HOUSE BUILDING FINANCE COMPANY LIMITED

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WHY MORTGAGE FORECLOSURE REMAINS A STRUGGLE IN PAKISTAN

RESEARCH REPORT

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ABSTRACT

This research examines Pakistan's mortgage foreclosure process, analyzing its legal framework, implementation challenges, and impact on the housing finance sector's development. The study reveals that Pakistan's foreclosure system, governed primarily by the Financial Institutions (Recovery of Finances) Ordinance of 2001 and Rules of 2018, faces significant structural and procedural inefficiencies that contribute to the underdevelopment of the mortgage market. The current 90+ day timeline involves multiple steps including mandatory chartered accountant assessment, three separate demand notices, valuation by multiple valuers, and court-supervised possession proceedings, creating substantial delays compared to international benchmarks.

Through comparative analysis with international practices in Sri Lanka, Texas, and Singapore, the research identifies key bottlenecks in Pakistan's foreclosure timeline. Each step of Pakistan's process is benchmarked against global alternatives, revealing opportunities to streamline procedures while maintaining borrower protections. The research proposes adopting elements from Sri Lanka's internal debt assessment, Texas's condensed notice periods, and Singapore's efficient court-supervised auctions to reduce Pakistan's foreclosure timeline without sacrificing fairness.

The findings demonstrate a direct correlation between foreclosure challenges and Pakistan's stunted mortgage market, which stands at merely 0.2% of GDP compared to regional peers like Malaysia (44.4%), Singapore (33.0%), and India (11.2%). Banking statistics from December 2024 further illustrate this relationship, showing that mortgage loans constitute only 23.3% of consumer sector advances while accounting for a disproportionate 36.97% of consumer non-performing loans. With a concerning infection ratio of 6.8%, mortgage lending remains a high-risk sector for Pakistan's banks despite their healthy capital adequacy ratio of 20.6%.

The research concludes with seven targeted policy recommendations to streamline the foreclosure process, including establishing dedicated foreclosure tribunals, digitizing land records, creating secondary markets for distressed properties, and implementing flexible cost-of-funds mechanisms. By addressing specific inefficiencies identified in the comparative analysis, these reforms aim to enhance lender confidence, reduce recovery timelines, and ultimately expand access to housing finance in Pakistan, bringing the country closer to regional standards of mortgage market development.

WHAT IS FORECLOSURE?

Foreclosure is a legal process where a lender seeks to recover the outstanding loan amount from a borrower who has defaulted on their mortgage payments. When a borrower fails to meet their repayment obligations, the lender may take possession of the mortgaged property, sell it, and use the proceeds to settle the debt. Globally, foreclosure balances the rights of lenders to recover funds and borrowers to receive fair treatment under the law.

WHAT IS DEFAULT IN LAW?

In Pakistan's legal context, a default occurs when a borrower fails to fulfill their obligations to a lender, such as missing mortgage payments or breaching other terms of the loan agreement. This failure, as defined under the Financial Institutions (Recovery of Finances) Ordinance, 2001, triggers the lender's right to initiate foreclosure proceedings to recover the outstanding amount.

HOW FORECLOSURE WORKS LEGALLY IN PAKISTAN

In Pakistan, foreclosure under the Financial Institutions (Recovery of Finances) Ordinance, 2001, and Rules, 2018, is a structured process designed for transparency, typically spanning over 90 days. It begins with a lender verifying the defaulted amount through an independent Chartered Accountant, followed by issuing multiple notices over 58 days to demand payment. If unpaid, the borrower's rights to collect rent from the property transfer to the lender, securing income. The property is then valued by experts, advertised in newspapers, and sold at a public auction, with the highest bidder completing payment within 17 days. A Banking Court oversees the sale deed and any eviction, protecting bona fide tenants until their lease expires or compensation is provided, while surplus proceeds return to the borrower after creditor payouts, with a seven-day window to challenge the sale for fraud. If the lending institution is unable to liquidate the collateral through the auction process, they may extinguish the debt by exercising their right to execute a debt property swap.

