CHAPTER III

HOUSING FINANCE – AN OVERVIEW
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Housing Investment is viewed both as consumption and investment. It is a consumption because in buying a house the individual acquires an asset at higher cost, which he ‘consumes’ over time very much like a consumer durable. It is an investment, because while he consumes the services having provided the investment appreciates in value, its replacement cost escalates. In this sense housing is considered as an investment.

House is a basic human need, and as an intrinsic part of human settlement is closely linked with the process of overall socio-economic development. Though a house is essentially a place of dwelling, it also fulfils many important social needs of the households. Being a necessity, housing industry has been put under priority sector industries.

Housing has several components. The usefulness of land depends on its location and area, the services, such as water sewerage, electricity and roads supplied to the plot and the transport available to that location. Land and the materials, capital and labour required for construction and access other than for housing and their co-ordination on the site are very essential. The components
together determine the total cost of the dwelling and components may be adjusted depending on the cost per unit. Housing activity serve to fulfil many of the fundamental objectives of the planned development.

3.1 ORIGIN AND GROWTH OF HOUSING FINANCE

Housing is the single largest investment of an individual where credit, legal and technical skills and infrastructure are required, apart from making available finance. Housing Finance Institutions fulfil the housing shortage in the country, and support the development of over 300 other industries. Housing Finance is growing despite economic slowdown.

In the earlier days, Banks that were the sole financing agencies in the country were catering mainly to industry, trade and commerce. The 1980’s saw a series of development, which has a positive effect on the housing finance sector. They are

➢ The planning commission set up several task forces during 1979-84 to review strategies for housing development.

➢ In 1985, the RBI made many recommendations for liberalization in the housing finance system based on the report of Chakraborty Committee.

➢ In 1987, HFC’s amended the Insurance Act of India 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 issue large loans for housing without imposing rigid restrictions on interest rate or loan quantity ceiling. National Housing Bank (NHB) was set up in July 1988 with the equity support from the RBI and is intended to act as the apex institution for coordinating and developing the housing finance schemes. Later, the UTI set up in 1989, a Housing 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 started to be another landmark in the promotion of housing industry.

The setting up of National Housing Bank as a fully owned subsidiary of the RBI, and as an apex institution was the culmination of the fulfilment of a long overdue need of the housing finance industry in India. The system has also been characterized by the emergence of several specialized financial institutions, which have considerably strengthened the organization of the housing finance system in the country.

In 1990’s the pace set in the earlier decades was carried forward. Many 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 for their lending to the housing sector from 1.5 per cent to 3 per cent (Union budget 1999-2000).

Traditionally in India, most people depend on their provident fund and gratuity amounts received after retirement for buying a home. However, with the emergence of housing finance as a major business in the country, an increasingly large number of people are going in for home loans. Socially too, India has changed, and there is no stigma attached today for borrowing funds.

Five-year plans have been emphasizing on the need for promoting housing finance schemes particularly for the poor and weaker sections of the society. The implementation of housing finance policies pre-supposes efficient institutional arrangements. Although there were many agencies that followed direct finance system till the mid-eighties, it has not been integrated with the main financial system of the country. The public sector banks were allowed to provide housing loans directly to retail clients only in 1998, following modifications in RBI guidelines. Earlier, public sector banks could provide housing loans only through special RBI schemes, NHB/ HUDCO bonds or through subsidiaries.
The Government of India had recently made the development of the housing sector a priority, both from the demand and the supply side by fiscal concessions to the providers of the house and to the borrowers.¹

3.2 EXISTING SECENARIO OF HOUSING FINANCE

India's housing loan has been one of the star performers amidst an otherwise lackluster economic environment. In fact, growth has averaged 30 per cent per annum for the last couple of years, and shows no signs of slowing down in the near future. There are several reasons for the growth of housing industry.

➢ Loans are offered normally upto 85 per cent of the cost of property.

➢ Attractive tax benefits on housing loans are provided by the government, especially in the last three years.

➢ Interest rates have fallen to a record at the lowest rate, making loans very affordable.

➢ Lack of suitable alternative investment avenues-especially with a poorly performing equity market.

➢ Real estate rates have remained stagnant or declined since 1995. Hence the inflation-adjusted cost of urban housing has fallen considerably over the last few years, making housing much more affordable.
Deregulation of the sector has brought in many new players, including banks, which has helped widen the range and reach of products offered.

Demographic and socio-economic changes, such as nuclear families, urbanization, greater mobility amongst young professionals and a mindset that does not view debt as a bad thing.

