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Affordable housing for all: Still an unconquered territory in liberalized Indian economy

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Introduction:
Housing is one of the most important segments of the economy due to its backward and forward linkages and interrelationships with other sectors such as manufacturing and services. Housing activities not only generate employment opportunities but also add to capital formation. Over the last 25 years, there has been a veritable revolution in housing finance in India. The formal institutional funding for housing in 1982-83 was Rs.1,071 crores; in 2010-11 the corresponding figure was Rs. 1,75,000 crores. In the last five years, the housing finance portfolio of banks and housing finance companies has expanded at a Compound Annual Growth Rate of 15.9 per cent. Access to housing finance has thus been considerably widened. Housing loans are available at all the metropolitan, urban and semi-urban branches of banks and in almost all branches of housing finance companies. Improved levels of housing have an overall positive impact on the human resource quality of the country. A conscious national policy of maximizing home ownership in the country will certainly depend on the depth and stability of the mortgage market. We need to draw appropriate lessons from the sub-prime mortgage market crisis of the advanced countries. What was wrong to start with was loaning to borrowers whose income and net worth did not warrant the grant of such loans. What is clearly needed is a balance between regulation and innovation. Too little regulation may lead to instability but too much of it can come in the way of innovations which are badly needed. If the normal precautions in the form of sufficient diligence, comprehensive appraisals and conservative valuations are taken, there is no reason why loans should go bad.

Source : Keynote Address: Housing Finance – The Way Forward: Dr. C. Rangarajan, Chairman: Economic Advisory Council to the Prime Minister: July 9, 2012:National Housing Bank

Although there have been continued deepening and broadening of the financial system, largely due to liberalization policies and a series of comprehensive financial reforms, housing finance remains underdeveloped at 7.25 percent of GDP, when compared with China (12 percent), Thailand (17 percent), and Malaysia (29 percent). The housing finance market in India amounts to about Rs 4 billion, of which 66 percent is held by commercial banks and the balance by specialized housing finance companies**.(Reference: www.moneycontrol.com).** With liberalization and private investors queuing up, housing for all seems to be a possibility now. Though some challenges and roadblocks are still staring in the face the progressive state and central governing bodies can easily come up with certain positive steps for achieving the mission “Housing for all”. Even though we claim that we are a liberalized economy the challenge of making housing affordable for all still exists due to non liberalized practices in the housing sector per se.

Current State of Housing: It is estimated that, at the beginning of 2006, the total housing stock in the country stood at 211.86 million units (153.03 million units in rural areas and 58.83 million units in urban areas), against a total 222.93 million households (156.63 million households in rural areas and 66.30 million households in urban areas). The National Sample Survey Organization (NSSO) uses the classifications of *kutcha* (primarily of mud/soil), semi-

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pucca (combination of soil and concrete), and *pucca* (primarily of concrete) construction. According to the NSSO, of the total estimated housing stock in 2002, 117.63 million houses were *pucca* houses, 65.53 million units were semi-*pucca* houses, and the remaining 28.70 million units were *kutcha* houses needing replacement. For housing other than *pucca* construction, formal financing is unavailable because of the added risks.
(Government of India, Ministry of Statistics 2004; NHB 2006).

Housing as a priority sector ?

The housing and housing finance markets in India have seen remarkable progress in the recent past, but various challenges remain. The sectors are vibrant enough and have substantial growth potential. With a modicum of enabling activities, housing will become accessible to a much wider share of the population. Since independence in 1947, successive Indian governments have highlighted the priority of housing in government planning through different five-year plans. The total investment proposed in housing has increased from Rs 11.5 billion under the First Plan to Rs 7,263 billion under the 10th Plan. However, the absolute investment in housing as a percentage of the total plan investment has declined because of the **shift in the government's emphasis from provider to facilitator (Garg 1998).** That brings to surface some critical questions. **Why housing for all is not happening? Why housing as a sector has still not flourished as desired by all the planning commissions so far?** Some promising suggestions are outlined below which can be modified, redesigned and implemented under the able guidance of the NHB and the RBI.

The Low-Cost Housing Market
Initial data on urban housing prices suggested that even at prevailing real estate prices, a significant portion of lower-income segments may be able to afford housing. Currently, the private sector is building small, one-bedroom units in the suburbs adjacent to major towns. These units are approximately 500 square feet in size and sell for Rs 400,000–500,000, including land .They are well connected by public transportation (within an hour of the city center); and are close to markets, schools, and health care facilities. So if units of 200–350 square feet selling for approximately Rs 200,000–320,000 are constructed at the same property rates (in most metropolitan areas, Tier I and Tier II towns), a number of low-income customers could afford them, without subsidies, if they had access to finance. The numbers are considerable: **There are 23–28 million middle- and lower income households in urban India with monthly incomes between Rs 5,000 and Rs 11,000**.The financial and social impact for these households could be transformative—from enhancing economic prosperity by converting rent into ownership of an asset, to providing a safety net, to improving living conditions and the quality of life.

