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## **Problems Faced by Financial Institutions and Borrowers in House Financing**

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# Chapter # 1

## Background of the Topic and Statement of problem:

- a) Introduction
- b) Demand and supply of House Finance in Pakistan
- c) Mortgage market in Pakistan-strong commitment to reform
- d) Banks House Finance
- e) HBFC House Financing
- f) Housing Policy-2001
- g) Problem Statement
- h) Significance of Study
- i) Scope
- j) Delineation
- k) Definition of term

## **Background Of The Topic And Statement of problem:-**

### **a) Introduction:-**

“Food, Cloth and Shelter” – The slogan mostly underline the fact that the housing is one of the most fundamental needs - as every family requires roof of his own. It is of course but as natural as food and clothing, yet many are caught in the struggle of having a house. According to the Population and Housing Census of Pakistan, in the year 1998 there were over 19.3 million Housing Units in the country. With the population at 149 million by the end of June, 2003, the housing unit requirement on the basis of the World Bank’s recommendation at the occupancy rate of 6 persons per house and the total number of Housing Units required in the country should be around 24.8 million. The above formula shows that there is shortfall of over 5.0 million Housing Units.

There are a number of people in the country who have expressed doubts about the emphasis being given to consumer financing in the country. Their mindsets are still frozen in the traditional way of public sector and government led growth model supplemented by a corporate and industrial sector. I would like to draw their kind attention to the basic economic law (identity) for generating national income in any economy-developing or developed- which stipulates that:

$$\text{GDP} = \text{Private Consumption} + \text{Private Investment} + \text{Public Consumption} + \text{Public Investment} + \text{Exports} - \text{Imports}$$

In Pakistan private consumption is the largest single component of GDP, accounting for 80 percent of the total GDP. Thus it is obvious that any move to boost private consumption will have a much larger impact on the GDP growth than any other measure.

Mortgage financing and auto financing as key elements of private consumption not only provide strong forward and backward linkages to industrial and services sectors with a multiplier effect of 3 to 4, but also enhances the overall level of private savings. How

does this happen? In absence of owner-occupied housing the owner does not have any pressure or incentive to make any forced saving out of the current disposable income. But in his quest to obtain mortgage financing he has to save at least 20 percent of the total cost upfront as down payment in form of equity. In addition, every month he has to allocate some extra income over and above monthly rental income to meet the mortgage installment. Thus, this action results in forced or compulsory saving and if aggregated across households with identical behavior leads to an increase in level of domestic savings in the country. It is an empirically known fact that countries with well established vehicles such as Mortgage Financing, Pension Funds, Benevolent and Provident Funds, Mutual Funds have higher domestic savings rate compared to those where such opportunities do not exist.

### **b) Demand and supply of House Finance in Pakistan**

According to the convener of the housing advisory group the country needs an additional supply of 570,000 Housing Units per annum. While the actual annual supply does not exceed 300,000, thus there is net shortfall of 270,000 Housing Units per annum and the backlog is increasing every year. To meet this shortfall Housing Finance to the extent of Rs.68 billion is required as against Rs.4/5 billion being outlaid at present.

These alarming statistics have created a red-light situation where million of peoples are homeless. In addition to population growth of 3.2% during the last decade the country was burdened with sheltering hundreds of thousands of refugees of the effected neighboring country further encountered by the climatic extremes. Hence, it is a matter of great concern and demands very serious attention to be paid on a national level. Governments normally do not have enough funds resources to provide readymade Houses to their badly needed citizens. But it is the endeavor of every welfare State to create an environment, where construction and ownership of home is facilitated.

### **C) Mortgage Market in Pakistan – Strong Commitment to Reforms**

Currently, the total formal mortgage lending is estimated at PKR 22 billion (USD 380 Million). The market is dominated by House Building Finance Corporation (HBFC), a public sector housing Finance Corporation with a market share of 82% and is funded directly by State Bank of Pakistan, the central bank.

Three private sector housing finance companies were set up in the 1990s, of which International Housing Finance Corporation remains the sole survivor. Current macroeconomic conditions such as reduced government borrowings, ample liquidity, de-dollarization of the economy and rising inflows from remittances have resulted in a low Interest rate regime. With easy availability of credit, the margins of banks have reduced and hence banks have had to look at alternative lending opportunities. Housing finance provides an attractive opportunity as both, profit margins and recovery rates are higher for mortgage finance than corporate/project lending and hence banks have become active in this area.

The international community has shown considerable interest in the Pakistan mortgage market following the rapid policy initiatives on housing finance taken by the government and the State Bank of Pakistan. For instance a standing Advisory Group has been constituted to advice on the sequence of reforms in housing finance. Sweeping fiscal incentives have been introduced in the Federal Budget 2003-04 to encourage mortgage finance. Banks' exposure to housing finance has been enhanced to 10% of their net advances; the maximum per party limit has been increased to PKR 7.5 million with a debt equity ratio of 80:20 for a period of up to 20 years.

With strong commitments from the authorities, the mortgage market in Pakistan has tremendous potential. However, a strong vigil will be required to ensure that lenders maintain credit quality.

## **D) BANK-HOUSING FINANCE**

In order to meet the backlog and shortfall of the housing units in the country in the next 20 years, the overall housing production has to be more than 570,000 housing units annually.

It is refreshing to note that favorable developments at the market place are facilitating origination of housing loans in the primary mortgage market. On the supply side bank are flushed with liquidity due to *reduced borrowing from government, de-dollarization of the economy and rising inflows of remittances.*

Consequently interest rates have reached their lowest ebb. In this scenario banks are looking for alternate lending opportunities and develop asset based consumer products. Housing finance provides an attractive opportunity as both profit margins and recovery rates on average are higher for mortgage finance than project and corporate lending. On the demand side marketing efforts by banks are creating awareness amongst general public for early home ownership through housing finance. The increasing scope of House Financing in Pakistan has made many local and foreign banks engaged in House Financing activities. The potential of the industry promises sound future of the capital resource.

### **e) HBFC House Financing:**

The House Building Corporation (HBFC) was established in the year 1952 under an Act of the Parliament. The purpose was to provide financial assistance to the citizen of Pakistan to cater to their housing needs. With its establishment, the concept of institutionalized housing finance was introduced.

At present HBFC has a large network of 58 District offices, spanning across the country including Azad Kashmir & Northern Areas, managed through 12 zones with its headquarters at Karachi.

HBFC has financed around 430,000 housing units to the tune of Rs.36.300 billion. At present it is handling over 132,000 operative accounts with the total investment portfolio of around Rs.20.000 billion. The annual disbursement is around Rs.1.500 billion and recoveries are over Rs.2.500 billion.

During next 50 years, the Corporation gradually and steadily developed to maintain its role of leading institution in providing financing facilities for the construction, reconstruction, repairs and purchase of houses/flats in Pakistan. Despite of the fact that its monopolistic position in housing finance was abolished since late 1990s and with a large competitors to cater to the financing needs of this sector including large commercial banks & leasing companies with large base and cheap cost of funds.

The latest introduction of the non interest bearing new schemes of *Shandaar Ghar Scheme (Murabaha)-2001* & *Ghar Aasaan Scheme (Musharakah)-2002* which are shariah compliant have attracted attention

It provides financial assistance for the construction and purchase of house, development of land, also for repair and re-construction. Development of land and also for undertaking construction of housing projects for sale to public. On the directions of the Government HBFC has also disbursed amounts as relief and rehabilitation to the extent of Rs. 714 million. In addition an amount of Rs.1229 million also sanctioned as remission to widows, orphans and retired government employees.

#### **f) NATIONAL HOUSING POLICY – 2001**

The present government appreciating the gravity of situation and realizing the importance of this sector for its potential to generate employment, decided to revitalize it as a *vehicle for economic revival*. Accordingly, Ministry of Housing and Works formulated a new National Housing Policy – 2001 approved by cabinet on 5-12-2001. The policy addresses all the issues relating to land matters, house finance, construction, services sector, low cost and rural housing, building material and infrastructure development, building and

zoning regulation, and institutional framework. It clearly sketches out the role of Federal government upto the local government defining the desired roles to be played by governing bodies on each level. The policy also seriously considers the multifarious problems including housing shortage, lack of housing finance, non-existence of foreclosure laws, lack of planning, outdated building and zoning regulations, etc. The major emphasis of the policy is on resource mobilization, land availability, incentives for home ownership, incentives to developers and constructors and promotion of research and development activities to make construction cost effective. The main objective of the policy is to *create affordability to owning a housing unit*, especially for the middle and low income groups.

For the monitoring and implementation of the policy a number of committees have been constituted and are being regularly convened to ensure implementation and monitoring.

