Recent developments in Indian housing finance

By Nasser M. Munjee

HOUSING policy in India during the country's first six economic development plans (1947-85) remained largely implicit: housing was seen to be a social sector and therefore not a major part of economic development. In preparation for the Seventh Plan (1985-90), the Planning Commission set up a series of Task Forces to enquire into the issues and policy alternatives for the shelter and urban sector in India. The reports produced by these Task Forces[1] remain today to be the major documents analysing the state of housing development in India.

As a consequence of these reports, a number of initiatives were undertaken in 1988 — the penultimate year of the Seventh Plan — which will be reported subsequently. This article provides a brief summary of the evolution of the housing finance system in India, describes some recent developments, places the recently established National Housing Bank in perspective, and concludes with some issues that remain to be addressed by future policy.

India's progress towards a strategy for housing development may be measured by institutional processes that began in the 1970s. Initially, the concern for the lowest income urban households (less than the 40th percentile of the distribution of income) resulted in the establishment of a network of State level Housing Boards entrusted with the task of parcelling and harnessing available publicly owned land resources for the development of residential housing for these target households. An apex financial institution, the Housing and Urban Development Corporation (HUDCO), was entrusted with financing these efforts through a techno-financial link with these various house building agencies.

The second pillar of the initial strategy was the co-operative movement catering largely to the private sector. Households were encouraged to form co-operative societies, invest initial capital for land purchase and then were financed through State level Apex Co-operative Housing Finance Societies. These societies, in turn, were funded through the Life Insurance Corporation which set aside for this purpose a particular quantum of the resources they had available for investment.

The third pillar comprised the House Building Advances made to employees of public sector corporations and financial institutions as well as to civil servants. Capital formation in housing for the rest of the private sector was left almost entirely to market forces. Chart I (overleaf) illustrates the flow of funds to the housing sector.

It is estimated (very roughly) that about Rs7,000 crores ($US4,516 million) has been the total formal sector's finance for housing which, after netting out inter-sectoral flows, works out to roughly half the gross figure, ie Rs3,500 crores ($US2,258 million). A schematic representation of the flow of funds to housing through a select network of major financial institutions is indicated in Chart I. Table I illustrates in more detail the flow of funds through public institutions.

Housing finance, as a financial intermediation process, commenced only in 1978, with the establishment of Housing Development Finance Corporation (HDFC) as a specialised lender to households and corporate entities specifically for housing purposes. Since then, the sector has grown to encompass three major regional institutions with the promise of a further seven in the near future. Table II illustrates the institutional growth of the sector during the 1980s and Table III summarises the performance of the major operating specialised housing finance institutions in the country.

Some recent developments

Spurred by the United Nations declaration of 1987 as the International Year of Shelter, combined with the resolve of the Government of India to initiate processes which would reallocate resources to housing and urban development, a number of initiatives were taken, all to emerge in 1988, to create a policy framework for the sector. These could be listed as follows:

(1) The formulation of a National Housing Policy Document.
(2) The publication of the final report of the National Commission on Urbanisation.
(3) The establishment of the National Housing Bank as a wholly owned subsidiary of the Reserve Bank of India.

Despite these initiatives, the future role of the public and private sectors, the constraints faced at present and an operational strategy for the future have not been tackled analytically for

