CHAPTER 3

HOUSING FINANCE SYSTEM IN INDIA:
AN OVERVIEW

Housing being one of the three basic needs of life always remains in the top priorities of any person, society and economy. As a human being, an individual needs his own space and privacy, which can be provided by the ownership of a house. The home is the basic unit of the society. Home provides a platform to the family and the family is the most important social institution, which leaves its imprint on an individual for whole life. Thus housing deserves significant attention in the context of developing policies and strategies for human development. But still the majority of human populace lives in slums, shanties and temporary shabby shelters in rural areas. The shortage of housing is a big impediment in the healthy development of an individual and consequently the society, and the nation.

The problem of space, privacy, security and sanitation leads to social, economic and environmental degeneration. The perpetual strife for space and house-ownership leads to personal and social disorganization, which is detrimental for the society and the economy. A developing nation like India has to focus more on housing sector to cater to the housing needs of burgeoning population and to accelerate the economic growth. The housing sector has been globally used as an engine to propel the economic growth as it generates employment and demand in the market. Last one decade has witnessed the authorities giving significant focus on the housing sector in India. The government of India has been trying to nurture and strengthen the housing sector in recent times through various fiscal and legislative measures. The incentives given through fiscal and monetary policies in tandem with
healthy economic environment in India are providing boost to housing sector. Low interest rates, reduced cash reserve ratio, low non-performing assets in housing finance sector and slowdown in growth of other sectors of economy have made the housing sector more attractive. In order to attract the customers further, the financial institutions have liberalised the lending norms, reduced the rates of interest, increased the period of loan, eased the collateral requirement etc. (NHB, 2002)

The housing finance market has been consistently exhibiting rapid growth in the past few years with an estimated CAGR of 38%. Growth has been largely in urban areas and in the middle to high income groups, in particular the salaried class. This growth was partly fuelled by the entry of commercial banks seeking asset growth in a sluggish business environment coupled with the tax incentives on housing loans. The banks, with their lower cost of funds, extensive branch network, capability to provide a range of personal banking services and aided by the average low default rates in housing finance, could expand the market considerably.

Despite the phenomenal growth of housing finance, outstanding housing loans constitute a mere estimated 4% of the country’s GDP, much lower than other comparable countries such as Korea, China, Thailand, Malaysia, Brazil. Widespread access to long-term, competitively priced mortgages has revolutionized housing in high-income industrialised countries over the past 60 years. An overwhelming share of households in these countries has now acquired homes with market-rate mortgages from private-sector financial institutions (Ferguson, 2001). In the context of the apparent potential for housing finance in the country, the issues of affordability, new and customised products, delivery channels, policy interventions and their sequencing assume relevance. While the expanding middle and higher income groups may continue to access conventional housing finance, increasing
attention should be paid to the needs of the unserved and underserved. This chapter has attempted to outline the relationships between housing policy and the development of housing finance system in the country. It has emphasized that while large welfare gains can be expected by the development of housing finance systems, housing finance systems alone cannot be expected to meet the task of housing the poor. Other mechanisms, including subsidies, microfinance, and the development of other tenures need to be considered.

3.1 Housing Scenario in India

Housing being one of the basic needs of human beings assumes multifaceted significance in terms of degree of economic well being and human development as well as socio-cultural progression and political stability. The development of satisfactory housing has always been the priority of both the central and state governments. A rapid rise in population results in higher demand of dwelling units for residential purposes. This coupled with the growth in household formation and increased urbanization in search of employment opportunities has resulted in severe pressure on urban infrastructure in recent years. The consequence has been overcrowding and unhealthy living environment, shortages of basic amenities and finally social and economic deprivation.

In 2001, India had a total housing stock of 187.16 million dwelling units of which 52.06 million was in urban areas and 135.1 million in rural areas. Of the total urban housing stock, 82 per cent formed pucca houses, 13.4 per cent semi-pucca, and 4.8 per cent kutcha houses (NSS Report, 2003). The percentage of households living in single room accommodation in urban areas declined from 39.6 per cent in 1991 to 36.5 per cent in 2001. As regards tenure status, 63.1 per cent lived in owned accommodation in 1991 and 85.05 per cent in 2001. Thus the proportion of those living in rented accommodation has come down from 46.5 per cent to 11.78 per cent during
the last decade. The estimated shortage of housing in 2001 was of the order of 22.1 million units, comprising 8.89 million units in urban and 13.21 million in rural areas.

As the country enters an era of economic growth, economic liberalization and prosperity, the country seem not yet ready to house the growing population and provide work and services and environmental infrastructure for all. The twin problems of affordability and availability prevail in most part of the country.

**Table 3.1**

<table>
<thead>
<tr>
<th>Population and Housing Stock</th>
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<tr>
<td><strong>Rural</strong></td>
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<tr>
<td>Population</td>
</tr>
<tr>
<td>Housing Stock</td>
</tr>
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</table>

Source: Census 2001.