### Key Features:

- The overall housing stock comprise of 39% kuchha houses, 40% semi-pukka houses and 21% pukka houses.
- The housing backlog, as estimated according to the 1998 census, was 4.30 million units.
- The annual additional requirement is estimated around 570,000 housing units whereas the annual production is estimated around 300,000 housing units resulting in a recurring shortfall of 270,000 housing units annually, taking the household size as 6.6 persons and the occupancy per room as 3.3 persons.
- To make up the backlog and to meet the shortfall in the next 20 years the overall housing production has to be raised to 500,000 housing units annually.

- A Housing Advisory Board of nearly 40 members, half of them from private sector was constituted in the Ministry of Housing and Works to formulate a workable National Housing Policy.
- The objective is to create affordability, specially, for the middle and low-income groups. One of the corner stones of the Policy is to ensure development of housing for the poor and needy and housing for the majority rural population through the use of different instructs like free land, cross-subsidy and concessionary finance, etc.

### Policy Measures:

The Policy Measure were approved in principle by the President and Chief Executive during presentation of National Housing Policy formulated by the Board on the 22nd June, 2001 which are as follows:-

- Financial Institutions shall be encouraged to give mortgage loans for housing purposes at market rates
- All commercial banks shall be motivated to advance loans for housing and housing projects by earmarking a substantial percentage of their loan portfolio
- Financial Institutions and Housing Financial Institutions (HFIs) shall be encouraged to float long term bonds at market rates
- Housing refinance window shall be set up at State Bank of Pakistan for long term funds from multilateral agencies
- Housing finance institutions shall be encouraged to promote savings and provide micro loans for low income group through community organization, NGOs and CBOs

- Restructure HBFC and enhance annual disbursement of HBFC from the present Rs.1.2 billion to Rs. 7.00 billion over the next five (5) years.
- HBFC shall reintroduce bridge financing and bulk financing of housing projects through escrow accounting with appropriate safeguard
- HBFC and other financial institutions shall formulate packages of preferential/ concessional rates with affordable system of installments for repayment to provide affordable credit to low income groups
- Foreclosure laws shall be introduced to ensure effective recovery of loans and advances from the defaulters
- Property tax on rented property shall be reduced from the current high rate of 25% to 5%
- Mark-up on Housing loan installment for individuals shall be treated as expense in tax return
- Banks and DFIs shall extend credit facilities for Balancing, Modernisation and Replacement (BMR) of machinery used for Housing and Construction Industry
- Import of plant and machinery and spares by the housing and construction companies, not manufactured locally, shall be exempt from custom and import duties in excess of 10%
- Stamp duties and registration fees shall be adequately reduced to an aggregate total value of 1%
- Initiation of low cost housing scheme and provision of cross subsidy to the poor through auction of commercial plots

- Subsidized micro loaning facilities shall be extended for rural housing construction and improvements through micro financing systems and institutions like Khushhali Bank, Zakat funds, etc.
- Provision of trunk infrastructure shall be the responsibility of utility agencies like WAPDA, PTCL, SNGPL, SSGCL, KESC, etc. The cost of trunk infrastructure shall not be an additional charge to the public or private housing development scheme within the planned area

### **g) Problem Statement**

- What problems are being faced by different financial institution for recovering house loan repayments
- What problems are being face by the borrowers in getting house loan approved
- What product characteristics of loan are required by the consumer in house finance loan?

### **h) Significance of Study:**

The basic significance of study is to explore the problems faced by different financial instituion in terms of recovery of house loan and borrowers in house finance in terms of insufficient product characteristics of house loan and house loan approval problems.

### **i) Scope**

- The time period for this study will start from fall 2005 and continues until Feb 2006.

## **J) Delineations**

The research is limited to local banks (United Bank Limited and National Bank of Pakistan) and house building Finance Corporation of Pakistan taken as sample representing all the house finance institutions in Pakistan.

## **k) Definition of Terms**

- HBFC: House Building Finance of Corporation
- SBP: State Bank of Pakistan
- GDP: Gross Domestic Product
- GOP: Government of Pakistan

# Chapter # 2

## Research Methodology & Procedures:-

- a) Research Design
- b) Respondent Of The Study
- c) Instruments
- d) Treatment Of Data/Information/Analysis
- e) Presentation Analysis

## CHAPTER # 2

### Research Methodology & Procedures:

#### a) Research Design:

The data for this project had been collected through interpersonal approach so that the project should contain the most recent information related to the topic along with interpersonal approach. I had also take into account the theoretical knowledge which has been written by the authors as well as articles from the newspapers.

#### b) Respondent Of The Study:

respndent name	ORGANIZATION NAME	DESIGNATION
MUJAHID ZAMEER	HBFC	EXECUTIVE RECOVERY
JALEES-UR-REHMAN	HBFC	MANAGER RECOVERY
ASAD JAFRI	HBFC	MANAGERS OPERATION
AMEER SIDIQI	NBP	EXECUTIVE SAIBAN
FARHAD ZULFIQAR ALI	NBP	ASST:VICE PRESIDENT NATIONALSALES MANGER
NAEEM RASHID	UBL	VICE PRESIDENT CONSUMER FINANCE.
ASAD FAROOQ	UBL	BUSINESS ANALYST PRODUCT MANAGMENT

SALMAN MAGHA	UBL	ASST: PRDOCUT MANGER
AMEER ANWAR	NBP	MANAGER SAIBAN PROCESSIN ZONE

**c) Instruments:**

The data for research is conducted through primary and secondary Sources.

For primary Data Collection;

- a) Questionnaires (structured and open-end).
- b) Interviews (structured).

For secondary Data Collection;

- a) Magazines.
- b) Periodicals.
- c) Newspapers.
- d) Books.
- e) Internet.

**d) Treatment Of Data/Information/Analysis:**

The data gathered through the sources are analyzed by quantitative and qualitative methods and verbal analyses also done.

e) **Presentation Analysis:**

The final presentation of the data is in the form of tables, graph and charts and in qualitative frame work to present the clear picture of the problems of House Finance in Pakistan.

# Chapter # 3

## Review Of Literature And Studies.

- a) Banks put restriction on housing finance
- b) Home mortgage finance
- c) Financing Housing construction

### **a) Banks put restrictions on house financing**

This article has been taken from the Dawn dated 12-nov-2003 written by Sabihuddin Ghausi.

The article is about the private commercial banks that placed journalist police man and lawyers on the negative list of their housing loan operations and many banks refuse to approve the housing loan to certain areas of Karachi like Nazimabad, Malir, Liaqatabad, Orangi, and few other parts. SBP also give instruction to banks to provide financing for construction of houses to the extent of Rs.5 millions now increased to Rs.7.5 millions up to 20 years.

But Private Banks are not working according to the National Housing Policy 2001 because of the recovery problems. As far back as on August 30, 2001 the banks and financial institutions were give the authority to acquire and sell the mortgage property on the expiry of final notice for recovery of loan. "Framing law is one thing and implementing it is something entirely different" remarked a banker, saying it is impossible to acquire any property where tribalism and biradaris are still very powerful and state organs are weak.

## **b) House mortgage financing**

The article has been taken from Dawn Magazine written by SAALIM SALAM ANSARI.

The article is about suggestions for house financing institutions to improve their and service and reduce backlog of 270000 houses.

House financing requires improvement in Pakistan as for as the rate of mark up based on rental sharing and quantum of monthly installments, length of payment of monthly installments as well as waiver of government duties/stamp and relaxation in documentation are concerned.

### **c) Financing housing construction**

THE GOVERNMENT is keen to provide housing, a basic need to its people, with its National Housing Policy 2001, carrying the objectives:

- (1) To accelerate housing activity and contribute towards employment generation and economic development;
- (2) To facilitate provision of housing inputs including land, finance, building materials, institutional and legal framework;
- (3) To analyze poverty and the forces generating ever-increasing slums and Katchi Abadis, including the political, the socio-economic, the bureaucratic and the environmental forces;
- (4) To promote ways and means for housing development by enhancing the affordability, the saving capacity, the human tendencies and the potentials;
- (5) To provide safeguards against the malpractice, the bureaucratic inefficiencies, the institutional weaknesses and the mafia assaults and;
- (6) To develop the indigenous and cost-effective approaches, particularly for the low-income groups. To realize these objections, implementation of certain measures is important.

**Housing situation, backlog and future targets:** According to the 1998 Population and Housing Census in Pakistan, there were over 19.3 million housing units, of which 67.7 per cent were in rural and 32.3 per cent in urban areas, accommodating a total population of 131.5 million. Of the total houses, nearly 15.6 million (80.8 per cent) were owned, 1.7 million (9.0 per cent) rented, and 2.0 million (10.2 per cent) rent-free. The percentage of the owned housing units was higher in the rural areas as compared to the urban areas. However, the percentage of rented houses was significantly higher at 23.2 per cent in the urban as compared to only 2.3 per cent in the rural areas.

