



Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 03-Mar-2017 | Report No: 114473



BASIC INFORMATION

A. Basic Project Data

Country Pakistan	Project ID P162095	Parent Project ID (if any)	Project Name Pakistan Housing Finance Project (P162095)
Region SOUTH ASIA	Estimated Appraisal Date June 19, 2017	Estimated Board Date Sep 19, 2017	Practice Area (Lead) Finance & Markets
Lending Instrument Investment Project Financing	Borrower(s) Ministry of Finance	Implementing Agency PMRC, State Bank of Pakistan (SBP)	

Proposed Development Objective(s)

The Development Objective of the project is to increase access to affordable housing finance in Pakistan.

Financing (in USD Million)

Financing Source	Amount
International Development Association (IDA)	150.00
Total Project Cost	150.00

Environmental Assessment Category

FI-2-Financial Intermediary Assessment

Concept Review Decision

Have the oversight and clearance functions been transferred to the Practice Manager? (Will not be disclosed)

Other Decision (as needed)

B. Introduction and Context

Country Context

- Pakistan’s economic growth accelerated in FY16 and started to catch up with its regional neighbors with gross domestic product (GDP) in FY16 expanding at 4.7 percent**—the highest rate in eight years and a significant increase from the previous year’s 4.0 percent.¹ Amidst an environment of soft global demand, Pakistan’s growth in FY16 was driven by strong domestic demand. Consumption accounted for an overwhelming 92 percent of GDP in FY16, and contributed 7 percentage points towards GDP growth (moderated by a negative contribution of 2.2 percent from net

¹ Source: World Bank Group. Pakistan Economic Development Update. Making Growth Matter. November 2016.



exports), supported by sustained growth in remittances. In the medium-term, Pakistan's growth is expected to continue to accelerate, reaching 5 percent in FY17 and 5.4 percent in FY18 driven by investment and productivity gains in services and manufacturing. These sectors should benefit from the structural reform agenda leading to decreased electricity load-shedding and improvements in the business climate. In the near term, investments under the China Pakistan Economic Corridor (CPEC) and low international oil prices would also support growth. Increasing reserves continue to contribute to stability in foreign exchange markets, which contributed to low inflation of 4 percent in FY16. The Pakistan Rupee (PKR) remained largely stable with a small depreciation of about 3 percent against the US Dollar during FY2014/15.

2. **The low and stagnant investment rate, however, continues to pose significant challenges to economic growth.** After strong growth in FY15 of 13 percent, investment grew by only 5.7 percent in FY16. The ratio of investment to GDP is 15.6 percent—compared with an average rate in South Asia of 34 percent between 2010 and 2015. Pakistan's much lower rate of investment is driven by its volatile security situation, energy shortages and poor business regulatory environment (now ranked 144 of 190 countries), despite recent progress. The implementation of the federal and provincial governments' joint action plan to improve the investment climate will be one important step towards reversing this long-term trend. Pakistan also has very low levels of financial intermediation which contributes to this situation and hinders its progress towards more inclusive and higher growth. In 2015 financial sector assets stood at about 68.5 percent of GDP, below that of other relevant emerging markets. Private sector credit to GDP, which declined significantly from 2008-2015, was just 15.4 percent, significantly below the regional average of 47.6 percent.

Sectoral and Institutional Context

3. **In the last 25 years, Pakistan's financial sector went from being dominated by underperforming state-owned banks to a modern and sound financial sector dominated by private banks.** The banking sector, consisting of 36 commercial banks and 10 microfinance banks, accounts for about 74.7 percent of total assets in the entire financial sector, while the remaining is held by 45 nonbank finance corporations (NBFCs), including insurance companies, stock exchanges, pension funds, development banks and a public specialized housing lender House Building Finance Company Limited (HBFCL), a non-deposit taking Development Finance Institution (DFI). The microfinance sector is still relatively small, holding about 0.5 percent of the total financial sector assets, although it has considerable significance from the lens of financial access. The financial soundness indicators show that the banking sector remains profitable with the return on asset ratio and the return on equity ratio, respectively, at 1.5 percent and 15.6 percent for 2015. Banks are also well capitalized with an overall capital adequacy ratio of 17 percent, well above the minimum regulatory requirement of 10 percent. A notable feature of the Pakistani banking sector is the relative importance of Islamic banks. Islamic finance is growing rapidly, and currently accounts for 11 percent of sector assets. However, overall financial intermediation levels are very modest leading to a limited role in contributing to sustained and inclusive growth. According to World Bank Global Financial Inclusion Database (FINDEX), only 13 percent of adults had access to a formal account in 2014, far behind Sri Lanka at 83 percent, India at 53 percent and Bangladesh at 31 percent.
4. **Although lack of financial intermediation cuts across market and product segments, a key area which is particularly underdeveloped is housing finance.** Pakistan's mortgage finance to GDP ratio of 0.5 percent is extremely low compared to the South Asia average of 3.4 percent. At the end of 2015, there were only approximately 60,000 residential mortgage loans outstanding for a consolidated amount of PKR 66 billion (US\$660 million).² The average for mortgage lending to GDP is 4 percent for comparable countries with neighboring India standing at a relatively healthy

² A significant share of these outstanding mortgage loans were by banks to their employees



10 percent.³ At present, only 1,500 new mortgage credits are extended annually in Pakistan. Thus, there is a significant market gap across all segments with the largest market gap for mortgages between PKR 0.5 (US\$5,000) and 3 million (US\$30,000), i.e., between micro credit⁴ for housing and mainstream mortgage.