Most of these growth drivers are likely to remain in place for a while. In addition, there are some more factors that will help sustain growth in housing finance.

- 50 per cent of Indians do not have “pucca” housing, so the demand for homes will take a long time to reach saturation levels.
- Only an estimate 20 per cent of homes in urban areas are financed through loans. Over the next decade, penetration is expected to reach close to 50 per cent.
- Other initiatives like the development of a market for “Securitisation” of loans will provide more funding options for housing finance companies.

However, the advent of competition (there are more than 380 players now) is bringing forth structural changes in the market. Greater reach and constant innovation from new players, especially banks are causing problems for some of the incumbents. Already small players like Gruh Finance and Home Trust Housing Finance have been gobbled up by HDFC. The cut-throat
competition is leading to slimmer and an all-out battle for market share. Already there are reports that HDFC’s market share has fallen below 50 per cent, while public sector banks (especially SBI) and ICICI have gained. Some of the smaller incumbents have fared much worse.

The Housing Sector in the country, which was passing through a recessionary phase, has witnessed dramatic changes over the last few years coupled with the much-needed recovery from the reversionary trends and gaining never-before buoyancy. In a lackluster economic scenario, housing is among a few sectors to have defied the adverse trend. The Government has been supporting the Housing Sector through a series of fiscal incentives in the budgets. Property prices have more or less stabilized. Interest rates have been showing a steadily declining trend. Purchasing power and borrowing power of the people have significantly gone up. These factors drove the people to invest in Housing Sector.

All these have pushed up the demand for housing as well as housing finance. Increasing demand for housing naturally has increased the demand for housing finance also and there is an exponential growth in housing finance market. This has prompted many new players to enter the housing finance market and become very aggressive apart form the already established ones. Due to the general slow down in the economy, credit off-take in the industrial sector has been declining. Further, housing finance is considered to be a relatively low risk
form of advance. These factors have prompted commercial banks also to become active in housing finance. These developments have fuelled in an unforeseen competition among the various players and triggered an interest rate war in the housing finance market.

The interest rates in the housing finance industry have been witnessing a steadily decreasing trend in tune with the decreasing interest rate regime established in the economy. The players in the housing finance market, finding the competition getting tougher day by day, have been offering heavy concessions to the home finance seekers to woo them.

The ultimate beneficiary in the stiff competition prevailing in the housing finance market is the home finance seeker, as the various players are varying with one another to provide most value added and efficient service to the customer. With various home loan options available for him, the market is virtually dominated by the customer.

A boost to the housing finance industry can push up the Indian economy scenario in a large scale. Housing has a tremendous tendency to create income and insist for resources, tools and services. Finances owed to housing arrive in the profile of profits.

In terms of the financial turnover, institutional sources account for only 10 per cent of the total finance in housing sector. Apart from this the informal
sources of finance have significant contribution. Out of the finance for the formal housing sector disbursed mainly through different institutions (HUDCO, HDFC), very little part of the finance reaches the low-income group and the economically weaker sections. The disbursement mechanisms through financial institutions are not at all impressive because of its rigid lending terms. Most of the time the terms and conditions are not easy enough for these group of people to obtain a housing loan.

3.3 MAJOR PLAYERS OF HOUSING FINANCE INDUSTRY

The relative safety in financing a house and the far-reaching changes in the financial sector have led to the emergence of new players and changing business strategy of established intermediaries in housing finance.

Banks started to devote better attention to finance the housing Sector after the introduction of social control over commercial banks in 1968 and the subsequent nationalization of fourteen major commercial banks in 1969. Housing did not get the required thrust from the banks, mainly because there was no rational policy to induce them for lending to the housing sector, while the demand for housing kept on increasing due to increasing population and rapid urbanization.

The 1970's saw the emergence of specialized Housing Finance Institutions (HFIs) with the formation of the fully owned Government of India
undertaking, the Housing and Urban Development Corporation (HUDCO) in 1970, which was started to accelerate the pace of housing construction in the country. In 1977, Housing Development Finance Corporation Ltd. (HDFC) was set up. After HDFC, a number of housing finance companies were set up in the private and joint sector in the 1980's.

