Emerging Trends of Housing Finance in India

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Abstract: Housing Finance plays a vital role as an engine of equitable economic growth through the reduction of poverty and prevents slum proliferation in economy. The demand for housing has increased rapidly day by day. Therefore, to meet with the growing housing demand is the aim of the government. To achieve this aim it is required to provide the finance for housing to the people. The liberalization of the financial sector of the economy has also become possible by the housing finance. Housing finance has risen to the top of research and policy agendas in recent years. Housing finance in India is one of the emerging segments of the financial system which involves Commercial Banks, Financial Institutions, Insurance Companies, Co-Operative Banks, and other Indigenous Banks, due to vast growth prospects and business opportunities. Housing Finance Institutions provides attractive scheme and policies to capture the customers through advertisements, sales personnel etc. But in a real situation, rate of interest become a major reason to decide and select the housing finance institutions by the customers. In this context, the present study is under taken in order to present the various phases of Indian Housing Finance. The paper will also provide current housing position in India and institutional performance of Indian housing sector and finally, the manuscript will conclude with recommendations to improve the national dwelling position.

Keywords*:* Housing Development, Housing Sector, Labour Intensive, Collateral Security.

Introduction

Housing is one of the top priorities for most people, regardless of their income levels. Without the security and comfort of a home, there is no escape to the difficulties resulting from poverty. Adequate housing is essential for human survival with dignity.. The acute shortage of housing in urban areas is due to increase in population . Housing is one of the primary human needs and is next in importance to food and clothing. There has been increasing concern about the housing condition of the poor in the deserted declining effectiveness of housing finance institutions coupled with economic and fiscal crises have made governments more aware of the need to promote savings, reduce subsidies and mobilize domestic resources and motivate the involvement of private financial institutions. Housing finance has risen to the top of research and policy agendas in recent years. Yet, although our understanding of the formal delivery of housing finance has improved considerably, we know far less about households use and production of housing finance. India is the second largest populous country in the world, next only to china. Home to roughly 1.1 billion people, India is the second most populous country after China and is expected to overtake it by 2030. About one in every sixth person on earth lives in India, and the growth rate of the population is still rapid. Housing finance is a relatively new concept in India comparing to other financial services that are widely available in the country since a long year back (Annual report ICRA, 2011). However, the speedy development in housing and various housing activities have understandably led to the growth of Indian housing finance market. As a result, a number of players have barged into the market.

Objectives of the study

- To study about housing finance in India
- To study the present condition of housing sector in India such as current position of housing stock and contrast the evolution of housing finance
- To examine the Trends in Housing Finance in India
- To give some significant recommendations to improve the housing development in India

Methodology

The study is an empirical investigation based mainly on the secondary data. It would be of interest to mention a few methodological issues involved in the present study. As a matter of fact, considering the size and the scale of operations, the uniform period for all the activities is required. However, varying period for each activity is considered because of non availability of data. The secondary data are collected from annual publications of the NHB and other unpublished sources. Further, simple statistical tools and techniques such as percentages, averages are used in the study.

Need and Importance of Housing

Macroeconomic stability and the housing sector are inextricably linked. Housing is a significant engine for growth and development of any economy. Safe, secure and affordable housing implies an increase in employment and educational opportunities for individuals and also enriches communities leading to a better quality of life and a better civil society. The housing sector has strong backward and forward linkages to over 250 ancillary industries which includes construction workers, builders, developers, suppliers, civil engineers, valuers, property consultants, furnishers, interior decorators, and plumbers – a virtually unending list. Housing ranks fourth in terms of the multiplier effect on the industries in terms of total linkage effect. After agriculture, the housing and real estate industry is the second largest employment generator in India. The sector is labour intensive and, including indirect jobs, provides employment to around 33 million people. It is estimated that about 70 per cent of these are employed in the infrastructure segment and the remaining 2 30 per cent in the real estate segment. According to industry estimates, the industry is expected to generate additional employment of 47 million, with the total number of persons employed in the sector reaching 83 million persons by 2022.