5. **At the same time Pakistan's population is increasing at a sustained rate and becoming increasingly urban.** Housing needs are projected to increase considerably and necessitate large volumes of investment to meet the demand. The country's population of 200 million is expected to reach between 270 and 300 million by 2050. Despite the lack of current demographic data from the census, evidence suggests a large increase in the demand for urban housing over the last decades that is likely to persist at similar levels in coming decades. Over the next 20 years, annual urban population increase is expected to be about 2.3 million per year (around 360,000 households if they remain at 6.5 individuals per household). The demand for urban housing is particularly strong in the largest urban agglomerations such as Karachi that concentrate a large share of the population. A decline in household size and the aging of a large cohort of young individuals who form their own households are expected to further increase the demand for housing.
6. **The estimated housing shortage in Pakistan is up to 10 million units and the deficit continues to grow, particularly in the urban areas.** While data to capture the existing stock and flux of housing units are limited, existing evidence suggests an existing backlog in housing units that is rising rapidly as the annual number of new adequate units covers less than half of the annual new demand. Estimates of annual new demand range between 400,000 and 700,000 units with only about 100,000 to 350,000 formal units being built annually. While the magnitude varies, all estimates indicate that formal supply covers less than 50 percent of new demand. Various estimates place the total housing backlog at 9 to 10 million units⁵ (of which 3.5 to 4 million units in urban areas),⁶ increasing approximately 400,000 units per annum).⁷
7. **The quantitative housing gap is exacerbated by qualitative deficits of the existing stock, such as overcrowding, and the low quality and continuous deterioration of existing stock.** Overall, as of 2009, it was estimated that 46.6 percent of the urban population was living in slums or *Katchi Abadis*, representing 29 million people or 4.3 million households. The share of the population living in housing units classified as slum is therefore well above the poverty rate (36%), reflecting that due to constraint on formal housing supply and the lack of housing finance, the housing shortage is not only affecting poor households but also low and moderate income households. Roughly 200,000 low-cost units are needed annually to stem the growth of *Katchi Abadis*. For instance in Karachi, a growing number of people – not always poor – do not have other options than live in illegal and substandard slum settlements that now house more than half the population of Karachi today (compared to less than 20 percent in the mid-seventies). Many settlements have structural deficiencies, lack access to basic infrastructure, and lack title or permit. More than 40 percent of the population of Karachi, for instance, is not connected to the main water or sewerage network.
8. **The housing shortage disproportionately affects low-income segments.** Several elements explain why this is so. First, current housing supply mostly covers price ranges that exclude these categories. Second, the lack of decent housing and financial options for urban dwellers results in low housing quality standards with a proliferation of slums (*Katchi Abadis*). Third, there is an inverse relationship between household size and income: the lowest 2 income quintiles

³ Source: Housing Finance Across the Globe. WBG Policy Research Working Paper 2014

⁴ Microfinance banks - primarily Tameer bank- offer housing loans to the microfinance client segment. Rates are typically variable, based on one year KIBOR, and range currently from 9 to 12 percent.

⁵ Enclude, "Final Report: Diagnostic Survey of Housing Finance in Pakistan". Submitted to the State Bank of Pakistan. November 2015.

⁶ International Growth Centre (ICG). "Housing inequality in Pakistan: The case of affordable housing." Note. February 2016.

⁷ House Building Finance Company Limited. "Affordable Housing for Low Income Group." Presentation. November 11, 2016.



average (nationwide) 8.2 and 7.4 people per household respectively, while the upper quintile averages 4.8. As a result, low-income households need larger housing units, which increases the challenge of providing them with affordable and quality solutions. There is an acute need to increase the supply of housing in the range of PKR 1 to 3 million (US\$10,000 to US\$30,000) in the main urban centers, which the population earning between PKR 30,000 and 100,000 (US\$ 300 - US\$1,000) monthly could afford. Hence, increasing the housing stock will require a supply side policy including better urban planning, land value capture instruments, mobilization of resources for infrastructure, and support for large-scale, mixed-use developments, which would help increase incentives for developers to supply affordable housing for lower income groups.

9. **Housing finance is crucial for developing a stock of affordable housing.** Lack of housing finance instruments offered by the formal financial sector is an important factor behind the low coverage of housing needs. As discussed above, housing finance remains severely underdeveloped in Pakistan relative to the size of the population and economy. This is despite significant progress in the financial sector under the committed leadership of the central bank, the State Bank of Pakistan (SBP), which has been championing reforms for financial inclusion for over a decade with significant milestones achieved, including on the regulatory framework, credit information, payment and settlement systems and financial literacy. These reforms are inscribed in the National Financial Inclusion Strategy (NFIS) which identifies housing finance as a priority area for government intervention to address the country's housing shortage.
10. **Until 2003, the provision of housing finance in Pakistan was limited to the state-owned specialized House Building Finance Company Limited (HBFCL).** Stimulating policy measures, abundant liquidity and declining mark-up rates led to the entry of commercial banks and the market grew rapidly until 2008. But lending for housing was hard hit by the economic crisis in 2007-2008, which resulted in a surge of unemployment and a mark-up rate hike. Some of the major banks withdrew from the market, which has been shrinking since (with the exception of Shariah-compliant home finance). Currently, 25 financial institutions (24 commercial banks, one microfinance bank) and HBFCL, are providing housing finance although relative to needs the volume of financing is substantially inadequate. There are no specialized, non-bank finance companies (NBFCs) operating as mortgage lenders for the time being, as was the case in the early-mid 2000s, with the last surviving housing NBFC being acquired by a local bank in 2007. The market share of private sector banks decreased from 33 percent to 30 percent between June 2015 and June 2016. However, the share of Islamic banks increased from 32 percent to 38 percent during the same period. In fact, the market share of Islamic banks since 2013 almost doubled to 40 percent with the aggregate Shariah-compliant mortgage portfolio of almost PKR 28 billion as at mid-2016.
11. **The few mortgages that are made are largely extended to formally salaried middle class and above borrowers (60% of aggregate portfolio) with the rest of originations going to the borrowers with a business income (non-salaried).** Average loan term is around 13 years, average loan to value (LTV) ratio is quite low at 48 percent, average annual interest rate of around 10 percent. National portfolio average loan size is PKR 5 million (US\$50,000); the Islamic loan average is twice as much and HBFCL average is PKR 1.8 million (US\$18,000). Variable rates, non-standardized underwriting practices, and significant maturity mismatch⁸ expose primary mortgage lenders (PMLs) to higher credit and liquidity risks which are reflected in higher spreads charged on mortgage loans, and higher non-performing loan (NPL) ratios. The rate of NPLs,⁹ although decreasing, remains abnormally high despite the small size of the market – over 13 percent for the industry in terms of amounts outstanding,¹⁰ with a higher figure for HBFCL (28.5 percent) despite a sharp decline in the recent years, and a much better performance of Islamic banking (7 percent).

