Chapter 1

Introduction, Objectives, Approach, Overview of Literature and Relevance of the Study

1.1 Introduction

Shelter is considered to be one of the basic needs of mankind. If one goes by the 'basic needs hierarchy' as postulated by Maslow\(^1\), shelter is ranked next to food and clothing. It protects mankind from the vagaries of nature. Besides housing, shelter also includes a series of services like adequate water supply, arrangement for disposal of sewage waste, provision of electricity, etc., which are an integral part of specific location and dwelling. These services are essential for healthy and environmentally sustainable shelter. In this thesis, the core theme will be 'housing'; the series of services like adequate water supply, provision of electricity and toilet facilities, etc. will be dealt with as a peripheral theme.

Comparatively, little attention has been paid to the housing finance constraint in dealing with severe housing problems. It may be said that even if there are projects, which can improve housing conditions, and even if affordable housing units can be
built, progress still may be frustrated if financial mechanisms are inadequate to enable house purchase and improvement to be effected.

In most industrialised countries, there is no longer a housing finance constraint to the achievement of housing objectives. In other words, where people can afford to buy houses, there are financial mechanisms, which will help them to do so. However, developing countries face severe problems in respect of housing finance that are specific to them. These problems basically are the lack of financial markets generally and unfamiliarity with certain basic concepts like long-term loans, interest and repayments.

Since the thesis deals with housing finance in India, it is pertinent to have an idea of the existing various types of housing finance system.

A housing finance system is a mechanism by which funds can be transferred from those with savings to those who need to borrow. There are four basic types of housing finance system existing. They are:

(i) *The direct system.*

(ii) *The contractual system.*

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(iii) *The deposit-taking system.*

(iv) *The mortgage bank system.*

Of the four systems, it is the *direct system,* which predominates in developing countries. Under this system, the funds which house buyers require are obtained directly from those who have available funds. Often these funds will be obtained from relatives, with older people lending to younger ones to enable them to purchase homes.

The *contractual system* is a method by which the savings of potential house buyers are used to provide the funds for house purchase. A person enters into a contract to save a certain sum of money over a period of time generally at a below-market rate of interest. When the period of saving is completed, there is an entitlement to a loan also at a below-market rate of interest.

Under the *deposit-taking system* institutions which in the normal course of their business take deposits make loans to house purchasers; both operations generally being done at variable rates of interest. The institutions providing this service can be either general commercial or savings banks or specialist building societies or savings associations.
The mortgage bank system makes use of the wholesale markets. Institutions raise funds through bond issues and other instruments on the wholesale markets and use these bond issues to make loans to house purchasers on matching terms.

In most developing countries there is no easily recognisable housing finance system. This seems to be true in the case of India also. House purchase is financed mainly by drawing on savings, the sale of assets and various other informal means, including a small element of direct financing and often loans within families. Recently in India, a lot of effort has been put in by the Government to boost the activities of specialised formal housing finance institutions through mortgage bank principle.

1.2 Objectives

The study has the following objectives:

- To review the public and private investment in housing in the various Five Year Plans and to study whether the investment was adequate or not in the light of quantitative as well as qualitative improvement of housing in India.
• To analyse the importance of housing in the Indian economy in the context of its contribution to Gross Domestic Product, Gross Capital Formation and employment generation.

• To study the difference between housing demand and housing need and the relevance of the later in the Indian Context.

• To analyse the flow of funds from the formal sector into housing and the role and importance of Housing Finance Companies (HFCs) vis-à-vis other formal sector institutions.

• To analyse the growth and mobilisation and disbursement of funds with respect to HFCs and review the irritants in their functioning.

• To analyse the financial performance of HFCs with a view to judge their competence in serving the housing sector in India.

• To give a summary of the research findings and concluding thoughts.

1.3 Approach

The first chapter of this thesis is an introductory chapter. It outlines the major objectives of the research study and includes separate sections on review of literature and relevance of the study.
In Chapter II, a review has been made with regard to housing investment in India over various Five Year Plans and expenditure in housing by Central and State Governments with a view to identify the role of government in house building activities. It also includes a separate section which analyses the housing situation in India both in quantitative as well as in qualitative terms. The chapter ends with discussions on importance of housing in developing economies, contribution of housing to Indian economy and various policy measures directed towards the housing sector in different Plan Periods.

