apparent that the difficulties with which procedures for verification of title deeds is beset can hamper the promotion of the business of housing finance companies. In the developed world the process of verification of title is so

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regulated as to efficiently inform the searcher of the true owner of any property and the law is so framed as to safeguard all equities in respect of the transactions pertaining to the immoveable property if such equities have not already been translated into legal documentation finding mention in the computerized entries in respect of every plot of land. As such, reforms are needed in the process of title verification in Pakistan without which the HFC will have to rely on additional indemnities and guarantees to safeguard its interest in the property mortgaged. The HFCs should present their recommendations for reform in this regard to the appropriate authorities.

(2) Mortgage Registration: In Pakistan much confusion still prevails with regard to the rights of a mortgagee of an immoveable property. Many a good lawyer is yet confused as to whether one needs to go to Court to enforce the power of sale granted by a mortgage deed and whether there is any difference between the mortgage created by deposit of title deeds and a mortgage created by a registered mortgage deed.

It may be expedient to briefly review the relevant provisions of law in order to understand the problems being faced by HFCs in Pakistan.

No right in immoveable property can be created by a document which is not registered. Such prohibition is contained in Section 17(1)(b) of the Registration Act, 1908. However, under the Transfer of Property Act, a mortgage can be created by mere deposit of title deeds to the properties sought to be mortgaged as long as the intention is to mortgage the property and to thereby secure a debt due and payable. Section 58 of the Transfer of Property Act lists various kinds of mortgages and defines a mortgage as being a transfer of an interest in specific immoveable property for the purpose of securing payment of money advanced or to be advanced by way of loan, or an existing or future pecuniary liability. The consequence of a mortgage being created are also dealt with by the Transfer of Property Act.

In view of the fact that a mortgage deed requires to be stamped under the Stamp Act and the amount of such stamp duty, in cases where possession is also transferred to the mortgagee, is substantially high (9% in Sindh, 8.5% for property up to Rs. 350,000/- and 10% for property of more than Rs. 350,000/- in Punjab, 7% in NWFP and 4% in Balochistan) gives an incentive to the mortgagors to prevail upon the mortgagees to obtain the mortgage by deposit of title deeds in accordance with the provisions of Section 58(f) of the Transfer of Property Act rather than by registered mortgage deed. A mortgage deed, which is not coupled with the possession of the mortgaged property to the mortgagee, is required to be stamped as a bond. In Sindh mortgage deed without possession would, therefore, require to be stamped at 3% and in Punjab and other provinces it would be 2%.

Under Section 67 of the Transfer of Property Act a mortgagee has a

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right to obtain from the Court a decree that the mortgagor be debarred to redeem his property and that the property be sold. Under Section 69 of the Transfer of Property Act a mortgagee has the power to sell the mortgaged property without the intervention of the Court when neither the mortgagor nor the mortgagee is a Hindu, Muslim or Buddhist; or where the mortgagee is the Federal Government or Provincial Government or a banking company as defined in the Banking Tribunal Ordinance; or where a power of sale without the invention of the Court is expressly conferred on the mortgagee by the mortgage deed and the mortgaged property or any part thereof was on the date of the execution of the mortgage deed situated within the town of Karachi or in any other town or area which the Provincial Government may by notification in the Official Gazette specify in this behalf.

It was in view of the provisions of Section 69 that the financial institutions required that the security by way of mortgage be created by a mortgage deed. However, after the amendment in the Section 69(b) of the Finance Act of 1986 which did away with the distinction between a mortgage created by a mortgage deed and mortgage by deposit of title of property where the mortgagee is the Federal Government of Provincial Government or a banking company as defined in the Banking Tribunals Ordinance, the necessity of creating mortgage by a mortgage deed was obviated.

The provisions of Section 69(c), since it talks of power conferred on the mortgagee by "the mortgage deed", seem to suggest that in order to grant the power of sale without the intervention of the Court only a mortgage created by a mortgage deed would suffice. It is due to the fact that "banking companies" as defined by the Banking Tribunals Ordinance do not as yet include HFCs that HFCs are required to create mortgages in their favor by a mortgage deed rather than a deposit of title deeds. As such if the amendment of Section 69(b) is extended to include housing finance companies as well as banking companies then housing finance companies would not require the mortgages in their favor to be created by a mortgage deed. As such a simple amendment would save millions of rupees for mortgagors seeking to obtain finances from HFCs and would go a long way in promoting the activities of HFCs in Pakistan.

If HFCs are allowed to be classified as "banking companies" then they could accept equitable mortgages thereby enabling their customers to avoid the high transactions costs. For it is unlikely that the provincial governments would agree to a reduction in registration charges and stamp fees in view of their budgetary requirements.

Be that as it may, the laws also need to be amended in order to ensure that the HFC is not only allowed to sell the property without recourse to a court of law but that it may also obtain a summary order of possession. Ability to sell immoveable property, be it residential or commercial, without the ability to have the property evacuated and to transfer vacant possession to the purchaser of such property, would not enable HFCs to achieve the

optimum value of such mortgaged property. In order to ensure that HFCs are able to maximize the amount recoverable from such mortgaged property, they must be given legal powers to obtain immediate physical possession of the mortgaged property through a summary procedure.

BUSINESS PLAN

III. BUSINESS PLAN

A. Base Case Financial Projection

A financial projection of the HFC's business plan is presented in Appendix 4. The assumptions underlying the financial analysis are given in Appendix 5. The financial projections reflect the basic objectives of the HFC which are to attain profitability no later than the third year of operations and a Return on Equity of at least 20 per cent by the fifth operating year.

The salient features of the five year base case financial projections are as follows:

Year	Loans Disbursed (Rs. mil.)	Net Income (Rs. mil.)	Return on Equity (%)	Debt to equity
1	62	-1.54	-3.1	1.31
2	136	-6.67	-6.7	1.51
3	136	7.85	7.9	2.11
4	136	11.80	11.8	2.22
5	136	23.28	23.3	1.98

Note: (i) Return on equity calculation uses sponsors equity of Rs. 50 million in first year and Rs. 100 million in subsequent years in denominator. (ii) Debt in debt to equity includes savings deposits in addition to loans.

Under the set of assumptions used here the HFC will only start making profits once it has booked about Rs. 242 million in loans to both individuals and developers. This business volume is reached in the first quarter of the third year of operations.

The debt to equity ratio grows at first but is expected to taper off once sustained profitability is achieved.

B. Sensitivity Tests

The financial projection is a best estimate of what the HFC can expect to achieve under reasonable assumptions. For the first year at the least, this should be used as a budget to guide performance.

According to the base case financial projection there will be a loss of Rs. 1.54 million in the first year and a profit of Rs. 23.3 millin in the fifth year. How these figures vary with changes in assumptions is presented below.

1) Variation of net income in first year with changes in the mark-up on mortgage loans: Table 1 in Appendix 6 presents the result of a sensitivity test indicating that the loss would be Rs. 1.91 million if the mark-up charged on individual loans were 19 per cent instead of the 22 per cent assumed in the base case. On the other hand, if the mark-up charged individuals was 24 per cent the loss would be lower at Rs. 1.29 million.

2) Variation of net income in first year with changes in financial cost of funds borrowed: The loss will vary from Rs. 1.1 million to Rs. 1.76 million if the cost of debt is 14 per cent and 20 per cent, respectively, instead of the base case assumption of 18 per cent (Table 2, Appendix 6).

3) Variation of net income in first year with changes in quantum of deposits: Table 3 in Appendix 6 reveals that the loss will decline slightly if more reliance is placed on relatively lower cost deposits compared to higher cost borrowing. Thus the loss will decline to Rs. 1.40 million from Rs. 1.54 million estimated for the base case if the HFC can increase the target quantum of deposits to 50 per cent of the value of individual mortgages booked instead of the 20 per cent base case assumption.

4) Variation of net income in first year with changes in the average size of loan: According to Table 4, the lowest loss in the first year would be in case the HFC concentrated all its funds in loans to developers (3 loans of Rs. 15 million each) and were to only grant small loans of an average size of Rs.200,000 to the 80 individual borrowers projected for the first year. However, in actuality the single borrower limit would apply as the HFC is assumed only to have Rs. 50 million in equity in the first year and a Rs. 15 million loan to a single party would exceed the 20 per cent ceiling. With this constraint in mind, the second best option appears to be the base case assumption (only slightly bettered by a combination of an average loan size of Rs. 10,000,000 to developers and Rs. 450,000 to individuals in which case the loss declines to Rs. 1.31 million).

5) Variation of net income in first year with level of provisions: The level of net income in the first year is most sensitive to the level of provisions for bad debts. As Table 5 in Appendix 6 indicates, if the level of provisions is assumed at 1% then the net income is a negative Rs. 0.92 million compared to a negative Rs. 1.54 million in the base case. On the other hand, if the level of provisions is as high as 8%, then net income plummets to a negative Rs. 5.3 million indicating the importance of sound credit evaluation for the small number of loans on which income is being generated by the HFC at this stage.

6) Variation of net income in fifth year with changes in the mark-up on loans: Table 6 in Appendix 6 indicates that net income in the fifth year will vary between Rs. 14.6 million and Rs. 28.6 million depending on the mark-up on individual loans which is 19 per cent in the former case and 24 per cent in the latter. (The base case estimate of Rs. 23.3 million falls between these two instances.)