Steps	Description	Timeframe	Exact Legal Text	Notes
Determination of Liability	Pre-notice step. Financial institution engages an independent Chartered Accountant (CA) firm to determine the outstanding mortgage money. Other mortgagees are asked to submit claims. CA examines accounts and reports liability.	7 days notice; 30 business days for report	CA Notice to Parties: "after seven days due notice to the parties". CA Report Submission: "within thirty business days from the date of the appointment". Other Mortgagees: No legal time frame specified.	Governed by Rule 3(a) of the Financial Institutions (Recovery of Finances) Rules, 2018. Demand notices cannot exceed the CA-determined liability.
First Notice of Demand	Triggered by customer default. Financial institution sends notice demanding payment of outstanding mortgage money.	14 days	"...demanding payment of the mortgage money outstanding within fourteen days from service of the notice...".	Section 15(2) of the Ordinance.
Second Notice of Demand	Sent if payment is not received after the first notice period expires.	14 days	"...send a second notice of demand for payment of the amount within fourteen days.".	Section 15(2) of the Ordinance.
Final Notice of Demand	Served if the customer continues to default after the second notice period expires.	30 days	"...demanding the payment of the mortgage money outstanding within thirty days from service of the final notice on the customer."	Section 15(2) of the Ordinance.
Transfer of Rent/ Profit Rights	Upon service of the final notice, the mortgagor's rights to recover rents/ profits from the property transfer to the financial institution. Tenants must pay rent directly to the financial institution upon notice.	Effective upon service	"When a financial institution serves a final notice of demand, all powers of the mortgagor in regard to recovery of rents and profits from the mortgaged property shall stand transferred...". No specific duration mentioned.	Section 15(3) of the Ordinance.
Valuation of Mortgaged Property	If payment fails after the final notice period, the financial institution hires three approved valuers to determine the forced sale value (reserve price = highest value). Requires re-evaluation if older than 6 months.	7 business days to hire; 15 days to value; 6 months validity	Hiring Valuers: "within seven business days after the expiry of the thirty days period of the final notice...". Valuation Completion: "within fifteen days of their appointment...". Valuation Validity: Re-evaluate if older than "six months" at publication time.	Governed by Rule 3(b) of the Rules, 2018. Linked to Section 15(4)(a) & (d) of the Ordinance.

Steps	***Description***	***Timeframe***	***Exact Legal Text***	***Notes***
Publication of Auction Notice	Financial institution publishes auction notice in one English and one Urdu daily newspaper with wide circulation in the relevant province. Notice includes property details, amount, reserve price, auction time/place etc..	Not specified	No legal time frame specified between valuation completion and publication.	Rule 3(c)(i) of the Rules, 2018 and Section 15(4)(b) of the Ordinance. Current practice needs updating as newspaper readership has declined substantially.
Notice to Mortgagor & Parties	A notice with the same details as the public notice is sent to the mortgagor and all known interested parties (mortgagees).	Not specified	No legal time frame specified relative to the public notice.	Section 15(4)(c) of the Ordinance.
Public Auction	The public auction takes place to sell the property.	After 15 days	"...shall take place after fifteen days of the publication of the notice under clause (b) of sub-section (4) of section 15...".	Rule 3(c)(ii) of the Rules, 2018. Financial institution can participate/bid.
Bidder Deposit (Initial)	Successful bidder deposits a minimum percentage of the bid amount soon after the auction.	2 business days	"...deposit minimum twenty-five percent of the bid amount within two business days of the auction.".	Rule 3(c)(v) of the Rules, 2018.
Bidder Deposit (Remaining)	Successful bidder deposits the remaining balance. Failure results in forfeiture and re-auction.	15 days	"...deposited within fifteen days from the date of the initial deposit.".	Rule 3(c)(v) of the Rules, 2018.
Execution & Registration of Sale Deed	Financial institution executes the sale deed as the mortgagor's attorney, transferring ownership to the purchaser.	After 7 days	Cannot be executed/ registered "until expiry of seven days after the completion of the public auction...".	Section 15(8) & (9) of the Ordinance. Rights vest free from encumbrances upon registration.

Steps	*Description*	*Timeframe*	*Exact Legal Text*	*Notes*
Filing of Sale Accounts	Financial institution files accounts of sale proceeds with the Banking Court. Proceeds distributed to mortgagees; surplus to mortgagor.	14 days	"...file proper accounts of the sale proceeds in a Banking Court within fourteen days of the sale.".	Section 15(11) of the Ordinance.
Application to Set Aside Sale (Fraud)	Mortgagor or affected party may apply to Banking Court to set aside sale only for fraud causing substantial injury. Requires deposit/security.	7 days	Application "must be made within seven days of completion of the public auction..."Requires deposit equal to twenty-five percent of the reserve price or security for the same amount.	Section 15(14) & (15) of the Ordinance.
Possession / Eviction	If possession is not given voluntarily, the financial institution or purchaser applies to the Banking Court, which can order possession. Bona fide tenants may be protected.	Not specified	No legal time frame specified for the court application or the process of granting possession.	Section 15(7) of the Ordinance. Eviction of bona fide lessee only after lease expiry or compensation.
Debt Property Swap Option (Alternative)	When auction attempts fail to liquidate the collateral, banks/DFIs may acquire property to settle debt bypassing auction, with PBA-approved valuation and verified title, approved by a higher authority.	Not specified	Regulation 1, Clause 3: "DPS should be transacted only for the loans classified in the category of 'Loss'."	After Final Notice. Governed by SBP's 2016 DPS Regulations. Limited to 25% of 10% real estate exposure (Regulation 3).

COMPARATIVE ANALYSIS OF PAKISTAN FORECLOSURE PROCESS WITH INTERNATIONAL BEST PRACTICES

Foreclosure processes worldwide offer insights for Pakistan to streamline its 90+ day timeline, enhancing lender efficiency while preserving fairness. Below, each of Pakistan's foreclosure steps, including eviction, is compared with practices in Sri Lanka (Parate Law), Texas (non-judicial foreclosure), and Singapore (judicial foreclosure), proposing the best alternative practice for legal reform to expedite sales and reduce costs.

