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Central Bank as Real Estate Regulator: Can the SBP's Latest Guidelines Help Meet the Housing Shortfall?

Ibrahim Khalil

- The latest State Bank of Pakistan (SBP) guidelines for housing finance, though motivated by the right policy instincts, assume that mortgage providers will provide mortgages for already under-construction projects—a practice that is largely out of synch with international best practice.
- The SBP should entrust commercial banks with their qualified staff and internationally experienced boards of directors to develop risk assessment criteria and appropriate transaction structures for construction lending.
- Construction financing tends to bring immense transparency to real estate projects. In the absence of a robust real estate regulatory authority, the likelihood that the guidelines will result in making up the ten million housing shortfall is low, given the incentives for real estate developers to avoid transparency.

On September 2, 2021, the State Bank of Pakistan (SBP), issued a press release, a circular and announced new guidelines to promote the financing of housing units in under-construction projects. Four types of under-construction projects were mentioned by SBP in the circular:

- Projects comprising of horizontal houses where builders/developers have availed construction financing.
- Projects comprising of horizontal houses where builders/developers have not availed construction financing.
- Projects comprising of vertical houses where builders/developers have availed construction financing.
- Projects comprising of vertical houses where builders/developers have not availed construction financing.

What SBP is referring to as horizontal and vertical houses are usually referred to as low-rise and mid/high-rise respectively.

The announced guidelines are mainly for the benefit of high-rise construction projects. SBP identified three benefits of the new guidelines for the purchasers of housing units: firstly, purchasers will get units at lower cost in under construction projects, secondly, banks will ensure strong monitoring of the project and facilitate timely completion of the project, and thirdly, the purchasers will have lower maintenance and renovation cost for initial few years. SBP predicts that this will increase demand for under construction projects.

How Conventional Construction Financing Works

It is important to distinguish two types of finance that can be mistaken for each other. To avoid confusion in this paper, we will refer to the financing/loan provided by a construction lender for the construction of a building as "construction finance". The loan or mortgage provided by a mortgage or loan provider to the purchaser for purchasing the housing unit will be referred to as "housing finance". Commercial Banks/DFIs play the role of construction lender and mortgage provider. The same institution can be both the provider of construction finance and the provider of housing finance.

Before we review the SBP circular, it will be helpful to review how construction financing works in the markets with active construction financing activity. A builder has three main sources of funding available to construct the project.

1. Builder's own money is referred to as equity.
2. Purchaser's (end user's) deposits from pre-sold units.
3. Construction financing from the construction lender.

This is referred to as the capital stack or sources of funds. The capital stack should be equal to the project cost.

In a conventional process, the builder initially uses equity to purchase the land and carry out the preliminary work such as arranging planning permissions and construction permits. Afterwards, the builder launches the sales of the apartments in the project and collects down payments from the purchasers. Once a sufficient number of apartments have been pre-sold i.e. purchaser has made the down payment, the builder approaches the construction lender for arranging the construction financing.

A construction lender will assess the request based on the answer to the following three questions:

- Are the number of qualified pre-sold units sufficient to repay the construction loan?
- What is the maximum loan to cost (LTC) ceiling set by the internal risk committee of the bank?
- Can a financial close be achieved with the amount of construction financing requested and subsequently approved by the construction lender?

Are the number of qualified pre-sold units sufficient to repay the construction loan?

Qualified pre-sold units are those pre-sold/booked units that have mortgage approvals in place from the mortgage provider. This ensures that as soon as the building is complete, mortgage providers will repay the construction lender completely. Simultaneously, the construction lender will remove the mortgage charge from the project lands and mortgage providers will register their mortgage charge on the individual flats. Having sufficient qualified pre-sales mitigates the repayment risk of the construction lender.

Qualified pre-sales set the ceiling for the construction loan. The higher the pre-sales, the higher the construction loan amount that the construction lender can approve. Higher levels of pre-sales also indicate a higher desirability for the housing units in the project.

