

The Role of Islamic House Financing in the Economic Development of Pakistan

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Abstract

Pakistan is a developing country, the importance of house financing is very high as majority of the people don't have their own houses. Due to the limited resources of Government, conventional banking sector is providing house financing on interest basis. As 98% population is Muslim in Pakistan, a large number of needy people did not avail this facility due to the prohibition of *Riba* (Interest).

Islamic banking started in Pakistan in 2002 and at present, there are 6 full-fledged Islamic banks and 17 conventional banks with Islamic Banking Divisions are providing Islamic House Financing according to the principles of *Sharia'h*. Currently, Islamic banking sector is playing its leading role in house financing by providing Pak Rupees 22.64 billion out of total house financing of Pak Rupees 62.96 billion by all banking sectors including House Building Finance Company Limited (HBFCL). Similarly, NPLs of Islamic banks is only 5.7% of total NPLs of all banking sectors which shows the seriousness and sincerity of Islamic bank consumers towards the return of their house financing amounts. Therefore, Islamic banks are imparting their positive role in the economic development of the country as more and more people are getting their own houses in Pakistan.

Keywords: House Financing, Islamic Banks, Pakistan

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Introduction

To be the owner of a house is the biggest human desire at all times. It gives maximum mental relaxation to all family members who live in their owned house. If a person is not in a position to build his house by his own, he has to get the services of any financial institution. Historically, this process is very old and financial institutions played very important role for this cause. As conventional financial system is based on *Riba* (interest), it provides financial assistance to the individuals but in return, they take back their amounts with accumulated interest. This mechanism is prohibited in Islam therefore there was a need to establish a financial system which can provide house financing facility to the consumers as per the teaching of *Sharia'h*.

Conventional banking system is gradually being replaced by Islamic banking system in a large number of countries including Pakistan. In Islamic banking system, all financial services are provided to the consumers which are *Sharia'h* compliant and as per the teaching and guidelines of Islam. House financing is also a part of these financial services. According to Haroon (2005) and Amin (2008), Islamic house financing is based on *Sharia'h* which eliminates all elements of interest and uncertainty. In conventional financing, house financing loans are secured by real asset and repayment schedule is decided which is based on interest. However, Islamic house financing is based on flat profit rate instead of interest rate (Amin, 2008). In this system, installments are decided in the beginning of the contract and profit rate is not changed even there would be an increase in the price of the asset. For this purpose, Islamic bank purchases or build a house, as per the requirements of client and sells it to him on installment basis along with its profit (Maali et al, 2006). Charging of interest is prohibited in Islam because it promotes an unfair distribution of wealth in a society (Olson and Zoubi, 2008). Therefore, the difference between cost price and selling price is the profit of the bank (Rosly, 1999).

Islamic banking in Pakistan

Banking industry in Pakistan is mainly consisting of conventional banking which has very deep roots since its independence in 1947. An experiment was made in 1950s to convert conventional banking into Islamic but it failed due to several reasons. Finally, as per the decisions of Supreme Court of Pakistan and Federal *Sharia'h* Court in 1992, State Bank of Pakistan started its working for the establishment of Islamic banking industry in the country. Meezan Bank was the first Islamic bank established in 2002. Till today, there are 6 full-fledged Islamic banks working in the country having 1,168 branches. 17 conventional banks are also providing Islamic banking services with 760 branches throughout the country along with 154 sub-branches by Islamic and conventional banks. Therefore, total network of Islamic banking branches is 2,082, having total assets of Pak Rupees 1,625 billion and total deposits of Pak Rupees 1,336 billion. Within a period of 14 years, Islamic banking has achieved a growth rate of 15 to 20 percent and captured 11.9% share of total banking assets and 12.9% of total banking deposits in the country (SBP). These milestones reflect that at present, Islamic banking industry is achieving extraordinary growth and development and it has potential to grow further in Pakistan.

House financing in Pakistan

According to the last conducted census in 1998 by Pakistan Bureau of Statistics, total population of Pakistan was 132.4 million. To cater this population, total number of housing units in the country was 19.2 million. As per different estimations by government departments, country's current population is nearly 200 million and total number of housing

units is nearly 30 million. These housing units are still not enough and not fulfilling the needs of the residents in Pakistan. The big reason of this shortage is the unavailability of financial resources by individuals. To overcome this problem, financial institutions started providing financial assistance for building or purchasing of houses. As per State Bank of Pakistan, 48 conventional banks and financial institutions are operating in the country and out of which 15 are providing house financing facilities on interest basis. Similarly, 5 full-fledged Islamic banks are also providing this facility as per Sharia'h principles.