⁸ Banks finance housing loans through short term deposits

⁹ Defined by 90 days + arrears

¹⁰ But 54 percent in terms of number of borrowers



12. HBFCL, remains the main player and the only one active in the affordable segment – its market share for new loans in terms of number of borrowers (over 50 percent) is twice what it is in terms of value of loans. In 2015, the average loan amount at HBFCL ranged from PKR 1.1 million (US\$11,000) for renovation to PKR 1.8 million (US\$18,000) for purchase purposes. The average income of borrowers ranged from PKR 69,000 to PKR 100,000 per month¹¹ respectively. HBFCL loans, including Shariah-compliant loans in its portfolio, have maturities between 12 and 15 years and are priced typically at one year KIBOR +3.5 percent - close to 10 percent currently.

13. Mortgage lending in Pakistan remains limited due to a number of constraints from market infrastructure to lending environment. They include:

- The inefficiency of mortgage rights due to the cumbersome and therefore expensive judicial proceedings. An out of court foreclosure option was created by a 2001 ordinance, but was struck down as unconstitutional by the Supreme Court. This has now been greatly alleviated through an October 2016 Act amending the law that both strengthens the mortgage execution process and sets out new provisions to protect debtors' rights throughout this process.
- The unreliability of property and security rights registration systems. This has a direct consequence on the outreach of housing finance, since lenders focus on areas where efficient titling systems exist, which are also areas where housing prices are high;
- The absence of long term funding channels, which results in the predominantly variable rate mortgages with deposit-based funding generates interest rate risk for the borrowers, indirectly credit risks for the lenders and systemic stability risk overall.¹²

14. Land market frictions are considered a substantial factor constraining housing supply. A survey of over 700 real estate firms showed that 79 percent identified acquisition and site development regulations as barrier (54 percent as a severe barrier); it took on average 140 days and 20 different documents to acquire government land and 64 days and 10 documents for private land with documents needed from different authorities. Other supply side constraints include: widespread public ownership of land; inadequate trunk infrastructure provision to developable sites; complicated property rights, land titling and registration systems; inappropriate and inefficient land use regulations (e.g. highly restrictive floor area ratios), sub-division and building codes that are expensive and restrictive, and a complex institutional framework for managing the housing and urban development sector. In Karachi, 90 percent of land is controlled by government agencies, which release parcels in a haphazard way with little or no coordination, as evidenced by the large swaths of vacant land in prime areas of city centers. Local master plans are often outdated or poorly enforced. Land records are maintained manually, and are highly prone to errors and omissions.

15. The policy framework for the housing market contains critical gaps. The National Housing Policy adopted in 2001 marked a departure from the prevalent view of the government being the major provider of housing units and recognized the role of the government as a facilitator. There has been also a push to empower all stakeholders, particularly, private sector, non-governmental/community-based organization as well as local authorities to play an effective role in financing, planning and managing housing. However, a review of the policy by the State Bank of Pakistan found that policy implementation had not been adequate in addressing increasing housing deficit. In 2013, a revised National Housing Policy was drafted, which included the *Apna Ghar* ("Our Home") program to build 500,000 affordable units in five years via public-private partnerships. While some progress has been made in particular working

¹¹ These borrowers would be classified as middle income rather than low income households. As a reference, the minimum wage rate for unskilled workers in Pakistan was raised to PKR 14,000 (\$140) per month as of July 2016.

¹² In large part due to the above funding inefficiencies and subsequent systemic risks SBP mandates a 10 percent ceiling on real estate finance in bank portfolios.



with local authorities to identify land for housing development, the program has yet to be developed further and requires financial, technical, and institutional strengthening.

16. **Despite current constraints, important policy or sectoral measures have been recently taken to foster a revival of residential mortgage lending and affordable housing finance.** These positive actions are progress in the right direction and serve as key initial steps required to increase access to affordable housing in Pakistan. They include:

- i) A specific prudential framework for mortgage lending, (which regulated before then with other forms of consumer credit) was issued by SBP in 2014.
- ii) A mortgage refinancing facility, Pakistan Mortgage Refinancing Company (PMRC), was established in early 2016 and registered with the securities and exchange commission of Pakistan (SECP) as a limited liability company. PMRC has over 50 percent ownership with private sector banks in addition to GoP/Ministry of Finance investing PKR1.2 billion in its capital. Of the PKR 6 billion minimum capital requirement, an initial amount of PKR 150 million has been paid and PKR3.45 billion committed.
- iii) A key amendment to the mortgage recovery law has been passed by the two Parliamentary Assemblies in 2016. It now needs Presidential assent to become law. When finally adopted, these legal changes will represent a critical positive step to revive the mortgage industry and motivate lenders.
- iv) A refinancing facility for microfinance, Pakistan Microfinance Investment Company (PMRC), has been established by the Pakistan Poverty Alleviation Fund with DFID and KFW participation to support microfinance institutions (MFIs). Although not specifically focused on one type of lending, PMRC can be very helpful in supporting the housing microfinance market development, particularly from the perspectives of loan affordability and terms (longer tenors, larger amounts, improved origination and servicing standards, etc.)
- v) The government established a National Financial Inclusion Steering Committee chaired by SBP Governor to implement the financial inclusion strategy. Within the steering Committee, a sub-committee is dedicated to housing finance issues.
- vi) Some progress is being made on the titling issues and strengthening of the property registration systems (e.g. ongoing Land Record Management Information System (LRMIS) project in Punjab, computerization efforts in Karachi). Both of these constraints negatively affect the lower income market segment asymmetrically, as the SECP is establishing rules for the qualification and the conduct of real estate valuers.¹³

17. **The creation of PMRC marks an important milestone in the GoP's objective to improve access to housing finance in Pakistan.** PMRC is expected to materially improve the housing finance funding landscape and address several of the existing market failures and issues: availability of fixed rate loans, origination, underwriting, and servicing standardization, capital market funding channel, affordability and access. A successful PMRC is paramount in GoP's efforts to increase the supply and financing of affordable housing. The proposed project will, thus, leverage SBP and GoP's efforts by helping to address the challenges described above by extending financial as well as technical assistance to PMRC and related market players, i.e. HBFCL and other financial institutions as well as SBP and the Ministry of Housing and Works who are key in developing sustainable housing finance in Pakistan.

¹³ Price appraisal faces in addition acute issues due to the under-stated values reported in the land registries and the resulting dual price system



18. **The proposed project will complement a number of on-going and planned activities in the Bank’s engagement in the financial and urban sectors.** That includes a Bank’s policy loan in preparation that would unlock various constraints in the financial sector including financial sector actions on improvement of credit infrastructure and a project in preparation on Financial Inclusion and Infrastructure. The project will closely coordinate with IFC activities focusing on Housing Finance and with other development partners such as DFID also engaged in complementary initiatives. In addition, the proposed project complements the ongoing sub-national engagement in Karachi and Punjab to strengthen land market development (e.g. institutional coordination and framework for public land management, land asset management, property tax improvement), to support enabling environment for housing development (e.g. simplification of construction permit and business licenses.)

Relationship to CPF

19. The WBG engagement with the Government of Pakistan in supporting the development of the National Financial Inclusion Strategy (NFIS) has provided a comprehensive framework for reform efforts on financial inclusion and the WBG is now providing a comprehensive package of support to enable Pakistan to achieve its national financial inclusion targets. The proposed project is aligned with the CPF. As indicated in the CPF, the Bank will focus its analytical work on supporting development and implementation of the *Financial Inclusion Strategy* under Pakistan’s first Reimbursable Advisory Services (RAS) to include product development for MSMEs, low-income housing, and crisis-prone sectors (crops and livestock), and insurance markets. IFC will support the deepening of financial markets through equity and debt investments in financial institutions including further private participation, and expanding its advisory services to the banks. IFC will also explore opportunities to support long-term market development through local currency bond issuance and support to housing finance.
20. The project’s multi-sectoral approach is aligned with the *One WBG Housing Strategy*, which emphasizes working across the entire housing value chain for comprehensive housing market/policy solutions. The housing value chain incorporates aspects from both the supply (land regulation, construction, infrastructure, etc.) and demand side (end-user finance, developer finance, subsidies, secondary markets, etc.)

C. Proposed Development Objective(s)

The Development Objective of the project is to increase access to affordable housing finance in Pakistan.

Key Results (From PCN)

21. PDO outcome indicators are:
1. Increase in the number of PMRC-refinanced mortgage loans
 2. Increase in the number of outstanding mortgage loans by PMLs

D. Concept Description

22. The proposed project will organize its activities to support key stakeholders to achieve its objectives. These will be organized around three main components: (i) support to expand conventional mortgage lending; (ii) Support to increase lower-income housing finance; and (iii) capacity building and technical assistance for housing policy.



Component 1: Support to Expand Conventional Mortgage Lending (US\$115 million)

23. The objective of this component is to improve and increase conventional mortgage lending by PMLs through support to PMRC and SBP. Both organizations are responsible for stimulating the mortgage loan environment by addressing the liquidity constraints of lenders for PMRC and providing a conducive regulatory environment for housing finance for SBP.

Subcomponent 1a. Support to PMRC (US\$110 million)

24. Technical assistance as well as financing will be provided to PMRC to operationalize its activities as a refinancing facility for mortgage lending in Pakistan, set up requisite market standards to promote efficiency and mitigate risks in mortgage lending. Specifically, the activities under this subcomponent will include:

- a. *Technical assistance* to create a conducive lending environment for PMRC' funding reflecting its extremely low risk profile, and to help PMRC in setting up structures and systems for running the liquidity facility, developing products – including Shariah-compliant refinancing services developing operation manuals, defining adequate refinancing standards, and monitoring the refinancing program. IFC participation in this program is also being explored.
- b. *A Line of Credit* will be provided to allow PMRC to respond to the current market demand of PKR 18 to 20 billion (US\$180 to 200 million) refinancing needs before PMRC is able to tap the capital market for debt issuance. PMRC will provide refinance loans to primary mortgage lenders (PMLs)¹⁴ with full recourse, i.e., delinquent loans are transferred back to the PMLs who have to replace them. The refinanced loans will be secured by the PML's portfolio of eligible mortgage loans with 120 percent overcollateralization. PRMC will refinance with recourse both conventional and Islamic loans. Before establishing its name in the market to successfully make its debut in the bond market, PMRC will fund its refinancing activities from its paid-up capital and project funds to be disbursed as a long-term loan from MoF to PMRC. The regulatory environment, applicable to PMRC as well as future investors in its bonds, will be assessed with the view to facilitate the adequacy between the low-risk profile of the new structure and its funding conditions.