Any payment that the purchaser makes before the building is completed such as a down payment for booking the flat or periodical instalments till the building is completed, the purchaser makes such payments from his or her savings. Mortgage providers do not provide the loan to the purchaser until the building is completed—this means that the mortgage provider does not bear any risk until the building is complete.

What is the maximum loan to cost (LTC) ceiling set by the internal risk committee of the bank?

Based on internal criteria as well as the central bank's prudential regulation (in Pakistan's case the SBP), the construction lender's policy may define the maximum loan that can be provided to finance the project cost. This is known as maximum LTC ratio. For example, the bank's policy may state that for a high-rise residential construction projects of fifteen storeys or higher, located in the urban heart of Karachi, Lahore and Islamabad, built by an approved builder classified as Class A as per the bank's internal classification, the maximum that the bank will lend is 60% LTC—provided that the project has achieved a qualified pre-sales of at least 50% of apartment units.

Can a financial close be achieved with the construction financing being asked for?

Once the maximum loan amount has been determined based on qualified pre-sales and LTC ratio, the construction lender's credit underwriting process will include assessing that the loan amount is sufficient to complete the building. The construction lender releases the construction financing after both equity and deposits have been completely used up towards the construction of the building. If there is a shortfall in the capital stack, the builder will either have to arrange for more equity (put in more money from her pool of funds) or sell more units to achieve a higher pre-sale (collect more deposits through sales) or both to complete the capital stack. The construction lender will not release the construction financing until the capital stack is complete i.e. financial close has been achieved.

Consequently, the construction lender will only count those deposits as part of the capital stack that the builder has already received in its bank account. The deposits that are expected to be received in future are not counted in the capital stack.

This mitigates the project completion risk for the construction lender by ensuring that sufficient funds are in place to complete the building even if the builder and/or purchaser(s) defaults and/or goes bankrupt.

A Thought Exercise on High Rise Construction Financing

The aforementioned procedures can be illustrated through an example. Consider a high rise building of one hundred (100) apartments with each apartment selling at Rs.10 million. The total sellout value of the building comes to Rs. 1 billion. Let's say that the builder's profit margin in this example is 20%. This makes the cost of the project Rs.800 million. Consequently, the capital stack of the builder should add up to Rs. 800 million for the construction lender to allow disbursements of construction financing. The builder would have contributed 20% of the project cost as equity for purchasing the land.

At the time of booking, the purchaser deposits 20% as a down payment and has mortgage approvals from mortgage providing banks for the balance amount. The maximum LTC that the construction lender will lend at is 60%.

Let's look at three examples of qualified pre-sales of 40%, 60% and 80%.

Assumptions				
Price of apartment	A	10,000,000		
Number of Apartments	B	100		
Sell out value of the building	C = A x B	1,000,000,000		
Builder profit margin	D	20%		
Cost of the building	E = C * (1 - D)	800,000,000		
Equity by the builder	E * 20%	160,000,000		
Max LTC	F	60%		
Downpayment at the time of booking	G	20%		
Pre-Sales level	**H**	**40%**	**60%**	**80%**
Loan Sizing				
Total mortgage amount available at building completion from qualified pre-sales *	I = A x B x H x (1 - G)	320,000,000	480,000,000	640,000,000
LTC	J = E x F	480,000,000	480,000,000	480,000,000
Maximum loan available (lesser of I and J)	K	320,000,000	480,000,000	480,000,000
Capital Stack				
Builder equity	F	160,000,000	160,000,000	160,000,000
Deposits	L = A x B x G X H	80,000,000	120,000,000	160,000,000
Maximum loan available	K	320,000,000	480,000,000	480,000,000
Total Capital stack	M = F + L + K	560,000,000	760,000,000	800,000,000
Surplus / (Shortfall)	**M - E**	**(240,000,000)**	**(40,000,000)**	**-**

We see that at pre sales levels of 40% and even at pre sales levels of 60%, the project does not have access to enough mortgages to pay off the construction loan at maturity. Before it can disburse the loan, the construction lender may ask the builder to generate additional funds either Rs.240 million (at 40% pre sales) and Rs. 40 million (at 60% pre sales). The builder can generate these funds either by contributing more equity or by selling more housing units or a mix of both. In exceptional cases, the construction lender may decide to provide construction financing despite the shortfall in the capital

stack but in such a case, the commercial bank is taking loan repayment risk and may only do so for blue chip clients or at a higher interest rate to account for the higher risk.