Table 1: List of conventional banks and names of house financing

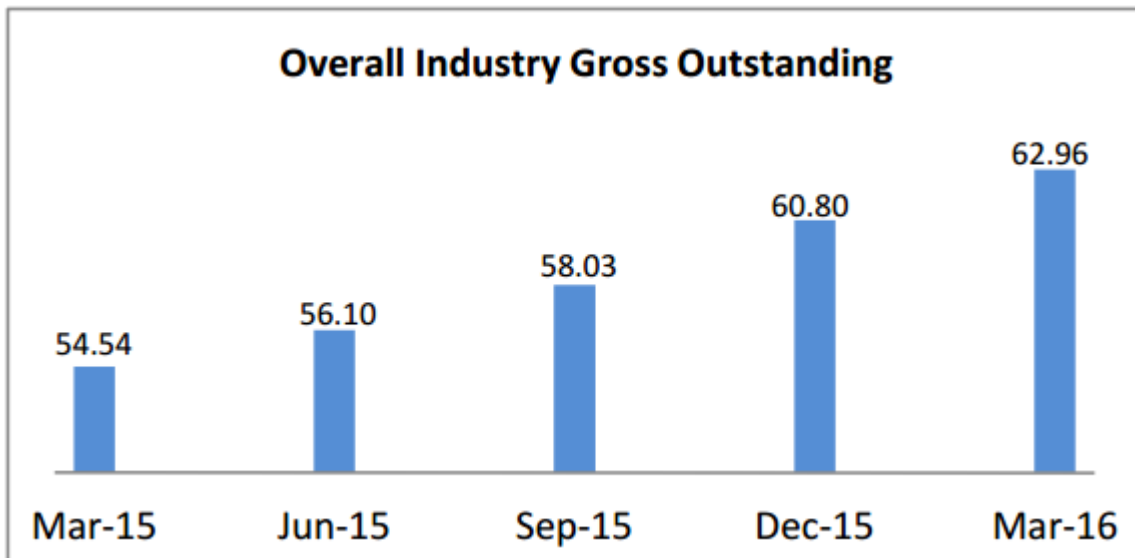
Bank	Name of House Financing
National Bank of Pakistan	Saaiban
The Bank of Khyber	Suhana Ghar
The Bank of Punjab	Apna Ghar Apna Jahan
Askari Bank Limited	Makaan Se Ghar Tak
Bank Alfalah Limited	Alfalah Home Finance
Bank Al-Habib Limited	Housing Finance
Faisal Bank Limited	Faisal Home Finance
Habib Bank Limited	HLB Home Loan
JS Bank Limited	JS Ghar Apna
MCB Bank Limited	Home Loans
Standard Chartered Bank Limited	Saadiq Home Finance
NIB Bank Limited	NIB Home Loan
United Bank Limited	UBL Address Home Loan Facility
APNA Microfinance Bank Limited	Apna Ghar
House Building Finance Company Limited	Ghar Aasan Flexi

Table 2: List of Islamic banks and names of house financing

Bank	Name of House Financing
Al-Baraka Bank (Pakistan) Limited	Al-Bait Home Finance
Bank Islami Pakistan Limited	MUSKUN Home Financing
Burj Bank Limited	Burj Home Musharakah
Dubai Islamic Bank Pakistan Limited	Dubai Islamic Home Finance
Meezan Bank Limited	Meezan easy Home
MCB Islamic Bank Limited	-

House Building Finance Company Limited (HBFCL) is the largest financial institution, providing financing to the consumers in Pakistan. As HBFCL is managed and controlled by Federal Government, it is fulfilling its responsibility to provide house financing facilities to the people of this country. Conventional banking is in practice in Pakistan since its establishment in 1947, whereas Islamic banking industry has started its operation in 2002. All conventional banks are providing house financing facility on conventional basis whereas, Islamic banks are using Islamic modes of financing for the provision of his facility to the consumers.

Figure 1: Overall Industry Gross Outstanding (Pak Rupees in Billion)



Currently, house financing sector is growing rapidly in Pakistan. Figure 1 represents the overall industry gross outstanding. According to the statistics, it was PKR 54,54 billion in March 2015. By the end of March 2016, it reached at PKR 62.96 billion which is 4.6% increase in one year. This shows that house financing sector is gaining the attention of all those who can afford to avail this facility. This trend also shows that the need for own house is increasing in Pakistan.