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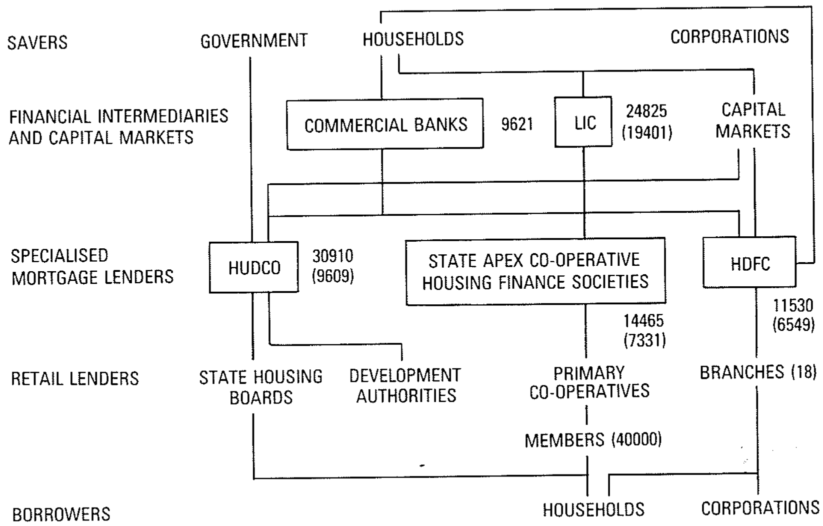
Chart 1

Schematic Representation of Formal Housing Financial Intermediation in India as of March 1988

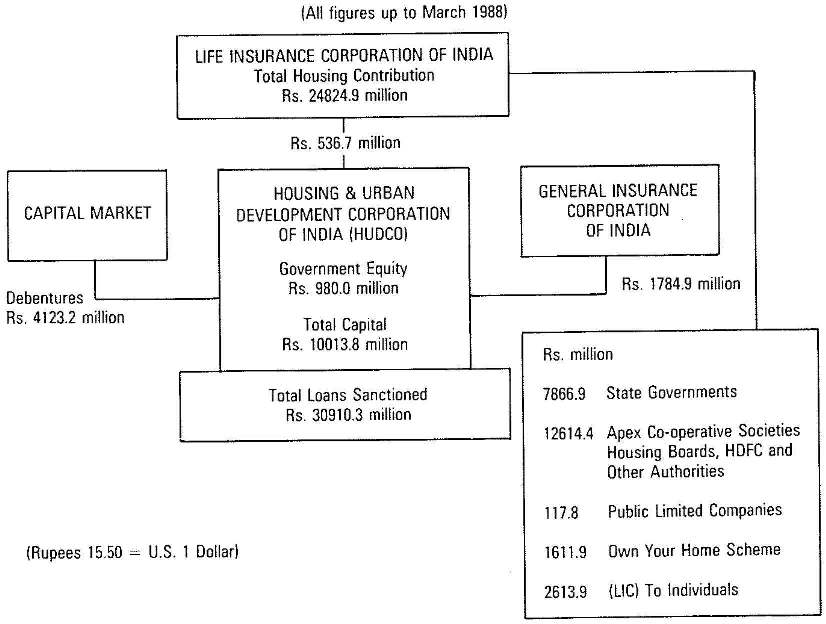


1. All figures in Rs. millions.
2. Figures indicate cumulative approvals as of March 31, 1989.
3. Figures in parentheses represent outstanding housing loans.

Table 1

Public Institutions Financing Housing

(All figures up to March 1988)



(Rupees 15.50 = U.S. 1 Dollar)

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the sector as a whole. The National Housing Policy Document makes only two references to this issue, one in the preamble:

"There is obviously a need to recognise and rely on a multiplicity of actors including the Government in the production and improvement of housing on the scale required. Government will need to devise and implement coherent and well-set-out shelter strategies which will enable all the various actors to complement one another and to ensure most efficient utilisation of resources."

and the other in the objective statement:

"To create an enabling environment by eliminating constraints and developing an efficient and accessible system for the delivery of inputs to maximise housing efforts."

The document does not illustrate how this might be achieved. The creation of the National Housing Bank ostensibly to "be the principal agency to promote housing finance institutions and provide financial and other support to them" will be of great operational significance to the future growth and development of the emerging housing finance system as it evolves in the years ahead.

The National Housing Bank

One of the key recommendations of the Task Force on Housing in 1985 was to establish two key institutions: a Housing Bank and an Urban Infrastructure Finance Bank. The Government accepted the first to be implemented in the Seventh Plan period and, as a consequence, the National Housing Bank (NHB) was established in July 1988.