The main discussions in Chapter III relate to flow of funds in the housing sector in India and the role of housing finance institutions with special reference to the Housing Finance Companies. However, to make the discussion on flow of funds more meaningful, analysis of housing need/shortage in India has been undertaken.

Chapter IV deals with HFCs only. It analyses the growth of HFCs and mobilisation and disbursement of funds by the HFCs. It also takes a note of the various irritants in the functioning of HFCs in India.
An in-depth analysis regarding the financial performance of the major HFCs has been carried out in Chapter V with a view to judge their strength, soundness, profitability and performance. In addition, a simple econometric exercise has been carried out to determine the factors affecting profitability of HFCs. The chapter concludes with a cost structure analysis of HFCs, which could be used as a surrogate for productivity analysis of HFCs.

Chapter VI is the concluding Chapter of the thesis. It includes the experience of select developing countries of Asia with regard to Housing and Housing Finance, lessons for India, summary of the major research findings of the thesis and concluding thoughts.

1.4 An Overview of Literature

Owning one's place of living is such a strong urge that 'housing' has proved to be a multi-dimensional issue. There is a lot of literature available on the general aspects pertaining to housing. The major aspects identified, with reference to the present thesis, relate to (a) importance of housing in developing economies (b) housing need and shortage (c) availability of housing amenities, and (d) housing finance. A moderately large
number of research publications with respect to the economics of housing and housing market are also available.

For the purpose of the present thesis, literature related to housing finance has been dealt with in an in-depth manner. However, published research works on other aspects (as mentioned above) of housing have also been reviewed since housing finance has a link to most of the other housing related issues.

The literature reviewed has been divided into two broad heads:
1. General aspects of housing without issues relating to housing finance; and
2. Housing finance.

**General aspects of housing without issues relating to housing finance**

There is a strong debate about the position of housing in an economy, especially in the context of developing economies. Some economists believe that spending in housing means investing in consumptive capital which increases capital stock and present welfare without much positive impact on future welfare. However, another school of thought believes that
housing is a productive capital. L.H. Klaasen² has argued that like food, medical care and education housing is a necessary consumptive goods with inherent productive aspects that helps in the sustainable growth of any economy to a large extent. According to him improved shelter provides more stable families, increased privacy, improved mental and physical health, less absenteeism at work places and improved social climate, which in turn increase productivity of the occupants. A rise in their productivity will increase future output and income. Klaasen has also found that in developing economies, income multipliers are high for investments in housing without any significant adverse effect of inflationary pressure provided import of material inputs is minimum, less of skilled workers are employed in house building and no supply constraints exist.

Some empirical research studies pertaining to various developing countries have been carried out by International Housing Productivity Study (IHPS)³, Wegelin⁴ and Jorgensen⁵. In all the cases it has been established that shelter has a positive impact on performance at workplace of the occupants. There are a number of estimates of housing shortages in India. The two

⁵ Jorgensen, N.O. 1975. Housing Finance for Low Income Groups, with Special Reference to Developing Countries, Rotterdam: Bouwcentrum.
most prominent sources are the National Buildings Organisation (NBO)⁶ and the National Report for Habitat II Conference⁷. A comparison of the two estimates reveals a significant difference between the two. While NBO has estimated that there would be a housing shortage of 19.4 million units in 2001, the Indian National Report has stated that the shortage would be around 44.5 million units during the same year. However, both the estimates infer implicitly that the Government of India is not going to achieve its mission (as stated in the housing policies) of 'shelter for all by the year 2001'.

The information regarding the availability of housing amenities like safe drinking water, electricity and toilet facilities are available from the Census of India. The Census of India in its publication⁸ has shown that more number of households have access to these basic housing amenities in 1991 compared to 1981. However, it is also evident that a significant number of households still do not have access to safe drinking water, electricity and toilet facilities. Cedric Pugh⁹ has done a

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pioneering work on housing in India. In different case studies pertaining to Delhi, Calcutta, Madras and Bombay, he found that the housing amenities were inadequate. According to him, large housing or planning authorities designed and built the drinking water supply systems but other small authorities were subsequently responsible for the ongoing management and maintenance. Problems cropped up because the local government units, which were left with management and maintenance responsibilities, often had neither the financial resources nor the professional capacity to perform the ongoing maintenance tasks. The equipment and installations were then left in a state of disrepair.