Figure 2: Gross Outstanding as per Banking Sectors (Pak Rupees in Billion)

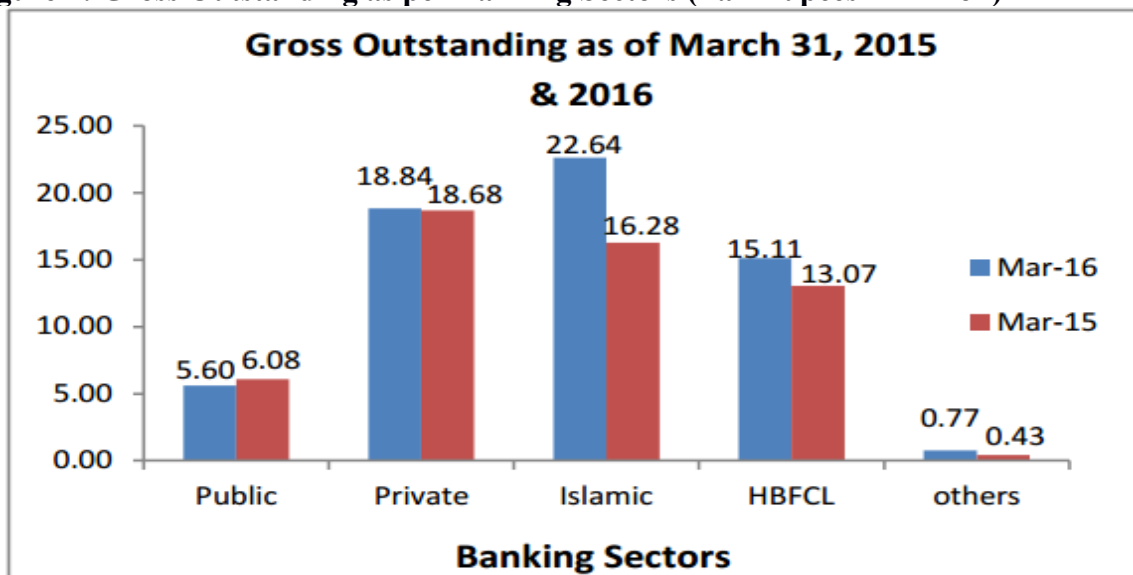
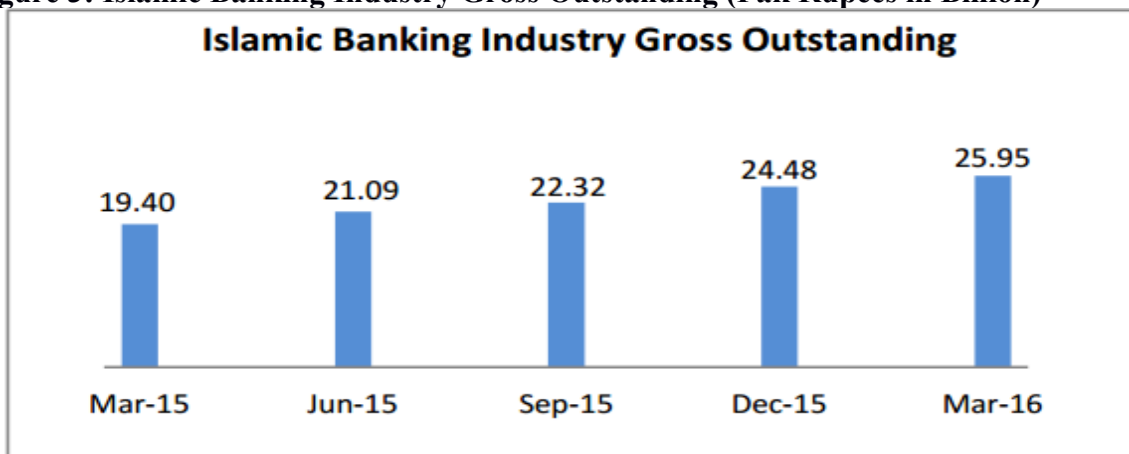


Figure 2 shows house financing gross outstanding as per different banking sectors and financial institutions. Public sector banks have an outstanding of PKR 6.08 billion in March 2015 and it decreased to PKR 5.60 billion by the end of March 2016. This decrease was due to the shifting of consumers towards other financial institutions. Conventional and private banks gross outstanding was PKR 18.68 billion in March 2015 which increased to PKR 18.84 billion in March 2016. This shows an increase of only 1% due to the reason that people are switching towards Islamic banking system. House Building Finance Company Limited(HBFC) only has contributed PKR 13.07 billion in March 2015 which increased to PKR 15.11 billion in

March 2016 which is 15.6% increase. The reason of this increase is that HBFCL has also started Islamic House Financing along with conventional system. Therefore, many of the consumers have availed Islamic house financing from HBFCL. Islamic banking sector has shown an extraordinary growth as its total outstanding was PKR 16.28 billion in March 2015 which increased to PKR 22.64 billion which is 39% increase in only one year's time. This huge increase is showing the confidence and trust of consumers towards Islamic house financing system which is playing its major role with 36% share in this sector.