NHB's main objective was to ensure the development of a viable and accessible institutional system for the provision of housing finance. The NHB was established by Statute under the National Housing Bank Act (1988) and was capitalised by the Reserve Bank of India with an initial capital of Rs100 crores ($58 million).

The NHB views its role as an "Apex" housing finance institution which has a regulatory, promotional and refinance role for other institutions that have appeared or have been operational in the field.

In its initial year, the NHB has taken a number of steps to operationalise its objectives:

(i) In November 1988, NHB announced the role that it envisages for the commercial banking system in housing finance. Commercial banks had hitherto allocated a certain quantum of funds each year, under guidelines issued by the Reserve Bank of India, for both direct as well as indirect lending for housing finance. The new guidelines indicated the terms and conditions on which banks could finance individuals, institutions, Housing Boards and private developers. The terms for individual households were comparative to those currently offered by HDFC.

(ii) In March 1989, NHB announced detailed guidelines for a Home Loan Account Scheme that would be offered and operated by banks through their branch network. A household would be able to save under the scheme for a minimum period of five years at a rate on return of 10% per annum, after which the saver would be eligible for a housing loan of a multiple of the total savings subject to a ceiling of Rs300,000 ($17,500), as well as some restrictions on the size of the unit to be financed. The scheme is to be a national scheme which would replace all other products, if any, offered by the banks.

(iii) In April 1989, the NHB announced its refinance guidelines to existing housing finance institutions, aimed at refinancing these institutions, especially for loans made to lower income households and loans made for renovation or for upgrading of low cost housing. Refinance is available up to Rs50,000 ($3,000) per household and loans made for purchase or Rs30,000 ($1,700) per household for renovation or upgrading of an existing unit. The rate of interest varies from 10.5% to 13% per annum depending upon the size of the loan with a slight difference of ½% for rural housing.

(iv) In June 1989, NHB also announced guidelines for acceptance of deposits by housing finance institutions. The major feature of these guidelines is that housing finance institutions cannot now accept deposits for a period of less than 24 months.

(v) Finally, NHB has also issued guidelines for the promotion of Housing Finance Institutions in private or joint participation which would be applicable if these institutions expect financial support from NHB. The guidelines, *inter alia,* include paid-up capital requirements, gearing ratios, acceptance of deposits rules, and terms and conditions offered by these institutions for housing finance. *(See Annex I.)*

Table II

Existing Housing Finance Institutions	
Institution	*Head Office Location in India*
1. Housing Development Finance Corporation Ltd	Bombay
2. Gujarat Rural Housing Finance Corporation Ltd (GRUH)	Ahmedabad
3. Housing Promotion & Finance Corporation Ltd (HPFC)	Calcutta
4. Can Fin Homes Ltd	Bangalore
Proposed Housing Finance Institutions	
Promoted by:	
1. General Insurance Corporation of India (Subsidiary)	Bombay
2. Life Insurance Corporation of India (Subsidiary)	Bombay
3. Bank of India	Bombay
4. Central Bank of India	Bhopal
5. Punjab National Bank (PNB) Housing Finance Ltd	New Delhi
6. United Commercial Bank (for rural housing)	Orissa
7. UP Rural Housing Finance Corporation Ltd (for rural housing)	Uttar Pradesh

There are about 40 other minor housing finance institutions spread throughout India.

Table III

Rs Crores

		HDFC	*CAN FIN HOMES*	*GRUH*	*HPFC*
CUMULATIVE LOANS	Approved	1,500	41.4	6.86	5.47
	Disbursed	1,100	27.6	2.51	1.19
LOANS OUTSTANDING		850	29.69	2.49	1.18
RESOURCES	Net Worth	65	10.52	2.23	4.43
	Loans	500	—	2.00	—
	Deposits	485	32.80	—	—
FUNDS EMPLOYED		1,050	43.32	4.23	4.43
PROFIT BEFORE TAX		17.2	0.43	0.18	0.15

Housing Finance: the issues

With formal institutional finance for home purchase being in its infancy in India, the major objectives of a future strategy would seem to be the following:

(1) To enhance the loan origina-

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tion process for housing throughout the country.