How Construction Lenders Condition Fund Releases

The construction lenders do not disburse the entire loan amount in one lump sum. Once the construction lenders receive credit approval and all building approvals and permits are in place, the construction lender appoints a qualified quantity surveyor or a cost consultant that reviews and verifies the project budget as submitted by the builder. This ensures to the construction lender that the construction loan as approved is sufficient to complete the project. The cost consultant then periodically prepares a report, for the construction lender, by visiting the site to see the progress of the project and reviewing material and labour invoices to estimate the cost of work completed in that period. The construction lender only releases the amount of loan equal to the work done by the builder in that period. If the customer deposits are kept in an escrow account, the same report may also be used to release the funds from escrow accounts to be used for construction. This ensures that all the funds (construction loan and deposits) are utilized towards the construction of the project that they are meant for, and are not treated as fungible pools that investors or builders can use for other means. In short, these controls mitigate against the risk of misuse and fraud, by maintaining a constant transparency to the benefit of all stakeholders.

As additional security, the construction lenders require the builder to sign step-in agreements and get the major contractors such as architects, cement suppliers, and steel suppliers to sign or acknowledge an assignment clause in their contracts. The step-in agreement allows the construction lender to take over control of the project in case of a builder default. The assignment clause assures that if the construction lender is forced to brings in another builder to complete the project, the contractors will continue as if working with the original builder. As the construction lender is paying the bills of the contractors, contractors usually do not object to this and this ensures that the building is completed, even if the builder defaults.

If the purchaser defaults in purchasing the apartment when the building is complete by not being able to arrange a mortgage or cash to purchase the unit, the purchaser forfeits his/her deposit. In the earlier example, the purchaser had provided Rs.2 million as a deposit. If the purchaser defaults, the builder can sell the apartment at a price as low as Rs.8 million and still make the same profit.

Identifying the Key Actors & their Stakes

Now that we have covered the basics, let's discuss the role of the three main players.

Commercial bank/construction lender

The construction lender designs policies and the risk assessment criteria for construction projects. The criteria includes but is not limited to builder assessment criteria and project assessment criteria. Builder assessment is based on the builder's financial capacity and track record. Project assessment criteria will assess such factors as the economic environment, marketability of the project, cost of the project, risk of increase in material and labour costs of the project, size of the target market of the project, and other approvals and permits required from municipal authorities to construct and complete the project. The construction lender will also devise an internal rating criteria which will define the maximum LTC the bank will lend for different types of projects and/or builders. Individual banks devise their own criteria.

Real estate regulatory authority (RERA)

Such an authority does not exist in Pakistan though a RERA Act for Islamabad has been cleared by the parliament. Real estate and land are provincial subjects, and so the federal government cannot devise a nationwide real estate regulatory regime. Each provincial parliament will need to devise its own RERA.

Globally, the real estate regulatory function is one that is motivated by the protection of the landowner and/or future homeowner. As consumer protection agencies, the purpose of a RERA is to introduce transparency and safeguards that protects the rights of the purchasers, a step that ultimately ends up benefiting the overall real estate sector. RERAs brings in such measures as municipal approvals

required before the project is launched for sales, minimum information to be provided to prospective purchasers at the times of sales, and the size of the penalties imposed on the builder if the builder does not deliver housing units as per the booking/purchase agreements whether in quality of the unit or in the timeline agreed with the purchasers. RERA may also require that the customer deposits are held in escrow so that builders do not misuse the customer deposits in unrelated projects and describe the mechanism of how and when the deposits can be released. Moreover, it is for RERA to devise policies for how the project will be managed if the builder defaults or the purchaser defaults and how and what level of consents to arrange to continue the project if a change in required in the project after the project is launched due economic and structural forces acting on the project.

