A third world housing finance success story

How the Housing Development Finance Corporation is helping to tackle India's housing problem

IT IS difficult for those in Western countries to understand the magnitude of the housing problem in a country like India. The numbers alone illustrate the size of the problem. It is estimated that in 1985 there were 135 million households but only 111 million serviceable housing units, giving a shortage of 25 million units. Furthermore, it is anticipated that the problem will get worse rather than better. Projections made by the National Buildings Organisation are that by the year 2001, the number of households will have increased to 187 million but that the number of housing units will have increased to only 148 million, resulting in a deficit of 39 million units.

The poorest people in India have nothing which can be called a home. In the major cities there are massive squatter settlements, and many other people do not even have any roof over their heads; instead, they sleep on pavements. Faced with such an enormous housing problem, it is difficult to know where to start. State governments have constructed large quantities of housing for low income people, but often this is badly built and after only a few years shows signs of serious deterioration.

Private sector institutions cannot hope to help the economically weaker sections of the community, while remaining viable institutions themselves. However, even for those who are able to afford modest housing, there has been a lack of a housing finance mechanism to help them to purchase their own homes. It is against this background that the Housing Development Finance Corporation (HDFC) has rapidly established itself as a pioneer in housing and housing finance activities in India.

The establishment of HDFC

HDFC is the brainchild of one of the outstanding figures in finance in India, H. T. Parekh, who developed the idea of a private sector housing finance institution in the early 1970s. His idea was backed by a development bank of which he was chairman, the Industrial Credit and Investment Corporation of India. A feasibility study on the institution was presented to the World Bank, which passed it on to the International Finance Corporation which, in turn, conducted its own feasibility study.

IFC decided to back the institution with some equity capital of its own. A final partner was the Aga Khan, and these three groups each contributed 5% of the initial share capital. HDFC then made a public issue of capital in 1978, and this received overwhelming response from the public and from institutions.

HDFC is a company established under Indian company law with a widespread shareholding. In June 1986, it had over 14,000 shareholders. Companies hold 48% of the shares, banks 15%, individuals 14%, finan-

THROUGHOUT the third world, it is now recognised that housing finance institutions can themselves contribute towards the solving of acute housing problems. However, in most developing countries, such institutions have only scratched the surface of the problem and, in some cases, institutions have been established only to wither away or to develop into more wide-ranging financial institutions. One institution which stands out against this general trend is the Housing Development Finance Corporation in India. It is one of the few purely private sector institutions, without significant government backing, which has made a significant direct contribution towards dealing with acute housing problems and, moreover, it is an institution which is dedicated to sharing its experience with others in India and outside.

The development and role of this unique organisation is described in this profile, written by the editor of Housing Finance International, *Mark Boleat.*

cial institutions 13%, insurance companies 3% and others 5%.

The managing director of HDFC is Deepak Parekh, a London trained accountant who was formerly with Chase Manhattan Bank. He is chairman of the Housing Finance Development Committee and a vice-president of IUBSSA. Pradip Shah, a Harvard MBA who helped set up HDFC, is general manager. Four other general managers complete the senior management team: D. M. Satwalekar (finance and planning), G. W. Kshirsagar (resources), Nasser Munjee (human resources) and T. S. Chandrasekhar (HDFC developers).

Resource mobilisation

The problem for any financial institution in developing countries is the mobilisation of resources. While people may have substantial savings, these are often held in a physical form, and there is a wariness in investing in institutions which are seen to be remote. A newly-established institution faces particular problems in this respect, especially in India where most of the banks are nationalised, and where the Government offers very attractive tax free returns on some of its own instruments. HDFC has, therefore, not been able to mobilise large amounts of personal savings.

Its main source of funds is its certificate of deposit scheme. The certificates have a mimimum denomination of 2,000 rupees (about $150), and a maturity of between six months and five years. Currently the rate of interest varies from 9.5% for six month certificates to 12% for 12 month certificates.