Figure 3: Islamic Banking Industry Gross Outstanding (Pak Rupees in Billion)



Gross outstanding of Islamic Banking Industry has increased from PKR 19.4 billion in March 2015 to PKR 25.95 billion in March 2016 which is 33.8% increase within a period of one year. This huge growth is showing the acceptance of Islamic house financing by the consumers in Pakistan.

Figure 4: Breakup of total outstanding according to loan size (Pak Rupees in Billion)

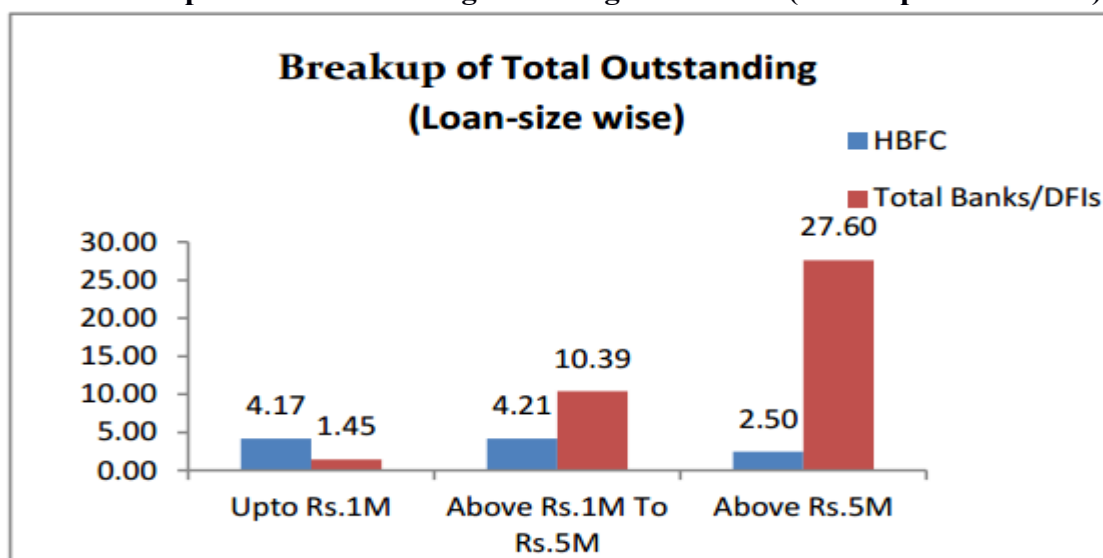
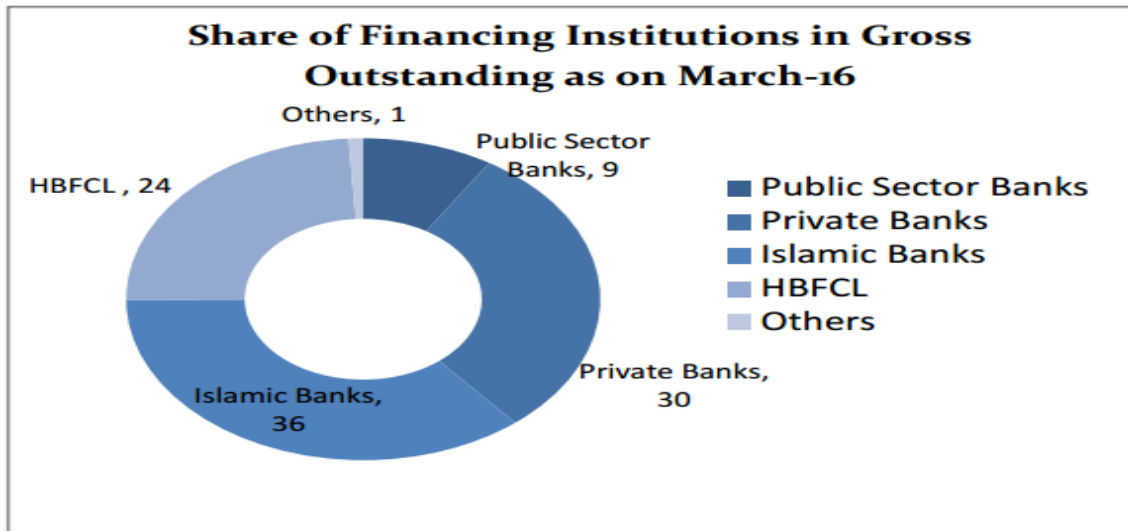


Figure 4 represents the breakup of total outstanding according to loan size. By the end of March 2016, total outstanding was PKR 1.45 billion of all conventional and Islamic banks and PKR 4.17 billion of House Building Finance Company Limited(HBFCL) of those loans which were up to PKR 1.0 million. This financing is availed by low income segment of the society. Total outstanding was PKR 10.39 billion of all conventional and Islamic banks and PKR 4.21 billion of House Building Finance Company Limited(HBFCL) of those loans which were

from PKR 1.0 million to PKR 5.0 million. However, total outstanding was PKR 27.60 billion of all conventional and Islamic banks and PKR 2.5 billion of House Building Finance Company Limited(HBFCL) of those loans which were above PKR 5.0 million. This trend shows that those consumers whose financing affordability is high, are preferring banking industry including conventional and Islamic.