Effective Demand and Affordability in the Mid/Lower-Income Group Earning Rs 5,000–11,000 a Month: Most households in the target income group are nuclear families with one wage earner; they pay 20–30 percent of their monthly income as rent. Those with a monthly income of Rs 6,000–8,000 save 10–20 percent of income every month; those in the Rs 3,000–6,000 segment save 0–15 percent; and in the lowest-income segment, many report no monthly savings. For example, a household earning Rs 6,000 a month often can make a down payment of approximately Rs 50,000 and an equated monthly installment (EMI) that is about 35–40 percent of income; these customers are willing to borrow for 15 years. At current annual interest rates of 12 percent, this should allow them to buy a unit priced between Rs 225,000 and Rs 250,000. Assuming real estate rates of Rs 900–1,000 per square foot, these customers can buy a unit in the range of 225–250 square feet.

Lease to ownership product: Lease to ownership product can be another mode to tackle this gigantic issue. It is the mode by which the buyer gives a deposit equal to the down payment and rent equal to the EMI. The ownership of the flat would be in the bank's name until the entire loan amount gets repaid.

Savings-linked loan product: In this case, customers would prove their creditworthiness by depositing a fixed amount into a bank every month for two years (for example, Rs 500 a month for a customer whose monthly income is Rs 5,000). At the end of the period, the customer would be eligible for a loan that was a multiple of the money deposited plus the additional down payment made by the customer. The monthly savings amount should be low because prospective borrowers would also be paying rent during the savings period. Furthermore, the price of the property should be fixed at the start of the savings period to avoid an escalation in property value that would make it difficult for them to afford a unit even with a loan.

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Construction financing would be helpful in stimulating the market: Some small and medium-size developers see low-income housing as a good commercial opportunity. The sector can attain housing cost (land and construction) within a square-foot price range of Rs 900–1,000 and make reasonable margins (20–25 percent gross margins); some developers are concerned about the commercial feasibility of low-cost housing in metropolitan areas and Tier I cities. Construction costs are in the range of Rs 400–600 per square foot; and low-cost construction materials and technologies could make it possible to reduce construction cost by 10–20 percent. To serve the market, developers need assurance that lower-income customers will receive housing loans, some help (at least initially) in demand aggregation, and reasonable cooperation from the public sector in producing basic infrastructure.

Market Solutions: Several solutions have been found effective, sustainable, profitable, and feasible in market conditions. For low-income salaried customers earning more than Rs 5,000 a month, employer-driven models that target leading employers will be useful in starting the market. Financial institutions are comfortable in lending to these customers. Developers also are interested because they see this as a way of getting large volumes of "pre financed" customers. The developers also would like construction finance, and financial institutions are open to this because the presence of pre financed customers provides take-out financing that significantly reduces risk. Because most of these small developers do not get customers to finance their construction, the construction finance would improve returns significantly. Scaling up this market may be possible by demonstrating commercial viability and implementation feasibility through pilot projects, by spreading the word over a broader cross-section of employers and developers, and by the government introducing policy initiatives that could increase the supply of "affordable land" and encourage developers to serve this market.

Introduction of low-cost construction technologies and potential policy changes (such as reduced stamp duty for small housing units) could enhance affordability and further facilitate serving this market: This approach may serve a large number of the 5–6 million target households with monthly incomes of Rs 5,000–8,000; and the 4–5 million households in the underserved group earning Rs 8,000–11,000 a month. For low-income self-employed and salaried unorganized customers earning more than Rs 5,000 a month, financial institutions are concerned about credit risks and high transaction costs involved in serving this segment; therefore, addressing these concerns is the key task.For households earning between Rs 2,500 and Rs 5,000 each month, pure market based solutions will not work. If home ownership is to be promoted in this segment, it needs a comprehensive housing program that makes housing more affordable and prompts financial institutions and developers to finance and construct such housing.
Reference: www.rbi.org.in/scripts/FAQView.aspx?Id=77

Efficient System of Land Administration: An effective housing market depends on efficient and reliable property transactions. Buyers and sellers need to be able to verify and confirm their rights to title with the appropriate third-party authorities. Inordinate delays in verifying ownership, cases of fraud, and failure to secure legal redress undermine the confidence required for a vibrant housing market. To achieve this, India's land administration and titling system requires some timely initiatives, including computerization, better coordination and improved efficiency of agencies with land administration jurisdiction, and reductions in duties and fees.

Improved Sub registry and Transfer Office Efficiency: Improving the efficiency of the sub registry and land transfer offices would dramatically reduce registration time in all cities. It would also reduce costs by encouraging entrepreneurs to conduct the procedures themselves, not through lawyers. To do so, local government could further computerize land records and train personnel to use the new system. Such reforms, under different names, have already taken place in a number of states:, such the Property Registration Information System Module (PRISM), initiated in 1997 in Punjab; the Computer-Aided Administration of Registration Department (CARD) program in Hyderabad; and the Karnataka Valuation and e-Registration Initiative (KAVERI) in Bangalore, set up in 2002.