The Table 3.1 shows decadal growth of population and housing stock. It is evident from the Table 3.1 that the population has been steadily increasing. It rose from 683.33 million in 1981 to 1027 million in 2001. This statistics also reveals that housing shortage is more acute in rural areas as compared to urban areas. But, it is not ideal to envisage the housing problem as a mere demand-supply gap and leave the onus on market dynamics especially in a country like India. Because of inequitable income distribution in our country, there is bound to be a wide gap between the demand for the houses and the need for house, because the need is translated into demand only when it is backed by the purchasing power. Hence there is a definite need for intervention through the supply side by making available affordable housing to the people belonging to lower economic strata (NHB, 2003).
3.1.1 Housing: The magnitude of the problem

Rapid population growth coupled with rapidly increasing urbanization and widespread poverty have created a serious shelter problem in India, contributing to the proliferation of slums, increased demand for urban infrastructure and services, and declining quality of life for low-income households. Other important factors that have aggravated India’s critical housing situation include institutional deficiencies, especially among state and local housing agencies, and regulatory constraints to new housing development and investment such as the Urban Land (Ceiling and Regulation) Act of 1976 and the State Rent Control Acts. In terms of the magnitude of the housing shortage, the Working Group on Housing has estimated the urban housing shortage at the beginning of Tenth Plan at 8.89 million units. While this is indeed an alarming number, it includes the ‘congestion’ needs of joint families, obsolescence and replacement of old houses, and upgrading of all the kutcha houses. The total number of houses required cumulatively during the Tenth Plan period is assessed at 22.44 million (Planning Commission 2002).

One critical indication of the housing shortage in urban areas is the unprecedented growth of slums. Provisional data relating to slums in the 2001 Census throw some light on the slum population. Nearly 28 million persons lived in the slums in 1981, accounting for 17.5 per cent of the urban population. The estimates for 1991 were 45.7 million slum dwellers accounting for 21.5 per cent of population. According to the 2001 Census, there are 40.6 million persons living in slums in 607 towns/cities, and they account for 22.8 per cent of the population of these cities (Planning Commission 2002). The health and environmental implications of households’ lack of access to potable water, sanitation facilities, adequate drainage, and proper solid waste collection and disposal services are
overwhelming, especially for women and children who spend proportionally more time at home than men. It is estimated that nearly 25 percent of slum residents are home-based workers, mostly women. For these families, access to decent living conditions and basic urban infrastructure and services is extremely important, as they are primary factors of production as well as productivity.

In terms of investment requirements to meet housing shortage, the 33 million units target of the Ninth Five-Year Plan was estimated to require over Rs1,50,000 crore. However, not more than 25 percent of funding required to meet staggering housing shortage is expected to flow from formal sources such as banks; financial institutions; government-directed insurance companies; and central, state, and local governments. With the exception of government-sponsored housing programmes, formal housing finance institutions (HFIs) are reluctant to lend to low-income households because of factors such as the relatively high transaction and servicing costs, irregular and unsubstantiated income sources, and the absence of collateral in the form of title to property.

For millions of poor workers, especially those in the self-employed or informal sector, the predominant delivery mechanism for housing has been people’s own efforts. The Working Group on Finance for the housing sector for India’s Eighth Five-Year Plan noted that in spite of interventions made by the government to facilitate access to housing by the poor, coverage has remained insignificant. Some of the causes identified include insecure land tenure (especially in urban areas), lack of access to formal housing finance, and monopolistic housing supply markets leading to inflated house prices. According to the Indian National Sample Survey’s (NSS) 44th round survey, more than 80 per cent of housing finance comes from private savings, sale of assets and non-formal sources of credit. Therefore, increasing funding
through both the formal and informal sector is an essential and integral means to meet the housing needs of low-income households in India.

3.1.2 The National Housing and Habitat Policy, 1998

The Global Shelter Strategy for the year 2000 adopted by the United Nations in 1988 called upon member countries to take appropriate steps to ensure a roof over every head by the turn of the century. India is a signatory to the UN document. In tune with Global Shelter Strategy of the UN, the National Housing Policy (NHP) was formulated and tabled in parliament in July 1992 and was finally approved in August 1994. The policy admitted that despite considerable public investment and efforts, the housing problem remained unresolved for long.

The National Housing Policy, 1994 has recognised that rural housing is qualitatively different from urban housing. The housing policy aims at reducing homelessness, improving the housing conditions of the poorly housed and providing a minimum level of basic services and amenities to all. It envisaged a paradigm shift in the role of the government from that of a builder of houses to a facilitator of housing activities. The policy recognised the role of co-operatives and Non-Governmental Organizations (NGO’s) in assisting the economically weaker sections to secure adequate shelter.

