Chapter 3

THEORETICAL FRAMEWORK OF HOUSING FINANCE IN INDIA

3.1 Introduction

The objective of this chapter is to give a brief note on the housing finance industry in India. The chapter is divided into different sections. The first section covers the concept of housing and the situation of housing availability in India. It gives a clear picture about the demand and supply of housing in India. It explains the role of the government in filling up the shortage of housing in urban and rural areas. The second section describes about the development of housing finance industry in India. A brief note of the major players in the housing finance industry is given in this section. The third section explains the challenges faced by the housing finance industry in India. The future of housing finance industry is highlighted in the last section.

3.2 Housing in India

The housing is one of the basic needs of the people as it ranks next to food and clothing. A certain minimum standard of housing is essential for a healthy and civilized living. Thus, the priority has to be given for the development of housing in a country. The human settlements have a lot of impact on environment. It is a tool for modern economic development. The census records of India exhibits that there was no deficit-housing problem in India till the first half of the century. In 1901, there were 55.8 million houses for 54 million households showing a surplus of 1.8 million houses. This surplus situation continued till 1941. It was only after 1951, the deficit trend has started and is continuing with an escalating magnitude. In 1971, total number of households was 100.4 million and the number of houses was 90.7 million, showing a deficit of 9.7 million. The housing shortage in 1991 was

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1 Source: Census of India (Various years)
about 31 million units. The housing shortage during 2001 was 41 million. The estimated housing stock requirement in the country by 2021 is about 77 million in urban areas and 63 million in rural areas. The households, usable housing stock and housing shortage in India in 1991 and 2001 are given in Table 3.1.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>1991</th>
<th>2001</th>
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<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>Urban</td>
</tr>
<tr>
<td>Households</td>
<td>113.5</td>
<td>47.1</td>
</tr>
<tr>
<td>Usable housing stock</td>
<td>92.9</td>
<td>35.7</td>
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<tr>
<td>Housing shortage</td>
<td>20.6</td>
<td>10.4</td>
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</table>

Source: Census of India

The increasing number of houses and a rising trend in the size of the households has contributed to the shortage of housing stock in the urban areas. Only 20% of the Indian population lived in urban areas in 1970 (UNDP 1998). The urbanization is expected to increase still. This resulted in an estimation of 36% of the population to live in urban areas by 2015.

In India, there is an ever-widening gap between the supply and demand for housing. There is an urgent need to modify the policy on one hand and look for an innovative approach for construction of houses on the other to reduce the deficit. The government of India had introduced schemes and projects for housing problem in every five year plans. The National Housing Policy formulated by government of India takes into account the developments on national and international scene on shelter sector The

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3 Source: National Building Organisation
3 Source: Habitat II estimate based on Society for Development Studies Work

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adoption of National Housing Policy by the Parliament in 1994 was a landmark step in promoting housing development in the country. The policy in its endeavor has reduced deficit of housing to some extent. It envisages a major shift in the Government's role towards being a facilitator rather than provider.

The working group on urban housing for the ninth plan gave a thrust to housing development and targeted construction of 8.87 million housing units. The National Housing and Habitat Policy 1998 emphasized "housing for all" by the end of 2007 (Peter D F Cardozo). This would be achieved with the help of public and private firms and corporate sectors. The rapid urbanization and a changing socio-economic scenario led to a greater demand for housing. This led to an exponential growth in housing finance market.

3.3 The Indian Housing Finance Industry

The housing is the single largest investment of an individual. The housing finance is growing at a rapid speed. The major sources of finance for housing for both buyer as well as builders have been largely from the unorganized sector (Dangwal, R C 1998). In India most of the people depend on their provident fund and gratuity amounts received after retirement for buying a house. The people started relying upon the housing finance institutions (both banks and housing finance companies). India has changed socially and there is no stigma attached today to going in for borrowed funds. The emergence of housing finance is a major business in the country. The housing finance institutions fulfill the shortage of housing in India. The demand for housing loans is rapidly increasing in recent years. The reasons for this are easy affordability of housing, declined property prices, reduced interest rates and attractive tax incentives.