Figure 5: Share (%) of financial institutions in



As on 31st March 2016, share of public sector banks in total house financing is 9% and share of private banks is 30%. These banks are working on conventional basis out of which 17 banks have established their Islamic Banking Divisions. Share of HBFCL is 24% which is also working on conventional basis with a limited portion of Islamic house financing. Other financial institutions contribute only 1% in total house financing. Remarkably, the share of Islamic banks in total house financing is 36% which is the highest proportion by any category. This shows the rapid growth of Islamic house financing in Pakistan.

Figure 6: Share of Islamic banking and Islamic Banking Divisions of Conventional Banks

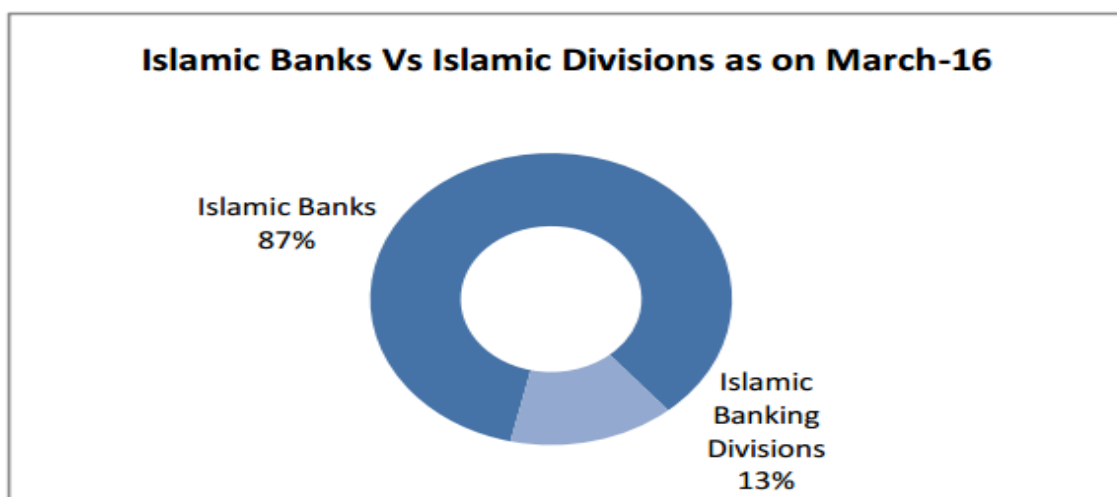
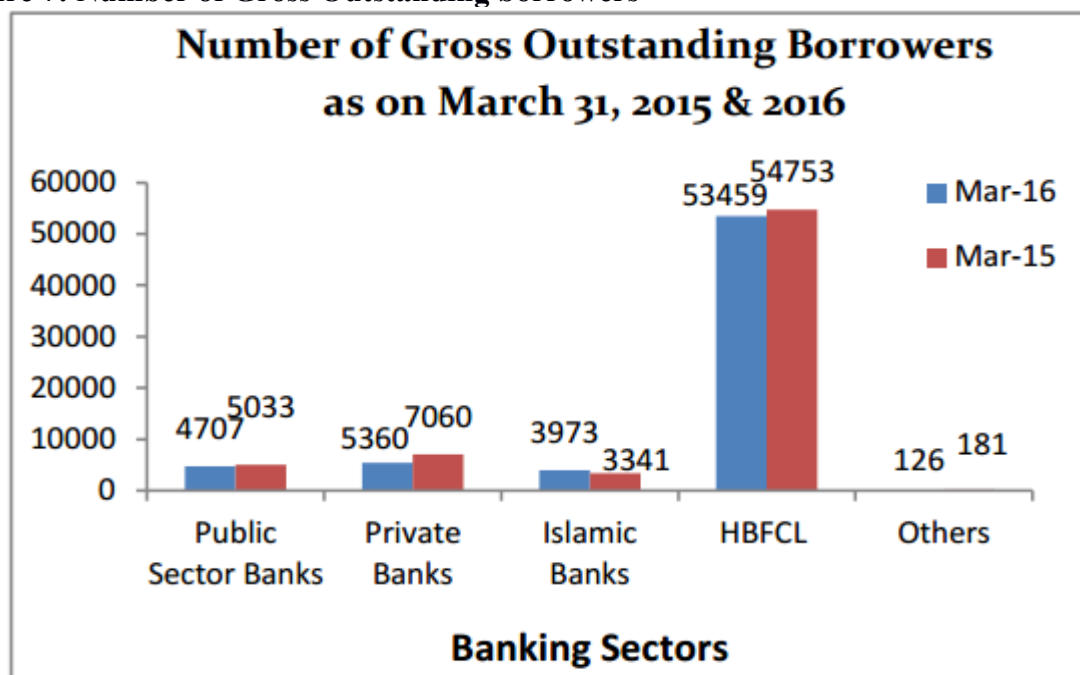