Subsequently, in pursuance of the National Agenda for Governance a new National Housing and Habitat Policy was laid before the parliament in July 1998. The thrust of National Housing and Habitat Policy (NHHP) is in consonance with the macro-economic policy in advocating a supportive and facilitative role of government in housing. The envisaged roles of governments at various levels and other public agencies for the implementation of this policy are to act as a facilitator, provider, catalyst, to reorient and promote the various housing activities. The policy, undoubtedly,
envisages that the direct role of government in the construction of houses should be specifically reduced and focused on the poorer and other vulnerable sections of the society. The new National Housing and Habitat Policy, 1998 has clearly defined the roles of various stakeholders including the state and central governments. The need to protect the interests of women, particularly women headed households has been recognised (Sivaramakrishnan and Singh, 2002).

The NHHP, 1998 identified ‘Housing for All’ as a priority area and emphasised more on the needs of the poor (vulnerable groups). The policy document promised to treat housing along with supporting services as a priority sector at par with the infrastructure. The central theme of the Habitat policy is to build up a strong public-private partnership for tackling housing and infrastructure problems. The national housing policy recognises that provision of shelter is important in the following terms: (i) improves the quality of life of the poor, (ii) creates conditions for the attainment of better health, hygiene and education, (iii) stimulates economic activity, (iv) enhances productivity, (v) creates employment opportunities, (vi) motivates savings, and (vii) promotes social justice.

The National Housing and Habitat Policy also seeks to impose a social mandate on the private sector, advising them to provide a specified percentage reservation for the poor, in their projects. These units will be cross-subsidised to make them affordable to the poor. However, the onus of the major percentage of the shelter delivery for the poor will rest with government. To make such shelter affordable and accessible to the poor, the government on one hand seeks to make cost-effective houses for them and on the other hand seeks to increase the purchasing power of the poor, by linking economic growth to employment for the poor. The health of the housing and
construction sector is seen as a major index of the health of the economy. It is one of the largest providers of employment to the poor.

3.1.3 The Role of Government

The progress of any nation can be appreciated by the quality of life attained by its people. Besides the basic requirement of food and clothing, availability of decent and safe shelter is also an important component of quality living. With a view to freeing millions of Indians from the shackles of human indignity, the National Housing and Habitat Policy 1998 was formulated with a promise to serve the underprivileged through institutional assistance. One of the major obstacles facing the public initiative for housing is the unrestrained population explosion. Further, the constant migration of people from rural areas to cities in search of jobs puts housing and basic services in the urban areas under considerable strain. The NHHP 1998 has therefore envisaged addressing the need for conserving the resource as well as the most effective utilization of available resources in tune with global concerns in this regard. The Government adopts the role of a facilitator instead of a provider. The other partners, private and cooperative sectors, are being encouraged through suitable fiscal incentives.

The Working Group on Housing for the Tenth Plan has observed that around 90 per cent of housing shortage pertains to the weaker sections. There is a need to increase the supply of affordable housing to the economically weaker sections and the low income category through a proper programme of allocation of land, extension of funding assistance and provision of support services (Planning Commission, 2002). Inadequate funds have always been the biggest impediment to housing development in the country. The investment in housing as a proportion to the total investment is steadily declining in the successive five year plans. Table 3.2 shows that the share of private investment in total investment in housing rose significantly between
1951 and 1990 from 78% to 92%. However, it started declining from the Eighth Plan to 43% in the Tenth Plan. Although in absolute terms, the investment in housing has increased substantially over the years, from Rs. 1150 crore in the First Five Year Plan to Rs. 7,26,300 crore in the Tenth Plan (Table 3.2), the relative share of housing sector in the total plan investment has declined sharply from an impressive 34% in the First Plan to 12% in the Tenth Plan.(Planning Commission, 2002). The figures in the Table 3.2 suggest that housing has not received its due priority in India.

**Table 3.2**

**Investment in Housing during Five Year Plans**

(Rs. in Crore)

<table>
<thead>
<tr>
<th>Five year plans</th>
<th>Public Investment</th>
<th>Private Investment</th>
<th>Total investment</th>
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<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>% to Total</td>
<td>Amount</td>
</tr>
<tr>
<td>1951-56 (First)</td>
<td>250</td>
<td>22</td>
<td>900</td>
</tr>
<tr>
<td>1956-61 (Second)</td>
<td>300</td>
<td>23</td>
<td>1000</td>
</tr>
<tr>
<td>1961-66 (Third)</td>
<td>425</td>
<td>27</td>
<td>1125</td>
</tr>
<tr>
<td>1968-74 (Fourth)</td>
<td>625</td>
<td>22</td>
<td>2175</td>
</tr>
<tr>
<td>1980-85 (Sixth)</td>
<td>1491</td>
<td>8</td>
<td>18000</td>
</tr>
<tr>
<td>1985-90 (Seventh)</td>
<td>2458</td>
<td>8</td>
<td>29000</td>
</tr>
<tr>
<td>1992-97 (Eighth)</td>
<td>31500</td>
<td>32</td>
<td>66000</td>
</tr>
<tr>
<td>1997-2000 (Ninth)</td>
<td>52000</td>
<td>34</td>
<td>99000</td>
</tr>
<tr>
<td>2002-2007 (Tenth)</td>
<td>415000</td>
<td>57</td>
<td>311300</td>
</tr>
</tbody>
</table>