There are many agencies catering to the needs of housing finance. The notable among them are Housing and Urban Development Corporation.
(HUDCO), National Housing Bank (NHB), Housing Development Finance Corporation (HDFC), State Housing Boards (SHBs), Life Insurance Corporation (LIC) and many private Housing Finance Institutions (HFIs).

3.4 Growth and Development of Housing Finance in India

In 1980's there was a series of development that had a positive effect on the housing finance sector. They are as follows. The planning commission set up several task forces during 1979-84, to review strategies for housing development. In 1985, the Reserve Bank of India (RBI) made many recommendations for liberalization in the housing financial system based on the Chakraborty Committee Report. In 1987, the Insurance Act of India was amended to allow the Life Insurance Corporation (LIC) and the General Insurance Corporation (GIC) to enter the housing finance business. In 1988, the National Housing Bank was set up as a subsidiary of the RBI to act as an apex regulatory and promotional agency. In 1989, the RBI allowed Commercial banks to make large loans for housing without an interest rate or loan quantity ceiling.

The National Housing Bank (NHB) was set up with the equity support from the RBI and is intended to act as the apex institution for coordinating and developing the housing finance schemes. In 1989, UTI has set up a housing and construction investment fund for direct investment in construction projects and real estate development. The entry of LIC and GIC, and many banks like SBI and Canara Bank through their subsidiaries has been stated to be another landmark in the promotion of housing industry. The system has also been characterized by the emergence of several specialized financial institutions. These have considerably strengthened the organization of the housing finance system in the country. The Housing Finance Companies (HFCs) were set up under the directions of the NHB. The process of liberalization covered the retail housing finance sector substantially. The most significant change was the enhancement of the amount set aside by the commercial banks. This amount is made used for
lending to the housing sector from 1.5% to 3% in the Union budget 1999-
2000. The Government of India had recently made the development of the
housing sector. It is considered as a priority both from the demand and the
supply side. This is done by fiscal concessions to the providers of the house
and to the borrowers.

3.5 The Major Players in the Indian Housing Finance Industry

There were a large number of agencies providing direct finance to
individuals for house construction. There was no well-established financial
system till mid-eighties. The National Housing Bank was set up for the
fulfillment of the long overdue need of the housing finance industry in India.
The system paved way for the entry of the specialized financial institutions.
This has strengthened the organization of the housing finance system in
India. The relative safety in financing a house and the far-reaching changes
in the financial sector has led to the emergence of new players. This has
changed the business strategy of established intermediaries in housing
finance. The following paragraphs give a brief notes on the major players in
Indian housing finance industry.

3.5.1 National Housing Bank

The National Housing Bank was set up in July 1988 as a wholly
owned subsidiary of the RBI. It controls, regulates and provides refinance to
banks and HFCs. It borrows from RBI, from government, banks and from the
foreign capital market. It has thus augmented its resources from all these
sources. The NHB has initiated a number of new schemes for promoting
housing loans. The institutions eligible for refinance from NHB are the
scheduled Commercial and Cooperative Banks. The non-banking finance
companies, namely, HFCs, apex Co-operative Housing Societies and State
Land Development Banks are also refinanced by NHB.
3.5.2 Central and State Governments

The responsibility to provide housing finance rested by and large with the government till the mid eighties (Khan, M Y 2002) The central and state governments support the housing sector indirectly The central government has introduced, from time to time, various social housing schemes. The central government through these schemes provides necessary advice and financial assistance The expenditure of the central government on housing increases every year and this is shown in Fig 3.1

The financial assistance is in the form of loans and subsidies to the state governments and union territories. The central government has set up the Housing and Urban Development Corporation (HUDCO) to finance and undertake housing and urban development programme. This corporation is financing the urban infrastructure development projects approved by the government. It is the model agency for implementing government

![Fig 3.1 Central Govt. Expenditure on Housing](image)

Source: Planning Commission (various years)

programmes. It has been giving loans through urban local boards, housing boards, slum boards etc. The HUDCO and NHB are working together in the field of housing finance. Apart from this, both central and state governments provide house building advances to their employees The central government
formulates the housing finance schemes and the state governments are implementing those schemes.