Figure 6 represents the percentage share of Islamic banks which is 87% in total outstanding house financing by Islamic banking industry. The share of Islamic Banking Divisions of conventional banks is only 13% which shows that consumers are preferring to avail house

financing from Islamic banks and they are not fully relying on Islamic Banking Divisions established by conventional banks in Pakistan.

Figure 7: Number of Gross Outstanding borrowers



Total number of house financing borrowers from public sector banks was 5,033 in March 2015 which decreased to 4,707 by the end of March 2016. Borrowers from private banks were 7,060 in March 2015 which were decreased to 5,360 by the end of March 2016. Similarly, house financing borrowers from House Building Finance Company Limited(HBFCL) are decreased from 54,753 in March 2015 to 53,459 by the end of March 2016. Decrease in all these banks and financial institutions is due to the shifting of consumers toward Islamic house financing. Therefore, the borrowers of only Islamic banking sector are increased from 3,341 in March 2015 to 3,973 in March 2016 which shows the trust and confidence of bank consumers towards Islamic house financing.

Table 3: No. of outstanding borrowers, NPLs and active borrowers

Banks/DFIs	March 2015			March 2016		
	Total O/s Borrowers	Borrowers Classified as NPL	Active Borrowers	Total O/s Borrowers	Borrowers Classified as NPL	Active Borrowers
Public Sector	5,033	942	4,091	4,707	914	3,793
Private Banks	7,060	1,668	5,392	5,360	1,870	3,490
Islamic banks	3,341	270	3,071	3,973	227	3,746
HBFCCL	54,753	36,580	18,173	53,459	33,370	20,089
Others	181	122	59	126	104	22
Total	70,368	39,582	30,786	67,625	36,485	31,140

Figure 8: NPLs of all banking sectors (Pak Rupees in Billion)