7) Variations of net income in fifth year with changes in financial cost of funds borrowed: Table 7 indicates the range of outcomes for net income in the fifth year when the mark-up on borrowing ranges from 14% (Rs. 27.7 million) to 20% (Rs. 21.1 million).

8) <u>Variation of net income in fifth year with changes in quantum of deposits:</u> Net income in the fifth year would go up to Rs. 33.0 million if the proportion of savings deposits mobilized as a proportion of mortgages disbursed to individuals increases to 50 per cent instead of the base case assumption of 20 per cent.

9) <u>Variation of net income in fifth year with changes in average loan size:</u> Table 9 indicates that the best combination for net income in the fifth year is a combination of an average loan size of Rs. 10,000,000 to developers and Rs. 500,000 to individuals in which instance the net income is Rs. 32.0 million instead of the Rs. 23.3 million estimated in the base case.

10) <u>Variation of net income in fifth year with changes in the level of provisions:</u> Depending on the level of provisions for bad debts, Table 10 indicates that net income can vary between Rs. 24.1 million (1% level of provisions) to Rs. 18.4 million (8% provision). Since at this stage there is a large pool of mortgages outstanding the impact of a higher level of provisions is not as severe as in the first year.

CONCLUSIONS

IV. CONCLUSIONS

This report has covered the key issues to be faced by HFCs in preparing a business plan. The constraints in the environment, which the companies are already aware of as indicated in our first two reports, have been highlighted. Further, a business plan based on the market conditions prevalent today has also been prepared.

The key conclusions that emerge from the business plan are:

1. HFCs will have to fight hard to generate profits in what is basically a difficult economic and legal environment.

2. Notwithstanding the initial losses, a HFC that is prepared to weather teething problems can operate profitably in this business environment.

3. Due to the limited size of the market, not all HFCs will be able to operate profitably. Our judgment is that during the next five years at most three companies will make the grade -- a conclusion that confirms our understanding gained from earlier fieldwork relating to the seven HFCs themselves.

4. Reforms in the legal framework governing HFC lending operations are essential for expanding the total market in which HFCs can operate with ease. In this regard, the SRMP and the HFC Trade Association can continue to apprise the GOP of the key issues.

5. The objective of affordable housing for the masses will remain a chimera unless the GOP undertakes some major steps to trim its fiscal deficits, grants appropriate tax and non-tax incentives for saving by the population particularly those who want to save for a house, and provides appropriate reliefs to borrowers from HFCs.

REPORT 4

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INTRODUCTION

I. INTRODUCTION

The objective of this report is to present a description of the skills needed by a 'model' HFC in the first years of its operations. Following from this organization description is an assessment of the training and technical assistance requirements of the private sector HFCs given that all relevant skills may not be available "off the shelf" in Pakistan and that certain skills will have to be developed either in-house or through appropriate training programs at selected local and foreign institutions.

Since the HFC will be faced with financial constraints during the first few years of its operations, we do not expect that all positions will be filled immediately. Rather, and as we indicated in Report 3, there will be incremental additions to the organization after the start of operations for about a one year period. Thus the training and technical assistance programs will also have to dovetail with the recruitment schedule.

ORGANIZATION STRUCTURE

II. ORGANIZATION STRUCTURE

An HFC organization chart is given in Figure 1 on the following page. As indicated there the HFC will be structured into three functional divisions. The Operations Division will house the line positions of the organization and will be supported by staff positions in the Finance and Accounts Division and the Human Resources Division.

The organization structure depicted in Figure 1 has been derived on the assumption that the HFC will be working for the first year or so out of its main office and that branches will be opened after the initial teething period is over. The addition of branches will only require a slight modification of the organization chart to encompass the reporting relationship of the branch managers.

The key positions in the organization are described in more detail below:

(i) <u>Chief Executive</u>: His primary responsibility will be to ensure that the HFC operates in accordance with the policy guidelines and budgetary targets set in agreement with the Board of Directors. He will keep the Board informed of variances from target indicating reasons thereof. He will be the strategic thinker who has to orchestrate the planning process by coordinating the efforts of the heads of the different divisions of the HFC. Will represent the HFC with governmental organizations and with international agencies.

<u>Qualifications of Chief Executive</u>: (1) Education: Degree in Liberal Arts/Economics/Engineering from reputable university preferably with graduate qualifications such as MBA. (2) Experience: At least 15 years experience in financial institutions with a minimum of 5 years experience at senior level. International experience will be given added weight.

(ii) <u>General Manager, Operations</u>: He will have overall responsibility for the HFCs operations division, and, in collaboration with the General Manager, Finance, for preparation of budgets that will set targets for loan disbursements, recoveries, and operational expenses in line with the guidelines indicated in the HFCs strategic plan. Will be actively involved in recruitment and selection at branch offices in collaboration with the General Manager, Personnel and Training.

<u>Qualifications of General Manager, Operations</u>: (1) Education: Degree in Liberal Arts/Economics/Engineering from reputable university preferably with MBA. (2) Experience: At least 10 years experience in a financial institution or in the construction industry with 2 years experience at the senior level.

(iii) <u>Marketing Manager</u>: Marketing of loan origination through contacting private and public sector organizations, developers, and high net worth individual households. Will collaborate with branch

personnel in making the necessary contacts.

Qualifications of Marketing Manager: (1) Education: Degree in Liberal Arts/Commerce/Business from reputable university. (2) Minimum of 7 years of marketing/sales experience in a reputable commercial or manufacturing organization.

(iv) Loan Processor: Primary function is to underwrite and process the loan from application through closing. His job will be to review the documentation for completeness and accuracy. Thus he will verify the applicant's employment status, income level, and overall financial status. In consultation with the Technical Manager, will check the accuracy of the stated value of the property. After completing the review, he will determine the preliminary approval or rejection before passing it on to the General Manager, Operations for final approval. Will make recommendations about disbursements to the General Manager, Operations. Upon approval of the loan application and issuance of loan commitment, he will be responsible for coordinating the loan closing and preparing the necessary documentation (mortgage agreement, etc.)

Qualifications of Loan Processor: (1) Education: Degree in Law/Commerce/Economics from reputable university or professional qualification in accountancy (ACCA/FCA/FCMA). (2) Minimum of 7 years experience in a lending operation preferably in the housing field.

(v) Technical Manager: Primary function is to visit the construction site and prepare report for use in package by the Loan Processor. He will check on the accuracy of the construction budget submitted by potential borrowers, monitor construction progress and make recommendations to the Loan Processor for disbursements.

Qualifications of Technical Manager: (1) Education: Degree in Civil Engineering from reputable university preferably with MBA. (2) Minimum of 7 years experience in construction management and/or property valuation.

(vi) Manager Recoveries: Will be responsible for keeping track of loan cycle from date of disbursement. Will write welcome letter to new borrowers. Will ensure that debit notes are issued to borrowers every month reminding them of payment date, receipts issued for payments, reminders for overdue payments, and will make phone calls to customer in case loan is more than one month overdue. In case loan is more than two months overdue will investigate reasons and may reschedule loan in agreement with borrower. In case of further default will initiate legal action for recovery through the Legal Advisor. Will ensure that quarterly statement of accounts are issued to all borrowers.

Qualifications of Manager Recoveries: (1) Education: Degree in Commerce/Economics from reputable university or member of

professional accountancy institute with qualifications such as ACCA/FCA/FCMA. (2) Experience: Minimum of 7 years in lending operations with a financial institution.

(vii) General Manager, Finance: He will have primary responsibility for setting appropriate financial policies for the HFC in light of the Board's guidelines and for supervising accounting operations. Will ensure that effective budgetary and financial controls are exercised in HFC. Will prepare annual budgets in collaboration with the General Manager, Operations, as part of which he will also set targets for annual resource mobilization program after taking into account the existing level of funds and expected recoveries on past loans. Will be responsible for presenting HFCs financial status to institutional and other major shareholders, brokerage houses, and other potential long term investors.

Qualifications of General Manager, Finance: (1) Education: Degree in Finance/Accounting from reputable university or member of professional accountancy institute with qualification such as ACCA/FCA/FCMA. (2) Experience: Minimum of 10 years in middle and top management of a financial institution. Must have at least five years experience in managing and using an EDP system.

(viii) Manager Accounts and MIS: He will design and maintain a computerized accounting system that records all financial transactions including general ledger transactions, loan disbursements, deposit related transactions, loan origination records, and loan payment schedules. Will alert Manager Recoveries in Operations Division about overdue loans.

Qualifications of Manager Accounts and MIS: (1) Education: Degree in Finance/Accounting from reputable university or member of professional accountancy institute with qualification such as ACCA/FCA/FCMA. (2) Experience: Minimum of 5 years in accounting department of a financial institution. Must have experience of developing and managing computerized accounting systems.

(ix) Manager Treasury: He will be primarily responsible for ensuring that sufficient funds at some predetermined cost are available for the budgeted operations of the HFC. Will compare actual and projected flow of funds on a daily basis and take corrective action when necessary. Will design short term financial instruments to ensure availability of short term funding from the money market and from financial and non-financial institutions. Will identify avenues for investment of surplus funds.