Subcomponent 1b. Support to SBP (US\$5 million)

25. Technical assistance will be provided to SBP to improve the legal and regulatory framework for housing finance. Activities will focus on strengthening specific elements of the housing system to make it more inclusive while insuring its safety and soundness. This will include in particular: (i) direct support to SBP to complement the prudential framework for mortgage lending, including the development of the regulatory environment for refinancing activities by PMRC as well as lending to lower, or informal income earners, (ii) capacity building or additional regulatory drafting to facilitate the implementation of the amended Financial Institutions (Recovery of Finances) Ordinance, (iii) development of a mechanism to bring security in the financing of off-plan purchases, today financed in cash and therefore being both a risk factor and an exclusion factor (households without sufficient savings do not have access to new developments). Assessment and analytical work, including on the investment potential in the housing sector, rent-to-own schemes, a consumer protection framework for mortgage borrowers, or an assessment of the PMRC's potential market depth will also be undertaken with SBP.

Component 2: Support for Increasing Lower-Income Housing Finance (US\$30 million)

26. The majority of mortgage finance is directed at higher income households leaving a significant market gap across all lower-income segments. The largest market gap appears to be between PKR 0.5 and 3 million, i.e., between housing microfinance and mainstream mortgage. Attracting more financial institutions to this market segment will require

¹⁴ PMLs include banks as well as non-bank financial institutions including Microfinance banks. Other microfinance institutions are catered for by PMRC.



incentives or insurance to partially alleviate the perceived additional credit risk for going down market. Project support will include the following activities:

Subcomponent 2.a. Line of Credit (US\$15 million).

27. Project funds will be used for the implementation of a tripartite agreement that will bring together banks (PMLs), developers (sellers) and buyers for the development of mortgage loans of up to PKR 3 million that lower income households can afford.¹⁵ That is below the current national average of PKR 5 million for mortgage loans. Under the agreement, lenders will have access to a line of credit to provide mortgage loans to lower income households.¹⁶ The liquidity facility will be managed by PMRC¹⁷ or SBP while the PMLs as partner financial institutions, will be responsible for identifying projects for pre-financing that meet set eligibility criteria. The feasibility and design of this component will be further evaluated during project preparation.

Subcomponent 2.b. State-backed Mortgage Guarantee (US\$5 million).

28. Establishing a mortgage guarantee scheme could provide credit **risk** mitigation to lenders to reach down to the lower income level and to those working in the informal sector. It would target the category of borrowers who are currently only served by HBFCL, i.e., those earning less than PKR 50,000 (US\$ 500)¹⁸ per month to finance the purchase or construction of low cost homes through mortgages of up to PKR 1 million.¹⁹ State-backed mortgage credit guarantee facilities with a social purpose are a common part of many developed markets as well as in some emerging markets such as Mexico, Morocco, Romania and South Africa. The project will undertake a feasibility study to assess the adequacy of establishing a guarantee mechanism and providing seed capital for operationalization of the scheme.

Subcomponent 2.c. Strengthening the capacity of HBFCL (US\$10 million).

29. The main player in the affordable housing market, HBFCL needs to be financially viable. WBG activities will thus focus on providing TA to help HBFCL continue its main task of providing mortgage loans, including Shariah-compliant mortgages, to lower income populations on a sustainable basis and increase its ability to access long term liquidity, in priority through PMRC. It is important to stress that both the recently appointed new management as well as SBP are keen to achieve the overhaul of this institution that previously relied on artificial and distortive funding (by SBP),²⁰ and was weakened by corruption and political interference.

Component 3. Capacity building for the Ministry of Housing and Public Works (US\$5 million).

30. The project will provide technical assistance to the Ministry of Housing and Public Works to strengthen its institutional and technical capacity for overall government's housing policy and implementation strategy. In particular, the component will support developing policies and strategies to address gaps in the national housing policy and legal framework in the sector. It will provide analytical and policy support to selected areas to help alleviate some of the supply side constraints.

¹⁵ A detailed market analysis and affordability of different income groups will be undertaken to confirm the target group

¹⁶ Homes priced below PKR 10 million and loans up to PKR 5 million will be considered. No construction finance or loans to developers is envisaged.

¹⁷ If permitted by its Board and business model

¹⁸ PKR 100,000 if two spouses are co-borrowers

¹⁹ To be confirmed through a feasibility study

²⁰ SBP credit lines have been converted into equity, and SBP stopped providing such funding



ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT

A. Project location and salient physical characteristics relevant to the E&S risk management analysis (if known)

Pakistan Housing Finance Project aims to support both supply and demand sides of the housing supply chain in Pakistan by providing finance and capacity building to a range of financial institutions in order to increase availability of affordable housing and access to affordable housing finance. Main types of activities and their characteristics relevant to environmental and social (E&S) risk management analysis are as follows:

- (1) **Technical assistance and capacity building components**, i.e. Subcomponent 1(a) – Activity (a); Subcomponent 1(b); Subcomponent 2(c)²¹; will involve capacity building, defining financial and monitoring approaches, policy and market research, and institutional strengthening and will not lead to E&S risks or impacts. Such activities and research will not lead to the identification/development of specific physical activities which would cause E&S risks or impacts. Thus, no World Bank safeguards policies are triggered and no specific arrangements or management plans are required for E&S risk management of these components. With regard to Component 3 (strengthening of institutional capacity of the Ministry of Housing and Public Works), application of safeguards policies – and more specifically, OP/BP4.12 – will be further evaluated during project preparation in light of potential implications in the longer term for the promotion of housing provision and future housing projects in the country.
- (2) **Component involving Financial Intermediation using commercial lending instruments/ financial products) with individual mortgage borrowers as end borrowers (Mortgage Finance)**, i.e. Subcomponent 1(a) – Activity (b). This Subcomponent 1(a) – Activity (b) is a Line of Credit (LoC) designed using a wholesale-retail Financial Intermediation model, with PMRC refinancing lending portfolios originated by Primary Mortgage Lenders (PMLs). This financing designed to help PMRC meet the refinancing needs of the market until it is able to access the capital market and is expected to be provided for mortgages for purchase of existing housing.²² The following important characteristic relevant to E&S risk analysis are taken into consideration for this component. If not managed properly, these are likely to have adverse impacts on credit and reputational risk for the PMLs and to a lesser extent PMRC²³. This is primarily associated with (i) the quality of the collateral (properties to be refinanced) and (ii) the ability of the mortgage borrowers to repay loans. Therefore, screening for these factors can help reduce such risk exposure and, ultimately benefit PMRC and PMLs.

(i) *Building safety*. Key risks involve health and safety issues linked to improper techniques during construction of mortgaged properties (e.g. use of hazardous materials, inadequate life and fire safety, weak structural integrity etc.). This can affect both quality of collateral and personal health and safety of end borrowers. Compliance with national building codes/ regulations can reasonably mitigate these risks for formal housing²⁴, which is the primary target borrower group for this LoC.

(ii) *Locations of the housing/ properties to be refinanced*. The locations are expected to be predominantly

²¹ Under Subcomponent 2(c), capacity building will be provided to HBFCL, a retail FI (mortgage lender), which is the main player in the affordable housing market. WBG activities will focus on providing TA to help HBFCL continue its main task of providing mortgage loans, including Shariah-compliant mortgages, to lower income populations on a sustainable basis and increase its ability to access long term liquidity, in priority through PMRC. This Subcomponent in itself does not have E&S risks and impacts. However, should HBFCL access funding or guarantees under any of the Financial Intermediation components of the project, it will be required to comply with Applicable E&S Requirements for those components accordingly, as described in the PID/ISDS, as any of the PMLs.

²² Which may be both older and newly built construction. However, given acute shortage of housing units in Pakistan, most of the mortgages to be refinanced are expected to be originated for newly built housing.

²³ In line with this Financial Intermediation structure, PMRC will provide refinancing with full recourse, i.e. delinquent loans are transferred back to the PMLs who have to replace them. Thus, credit risk and thus any E&S risks that may affect credit risk are predominantly borne by the PMLs.

²⁴ Relevant national regulations / codes in Pakistan and their enforcement will be further evaluated during project appraisal.



in urban areas that can be often densely populated. Locational characteristics may include sites in poorly managed areas with limited or no basic services such as water supply and sanitation, which could sometimes lead to health risks and impacts for end borrowers or impact property values. Risks should also be minimized by avoiding locations which are prone to disasters and/or cause adverse impact on natural environment and/or human health (e.g. locations near waste dump sites, high tension cables, canals etc.). Such locations have a potential to reduce value of the properties, thus leading to deterioration in the value of the collateral.

- (iii) *Household activities hazardous to the environment and / or human health and safety.*²⁵ Household activities of end borrowers, such as those related to livelihood earning, may pose risk in terms of fire safety and/or health hazards that may put the collateral at risk. Examples include storage and use of hazardous fuels and chemicals.
- (iv) *Resettlement/ displacement/ adverse impacts on vulnerable communities.* It is not envisioned that resettlement/ displacement issues will arise within the scope of this component of the project. Loans would only be provided to people with evidence of tenure (right to occupy their dwellings). However, originating and refinancing mortgages for properties built on land from which government agencies or developers may have removed communities, squatters or encroachers without proper compensation could represent a risk to the project and must be avoided.²⁶

(3) **Components involving Financial Intermediation using commercial lending instruments/ financial products under the “tripartite agreement” model**, i.e. Subcomponent 2(a) and Subcomponent 2(b). This component consists of a Line of Credit (LoC) to provide mortgage loans to lower-income households and a Mortgage Guarantee scheme respectively, both designed using wholesale-retail Financial Intermediation model with PMRC or SBP as a wholesale FI and PMLs as participating financial institutions. The nature and magnitude of E&S risks and impacts under these sub-components, the modalities and nature of E&S risk exposure for financial institutions involved, applicable E&S requirements, and the design of the associated mitigation measures will be further assessed and defined during project preparation depending on the exact design of the “tripartite agreement” model, which is not fully elaborated at this time.

Rationale for classification as Category FI-1, FI-2, or FI-3:

OP/BP 4.03 (*“Performance Standards for Private Sector Activities”*) will be applicable to the project in lieu of the World Bank’s safeguard policies. OP/BP4.03 is better suited for this project given that it will constitute private sector activities and is executed through PFIs, which are commercial private sector financial institutions.