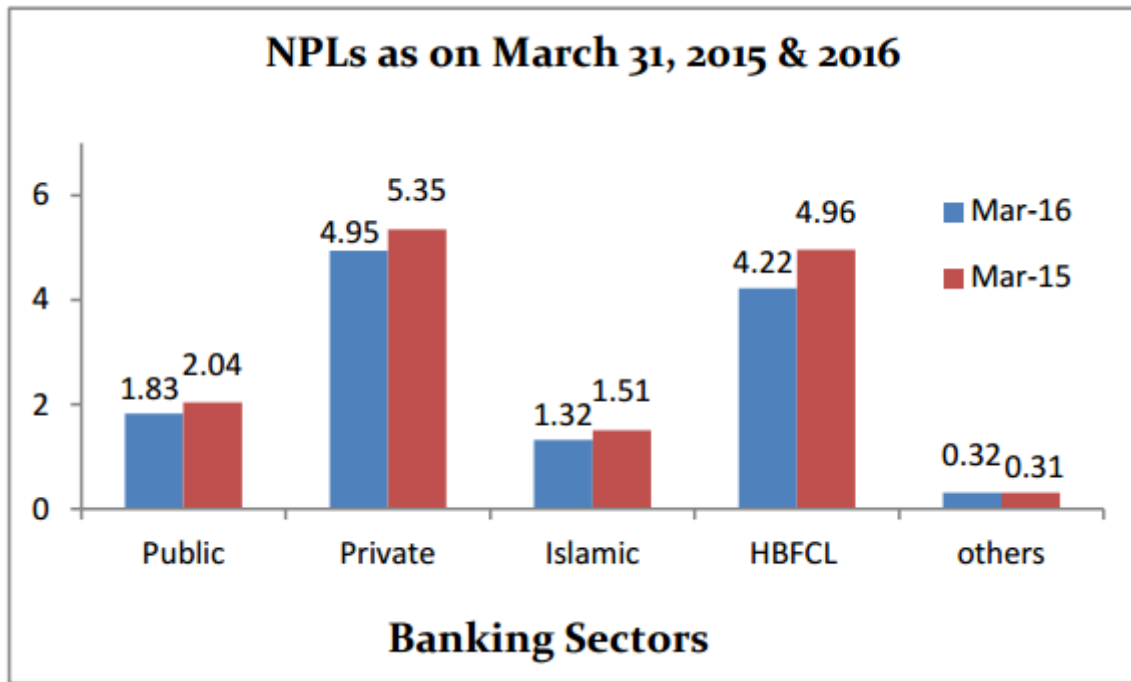


Table 3 shows the figures of total outstanding house financing borrowers, borrowers classified as NPLs and total active borrowers by the end of March 2015 and March 2016. Similarly, Figure 8 shows the amount of NPLs of all banking sectors. Total NPLs of public sector banks were Pak Rupees 2.04 billion in March 2015 which were 18.7% of total outstanding borrowers. This amount decreased to Pak Rupees 1.83 billion in March 2016 which are 19.4 % of total outstanding borrowers. Total NPLs of private banks were Pak Rupees 5.35 billion in March 2015 which were 23.6% of total outstanding borrowers. This amount decreased to Pak Rupees 4.95 billion in March 2016 which are 34.9% of total outstanding borrowers. Total NPLs of Islamic banks were Pak Rupees 1.51 billion in March 2015 which were 8.1% of total outstanding borrowers. This amount decreased to Pak Rupees 1.32 billion in March 2016 which are 5.7% of total outstanding borrowers. Total NPLs of House Building Finance Company Limited (HBFCCL) were Pak Rupees 4.96 billion in March 2015 which were 66.8% of total outstanding borrowers. This amount decreased to Pak Rupees 4.22 billion in March 2016 which are 62.4% of total outstanding borrowers. Total NPLs of other financial institutions were Pak Rupees 0.31 billion in March 2015 which were 67.4% of total outstanding borrowers. This amount increased to Pak Rupees 0.32 billion in March 2016 which are 82.5% of total outstanding borrowers. All these figures and rates show that the borrowers of Islamic banks are sincerer in returning their house financing amounts as compare to all other financial institutions.

Figure 9: Gross outstanding as on March 31, 2016 (Pak Rupees in Billion)