Qualifications of Manager Treasury: (1) Education: Degree in Commerce/Economics/Finance/Accounting from reputable university or member of professional accountancy institute with qualification such as ACCA/FCA/FCMA. (2) Experience: Minimum of 5 years experience in Treasury Department of a commercial bank of which 2 must be in senior position.

(x) Manager Deposit Mobilization: Will develop and design procedures for the annual planning process for resource mobilization covering major objectives for the year and targets for different types of deposits on a monthly basis in terms of number of accounts and amounts. Will devise deposit savings schemes covering type of instrument, forms and procedures to be used including rate of return calculations, promotional literature, and monitoring and control systems. Will pay special attention to the possibility of developing a contractual savings scheme. In collaboration with the Manager Accounts and MIS will develop system to record deposit transactions. Will design a promotional campaign for the HFC and involve branch managers in this campaign by setting targets for branches and incentives for individual managers. Will prepare detailed procedures to maintain good customer relations on existing deposits such as reminders to renew deposits, information on mark-up earned,etc.

Qualifications of Manager Deposit Mobilization: (1) Education: Degree in Commerce/Economics/Finance/Accounting from reputable university or member of professional accountancy institute with qualifications such as ACCA/FCA/FCMA. (2) Experience: At least 7 years of experience, of which 2 must be at senior level, in designing savings mobilization schemes at commercial banks or DFIs.

(xi) General Manager, Human Resources: His primary responsibility would be to select, recruit, and have trained a cadre of manpower suitable to the HFCs medium and long term needs. Will be responsible for developing manpower recruitment and selection plans in consultation with the General Manager, Operations and, on the basis of agreed job descriptions and qualification requirements, project quantitative training requirements. Will identify appropriate training organizations to ensure that training programs are executed and is expected to liaise with business schools and management development institutes in this regard. Will advise on appropriate remuneration schemes that would attract suitable personnel at reasonable cost to the HFC. Will design and maintain performance assessment procedures, and promotion and career development policies for employees.

Qualifications of General Manager, Human Resources: (1) Education: Degree in Arts/Sciences from reputable university. (2) Experience: At least 10 years in middle and top management of commercial or manufacturing organizations or financial instiution with exposure to all aspects of personnel management including career planning and human resources development.

(xii) The Internal Audit is a statutory requirement under the NBFI regulations. As per the NBFI regulations, the Internal Auditor will report directly to the Managing Director. He will check on the accounting and other procedures prescribed by the Board and the adherence of management and staff to them. He will check on the accounting accuracy and efficiency and verify the physical existence of fixed assets.

Qualifications of Internal Auditor: (1) Degree in Commerce/Accounting/Finance from reputable university or member of professional accountancy institute (ACCA/FCA/FCMA). (2) Experience: At least 7 years experience in the accounting department of reputable private sector commercial or manufacturing organizations or with financial institutions at least 2 of which must be in internal audit.

(xiii) Legal Advisor: He will report to the Managing Director and will follow up on matters such as recoveries on problem loans at the behest of the Operations Division. He will be a practicing attorney with at least 10 years experience in property conveyancing, mortgage registration procedures, application of banking laws and procedures, and also in the procedures of the Banking Tribunals. He will not be a full time employee of the HFC but will be engaged as a consultant to advise the HFC in case of need. The remuneration will vary with the time requirements of the position.

TRAINING AND TECHNICAL ASSISTANCE NEEDS

III. TRAINING AND TECHNICAL ASSISTANCE NEEDS

A. Training needs

Some of the positions outlined in the previous section will be difficult to fill as persons with the requisite qualifications may not be found in Pakistan. Our interviews with the seven HFCs indicate that apart from a shortage of top level managers with the general knowledge of the Pakistani housing sector and different systems of housing finance -- skills essential for strategic planning -- persons with skills in the following specific functional areas will be hard to identify and recruit:

(i) Loan processing: The loan processing function deals with the entire cycle of documentation for loan closing including preparing the credit report and verification of employment status of applicant, bank deposit verification, title searches, and, after consultation with the Technical Manager, property appraisal.

As consumer finance operations are still in their infancy in Pakistan, a pool of professionals with experience of assessing the creditworthiness of individual borrowers is non-existent (Citibank, of course, with its auto loan and credit card experience in Pakistan and its worldwide experience in consumer finance operations is the exception to this). This task is expected to be particularly important in an environment where there is no institution such as a credit bureau that keeps track of individuals' credit status or for that matter where loan foreclosure in case of default by borrower is time consuming and fraught with uncertainty of outcome.

Another aspect of the loan processing function for which training will be required, as any person recruited for this position is likely to have little exposure in this area, is the title search.

(ii) Property appraisal: The property appraisal function is another key in-house skill that must be developed particularly in relation to the under-construction category of mortgage loans. The property surveying profession is in the nascent stages in Pakistan with very few firms of repute (one of which has been engaged by Citibank) and there are few experienced individuals in this area.

(iii) MIS and Systems Development: At least one HFC has identified this as an area in which they would need technical assistance and has approached the SRMP in this regard.

The MIS for a HFC would require a computerized system to handle the following: (a) internal accounting; (b) cash management; (c) asset management; (d) liabilities management; and (e) external reporting for prudential regulations purposes. While systems developed for other financial institutions by software consultants may be relevant to some extent, the requirements of mortgage lending would require a customized approach that is best addressed through training of a permanent HFC staff member recruited for the MIS position who has a basic grounding in accounting and financial

analysis in a computerized environment.

(iv) <u>Loan recoveries</u>: This position would require not only the following of prescribed procedures but also training in interpersonal skills. Since HFCs will have to emphasize sound recovery procedures to minimize write offs of bad loans which they can ill afford, training in this area is essential.

B. <u>Training Strategy</u>
The skills described above may be developed through a combination of short term measures relying on technical assistance and short period training programs at selected institutions and long term measures for institutional development.

(i) Short term strategy: The short term strategy relies on a combination of technical assistance and short period training. The technical assistance will entail visits of up to 2-3 months by experts in the above areas to Pakistan where they will be involved with problem solving and on the job training of HFC staff.

For short term technical assistance which is also cost effective we recommend that several HFCs pool their resources and approach the International Executive Service Corps (IESC), an organization that sends retired American executives for short periods overseas. The IESC charges some $8,000-$10,000 to identify an American executive with the relevant profile that must be defined by the overseas client and arranges for his visit to the client's business for a 2-3 month period. Accommodation and incidental expenses are also the responsibility of the client. Thus, provided the HFCs have defined their needs clearly, the IESC representative with the right background can help to train staff on the job. The IESC has a representative office in Pakistan. (A similar approach to the IESC is taken by the British organization with similar objectives, British Executive Service Overseas (BESO), which has a pool of retired British executives to draw from. The cost of engaging an expatriate from BESO is somewhat less than doing it through the IESC.)

The SRMP can help in promoting short term technical assistance by bringing in short term consultants/trainers who can help with on the job training in the various fields and with development of management control systems for the HFCs. An instance of this is SRMP's provision of expatriate consultants for MIS development. The HBFC's Training Center in Karachi could be used as a venue for presentations by visiting consultants/trainers to discuss the outcome of their work in Pakistan.

In addition to short term technical input from expatriate consultants, HFC managers should be sent for training at suitable training institutions outside the country since there are as yet no local institutions that have the requisite expertise. Although there are several local institutions that have the potential to take on the training tasks provided some training of trainers is undertaken (the Institute of Business Administration, the Lahore

University of Management Sciences, and the Pakistan Institute of Management were all cited by our HFC respondents as having the right calibre of staff), this is more of a long term institutional development goal. (Further, whether an existing institution should be strengthened or whether the HFCs should develop their own institution 'ab initio' is also a point of debate. We have opted for the new institution catering exclusively for the needs of the HFCs as we hold that housing finance is a specialized field with generic requirements that should be addressed by an institution that is controlled by the HFCs themselves.)

Short term training is also available through the 'Asian Coalition of Housing Finance Institutions', a joint UNCHS/UNDP sponsored project, of which the following institutions are members: Government Housing Bank of Thailand, Housing Development Finance Corporation of India, Korea Research Institute for Human Settlements, and National Home Mortgage Finance Corporation of the Philippines. The Coalition can arrange both for short term technical assistance and, better still, can arrange for short term courses at the HDFC's 'Center for Housing Finance' at Lonavla in India. The costs of attending the CHF's courses are reasonable. Thus for a three week course entitled 'Banking, Capital Markets and Housing Finance in Developing Countries' the fee is US$4,000. This also covers the cost of room and board. When one takes into account the fact that travel related costs to India would be far less than travelling to the USA or Britain to attend similar courses there, and taking the high quality of HDFC's courses which previous participants have commented upon to us, the cost effectiveness of this short term training option is evident. (The emphasis is on cost effectiveness which is not to deny the outstanding quality of short period executive programs offered by the Fels Institute at the University of Pennsylvania and the Special Program for Urban and Regional Studies (SPURS) at the Massachusetts Institute of Technology offered in collaboration with Harvard University.)

While technical assistance through consultants' inputs and short period training abroad are both important, in general we find that SRMP's role in bringing in outside consultants for on the job training of HFC managers or for training of trainers here would be more cost effective. By bringing consultants-cum-trainers here greater number of people in the organization could benefit than would be the case if the HFC managers were to be sent abroad. This is likely to be particularly true in the early stages of an HFCs life cycle when an HFC will be understaffed anyway and can ill afford to spare its managers at a continuous stretch away from their official functions.