The facilitating role of the government and other financial institutions along with private intervention in facilitating finance to address the housing needs of the society is an indication of the significance of the sector in overall development of the economy. The National Agenda for Governance, which
envisages the construction of 2 million dwelling units every year, also emphasizes that housing activity would be an engine for substantial generation of employment in the country. To this end, efforts are being made to identify the legal and administrative impediments and addressing them suitably. The earlier dependence on the public agencies is now slowly giving way to create a strong Public - Private partnership for tackling the housing and habitat issues. The Government’s role in the mammoth task of tackling the growing housing shortage will be peripheral and its intervention will be limited through fiscal concessions, legal and regulatory reforms and creating an enabling environment while the private and co-operative sectors as the other partner would be encouraged to take up land assembly, housing construction and invest in infrastructure services.

The Central Government and state governments are implementing a plethora of housing and habitat development schemes to ameliorate housing problems related to urban and rural areas. These schemes target economically weaker sections (EWS) and low income groups (LIG) in the country. Two flagship programmes are presented below:

3.1.3.1 Valmiki Ambedkar Malin Basti Awas Yojana (VAMBAY)

The Scheme was launched in December, 2001 to provide shelter and upgrade the existing shelter for the urban slum dwellers living below poverty line. The Scheme involves a Government of India subsidy of 50% while the balance 50% is expected to be arranged by the State Governments with funds from any source in the form of subsidy or loan from HUDCO or any other agency. The Scheme also aims at providing health and enabling urban environment facilities through community toilets under Nirmal Bharat Abhiyan. Reputed NGOs can also be associated with the Scheme, especially in regard to the Nirmal Bharat Abhiyan.
During the 10th plan period when VAMBAY will be launched in full swing, the annual allocation will be Rs 1000 crores which will be matched with a long-term loan by HUDCO of Rs 1000 crore on a 1:1 basis. The rate of interest of this loan will be the same as the rate of interest charged by HUDCO for EWS housing. State Government has the option to mobilize its matching portion of 50% from other sources, such as their own budget provision, resources of local bodies, loans from other agencies, contributions from beneficiaries of NGO's etc.

The Scheme received very encouraging response from the State / UT Governments. Against the Government of India’s allocation of Rs.69 crore during 2001-02, huge demands from 16 States/ UTs necessitated release of additional amount of Rs.4.56 crore, with the final figure reaching Rs.73.56 crore. During 2002-03, a budgetary provision of Rs.256.86 crore was made out of which Central subsidy of Rs.217.60 crore was released. The budgetary provision for 2003-04 was Rs.238.50 crore.

3.1.3.2 Indira Awaas Yojana (IAY)

The Government of India is implementing the Indira Awaas Yojana since the year 1985-86 with the objective of providing assistance primarily to the below poverty line (BPL) rural households belonging primarily to the Scheduled Castes, Scheduled Tribes and freed bonded labour categories. From the year 1993-94, its scope has been expanded to cover non-scheduled castes and non-scheduled tribes rural BPL poor subject to the condition that non SC/ST households shall not receive more than 40% of the IAY allocation. Benefits of the scheme have also been extended to the families of the ex-servicemen of the armed and paramilitary forces killed in action. 3% of the houses are reserved for the BPL physically and mentally challenged persons living in rural areas.
The Government has recently launched Bharat Nirman – an ambitious programme for creation of rural infrastructure in four years. Under Bharat Nirman, action is proposed in the areas of Irrigation, Rural Roads, Rural Housing, Rural Water Supply, Rural Electrification, and Rural Telecommunication Connectivity. Rural Housing is one of major goals of Bharat Nirman and targets to construct 60 lakh houses through IAY by incurring an expenditure of Rs.12,000 crore.

The ceiling on construction assistance under the Indira Awaas Yojana currently is Rs. 25,000/- per unit for plain areas and Rs. 27,500/- for hilly/difficult areas. The ceiling on upgradation of a kutcha house to semi-pucca/pucca house is Rs. 12,500/-. Under the IAY, Gram Sabha is empowered to select the beneficiaries. Further, the allotment of dwelling units should be in the name of female member of the beneficiary household. Alternatively, it can be allotted in the name of both husband and wife. Sanitary latrine and smokless chullah are the integral part of an IAY house. The construction of the house is the responsibility of the beneficiary. Since inception of the scheme up to January 2006 about 139 lakh houses have been constructed under the IAY by incurring an expenditure of Rs. 25,500 crore (Pawan Kumar, 2006).