On the basis of the World Bank's recommended occupancy rates of 6 persons per house, the total number of required housing units in the country would be roughly 24.3 million by the end of June, 2002, based on the population of 146 million at present. Every year, 0.3 million new houses are added to the existing stock by the public and the private sectors. On the other hand, 10 per cent houses of the total supply are depleted/destroyed/demolished every year, decreasing the available units to 20 million, leaving a backlog of 4.3 million units. In order to make up for the backlog and meet the shortfall in next 20 years, the government estimates that the overall housing production has to be raised to 500,000 units per annum from the present 300,000.

An increase to 500,000 units annually, offers big opportunities to the HBFC, the commercial banks and other financiers. Assuming the self-finance to cover around 50 per cent housing units each year, around 250,000 would require loan assistance from the HBFC and other institutions. The total annual cost will be around Rs50 billion, on the basis of Rs0.2 million average loan per housing unit, of which Rs20 billion (40 per cent) shall be met through loans, and the rest by the owners, themselves. Some construction industry experts value the annual housing market at Rs15 million. Moreover, major repairs or replacement of mud houses with concrete construction, loan needs may further increase. Different assumptions will give lower or higher funding estimate, but it is certain that as the funding needs for new houses are pretty high, there exist opportunities for financiers. This paper attempts to review difficulties in the way of smooth construction of houses, and offers suggestions to accelerate the financing of construction activities.

**Government action for creating conducive environment:** The federal government has already referred the policy to the concerned organizations and the provincial governments for implementation. The provincial governments have set up committees under their respective Chief Secretaries to monitor progress on the implementation process. Initially, it was slow due to the devolution of power, but now it has geared up. To meet the annual target of 500,000 new houses, action on priority basis is required in the following areas:

- a). Local governments should identify state and other lands in, and around urban and rural settlements at reasonable rates.
- b). The government should allocate funding for infrastructure, amenities and other developments and to direct, for the provision of trunk infrastructure, utilities like Wapda, the PTCL, the SNGPL, the SSGCL, the KESC, etc.
- c). The government needs to reduce stamp duties and registration fees.
- d). The foreclosure laws may be reviewed and improved for earlier relief to the creditors. At present it is cumbersome and lengthy.
- e). Rationalization and reduction of duties and taxes on major materials should be reduced for making the construction more affordable.
- f). The government should standardize and approve, for each category of plot and location, up to five designs. At present it is a big irritant and causes delays. It should be decided that in case the standardized designs were used, there should no need for formal approval of the construction plan/designs. The house builder should simply inform the civic authorities of the design thus selected.
- g). The provincial governments should consider granting proprietary rights to individuals and families residing in houses constructed on Shamlat and state land.
- h). The dwellers of Katchi Abadis should be given ownership rights and must be required to construct houses as per approved plans after the payment of cost of land and other related charges.
- i). The government should review rent laws. Non-payment of rent by the tenant should result into his ejection from the rented houses. At present the process is cumbersome and the landlords may have to fight the legal battle for years.

**Financing for construction:** The government and the State Bank of Pakistan have a big role to play. The following measures may be considered in this regard:

**a).** The HBFC, with a view to become customer-friendly, should revise its loaning procedures, guidelines and formats of different documents. It should also train and motivate its personnel for customer service.

**b).** The HBFC determines the construction cost of a house and the monthly rental value. There are chances the investment could be shown low and the monthly rent at higher level. Both these measures are liable to put the owner at disadvantage vis-a-vis the HBFC when it comes to determining the investment of each party and the share in the monthly rent. There is a cause of concern over fixing customer's upper age limit for funding at 55 years, and the collection of future installment cheques by the HBFC. These and similar other practices may be changed for transparency and fairness.

**c).** The existing level of loan by the HBFC is stated to be around Rs1.2 billion, which will increase to Rs7 billion in five years. With an average of Rs200,000 loan per housing unit, it is estimated 6,000 new applicants are being handled each year. In five years' time, this would grow to 35,000 applicants, annually. The corporation will have to undergo major restructuring to be able to handle this workload.

**d).** The HBFC could be on the privatization list like the other DFIs. In view of the type of financing, it would be better if its operations are unbundled on provincial basis, by incorporating four successor companies. The provincial government might retain the majority ownership, but the management control may be given to private sector. This may bring a sea of change in the efficiency and the financing of the housing construction.

**e).** In view of the high target for next 20 years, the government should consider measures to enhance the availability of finance on easier terms to larger number of customers. The SBP should instruct the banks and the DFIs to make minimum 5 per cent of total annual loans to the housing sector. This will open new opportunities.

**f).** The SBP should allocate separate credit lines to the HBFC for the bulk financing and for individual house owners. It may also consider such credit lines to commercial banks, from its own resources, or credit lines obtained for the purpose for multilateral agencies.

In each case, the margin allowed to the HBFC or the commercial banks and the DFIs should be commensurate with the credit risk profile of the Pakistani customers. The existing SBP practice of 1.5 to 2 per cent margin is not adequate and may not promote housing construction.

**g).** Lending on merit. The borrowers have to be credit worthy with the capacity to repay on time. The government and the SBP may emphasize compliance with the prescribed lending guidelines. Foreclosure is good as a threat to defaulters but is not an effective tool for effecting full recovery. Capacity for good loaning has to be developed in lending institutions.

**Need to encourage new financiers:** The backlog and the new needs may not be adequately tackled through traditional methods. Other appropriate methods need to be explored. The following are few options:

**a).** Private individuals as investors (not the usual builders) should be encouraged to build small houses and rent out the same for regular income. This can be a big source for housing finance throughout Pakistan, provided these individuals are assured that the Rent Laws will be changed so that the tenants in rent-default are thrown out if they miss maximum three months' rent. Tax concessions may also be allowed to these small financiers. Mark-up rate on such loans may be brought in line with the net return to investors received from the National Saving Schemes. These measures are expected to give a boost to the construction business.

**b).** The government and the SBP should consider subsidized micro loaning facilities for rural areas through institutions like the micro-finance banks, the Khushhali Bank, Zakat funds, etc. These steps may bring more benefit to Sindh and Balochistan, where the situation is quite alarming.

**c).** Employees of the Old-Age Benefits Institution, the Workers Welfare Fund and other similar funds should consider making investment in housing schemes, as per prescribed procedures. The houses so constructed could be given in a transparent and fair manner.

d). The industries producing construction materials should diversify to housing construction, initially for their workers and later for the public. They should go for deferred payment, say for 5-10 years. This will increase the industrial activity.

**Other issues:**

a). Normally, defaulters deserve no sympathy. However, when it comes to house loan defaulters, one has to be more considerate. The government and the SBP should explore certain insurance or guarantee programs to save the defaulter from being thrown out on streets.

b). The HBFC housing finance is said to be on the partnership basis with private investors as joint owners. As time passes, the loan gets reduced and so does the monthly rent that is collected in lieu of the interest by the bank. In case of default for say about one year, the bank may allow the defaulter enough time to improve his/her finances to start repayment. To the extent the bank has not been paid, it may increase its share in total investment. In foreclosure, the banks may consider some relief to the families, which do not have any other shelter.

c). The builders and small investors: The builders play an important role in housing construction. They need to be encouraged and allowed to make fair return on their investment. However, it is said that some of them do not stick to the delivery schedule or the agreed cost. The construction quality is poor as compared to the one shown in the brochures, at the time of bookings. The house owners are obliged to incur substantial extra cost for final finishing or electricity wirings, pipe fittings, etc.,. The government, the SECP and the SBP should consider steps to end such exploitations. Independent agencies may be appointed to monitor the contract compliance by the builders.

**By Muhammad Bashir Chaudhry**

# Chapter # 4

## **PRESENTATION ANALYSIS**

- a) Questionnaires from financial institutions
  
- b) Questionnaires from consumers

# **QUESTIONNAIRES FROM FINANCIAL INSTITUTIONS**

## **Question no:1**

**What are the factors does lender consider in lending the home loan**

- **Collateral**
- **Credit reputation**
- **Capacity of borrower to repay**

## **Purpose of the question**

The idea behind the question is to find out on what basis financial institution should sanction the house loan so that they can recover their loan in timely fashion.

## **Analysis:**

Most of the respondents favor capacity of borrower to repay the loan and consider credit reputation at next. Banks and HBFC collect credit history of borrower from CIB (credit information bureau).

## **Question no 2:**

**What lender will prefer when reviewing the collateral for home loan?**

- **House value**
- **Down payment**
- **Property type**
- **Others**

## **Purpose of the question**

To find out what most important thing financial institution are considering in the collateral before approving the loan.