A complementary though lower priority training tool is the study tour. If funds allow, the SRMP can also fund study tours of countries with effective housing finance systems such as India, Thailand, and Malaysia. This will also be an effective short term training tool to enlarge the strategic vision of senior managers in HFCs.

(ii) Long term strategy: It would not be feasible for each HFC to develop its own training function in-house because of the small scale of their operations and the fact that there will be initial operating losses. Thus the HFC should avoid adding to its overhead costs by developing a full fledged training organization in-house. We therefore recommend that all the HFCs including the revamped HBFC pool their resources to fund the establishment of a Center for Housing Finance with the HBFC possibly taking a lead role because of its already available spacious facilities. This step must be taken only after it has become clear just how many HFCs are likely to remain in this business, which is to say not before three or four years from today.

To fund the Center there must be an initial contribution to cover capital expenditures for training related equipment such as overhead projectors, copying machines, and for rental of premises. Each participating HFC must contribute an equal amount. At current prices, the initial contribution is not expected to exceed Rs. 150,000 per HFC provided there are five HFCs in all that decide to participate. On the other hand, should the HBFC decide to provide its own equipment and premises to the Center thereby obviating the need for additional capital expenditures it must be compensated by a suitable rental that must be included as a line item in the budget for operating expenditures. The Center must also have full time staff, preferably those with working experience of HFCs in addition to having solid academic backgrounds. Salaries of staff must be met for the most part out of the revenues generated by the Center from the fees for courses.

To supplement the Center's revenues from training programs, it is expected that the Center's staff will also engage in consultancy work for the companies from which the Center will derive fee income.

We also recommend that the HFCs in Karachi liaise with the Institute of Business Administration, Karachi University for the development of a course in housing finance as an elective in the MBA program. Similarly, the Lahore based HFCs should approach the Lahore University of Management Sciences for the development of such a course. The course will be taught with extensive reliance on 'guest speakers' from the HFCs. This will make graduating MBAs conscious of the possibility of a career in housing finance and give HFCs access to a pool of qualified but relatively raw professional manpower which it can mold to its own requirements.

APPENDICES

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HFC QUESTIONNAIRE

QUESTIONNAIRE FOR HFCs

A. GENERAL

1. NAME OF COMPANY: ____________________

2. CHIEF EXECUTIVE OF HFC: ____________________

B. SPONSOR

3. HAS SPONSORS' EQUITY BEEN FULLY PAID-UP AND BANKED IN COMPANY'S ACCOUNT? YES/NO. IF NO, WHAT PERCENTAGE HAS BEEN PAID-UP SO FAR? _____%. WHEN WILL THE BALANCE BE PAID-UP? _________.

4. HAS THE COMPANY RECEIVED A LICENSE TO COMMENCE BUSINESS FROM THE INTERNAL FINANCE WING, MINISTRY OF FINANCE? YES/NO.

   IF ANSWER IS NO, WHEN DOES IT EXPECT TO RECEIVE LICENSE?

   ANY PROBLEMS ANTICIPATED IN LICENSING PROCEDURE?

5. HAS THE COMPANY RECEIVED A COMMENCEMENT OF BUSINESS CERTIFICATE FROM THE CORPORATE LAW AUTHORITY? YES/NO.

   IF NO, WHEN IS THE COMMENCEMENT OF BUSINESS CERTIFICATE EXPECTED TO BE ISSUED?

   ANY PROBLEMS ANTICIPATED IN ISSUANCE OF COMMENCEMENT OF BUSINESS CERTIFICATE?

6(a) PRESENT LOCATION OF BRANCHES:

(b) NUMBER OF BRANCHES PLANNED OVER NEXT FIVE YEARS. PLEASE INDICATE LOCATION(S):

C. MARKET ANALYSIS

7. WHAT IS YOUR TARGET MARKET? (PLEASE DESCRIBE PROFILE OF TYPICAL INDIVIDUAL BORROWER IN TERMS OF GROSS INCOME, AGE, AND OCCUPATION ETC. IN CASE OF COMPANIES DESCRIBE THE CORPORATE PROFILE OF POTENTIAL BORROWERS)

8. WHAT IS THE TOTAL POTENTIAL NUMBER OF BORROWERS IN PAKISTAN OF THE TYPE DESCRIBED BY YOU IN (7) ABOVE?

BORROWER TYPE	NUMBER IN PAKISTAN

9. WHAT IS THE TOTAL POTENTIAL NUMBER OF BORROWERS OF THE TYPE DESCRIBED IN (7) AMONG OVERSEAS PAKISTANIS?

10. OF YOUR TOTAL LENDING WHAT PERCENTAGE WILL YOU LEND FOR?
    LAND PURCHASE___%
    LAND PURCHASE AND CONSTRUCTION OF RESIDENTIAL PROPERTY___%
    LAND PURCHASE AND CONSTRUCTION OF COMMERCIAL PROPERTY ___%
    IMPROVEMENT AND ADDITIONS TO RESIDENTIAL PROPERTY____%
    IMPROVEMENT AND ADDITIONS TO COMMERCIAL PROPERTY___%
    OTHER(PLEASE SPECIFY):
    ____%.
    ____%

11. WHAT TYPE OF MORTGAGES WILL YOU OFFER?

    FIXED RATE MORTGAGE
    ADJUSTABLE RATE MORTGAGE
    SHARED APPRECIATION MORTGAGE
    SHARED EQUITY MORTGAGE
    OTHER (PLEASE INDICATE):

12. DO YOU ANTICIPATE GETTING INTO LEASING OR HIRE PURCHASE OF PROPERTY? YES/NO. IF YES, WHEN DO YOU EXPECT TO DO THIS?

13. MINIMUM LOAN AMOUNT (Rs):________ ; MAXIMUM LOAN AMOUNT (Rs)__________.

14. AVERAGE LOAN SIZE EXPECTED(Rs): __________.

15. EXPECTED DURATION OF LOAN (YEARS):_________.

16. EXPECTED MARK-UP ON LOAN:______.

17. INDICATE REPAYMENT AMOUNT AND SCHEDULE FOR AVERAGE LOAN:

18. PLEASE INDICATE THE FOLLOWING CLOSING COSTS FOR AN 'AVERAGE' MORTGAGE LOAN:

Loan Application fee	Rs.______
Income verification fee	Rs.______
Loan processing fees	Rs.______
Appraisal of property by lender	Rs.______
Lawyer's fees	Rs.______
Architect's fees	Rs.______
Title search and title insur.	Rs.______
Stamp duty	Rs.______
Title transfer fees (other than stamp duty indicated above):	
(a)	Rs.______
(b)	Rs.______
(c)	Rs.______
Mortgage life insurance fee	Rs.______
HFC's commitment fees	Rs.______
Property and casualty insurance	Rs.______
Other (please indicate):	
(a)	Rs.______
(b)	Rs.______

19. WHAT IS THE MAXIMUM LOAN YOU WILL GRANT AS A PERCENTAGE OF THE TOTAL COST OF THE FOLLOWING:

LAND PURCHASE COST	______%
RESIDENTIAL PROPERTY	______%
NON-RESIDENTIAL PROPERTY	______%
ALTERATIONS & IMPROVMENTS	______%

20. NUMBER OF LOANS EXPECTED TO BE BOOKED AFTER START-UP:

Years after start-up	No. of loans booked
1	
2	
3	
4	
5	

21(a) WHAT DO YOU THINK ARE THE 'KEY SUCCESS FACTORS' FOR THIS INDUSTRY?

(b) WHICH OF THE ABOVE MENTIONED 'KEY SUCCESS FACTORS' ARE ENVIRONMENTAL AND THEREFORE OUTSIDE YOUR CONTROL AND WHICH INTERNAL TO YOUR ORGANIZATION?

(c) PLEASE ANSWER THE FOLLOWING:
WHAT IS AVERAGE GROWTH RATE OF GDP LIKELY TO BE OVER NEXT FIVE YEARS? ____%.
GOVERNMENT'S BUDGETARY DEFICITS WILL INCREASE/DECREASE/STAY SAME OVER NEXT FIVE YEARS.
WHAT IS THE AVERAGE ANNUAL INFLATION RATE LIKELY TO BE OVER NEXT FIVE YEARS? ____%.
BUILDING SECTOR WILL GROW AT AN ANNUAL RATE OF ____% OVER NEXT 5 YEARS.
BECAUSE OF DEREGULATION OF FINANCIAL SECTOR COST OF MOBILIZING FUNDS BY HFCs FROM MARKET WILL INCREASE/DECREASE OVER NEXT FIVE YEARS.
BECAUSE OF DEREGULATION OF FINANCIAL SECTOR MARK-UP ON HOUSE MORTGAGES WILL INCREASE/DECREASE OVER NEXT FIVE YEARS.

22. APART FROM OTHER HFCs, DO YOU SEE THE FOLLOWING AS YOUR COMPETITORS OVER THE NEXT FIVE YEARS?

HBFC? YES/NO. REASONS:

COMMERCIAL BANKS? YES/NO. REASONS:

23. DO YOU THINK THERE IS ROOM FOR MORE PRIVATE SECTOR HFCs GIVEN THE CURRENT BUSINESS ENVIRONMENT? WHY OR WHY NOT? PLEASE DISCUSS YOUR REASONS.