STEP 1: DETERMINATION OF LIABILITY

Pakistan's Approach:
Pakistan initiates foreclosure with a 30-day Chartered Accountant assessment to verify the defaulted amount, ensuring accuracy before notices (Rule 3(a), 2018 Rules). This delays action, even if borrowers settle early. This requirement is particularly problematic given that only about 1,000 of Pakistan's 10,000 qualified chartered accountants work in public accounting practices, creating potential bottlenecks.

Global Alternatives:
No other country requires financial institutions to undertake independent verification of liability prior to sending a notice of default. Even within Pakistan's own regulatory framework, the SBP's Debt Property Swap Regulations (2016) do not mandate independent CA verification, instead relying on the bank's internal assessment for loan classification as "Loss" before initiating a debt property swap.

Sri Lanka's Parate Law deems the entire loan due upon default, using bank records without external audits, enabling immediate steps (Section 3, Act No. 4 of 1990).

Texas relies on internal calculations, avoiding third-party costs (Texas Property Code § 51.002).

Singapore similarly uses lender records, bypassing formal verification for speed.

Comparative Analysis:
Pakistan's CA reduces disputes but slows progress compared to Sri Lanka's 45-60 day timeline or Texas's 60-day auction.

Best Alternative:
Sri Lanka's internal debt assessment allows rapid action. Pakistan could amend Section 15 of the 2001 Ordinance to shift liability verification after notices, requiring CA audits only for unresolved defaults, lowering costs for cases settled early, aligning with Sri Lanka's efficiency.

STEP 2: NOTICES OF DEMAND

Pakistan's Approach:
Pakistan mandates three notices—14 days, 14 days, and 30 days—totaling 58 days to demand payment, prioritizing transparency (Section 15(2), 2001 Ordinance). This prolongs the process compared to global systems.

Global Alternatives:
Sri Lanka's Parate Law uses no fixed default notice, moving to a board resolution and a 14-day sale notice for auctions (Sections 8-9).

Texas issues a single 20-day cure notice, followed by a 21-day sale notice, totaling 41 days (Texas Property Code § 51.002).

Singapore requires a 30-day statutory notice before court action, keeping the timeline lean (Conveyancing and Law of Property Act).

Comparative Analysis:
Pakistan's notices ensure borrower opportunity but delay auctions.

Best Alternative:
Texas's single 20-day notice balances rights and speed, shortening the timeline. Amending Section 15(2) to consolidate notices into one 20-day or two 15+25-day demands could accelerate foreclosure, nearing Texas's 60-day benchmark while maintaining fairness.

Moreover, notice delivery methods need modernization. Current requirements for physical notices are outdated in the digital era. Pakistan's legal framework already supports this modernization - under the Qanoon-e-Shahadat Order (QSO) 1984, specifically Articles 46-A and 164, digital evidence produced by modern devices or techniques is admissible in court. Additionally, the Electronic Transactions Ordinance 2002 ensures that no document, record, or transaction is denied legal recognition solely because it is in electronic form. Curing notices should be permitted via phone calls, text messages, or emails, with physical notices as backup rather than primary requirement. Full repayment demands could similarly be communicated through digital channels, leveraging the legal validity of electronic communications. This would significantly accelerate the notification process while maintaining a verifiable record of communications.

STEP 3: TRANSFER OF RENT/PROFIT RIGHTS

Pakistan's Approach:
After the final notice, Pakistan transfers the borrower's rent/profit rights to the lender, securing pre-sale income, a unique feature absent globally (Section 15(3), 2001 Ordinance).

Lenders legally determine rent through mortgage documents or demands for lease details during notices (Sections 15(1)-(2)), with tenants notified via registered post or publication to redirect payments (Section 15(2)).

Tenant occupancy is confirmed using the borrower's registered address, municipal records, or inspections, ensuring notices reach the correct party (Sections 15(1), 15(3)).

Global Alternatives:
Sri Lanka addresses tenant possession only post-sale, with no rent redirection (Section 16, 1990 Act).

Texas evicts tenants post-auction, ignoring interim income (Texas Property Code § 51.002).

Singapore focuses on sale proceeds, not rents, post-possession.

Comparative Analysis:
Pakistan's approach enhances recovery during its 90+ day timeline, though the 58-day delay and challenges in verifying tenancy (e.g., informal leases, borrower obstruction) may limit income capture. Furthermore, when rental yields fall well below the Monetary Policy target rates adjusted for credit spreads, this mechanism becomes financially inefficient for lenders who must allocate capital under Capital Adequacy Directive requirements.

Best Alternative:
Rather than relying on rent transfers, Pakistan should adopt Singapore's streamlined foreclosure process, which emphasizes rapid sale and recovery rather than interim income collection. This approach recognizes that property possession and sale typically provide greater recovery value than rent collection. Pakistan should amend Section 15(3) to focus on expediting the foreclosure timeline rather than extending the rent collection period, which often provides insufficient returns relative to capital requirements.

STEP 4: VALUATION AND AUCTION

Pakistan's Approach:
Pakistan employs three valuers to set a forced sale value within 15 days, followed by newspaper ads and a 15-day wait for a public auction, totaling 30+ days (Rule 3(b)-(c), 2018 Rules). This ensures fair pricing but restricts bidder reach.

