
3.1 BILLION PKR PAKISTAN MORTGAGE REFINANCE COMPANY SUKUK: A FIRST OF ITS KIND FOR HOUSING FINANCE

Dania Hasan

Student of Master of Science Islamic Banking and Finance

Institute of Business Administration Karachi, Pakistan

E-mail: dh_0712@hotmail.com

 <https://orcid.org/0000-0002-4116-2263>

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ABSTRACT

The following presents a case study pertaining to innovation in the Sukuk industry in the Islamic capital market of Pakistan which has gained momentum over the last five years. The purpose of this case is to describe a recent Sukuk issued by Pakistan Mortgage Refinance Company (PMRC), a Mortgage Liquidity facility that issued Musharka Sukuk based on Shirkat-ul Aqd, aimed at developing housing finance market in Pakistan. Given the acute shortage of houses and reluctance amongst banks to grant consumers housing loans for a longer-term duration, this facility will enable affordable house financing through a Shariah-compliant mode, while offering a new avenue of investment for capital market participants. This paper describes the key features of the Sukuk, outlines its Shariah structure, and elaborates upon the mechanism of the transaction. A graphical illustration of the Sukuk structure is made to facilitate the reader's understanding of each step of the transaction. The PKR 3.1billion PMRC Sukuk with the fixed-rate offering of 8.25% for 3 years is expected to be a landmark for the development of the housing sector of the country. It supplements the idea of how the issuance of Sukuk can play a vital role in addressing real economic needs.

Keywords: House Financing, Islamic Finance, Shirkat-ul-Aqd, Sukuk, Musharka.

JEL Classification Codes: G21, O18, Z23.

BACKGROUND

In September 2020, it was announced that the government is working on issuance of Rs 3.5 billion sukuk to address the surge in demand for Islamic Financing in the housing sector. Out of the present share of 51 percent Shariah compliant financing in Pakistan, the total outstanding Islamic house financing stands at Rs 103 billion in September 2020. While the total house financing, including the funds given by NBFC stood at Rs 180 billion, the demand for house

financing was anticipated to rise as directives from the State Bank has mandated for banks to allocate at least 5% of their total available financing for the construction and housing sector by December 2021. This would amount to Rs 330 billion, and presents a lucrative opportunity for house financing market (Siddiqui, 2020).

Banks avoid lending for financing needs because loan maturity is usually for 10-20 years and banks do not prefer to assume risk for such longer periods. Hence, PMRC's financing to banks may help them meet the 5% limit imposed by SBP by the deadline.

Furthermore, in line with the government's mandate to address the acute shortage of houses, the issuance of this landmark sukuk by PMRC is expected to pave way for raising funds to support the growth in the housing sector and increase accessibility to affordable house financing via a Shariah Compliant mode while providing a fixed rate offering for capital market participants.

It was the first time that a sukuk was issued to cater house refinancing needs in the local market, and is based on Shirkat-ul Aqd based Musharka Contract. Mohsin Tayebaly & Co. was engaged for drafting legal documentations. Meezan Bank Limited was appointed as the Shariah Advisor to structure the deal along with PMRC's Shariah Advisor Mufti Ehsan Waquar and its team.

The issuance of Sukuk was jointly led by Pak Kuwait Investment Company and Bank of Punjab. PMRC received an overwhelming response from capital market participants. The issue was privately placed and the Partner Financial Institutions include HBL (Islamic Banking), Askari Commercial Bank (Islamic Banking), Bank Islami, PKIC, BoP (Bank of Punjab), and Karandaaz Pakistan. (Rehman, 2021)

On March 19, 2021, PMRC issued sukuk of Rs3.1 billion at 8.25 percent for 3 years. The Sukuk has been assigned AAA Rating (Preliminary) by the Pakistan Credit Rating Agency Limited (PACRA) (Kaleem, 2021).