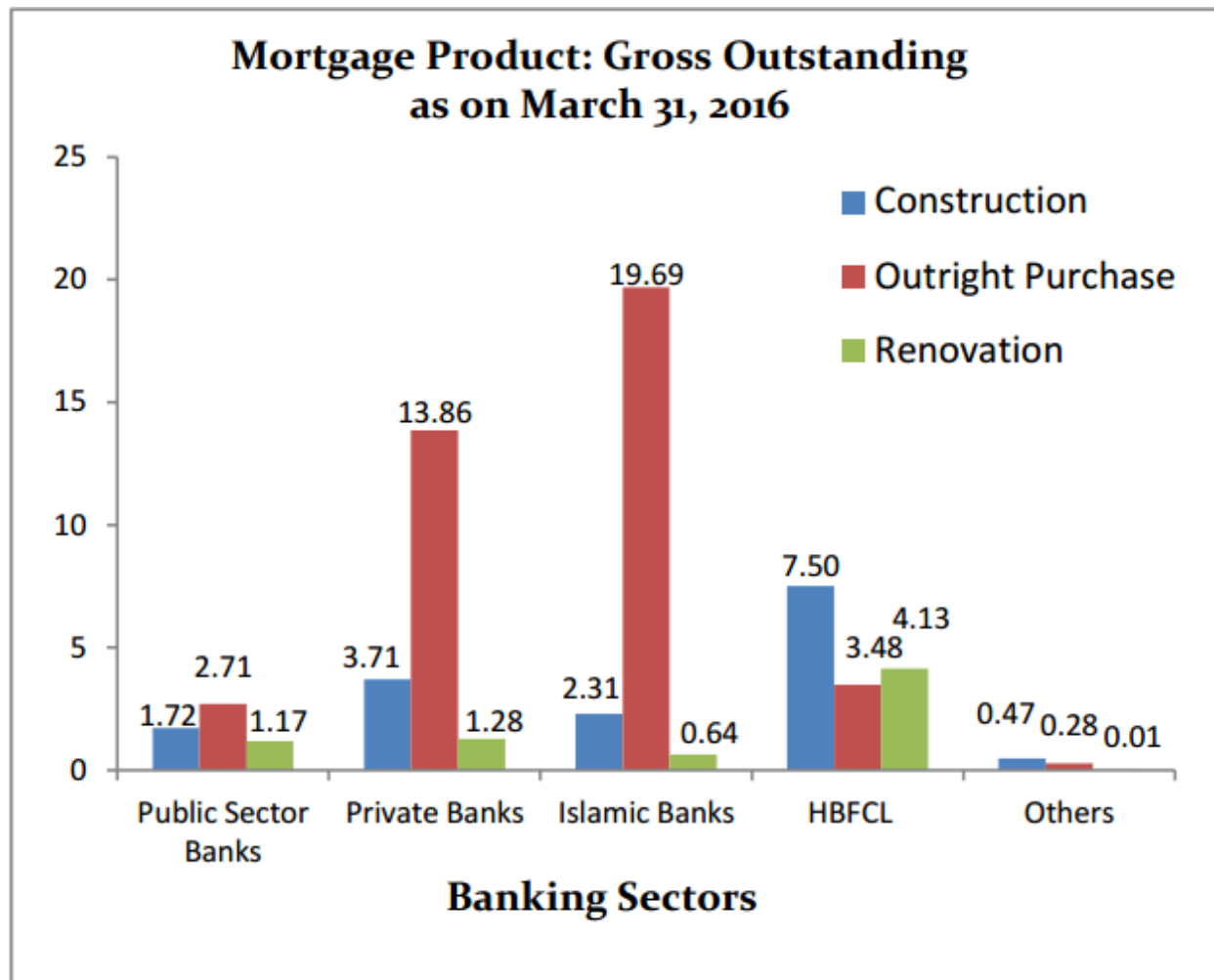


Figure 9 represents the gross outstanding amount of all banking sectors by the end of March 2016. Total outstanding amount of public sector banks is Pak Rupees 5.6 billion consisting of Pak Rupees 1.72 billion for construction, Pak Rupees 2.71 billion for purchase and Pak Rupees 1.17 billion for renovation purposes. Total outstanding amount of private banks is Pak Rupees 18.85 billion consisting of Pak Rupees 3.71 billion for construction, Pak Rupees 13.86 billion for purchase and Pak Rupees 1.28 billion for renovation purposes. Total outstanding amount of Islamic banks is Pak Rupees 22.64 billion consisting of Pak Rupees 2.31 billion for construction, Pak Rupees 19.69 billion for purchase and Pak Rupees 0.64 billion for renovation purposes. Total outstanding amount of House Building Finance Company Limited (HBFCL) is Pak Rupees 15.11 billion consisting of Pak Rupees 7.50 billion for construction, Pak Rupees 3.48 billion for purchase and Pak Rupees 4.13 billion for renovation purposes. Total outstanding amount of other financial institutions is Pak Rupees 0.76 billion consisting of Pak Rupees 0.47 billion for construction, Pak Rupees 0.28 billion for purchase and Pak Rupees 0.01 billion for renovation purposes. Overall, total outstanding amount of all banking sectors is Pak Rupees 62.96 billion consisting of Pak Rupees 15.71 billion for construction (24.9% of total outstanding amount), Pak Rupees 40.02 billion for purchase (63.56% of total outstanding amount) and Pak Rupees 7.24 billion for renovation purposes (11.5% of total outstanding amount). These figures show that house financing consumers are more inclined towards purchasing of houses in Pakistan.

Conclusion

The importance of house financing is a key element in the economic development of any country. Being a developing country, this sector has tremendous importance as a vast majority

of people don't have their own houses in Pakistan. Government is trying its level best to provide housing facility to all needy people but it is not possible for it to cater all segments of the society. Therefore, there is a huge responsibility of financial institutions to provide house financing to the consumers. As conventional banking is as old as the country is, this sector has established house financing and providing finances to the consumers for purchase, construction and renovation of houses. The age of Islamic banking is very small as it started in 2002 in the country. Currently, there are only 6 full-fledged Islamic banks operating in the country with 2,082 branches which are offering Islamic house financing. 17 conventional banks have also established Islamic Banking Divisions and providing Islamic house financing to the consumers. Therefore, Islamic banking sector is playing its leading role in the provision of Islamic house financing.

By the end of March 2016, total outstanding house financing by all financial institutions is Pak Rupees 62.96 billion. Out of this amount, the proportion of Islamic house financing is Pak Rupees 22.64 billion which is 36% share of total outstanding amount. This shows the trust and confidence of bank consumers towards Islamic banks and they are preferring their banking services due to reason that Islamic banks are working under the principles and guidance of *Sharia'h*. The economic development of any country is also associated with the development of housing sector. Therefore, by the development of house financing, Pakistan's economy is also developing. Islamic house financing, as a major shareholder, is playing its vital role in economy's development and it is expected that this sector will increase its share in future.

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Currency Conversion Rate: 1 US\$ = Pak Rupees 105.00 (as on 15 April 2017)

Appendix 1: List of conventional banks who established Islamic Banking Divisions

Allied Bank Limited	Askari Bank Limited
Bank Al-Habib Limited	Bank Al-Falah Limited
Faysal Bank Limited	Habib Bank Limited
Habib Metropolitan Bank Limited	MCB Bank Limited
National Bank of Pakistan	Silk Bank Limited
Sindh Bank	Soneri Bank Limited
Standard Chartered Bank (Pakistan) Limited	Summit Bank Limited
The Bank of Khyber	The Bank of Punjab
United Bank Limited	