3.5.3 Insurance Corporations

The Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) support housing activity both directly and indirectly. The LIC is statutorily requested to invest 25% of the net accretion of funds in socially oriented schemes like housing, electrification, water supply and so on. The LIC subscribes to bonds of HUDCO and State housing boards. It grants loans to state governments for their rural housing programmes. It extends loans to public sector companies for construction of staff quarters. The LIC has been granting loans directly to individuals. In June 1989, LIC promoted a subsidiary namely LIC Housing Finance Limited. This provided a thrust to the housing finance. The GIC and its subsidiaries are required to invest 35% of their annual accretions by way of loans to socially oriented schemes such as housing. It supports housing facilities and indirectly by subscribing to bonds and debentures floated by HUDCO and State housing boards. It has also set up a housing finance subsidiary called GIC Housing Finance Limited in July 1990, to lend housing finance directly to individuals.

3.5.4 Commercial Banks

The commercial banks, with their vast branch network throughout the length and breadth of the country, occupy a very strategic position in the financial system. They have an important role to play in providing credit to the housing sector in accordance with the National Housing Policy. Therefore the banks were geared up to deliver the requisite 'housing finance'. The commercial banks started lending to individuals for housing. The commercial banks have been lending to the housing sector based on annual credit allocations made by RBI. In terms of the RBI guidelines, scheduled commercial banks are required to allocate every year 1.5% of their incremental deposits for disbursing as housing finance. The allocation is 20
per cent for direct housing loans. Out of it only 10 per cent of the allocation has to be in rural and semi-urban areas. Another 30 per cent is indirectly lent by way of term loans to Housing Finance Institutions (HFLs) and Housing finance companies (HFCs). It also indirectly lends to the public housing agencies for acquisition and development of land to private builders for construction. The balance 50 per cent is subscribed to HUDCO and NHB bonds.

3.5.5 Cooperative Banks

The cooperative banking sector consists of State Cooperative Banks (SCBs), District Central Cooperative Banks (DCBs) and Primary Urban Cooperative Banks (PUCBs). In 1984, the first set of comprehensive guidelines from the RBI was issued to these cooperative banks for providing housing finance. Though the Co-operative banks and the Regional Rural Banks are allowed to lend for housing, they are not active in this field.

3.5.6 Agriculture and Rural Development Banks

The Agriculture and Rural Development Banks (ARDBs) are term lending institutions operating exclusively in the rural sector. The housing finance was not originally within the ambit of their functions. The strong thrust was given to the housing sector in the late eighties. The establishment of NHB has made several States to amend their respective Acts to enable ARDBs to lend for housing in the rural areas.

3.5.7 Specialised Housing Finance Institutions

There are certain institutions, which cater only to the needs of the housing sector, termed as ‘Specialised Housing Finance Institutions (HFLs)’. They can further be classified as Housing Finance Companies promoted in the public, joint, or private sectors, and Cooperative Housing Finance Societies. The lead player in the HFC category is Housing Development Finance Corporation (HDFC), which holds over 50 per cent of the total disbursements made by the HFCs. The number of HFCs that had been
sponsored by Banks are SBI Home Finance Ltd., Canfin Homes Ltd., Indbank Housing Finance Ltd., Citihome and so on (M.Y. Khan). The Housing Finance companies are basically non-banking financial companies. At present there are more than 350 such companies. However, most of them are very small companies having little or no business. There are 29 major companies, which account for more than 95% of the total housing loans sanctioned by all these companies put together. The other set of specialized housing finance institutions are the Co-operative Housing Finance Societies. These HFIs cater to the housing needs of the community at large.

To cater to the diverse needs of housing finance in the country, the HFCs have tailored a variety of housing finance schemes for individuals, corporate, builders and promoters. The HUDCO commercial and cooperative banks have designed schemes specifically for lower and middle-income groups. Apart from the organized sector to provide housing finance to the individuals, unorganized sector also plays a vital role in filling up the shortage of housing in India.