ABOUT PMRC

One of the key challenges faced by the banking sector has been liquidity crunch. A step towards institutional reform initiated by the State Bank of Pakistan was setting up PMRC, as a Mortgage Liquidity Facility. The aim was to provide long term funding to the conventional and Islamic Primary Mortgage Lenders (PMLs). Established in 2018, the business model of PMRC is based on providing liquidity at a competitive rates to financial institutions, thereby encouraging expansion of financing for home ownership. The issuance of bonds and sukuk is playing an integral role in the development of capital markets and housing finance.

About 33% shareholding of the PMRC is owned by Ministry of Finance whereas, the remaining 67% is owned by a pool of 9 private and public sector financial institutions. (Pakistan Mortgage Refinance Company)

KEY FEATURES OF THE SUKUK

Table 1. Table presents a term sheet of the sukuk

Issuer	Pakistan Mortgage Refinance Company
Joint Lead Arrangers (MLAs)	Pak Kuwait Investment Company Bank of Punjab
Partner Financial	HBL (Islamic Banking),

Institutions(PFIs)	Askari Commercial Bank (Islamic Banking), Bank Islami, PKIC, BoP (Bank of Punjab), Karandaaz Pakistan
Purpose	To utilize the proceeds of this sukuk for development of shariah compliant housing/ residential mortgage financing as well as Housing Finance Portfolio (HFP) of eligible Islamic Financial Institutions.
Issue Amount	Up to PKR 3.5 billion including Green Shoe option
Green Shoe Option	PKR 1.5 billion
Face Value of Sukuk	PKR 1000,000
Tenor	3 years
Issue Redemption	The entire issue would be redeemed in bullet at the expiry of the tenor
Profit Payment frequency	Semiannual in arrears
Expected Profit Rate	8.25% based on actual profit of Housing Finance Portfolio
Transaction Structure	Musharka (Shirkat -ul -Aqd)
Underlying Transaction Assets	Fixed assets, current assets & future assets
Security	First/Exclusive Hypothecation charge over specific receivables of PMRC with 25% margin (primary security). In case of any shortfall in receivables, PMRC shall provide charge on Islamic Deposit/Islamic Term Deposit/ GoP Sukuk etc. (“Cash Equivalents”) till such time receivables to be provided as primary security to cover the shortfall.
Legal Advisor	Mohsin Tayebaly & Co.
Shariah Advisor	Mufti Ehsan Waquar
Shariah Structuring Agent	Meezan Bank Limited
Trustee	Pak Oman Investment Company
Investment Agent	Pak Oman Investment Company
Listing	Privately Placed /OTC listed
Rating	AAA Long Term Rating by PACRA

OVERVIEW OF TRANSACTION STRUCTURE OF SUKUK

Sukuk Subscription and Issue Agency Agreement

(Between Investors and Issue Agent):

Investors will enter into Sukuk Subscription Agreement and appoint Issue Agent through Issuet Agency Agreement in order to authorize the Issue agent to act on behalf of the investors.

Sukuk Issuance Agreement

(Between PMRC and Issue Agent):

PMRC and Issue Agent will enter into Sukuk Issuance Agreement , through which Issuer will be obliged to protect the interests of the investors, hold the underlying security and distribute profit amounts amongst Sukuk holders at the respective distribution dates.

Musharaka Agreement:

(Between PMRC and Issue Agent)

Issue Agent and PMRC will enter into Musharka agreement. The subject matter of Mushraka investment is the Housing Finance Portfolio. Investment Agent will utilize sukuk proceeds to purchase partial share of PMRC's Housing Finance Portfolio of IBIs

Undertaking to Purchase Musharak Share

(Between PMRC and Issue Agent):

PMRC will undertake to purchase Musharka share of investors at the maturity of Sukuk at an agreed value or Buy out price (Net Asset Value subject to profit/loss).