The Indian housing finance sector is crowded with players of all sized and nature, government organizations, insurance companies, banks, housing finance companies and co-operative organizations like HUDCO and NHB. Major players in the Industry are HDFC, LIC Housing Finance, Dewan Housing, Canfin Homes, SBI Home Finance and Gujarat Rural Housing. The youngest entrant into the Industry, which in penetrating rapidly, is ICICI. Interestingly, both Canfin Homes Limited and its parent Canara Bank are into housing finance. It is the same with quite a few banks, for example, SBI and SBI Home Finance Limited, Bank of Baroda and BOB Finance, Vysya Bank and Vysyabank Housing.2

3.4.1 National Housing Bank

National Housing Bank was set up in July 1988 as a wholly owned subsidiary of the RBI. It is an apex body for control and regulation and provision of refinance to banks and Housing Finance Companies for the housing loans that

2 www.ficci.com
they provide. It can borrow from the RBI out of its funds, namely National Housing Credit Fund. It can also borrow from the Government, Banks and the Foreign Capital market. The NHB has thus augmented its resources from all these sources. The institutions eligible for refinance from NHB are the following:

1. Scheduled Commercial and cooperative banks.

2. Non-Banking Finance Companies, namely, HFCs, Apex Co-operative Housing Societies and State Land Development Banks.

NHB has initiated a number of new schemes for promoting housing loans.3

3.4.2 Role of Central and State Governments

In the mid-eighties, the responsibility to provide housing finance vested by and large with the government. The central and state governments support the house building effort indirectly. The central government has introduced, from time to time, various social housing schemes. The role of the central government vis-à-vis these schemes is confined to laying down broad principles, providing necessary advice and rendering financial assistance 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, development of land for satellite towns, besides setting up of building materials industry. This

3 www.nhb.org
corporation is financing the urban infrastructure development projects, approved by the government. It is the model agency for implementing government programmes, for eliminating manual scavenging, for providing shelter to the poor and low-income groups. It has been giving loans through urban local boards, housing boards, slum boards etc. HUDCO and NHB work together in the field of housing.

3.4.3 Role of Insurance Organisations / Corporations

The LIC and GIC support housing activity both directly and indirectly. The LIC is statutorily required to invest 25 per cent of the net accretion of funds in socially oriented schemes like housing, electrification, water supply and so on. Besides subscribing to bonds of HUDCO and state housing boards, LIC grants loans to state governments for their rural housing programmes and to public sector companies for construction of staff quarters. LIC has been granting loans directly to individuals, the thrust to housing finance was provided, in June 1989, when LIC promoted a subsidiary for the purpose, namely, LIC Home finance Ltd.

The GIC and its subsidiaries are to invest 35 per cent of their annual accretions by way of loans to socially oriented schemes such as housing. It supports housing almost exclusively and indirectly by subscribing bonds/debentures floated by HUDCO and state housing boards. It has also set up a
housing finance subsidiary called GIC housing finance Ltd., in July 1990, to enable it to lend directly to individuals.

3.4.4 Role of Commercial Banks

Lending loans to individuals for housing by commercial banks, emerged in the wake of the report of the working group, on the role of banking system in providing finance for housing schemes. In terms of the RBI guidelines, scheduled commercial banks are required to allocate every year 1.5 per cent of their incremental deposits for disbursing as housing finance. Of this allocation, 20 per cent has to be by way of direct housing loans of which again at least half, i.e., 10 per cent of the allocation has to be in rural and semi-urban areas. Another 30 per cent could be for indirect lending by way of term loans to Housing Finance Institutions (HFIs), Housing Finance Companies (HFCs), Public Housing Agencies for acquisition and development of land to private builders for construction. The balance 50 per cent is for subscription to HUDCO and NHB bonds\(^4\).

3.4.5 Role of Co-operative Banks

The cooperative banking sector consists of State Cooperative Banks (SCBs), District Central Cooperative Banks (DCCBs) and Primary Urban Cooperative Banks (PUCBs). The first set of comprehensive guidelines by the

\(^4\) www.rbi.org.
RBI was issued to these cooperative banks in 1984. While the Co-operative banks and the Regional Rural Banks are allowed to lend for housing, they have not been very active in this field.

3.4.6 Role of Agriculture and Rural Development banks

The Agriculture and Rural Development Banks (ARDBs) are term lending institutions operating exclusively in the rural sector. Housing Finance was not originally within the ambit of their functions. Following the thrust given to the housing sector in the late eighties and more particularly after the establishment of NHB, several States have amended their respective Acts to enable these institutions to lend for housing in the rural areas.

3.4.7 Role of Specialized Housing Finance Institutions (HFIs)

There are certain institutions, which cater only to the needs of the housing sector, termed as 'Specialized HFIs'. They can further be classified as Housing Finance Companies (HFCs) promoted in the public/joint/private sectors and cooperative housing finance societies. A leading 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. It has been set up by ICICI and lends mainly for new, residential housing to individuals, groups of individuals, and individual members of cooperative societies.
Besides HDFC Limited, a number of HFCs have been sponsored by Banks such as SBI Home Finance Ltd., Canfin Homes Ltd., INDBank Housing Finance Ltd., Citihome and BOB Housing Finance and so on.