(2) To develop an institutional network that would facilitate this origination process.

(3) To identify a potential resource base for the system as a whole.

(4) To codify and simplify the legal system with respect to risk management of housing finance institutions (liquidity, interest rates and default risks in particular).

(5) To rationalise and reorient the fiscal system to reallocate funds to the housing sector by providing incentives for household thrift as well as institutional growth.

(6) To link formal networks with informal networks which are the major source of financial and economic activity for the rural and urban poor.

The current debate for policy formulation attempts to resolve the vexing question of how the loan origination process can be expanded in the short run with a combined strategy for institutional development and resource mobilisation in the long run. In this respect, recent developments in the sector include the following:

(a) A major entry by the Life Insurance Corporation of India in *direct* household mortgage loan origination. Until 1988, LIC's total direct loan originations for housing under its Own Your Own Home Scheme were 37,730 loans (Rs161 crores) ($US95 million). During 1988 alone, 4,525 loans were originated (Rs33 crores) ($20 million) and 15,000 loans are expected to be originated (approximately Rs150 crores ($88 million) during 1988-89. These are likely to rise to 75,000 loans in 1989-90. LIC is also likely to establish a subsidiary company exclusively to undertake housing finance activities.

(b) A major initiative by the National Housing Bank to include the commercial banking system in the direct loan origination process through its 55,000 branches throughout the country.

(c) Major initiatives by the commercial banks to create housing finance subsidiaries either jointly with existing housing finance institutions or on their own.

(d) Entry of the General Insurance Corporation of India into home loan origination through a subsidiary company.

Supply constraints

While the loan origination process will be considerably strengthened by these recent developments, little attempt has been made, at present, to identify the *long-term* strategic issues posed by the supply constraints of housing in the years to come. These issues include the following:

(a) While housing finance availability is critical to household effective demand for housing, how will housing supply responses cope with this additional demand?

(b) Land parcelling and servicing is the critical constraint on urban housing development largely as a result of the Urban Land Ceiling Act (which limits permissible land holdings in urban areas and freezes the remainder) as well as the inability of the judicial system to expedite cases involving land disputes.

(c) The House Price to Household Income Ratio in India on average is 6.2, well above the average for developing countries of about 5.25, indicating that housing remains expensive thus limiting the affordability of market-related housing finance.

(d) The Housing Delivery System is characterised by relatively small "builders" rather than large-scale construction companies, limiting the benefits that might be derived from economies of scale, modular construction and industrialised techniques.

As a result of these constraints, the input costs of housing development (especially land) are extraordinarily high. Housing for the poor can, therefore, be limited only to areas where land is either Government owned or acquired by Government for the purpose.

While private developers are the major suppliers of housing in most major urban centres, housing for the poor remains largely outside the formal private delivery system. Much remains to be done in designing and financing low income housing. A recent evaluation of sites and services projects by the World Bank[2] concluded that, while the concept was a valid one, replicability remained elusive largely owing to erroneous judgements on appropriate affordability estimates.

This would seem to highlight the need to link low income housing or shelter projects much more closely to the perceived needs of the beneficiaries backed by their willingness to pay for the service stream of benefits over time. Links between formal financial institutions and informal local level networks would seem to be critical to future policy in this area.

Our experience in India is that the potential for these links can be extremely effective in understanding local problems and designing specific approaches for their solution. HDFC recently promoted the Gujarat Rural Housing Finance Corporation (GRUH) specifically to deal with some of these issues. GRUH finances the acquisition or upgrading of housing in rural areas and small towns with a population below 50,000.

