

Developments in Housing Finance in India

by Dr. Piyush Tiwari

INTRODUCTION

Housing finance in India has traditionally been accorded and continues to receive a low priority in policy formulation compared to other sectors. By international standards, housing finance constitutes a small proportion of Gross Domestic Product (GDP); and not withstanding the extraordinary growth in the volume of housing investments over the past four decades, it still falls short of the country's requirements. The share of mortgage finance in total housing investment is presently approximately 10% compared with 85% in OECD countries (Buckley, 1994).

This reflects the shallowness of the financial system in India. Years of financial repression not only have minimized the role of the formal sector in housing finance, but have contributed to high housing prices because negative real interest rates favored investment in real assets. The average ratio of housing value to annual housing income is around 8–10 compared to 3.0 in two high-income countries.

The present paper discusses key trends, development and issues in financing homeownership in India. Housing finance in India has undergone substantial development in

the past decade largely owing to the creation of the Housing Development Finance Corporation (HDFC) nearly two decades ago. However, the controlled financial regime still haunts the flow of resources to the sector. Marred with many supply-side and demand-side problems, housing finance, at best, can be described as a caged tiger awaiting an opportunity to be freed.

This paper is organized as follows: Section 1 discusses the changing dynamics of housing finance. Section 2 overviews the pricing of housing loans. Sections 3 and 4 discuss financing and refinancing of housing loans. There is a brief discussion on finances for

property development in Section 5, and Section 6 presents trends in construction finance. Section 7 is a short discussion on housing finance for the urban poor. Finally, Section 8 presents the future of housing finance in India, followed by a conclusion.

1. CHANGING DYNAMICS OF HOUSING FINANCE

A key statistical table which indicates the flow of resources—given a planned economy—to the housing sector in India has been plan allocations of resources during successive plan periods. The plan allocation in the housing sector is shown in Table 1.

Table 1. Investment in Housing in India (Rs. millions)

Plan	Public	Investment in Housing		
		Percent	Private	Percent
First	2,500	22%	9,000	78%
Second	3,000	23	10,000	77
Third	4,250	27	11,250	73
Fourth	6,250	22	21,750	73
Fifth	10,440	22	36,360	78
Sixth	14,910	11	115,000	89
Seventh	24,580	9	290,000	91
Eighth	63,770 + 250,000*		not ascertained	
Ninth	140,000 + 380,000*		not ascertained	

* Institutional

Sources: Eighth Five Year Plan; Working Group on Housing for the Ninth Five Year Plan

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Formal Sector

In general, the flow of resources through the formal institutions to the housing sector emanates from two major sources: (a) formal credit; and (b) the retail market. Formal credit refers to the resources available at the apex level, largely through directed credit from various institutions operating in the formal sector, and also includes budgetary support from central and state governments. The retail market, on the other hand, covers self-reliant resource mobilization efforts by housing finance institutions (HFIs) through the capital market, deposits from the household sector and new instruments such as Securitisation.

The housing finance system in India has had three distinct phases: The first phase was before the 1970s, when the only provider of support to house building activity was government, through its various social schemes for public housing. Government implemented its schemes through state housing boards, which were responsible for allocating serviced land and houses to individuals based on social equity principles.

The 1970s saw two major developments in housing finance. A public sector housing company, the Housing and Urban Development Corporation (HUDCO), was established in 1970; and a private sector company, Housing Development Finance Corporation (HDFC), was created in 1977. The mandate for HUDCO was to assist and promote housing and urban development programs with government agencies. HDFC pioneered individual lending based on market principles for homeownership in India. The success of HDFC over the years indicated that financing houses can be a profitable business. This has motivated many new housing finance companies to venture into the housing finance business.

Other Institutional Support

An important event of the 1980s was the formation of the National Housing Bank (NHB) in 1987. The objective of NHB was to channel formal sector resources to housing finance (urban and rural) through the promotion of a sound, healthy and cost-effective housing finance system.