Figure 1. Transaction Structure of Sukuk

MECHANISM FOR MUSHARKA SUKUK

- Initially, all the Housing Finance assets owned by the Islamic Banking Institutions shall be clubbed into a separate pool (the Housing Finance Portfolio). For the purpose of securitization, PMRC shall invest in Housing Finance Portfolio by purchasing a part of Islamic Bank's share in this pool of asset. Upon such purchase a Shirkatul Aqd (Partnership in Business) in the HFP shall be created between the Islamic Bank and PMRC; who will now be the Musharakah Partners in the Housing Finance Portfolio in a specified ratio.
- The investors will appoint an IFI as an Issue agent through Issue Agency Agreement , which will authorize the agent to perform all acts necessary for the purposes of investment in the Musharaka and for safeguarding the interests of the investors in respect of their investments including securing the commitments of the investors, entering into agreements on behalf of the investors, performing Musharka profit/loss calculations and ensuring timely issuance of notices as per specifications under the transaction documents.
- On the date of sukuk issue, the Issuer will issue sukuk and the sukukholders will pay the issue price in respect of the sukuk to the Issuer, the proceeds of which will be contributed towards the Musharka Capital for a Shariah compliant Musharka Contract.
- Issue Agent and PMRC shall enter in to a contract of Musharka, based on Shirkat ul Aqd, in which PMRC will invest the Sukuk proceeds in acquiring the partial share of PMRC in the pool of Housing finance portfolio of Islamic Banking Institutions. Thus, each sukuk represents proportionate share in the assets of the Housing Finance Portfolio. The sukuk holders will be entitled to a return based on the income generated from the Housing Finance Portfolio and passed onto PMRC.
- On each distribution date , the Musharka Profit will be divided between PMRC and the sukuk holders in accordance with an agreed profit sharing ratio
 - o Distribution of Musharka Profit up to the ceiling amount: As per the investment ratio
 - o Distribution of Musharka Profit above to the ceiling amount: 0.5% and 99.5% for Sukuk holders and PMRC respectively.
 - o A Special Reserve will be maintained by PMRC from the Musharka profits at the end of first and second year before allocating the profits to meet any shortfalls in the expected profits or loss in the coming periods. Special reserve will be capped at maximum 15% of the sukuk holder's investment.
- In case of Musharaka loss, it will be shared between the Investors and PMRC as per their Investment Ratio. However, funds in Special Reserve will be utilized to cover the loss. PMRC will not be responsible to compensate for the loss, if incurred without negligence on its part.
- On the date of maturity of Sukuk, PMRC will execute Undertaking to Purchase Musharka Investment by purchasing sukuk holder's share in the Musharka Investments at the Buyout Price or at any agreed value on the date of dissolution after accounting for loss/destruction in the Housing Finance Portfolio.