## **Analysis**

Majority of the financial institution prefers house value in the collateral, because if borrower fails to repay their loan the value of house should be equitable to repay that default. At next banks also consider the locality of that collateral such as landi, **lyari and malir** they don't give house loan to these areas, because banks have their positive and negative areas for house loan.

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### **Question no 3:**

**On the basis of capacity of borrower what factor do u mostly considered**

- **Income of borrower**
- **Pervious debt of borrower**
- **Cash reserve.**
- **Savings**
- **others**

### **Purpose of the question**

To find out factors considered by financial institutions in the approve loan on the basis of borrowers capacity.

### **Analysis:**

On the basis of capacity of borrower majority of financial institutions consider current income first and pervious debt of the borrower at next.

### **Question no 4:**

**How many years is your loan for?**

- **1-10 years**
- **10-20 years**
- **20-30 years**
- **When borrower reach at the age of 60 year**

### **Purpose of the question**

The idea behind these questions is to find out the age group mostly preferred by financial institutions for loan approval

### **Analysis:**

Majority of the financial institutions approve loan for 10-20 years. And 1-10 years at next.

### **Question no 5:**

**What are the main reasons that the borrower does not repay their house loan?**

#### **Purpose of the question**

To find out why most of the borrower defaults in house loan.

#### **Analysis:**

Majority of the borrowers faced this problem because of financial hardship, mishaps contingencies, and lack of follow up, guarantor deviation and conscious fraud. There are some other reason due to which people default such as habit to default, these kind of defaulter have habitual to default in their general life, and there are some of the defaulter whose repayment depends on their mood if they are in good mood they will repay the installment if not they will default, there is another important category of defaulter which is quite common in Pakistan that is willing to pay but cant pay, these kind of borrower default because they are willing but they don't have capacity to repay the loan.

### **Question no:6**

**What percentage of borrower repays their loan before time?**

#### **Purpose of the question**

The percentage of borrower who pay their loan before time (prepayments).

#### **Analysis:**

Banks borrower's didn't pay prepayments and its hardly 1% but in HBFC its about 5%-10% repay their loan before time.

In HBFC if borrower repay their loan before time they impose penalty on it that is to take one year rent of house.

## **Question no 7:**

**What percentage of borrower default in house financing?**

### **Purpose of the question**

To determine the percentage of borrower default in house finance

### **Analysis**

The percentage of default in banks is low that is approximately 1% and the reasons behind this is improper loaning otherwise their borrowers do not default because of their tight monitoring and follow up system.

The percentage of default in HBFC is high than banks that is 40%-50%. The reasons behind these default rates are.

- **Lack of follow up as bank do**
- **They do not collect their loan by own but collect through collection unit.**
- **Collection unit problems**
- **Post deducted check**
- **Guarantor default**
- **Political influences**
- **Market trend.**

### **Question no 8:**

**What steps do you take, if borrower fails to repay their loan?**

### **Purpose of the question**

To find out the methods follow by different financial institution if the borrower default.

### **Analysis**

If the borrower unable to repay the installment then first of all financial institution make collection and recovery calls to their customer and analyze his or her behavior about repayment of installments if they confirmed that borrower is not in the mood to repay their loan then they send them legal notice according to the Act Recovery of finance ordinance. Even after the borrower doesn't present to the financial institution for the repayment then they auction that property. If there is no buyer available to buy that property then they have the right to possess that house.

### **Question no:9**

**What age group do you consider for the sanctioning of home loan?**

### **Purpose of the question**

What age group should consider by financial institution for house finance.

### **Analysis**

Most of the financial institutions consider age of 20-60 because Pakistan's average person life is 60years.

### **Question no 10:**

**What minimum income does borrower required in order to pay your installments?**

#### **Purpose of the question**

To find out what should be the minimum income of borrower to repay their loan.

#### **Analysis**

In the case of bank their requirement is 15000 rupees per month to repay their installment. But HBFC doesn't follow that their requirement is 33% of the income and sanction the loan according to that 33% amount because it is semi government organization and their motto is to provide housing for all.

### **Question no 11:**

**What documents do you require at the time of approving the loan?**

#### **Purpose of the question**

To find out what are legal documents required by different financial institutions for the approval of loan.

#### **Analysis**

Most of the institutions required lease slip, approved building plan documents, permission to mortgage, search certificate.

## **Question no 12:**

**How do you verify the collateral documents in house financing?**

### **Purpose of the question**

To identify the collateral document which they consider in home financing.

### **Analysis**

To find out the process of verification of documents for different financial instituion. Most of the financial institutions verify documents through KMC, KDA, and personal lawyer and through relevant authorities.

## **Question no 13:**

**What factor do you consider at the time of approval of house financing?**

### **Purpose of the question**

Financial institutions for the approval of home loan should consider what factors

### **Analysis**

Majority of the financial institutions consider income, property value, collect information about borrower pervious debt record from CIB.

## **Question no 14:**

**What are your policies to maintain the large number of borrowers default?**

### **Purpose of the question**

To find out what should be the policies of financial institution to reduce default rate.

### **Analysis**

Most of the respondent said that financial institutions should have following policies to reduce the default rate.

- **Follow up**
- **Reduce rate of interest.**
- **Discussion and advice to borrower**
- **Consider all the factors carefully before loaning**
- **Professionalism in Recovery**
- **Warnings.**
- **Stress testing**

### **Question no 15:**

**What product characteristics mostly preferred by borrowers**

#### **Purpose of the question**

To find out the product characteristics required by borrowers from financial institution.

#### **Analysis**

Most of the financial institution consider that borrower required less complications and low interest rate and no hidden cost. HBFC operational manager said that we have 70% illiterate people for loaning they just require what you are giving and what will you take from me.

### **Question no 16:**

**Specify product characteristics do you offer to create value of your house financing?**

#### **Purpose of the question**

To find out product characteristics should be offered by financial institution in house finance.

#### **Analysis**

Majority of the financial institution respond that their should be minimum requirements and maximum facility for borrower and focus on customer satisfaction.

**Question no 17:**

**What problems are borrowers facing in getting their loan approved**

**Purpose of the question**

To find out the major problems face borrowers in loan approval.

**Analysis**

Time period, personal preferences in HBFC, insufficient income.

## QUESTIONARIES FROM CONSUMERS

### Question no 1:

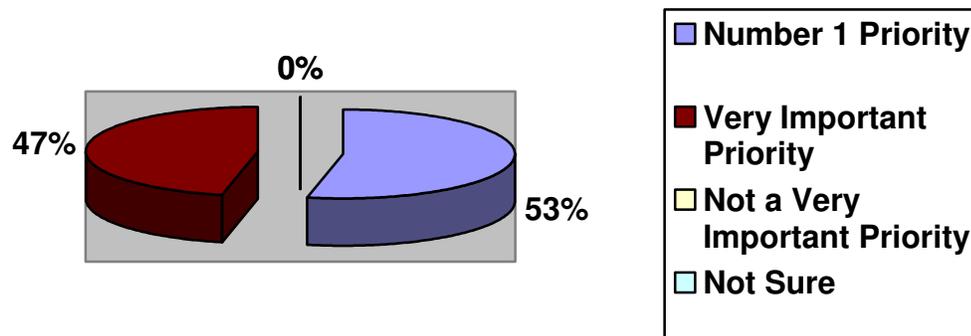
How high priority is it for you to buy a home of your own?

- Number One Priority
- Very Important Priority
- Not a Very Important Priority
- Not Sure

### Purpose of Question:

To find out how really people are willing to have own home

### Presentation of Results:



### Analysis:

Majority of the respondent give priority to the house because everyone needs their own house.

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## **Question no 2:**

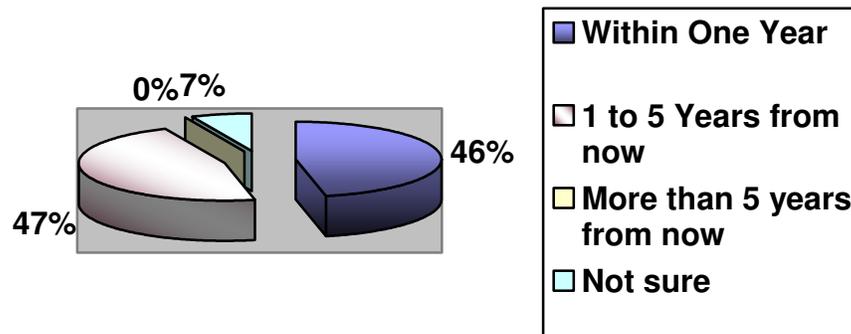
**If buying a home is a high priority, how soon do you plan to do so?**

- Within One Year
- 1-5 Years From Now
- More than 5 Years From Now
- Not Sure

## **Purpose of Question:**

It they are willing how much time they will take to plan for it.