Global Alternatives:
Sri Lanka sets an upset price via board discretion, with a 14-day multi-language sale notice, enabling auctions in 20-30 days (Sections 9, 11).

Texas uses lender estimates, no formal valuation, with a 21-day notice to a fixed monthly auction, concluding in 25-30 days.

Singapore's court-ordered auctions, post-30-day notice, leverage robust markets for quick sales (30-45 days).

Comparative Analysis:
Pakistan's process is thorough but slower.

Best Alternative:
Singapore's court-supervised auctions, supported by a single valuer and digital listings, attract high bidders in fewer days. Pakistan could revise Rule 3 and Section 15(4) to use one valuer and utilize specialized web portals such as those comparable to Foreclosure.com, RealtyTrac, Zillow, and Auction.com internationally. These platforms offer various types of distressed properties, including pre-foreclosures, bank-owned properties, and those sold at auction. Moving beyond traditional newspapers to digital platforms would reach a wider audience of potential buyers, shortening the timeline and enhancing sale prices.

STEP 5: SALE AND POSSESSION

Pakistan's Approach:
Pakistan's highest bidder pays 25% within two days and the balance in 15 days, with a sale deed executed. Eviction requires Banking Court approval, protecting tenants until lease expiry or compensation, taking 30-60 days (Section 15(7)-(9), 2001 Ordinance).

Global Alternatives:
Sri Lanka's sale vests title via a certificate, with possession through District Court orders or tenant notices in 15-30 days (Sections 15-16).

Texas completes sales at auction, with eviction via a 3-day notice and forcible detainer lawsuit in 10-20 days.

Singapore's court orders possession post-sale, evicting in 30 days with minimal tenant protections.

Comparative Analysis:
Pakistan's safeguards slow possession.

Best Alternative:
Singapore's streamlined possession, post-court auction, balances speed and oversight. Amending Section 15(7) to expedite court eviction orders while compensating tenants could shorten possession time, improving recovery, drawing on Singapore's efficiency.

STEP 6: POST-SALE PROCESS

Pakistan's Approach:
Pakistan requires filing sale proceeds with the Banking Court within 14 days, distributing to creditors, with surplus to the borrower and a seven-day fraud challenge window, adding 7-14 days (Section 15(11), (14)-(15)).

Global Alternatives:

Sri Lanka's banks distribute proceeds directly, with no standard challenge period, concluding in 5-10 days (Section 14).

Texas avoids court filing, resolving challenges privately in 5 days.

Singapore's courts oversee distribution, wrapping up in 10-15 days with limited challenges.

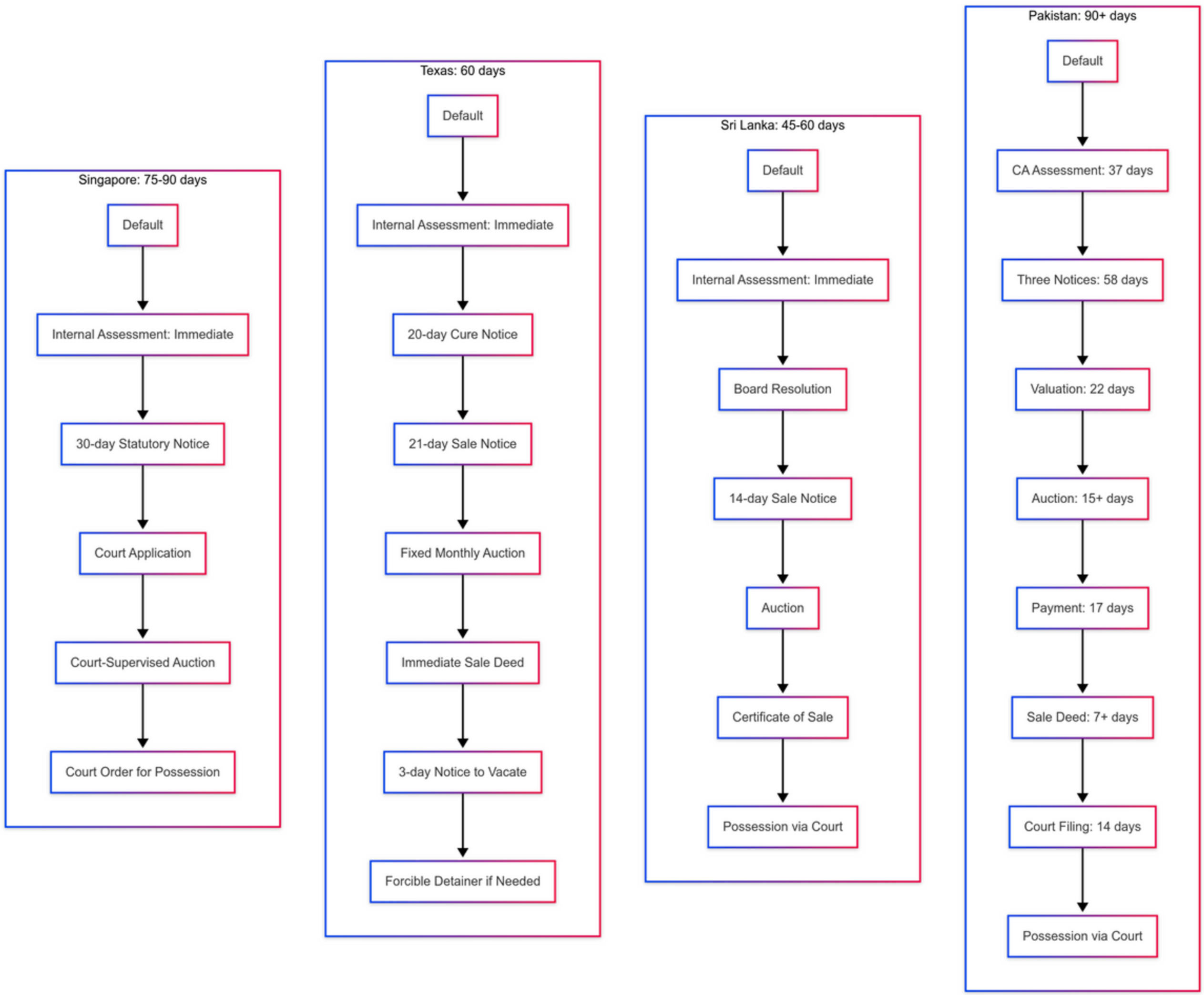
Comparative Analysis:

Pakistan's oversight ensures equity but delays closure.

Best Alternative:

Sri Lanka's direct bank distribution speeds closure. Amending Section 15(11) to allow banks to distribute proceeds with auditor oversight, retaining the fraud challenge, could reduce delays and lower court costs, aligning with Sri Lanka's model.

Foreclosure Timeline Comparison Across Countries



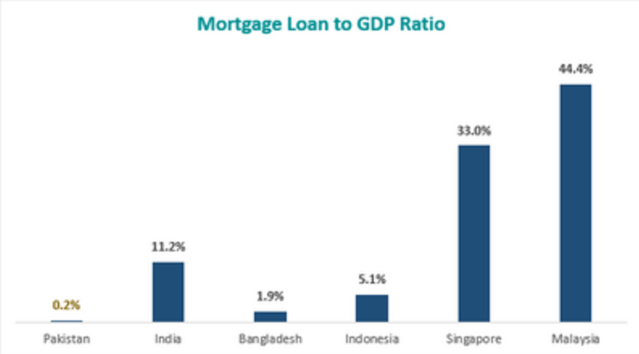
WHY PAKISTAN LAGS IN MORTGAGE MARKET DEVELOPMENT

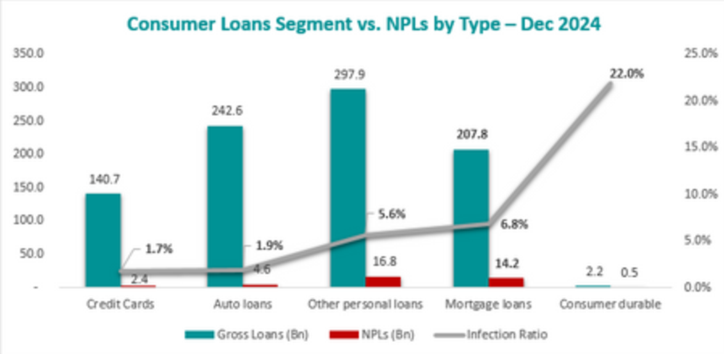
Countries like Singapore, Malaysia, and India have significantly more mortgage borrowers than Pakistan due to targeted policies that expand access and reduce lender risk, as seen in their higher mortgage loan-to-GDP ratios—Singapore at 33.0%, Malaysia at 44.4%, and India at 11.2%, compared to Pakistan's 0.2%. These countries offer subsidized mortgage products and efficient foreclosure frameworks that encourage lending, with Singapore's HDB scheme providing home loans at 2-3% interest, Malaysia's My First Home Scheme offering 100% financing at 3-4%, and India's PMAY giving interest subsidies of up to 6.5% for low-income borrowers. Additionally, lending behavior in Pakistan is shaped by the overall risk environment faced by banks, with high NPL ratios in key sectors (Sugar 11.6%, Electronics 15.6%, Textile 6.9%) making institutions conservative in their lending strategies. Recent data from December 2024 shows that mortgage loans have an NPL ratio of approximately 6.8% (PKR 14.2 billion NPLs out of PKR 207.8 billion total mortgage loans), further illustrating the hesitancy among lenders.

Pakistan's mortgage market remains underdeveloped due to a combination of low household income, high property prices, and limited access to formal credit. With median house prices in Pakistan at PKR 5.4 million and median annual household income at PKR 1.1 Million, the typical property costs approximately 5.06 times the annual income, making even basic homes unaffordable without significant financing.