State Bank of Pakistan

SBP is the regulator of commercial banks. It should provide broad guidelines to commercial banks to prevent the banks from taking excessive risk and exposing the banking sector to systemic risk. SBP should encourage banks to develop their own internal risk assessment criteria. SBP should not be designing the credit assessment criteria and only monitor the banks to be prudent in their lending practices.

Key Issues in the SBP's New Guidelines

Let's review the SBP guidelines focusing on high rises as this is where the SBP guidelines are directed. In the press release announcing the guidelines, the SBP appears to be leaning towards mortgage providers to provide housing finance in under construction housing against allotment letters. It also mentions that builders complain about the lack of housing finance in under-construction housing. As mentioned earlier, in countries where construction financing is prevalent, housing finance is not provided for under construction housing. Housing finance providers will provide mortgage pre-approvals to purchasers which will state that once the building is completed as per the municipal approvals and the title of the flat is ready to be transferred, the mortgage provider will provide the mortgage to the buyer to purchase the apartment.

> Banks are reluctant to offer finance for purchase of housing units in under construction projects, as compared to completed projects. The prevalent market practices are that builders allow the purchasers of housing units to make periodic payments when construction begins against allotment letters which is a convenient process in enabling home ownership. However, banks do not provide housing finance against allotment letters. As a result, buyers are deprived of the opportunity of availing housing finance from banks and hence owning affordable housing units in the under-construction phase of projects.
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> In addition, builders also complain that non-availability of housing finance from banks for the under-construction projects reduces demand and slows development of new projects. With an increase in financing after issuance of these guidelines, such concerns will be addressed.

If the mortgage providers in Pakistan are reluctant to finance equity instalments for the purchaser in an under-construction project, they are only following international best practice. Once the construction financing is approved, the capital stack should be complete and the builder should not be looking towards housing finance to complete its project.

> On the other hand, the land parcel of the apartments/flats is inseparable and is jointly owned by the purchasers/owners of all flats/apartments in the building. Further, title documents of flats/apartments may not be valid during the construction period such as an allotment letter of an incomplete flat in grey structure of an under-construction building or a flat on 7th floor of a building presently having three floors.
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> The mortgage on houses/apartments in under-construction buildings may not be perfected due to defects/non-availability of title of ownership.

The guidelines start by discussing that the mortgage provider cannot perfect the security in an under-construction building. As explained earlier, the mortgage provider has no reason to perfect or even register a security for an under-construction project. The mortgage provider does not and should not take a risk on the project during construction.

The guidelines go on to say that in case of default, the construction lender will try to sell the building to recover housing finance. This raises two key issues. One, if the construction lender has done its job well in terms of risk assessment and has signed the step-in agreement and assignment clauses, it is

preferable to take over the building to get it completed rather than trying to sell it as incomplete building. Selling an incomplete building may result in buildings selling at discounted prices and may result in much higher losses for both construction lenders and purchasers. Two, there is no recovery required for housing finance providers or mortgage providers as the mortgage provider only offers funds when the building is completed.

> Enforceability of mortgage in multistorey under construction buildings is further complicated as some purchasers of flats/apartments in an under-construction building may avail bank/DFI financing while others may not have availed bank/DFI financing. Therefore, in case of default of builder/developer or mortgage borrower, seeking consent of all owners to sell incomplete building or selling of a flat/apartment therein to recover housing finance may not be possible for the financing bank/DFI.
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> However, many of the issues and challenges are resolved in case a bank or consortium of banks/DFIs have provided financing to the builder/developer and the same bank/DFI or consortium of banks/DFIs is providing housing finance to the purchasers of housing units in the building. In this situation, project non- completion risk gets mitigated as the structure contemplates the creation of appropriate mortgage over the project land. This security (if enforced by the bank(s)/DFI(s)) can allow bank(s)/DFI(s) to sell-off the unfinished/incomplete project, recover its outstanding amounts and even refund any excess balance to the end-user unit purchasers who have made advance payment of instalments.