The late 1980s also saw enhanced government involvement in directing various agencies like insurance companies, commercial banks, provident funds and mutual funds (Unit Trust of India), to invest part of their annual incremental resources in housing. (Commercial banks fulfilled this requirement through their lending under priority sector requirements.) After 1989, the scheduled commercial banks have been allowed to allocate 1.5% of their incremental deposits to housing, under guidelines from the Reserve Bank of India (RBI). RBI further instructed them to lend only 30% of this fund directly to individuals and 70% indirectly to agencies for augmenting the supply of serviced land and constructed units and subscription to guaranteed bonds and debentures of NHB and HUDCO. This guideline has had an important impact by encouraging scheduled commercial banks to play a more active role in the sector, and many have created their own housing finance subsidiaries. Table 2 indicates their contribution.

Table 2. Bank Group-wise Housing Loans Disbursed (Rs. millions)

Bank Group	1990-91	1992-93
SBI Group	479.1	634.4
Nationalized Banks	4,192.3	1,923.0
Private Banks	334.5	82.9
Foreign Banks	50.2	419.9
Total	5,056.1	3,060.2

Source: NHB (1996)

The two insurance companies, Life Insurance Corporation of India (LIC) and the General Insurance Corporation (GIC), support housing both directly and indirectly. LIC is statutorily required to invest 25% of its net accretions to its investable funds in socially oriented schemes like housing, electrification, water supply, sewerage and construction of roads. Besides subscribing to bonds of HUDCO, and state housing boards / Development Authorities, LIC grants loans to state governments for their rural housing programs and to state cooperative housing finance societies and to public sector companies for their staff housing.

Similarly, GIC and its subsidiaries are required to invest 35% of their annual accretions in loans to socially oriented sectors including housing for economically weaker sections. GIC supports housing indirectly by subscribing to bonds/debentures floated by HUDCO and state housing boards/development authorities. LIC created its own housing finance company in 1989 and GIC in 1990.

Provident and pension funds play a very small but important role in housing finance. The prescribed investment pattern for provident and pension funds provides that 85% of the money be invested in the special deposit scheme of the central government and the remaining 15% in the various state government securities and other negotiable instruments. However, a small portion of the provident fund contribution is utilized for giving housing loans to members. These loans have played a major supplemental role for members in meeting their needs for housing finance.

The cooperative housing sector has traditionally played an important role in providing housing finance through a three-tiered structure:

- A three-tier structure of state, district and cooperative banks (including urban

- cooperative banks) and the primary affiliated credit societies at the village level;
- State Land Development (mortgage) Banks having affiliated structure of primary Land Development (mortgage) Banks at the taluka level; and
 - Apex and state-level housing finance cooperatives with affiliated cooperative housing societies.

The main source of finance for the cooperative housing sector is loans from insurance companies, HUDCO, NHB and commercial banks, and by contributions through its own membership.

In the post-1990s liberalization era, three distinct groups of housing finance companies have emerged: specialized housing finance companies, housing finance companies created as subsidiaries of some commercial

banks and housing finance companies set up by insurance companies. The first group of companies raise their resources from the market mainly through public deposits. For example, more than half of HDFC resources are now through public deposits. Much of the resources of the second group of companies is derived from their parent banks, and the insurance companies provide a line of credit to their own subsidiaries. This is illustrated in Table 3.

Table 3. Resource Pattern of Some Housing Finance Institutions (Percentage)