Recent banking statistics from December 2024 provide empirical evidence of Pakistan's underdeveloped mortgage market. While regional peers maintain significant mortgage loan-to-GDP ratios, the data reveals that mortgage loans constitute only PKR 207.8 billion (23.3% of consumer sector loans) of Pakistan's total consumer advances of PKR 891.2 billion. More concerning is the mortgage sector's disproportionately high NPL ratio—mortgage NPLs stand at PKR 14.2 billion, representing 36.97% of all consumer sector NPLs despite making up only 23.3% of the consumer loan portfolio. This clearly demonstrates that mortgage lending in Pakistan carries substantially higher risk than other consumer loan categories such as credit cards, which represent 15.8% of consumer loans but only 6.25% of consumer NPLs.

Pakistan faces numerous structural and institutional challenges that limit mortgage uptake, including high interest rates (around 12-15%), legal uncertainties in enforcing Section 15 of the Financial Institutions (Recovery of Finances) Ordinance 2001, prolonged foreclosure procedures, an informal economy where most potential borrowers lack documented income or credit histories, low financial literacy, cultural preferences for cash-based purchases and joint family living, and a shortage of titled, mortgageable housing stock. Although initiatives like the PBA's Mortgage Task Force, Naya Pakistan Housing Scheme, and digital tools such as eKYC and Raast P2M aim to address these gaps, meaningful progress requires fundamental reforms in foreclosure enforcement, credit infrastructure, and public awareness to replicate the success of regional peers and broaden mortgage market participation.





Note: Based on latest available figures

Source: HBFC Research, SBP

CHALLENGES IN PAKISTAN'S FORECLOSURE SYSTEM AND THEIR IMPACT ON HOUSING FINANCE

The challenges in Pakistan's foreclosure system directly correlate with banking sector hesitancy in mortgage lending. The latest banking statistics from December 2024 demonstrate this relationship clearly - mortgage NPLs stand at 14,222 million PKR with a concerning infection ratio of 6.8%, higher than the overall banking sector NPL ratio of 6.3%. This elevated risk profile reflects lenders' inability to efficiently recover assets through foreclosure.

While Pakistan's banking sector maintains a strong Capital Adequacy Ratio of 20.6% as of December 2024, indicating sufficient capital buffers to theoretically expand mortgage lending, the inefficiencies in foreclosure enforcement effectively lock this capital away from the housing finance market. The statistics show that despite robust Return on Equity (After Tax) of 21.5% across the banking system, financial institutions continue to favor safer lending avenues such as government securities rather than expanding their mortgage portfolios, directly attributable to the following foreclosure challenges:

1. Interest Restrictions on Defaulted Amounts

Under Section 3(2), lenders in Pakistan are only allowed to recover the State Bank of Pakistan's cost of funds on defaulted amounts, rather than traditional interest. This limitation becomes especially burdensome in high-inflation environments, where real economic losses remain uncovered. As a result, lenders face reduced financial motivation to pursue mortgage activity.

2. Eviction's Judicial Process Impact

Section 15(7) may require lenders to go through Banking Courts to obtain possession if possession is not voluntarily given, but this process often encounters delays of 30 to 90 days or more due to judicial backlogs. These delays not only tie up crucial capital but also lead to legal expenses often exceeding extra cost. The resulting inefficiencies undermine the overall effectiveness of the foreclosure system.

3. Borrower Stays during Notice Period

During the foreclosure notice period, borrowers may obtain temporary stays by alleging fraud or procedural issues under Section 15(13). These stays, typically lasting 30 to 90 days, significantly raise legal costs and disrupt timelines. Such tactics are often used strategically to delay lender actions and frustrate recoveries.

4. Unclear Property Titles

Pakistan's fragmented land record system frequently results in title disputes, complicating the enforcement of mortgages under Section 15(12). These disputes can delay recovery efforts by 6 to 12 months and add substantial legal costs. In worst-case scenarios, auctions may be reversed, severely undermining lender confidence.

Complicating matters further, the transfer of ownership or registration of mortgages with Property Registrars is a tedious and time-consuming process even in regular sale-purchase transactions, and foreclosures face the same bureaucratic hurdles. The jurisdictional complexity adds another layer of difficulty, as property matters fall exclusively under provincial domain rather than federal oversight. Consequently, post-sale facilitation requires the involvement of provincial governments, adding another layer of bureaucracy to an already cumbersome process. This fragmentation of authority creates significant inefficiencies in title transfers following foreclosure sales.

5. Weak Auction Market

Section 15(4)(d) mandates public auctions, yet these often attract limited interest, particularly for rural or distressed properties. Failed auctions delay recovery by 30 to 60 days with each attempt, sometimes forcing lenders to buy back the property themselves. This inefficiency reduces net recovery and prolongs the resolution process.

Valuations in Pakistan are fraught with systemic problems that further weaken the auction market. A major discrepancy exists between the traded value of property and its registered value, preventing lending institutions from achieving forced sales at reasonable discounts. Even the State Bank of Pakistan, in its Debt Property Swap Regulations (2016), acknowledges valuation complexities by requiring multiple valuation reports from different evaluators for larger transactions (two reports for amounts up to Rs. 50 million and three reports for amounts exceeding Rs. 50 million). The government has recognized this issue by mandating the Federal Board of Revenue (FBR) to set arbitrary values for various classes of immovable properties in specified geographies. This artificial valuation methodology, combined with unclear titles and possession challenges, deters potential bidders from participating in auctions, often resulting in failed sales or significantly below-market recoveries.