3.2 Emergence of Housing Finance System

3.2.1 Indian Financial System

The financial system is a set of inter related activities/services working together to achieve some predetermined purpose or goals. It includes different markets, institutions, instruments, services and mechanisms which influence generation of savings, investments, capital formation and growth. The primary function of the financial system is to provide a link between savings and investments for the creation of new wealth and to permit portfolio
adjustments in the composition of the existing wealth (Desai, 2005). It promotes efficient allocation of the financial resources for socially desirable and economically viable objectives and thus influences both the quality and the pace of economic development.

The financial system impacts the performance of an economy. The performance of the financial system in turn depends on the performance of the constituents of the financial system. The constituents of the financial system are financial institutions, financial services, financial markets and financial instruments. The financial system functions as an intermediary and facilitates the flow of funds from the net savers to the net borrowers. The resultant gains to the economy depend on the efficiency with which financial system performs the function of financial intermediation.

The Indian financial system is broadly classified into two broad sectors, viz, the organised sector and the unorganised sector. The organised financial system comprises of Banking system, Co-operative system, Development banking system, Money markets and Financial companies/ institutions. This system is operating directly under the control of Reserve Bank of India (RBI). Over the years, the structure of financial institutions in India has developed and become broad based. The system has developed in three areas – state, co-operative and private. Rural and urban areas are well served by the co-operative sector as well as by corporate bodies with national status. There are more than 4,58,782 institutions channellising credit into the various sectors of the economy. On the other hand the unorganised financial system comprises of relatively less controlled money lenders, indigenous bankers, lending pawn brokers, landlords, traders etc. This part of financial system is not directly amenable to control by RBI (Desai, 2005).
3.2.2 Growth of Indian Financial System

3.2.2.1 Pre-Reform Period

From the mid-1960s to the early 1990s, India’s Governments in effect treated the financial system as an instrument of public finance. A complex web of regulations fixed the details of deposit and lending rates and loan amounts, channeling credit to the government and priority sectors at below-market rates. Public institutions dominated the financial system; competition was limited, between banks and between the banking sector, the capital market and international financial markets. When problems and irregularities occurred, regulations were changed to prevent similar outbreaks, without much attention to their impact on the financial system as a whole (Hanson and Kathuria, 2000).

Despite the restrictions on deposit rates, India had a relatively “deep” financial system for a low income country. For example, in 1980 the ratio of broad money to GDP was 36%, as high as many middle income countries (World Bank, 1989). The stock market was also large in terms of number of listings and market capitalization. In 1985, capitalisation (as a percent of GDP) was similar to Brazil, and Korea, countries with much higher GDP per capita (World Bank, 1989).

3.2.2.2 Post Reform Period

India’s economic reforms of the early 1990s began in response to the balance of payments crisis of 1991-92, a response that also included a stabilisation program. The reforms specifically included financial reforms (Ahluwalia, 1999). The financial reforms sought to improve resource mobilization and allocate credit to its most efficient uses. The first Narasimham Committee Report (1991) provided a blueprint, particularly in the banking sector.
The reforms strengthened banking regulation and supervision, as noted above. Basle capital adequacy standards have been more than met generally; by 1998-99, 25 of 27 public banks and 95% of all banks exceeded the Government's new guideline of 9%. Of course this capital strengthening reflected substantial injections of Government funds into the public banks, which averaged over 0.2% of GDP annually between 1993-94 and 1997-98. Regarding non-performing assets, the tighter regulations led to recognition of the large volume of existing non-performing assets (NPAs). However, by 1998-99 the ratio of banks’ NPAs to total assets had fallen to about 6%, equivalent to about 3% of assets net of provisions (Hanson and Kathuria, 2000).

India has grown to become the 12th largest economy in the world in terms of gross domestic product (GDP), and fourth in terms of purchasing power parity (PPP). The growth of the economy is equally impressive with an average of over 8.0% during the last three years. Gross Domestic Savings as a percentage of GDP increased from 28.9 per cent in 2003-04 to 29.10 per cent in 2005-06 despite a 1.5 per cent decline in household's savings (22 per cent of GDP in 2004-05). During 2005-06, the saving rate is expected to have gone up to 30 per cent and would remain in the same range in the coming years also (RBI, 2006).

Despite economic progress and explicit socialist goals, India has amongst the world’s lowest GDP per capita ($ 763) and lowest penetrated retail banking systems, with less than 20% of rural India having access to formal financial services. The reasons for this are complex, as is identifying potential solutions. A multi-pronged approach is required to make the Indian retail banking system more inclusive. This will require a concerted effort by several stakeholders, including the Government of India, the Reserve Bank of India, and the commercial banks. To bring about this transformation, public
and private sector banks will need to play a key role in defining and implementing innovative business models and delivery channels using appropriate technology solutions (Vinod Nair et al., 2005).

