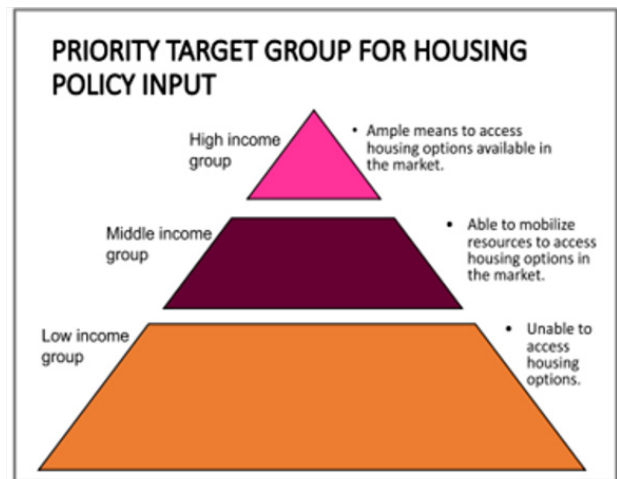


# Construction without real estate development

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Construction is an important industry which although despite only accounting for 3% of the GDP directly in the economy through its linkages with other important industries holds great significance. Given the strategic importance of the construction industry, it is often used by governments and policymakers to spur investment in the economy and revive growth through a cascading effect in times of economic downturn. In the wake of the economic downturn that has afflicted Pakistan's economy due to the coronavirus pandemic, the incumbent government has introduced special reforms and concessions to investors in the construction sector in the shape of a 'Construction'. The ultimate aim of the government is to revive growth in the economy by incentivizing private investment along with the public investment in the construction sector, this in turn through construction industry's linkages with other important industries will generate economic activity, create jobs and lead to a revival of the economy.

In a recent PIDE working paper, the authors argued that although there are concrete examples that can be cited from around the world where governments have used investment in construction sector to spur economic growth, any such growth can only happen if the right conditions in the economy exist. For particular emphasis is the need for well-established and functioning real estate markets that go hand in hand with the construction activity. The government aims through using construction to stimulate the economy also fulfill one of Prime Minister's campaign promises i.e. providing subsidized housing for the poor in Pakistan. But as the authors point out in their



paper any attempt to provide housing at the monumental scale that was promised (5 million units) can only be done through involving the private sector effectively and create well-functioning and affordable housing real estate and housing markets.

Firstly, the authors point out the obvious that the government does not have the financial capacity to finance subsidized housing on the scale that is being mentioned. Furthermore, they point out that even in relatively more developed economies; house ownership is restricted and by no means extensive within the population. Most people in advanced economies too are reliant of real estate and lease-markets to meet their housing needs. The fact of the reality is that the low-income group which comprises the largest chunk of the population in the country will still be unable to access the housing market despite any subsidized housing options that the government could provide given its own limitations. This section of population would most probably continue to live in informal squatter settlements which are often termed as 'katchi abadis'. The typical housing markets would only be accessible to those that belong to the high- and middle-income groups. Even for this part of the population, and particularly for the mid-

middle-income group, housing options are limited. The target of government policy should be to target this middle-income group that when given the right options are able to mobilize resources and get access to the housing and real estate markets.

But even here, as the authors point out there are serious impediments to increasing the reach of middle-income groups to housing options given the extremely high real estate costs and the economic uncertainty

that these middle income groups face at a micro-level with regards to stable sources of income. If one was to take the example of trying to establish a mortgage housing market in the country, the prices involved mean that only the very rich can get access to credit either private or at publicly subsidized rates to enable them to access the expensive housing options.

One way in which the very high costs of housing units can be reduced and hence brought within reach of the middle income group is by prioritizing apartment units over housing units. This however will require significant rethink of urban planning policy that has been yet far

favored in Pakistani cities. The current model prioritizes single unit horizontal housing units that take up a lot of space and end up driving the cost of housing space in the city along with contributing to uncontrolled urban sprawl. The need is to prioritize high-rise development which includes apartment buildings that can provide affordable housing options. Height restrictions on building need to be relaxed and the Floor-Area-Ratio regulations need to be relaxed to allow for high-rise construction. Furthermore, the cumbersome zoning laws need to be changed so that mixed use of land i.e. for both residential and commercial purposes is encouraged to a point that it becomes a predominant reality.

### Box: Some Mortgage Arithmetic

- While collateral is important for a mortgage, the creditor wants a steady source of income and does not want to undertake the costs of collecting on the collateral and disposing of it. Creditors also like to lock in a secure income to avoid the risk of collection or the price fluctuation of real estate. Thus, the most important element of a mortgage is the income of the mortgage holder.
- Mortgages are possible with property as collateral, but more importantly a "good job" is essential i.e., secure, steady, with income growth and some form of insurance to cover risk.
- The rule of thumb used by most creditors is that the borrower cannot commit her full income to servicing the mortgage. Taking into account the family's needs, servicing a mortgage, as when paying rent, should require no more than 25-30 percent of a mortgagee's income. Thus, it is safe to assume that mortgages will be available at 3-4 times a person's secure income. With that in mind, the following table shows the mortgage possibility for various income groups, from poor to rich.

Mortgage Potential by Income			
Monthly Secure Income	20,000	200,000	400,000
Annual Income	240,000	2,400,000	4,800,000
Mortgage=3*Annual	720,000	7,200,000	14,400,000
Mortgage =4*Annual	960,000	9,600,000	19,200,000

#### Conclusion:

- Given property prices of well over Rs.10 million, only the very rich can get a mortgage, provided they can show good, secure jobs.
- The poor, who have no secure jobs or prospects of increased income, will probably not be able to get a mortgage.



Summarized by: Raja Rafi Ullah