6. Community Resistance to Eviction

Efforts to seize foreclosed property often face strong community resistance, complicating possession despite the legal provisions under Section 15(7). Lenders may require court or police support, causing further delays and risking adverse publicity. These social dynamics introduce both logistical and reputational risks into foreclosure.

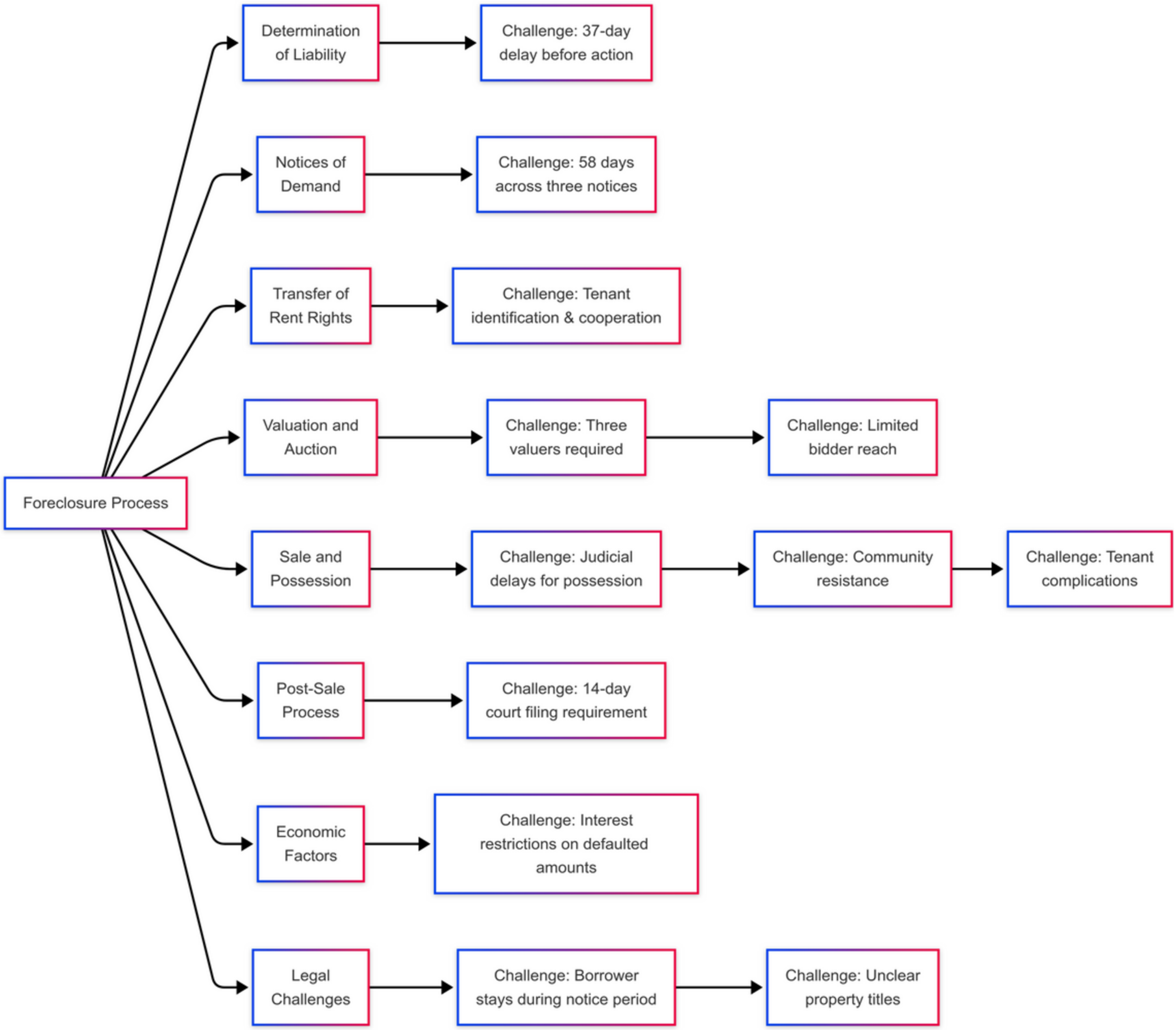
7. Tenant Complications

Bona fide tenants cannot be evicted until their lease terms end or compensation is provided, as per Section 15(7)'s proviso. Informal or undocumented leases further restrict rent collection under Section 15(3), affecting interim returns. This legal gray area slows down lender access to the asset and its income potential. The absence of preventative measures compounds these problems. Loan agreements typically lack negative covenants prohibiting borrowers from executing bilateral rental agreements without lender involvement. Implementing mandatory tri-party rental agreements (where lending institutions are part of the rental agreement) would significantly reduce tenant-related complications during foreclosure and ensure lenders maintain visibility into property usage and income potential throughout the loan term.