3.2.3 Housing Finance System in Developing Countries

Over the last few decades, comprehensive studies of housing markets and housing finance systems across the world have created a shared body of knowledge on what constitute effective and non-effective housing policies and housing market regulations.

In particular, programmes to finance social housing are perceived differently today than a few decades ago, both in developing countries and advanced economies. The focus is on creating well-functioning housing markets and the expansion of a safe and sound housing finance system.

Housing finance systems in many developing and emerging economies share several characteristics. First, most housing finance systems are, “institutional patchworks” that comprise private sector lenders as well as several government-managed housing finance institutions or programs (Renaud, 1996). They operate in the form of special government housing “banks” or special housing funds. Their reliance on the supply of low cost funds from payroll levies and central government transfers stifle competition in the financial system. The constant resource top-ups take away any desire to innovate by developing new financial instruments, look for new client groups and offer bespoke finance packages. Second, in most developing countries, only a minority of households can afford debt service on the least expensive contractor-built unit available. In Bolivia, Colombia, Suriname, and Venezuela, 60 to 80 percent of households in these countries lack the income to qualify for a loan for the least expensive contractor-built unit available (Ferguson, 2001).
Third, Traditional housing programmes in developing countries have produced complete units that are highly subsidised, high-cost solutions. Subsidies have gone largely to professional and middle-class households through political influence despite a rhetoric that supposedly targets low-income families. In more recent versions, the government funds the private sector to build these units and channels loans through a private sector financial institution, which then originates below-market interest rate loans to developers and to households (Ferguson, 2001).

Increasingly, developing countries move towards a more integrated modern housing finance system. First, there is a trend to increasingly rely on capital markets as sources of funds for primary housing finance lenders rather than on depository institutions alone. Second, it has been shown that, if assistance to low and moderate income households is necessary, subsidy programmes are best designed to allow households to participate in the housing market, rather than provide public housing. Third, support to moderate income borrowers to acquire loans through the private financial sector has proven to be most efficient if it is provided as a direct demand subsidy in combination with other facilitating measures and incentives to the banks rather than as interest-rate subsidies through segregated government lending programmes and institutions. Fourth, for those households who cannot use the private sector for their housing finance needs, even with incentive programmes, special social housing funds or lending mechanisms are used that provide shorter-term and smaller loans, at concessionary rates if necessary, but which are clearly separated from the rest of the housing finance system. Both types of finance subsidies are set up to be efficient, transparent and well targeted to those who cannot participate in the formal housing finance sector without such support (Hoek-Smit, 1998)
Like many Latin American countries and several South Asian countries, India has initiated a fundamental restructuring of her housing finance systems according to these principles. Even though all countries have a different history in the development of their housing and housing finance system, it is important to make use of the experiences of other countries with a similar economic and financial background.

### 3.2.4 Housing Finance System in India

The formal housing finance sector in India had its beginnings in the 1960s when the Government, through its various schemes for public and low-cost housing, was the sole provider of housing finance. The Government implemented many of its schemes through state housing boards that allocated serviced land and housing to individuals based on social welfare objectives, not commercial considerations. The 1970s marked two significant developments in the housing finance sector. A public sector housing company, HUDCO, was established in 1970, and the first private housing finance company (HFC), HDFC, was established in 1977. HUDCO served as the principal institution to finance Government-supported housing programmes, whereas HDFC introduced mortgage financing to India and has become the largest and most successful HFC in the country.

The late 1980s heralded a number of important events, beginning with the formation of NHB in 1988 as an apex bank for housing finance. NHB’s responsibilities include establishing guidelines for Housing Finance Institutions (HFIs) to ensure sound financial management, refinancing mortgage loans made by qualified HFIs, and mobilising formal sector resources into housing finance. The draft National Housing Policy (NHP), calling for the removal of many legal and regulatory constraints in the housing sector, was also tabled in Parliament in 1988, and ultimately adopted in 1994. Also in the late 1980s, the Government directed insurance
companies, commercial banks, provident funds, and other agencies to invest a part of their incremental resources in housing. Based on the success of HDFC, a number of new HFCs were subsequently established during the 1980s to enter into the mortgage lending market.