Housing shortage

Housing is one of the basic needs of every individual as besides providing shelter and security, it also enables easy access to the credit market by working as collateral comfort security. The urban population of India has been growing at a rapid pace. As per the Census 2011, 31.16 per cent of the total population is in the urban areas. The shortage of housing units for the urban areas for 2012 is 1 estimated at 18.78 million units .With time, there has been expansion and improvement in the housing finance market by way of various financial reforms, however the housing loans as a percentage of GDP have remained at around 7 per cent, significantly lower than the levels achieved in most of the developed countries. The major policy concern with respect to housing as well as housing finance market is the mismatch between the demand and supply of housing units and the financial solutions available for the same. On the demand side factors like growing middle class, income levels of the people, cyclical condition and urbanization, and on the supply side factors like the lack of availability of land, finance at reasonable rate, infrastructure, legal and regulatory framework and the limitations of the private and other stakeholders to provide low income housing play a major role. Also "Affordable Housing" has serious implications for the country's housing sector as the wide gap between the demand and availability of housing units can be narrowed down only by way of affordable housing. The same requires appropriate funding models within a regulatory framework and pro active participation of all stakeholders so as to improve the availability as well as the quality of housing in India.

Housing in India

As per CSO estimate almost 5% of GDP is contributed by the housing sector in next few years. It is expected to rise to 6%, 16% of Indian workforce is engaged in the construction sector, more over the construction sector has also been responsible for the development of over 250 ancillary industries such as cement, steel, paints, bricks, etc.

The construction industry ranks 3rd among the 14 major sectors in the terms of direct, indirect and in dual effects in all sectors of the Indian economy. A unit increase in expenditure in real estate sector can generate of five-fold increase in income.

The figure given below depicts the relationship between the housing system and the entire economy.

Evolution of Housing Finance in India

The Housing finance sector in India has no doubt, experienced unprecedented change in its structure from its formulation stage. Indian Housing Finance has far moved from the stage of being a solely government undertaking provided service during the 1970's to a very competitive sector with more than 45 housing finance entities providing housing loans worth ` 7,81,000 million to home buyers across India.

The housing finance revolution in India can be divided into five distinct phases:

Phases of Indian Housing Finance

- **Phase I Before 1970 Government Domination**
- **Phase II 1970 – 1980 HUDCO and HDFC establishes**
- **Phase III 1980 – 1990 Establishment of NHB**
- **Phase IV 1990 – 2000 Liberalization of Interest Rate**
- **Phase V 2000 to present High Growth**

The first phase began before 1970 when the sole provider of any house building support was the government of India through its various social schemes for public housing. The government implemented these schemes through state housing boards which were responsible for allocating serviced land and houses to individuals based on the principles of social equity.

ISSN 2321-2926

The second phase starts with the establishment of the public housing company, Housing and Urban Development Corporation (HUDCO). HUDCO was created to assist and promote housing and urban development programs with government agency. HUDCO still plays an important role in implementing government initiatives such as the Valmiki Ambedkar Awas Yojna which was launched by Government of India in 2001-02 to provide shelter or upgrade the existing shelter for the people living below poverty line in the urban slums. Another important private player, Housing Development Finance Company (HDFC) was established in 1977. HDFC pioneered in individual lending, based on market principles. HDFC today is one of the largest home loan providers of the country and its success displayed that financing homes can be a very profitable business.

The third phase covers the decade of 1980s, which is marked by the establishment of the country's housing finance regulator - National Housing Bank in 1987. The era also involved the government in directing various agencies like insurance companies, commercial banks (Under priority lending requirements which allowed banks to allocate 1.5% of their incremental deposits to housing under RBI guidelines.), provident funds and mutual funds to invest part of their increment sources on housing. Two Insurance companies, LIC and GIC, started supporting the sector both directly through their newly established housing finance companies and indirectly by investing a proportion their net accretions in socially oriented schemes.

The fourth phase is the era after liberalization and is characterized by dramatic changes in pricing of loans. Before 1994, the pricing of home loans were regulated by the NHB based on a differential rates charged according to the size of the loan. This policy was amended in 1994 and providers were free to charge market rates for the loans above 25,000. The fourth phase saw a dominance of fixed interest rates, but variable rate offers started emerging at the end of the decade.

The fifth Phase of rapid growth in the sector started after the millennium. Home loan disbursements rapidly grew during the first few years of this phase. The lower interest rate regime, rising disposable incomes, stable property prices and fiscal incentives made housing finance an attractive business. Home loan disbursements grew to ` 7,68,191.90 million in 2005 from ` 1,47,012 million in 2001. The year 2003 witnessed an annual growth rate of 76% in loan disbursements.