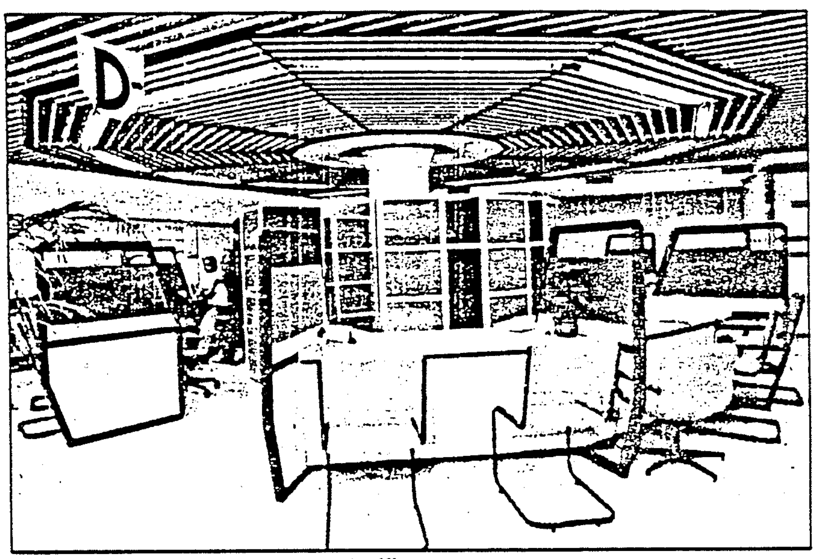
A slight variation of this scheme is the cumulative interest scheme, by which interest is compounded each six months rather than paid out annually. There is the same minimum denomination as for the normal certificate of deposit scheme, and maturities range from two years to five years. Current rates of interest vary from 11% for two year certificates to 12% for five year certificates.

HDFC has as yet made little progress in tapping the personal market, although it is conscious that it needs to do so to maintain its development. Its main scheme for attracting personal savings is the loan-linked deposit scheme. This is a flexible variation of the more formal contractual schemes operated, for example, in France, Germany and Austria. An initial deposit of 200 rupees must be made, and a savings period of between 18 months and five years is chosen. Savings carry an interest rate of 9%.

After completion of 18 months' saving, and provided there is a minimum amount in the savings account, the saver becomes eligible for a housing loan based on the amount deposited, and the repayment capacity. The maximum housing loan under the scheme is 200,000 rupees ($15,000). Interest earned on deposits up to 7,000 rupees is tax free. However, the scheme does not have to be used for housing loan, but can simply be used as an attractive savings scheme in its own right.

More recently, HDFC has introduced a formal contractual scheme in the form of the homes savings plan, which is greatly influenced by the Bausparkasse system in West Germany. Savings under this plan attract a rate of interest of 6%. At the end of the savings period a loan is available at a low rate of interest of 8.5%, and the loan must be repaid over 12 years. The scheme has only recently been introduced, and accounted for a modest 3 million rupees of deposits at the end of June 1986.

HDFC obtains much of its funds through loans and bonds. It has three outstanding 12.5% bond issues, redeemable between 1992 and 1996, and totalling 300 million rupees ($23 million). At the end of June 1986, banks had loans outstanding to HDFC of 438 million rupees ($34 million). Other sources of funds included the Army Group Insurance Fund (150 million rupees), the Life Insurance Corporation of India (100 million rupees) and the General Insurance Corporation of India (25 million rupees).



The branch in HDFC's new head office.

HDFC has made particular use of international sources of funds. The International Finance Corporation, in