3.6 Present Status of Housing Finance System in India

The existing housing finance system is dominated by a series of special and general financial institutions. Amongst them HUDCO, NHB are the specialized agencies. LIC, GiC and commercial banks and their subsidiaries are the general institutions. In terms of the financial turnover institutional sources, it accounts for only 10% of the total finance in housing sector. Apart from this, the informal sources of finance have significant contribution. From the disbursed finance for the formal housing sector institutions, (HUDCO, HDFC) very little part of the finance reaches the low-income group and the economically weaker sections. Fig 3.2 shows the framework of the existing housing finance system in India. The funds flow from the Ministry of Housing and Works to HUDCO and Cooperative Housing Societies. The HUDCO in turn lends to State Housing Boards, Urban development authorities, the building material industry and to the

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improvement trusts. The State Government funds the State housing boards and the cooperative housing societies also. The State Government extends the financial assistance to the secondary housing boards.

Fig 3.2
Existing Housing Finance Model in India
Finance Model for Housing

Source: Finance and Management Policies for Housing in India by M.O. Mathews
The Ministry of housing and works fund for Central government public sector schemes. The National Bank plays a vital role in the housing finance system. It provides funds to public limited and private sector HFCs, and to the co-operative housing societies. The secondary boards co-operative housing societies, Central government public sector schemes, and public and private HFCs directly fund the under-predominate housing in India.

3.7 The Challenges for Housing Finance

The housing finance sector has emerged as one of the outstanding successes over the last decade. In the earlier scenario, there were select few dominant players in the housing finance industry. In the current scenario, there is an increase in the number of players in the housing finance industry over last three years. This has increased a hefty competition in the housing finance industry.

Declining Interest Rates

The interesting trend that has emerged in the housing finance market over the last few years is the decreasing importance of interest rates (Anil K. Khandelwal 2002). This acts as a competitive tool. The interest rate charged by a small HFC was at

![Fig 3.3](image)

**Fig 3.3**

Housing Finance Disbursements vs. Interest Rates

Note: Interest rates plotted in the above graph are fixed interest rates calculated on an annual rest basis for a loan of Rs 5 lakhs and tenure of 15 years.
east two-and-a-half to three percentage points higher than the rate charged by HDFC. The banks would of course charge the lowest rate. The nationalized commercial banks, still offer the lowest rates on some occasion. There is no much difference in the interest rates among the players. The impact of lower interest rates have had on home loan disbursements can be seen from the Fig 3.3

Service and Product Innovation

The service and product innovation are the only way to differentiate one company's product from another. This is due to the absence of a significant difference in interest rates. The difference of a half-a-percentage point in interest on housing loans can be easily offset by quick and reliable service. The product innovation is used to capture the market in this industry. The competition has made the housing finance institutions look for the needs not met in a seemingly straightforward product. Now the HFCs are offering insurance packages that come attached to a housing loan product. The severe competition will bring few more innovations in the future. The product innovation is unlikely to remain unique for long because companies quickly mimic a successful introduction. The only benefit from product innovation is to build an image and the advantage of being the first to capture the market.

Smaller HFCs

The image building is likely to be very crucial to all HFCs. The traditional strengths of HDFC, ICICI and LIC housing finance made the life of smaller HFCs very tough. The smaller HFCs are likely to be more active in smaller towns. The smaller towns are less likely to witness head-on competition from bigger players. So in this segment, the smaller HFCs try to capture the market.