The guidelines also state that issues are resolved if the construction lender is the same as housing finance provider.

Firstly, as explained earlier, there is no risk with respect to the housing finance provider in case of an incomplete building.

Secondly, as the banks are new to this business, it may be preferable that both construction lender and housing finance provider is the same bank—to enable the bank to learn the ropes and iron out wrinkles in the process of building completion i.e. when the construction lender is simultaneously removing its mortgage from the land and the housing finance lender is registering its mortgage on the flat. The SBP, however, is suggesting this approach for the wrong reason.

In the subsequent paragraph, SBP is restricting construction financing to only those projects wherein the mortgage provider is the same as the construction lender. This will slow the growth of construction finance.

> 1. Builder/Developer Selection Criteria: Bank(s)/DFI(s) shall devise Builder Selection Criteria and Project Selection Criteria to select builders and their projects which are eligible to enter into arrangements for financing of under construction projects. The builder selection criteria may inter-alia include builder's/developer’s financial soundness, track record of builder/developer regrading compliance with legal and urban planning as well as fulfilment of milestones of completion in previous projects. For the purpose of these guidelines, builders/developers are entities which undertake construction of vertical residential or commercial-cum-residential projects for the purpose of selling of housing units in these projects to general public. These builders/developers can be private entities or government owned entities/departments/agencies.
> 2. The projects must have obtained all applicable approvals from regulatory and developmental authorities. Bank(s)/DFI(s) shall ensure physical and legal verification of the project's overall documentation such as title documents, NOCs from relevant development authorities/agencies, approved site plan etc. The project selection criteria may additionally include such factors as accessibility to schools, hospitals, availability of external road infrastructure, transport, utilities, etc. and marketability of housing units in the project. For the purpose of these Guidelines, under construction projects are vertical residential or commercial-cum-residential projects on which construction work is yet to start (new projects) or housing projects on which partial construction has already been made.
> 3. Bank(s)/DFI(s) shall sign a Master Financing Agreement (MFA) with the builder/developer. This agreement, in addition to financing terms shall also include the construction plan, timelines for completion of project, different construction milestones, loan disbursement plan and procedure for repayment of financing to bank(s)/DFI(s).
> 4. Bank(s)/DFI(s) may decide about debt equity ratio for the project keeping in view the risk profile of the builder/developer. However, bank/DFI financing shall not exceed 70% of the project value. In case of cost overruns, bank(s)/DFI(s) shall require builder/developer to arrange additional funds from own sources. Bank(s)/DFI(s) shall ensure that project feasibility accounts for cost overruns and builder/developer withstand unexpected additional project costs.

Pakistani commercial banks have more than half their assets in government securities, making record profits and enjoying significant (and some may say, rather large) capital buffers. A little risk-taking by commercial banks in the construction finance area will not adversely affect the stability of the banking sector.

Some of the conditions also merit examination. The commercial banks’ risk departments are staffed with well qualified risk professionals and their board of directors comprise of internationally experienced professionals that also sit on the board risk committees. SBP should trust the banks’ risk departments and risk committees to develop robust assessment criteria in light of international best

practices to manage construction financing. These kinds of conditions indicate a foundational lack of confidence in commercial banks. Only banks that lack the capacity and capability to assess the credit risk of construction projects would require such specific instructions. The counter factual here is obvious: if the SBP opts for such micro-management of processes, then perhaps there is merit to the commercial banks' preference to invest in PIBs, instead of economy-driving, and consumer-serving products and services.

If the project has achieved financial close, the construction lender has carried out a sound risk assessment of the project, and qualified pre-sales are sufficient to pay off the construction loan then the NOC (no objection certificate) condition also seems overly invasive, bureaucracy-serving and broadly unnecessary. The builder will have shared the price list of the unsold units with the construction lender as part of the construction loan request and if the price is within reasonable range of the price list, the builder should not need an NOC for selling any remaining units. For large projects, this will introduce unnecessary paperwork and may discourage builders from requesting construction financing if selling each apartment requires an NOC from the construction lender. Moreover, policies must be fit for purpose. Those devising market shaping guidelines should consider the question of whether the central bank should be describing how the minutiae of construction financing processes should be managed.