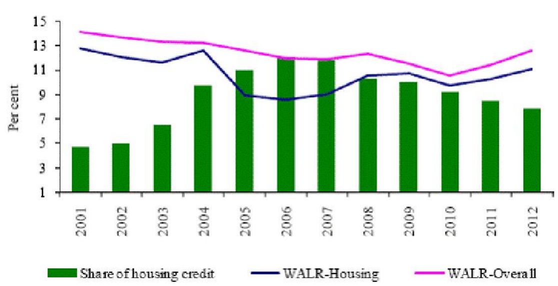
Housing finance trends in India

As per the Census, during the decade of 2001 to 2011, while housing stock increased by 51 per cent, number of households has increased by 47 per cent. Notwithstanding recent improvements, urban India in 2012 had an estimated shortfall of about 19 million houses. Most of the housing shortage is obviously for economically weaker section (56 per cent) and low income group (39 per cent) people. Institutional financing for housing in India is dominated by commercial banks. As on March 2012, outstanding housing loans by banks and housing finance companies was Rs.6.2 trillion, of which about two-thirds were accounted for by banks.

Overall trend in annual growth of credit of scheduled commercial banks in India indicates that the share of credit for housing in aggregate credit rose from under 5 per cent in March 2001 to 12 per cent by March 2006. This was facilitated by a number of favourable factors: First, sustained reduction in inflation resulted in lowering of lending rates. Second, removal of the restriction of prime lending rate (PLR) as the floor rate for pricing housing loan coupled with reduction in risk weight from 100 per cent to 50-75 per cent for housing loan to individuals aided competitive pricing of such loans. Third, the acceleration in GDP growth raised the demand for housing. Thereafter, the rate of growth in housing credit has moderated. Consequently, its share in total bank credit has declined gradually to about 8 per cent by March 2012.

As a percentage of GDP, outstanding housing credit from banks rose from 1.2 per cent in 2001 to a peak of 5.3 per cent in 2006 before moderating to 4.2 per cent by March 2012. The weighted average lending rate (WALR) on housing loan first declined from 12.8 per cent in March 2001 to a low of 8.6 per cent in 2006 before rising to 11.1 per cent by March 2012. Though the interest rate on housing finance has gone up since 2006, it has remained below the overall weighted average lending rate of banks.

Chart 1: Most part of the 2000s witnessed a sharp increase in housing credit alongside fall in housing interest rate



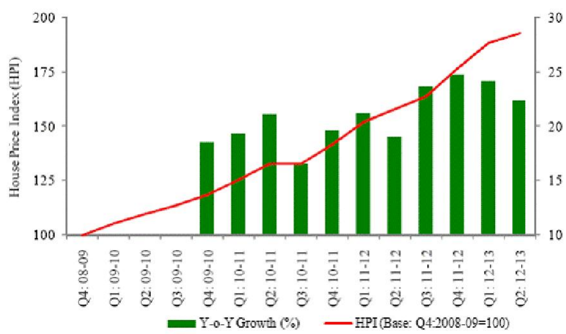
The moderation in growth of housing credit after 2006 could be attributed to the following factors: First, some slowdown in housing credit growth could be expected after the initial catch-up phase as the pent up demand is met. Second, GDP growth also moderated following the global financial crisis which dampened the demand for housing. Third, the tightening of prudential norms of increasing risk weights to a range of 50-125 per cent, higher provisioning against standard housing assets and prescription of LTV norms to mitigate risks could also have led to some moderation.

Notwithstanding tighter prudential standards, direct housing loan of up to Rs. 2.5 million and indirect bank finance to government agencies for rehabilitation of slum dwellers, and to housing finance companies (HFCs) for rehabilitation of slum dwellers as well as for construction of individual dwelling units of up to Rs. 1.0 million are treated as priority sector loans. Government also allows deduction from income up to Rs.0.1 million per annum for principal repayment and Rs. 0.15-0.25 million for interest component for income tax purposes. In addition, there are several specific government schemes for housing for the underprivileged. While these measures have incentivized house ownership, there is a huge gap between demand and supply besides affordability. Let me now turn to house prices which have implications not only for demand but also for financial stability.