	Age		Insurance	NHB	UTI	Banks	LOC	Term Loan	Deben-ture	Bonds	Govern-ment	Foreign	Public Deposits	Other Deposits
HDFC	20	1997	9.4	0.4	0	8.4	0	0	0	4.4	0	10.	53.06	12.6
		1996	7.5	0	0	10.7	0	0	0	4.0	0	14.3	50.0	13.2
Home Trust	2	1996	0	0	0	7.64	65.1	9.2	0	0	0	0	8.13	9.96
PNB	7	1995	0	30.5	0	.41	0	.2	0	0	0	0	68.9	0
DHFL	12	1996	0	55.1	0	4.86	0	0	0	0	0	0	40.0	0
		1995	0	55.2	0	6	0	0	0	0	0	0	38.8	0
HUDCO	26	1996	12.4	7.03	5	7.12	0	0	16.9	46.1	0.19	2.28	2.98	0
		1995	10.6	8.21	7.3	4.58	0	0	17.8	43.5	1.23	2.09	5.73	0
Centbank	5	1996	0	16.4	0	0	0	0	0	0	0	0	83.65	0
		1995	0	14.4	0	0	0	0	0	0	0	0	85.59	0
Gruh	10	1996	0	29.5	5.5	27.87	0	0	0	0	1.05	0	36.13	0
		1995	0	31.7	7.6	21.73	0	0	7.96	0	1.18	0	29.77	0
Vijaya	6	1996	0	8.59	0	18.88	0	0	0	0	0	0	72.53	0
		1995	0	15.5	0	26.96	0	0	0	0	0	0	57.49	0
SBI	8	1996	0	6.27	0	26.32	0	0	0	0	0	0	58.4	9.01
		1995	0	8.38	0	24.98	0	0	0	0	0	0	52.01	14.6
GIC	6	1996	84.11	0	0	15.89	0	0	0	0	0	0	0	0
		1995	100	0	0	0	0	0	0	0	0	0	0	0
LIC	7	1996	92.76	7.17	0	0	0	0	0	0	0	0	0.7	0
		1995	90.19	9.74	0	0	0	0	0	0	0	0	0.7	0
Canfin	9	1996	0	25.9	2.35	14.88	0	0	2.19	0	0	0	54.7	0
		1995	0	24.9	3.72	13.92	0	0	2.48	0	0	0	54.97	0

Source: Annual reports of various housing finance companies

2. PRICING

Before 1994, the pricing of mortgage housing finance had been regulated by the National Housing Bank. This policy was essentially a differential interest rate policy predicated on the size of the loan. Since 1994, the policy has been amended and housing finance companies are free to charge market interest rates on all loans above Rs 25,000.

Even though India is presently undertaking financial sector reforms, interest rates have not yet found their equilibrium on a market-related basis. Variable rates of interest on loans are just beginning to be applied, as a suitable reference rate has yet to emerge. Hence, the only choice available to borrowers today is to borrow on a fixed-rate basis. There are tiers of interest rates based on the amount borrowed. The maximum loan tenure is up to 15 years. A few HFCs have started offering loans of tenure more than 15 years at slightly higher rates. GICHF offers loans of more than 15 year tenure at an additional charge of 0.5% per annum.

Dramatic Changes in the 1990s

Until 1989, there had hardly been any changes in lending rates by HFCs. However, during the 1990s, the economy saw dramatically rising interest rates as liquidity conditions in the money market became extremely tight. In 1991 a major crisis in the Indian economy triggered the reform process. During the next few years resources for financial institutions became extremely difficult. Housing finance companies, together with the traditional development finance institutions, began raising their own funds in the market through public deposits and the introduction of innovative instruments such as deep discount bonds. HDFC also began its highly successful retail resource program in mid-1991. During 1996-97, deposits have constituted 56% of HDFC's total borrowings.

With changes in the cost of funds, the cost of lending also changed. With deregulation of interest rates, HFCs now have to manage interest-rate risk. This risk arises out of changes in interest rates at a later date, after having contracted to borrow/lend at a particular rate. Since HFCs lend to the borrowers on a fixed-interest-rate basis, increases in interest rates in the future will affect the performance of the HFC. Moreover, as the term of the loans is generally long, the sensitivity of interest rate fluctuation on spreads will be higher.

Another problem associated with fixed lending rates is asset-liability mismatch. While HFCs provide long-term loans to their customers, ranging from 10 to 15 years, often they are forced to source their funds for much shorter periods (maximum of seven years) which creates a maturity mismatch. The weighted average duration of asset portfolio

of HFCs range from 6.8 years to 10.2 years; the weighted average duration for the sources range from 4.2 years to 9 years. To facilitate better asset-liability management, HFCs generally lend a portion of funds to short-term users like developers and corporations.