HFCs vs Banks

The banks and HFCs are competing each other in the housing finance market. The severe competition between these two housing finance
providers had made them to adopt various strategies to increase their market share. The HFCs are facing lot of constraints as against the banks. The banks have access to lower cost of funds compared to HFCs because banks have easy access to low cost retail funds and low minimum capital adequacy ratio. The HFCs are not given refinance by NHB at competitive rates. The banks despite a late entrant have overtaken the HFCs in the home loan markets. The share of banks in total home loan disbursements has risen from 43.6% in the year 2000-01 to 65.5% in 2002-03

Consumer Services

The current housing finance market is skewed in the favor of the buyers. The home buyers are rushing to take a housing loan without fully exploring the options available. The housing finance sector has certainly become more competitive in recent times. The banks and housing finance companies market their housing finance products much more aggressively. The customers are seeking more convenience in the entire process of acquiring a home as well as the finance for it (Rajiv Sabharwal 2002). Therefore the marketing has assumed significance in the rapid increase in activity of housing finance sector. The housing finance institutions are resorting to various marketing strategies to effectively market the specialized finance products. The housing finance providers are trying to satisfy the customer. As far as the industry is concerned, the customer appears to gain from the competition in the way of better products, better prices and better services (Gunit Chadha 2002). The real discriminating point, as far as the customer is concerned, will become his perception of the quality of service of one company over another.

3.8 Marketing of Housing Finance Services

The housing finance companies as well as the banks have started attracting the customers to gain a greater market share. A number of players have virtually entered an “interest rate war”. Some other has reduced the charges and fees. Some more others have launched innovative products.
The service is considered to be the common for all. The companies are
doing their best to offer customers with personalized services. The
appointment of franchises, direct selling agents and corporate tie-ups had
resulted in higher volumes of business (Kranti Sinha 2002).

The biggest segment that is targeted by all housing finance institutions
is the middle class who contributes a big number in this country. The drop in
the interest rates, and with promises of further drop, the middle class has
come up in a big way to think of owning a house. The higher segments of
people who are in higher income earning brackets are also targeted by HFCs
for loans being given. The strategy of marketing loans to such segments is
to work out benefits through savings on taxes. The competition has resulted
in the players moving into the untapped rural markets also. The pressure on
spreads has resulted in the players eyeing the economically weaker
segments and the self-employed categories of customers. The good
marketing back up with service orientation is bound to become very useful.
The significance of good marketing efforts will thus revolve around identifying
those stable factors to add to the brand image of the company (Knnshnan, D
2002). The aggressive marketing, more loan options and increased
emphasis on customer service are changing housing finance from a seller’s
market to a buyer’s paradise.

3.9 Future of Housing Finance in India

The housing finance is likely to remain a low risk, low margin business
that records fast growth in the foreseeable future. The market is likely to get a
little broader based (Mistry K K 2002). The HDFC’s market share may be
eaten by ICICI. The industry will continue to be dominated by a handful of big
players. It is difficult to see beyond HDFC, LIC Housing Finance and ICICI as
dominant players at this point. The HFCs will continue to operate in a highly
competitive market with higher demand for home finance. The housing
shortage and the government initiatives and above all the customer-centric
interest rates will be the drivers of HFCs. The improvement in products.
services, access and reduction in interest rates will retain and create customers. The buyers are the ultimate beneficiaries at large. There are several bottlenecks exist in this industry. They have to be taken care, before any of the above can bring about an improvement in the prospects of the industry. The overall demand for housing is ever rising and the same would be reflected on the demand for funds. Hence the profitability of the industry should commence on the positive track in the future.

The HFCs and banks may adopt some marketing strategies in future to increase their market share in the home loan sector. They may tape newer segments such as packages for professionals, single clearance loans upto Rs 15 lakhs, providing personalized services to customers, cross selling by capitalizing on the networks of other companies, competitive pricing in terms of lower interest rates and front end charges. They also have started entering into tie-ups with reputed builders and development authorities and private developers. The housing finance institutions will increase their reach by penetrating into rural and semi urban areas. The greater publicity through newspapers, websites and other media will fetch greater importance in this industry.

3.10 Chapter Summary

It is well understood that housing is not a problem for rich; it is a problem of economically poor and middle class families. So the housing finance providers should target to serve for these sectors for better economic development. The chapter clearly explained the housing finance scene in India. Though the major players are concentrating on various services, they have to concentrate on satisfying the customers. The future of housing finance is witnessing stiff competition. This forces the housing finance institutions to come out with strong marketing strategies. The outline about the housing finance industry in India given in the chapter evidences the need for implementing effective marketing strategies.
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