## **Presentation of Results:**



## **Analysis:**

47% are planning for their house within 1-5 from now because they give very important priority to the house. And 53% are planning for their house within one year from now and give number one priority to house.

### **Question no 3:**

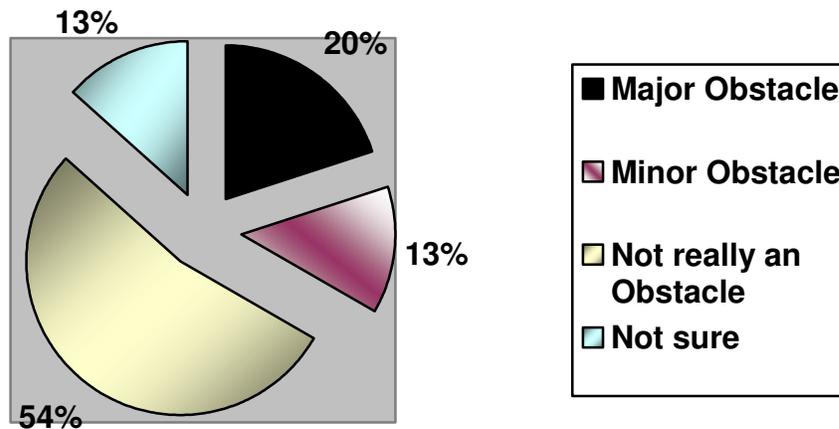
**Knowing how to get started financing a home.**

- Major Obstacle
- Minor Obstacle
- Not Really an Obstacle
- Not Sure

### **Purpose of Question:**

To find out borrowers perception about financing a home.

### **Presentation of Results:**



### **Analysis:**

Majority of the respondent feels that financing a house is not really an obstacle because financial institution create lot of awareness among the general public and everyone knows about the product characteristics and specification of house loan.

### **Question no 4:**

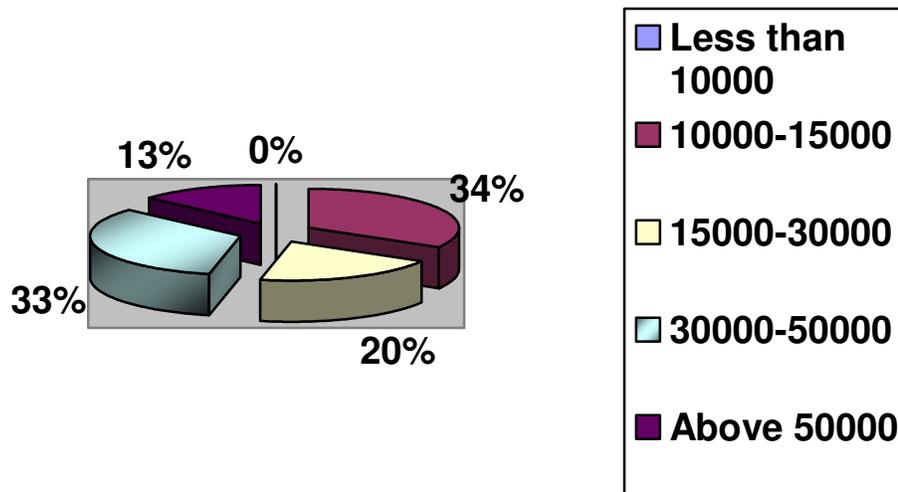
**What is your monthly income?**

- Less than 10000
- 10000-150000
- 15000-30000
- 30000-500000
- above 50000

### **Purpose of Question:**

To find out range of income on which borrower required different product characteristics and face problem in approval of house loan.

### **Presentation of Results:**



### **Analysis:**

Majority of the borrowers have monthly income range from 15000-30000. and are willing to own their home .

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### **Question no 5:**

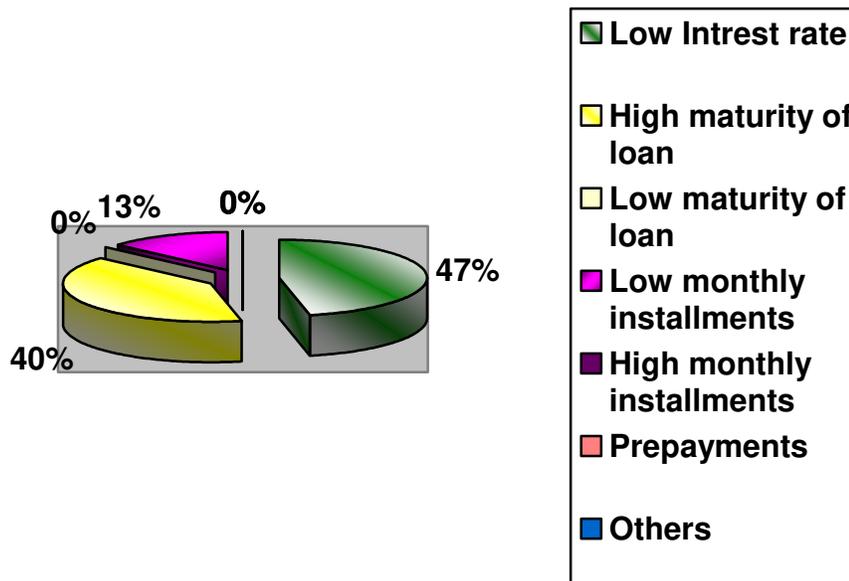
**What product characteristics you mostly preferred in house financing?**

- low Intrest rate
- high Maturity of loan
- low maturity of loan
- low monthly installments
- high monthly installment
- prepayments
- Others

### **Purpose of question:**

To find out the preferences of people about the product characteristics of house loan.

### **Presentation of Results:**



### **Analysis:**

Majority of the borrowers require low intrest rate and high maturity of loan in house financing and 13% need to have low monthly installment.

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### **Question no 6:**

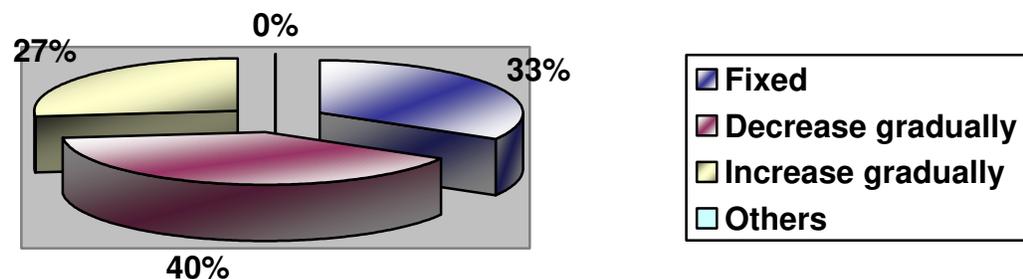
**What monthly repayment criteria would you like to consider in house financing**

- fixed
- decrease gradually
- increase gradually
- others

### **Purpose of question:**

To find out the monthly repayment criteria that borrowers are willing to pay.

### **Presentation of Results:**



### **Analysis:**

Majority of the respondent interested in increased gradually criteria for repayments, because at time of sanctioning of loan they paid 20% downpayment and have shortage of fund.

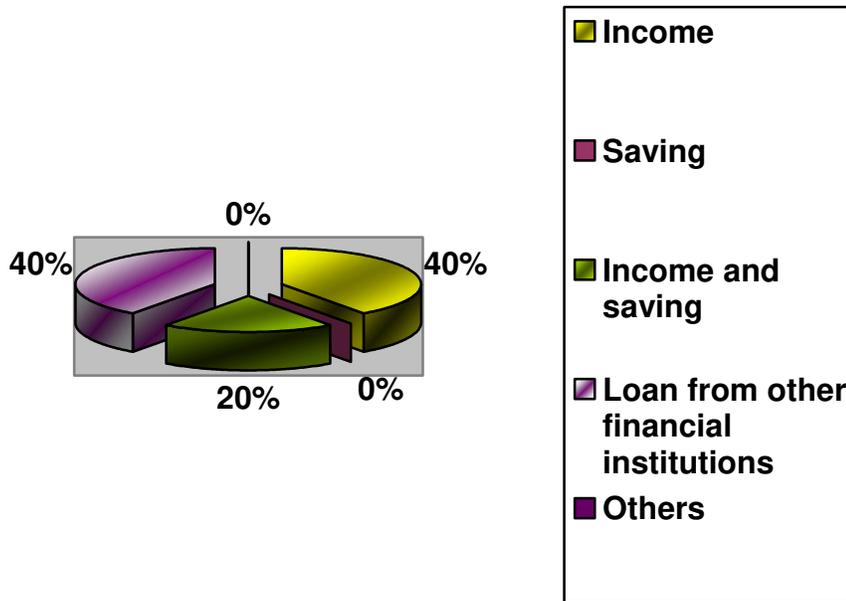
### **Question no 7:**

**What is your source for the repayment of installments?**

- income
- Saving
- income and saving
- loan from other financial institution
- Other.....