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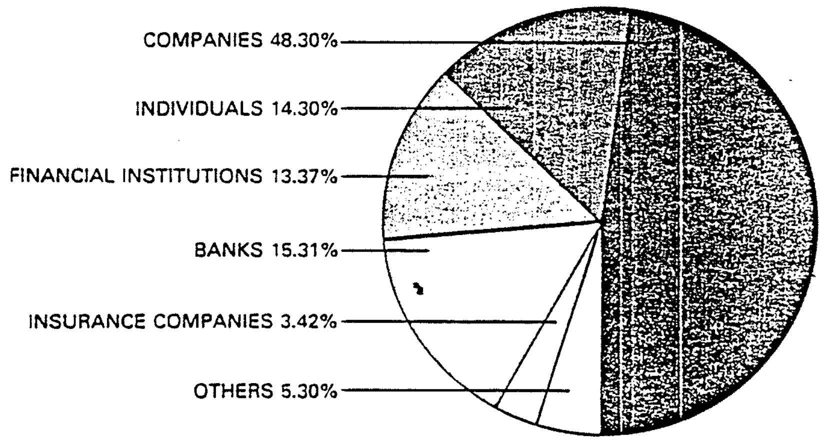
addition to providing equity capital, has a loan outstanding of 14 million rupees. The Corporation has raised $75 million from the US capital markets, under the housing guarantee programme of the United States Agency for International Development (AID). The funds are raised in dollars with the exchange risk being taken by the State Bank of India, the Bank of India and the Industrial Development Bank of India. The AID funds are specifically earmarked for borrowers with incomes below the median for the country.

Lending

Lending for house purchase in India is not the relatively simple matter that it is in most industrialised countries. One particular problem is the security. Such is the legislative process in India that it can take from eight to 10 years for a lending institution to gain possession of a property following the default of the borrower. Lending institutions cannot, therefore, rely on the property alone as security.

It is HDFC's policy to seek two additional guarantors. In addition, if the property is secured by an insurance policy with the Life Insurance Corporation of India (a nationalised body which has a monopoly of life insurance), then that policy must be charged to the property. Obtaining guarantors inevitably takes time, slows up the process of house purchase and is particularly difficult for the low income people which HDFC is trying to assist.



Distribution of HDFC's shareholding

The second problem, particularly related to lower income people, is that of ascertaining income. Many people in India do not have stable jobs with regular pay cheques. In the case of self employed people in particular, it may well be necessary for HDFC lending officers to spend some time ascertaining precisely what the income of the applicant is, and whether he will be able to afford the loan repayment.

HDFC lends mainly for new residential housing, anywhere in India, to individuals, associations of individuals, groups of individuals and individual members of co-operative societies. HDFC makes advances primarily to individuals whose immediate families do not own any dwelling units. Loans will not normally be for less than 7,000 rupees ($540), and the maximum loan to any individual applicant is normally 100,000 rupees ($7,700). Loans do not normally exceed 70% of the cost of the property, including the cost of land. The rate of interest varies according to the size of the loan, from 12.5% for loans below 20,000 rupees to 14.5% for those loans above 100,000 rupees. The repayment period is normally in the range from five to 15 years.

HDFC channels some of its loans through co-operatives and institutional channels. It will give loans to companies for construction or purchase of new dwelling units for the use of their employees. HDFC normally lends up to a maximum of 50% of the

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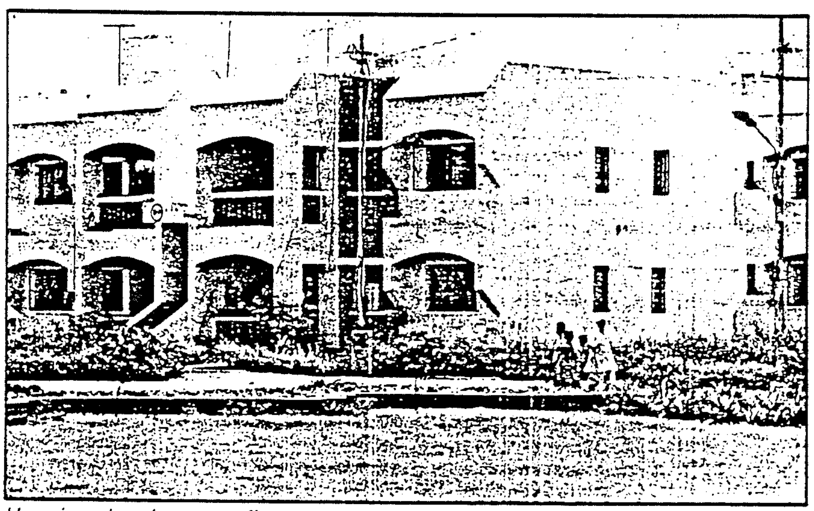

Housing development financed by HDFC.