The project is a Financial Intermediary (FI) project and is categorized as **FI-2** in accordance with OP/BP4.03. This categorization is based on the review of the prospective project activities and an expectation that, in accordance with BP4.03 paragraph 21, potential adverse environmental and social risks or impacts of will be few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures. It should also be noted that the E&S risk management design for Subcomponents 2(a) and 2(b) will incorporate measures, as commensurate with the nature of E&S risks and impacts, to limit financing of high risk / E&S sensitive activities (based on a clearly defined set of high risk criteria) to those PMLs that can demonstrate sufficient capacity to identify and manage them.

Application of OP/BP4.03 provides an advantage for this project, as OP/BP4.03 offers comparatively more clarity and

²⁵ This factor cannot normally be checked ex ante by the financial institutions so in practice PMLs would require end borrowers to represent that they would not undertake such activities.

²⁶ This consideration would only apply to such resettlement / displacement that took place specifically in anticipation or preparation for the real estate/ housing construction activities.



guidance in these circumstances than safeguards policies. In addition, as IFC may provide equity financing to PMRC, application of OP/BP 4.03 is expected to result in a more harmonized approach given that OP/BP 4.03 provisions – specifically the approach to environmental and social categorization of FI projects and the use of the “Environmental and Social Management System” concept – are similar to those outlined in IFC’s Policy on Environmental and Social Sustainability and associated guidance. Additionally, the eight World Bank Performance Standards²⁷ will be applicable to Subcomponents 2(a) and 2(b), as they represent high risk exposure through Project and / or Corporate Finance for PMLs associated with lending to real estate development/ construction activities.²⁸

B. Borrower’s Institutional Capacity

Per the requirements of OP/BP 4.03 (Section C), for projects involving Financial Intermediaries, it is required to develop and operate an Environmental and Social Management System (ESMS) that is commensurate with the level of risk in exiting and/or prospective business activities (E&S risks identified for each component are described in section A). Specifically, ESMS will ensure that adequate measures are in place to identify, manage, and monitor associated E&S risks and impacts in line with Applicable Environmental and Social Requirements, as described in Section D of this PID/ISDS.

During project preparation, the design and structure of the various components of the ESMS under the project will be further defined in collaboration with the Borrower, financial institutions, and key stakeholders. This analysis will include current E&S systems and capacity of the wholesale FIs (PMRC and, potentially, SBP should it be involved in implementation of Subcomponents 2(a) and / or 2(b)); respective responsibilities of PMRC, SBP and PMLs for achieving sound risk management outcomes; and capacity strengthening measures. Based on the identified gaps, an action plan will be developed to address gaps/ weaknesses in PMRC’s ESMS, including putting in place systematic measures to be taken to assess and establish/strengthen capacity of the participating financial institutions/ PMLs.

Preliminary Assessment of Environmental and Social Systems and Capacity of Key Institutions

PMRC was set up in 2016 as a company which has a majority private sector ownership and registered with the Security and Exchange Commission of Pakistan (SECP) to aid financial institutions extend housing loans in much more quantum by addressing their liquidity issues through refinancing facilities. PMRC does not yet have formal capacity in many areas, including E&S risk management.

SBP has prior experience in implementing a World Bank project on banking sector reforms. However, prior activities were not associated with E&S risks and impacts. The previous Bank-financed TABS project (implemented by SBP) focused on payment system upgrade etc. and was category C. Nevertheless, SBP has developed some institutional capacity to implement E&S risk management arrangements, as well as awareness on E&S issues among SBP staff. SBP has Financial Inclusion initiatives Division which is responsible for GRM and public awareness campaigns. Additionally, SBP has a specialized set of departments within Development Finance Group (DFG) that aims to enhance financial inclusion through provision of credit to priority sectors.

To strengthen institutional arrangements, the following is essential for the effective implementation of E&S risk management measures: (1) developing written E&S policy and procedures to fit the scope and nature of PMRC’s and SBP’s lending activities under the project, as well as to ensure WB Applicable E&S Requirements for the project are met;

²⁷ “World Bank Performance Standards” are, in effect, IFC Performance Standards on Environmental and Social Sustainability adopted as the “World Bank Performance Standards” in 2013 pursuant WB Operational Policy 4.03. IFC Performance Standards were first introduced in 2006 and updated in 2012. IFC Performance Standards can be found here:

http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes

²⁸ As the Performance Standards are primarily designed as an E&S risk management instrument for medium to large project financing, their relevant principles, definitions, and other technical parameters will guide the design of the E&S risk management instruments (such as exclusion lists), systems, and approaches best suited for the nature and types of the financial products utilized for financing this project.



(2) assigning clear responsibilities for E&S risk management to relevant PMRC and SBP staff, and (3) developing appropriate systems and capacity at the PMRC, SBP, and PMLs' level, as commensurate with scope of their engagement in the project (Mortgage Finance, Project / Corporate Finance, or both).

Thus, to ensure effective implementation of E&S risk management measures, training and capacity building needs will be evaluated during appraisal for SBP, PMRC and PMLs²⁹ and potentially a selected group of real estate developers to develop comprehensive understanding of E&S risk, as well as and specific tools for implementing risk screening and mitigation measures appropriate for the nature of financing.

Mechanisms for consultation and disclosure, with an emphasis on potentially affected people

The concept stage and appraisal stage PID/ISDSs will be prepared and disclosed by the Bank as the source of summary information on the Bank's findings regarding environmental and social issues and mitigation measures to be taken. The Bank will assist the Borrower in carrying out consultations with relevant stakeholder groups. Additionally, the Project Appraisal Document (PAD) will contain details on the environmental and social risks for the project, measures to be put in place to identify and manage them, and adequate plan and budget for capacity building.