### **Purpose of question:**

To find out the source of borrower to repay the loan.



### **Analysis:**

40% of the respondent are giving their repayment through income and saving and 40% are repaying their loan by getting loan from other financial institutions. The main reason behind is the high interest rate compare to other loan.

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### **Question no 8:**

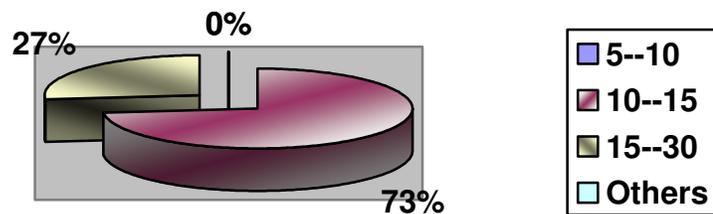
**What maturity do you need to have in home financing?**

- 5—10
- 10—15
- 15-30
- Others.

### **Purpose of question:**

The years of maturity required by borrower to repay their loans

### **Presentation of Results:**



### **Analysis:**

Majority of the borrowers want to repay their loan within 15 year because they want to save the intrest payment. And 27% are willing to repay their loan within 30 year because their cash flow is in circular.

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### **Question no 9:**

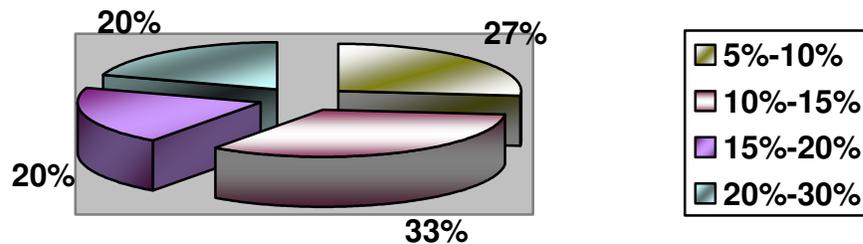
**How much downpayment do you like to pay for house finance?**

- 5%--10%
- 10%---15%
- 15-----20%
- 20%---30%

### **Purpose of question:**

To find out the amount of equity borrower willing to pay for low interest payment.

### **Presentation of results:**



### **Analysis:**

33% of the respondent need to pay downpayment range from 10%-15% and at next 27% want to pay less than that.

### **Question no 10:**

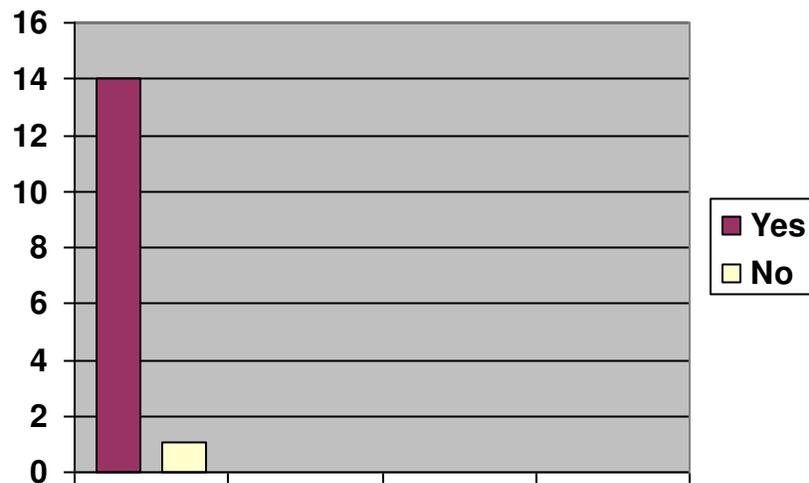
**Are financial institutions charging high interest rate on house finance as compare to other consumer finance product?**

- yes
- No

### **Purpose of question:**

To find out the high are low intrest rate compare to other financial products.

### **Presentation of Results:**



### **Analysis:**

Majority of the people feel that financial institutions are charging high intrest rate and that's the reason people are repaying their installment by getting loan from other institutions.

### **Question no 11:**

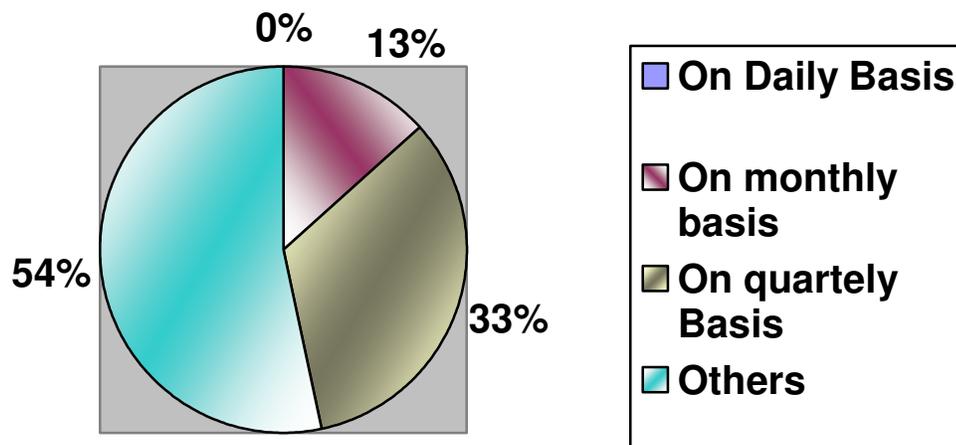
**How financial instituion charge interest rate in house finance?.**

- On daily basis
- On monthly basis
- On quarterly
- others

### **Purpose of question:**

To find out the method of financial instituion to calculate intrest rate.

### **Presentation of results:**



### **Analysis:**

Majority of the respondent prefers that intrest rate should be charge on annual basis because there are lots of variation in intrest rate. At next 33% prefers to that intrest should be charged on quarterly basis, because it can be reduced from original at which borrower sanction the loan.

## **Question no 12:**

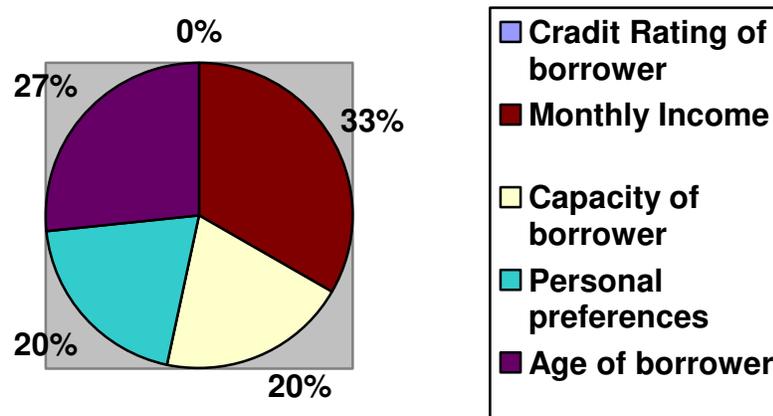
**On what basis the financial institution approve the house finance Rank them.**

- Credit rating of borrower
- Monthly income
- Capacity of borrower
- Personal preferences
- Age of borrower

## **Purpose of question:**

To find out the factor considered by financial instituion for the approval of loan.

## **Presentation of results:**



## **Analysis:**

Among these four factors lender first consider monthly income of the borrower and age of the borrower at next.

### **Question no 13:**

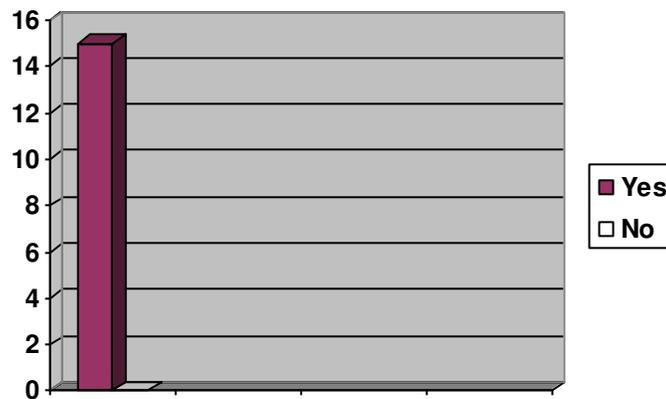
**Do you think the approval process of house finance is time consuming?**

- Yes
- No

### **Purpose of question:**

To find out the approval process time management.