The 1990s witnessed significant changes in housing policy starting with the NHP, which envisaged the Government’s role as a facilitator of housing activity, rather than one of provider; this position was reiterated and elaborated in the National Housing and Habitat Policy (NHHP) of 1998. As a result, Government contributions to housing finance have fallen to less than 9 percent, compared with 23 percent four decades ago. The liberalisation of the financial sector has also accounted for an increase in mortgage lending by formal finance institutions not traditionally in the housing sector, most notably commercial banks and non-bank financial institutions. Based on data from the National Sample Survey Organization, however, the share of formal sector housing finance varies from only about 22 percent for new houses in urban areas to less than 8 percent for additions and alterations in rural areas. By comparison, informal sources contribute as much as 79 percent of the finance for new construction in urban areas and 88 percent in rural areas. Another important event in the late 1990s, which has significant implications for the future development of India’s housing finance sector, was the structuring of a pilot mortgage securitisation issue that is expected to raise about Rs.60 crores.

Although there were a large number of agencies providing housing finance to the housing sector, there was no well established finance system till the nineties. It is, therefore, imperative that an effective housing finance system which is an integral part of the main financial system be created for the development of housing and real estate sector in the country. The setting-up of the National Housing Bank (NHB) as a fully-owned subsidiary of the
Reserve Bank of India as an apex institution paved the way for the implementation of housing finance system in India. The implementation of housing finance system sees the emergence of several specialised financial institutions which have strengthened the organisation of the housing finance industry in the country.

**Figure 3.1**

**The Housing Finance System in India**

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<th>Group</th>
<th>Sub Group</th>
<th>Channel</th>
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<tr>
<td><strong>Financial Institutions</strong></td>
<td>Development Financial Institutions</td>
<td>NHB</td>
</tr>
<tr>
<td></td>
<td>Non Banking Finance Company</td>
<td>NABARD</td>
</tr>
<tr>
<td><strong>Banks</strong></td>
<td>Scheduled Commercial Banks</td>
<td>Scheduled Urban Co-operative Banks</td>
</tr>
<tr>
<td></td>
<td>Co-operative Banks</td>
<td>District Co-operative Banks</td>
</tr>
<tr>
<td></td>
<td>Other Institutions</td>
<td>Scheduled State Co-operative Banks</td>
</tr>
<tr>
<td></td>
<td>Agriculture and Rural Development Banks</td>
<td>Primary Land Development Banks</td>
</tr>
<tr>
<td></td>
<td>Apex Co-operative Housing Societies</td>
<td>Housing Societies</td>
</tr>
</tbody>
</table>

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3.3 Housing Finance – Growth Factors

3.3.1 Softer Interest Rate Regime

The phenomenal growth in housing loan disbursals in the last few years has been triggered by a number of factors, but the most important being the declining interest rate on housing loans. The bank rate hit the lowest ground since May, 1973. It was brought down to 6.50% on October 23, 2001. The interest rate which was around 15 per cent a decade ago has declined to half that rate now, with many of the banks and housing finance institutions ready to offer loan at rates as low as 7.25 per cent. However, in recent times, the rate has started to move up as can be witnessed from the fact that during the last one-year period, interest rates on housing loans have been increased twice by about 50 bps. Fig 3.2 indicates the movement of SBI PLR, as well as interest rates on housing loans over the period 1988 to 2005.

**Figure 3.2**

**Housing Finance Interest Rates in India**
3.3.2 Growth in Housing Investment

The National Housing and Habitat Policy (NHHP) was adopted by the Government of India (GOI) in 1998 with the main aim of facilitating an investment environment for housing. GOI reaffirmed its commitment in 2005. This is reflected in the efforts of the Government to improve housing and habitat conditions by way of financial allocations in the Five Year Plans and fiscal measures related to housing announced in the Union Budgets. The reach of the institutional financial market has been extended to serve the housing sector in different regions and different segments of the population. The accessibility of housing finance for people in general has evolved, developed and improved over the years (UNCHS, 2001).

The growth of housing finance has resulted in an increase in its share in the GDP. Outstanding housing loans as a percentage of GDP has increased from 3.4 per cent in 2001 to 7.25 per cent in 2005 (see Fig.3.3.). The figure has been pegged at about 9 per cent by the end of the 10th Plan i.e. 2007. As a result of the increased investment in the services sector, which contributes about 50 per cent to the nation's GDP, and growth in urbanisation, it is expected that the share of housing in GDP and GFCF would go up substantially in the coming years.
3.3.3 Fiscal Policy Incentives

The Government of India continued with its endeavor to propel the housing and housing finance sector through various fiscal and budgetary incentives. These incentives include: (1) the fiscal concessions provided to individuals under Section 88 of the IT Act (now Section 80 C wherein the deductible amount is up to Rs. 1 lakh as compared to Rs.20,000 earlier u/s 88 of the IT Act) in 1995 and Section 24 (B) in 1999 (deductible amount of interest repayment is up to Rs. 1.50 lakh), have led to a surge in demand for housing loans resulting in increased disbursements of housing finance by primary lenders over the years; (2) the capital gains exemption provided under Section 54EC of the Income Tax Act, 1961 has been extended to bonds issued by the National Housing Bank; and (3) the customs duty on cement has
been lowered from 25% to 20%. Cement accounts for around 18% of the cost of construction of a house.