D. ORGANIZATION

24. DO YOU HAVE AN ORGANIZATION CHART? YES/NO. IF YES, WE WOULD APPRECIATE A COPY.

25. PLEASE INDICATE NAME, QUALIFICATIONS, AND EXPERIENCE OF ALL KEY MANAGERS IN YOUR ORGANIZATION:

POSITION	NAME	QUALIFICATIONS	EXPERIENCE

26. FOR ALL THE DEPARTMENTS INDICATED ABOVE, PLEASE INDICATE YOUR CURRENT STAFFING STRENGTH:

DEPARTMENT	NUMBER OF EMPLOYEES

27. HAVE YOU DEVELOPED A JOB DESCRIPTION MANUAL THAT DESCRIBES NECESSARY SKILLS AND POSITIONS FOR YOUR ORGANIZATION? YES/NO.

28. HAVE YOU DEVELOPED A STAFFING PLAN THAT PROJECTS YOUR STAFFING REQUIREMENTS OVER NEXT FIVE YEARS? YES/NO. IF YES, THEN INDICATE THE NUMBER OF PERSONNEL TO BE RECRUITED EACH YEAR BY DEPARTMENT:

Department	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5

29. ARE THERE ANY SKILLS THAT YOU WOULD LIKE TO HAVE IN YOUR ORGANIZATION BUT THAT ARE NOT AVAILABLE LOCALLY? YES/NO. IF YES, WHAT ARE THESE SKILLS THAT ARE NOT AVAILABLE?

30. ARE THERE ANY LOCAL TRAINING INSTITUTES/ORGANIZATIONS THAT COULD MEET YOUR HUMAN RESOURCE REQUIREMENTS? YES/NO. IF YES, THEN INDICATE NAMES AND LOCATION OF INSTITUTES

NAME OF INSTITUTE	LOCATION

31. ARE THERE ANY FOREIGN TRAINING INSTITUTES/ORGANIZATIONS THAT YOU WOULD LIKE TO SEND YOUR STAFF FOR TRAINING TO? YES/NO. IF YES, KINDLY GIVE NAMES AND LOCATIONS:

NAME OF INSTITUTE	LOCATION

32. WOULD YOU BE PREPARED TO COOPERATE WITH OTHER HFCs IN SETTING UP A TRAINING INSTITUTE THE COSTS OF WHICH WOULD BE BORNE BY ALL JOINTLY? YES/NO. IF YES, PLEASE INDICATE HOW MUCH YOU WOULD BE PREPARED TO PAY EACH YEAR TO SUPPORT THIS TRAINING ORGANIZATION?

33. COULD USAID'S SHELTER RESOURCE MOBILIZATION PROGRAM PROVIDE ANY ASSISTANCE IN HELPING YOU TRAIN YOUR STAFF? YES/NO. IF YES, PLEASE INDICATE HOW AND IN WHAT AREAS.

E. FUNDS MOBILIZATION

34. PLEASE INDICATE TOTAL FUNDS MOBILIZATION TARGET (OTHER THAN EQUITY) FOR EACH YEAR AFTER START-UP BY FINANCIAL INSTRUMENT:

	(Rs '000) Years after start-up				
	1	2	3	4	5
TOTAL					
OF WHICH:					
Instrument					
Term deposits					
Commercial paper					
TFCs					
Certificates of Investment					
Local Bank/NBFI credit lines					
Loans from pension/provident funds					
Loans from life insurers					
International agency credit lines					
Passbook deposits					
Inter-bank borrowing					
Other(Please indicate):					
(a)_______					
(b)_______					

35. FOR EACH OF THE INSTRUMENTS INDICATED ABOVE PLEASE INDICATE TERM AND APPROXIMATE YIELD TO BE PAID DEPOSITOR/LENDER.

Instrument	Term	Annual Percentage Rate

F. PORTFOLIO INVESTMENT

36. FOR EACH OF THE FOLLOWI.'G YEARS AFTER START-UP, WHAT ARE YOUR TARGETS FOR INVESTMENT IN THE FOLLOWING?

	(Rs. '000) Years after start-up				
	1	2	3	4	5
Loans for land purchase					
Loans for land and house construction					
Loans for improvement of existing dwelling					
Loans for constructed house purchase					
Loans to developers for houses					
Loans for commercial property					

Residential property lease investment
Commercial property lease investments
Investment in government securities:

- Investment in Treasury Bills
- Investment in FIBs
- Investment in NIT units
- Other (Please indicate)
  - (a)________
  - (b)________

37. FOR EACH OF THE ABOVE INVESTMENTS TO BE UNDERTAKEN, PLEASE INDICATE THE EXPECTED RATE OF RETURN PER ANNUM

Investment	Rate of return (%)

38. WHAT PERCENTAGE PROVISIONS DO YOU EXPECT TO MAKE FOR EACH OF THE INVESTMENTS UNDERTAKEN?

Investment	Level of yearly provisions (%)

G. FINANCIAL FORECAST

39. BASED ON YOUR FEASIBILITY STUDY/BUSINESS PLAN AND ACTUAL COST EXPERIENCE, PLEASE INDICATE THE FOLLOWING:

	Year					
	0	1	2	3	4	5
Capital expenditures (Rs.'000):						
Land purchase						
Building						
Office Equipment						
Vehicles						
Furniture & fixture						
Advance lease rentals						
Preliminary expenses:						
Registration charges						
Salaries during start-up						
Interest during start-up						
Other expenses (feasibility						

study, advertisements, etc.)
Other (please indicate):
(a)________
(b)________

Operating costs (Rs.'000):
Salaries
Office rent, rates, local taxes
Lease rentals
Telephone/fax
Postage/courier
Travelling expenses
Vehicle running expenses
Utilities
Advertising
Stationery/supplies
Staff training
Other
(a)______
(b)______

H. MIS

40. WHAT REPORTS WILL YOU HAVE PREPARED THAT WILL SATISFY BOTH YOUR MANAGEMENT CONTROL REQUIREMENTS AS WELL AS THE MINISTRY OF FINANCE AND STATE BANK PRUDENTIAL REGULATIONS. PLEASE INDICATE BELOW:

Type of report	Frequency of preparation	To be prepared by

I. POLICIES

41. DO YOU INTEND TO UNDERTAKE SMALL LOANS (THOSE LESS THAN Rs. 125,000)? YES/NO. WHY OR WHY NOT?

42. WHAT PROPORTION OF LIABILITIES TO EQUITY ARE YOU TARGETING?

43. WHAT PERCENTAGE OF AFTER-TAX PROFITS ARE TO BE PUT INTO RESERVES?

44. (a) WHEN DO YOU THINK YOU WILL BE ABLE TO HAVE A PUBLIC FLOTATION?
(b) BY WHEN ARE YOU REQUIRED TO HAVE A PUBLIC FLOTATION?

45. IF YOU WERE TO SELECT THREE OF THE FOLLOWING POLICY CHANGES WHICH ONES WOULD YOU SELECT? PLEASE RANK THE THREE POLICY MEASURES IN ORDER OF PREFERENCE.

(i) Corporate tax exemption for five years.
(ii) Borrowers to be allowed to deduct mark-up on loans from taxable income.
(iii Reduction of Government's budgetary deficits.
(iv) Reduction of transaction costs related to registration and transfer of property title from 12%+ to less than 3%.
(v) Tightening up/streamlining of foreclosure and repossession laws.
(vi) Permission to operate passbook savings accounts.
(vii) Access to inter-bank borrowing market at commercial bank rates.
(viii) Access to refinancing facilities through an APEX bank for HFCs.

46. PLEASE DISCUSS REASONS FOR YOUR INDICATED PREFERENCE ABOVE.

J. CONCLUSION

47. PLEASE INDICATE YOUR OVERALL VIEWS ABOUT THE BUSINESS ENVIRONMENT FACING YOU OVER THE NEXT FIVE YEARS AND WHAT YOU INTEND TO DO SHOULD THE ENVIRONMENT YOU DESCRIBE BE A DIFFICULT ONE FOR HFCs.

THANK YOU FOR YOUR COOPERATION.