### **Presentation of results:**



### **Analysis:**

Majority feels that approval process is time consuming and it should be done within time.

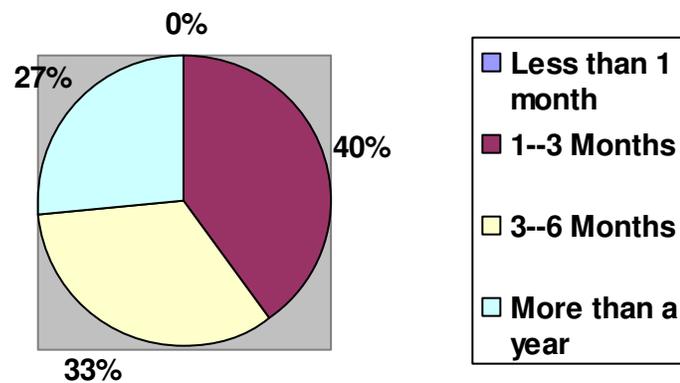
### **Question no 14:**

How much time does approval process take for sanctioning the loan?

- Less than a month
- 1---3month
- 3—6month
- More than a year

### **Purpose of question:**

To find out the time takes by financial instituion in the approval of loan.



### **Analysis:**

40% of respondent feels that approval process take about 1-3 months and 33% feel that it take 3-6 month to approve.

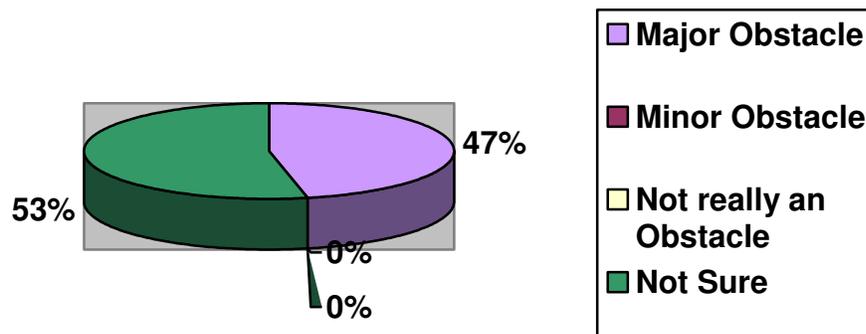
### **Question no 15:**

**Not enough money for down payment and closing costs**

- Major Obstacle
- Minor Obstacle
- Not Really an Obstacle
- Not Sure

### **Purpose of question:**

### **Presentation of Results:**



### **Analysis:**

53% of the respondent feels that it is a major obstacle and 47% are not sure about it.

## **Question no 16:**

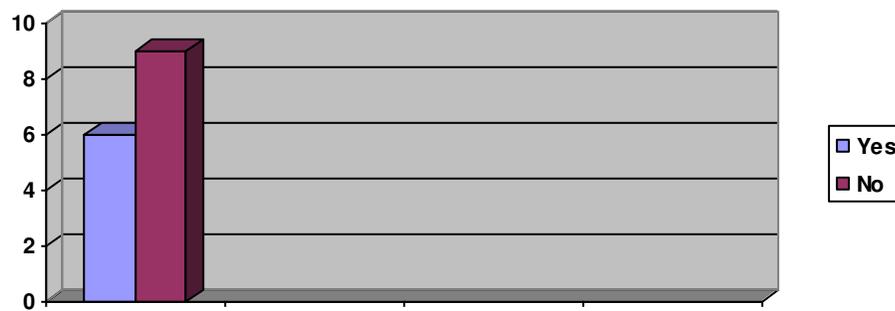
**Credit history should be considered in house financing.**

- Yes
- No

## **Purpose of question:**

To find out the consideration of level of credit level in house financing.

## **Presentation of results:**



## **Analysis:**

60% of respondents feel that credit history should be considered and other 40% feel that it should not be considered.

### **Question no 17:**

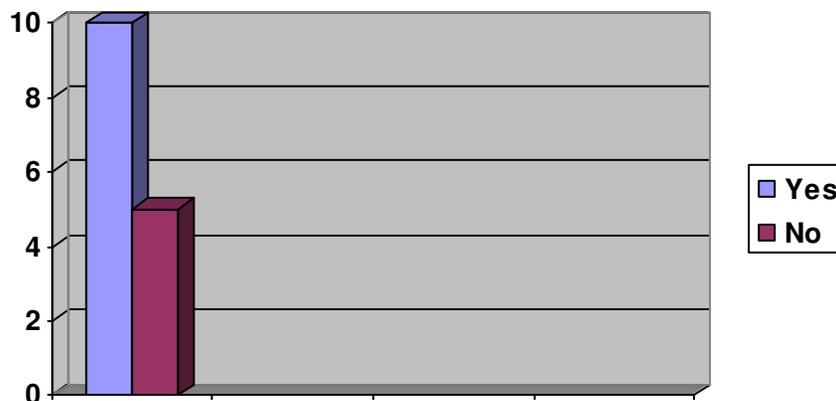
**Is there any discrimination or personal preference in the house loan approval?.**

- Yes
- No

### **Purpose of question:**

To find out personal preferences in house financing approval

### **Presentation of results:**



### **Analysis:**

Majority of the respondent feel that financial intuitions give loan on personal preferences. They approve loan those to whom they know well.

### **Question no 18:**

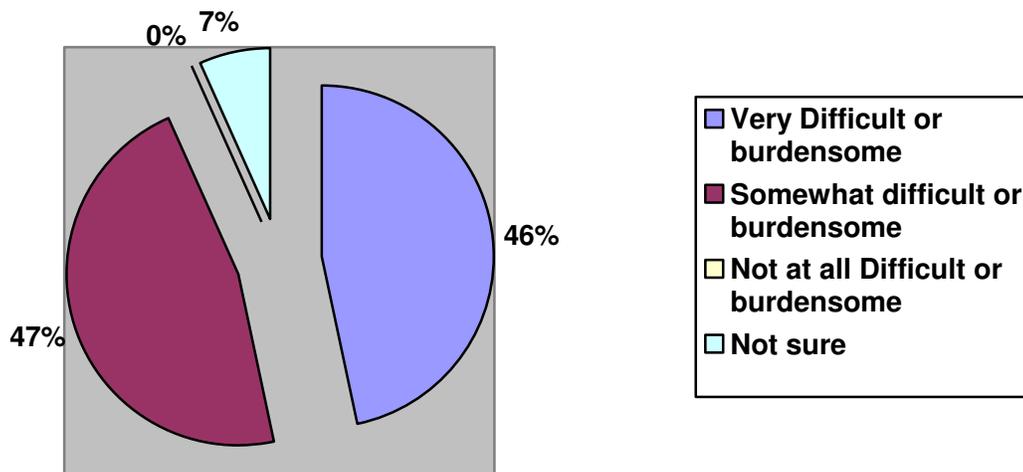
To what degree did you find the mortgage application process to be difficult or burdensome?

- Very difficult or burdensome
- Somewhat difficult or burdensome
- Not at all difficult or burdensome
- Not Sure

### **Purpose of question:**

To find out the difficulty of mortgage application process.

### **Presentation of Results:**



### **Analysis:**

Majority of respondent responds that the mortgage application process is difficult and burdensome.

### **Question no 19:**

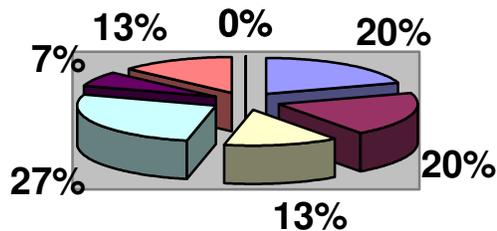
**What aspects of the mortgage process did you feel were most difficult? (Check all that apply)**

- Amount of documentation that I needed to provide.
- Unexpected or hidden costs during the application process.
- Application fee.
- Amount of time to get approved.
- Understanding the mortgage application process and documents.
- The uncertainty of not knowing whether or not you will be approved.
- Other
- No aspects were burdensome

### **Purpose of question:**

To find out the difficult aspects of mortgage process.