3. FINANCING

The contribution of government to housing finance has shrunk from 23% to 9% during the last four decades, as shown in Table 1. The flow of funds to the housing sector during the eighth five-year plan (1992-97) is given in Table 4.

Table 5 presents the projected flow of funds from the formal sector during the ninth plan (1997-2002) by the Working Group on Housing for the Ninth Plan that would be required to meet the projected need of the country's rural and urban housing.

Table 4. Estimated Flow of Funds During 1992-97 (Rs. millions)

	Estimated	Share Percentage
Central and State Government	50,000*	22.15%
Life Insurance Companies	45,000	19.94
National Housing Bank	18,000	7.98
General Insurance Company	7,000	3.1
Scheduled Commercial Banks	27,700	12.3
Provident/Pension Funds	9,000	3.99
Housing Finance Companies	45,000	19.94
Securitisation of Mortgage	0	0
Others	12,000	5.32
UTI	10,500	4.65
Home Loan Accounts	1,500	0.7
Total	225,700	

*Non-plan expenditure is not included

Source: Working Group on Housing for Eighth Plan

Table 5. Projected Flow of Funds from Formal Sector (Rs. millions)

<i>Institution</i>	<i>Flow of Funds</i>	<i>Share Percentage</i>
Plan and Non-plan Outlay of Central Government	60,000	11.54
Plan and Non-plan outlay of State Government	60,000	11.54
Employers House Building Construction	20,000	3.85
Life Insurance Corporation	45,000	8.65
General Insurance Corporation	10,000	1.92
Scheduled Commercial Banks	55,000	10.58
Provident Funds	50,000	9.62
Housing Finance Companies	95,000	18.27
HUDCO	25,000	4.81
National Housing Bank	30,000	5.77
Securitisation	25,000	4.81
Cooperatives	30,000	5.77
Others	15,000	10.7
Total	520,000	

Source: Working Group on Housing for the Ninth Plan

4. REFINANCE OF HOUSING LOANS

Refinance of housing loans is in a nascent stage in India. NHB refinances direct loans granted to individuals by scheduled commercial banks, housing finance institutions and cooperative housing finance societies for less than 50-square-meters-size houses, whose cost is less than Rs 200,000. NHB also provides refinance for upgrading and repairs. The spread between housing finance and refinance is restricted to 2% for loans up to Rs 25,000 and 1.25% for loans above Rs 25,000. To some extent, NHB also refinances rental housing and developers. The extent of refinance is marginal, however. During 1991-92, NHB refinance assistance amounted to Rs 6,754 million and during 1992-93 to Rs 4,859 million. The reason for the very low level of refinancing is lack of resources.

Securitisation is the most talked-about alternative for refinancing housing loans. However, in India many legal and tax impediments restrict the securitisation of housing loans. The sale of any asset attracts stamp duty, which varies from 3-10% depending on the state. Recently, the stamp duty in one state has been reduced to 0.1%, and this could have a ripple effect in other states.

Another factor that is detrimental to securitisation is the sorry state of foreclosure laws in India. Despite the growth of the housing finance industry in the past two decades and vigorous lobbying by the industry, foreclosing on property is fraught with difficulties and long delays. In the absence of legal redress, some third-party guarantee would be required before securitisation takes place. An efficient and effective legal system is an essential el-

ement of securitisation. With changes, it would be two or more years before securitisation would become a possible alternative for refinance.

5. FINANCING CORPORATES AND BUILDERS

Real estate developers and builders need finance for their building activity. However, in India the real estate developers and builders are viewed more as speculators than professionals. Lack of credibility has affected their access to finance from formal institutions. Housing finance companies lend to developers as part of the adjustment of their asset-liability mismatch. Usually the maximum tenure of loans to builders is three years.

Table 6 indicates construction finance by different companies.