GRAPHICAL STRUCTURE OF SUKUK TRANSACTION

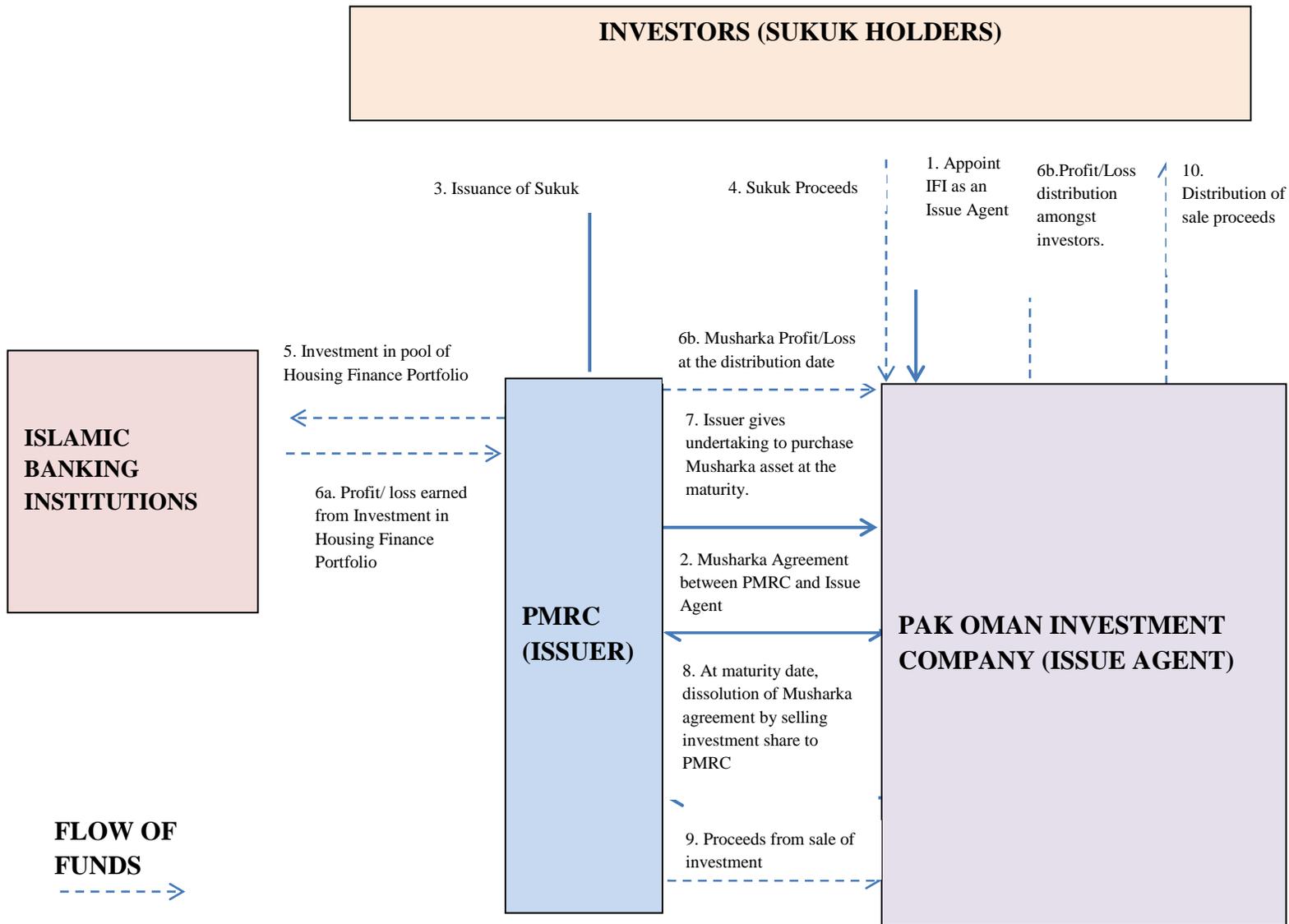


Figure 2. Author’s own source

CONCLUSION

With sukuk market continuously evolving since the last decade, the issuance of PMRC sukuk sets a precedent as an innovative instrument in the Islamic capital market. The success of new sukuk structures provides a much needed support to the development of capital market, while helping Islamic Banking Institutions to manage their liquidity. With the aim of addressing real economic need, that is housing refinance, PMRC sukuk will continue to create a positive ripple effect that is aligned with Maqaasid al Sharia. Moreover, PMRC sukuk also contributes towards efforts for developing sukuk industry through a diversification from typical sukuk structure which are prevalent in the country. Moving forward, with broader issuer and investor base, Pakistan’s sukuk industry is expected to flourish at a much faster pace in the upcoming year

AUTHOR CONTRIBUTIONS

Conceptualization: Dania Hasan
Data Curation: Dania Hasan
Formal Analysis: Dania Hasan
Funding Acquisition: Dania Hasan
Investigation: Dania Hasan
Methodology: Dania Hasan
Project Administration: Dania Hasan
Resources: Dania Hasan
Software: Dania Hasan
Supervision: Dania Hasan
Validation: Dania Hasan
Visualization: Dania Hasan
Writing – Original Draft: Dania Hasan
Writing – Review & Editing: Dania Hasan

CONFLICT OF INTEREST STATEMENT

The author declare that he has no competing interests.

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