No E&S framework is required to be prepared prior to appraisal under OP/BP4.03 for projects involving Financial Intermediaries. As per OP/BP4.03, FIs that participate in the project are required to develop and operate an ESMS (which is a system owned and internalized by the FIs as part of their lending process) that is commensurate with the level of E&S risks in its portfolio and prospective business activities). In accordance with BP4.03, disclosure requirements for projects involving FIs are as follows:

The FI to disclose through the FI's website, if a website exists, and to permit, in writing, the Bank to disclose at the Bank's InfoShop and local PIC, the following elements of the FI's ESMS:

- a) The FI's policy statement which describes specific objectives, metrics, and aspirations that the FI has set with regard to its environmental and social performance;
- b) The FI's procedures for screening and assessing risks and impacts of subprojects or individual transactions; and
- c) After Bank review, the summary of the environmental and social assessment that is required for any subproject considered high risk in accordance with the ESMS (for Subcomponents 2(a) and 2(b)).

PMRC, SBP, and PMLs will put in place and maintain a procedure for external communications to receive any concerns and feedback from the public regarding any aspects of their operations, for example, concerns related to their investment activities and/or a borrower/investee in portfolio. Additionally, under Components 2(a) and 2(b), real estate developers will conduct consultations and disclosure activities in line with the relevant requirements of the World Bank Performance Standards.

²⁹ This will primarily include relevant credit staff.



C. Environmental and Social Specialists on the Team

1. Ekaterina Grigoryeva, Environmental Specialist, GEN03
2. Salma Omar, GSU06

D. Policies that might apply

Policies	Triggered?	Explanation (Optional)
OP/BP 4.03 (Performance Standards for Private Sector Activities)	YES	<p>OP/BP 4.03, and more specifically, provisions related to private sector activities involving Financial Intermediaries, will be applied to the project in lieu of WB safeguards policies. Specifically, OP/BP4.03 will apply to Subcomponent 1(a) – Activity (b) and Subcomponents 2(a) and 2(b), as follows:</p> <p><u>Applicable E&S requirements for Subcomponent 1(a) – Activity (b)</u> (to be included in all relevant legal agreements under the project):</p> <ul style="list-style-type: none"> (i) Applicable national and local laws and regulations of Pakistan.³⁰ (ii) List of Excluded Activities for Mortgage Finance (to be prepared before appraisal) (iii) World Bank Performance Standards will, <u>through</u> their content and scope of coverage of E&S issues, inform the design and development of E&S risk management tools and solutions that are specifically tailored and appropriate for housing finance (as described in the sections above). This will include relevant provisions of the WBG Environment, Health, and Safety (EHS) Guidelines. <p><u>Applicable E&S requirements for Subcomponents 2(a) and 2(b)</u> will be confirmed based on the design of the “tripartite agreement” model as mentioned above and included in all relevant legal agreements under the project.</p> <p><u>Applicability of Performance Standards provisions to the ESMS for FIs</u> ESMS will incorporate, as appropriate for the project circumstances, relevant principles and elements of an ESMS described in Performance Standard 1 (PS1) on Assessment and Management of Environmental and Social Risks and Impacts, (as required by OP/BP4.03), in terms of its structure and key components.</p> <p>In addition, private sector financial institutions will manage the working conditions of their own workforce in accordance with relevant aspects of Performance Standard 2 on Labor and Working Conditions, as required by para.</p>

³⁰ In the case of housing finance, these may include national and local laws, municipal by-laws and other provision regulating housing development and certification by relevant authorities (e.g. building safety); waste management; LFS; access to basic services such as water and sanitation.



17(b) of BP 4.03.

OP/BP4.12 (Involuntary Resettlement)	TBD	Application of this policy with regard to Component 3 of the project will be further assessed during project preparation.
Projects on International Waterways OP/BP 7.50	NO	This policy will not apply as no project activities involving international waterways are expected.
Projects in Disputed Areas OP/BP 7.60	TBD	Use of this policy will depend on the exact nature of activities to be financed, and their locations. During preparation, efforts will be made to understand these issues, and subsequent triggering of the policy. If potential activities involving disputed areas are identified, they will be excluded from financing under relevant components of the project.

E. Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

TBD

Time frame for launching and completing the studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

Preparation for the relevant documents: An E&S Policy and Procedures for PMRC and SBP, which will constitute core written elements of PMRC’s and SBP’s ESMS³¹, will be prepared following the appraisal. Appropriate E&S risk screening and management policies and procedures will also be prepared and implemented by PMLs as a condition/ eligibility criteria of accessing financing from PMRC, whenever this becomes relevant. Assessment of adequacy of PMLs’ E&S policies, procedures, and capacity to implement them will be a direct responsibility of the wholesale FIs, as detailed in their ESMS.

The Bank will review PMRC and SBP ESMS and determine their adequacy based on the risk profile of corresponding project components. In addition, the Bank will assess proposed arrangements for capacity building. Based on this assessment, strengthening of current systems may be recommended and should follow the principle of continuous improvement to ensure that ESMS enables FIs to meet applicable E&S requirements. For this project, such assessment and recommended improvements will be included in the Appraisal PID/ ISDS, as well as the Project Appraisal Document (PAD). Once the key recommended improvements are completed, the Bank would approve the ESMS in a memorandum, following which these will be disclosed as per OP/BP4.03 provisions stated in Section B above.

³¹ In the case of PMRC, E&S Policy and Procedures will cover all of PMRC’s operations to ensure they are in line with Applicable E&S Requirements. This approach is due to the fact that in the case of PMRC, the purpose/ specified end use of World Bank financing under the project constitutes the entire purpose of this wholesale FI’s operations (i.e. housing finance). In the case of SBP, such E&S Policy and Procedures will cover activities related to Subcomponents 2(a) and 2(b) of the project only.



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