GRUH reaches out to local level networks in order to administer and disseminate housing finance — eg dairy and cotton co-operatives, nongovernment organisations — and those networks in turn have positive incentives to utilise GRUH's financial services. GRUH is experimenting with new methods of credit appraisal and training programmes are planned jointly with GRUH staff as well as local level organisations to help jointly administer operating systems more effectively.

Resource mobilisation and efficient intermediation have become the key ingredients of an effective financial system. The rationale for specialised institutions lies precisely in the development of specialised human resources, technological systems and managerial techniques to deal with very specific forms of activity in the most efficient (cost effective) manner possible.

India is now fortunate that these skills have been gradually developed and are being embodied in the emerging housing finance system. Their future evolution, however, will require a framework which will permit these institutions to fit into the financial system at large. As the Honourable Minister for Urban Development of the Indian Government recently emphasised: "Housing finance would need to be integrated into the financial system as a whole if it is to assume the proportions that will be required to finance projected needs."

The initial basic requirement for an emerging structure would be access to a resource base. The narrower the base, the fiercer the competition for available resources, which would result in enhancing costs. It would seem, therefore, that Government policy would need to define the savings base and the capital market base for housing finance institutions fairly carefully, keeping in mind the critical role of the price of housing credit. An institutional development strategy would demand that new institutions transform themselves from mortgage banks in their initial operations (wholesale borrowing and retail lending) to savings institutions (retail borrowing and retail lending) as they establish themselves in their respective market segments.

A future system would need to ensure that it was designed to be sufficiently robust to generate its own resources from within the system as well as contribute to financial deepening and institutional diversification of the financial system at large. It is this aspect — the sound structure of institutions within an evolving financial system — that will prove to have the most lasting impact on the real development of housing activity in developing economies. ■

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NOTES

1. Task Force Reports, Planning Commission of India, 1985.
   (i) Planning and Development
   (ii) Financing of Urban Development
   (iii) Management of Urban Development
   (iv) Shelter for the Urban Poor and Slum Improvement.
2. Stephen K. Mayo and David J. Gross, "Sites and Services — and Subsidies: The Economics of Low-Cost Housing in Developing Countries", *The World Bank Economic Review,* Volume 1, No 2, January 1987.

Annex I

SUMMARY GUIDELINES FOR HFIs ISSUED BY NATIONAL HOUSING BANK

1. Main Object:	The business of providing long-term finance for construction or purchase of houses in India for residential purposes	
2. Minimum Paid-Up Capital:	Rs1 crore (approx $US600,000)	
Minimum Promoters' Contribution:	30%	
Minimum Government/ Approved HFIs:	20%	
3. Gearing:	Net Owned Funds	Total Borrowing
	Up to Rs10 crores	10 times
	Rs10-20 crores	12.5 times
	Over Rs20 crores	15.0 times
4. Lending Rates:	Up to Rs20,000	12.5%
	Rs 20,000-Rs 50,000	13.5%
	Rs 50,000-Rs 1,000,000	14.0%
	Above Rs1,000,000	14.5-16%
5. Front End Charges:	Should not exceed 2% of the loan	

6. Tax Concessions:
   a) A public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes can create a special reserve within an amount not exceeding 40% of the total income; such a reserve is admissible as a deduction in computing income chargeable to Income Tax.
   b) Investments in the new equity shares of such companies are an eligible deduction up to 50% of the cost of such shares.
   c) Deposits with or investments in any bonds issued by such companies from income derived from property held under trust wholly for charitable or religious purposes qualifies as an eligible mode of investment.
   d) Interest on deposits with such companies qualifies for deduction from tax.
   e) Repayment of the amount borrowed from any such company for housing purposes is eligible for deduction from tax up to the limit of Rs10,000.
   f) Deposits made with such companies are exempt from Wealth Tax.

While these initial activities are gradually formalising the role of housing finance in the Indian Financial system, some significant policy issues remain for the future.