SENSITIVITY ON MARKET SIZE

TABLE 1

TOTAL MARKET FOR HOUSING CREDIT ASSUMING 1000 UNITS CONSTRUCTED BY UPPER INCOME GROUPS EACH YEAR (IN MILLION RUPEES)

Loan to value (%)

Cost of house (Rs. mil)	35%	40%	45%	50%	55%	60%	65%	70%	75%	80%
1.00	350	400	450	500	550	600	650	700	750	800
1.05	368	420	473	525	578	630	683	735	788	840
1.10	385	440	495	550	605	660	715	770	825	880
1.15	403	460	518	575	633	690	748	805	863	920
1.20	420	480	540	600	660	720	780	840	900	960
1.25	438	500	563	625	688	750	813	875	938	1000
1.30	455	520	585	650	715	780	845	910	975	1040
1.35	473	540	608	675	743	810	878	945	1013	1080
1.40	490	560	630	700	770	840	910	980	1050	1120
1.45	508	580	653	725	798	870	943	1015	1088	1160
1.50	525	600	675	750	825	900	975	1050	1125	1200

TABLE 2

TOTAL MARKET FOR HOUSING CREDIT ASSUMING A 40% LOAN TO VALUE RATIO BY UPPER INCOME GROUPS (IN MILLION RUPEES)

Number of units constructed yearly

Cost of house (Rs. mil)	1000	1050	1100	1150	1200	1250	1300	1350	1400	1450	1500
1.00	400	420	440	460	480	500	520	540	560	580	600
1.05	420	441	462	483	504	525	546	567	588	609	630
1.10	440	462	484	506	528	550	572	594	616	638	660
1.15	460	483	506	529	552	575	598	621	644	667	690
1.20	480	504	528	552	576	600	624	648	672	696	720
1.25	500	525	550	575	600	625	650	675	700	725	750
1.30	520	546	572	598	624	650	676	702	728	754	780
1.35	540	567	594	621	648	675	702	729	756	783	810
1.40	560	588	616	644	672	700	728	756	784	812	840
1.45	580	609	638	667	696	725	754	783	812	841	870
1.50	600	630	660	690	720	750	780	810	840	870	900

EMPLOYMENT SCHEDULE

EMPLOYMENT SCHEDULE

S.NO.	EMPLOYEE	DATE OF HIRE
1.	Chief Executive	Hired 3 months before start
2.	G.M. Operation	Hired 1 month before start
3.	G.M. Finance	Hired 1 month before start
4.	G.M. H. Resources	Hired 12 months after start
5.	Marketing Manager	Hired 12 months after start
6.	Loan Processor	Hired 2 months after start
7.	Technical Manager	Hired 12 months after start
8.	Recoveries Manager	Hired 12 months after start
9.	Manager Accts/MIS	Hired 1 month before start
10.	Manager Deposits	Hired 12 months after start
11.	Manager Treasury	Hired 12 months after start
12.	Internal Auditor	Hired 3 months after start
13.	Legal Advisor	Hired 3 months after start

BASE CASE FINANCIAL PROJECTION

PROFORMA INCOME STATEMENT

(Rs. '000)

	Month 0	1	2	3	4	5	6	7	8	9	10	11	12	Total 1st year
INCOME:														
Income from individ. loans					58.7	117.3	175.9	234.4	292.9	351.3	409.7	468.1	526.4	2634.7
Income from developer loans					200.0	200.0	200.0	400.0	400.0	400.0	600.0	600.0	600.0	3600.0
Other income				66.0	16.0	16.0	66.0	16.0	16.0	66.0	16.0	16.0	16.0	310.0
Total Income				66.0	274.7	333.3	441.9	650.4	708.9	817.3	1025.7	1084.1	1142.4	6544.7
EXPENSES:														
Fin.charges on deposit		0.0	0.0	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0	-80.0
General & Admin.		-325.2	-325.2	-403.2	-452.6	-479.9	-479.9	-518.9	-518.9	-518.9	-518.9	-518.9	-518.9	-5578.8
Other expenses	-420.5													0.0
Depreciation		-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-30.4	-365.0
Total Expenses	-420.5	-355.6	-355.6	-441.6	-491.0	-518.3	-518.3	-557.3	-557.3	-557.3	-557.3	-557.3	-557.3	-6023.8
Net Operating Income	-420.5	-355.6	-355.6	-375.6	-216.3	-185.0	-76.4	93.1	151.6	260.1	468.5	526.8	585.1	520.9
Fin. charges on borrowings		0.0	0.0	0.0	0.0	0.0	0.0	0.0	-233.8	-281.5	-310.7	-310.7	-867.4	-2004.0
Income from investments	1652.0	275.3	267.4	180.4	158.2	136.3	52.2	32.0	12.2	5.8	6.7	7.7	53.1	1187.3
Provision for bad debt				-264.0	-64.0	-64.0	-264.0	-64.0	-64.0	-264.0	-64.0	-64.0	-64.0	-1240.0
Income before taxes	1231.5	-80.2	-88.2	-459.2	-122.1	-112.7	-288.2	61.1	-134.0	-279.7	100.5	159.9	-293.1	-1535.8
Taxes	677.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NET INCOME	554.2	-80.2	-88.2	-459.2	-122.1	-112.7	-288.2	61.1	-134.0	-279.7	100.5	159.9	-293.1	-1535.8
Bonuses														
Reserve fund	110.8	0.0	0.0	0.0	0.0	0.0	0.0	12.2	0.0	0.0	20.1	32.0	0.0	64.3
Dividends	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Retained earnings	443.4	-80.2	-88.2	-459.2	-122.1	-112.7	-288.2	48.9	-134.0	-279.7	80.4	127.9	-293.1	-1600.1

PROFORMA INCOME STATEMENT

	1st Q	2nd Q	3rd Q	4th Q	Total 2nd yr	1st Q	2nd Q	3rd Q	4th Q	Total 3rd yr	4th yr	5th yr
INCOME:												
Income from individ. loans	2192.5	3506.2	4816.7	6123.7	16639.1	7427.1	8726.6	10022.1	11313.2	37489.0	58069.9	78316.3
Income from developer loans	1600.0	1800.0	1800.0	1800.0	7000.0	1600.0	1800.0	1800.0	1800.0	7000.0	7200.0	7000.0
Other income	220.0	170.0	170.0	120.0	680.0	220.0	170.0	170.0	170.0	730.0	680.0	680.0
Total Income	4012.5	5476.2	6786.7	8043.7	24319.1	9247.1	10696.6	11992.1	13283.2	45219.0	65949.9	85996.3
EXPENSES:												
Fin.charges on deposit	-60.0	-60.0	-60.0	-60.0	-240.0	-60.0	-60.0	-60.0	-60.0	-240.0	-240.0	-240.0
General & Admin.	-2057.6	-2057.6	-2057.6	-2057.6	-8230.2	-2263.3	-2263.3	-2263.3	-2263.3	-9053.2	-9958.5	-10954.4
Other expenses				-1250.0	-1250.0							
Depreciation	-91.3	-91.3	-91.3	-91.3	-365.0	-91.3	-91.3	-91.3	-91.3	-365.0	-365.0	-365.0
Total Expenses	-2208.8	-2208.8	-2208.8	-3458.8	-10085.2	-2414.6	-2414.6	-2414.6	-2414.6	-9658.2	-10563.5	-11559.4
Net Operating Income	1803.7	3267.4	4577.9	4584.9	14233.9	6832.5	8282.1	9577.5	10868.7	35560.8	55386.4	74436.9
Fin. charges on borrowings	-3719.6	-4455.0	-5128.6	-5128.6	-18431.8	-5128.6	-6123.8	-6995.6	-7506.0	-25754.0	-33199.1	-33199.1
Income from investments	28.8	50.4	72.0	93.6	244.8	794.0	582.5	396.8	236.8	2010.1	201.6	288.0
Provision for bad debt	-880.0	-680.0	-680.0	-480.0	-2720.0	-880.0	-680.0	-680.0	-480.0	-2720.0	-2720.0	-2720.0
Income before taxes	-2767.2	-1817.2	-1158.7	-930.1	-6673.1	1618.0	2060.8	2298.7	3119.5	9097.0	19668.9	38805.7
Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1247.8	1247.8	7867.5	15522.3
NET INCOME	-2767.2	-1817.2	-1158.7	-930.1	-6673.1	1618.0	2060.8	2298.7	1871.7	7849.2	11801.3	23283.4
Bonuses												
Reserve fund	0.0	0.0	0.0	0.0	0.0	323.6	412.2	459.7	374.3	1569.8	2360.3	4656.7
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Retained earnings	-2767.2	-1817.2	-1158.7	-930.1	-6673.1	1294.4	1648.6	1839.0	1497.3	6279.3	9441.1	18626.8

PROFORMA BALANCE SHEET

(Rs. '000)

	Month													Total
ASSETS	0	1	2	3	4	5	6	7	8	9	10	11	12	1st year
Cash	2249.8	3525.2	17430.6	8361.4	9397.9	20385.2	11177.4	12060.4	26194.6	16800.7	16347.8	6895.8	58348.1	58348.1
Government securities		0	0	96	192	288	384	480	576	672	768	864	960	960.0
Short term deposits	44054.4	42779.2	28866.1	25164.5	21496.6	7889.7	4504.8	1180.9	0.0	0.0	0.0	7120.0	0.0	0.0
Long term deposits														
Total cash & deposits	46304.2	46304.4	46296.6	33621.9	31086.5	28562.9	16066.2	13721.3	26770.6	17472.7	17115.8	14879.8	59308.1	59308.1
Loans to individuals				3200.0	6397.7	9593.0	12785.9	15976.4	19164.4	22349.8	25532.7	28712.9	31890.4	31890.4
Loans to developers				10000.0	10000.0	10000.0	20000.0	20000.0	20000.0	30000.0	30000.0	30000.0	20000.0	20000.0
Prepayments	600	550	500	450	400	350	300	250	200	150	100	50	0	0.0
Fixed assets	3650	3650	3650	3650	3650	3650	3650	3650	3650	3650	3650	3650	3650	3650.0
Less:Depreciation		30.4	60.8	91.3	121.7	152.1	182.5	212.9	243.3	273.8	304.2	334.6	365.0	365.0
Net fixed assets	3650	3619.6	3589.2	3558.8	3528.3	3497.9	3467.5	3437.1	3406.7	3376.3	3345.8	3315.4	3285.0	3285.0
Total Assets	50554.2	50474.0	50385.8	50830.6	51412.6	52003.9	52619.6	53384.8	69541.7	73348.8	76094.3	76958.2	114483.6	114483.6
LIABILITIES & SHAREHOLDERS EQUITY														
Saving deposits		0	0	640	1280	1920	2560	3200	3840	4480	5120	5760	6400	6400.0
Borrowings		0.0	0.0	0.0	0.0	0.0	0.0	0.0	15586.9	18769.7	20710.7	20710.7	57825.2	57825.2
Grants														
Provision for bad debts				264.0	328.0	392.0	656.0	720.0	784.0	1048.0	1112.0	1176.0	1240.0	1240.0
Total Liabilities	0	0	0	904.0	1608.0	2312.0	3216.0	3920.0	20210.9	24297.7	26942.7	27646.7	65465.2	65465.2
Equity	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0	50000.0
Retained earnings	443.4	363.1	274.9	-184.2	-306.3	-419.0	-707.2	-658.3	-792.3	-1072.0	-991.5	-863.7	-1156.8	-1156.8
Reserve fund	110.8	110.8	110.8	110.8	110.8	110.8	110.8	123.1	123.1	123.1	143.2	175.1	175.1	175.1
Total Liabilities & Shareholder's equity	50554.2	50474.0	50385.8	50830.6	51412.6	52003.9	52619.6	53384.8	69541.7	73348.8	76094.3	76958.2	114483.6	114483.6