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housing project, with a maximum loan per unit of 100,000 rupees ($7,700). The loan is normally repayable within five years at a set rate of interest of 14.5%.

HDFC will also enter into arrangements with companies under which it grants loans to individual employees, or groups of employees, with the company guaranteeing the loans. The rate of interest varies from 13.5% to 14.5%.

In 1985-86, 364 million rupees ($28 million) of loans were channelled through the corporate institutional sector, and 69% of the households benefiting from these schemes had incomes less than 1,000 rupees ($80) per month.

HDFC has recently been involved in a number of new lending initiatives. It has introduced a low start repayment facility, aimed at helping lower income groups and younger professionals to obtain larger individual loans than normal eligibility considerations would permit. It has also provided substantial financial assistance to low income groups, notably through the financing of 5,500 units through the rehabilitation housing scheme for the economically weaker sections affected by natural calamities in Kerala, and also financial assistance for employees of transport corporations.

In anticipation of 1987 as the International Year of Shelter for the Homeless, HDFC has already identified and approved finance, jointly with the Housing and Urban Development Corporation (HUDC), for two projects which are intended to benefit economically weaker households.

Growth

HDFC has grown spectacularly and has constantly had to revise its plans upwards. From a standing start assets passed the $100 million mark at the end of 1982 and then more than tripled by early 1986 and reached $400 million by the end of 1986. Well over 150,000 loans have already been approved. This growth is forecast to continue.

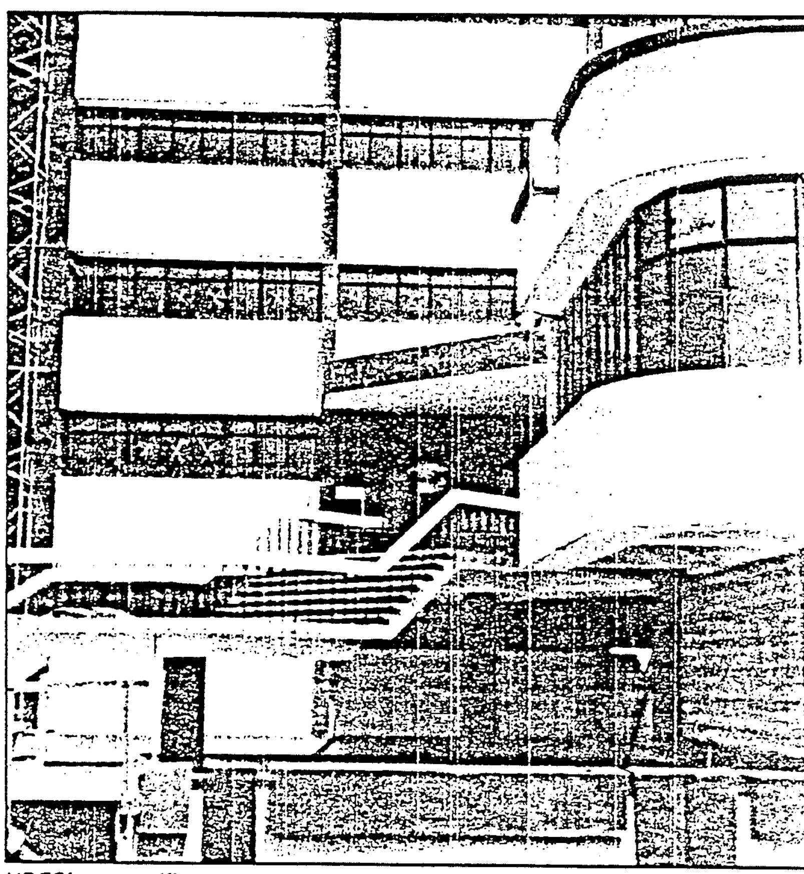
Development

It should not be thought that HDFC is simply a financial institution. It also has a subsidiary company, HDFC Developers Ltd, which aims to build good quality housing aimed at middle income people. A major project at present is for 644 units at Chinchwad Pune, and a second project involves a new office in South Bombay, together with 137 units of accommodation.