8. Economic Volatility

Persistent inflation, ranging from 10--20%, reduces real estate values, which in turn lowers auction proceeds under Section 15(10). Lenders often recover less than the defaulted amount and the SBP's cost of funds. This economic pressure heightens risk exposure and limits the financial viability of foreclosure recoveries.

PAKISTAN FORECLOSURE FLOWCHART SHOWING PROCESS AND MAJOR HURDLES



POLICY RECOMMENDATIONS FOR ENHANCING PAKISTAN'S FORECLOSURE PROCESS

Banking statistics from December 2024 underscore the urgent need for foreclosure reform. The consumer mortgage sector's infection ratio of 6.8% is 58% higher than the 4.3% infection ratio observed in the broader consumer sector, demonstrating how foreclosure inefficiencies specifically impact housing finance.

Implementing the recommended reforms could substantially improve recovery rates and reduce lender hesitancy. Currently, despite Pakistan's banking sector maintaining healthy liquidity (Liquid Assets to Total Deposits at 101.9%), this capital isn't flowing into mortgage lending. The Advances to Deposit Ratio of 49.7% indicates capacity for increased lending if foreclosure risks were mitigated.

The statistics reveal a sharp contrast between consumer durable loans (22.0% infection ratio) and credit cards (1.7% infection ratio), demonstrating how efficient recovery mechanisms in credit card lending lead to better portfolio performance. Similar efficiency improvements in mortgage foreclosure could potentially reduce the mortgage NPL ratio closer to that of well-managed lending segments, unlocking significant potential for market growth beyond the current 207,813 million PKR mortgage portfolio.

Pakistan's foreclosure system, governed by The Financial Institutions (Recovery of Finances) Ordinance, 2001, faces significant challenges that hinder lenders' ability to recover defaulted loans efficiently while maintaining fairness for borrowers. To address these issues, policymakers should adopt targeted reforms that strengthen legal protections, reduce delays, and align with Pakistan's economic realities.

1. Introduce a flexible cost-of-funds mechanism under Section 3(2) to allow lenders to recover a market-adjusted rate, certified by the State Bank of Pakistan that better reflects inflation rates of 10-20%. This would ensure lenders aren't financially penalized during defaults, boosting mortgage lending without violating Islamic finance principles. The reform is feasible as it builds on existing SBP oversight, requiring only regulatory tweaks.

2. Establish dedicated foreclosure tribunals to replace Banking Court oversight for possession and disputes under Sections 15(7) and 15(12). These tribunals, modeled on India's Debt Recovery Tribunals, could resolve cases within 60 days, cutting delays from 30-90+ days and saving lenders extra legal costs per case. This requires legislative amendments but leverages existing judicial expertise, making it practical.

3. Mandate an early Notice of Default before the chartered accountant's assessment (Rule 3(a)), granting borrowers a 21-day cure period to settle defaults. This reduces unnecessary foreclosure costs for lenders and encourages borrower repayment, aligning with global practices like Texas's system without disrupting the Ordinance's structure. Furthermore, these notices should leverage Pakistan's digital evidence laws (Qanoon-e-Shahadat Order Articles 46-A and 164) to permit delivery via email, SMS, and other electronic channels, significantly accelerating the notification process while maintaining admissible documentation for later enforcement proceedings.

POLICY RECOMMENDATIONS FOR ENHANCING PAKISTAN'S FORECLOSURE PROCESS

4. Digitize and centralize land records to eliminate title disputes that risk auction reversals under Section 15(12). By adopting a blockchain-based registry, as piloted in Punjab's land reforms, policymakers can ensure clear titles, cutting dispute-related delays from 6-12 months to weeks. This ambitious reform needs investment but is critical for scaling housing finance. Since property matters fall exclusively under provincial domain, implementation will require coordination with all provincial governments to develop standardized processes for mortgage registration and enforcement, addressing the jurisdictional complexity that currently creates significant inefficiencies in title transfers following foreclosure sales.

5. Create a secondary market for distressed properties to address the weak auction market under Section 15(4)(d). Encouraging real estate investment trusts, as seen in India, would attract bidders, reducing failed auctions that delay recovery by 30-60 days, and could be implemented via SBP incentives within two years. This should be paired with valuation system reforms to address the significant discrepancy between traded and registered property values. Rather than requiring multiple valuations (as currently mandated in the SBP's Debt Property Swap Regulations), establish a standardized, transparent market-based valuation methodology that better reflects actual transaction prices, potentially leveraging digital platforms to establish more accurate pricing benchmarks for distressed properties.

6. Introduce mandatory tenant notification and mediation protocols under Section 15(3) to streamline rent redirection and eviction, addressing your concern about tenant notices. Requiring a Tenant Rent Redirection Notice within seven days of the final notice, paired with mediation for bona fide tenants (Section 15(7), Proviso), would minimize delays and ensure fair treatment, feasible through rule amendments.

7. Launch public awareness campaigns to reduce community resistance to evictions under Section 15(7). By educating communities on foreclosure as a legal consequence, not a moral failing, policymakers can lower social pushback, easing possession without legislative changes but requiring coordinated efforts with media and banks.

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