Reduce Stamp-Duty Rates and Explore the Scope for Replacing Them with a Land Tax.
There is little doubt that the high rates of stamp duty currently assessed when registering land transfers push people into informality and reduce government revenue. Lowering these rates, which are very high by international standards, is likely to be necessary to ensure the sustainability of any improvements made in land administration, and would encourage entrepreneurs to formally register their property. The rise in registrations could offset, if not

exceed, the financial loss caused by the tax cut. In July 2004, after reducing the stamp duty from 10 percent to 5 percent, the state of Maharashtra saw its stamp-duty revenues jump by 20 percent.

Strengthen the Credit Bureau and Create a Mortgage Repository: The Credit Information Bureau of India Ltd. could extend its coverage to include information from retailers, trade creditors, utility companies, and nonfinancial institutions generally. The quality of information can be further enhanced by giving borrowers the legal right to inspect and correct their data. The financial sector would be encouraged to increase its reliance on data from the credit bureau, especially regarding housing finance. The Indian government is considering the proposed introduction of a mortgage repository, which would improve the functioning of housing finance markets by easing a lender's risk as to loan security.

Unified Record of Property and Housing Data: A specific housing databank should designed to provide periodic property and housing data, including data on housing supply and demand, housing finance, and construction.

National Housing Bank, HFC Supervision and Regulation, and Housing Development Policies:
To strengthen the NHB's supervisory and developmental roles, the bank needs a strategic plan to foster market deepening, as well as a clearly defined role for the bank in the development of new market products and instruments.

Establish a Financial Guarantee Facility: A financial guarantee facility could be used to mitigate the credit risk incurred by lenders. The guarantee fund could be set up to enhance the credit of low-income borrowers—mostly from the unorganized sector. Its mechanism should rely on risk-based premiums to ensure its sustainability.

Develop Market Solutions for Informally Employed Households Earning More Than Rs 5,000 a Month: Market solutions for informal customers would involve a series of new products, including these:

- *A modified group liability product,* through which the group provides a "rolling guarantee" for one year of EMI collections. After each year and with the mortgage lender's approval, defaulting members can be dropped by the group. The defaulting members then are served by the financial institution directly, at a higher interest rate. In other words, being part of the group gets the client a lower interest rate. The group may be maintained for five years, after which the client has built more equity and has established a track record of payments.

- *A savings-for-housing product,* through which the customer deposits a certain percentage of his or her monthly income (for example, Rs 500 from an income of Rs 5,000) with a financial institution for a specific period (one to three years). If the customer can adhere to a regular pre-agreed deposit schedule, he or she is given a loan at the end of the period. The loan is typically a multiple of the total money deposited (for example, three times) plus an additional down payment made by the customer. This product implies some initial regulatory difficulties, but it could be a very effective product over the medium term.

- *A flexible product* that provides flexibility in EMI payments for self-employed people who experience income fluctuations. It could include payment once a quarter (or minimum monthly payments ensuring that quarterly commitments are met).

Reference: www.nhb.org.in

- *A lease product,* through which a customer pays an up-front deposit (equal to the down payment) and a monthly rent (equal to the EMI) for a period equivalent to the loan tenor. More analysis is required to develop this product into a viable market alternative, though the potential value of such a product is considerable. This product could be used to go directly to the self-employed customer and really open up this market.

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- *An EMI deduction via bank account* would lower transaction costs. A variation on this involves the borrower putting some of the initial money (perhaps by paying a slightly smaller down payment) into an escrow account so that if an EMI payment is missed, the mortgage lender can use the money in escrow to settle one or two EMIs, while working with the customer to solve the repayment problem.

- *Mortgage insurance* is a classic insurance product that would reduce the risk for lenders, thereby allowing them to serve the informal sector.

- *A credit guarantee,* in the simple form of a partial guarantee with the first loss being borne by the lender. The level of first loss would have to be low (maybe consistent with the broader housing mortgage portfolio) to encourage lenders to participate in this market; but it would be good from a design perspective because it aligns incentives.

A responsive and meaningful regulatory regime and complimentary government policies are keys to a sustainable long term growth of the housing sector. A house as an asset transcends generations and provides benefits beyond mere financial returns. It improves the quality of living and directly or indirectly contributes to enhancement in earning capacity. Home ownership still remains at a low level in India. The goal of 'Affordable Housing for All' is what we must seek to achieve. With liberalization in full force and FDI policies in the offing, the central and state governing bodies, the NHB and the RBI can play both a catalytic and a direct role in realizing this dream and truly avail the benefits of "being liberalized."