### **Presentation of Results:**



- Amount of documentation that I needed to provide
- Unexpected or hidden costs during the application process
- Application fee
- Amount of time to get approved
- Understanding the mortgage application process and documents
- The uncertainty of not knowing whether or not you will be approved
- Others

### **Analysis:**

27% of respondent feel that approval process is a time consuming. And 20% feel that it is difficult because of unexpected or hidden cost involve in it

## Question no 20:

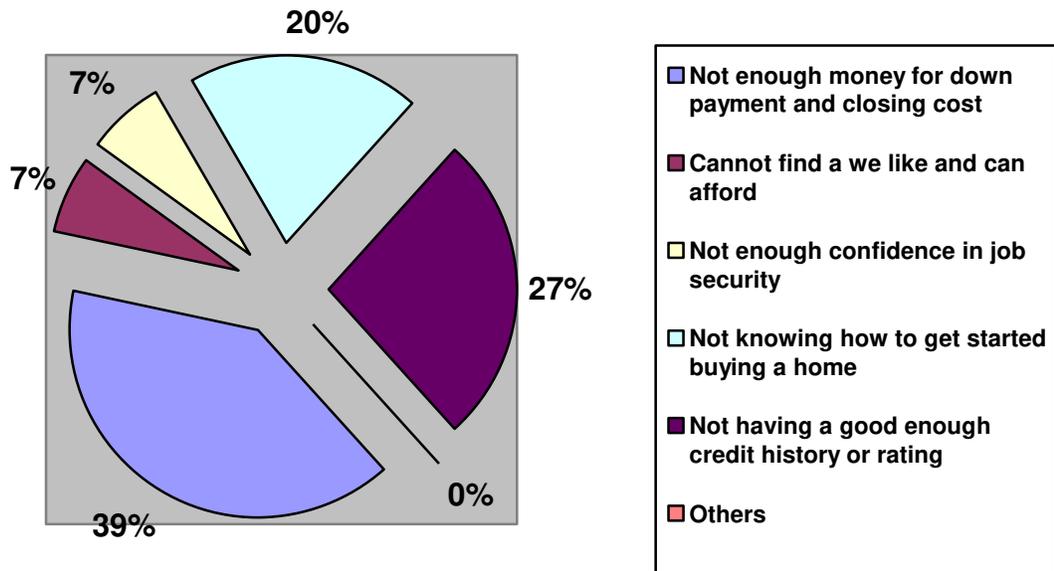
### **What do you think is your greatest barrier to buying a home?**

- Not enough money for down payment and closing costs.
- Cannot find a home we like and can afford.
- Not enough confidence in job security.
- The expense of maintaining or repairing a home.
- Not knowing how to get started buying a home.
- Not having a good enough credit history or rating.
- Discrimination or social barriers that prevent us from buying the home we would like to buy.
- Cannot find and/or afford a home that is accessible for a family member with a physical disability.
- Other

### Purpose of question:

To find out the barriers in home buying.

### Presentation of Results:



### Analysis:

Majority of respondent feel that greatest barrier to buying a home is not enough money for downpayment and closing cost.

# Chapter # 5

## **Summary Of Findings, Conclusion & Recommendations:-**

- a) Findings
- b) Conclusion
- c) Recommendations

## Chapter # 5

### **Summary Of Findings, Conclusion & Recommendations:-**

#### **a) Findings From Interviews and From Questionnaire**

It is worldwide-recognized fact that the housing/construction industry of a country plays a vital and significant role in the development of its economy and prosperity. In Pakistan 92% requirements of the total housing needs is provided by private sector. With a backlog of 270,000 housing units in the country the demand for housing finance is enormous. If the average cost of a housing unit is taken at Rupees five lacks (a very conservative estimate); and 50 percent self-financing ratio, the total demand for housing finance is close to Rs.68 billion against the current supply of close to Rs.3-4 billion. Thus there is a great scope for a quantum jump in the housing finance business.

Broadly speaking a rapid growth in housing business as a result of better financial inputs will accrue significant benefits to the economy in the form of employment opportunities, support to a variety of sectors, a higher economic growth and fulfillment of an important social need.

But due to some problems faced by different financial institutions and borrowers housing finance didn't achieve its target that it has to achieve. The major problem faced by different financial institutions regarding house finance is recovery problems, which are caused by increasing default rate of housing loan.

The general reasons for borrowers default are financial hardship, mishaps contingencies, lack of follow up, guarantor deviation and conscious fraud.(Ref.Q:5 . pg # 30)

**There are four main categories of defaulters:**

1. Willing to pay can't pay.
2. Habitual default
3. Depends on mood.
4. Fraud

There are some of the organizational irresponsibility's due to that borrower default (Ref Q: 7. pg # 31).

The percentage of default in banks is low that is approximately 1% and the reasons behind this is improper loaning otherwise their borrowers do not default because of their tight monitoring and follow up system.

The percentage of default in HBFC is high than banks that are 40%-50%. The reasons behind these default rates are, lack of follow up as bank do, they do not collect their loan by own but collect through collection unit and collection unit also create problem for HBFC to accumulate their recovery because of less staff, bouncing of post deducted check, guarantor default, political influences and market trend.

In HBFC one of the respondent said this is the semi government organization and the government pressurized us to give relaxation to the borrowers and due to that borrower feel fear free and willing to default.

If borrowers default then they take some steps to recover their house loan amount(Ref Q.8. pg # 32). First they take customer friendly steps and if borrowers is agree to give repayment then they make negotiation with them in terms of reduction in interest amount or increase maturity of loan. if not then financial institution take some legal action against borrower.

In legal action, banks and financial institutions were given the authority to acquire and sell the mortgage property on expiry of the final notice for the recovery of loan. "Framing law is one thing and implementing it is something entirely different," remarked a banker,

saying it is impossible to acquire any property where tribalism and biradaris are still very powerful and state organs are weak. Due to that banks have their positive and negative areas for the approval of home loan but in the case of HBFC it has to provide the loan for everyone because it is a semi government organization and its mission is provide house loan for everyone.

From above factor I analyzed that bank's borrowers are defaulting because of mismanagement of loan and some general reasons such as death of borrower, financial mishaps and contingencies which are rare in case, but in HBFC borrower default because of the organization improper system and political influences.

On the other hand borrowers are also facing problems in getting their loan approved and can't get proper characteristics of house loan product. In the approval process most of the borrower faces problem of the high time period, personal preferences of financial institution to the borrowers, banks made their positive and negative side of home loan approval, the uncertainty of not knowing weather or not loan will be approved, valuation of property by foreigners, high application fees, other hidden cost.

Borrowers are also facing problems in getting the proper product characteristics such as high interest rate as compare to other consumers product, high down payments, hidden cost such as they quote us 12% interest rate annually but actually it is 15%-19% including all hidden cost. Borrowers are also facing the maturity problems in their house loan product that is 10-20 years. .

From above factors I analyzed that borrowers have more problems in approval of house loan, time period and personal preferences are major part of it.

Product characteristics offered by financial institution are looking but not good, they don't clarify their borrowers about their product. They give them through knowledge of their positive features of product but never tell about the negative side such as if

borrowers didn't pay their loan what will be happen with him or what penalty they will have to pay. (Ref: Q: 1-20)

Financial institutions should reduce complication in their approval process and provide appropriate product characteristics and clarification of product to borrowers.

## **Conclusion:**

As is now evident from the above findings that financial institutions are facing problems in house finance from borrower in terms of recovery and borrowers are facing problems from financial institutions in terms of approval process and product characteristics.

The low share of Housing Finance to GDP does not represent any lack of demand – rather it reflects the absence of properly organized approach to housing finance which has hitherto suffered from rather high interest rates and somewhat lack of control on default rate in the financial sector.

The financial sector should reorganize their policies about recovery ,they should give training to their professionals for the recovery of payments and consider all the factors unbiasedly before sanctioning the loan. they should reorganize their approval system and provide loan to borrowers with cleared characteristics

#### **d) Recommendations:**

My recommendations to the financial institutions are as follows to make their recovery process default free.

- Follow up
- Reduce rate of interest.
- Discussion and advice to borrower
- Consider all the factors carefully before loaning
- Professionalism in Recovery
- Training to professionals for recovery
- Warnings.
- Proper valuation system of recovery.
- Stress testing

My recommendation to financial institutions for the satisfactory product characteristics and proper approval processes.

- Housing Finance should not be restricted to few cities like Karachi, Lahore and Rawalpindi. Few localities like DHAs, Army Schemes, Cantts, LDA and CDA. Selected borrowers like Bank employees, multinational reps, Business class personnel. It should be broad based in all respects
- There should be either fixed rates instead of floating rates or some cap into the Floaters.
- Loans should be provided by banks to developers of residential and commercial Projects based on their reputation, good will and feasibility. That is a “Developer Finance System”

- Title of documents of property should be computerized and made available on Demand in the shortest possible time.
  
- Single digit loans are ensured. Group funding without collateral should be generated for the very poor.
  
- Rationalization of Stamp duties/registration Fee.
  
- Low cost housing scheme for shifting the Katchi abadies in a more organized Manner.

Broadly speaking a rapid growth in housing finance business will accrue significant benefits to the economy in the form of employment opportunities, support to a variety of sectors, a higher economic growth, and fulfillment of an important social need of own house.