PROFORMA BALANCE SHEET

ASSETS	1st Q	2nd Q	3rd Q	4th Q	Total 2nd yr	1st Q	2nd Q	3rd Q	4th Q	Total 3rd yr	4th yr	5th yr
Cash	51559.9	47087.9	41964.0	45761.6	45761.6	31209.7	47717.6	60423.7	67895.9	67895.9	23961.3	-26213.7
Government securities	1680	2400	3120	3840	3840.0	4560	5280	6000	6720	6720.0	9600	12480
Short term deposits	0.0	0.0	0.0	36203.2	36203.2	23772.7	12714.4	3028.3	0.0	0.0	0.0	1790.6
Long term deposits												
Total cash & deposits	53239.9	49487.9	45084.0	85804.8	85804.8	59542.4	65712.0	69452.0	74615.9	74615.9	33561.3	-11943.1
Loans to individuals	55796.0	79643.2	103428.7	127149.1	127149.1	150800.7	174379.7	197882.0	221303.3	221303.3	314084.1	405157.0
Loans to developers	30000.0	30000.0	30000.0	20000.0	20000.0	30000.0	30000.0	30000.0	20000.0	20000.0	20000.0	20000.0
Prepayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fixed assets	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0	3650.0
Less:Depreciation	456.3	547.5	638.8	730.0	730.0	821.3	912.5	1003.8	1095.0	1095.0	1460.0	1825.0
Net fixed assets	3193.8	3102.5	3011.3	2920.0	2920.0	2828.8	2737.5	2646.3	2555.0	2555.0	2190.0	1825.0
Total Assets	142229.7	162233.6	181523.9	235873.9	235873.9	243171.8	272829.2	299980.2	318474.2	318474.2	369835.4	415038.9
LIABILITIES & SHAREHOLDERS EQUITY												
Saving deposits	11200.0	16000.0	20800.0	25600.0	25600.0	30400.0	35200.0	40000.0	44800.0	44800.0	64000.0	83200.0
Borrowings	82658.4	98999.6	113968.5	113968.5	113968.5	113968.5	136085.1	155457.4	165799.7	166799.7	184439.5	184439.6
Grants												
Provision for bad debts	2120.0	2800.0	3480.0	3960.0	3960.0	4840.0	5520.0	6200.0	6680.0	6680.0	9400.0	12120.0
Total Liabilities	95978.4	117799.6	138248.5	143528.5	143528.5	149208.5	176805.1	201657.4	218279.7	218279.7	257839.6	279759.6
Equity	50000.0	50000.0	50000.0	100000.0	100000.0	100000.0	100000.0	100000.0	100000.0	100000.0	100000.0	100000.0
Retained earnings	-3923.9	-5741.1	-6899.8	-7829.8	-7829.8	-6535.4	-4886.8	-3047.8	-1550.5	-1550.5	7890.6	26517.3
Reserve fund	175.1	175.1	175.1	175.1	175.1	498.7	910.9	1370.6	1745.0	1745.0	4105.2	8761.9
Total Liabilities & Shareholder's equity	142229.7	162233.6	181523.9	235873.9	235873.9	243171.8	272829.2	299980.2	318474.2	318474.2	369835.4	415038.9

CASH FLOW PROJECTIONS

(Rs. '000)

	Month 0	1	2	3	4	5	6	7	8	9	10	11	12	Total 1st year
BEGINNING CASH	0.0	2249.8	3525.2	17430.6	8361.4	9397.9	20385.2	11177.4	12060.4	26194.6	16800.7	16347.8	6895.8	2249.8
CASH RECEIPTS:														
Equity	50000.0													
Borrowings		0.0	0.0	0.0	0.0	0.0	0.0	0.0	15586.9	3182.8	1941.0	0.0	37114.5	57825.2
Saving deposits				640.0	640.0	640.0	640.0	640.0	640.0	640.0	640.0	640.0	640.0	6400.0
Mortgage repayment					261.0	322.0	383.0	643.9	704.9	765.9	1026.9	1087.9	11148.9	16344.3
Income from investments	1652.0	275.3	267.4	180.4	158.2	136.3	52.2	32.0	12.2	5.8	6.7	7.7	53.1	1187.3
Other Income		0	0	66	16	16	66	16	16	66	16	16	16	310.0
Total Receipts	51652.0	275.3	267.4	886.4	1075.2	1114.2	1141.1	1331.9	16960.0	4660.5	3630.6	1751.6	48972.5	82066.8
CASH DISBURSEMENTS:														
Mortgages disbursed				13200.0	3200.0	3200.0	13200.0	3200.0	3200.0	13200.0	3200.0	3200.0	3200.0	62000.0
Borrowings repaid														
Financial charges paid				8.0	8.0	8.0	8.0	8.0	241.8	289.5	318.7	318.7	875.4	2084.0
Purchase of fixed assets	3650.0													
Prepayments	600.0													
Expenses	420.5	275.2	275.2	353.2	402.6	429.9	429.9	468.9	468.9	468.9	468.9	468.9	468.9	4978.8
Short term investments	44054.4	-1275.1	-13913.2	-3701.6	-3667.9	-13606.9	-3384.9	-3323.9	-1180.9	0.0	0.0	7120.0	-7120.0	-44054.4
Treasury bills	0	0	0	96	96	96	96	96	96	96	96	96	96	960.0
Bonuses		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes	677.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total disbursements	49402.2	-1000.0	-13638.0	9955.6	38.7	-9873.0	10348.9	448.9	2825.8	14054.4	4083.5	11203.5	-2479.8	25968.5
ENDING CASH	2249.8	3525.2	17430.6	8361.4	9397.9	20385.2	11177.4	12060.4	26194.6	16800.7	16347.8	6895.8	58348.1	58348.1

CASH FLOW PROJECTIONS

	1st Q	2nd Q	3rd Q	4th Q	Total 2nd yr	1st Q	2nd Q	3rd Q	4th Q	Total 3rd yr	4th yr	5th yr
BEGINNING CASH	58348.1	51559.9	47087.9	41964.0	58348.1	45761.6	31209.7	47717.6	60423.7	45761.6	67895.9	23961.3
CASH RECEIPTS:												
Equity				50000.0	50000.0							
Borrowings	24833.3	16341.1	14969.0	0.0	56143.4	0.0	22116.6	19372.3	11342.3	52831.2	17639.9	0.0
Saving deposits	4800.0	4800.0	4800.0	4800.0	19200.0	4800.0	4800.0	4800.0	4800.0	19200.0	19200	19200.0
Mortgage repayment	13886.9	15459.1	16831.2	18203.3	64380.5	19375.5	20947.6	22319.8	23691.9	86334.8	108489.1	130243.4
Income from investments	28.8	50.4	72.0	93.6	244.8	794.0	582.5	396.8	236.8	2010.1	201.6	288.0
Other Income	220	170	170	120	680.0	220	170	170	170	730.0	680	680
Total Receipts	43769.0	36820.6	36842.2	73216.9	190648.7	25189.5	48616.8	47058.9	40241.0	161106.1	146210.6	150411.4
CASH DISBURSEMENTS:												
Mortgages disbursed	44000.0	34000.0	34000.0	24000.0	136000.0	44000.0	34000.0	34000.0	24000.0	136000.0	136000	136000.0
Borrowings repaid												
Financial charges paid	3779.6	4515.0	5188.6	5188.6	18671.8	5188.6	6183.8	7055.6	7566.0	25994.0	33439.1	33439.1
Purchase of fixed assets												
Prepayments												
Expenses	2057.6	2057.6	2057.6	3307.6	9480.2	2263.3	2263.3	2263.3	2263.3	9053.2	9958.5	10954.4
Short term investments	0.0	0.0	0.0	36203.2	36203.2	-12430.4	-11058.3	-9686.2	-3028.3	-36203.2	0.0	1790.6
Treasury bills	720	720	720	720	2880.0	720	720	720	720	2880.0	2880	2880
Bonuses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1247.8	1247.8	7867.5	15522.3
Total disbursements	50557.2	41292.5	41966.1	69419.3	203235.2	39741.5	32108.8	34352.7	32768.8	138971.8	190145.2	200586.4
ENDING CASH	51559.9	47087.9	41964.0	45761.6	45761.6	31209.7	47717.6	60423.7	67895.9	67895.9	23961.3	-26213.7