The Housing Finance Companies are basically non-banking financial companies. At present there are 354 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 per cent 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, which help them to cater to the housing needs of the community at large.

Many public Sector Banks have set up subsidiaries for providing services of financial nature, such as housing finance. In June 2000, the Union government, in order to endorse endowment for escalating housing delivery all over the country approved 29 new housing finance companies to hasten the National housing program. It is interesting to note that Tata Homes Finance Ltd., and Birla Home Finance Ltd., too have joined the housing finance providers race. Reliance Industries and GE Capital are also likely to storm housing finance market in near future.\(^5\)
3.5 CHALLENGES OF HOUSING FINANCE INDUSTRY

An important development in the housing finance business has been the entry of new players. The relatively low risk in a housing portfolio has spurred new entrants in the last few years. Arguably, the most significant entrant has been ICICI home finance. Among non-banking finance companies, Sundaram Finance and Tata Finance launched housing finance subsidiaries in the recent past, while banks have shown increased interest in acquiring housing assets. The entry of new players and the consequent increase in competition has been followed by an interesting trend. The interest rates of most housing finance companies (HFCs) move in unison, thereby suggesting that interest rate is not likely to be a competitor tool. The high level of competition has made it impossible for an HFC, with branches across the country, to charge an interest rate higher than what the competitor charges. Commercial banks are an exception to the rule in the sense that they always charge lower than the competitor.

Banks have always had subsidiaries handling housing finance, but in the recent past they seem to have taken a greater interest in building retail assets. Bank have a clear advantages in the field simply because they access the lowest cost funds in India. As things stand, a loan from a bank is less expensive than one from a housing finance company. Despite the overwhelming advantage that banks have, HFCs are unperturbed. The reasons range from a feeling that banks
will lose interests in retail finance after a point to a belief that banks are not geared to servicing a big thrust into housing finance. In short, the HFCs believe banks cannot match them in a critical area-service.

Companies are trying to distinguish themselves through a difference in service standards. Industry officials emphasize that service quality is the key to competitive strength. At the moment, there seems to be little to choose between housing finance companies when it comes to service. Assuming almost similar service standards, future growth is likely to be decided by access to resources. A strong brand name, such as HDFC, ICICI, or LIC, is likely to command access to a lot more resources and customers. Therefore, the bigger players are likely to be the dominant players.

Dewan Housing and LIC Housing Finance both run operations with profitability level of about 20 per cent. Despite that, Dewan is unlikely to grow at LIC Housing's pace in the current environment. LIC's superior pedigree and access to resources appears to have played a critical role in larger disbursements.

Among HFCs, most companies, big or small, are likely to register a similar level of profitability. But access to resources, may ensure that bigger companies will dominate the market and check the growth of others. For a while securitisation promised much, but problems associated with the process have seen negligible activity. As things stand, only top-run HFCs are really in a
position to make limited use of securitisation. For the rest, it remains a distant dream. The fast-changing environment had a telling impact on HFCs. Following heightened competition, spreads (difference between interest income and expenditure) have declined over the last couple of years. HDFC feels that its current spread, of 1.8-2 per cent, is likely to hold firm. Competition has whittled down high margins and changed housing finance into a low margin, low-risk business. Even here, the bigger players are in a different league. For instance, HDFC has the resource base to promote subsidiaries in most other areas of financial intermediation—be it asset management, insurance or commercial banking. Smaller HFCs that have wide distribution networks can only hope to leverage their reach for a commission. So far, an amount of around Rs. 6800 crore has been disbursed by these ACHFs to enable construction of more than 21 lakh dwelling units in the country. Presently, the ACHFs are advancing an amount of approximately Rs. 868 crore a year.

Housing is not a problem for the rich, it is a problem of economically poor and middle class families. Government efforts should be in this direction of providing housing finance (along with allotment of plots) at a low rate of interest repayable not less than within 15 years. Interest rate may vary according to the level of annual income and amount of loan granted to these customers.

6 www.crisil.com
It should be kept in mind that a general stepping up of housing activities and housing financing in the country are not supposed to solve the problem of houselessness. It, therefore, requires an explicit consideration for the poor. Our strategy must be to build houses for the poor and allocate separate funds for the poor under-privilege.