**Housing finance**

The literature related to housing finance mainly deals with the type and structure of housing finance system with a focus on the activities of the housing finance institutions. However, it should be mentioned that there is hardly any published research work on the financial performance of the housing finance institutions.
M. Boleat\textsuperscript{10} has argued that though there is no proof that housing finance can assist economic development, there are theoretical grounds for suggesting that this should be the case. According to him there is little doubt that home-ownership is a powerful incentive to save and that people will make sacrifices to purchase their homes. Boleat has also argued that housing finance is best provided by specialist institutions and formal institutions can increase their housing finance activity by various measures like promoting savings schemes linked to house purchase, establishing links with informal institutions (especially in developing economies), etc.

According to B. Renaud\textsuperscript{11}, the strategic variable for the expansion of housing finance systems is the mortgage interest rate level. Financial institutions should keep this rate close to the market cost of funds in order to be able to pay appropriate rates on deposits and to mobilise funds. Legislative frameworks limiting the flexibility of housing finance institutions should be reviewed


permit them to experiment with more varied mortgage instruments.

In the Indian context, the flow of funds from formal sector institutions, particularly the housing finance institutions, has been very restricted. The main reason attributed to this restricted flow of funds is the non-tradeability of mortgages.

O.P. Mathur\textsuperscript{12} has pointed out that mortgage financing is the principal mode of transaction in the housing finance in India. But since these mortgages are not tradeable, vast sums of capital and assets are locked for long periods, often for as long as 25-30 years thereby reducing the lending capacity as well as viability of the financial institutions. Hence, there is a need for the development of the secondary mortgage market in India. Further, mortgage finance stands handicapped by the fact that a majority of them are based on fixed interest rates and found to be disadvantageous to lending institutions in the event of rising interest rates and to borrowers in the case of falling interest rates.

O.P. Mathur\textsuperscript{13} and Kulwant Singh\textsuperscript{14} have argued that the weak

\textsuperscript{13} Mathur, O.P. op.cit\textsuperscript{12}
foreclosure laws and high stamp duties on mortgage documents are the main legal impediments in the development of secondary mortgage market.

It may be expected that with the Government of India taking serious initiatives in the promotion of housing and housing finance, the legal impediments in the creation of a vibrant secondary mortgage market will be removed within a short period of time. This would help the housing finance companies to magnify their role in the housing finance system in India.

1.5 Relevance of the Study

Generally, housing market may be segregated into three distinct phases, viz., the input market, the production process and the output market. The input market consists of land, infrastructure, finance, labour and material. Builders, developers and the landlords undertake the production process and the output market includes housing services bought by renters and homeowners. In developing countries like India, the housing input market has been facing more stringent problems than the production phase and the output market. The problems of the input market relate to the supply constraints of
the input factors, particularly, land and finance. Hence, it is relevant to study and analyse the housing finance in India.

In India, the formal sector institutions provide around 25 per cent of the required investment in the housing sector. The rest is met by the informal housing finance system, which is expensive and not efficient. The analysis of the flow of funds into the housing sector from formal sector institutions reveals that most of the institutions allocate funds for the housing sector. These institutions are not only engaged in housing finance activities but have other businesses to undertake. It was during the later years of the 7th Five Year Plan that the Government of India stressed the need of specialised housing finance institutions to serve the housing sector in India. Gradually, during the 8th Five Year Plan, the Housing Finance Companies (HFCs) came into prominence and the Government of India expected them to finance the housing sector in a bigger way. The target-achievement analysis of the HFCs during the 8th Five Year Plan shows that the HFCs were successful to a large extent in extending loans for housing activities. Moreover, the government of India has envisaged a greater participation from the HFCs during the 9th Plan Period. At this juncture it seems to be relevant to study the role of HFCs in the Indian housing finance system and analyse the financial strength of the HFCs.
with a view to judge whether they would be able to serve the housing sector in a proper way.