House Prices

Real estate prices are conceptually somewhat different from the prices of goods and services. While prices are generally determined by supply and demand, real estate prices additionally reflect market's expectations of future prices. As experience shows, if expectations are belied there could be dramatic adjustments in prices raising stability concerns. Compilation of house price indices is challenging not only because of difficulty of gathering accurate price data but also due to quality changes in the construction of similar size of houses even in the same locality. To overcome these challenges, various methods for measuring house prices such as hedonic prices, repeat sales, median prices and sale price appraisal ratio have been developed. It is therefore not feasible to construct a single index that would satisfy all the requirements. The choice of a method therefore is largely influenced by the ease of regular availability of data and the characteristics of the housing market.

Chart 2: House prices have nearly doubled since 2008-09



The above table depicts that that the house prices have nearly doubled from 2008 to 2013 this shows the boom of real estate and rising inflation which may further increase the price. In India currently, we have two publicly available House Price Indices (HPIs): (i) NHB-Residex compiled on survey based information for 20 cities, and (ii) RBI-HPI based on registration prices information for 9 cities. The work of compilation of a HPI was initiated by the Reserve Bank in 2007 beginning with Mumbai city. Subsequently, the coverage has been extended to eight more cities: Delhi, Chennai, Kolkata, Banglore, Lucknow, Ahmadabad, Jaipur and Kanpur. Apart from data for individual cities, a composite house price index (HPI) covering these 9 cities with base 2008-09:Q4=100 is currently being disseminated by the Reserve Bank on a quarterly basis. As per the Reserve Bank's composite HPI, house prices have nearly doubled since

Recommendations –

- **Greater political priority should be attached to the housing sector:** It should be recognized that the development of the housing sector could considerably contribute to economic growth, employment and poverty reduction. This stimulation could result both from the direct effects of new construction and indirect reconstruction and repair activities, as well as the effects on other sectors of the economy such as building materials, craft, utilities and housing services. Housing policy should be fully integrated into overall socioeconomic development policy.

- **A national housing strategy should be elaborated:** Although housing stock is considered as privately owned, the Government retains the overall policy responsibility for this sector of the economy. The development and implementation of the housing strategy should therefore be led by the Ministry responsible for housing policies, the current Ministry of Economic Development, and should involve other Ministries such as Refugees and Accommodation; Justice; Finance; and Culture, Monuments Protection and Sport, as well as authorities at the municipal level.

- **Housing policies should be implemented by involving international donors and NGO's:** Existing projects should be extended and pilot projects proposals should be developed to serve as examples and to trigger multiplier effects for developing housing policies further, following the priorities set out in the housing policy framework.

- **The capacity of the ministry responsible for housing should be strengthened:** The department dealing with housing in the responsible Ministry, currently the Ministry of Economic Development should be provided with a clear mandate and increased staffing with adequate expertise and clear responsibilities to have an impact on the housing sector and its policies.

- **The responsibilities of local governments related to housing should be reflected in their organizational structure:** Provided that with the new legislation on local self-government local units will have increased financial means, own property and adequate staff, their structure should foresee or strengthen departments dealing with and providing policies for: (a) Urban planning and construction (permits, standards, monitoring); (b) Reconstruction and maintenance of the existing housing stock; (c) Utilities (energy, water, waste).

- **Initiative from RBI**: In order to enhance the information base of the housing finance market, the Reserve Bank should place in public domain its detailed database on house price monitoring system.

- **Fixed housing rate**: In order to mitigate risks in housing finance, besides application of macro-prudential regulations, there is a need to develop a fixed rate housing loan product of longer maturity.

Conclusion

Next to food and clothing, house as a shelter is a basic human need. It is a composite and complex good that fulfils some of the basic necessities of life. It is estimated that overall employment generation in the economy due to investment in housing/construction is eight times the direct employment. This study analyzed the present condition of housing sector in India. Housing shortage is a universal phenomenon and it is more acute in developing countries. Hence, this article has highlighted the housing shortage and the housing prices in India. This manuscript is also recommended some significant issues to the development housing sector in India. It should assist the policy makers in designing and implementing specific and well targeted policies for the overall benefit of housing sector.

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