The construction lender, the builder and the legal counsels should be able to devise an appropriate security structure. In case of defaulted purchasers, the builder usually has access to forfeited deposits of the delinquent purchaser which provides the builder with sufficient flexibility to market the defaulted unit at a discount. As long as the bank has completed its due diligence when assessing the project

> 6. The builder/developer shall be required to obtain NOC from the lead consortium bank/DFI, on behalf of all financing banks/DFIs, before selling any housing unit in the project to a purchaser.

with respect to the marketability of the project, a buyback guarantee is not required. Moreover, how to deal with a delinquent purchase is a RERA jurisdiction.

To have an escrow account for the purchaser deposits is usually prescribed under RERA or similar authorities in other countries. It is a consumer welfare decision and not at all related to construction financing. Even in projects where the builder does not use construction financing, RERA regulations may require builders to receive all deposits in an escrow account.

The SBP's requirement for the builder's equity to be routed through escrow is also worth re-considering. If it is an under construction project, it is already too late to have the builder's equity routed through escrow as the builder would have utilized equity to purchase the land and bring the project to the status where it is approaching the construction lender for construction financing. Bank loan payments are not required to be routed through escrow. The construction lender establishes a separate project account for each project account and all payments are routed through the project account.

Overall, the guidelines repeatedly indicate that as the regulator for commercial banks, the SBP is acting beyond its conventional jurisdiction, and essentially seeking to regulate the builder and developer as well as the building and development process. Is the absence of provincial RERAs a good enough reason for the SBP to do this?

A Diagnosis of the SBPs Overreach into RERA Functions

Due to lack of structural reforms to power the economy, over many years the SBP has adopted or been given the responsibility of promoting various sectors either through concessionary financing for exports, or for renewable energy, or for SMEs, or for industrial expansion. In the last several years, the SBP has also promoted development activities such as mandatory targets for housing finance and construction finance as well as managing the interest rate subsidies on behalf of the Government of Pakistan for low cost housing and programmes like the Kamyab Pakistan Program. At the heart of this expansion of the monetary policy and banking sector regulator's function are noble intentions, after all, many may ask: "if the SBP doesn't do it, who will?"

The proposed SBP Amendment Act 2021 had sought to prohibit these kinds of policy influencing and market shaping activities by the SBP. The act appears to have been shelved, for the moment, and the Government of Pakistan continues to lean on the SBP to help achieve its wider policy objectives—the construction financing guidelines we have examined here, are a perfect example of the pursuit of such objectives. On the whole, the attempt by SBP to promote the construction sector and help the government achieve its target of increasing housing supply is not problematic in spirit. However, instead of providing broad guidelines to commercial banks and allowing the banks to devise their own criteria to achieve these aims, the SBP is formulating very specific guidelines, intruding into areas that should be RERA-domain, and in the process, the SBP is also likely to ensure a micro-management of the entire construction lending process.

9. The builder/developer shall provide guarantee to buyback the housing unit or arrange an alternative purchaser in case of delinquencies, whether delinquencies in payment of markup installments by the borrowing purchasers or delinquency in regular construction payments in case of non-borrowing purchasers of housing units in the projects. Further, in case of delinquencies by the borrowing purchasers of housing units during construction period, financing banks/DFIs shall require builder/developer to prioritize re-allotment/transfer of such housing unit to interested/potential purchasers.

11. All payments to the builder/developer for completion of construction/project shall be routed through an escrow account maintained by the lead bank/DFI of consortium. The builder's/developer's equity and purchasers' equity contribution and subsequent payments of the purchasers through mortgage financing shall be routed through the same account.