3.3.4 Monetary Policy Incentives

Recognising the contribution of the banking sector in the housing finance sector in the country, the Reserve Bank of India (RBI) in the Credit and Monetary Policy announced certain measures for housing finance by Banks. First, Reserve Bank of India directed Schedule Commercial Banks (SCBs) to lend at least 3 per cent of their incremental deposit for housing. It brought housing loans up to Rs.15 lakhs under Priority Sector lending of banks. Second, it issued guidelines regarding synchronisation of loan repayment instalments with the crop cycle to provide impetus to rural housing credit. Third, the risk weight on bank loans against residential housing properties was reduced to 50 percent against 100 percent stipulated earlier. Fourth, investments by banks in mortgage-backed securities (MBS) of residential assets by housing finance companies (HFCs) recognized and supervised by National Housing Bank (NHB) have also been assigned a risk weight of 50%. Fifth, investments by banks in MBS issued by HFCs under NHB’s supervisory ambit will be reckoned for inclusion in the prescribed housing finance allocation of 3 per cent.

3.3.5 Foreign Direct Investments

Foreign Direct Investments (FDIs) was allowed up to 100 percent under the automatic route in townships, housing, built-up infrastructure and construction development projects to catalyse investment in a vital infrastructural sector of the economy. FDI has also been opened up for construction-development projects over 50,000 square meters including housing, hotels and resorts, hospitals, commercial premises and educational institutes. However, a minimum investment cap of $10 million in 100 percent
FDI projects and $5 million in joint venture projects has been prescribed. Further, the existing 40 hectare stipulation has been reduced to 10 hectares for investment under FDI.

3.3.6 Special Economic Zones (SEZs)

A policy was introduced in April, 2000 for setting up of Special Economic Zones (SEZs) in the country with a view to provide an internationally competitive and hassle free environment for exports. The policy provides for setting up of SEZ's in the public, private, joint sector or by State Governments. In terms of this policy, the SEZs will include inter-alia the facilities like world class residential premises and social services. As a result of these incentives, housing stock in the country increased from 148 million units in 1991 to 187 million units in 2001 and is expected to grow to 218 million units in 2007.

3.4 Housing Loan Characteristics

3.4.1 Housing Loan Products by Primary Lending Institutions

Primary lending institutions (PLIs) i.e. Scheduled Commercial Banks (SCBs), Housing Finance Companies (HFCs), Apex Co-operative Housing Finance Societies, (ACHFS), and Primary Housing Co-operatives (PHCs) are offering various housing loan products which include:


b. Home Improvement Loans for repairs, renovation.

c. Home Extension Loans for up gradation of existing houses.

d. Home Equity Loans.
e. Finance to public and private builders to increase the supply of land suitable for building houses.

f. Financing for housing to Self Help Groups (SHGs)/ Micro Financing Institutions (MFIs).

These housing loan products are available with various options with regard to interest rates (floating/fixed), repayment options, security etc. General practices being followed by PLIs while sanctioning and disbursing housing loans are as follows:

### 3.4.2 Lending practices

**Interest rates:** The concept of Prime Lending Rate (PLR) has now become the benchmark in extending loans of different types depending upon the risk profile of the borrower or the project. The rate of interest on these loans depends on a number of factors such as the tenure of the loan, loan amount, and purpose of loan, repayment capacity of borrowers and the cost of the fund of the financier. Both, floating and fixed rates are offered to home loan borrowers.

**Amount of Loan:** The loan amount generally depends on the period for which the loan is needed and the repayment capacity of the borrower. The amount of the loan is also subject to the estimated value of property and clear title deeds of the borrower.

**Security:** Generally, the individual housing loans are secured by mortgage of title deeds while in the case of builders or corporates (project finance) it is secured by book debts and receivables.

**Administrative and Processing Fee:** Generally the lenders charge a reasonable percentage e.g. 0.50 per cent of the loan amount as administrative and processing fee to cover some portion of their operational expenses.
**Repayment of the Loan**: The repayment of the loan is generally done through the equated monthly installment method. In case of borrowers expecting a reasonable growth in their future income, installments may be on a graduated basis.

**Prepayment Charges**: Housing loan borrowers rarely intend to carry the loan for its entire period of 15-20 years and therefore, close the loan prematurely. Hence a prepayment penalty in the range of 0.50 per cent to 1 per cent of the outstanding loan amount at the time of prepayment has become a common feature of the housing finance system.

**Credit Scoring**: As an initial step towards the Risk Based Pricing of the loan the borrower is accorded appropriate scoring by the lenders depending upon his economic profile.

**References:**

4. Ibid.

8. Ibid.


11. Ibid.


14. Ibid.


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22. Ibid.