6. TRENDS IN SELF-CONSTRUCTION FINANCE

Financing for self construction is limited in India. As shown in Table 7, most of the finance for self construction has been either through own savings, friends and relatives

Table 6. Amount Disbursed by HFCs to Developers and Corporates (Rs. millions)

<i>Companies</i>	<i>Construction Finance</i>	<i>Percent of Company Total</i>
HDFC	18,165	31%
Home Trust	32.2	16
PNB Housing	769.5	76
CanFin Homes	1,390.9	30
LIC Housing Finance	2,230	10
GIC Housing Finance	516	20
GRUH	5,490	30

Table 7. Distribution of Building Construction Finance by Source

	1980-81 (percent)			1988-89 (percent)		
	Rural	Urban	Cities	Rural	Urban	Cities
Employer	1.27	10.86	25.85	1.7	3.25	3.12
Government	0.19	0.61	0.05			
Insurance Companies	0.03	0.87	0.48	0.14	0.78	0.29
Banks (including cooperative banks)	1.17	2.48	1.48	4.21	6.67	4.67
Cooperative Housing Finance				0.48	1.13	0.66
Provident fund	0.52	4.09	16.26	0.35	0.70	0.49
Friends and Relatives	5.59	7.8	17.98	9.36	15.39	8.43
Informal Market Borrowings	4.41	2.51	1.50	2.08	1.87	4.89
Own Savings	50.36	35.08	29.78	42.57	29.32	44.64
Pension, Gratuity, and Provident Fund	1.23	3.35	1.29	3.12	5.73	5.17
Inheritance and Sale of Assets	1.58	1.76	1.02	6.38	22.09	5.77
Others	33.11	30.59	4.31	22.02	10.1	12.62

Source: Sarvekshana (1992)

or borrowings from the informal market. It is an irony that over the years the share of formal institutions in total borrowed finance has actually declined, as shown in Table 8.

Table 8. Distribution of Borrowed Funds for Construction by Source

	'88-'89	'80-'81	'72-'74
Employer	6.4	37.2	15.4
Government	3.7	2.1	10.4
Banks	13.5	8.5	20.6
Provident Fund	2.1	14.0	4.7
Moneylender	9.1	4.3	14.8
Friends and Relatives	52.5	26.7	18.3
Other	12.3	7.2	15.8

Source: Sarvekshana (1992)

7. HOUSING FINANCE FOR THE URBAN POOR

A study by the National Institute of Urban Affairs (1992) based on surveys in four medium-sized towns indicates that only around 50% of households are served by formal-sector financial institutions. The excluded are dependent upon their own incomes, savings, family assets and informal sector money lenders. Savings constituted around 55% of the means by which the excluded financed their housing, revealing a widespread though variable capacity to save. The poorer households are more constrained in access to finance, with fewer than 24% achieving provisions in the formal financial sector. Further information on allocation of housing finance is provided in Table 9 from research conducted by Mehta and Mehta (1991).

Table 9 clearly shows the restricted access among the EWS and LIG groups. A companion table, Table 10, reveals the results of recent surveys of allocation of formal and informal finance among various income groups.

These two tables indicate the inaccessibility of housing finance to the poor. The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. For example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. However, the income of many self-employed households is not stable, regardless of its size.

A large number of small loans are needed to serve the poor, but lenders prefer dealing with large loans in small numbers to minimize administration costs. They also look for collateral with a clear title, which many low-income households do not have. In addition, bankers tend to consider low-income households a bad risk, imposing exceedingly high information monitoring costs on operations.

Among the private sector companies, HDFC has been making continuous and sustained efforts to reach the lower income groups of society, especially the economically weaker sections, and has developed a unique system for housing finance to low-income households.

HDFC Response

HDFC's response to the need for better housing and living environment for the poor, both in the urban and rural sectors, arose from its collaboration with Kreditanstalt für Wiederaufbau (KfW), a German Development bank. KfW sanctioned DM 55 million to HDFC for

Table 9. Share of Formal Housing Finance for Various Income Groups in Three Indian Cities (1985-86)