Building on experience

HDFC is now widely recognised as one of the most successful housing finance institutions in developing countries. Its senior officers have been involved in a number of consultancy projects. The United States Agency for International Development engaged HDFC as consultants for a new building construction company recently established in Nepal, and two HDFC executives conducted an operational review that covered all aspects of the company's operations. An HDFC executive also visited Nepal as a member of the team from the IFC which carried out a study on the feasibility of promoting a housing finance institution.

A senior HDFC executive has visited the Philippines, as part of a World Bank team, in order to assess and help restructure housing finance institutions in that country. Another



HDFC's new office complex at Vashi.

senior executive visited Indonesia as a member of the World Bank appraisal mission following an earlier visit, with a view to carrying out an institutional evaluation of the primary housing bank in Indonesia. Other countries where HDFC has been involved include Bhutan and Sri Lanka.

Despite its spectacular growth, HDFC recognises that it is but a small institution in the context of India, and it is able to make only a limited impact on the acute housing problems of that country. It sees one of its long-term objectives as being to help the development of an efficient housing finance system for India.

HDFC is already well respected within government circles, and is consulted on all proposals relating to housing and housing finance. It continues to press points such as the complications caused by the rent acts, and the difficulties of obtaining possession, both of which severely constrain the operation of housing finance institutions. It is anxious to help promote new institutions, perhaps including another institution like HDFC in the east of the country, and it is also willing to play its part in the promotion of building society type institutions.

For itself, HDFC wants to develop its deposit-taking base, as it cannot continue to grow simply by raising institutional funds. It also wishes to decentralise operations from head office to its 14 branches, but this is dependent on the development of the necessary skills within those branches. In the construction area it considers it necessary to develop large scale building techniques which can help deal with some of the worst housing problems.

HDFC's philosophy is well illustrated from the concluding words of the chairman's annual report for 1985-86:

> "The development of a housing finance facility is not the solution to the housing problem; it merely operates on the demand side of the equation. The greater task ahead is the modernisation of the housing industry; its technical components and the method by which it is put together; in other words on the supply side of the equation. The effectiveness of housing finance or the efficiency with which it can be utilised depends crucially on the development of the housing industry as well as the manner in which the industry can control costs.
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> By evolving new techniques across a wide spectrum of housing needs from the modest upgrading project to middle income housing through a modern institutionalised provision of housing finance, an entire industry can be transformed. It is vital for policy planners to examine both the supply and demand side of the housing market. Now that significant developments have taken place in the Indian environment, within the housing sector, these efforts need to be supplemented by considerable public policy support.
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> HDFC, in its own way, has attempted to introduce a housing finance system robust enough to develop in accordance with the growth and diversification of the housing industry. In the end, the housing sector is intimately intertwined with the financial system. HDFC's own name was constituted from the three words which, when fused together, constitute the interlocking of these key areas: Housing, Finance and Development." ■

HDFC, Assets and Liabilities, 30 June, 1986

Liabilities	Rupees m	$m	Assets	Rupees m	$m
Certificates of deposit	2,472	190	Housing loans		
Loan linked deposits	22	2	Individuals	2,804	216
Cumulative interest scheme	28	2	Corporate bodies and co-operatives	609	47
Home savings plan	3	—	Staff	4	—
Loans and bonds	1,569	121	Others	41	3
Share capital	100	8	Investments	431	33
Reserves and surplus	159	12	New current assets	356	27
			Fixed assets	36	3
			Other assets	13	1
Total	4,354	335		4,354	335

Source: HDFC Ninth Annual Report, 1985-86.

HDFC Progress, 1981-82 to 1985-86

		1981-82	1982-83	1983-84	1984-85	1985-86
No. of loans approved		12,000	19,000	27,000	28,000	41,000
Loan disbursements	rupees m	298	478	749	932	1,457
	$m	23	37	58	72	112
Housing loans outstanding	rupees m	564	985	1,612	2,347	3,518
	$m	43	76	124	181	271
Total assets	rupees m	691	1,213	2,164	3,064	4,354
	$m	53	93	166	236	335

Source: HDFC Ninth Annual Report, 1985-86.

Note: The rupee figures have been converted into dollars at the November 1986 exchange rate of 13 rupees to the dollar.