SALARIES EXPENSE

(Rs. '000)

Description	No.	Salary/month/ person	Total salary/ month	Total salary/ in 1st year	Total salary/ in 2nd year	Total salary/ in 3rd year	Total salary/ in 4th year	Total salary/ in 5th year
Chief Executive	1	40	40	480	480	480	480	480
G.M. Operations	1	25	25	300	300	300	300	300
G.M. Finance	1	25	25	300	300	300	300	300
G.M. H. Resources	1	25	25	0	300	300	300	300
Marketing Manager	1	18	18	0	216	216	216	216
Loan Processor	1	18	18	162	216	216	216	216
Technical Manager	1	18	18	0	216	216	216	216
Recoveries Manager	1	18	18	0	216	216	216	216
Manager Accts./MIS	1	18	18	216	216	216	216	216
Manager Deposits	1	18	18	0	216	216	216	216
Manager Treasury	1	18	18	0	216	216	216	216
Internal Auditor	1	18	18	162	216	216	216	216
Legal Advisor	1	20	20	180	240	240	240	240
Executive Secy.	3	10	30	300	360	360	360	360
Computer staff	3	7	21	168	252	252	252	252
Other support staff	6	5	30	180	360	360	360	360
Drivers	4	3	12	120	144	144	144	144
Guards	3	2.5	7.5	90	90	90,	90	90
				2658	4554	4554	4554	4554
Benefits @ 30%				797	1366	1366	1366	1366
Total				3455	5920	5920	5920	5920
Annual increase @ 10% starting third year				3455	5920	6512	7163	7880

GENERAL & ADMINISTRATIVE EXPENSES

(Rs. '000)

	Monthly	Year 1	2	3	4	5
Office rent	40	480	480	480	480	480
Telephone/fax	50	600	600	600	600	600
Repair & Maintenance	20	240	240	240	240	240
Utilities	15	180	180	180	180	180
Travel/conveyance	25	300	300	300	300	300
Promotion	20	240	240	240	240	240
Stationery	5	60	60	60	60	60
		2100	2100	2100	2100	2100
Annual increase @ 10%		2100	2310	2541	2795	3075

FIXED ASSET PURCHASED (PRIOR TO START-UP)

			(Rs. '000)
Office vehicles	4	600	2400
Office equipment/Computers			500
Furniture & fixture			750
			3650

PREPAYMENTS
(Rs. '000)

Advance Rent (1.25 years)	600

PRELIMINARY EXPENSES

		(Rs. '000)
Incorporation expenses		50
Feasibility study		75
Miscellaneous (travel, phone,fax, etc.)		100
Salary of Chief Executive	3 months	120
Salary of G.M. Finance	1 months	25
Salary of G.M. Operations	1 months	25
Salary of Manager Accounts	1 month	18
Salary of guards	1 month	7.5
		420.5

ASSUMPTIONS UNDERLYING BASE CASE FINANCIAL PROJECTION

ASSUMPTIONS UNDERLYING FINANCIAL ANALYSIS

1. Average loan for individuals for 15 years at 22% mark up.
2. Average mortgage loan to developer is for 9 months at 24% mark-up (excludes excise duty).
3. Loans to individuals will be repaid monthly in equal installments over 15 years.
4. Mark-up on loans to developers will be repaid monthly but principal will be repaid as a balloon at end of term.
5. Average size of loan to individual is RS. 400,000/-.
6. Average size of loan to developer is Rs. 10,000,000/-.
7. In the first year there will be an average 8 loans to individuals booked in each month starting the third month.
8. In the second and subsequent years there will be an average 20 loans to individuals each month.
9. In the first year there will be an average 3 loans to developers; in subsequent years there will be 4 loans/year to developers.
10. Average 15% will be paid on passbook savings and term deposits.
11. General & Administrative are projected based on itemization of expenses.
12. Interest on borrowings is calculated at 18% mark-up.
13. Short term investments earn 7.50% on an annualized basis (this does not include T.Bills).
14. Reserve for bad debts is set at 2% of all mortgage loans.
15. Taxes are calculated at 55% of net income in the first year and at 40% thereafter.
16. According to statutory regulation 20% of net income after taxes must be placed in reserves till such time as reserves equal paid-up capital.
17. Public flotation of Rs. 50 million will take place near the end of the second year of operations.
18. Level of savings deposit is calculated at 20% of the level of mortgage loans in the same period.

19. Pre-start up period will last for 6 months.

20. Sponsor's equity of Rs. 50 million paid in at beginning of 6 month period.

21. Flotation expenses of 2.5% incurred in second year.

22. Company to keep minimum cash balance of Rs. 1 million (equal to about 1 month's expenses)

23. An application/processing fee of 0.50% of the amount of mortgage loan will be charged borrower at time of closing.

24. Depreciation is taken at 10% of fixed assets.

25. Treasury securities at 15% of deposits kept as per statutory regulation.

26. Return on treasury bills is 12% per annum.

SENSITIVITY TESTS ON FINANCIAL PROJECTION

Variation of net income in 1st year with mark-up rate on individual loans

Mark-up Rate	Net income (Rs. '000)
19%	-1910
20%	-1785
21%	-1660
22%	-1536
23%	-1411
24%	-1286

Table 2: Variation of net income in 1st year with cost of borrowed funds

Mark-up on borrowings	Net income (Rs. '000)
14%	-1090
15%	-1202
16%	-1313
17%	-1424
18%	-1536
19%	-1647
20%	-1758

Table 3: Variation of net income in 1st year with quantum of deposits

Deposits as % of mortgages to individuals	Net income (Rs. '000)
10%	-1565
15%	-1558
20%	-1536
25%	-1513
30%	-1491
35%	-1469
40%	-1446
50%	-1401

Table 4: Variation of net income in 1st year with average loan size

Average size of individual loan (Rs.)	Average size of developer loan (Rs.)				
	5000000	7500000	10000000	12500000	15000000
200000	-1899	-1413	-2397	-1627	-838
250000	-1783	-2054	-2181	-1412	-899
300000	-1667	-1823	-1966	-1197	-2714
350000	-1753	-2521	-1751	-1390	-2529
400000	-2208	-2305	-1536	-1183	-4859
450000	-1994	-2090	-1307	-2936	-4732
500000	-2645	-1875	-1670	-2763	-4605

Table 9: Variation of net income in 5th year with average loan size

Average size of individual loan (Rs.)	Average size of developer loan (Rs.) 5000000	7500000	10000000	12500000	15000000
200000	6559	5779	8307	6989	8652
250000	8955	8902	9031	10795	12070
300000	13974	13778	13833	15026	13706
350000	18244	17280	18558	19217	18260
400000	21901	22091	23283	23881	20584
450000	26777	26816	28008	26500	25119
500000	30346	31541	31993	31100	29654

Table 10: Variation of net income in 5th year with level of provisions

Level of provisions (%)	Net income (Rs. '000)
1%	24099
2%	23283
3%	22467
4%	21651
5%	20835
6%	20019
7%	19203
8%	18387

PERSONS MET

PERSONS MET

1. Mr. Aneeq Khawar, Managing Director, Citibank Housing Finance.

2. Mr. Shahzad Kazi, Resident Vice President, Citibank.

3. Mr. Irfan Aziz, Director, National Housing Finance Company Limited.

4. Mr. Saeed-ul-Hassan, Chairman, Olympic Estate Finance Company (Pvt) Limited.

5. Mr. Muhammad Asif, Vice President, Olympic Estate Finance Company (Pvt) Limited.

6. Mr. Khalil A. Zobairi, Chief Executive, Empire Housing Finance Company Limited.

7. Mr. S. Masud A. Naqvi, Director, Empire Housing Finance Company Limited.

8. Mr. Saeed-ur-Rahman, Director, Empire Housing Finance Company Limited.

9. Mr. Syed Mohammad Husain, Partner, Khalid Majid Husain Shah Rahman, (Consultants to Jaffer Brothers Housing Finance Company).

10. Mr. Syed Shamshad Husain, Senior Manager, Khalid Majid Husain Shah Rahman.

11. Mr. Athar Naseem Shaikh, Director, Interfund Housing Finance Company Limited.

12. Mr. Hameed Khan, Managing Director, International Housing Finance Limited.

13. Dr. F.A. Rabbani, Chief Executive, 21st Century Management Consultancy (Pvt) Limited.

14. Mrs. Shahnaz S. Hamid, General Manager (Research & Planning), House Building Finance Corporation.

15. Mr. Majid Zaidi, Assistant Manager (Training), House Building Finance Corporation.

16. Mr. Akhtar Ahsan, Director, Office of the Executive Committee, National Housing Authority.

17. Mr. Ahmed Awais Pirzada, Deputy Secretary, Internal Finance, Ministry of Finance.