15. In case of purchasers not availing bank/DFI financing, the builder/developer shall be responsible for the collection and deposit of due amount, as per their payment schedule, in the Escrow Account.
16. The builder/developer shall be required to complete the project with arrangement of completion certificate, connection of utilities (water, electricity, gas etc.) and other approvals/NOCs from the relevant authorities/agencies.
17. Upon completion of the project, builder/developer shall be required to transfer ownership of housing units to purchasers through registered title deeds along with completion of all formalities as prescribed by relevant law and creation of mortgage in favor of mortgage financing bank(s)/DFI(s) without any legal impediment.

The establishment of autonomous RERAs in each province is vital for the promotion of consumer welfare and to bring transparency to the real estate sector. RERA regulates real estate developers by providing guidelines of how the real estate development process should evolve. Builders/developers oppose introduction of RERA as it brings transparency and accountability to the real estate sector. The advantage of RERA is that its jurisdiction extends to an entire region or a province and all builders within that region will have to comply with it. But when SBP is encroaching into RERA functions, the SBP regulations will only apply to those builders that will avail construction financing from construction lenders. On the positive side, construction financing will help the builders complete their projects quickly. On the negative side, builders that take construction financing will have to comply with those guidelines which are in RERA's domain and in some cases will add to the time and overhead costs of the project when compared to projects of the builders that don't avail construction financing. Consequently, this may discourage builders from financing the project from a construction lender and they may prefer to use investors' equity and/or purchaser deposits/equity to complete projects. In effect, this would end up countering the very effects the SBP wants to ingrain into the housing and constructing financing markets. The reason is simple: the SBP cannot substitute for RERA.

One of the benefits identified by SBP in its press release is strong monitoring and oversight of by the banks to facilitate timely completion of the projects. Though this is the end result in projects that will be financed by construction lenders, this is akin to introducing accountability in real estate (a RERA domain) through SBP guidelines.

Will the current guidelines lead to a large increase in housing construction

Real estate developers are shy of transparency, manifest from the fact that the recent surge in real estate activity has taken place on the back of a construction amnesty which generated a "no-questions-asked" approach on the builders' source of funds, as well as a free rein for builders to

minimize taxes on profitability. Under the amnesty rules, the FBR is not supposed to look at the books of the builders that have availed the amnesty, and is supposed to instead tax them at a flat rate based on the area of the housing units built.

When builders avail construction financing from the banks, by the very design of construction financing programs but also due to SBP guidelines, they are supposed to provide to the banks, a feasibility study of their project which will make it evident what is the true profitability of the project. In addition, all the construction funds are to be routed through project accounts and a cost consultant/quantity surveyor is to provide a regular cost report. This measure is designed to substantiate the profitability of the project. Presently, FBR taxes housing units on DC rates which are significantly lower than market rates. By availing construction financing, the builder will bring to light the actual sales price of the unit—which again, has to be routed through the project account. Investors who usually buy the early units in the project and in a way, provide financing to the builder will shy away from such projects. With the exception of a few blue chip builders who regularly and promptly pay their tax bills and usually build apartments targeted towards the upper income segments, most builders will likely shy away from construction financing altogether.

The assumption underlying SBP's guidelines is that the availability of construction financing will entice the builder to comply with real estate regulations, bring additional transparency into the project and pay their fair share of taxes. Time will tell, but there is a chance that this overreach of SBP into real estate regulation will discourage the majority of the builders from approaching the banks for construction financing. To actually encourage builders to take construction financing, a RERA needs to be introduced which brings transparency to all projects whether the builder utilizes construction financing or not. The SBP's noble intentions in this instance will not be enough to level the playing field amongst the builders, and they will do little to incentivize better treatment of consumers at large.

It is likely that the new guidelines to promote the financing of housing units in under-construction projects will end up encouraging the construction of high-end apartments by renowned builders. Though this will help SBP inch closer toward its targets for construction financing, it will fall short of generating more affordable housing units in the country, ostensibly the very policy goal of the push for easier construction financing. It will also not help in substantially contributing to the reduction of the ten million housing units' gap in Pakistan.

Ibrahim Khalil is responsible for project financing of residential real estate construction for one of the premier real estate companies in Canada and has vast experience of investing in managing residential real estate in the US, the UK and France.

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