Monthly Household Income (Rs)	EWS 700	LIG 700-1500	MIG 1500-2500	HIG 2500 +	Total (Rs. million)
<i>Indore</i>					
Public Housing	12.5	37.5	42.6	7.4	27.3
Financial Institutions		21.0	56.0	23.0	43.2
HBA		12.0	65.0	23.0	66.0
Overall Share	2.5	19.9	57.7	19.9	136.5
<i>Ahmedabad</i>					
Public Housing	17.5	43.6	30.9	8.0	85.7
Financial Institutions		23.5	49.0	27.5	177.9
HBA		12.6	64.6	22.8	180.2
Overall Share	3.4	22.9	51.9	21.8	443.8
<i>Mumbai</i>					
Public Housing	23.0	33.0	31.5	12.5	279.7
Financial Institutions		13.5	45.5	41.0	153.5
HBA		10.0	50.0	40.0	478.0
Overall Share	7.1	17.6	43.6	31.7	911.2

EWS—Economically weaker section
LIG—Low income group
MIG—Middle income group
HIG—High income group

Source: Mehta, M. et al. (1991)

low-cost housing projects in India. HDFC's approach to low-income lending has been extremely professional and developmental in nature. Avoiding the concept of dependence, HDFC's low-cost housing schemes are marked by an emphasis on people's participation and usage of self-help approaches, wherein the beneficiaries contribute both in terms of cash and labor for construction of their houses. HDFC also ensures that the newly constructed houses are affordable to the beneficiaries and thus promotes the usage of innovative low-cost technologies and locally available materials for construction of the houses.

To implement low-cost housing projects, HDFC collaborates with organizations, both governmental and nongovernmental. Such organizations act as coordinating agencies for the projects, involving a number of individuals belonging to the economically weaker sections. The projects could be either in urban or rural areas.

At present HDFC has 82 sanctioned projects, covering over 84,000 weaker section families. The total loan exposure for these projects is approximately Rs 780 million, the average cost per tenement and the average loan amount per tenement being Rs 30,000 and Rs 25,000 respectively.

Table 10. Sources of Finance by Household Characteristics (1991)

Household Income Rs/Month	No Financing	Baroda			Bhavnagar			
		Formal	Informal	Both	No Financing	Formal	Informal	Both
Less than 1050	34.4	40.0	25.6	0	66.7	13.3	20	
1051-2200	21.8	49.0	21.9	7.3	54.8	9.7	32.3	3.2
2201-3700	12.5	58.0	13.4	16.1	26.3	10.5	52.6	10.5
3701-5000	16.0	49.1	12.3	22.6	12.5	50.0	37.5	
Above 5000	3.8	53.6	25.0	17.6	60.0		40.0	

Fund Sources and Collateral

Apart from the mortgage of the houses being financed, HDFC also accepts collateral such as a lien on deposits from beneficiaries. In most of the existing housing programs, the beneficiaries have, from their savings, deposited 15-20% of the loan amount being advanced to them with HDFC. In a few cases, small donations received by nongovernmental organizations for housing the weaker section families have been used as revolving funds to leverage higher loans for the beneficiaries in order to complete their houses.

HDFC has a lien on such deposits and services the same with interest of 14–15% per annum. As the loans are advanced at 7.25% or 9% per annum, the interest earned on the deposit to a certain extent takes care of the monthly installments to be paid by the beneficiaries for the loans advanced to them. In cases where there is no need to adjust the interest on deposit against monthly installments of the loan, after a period of 10–15 years the deposit along with accrued interest is adequate to take care of the principal outstanding on the loan. However, in the case of revolving funds, the loans are recovered from beneficiaries so that the revolving fund is used for leveraging loans for another set of beneficiaries. This kind of deposit-linked arrangement for providing housing finance works because of the low interest charged on loans as compared to the interest given on deposits.

8. FUTURE OF HOUSING FINANCE SYSTEMS IN INDIA

Increasing attention has been placed in recent years on developing a dynamic housing finance system in the country. In general, it is contended that a dynamic housing finance system is essential to enhance significantly the level of savings by the household sector. It is essential because housing investment has strong macroeconomic linkages and is directly tied to the internal efficiency and productivity of cities.

A dynamic housing sector is needed as the existing housing finance institutions are currently serving, at best, a minority of households at a high cost and with only limited results. It is also needed as the fragmented nature of the housing finance services obtainable within the informal sector is not able to mobilize domestic savings in the form of financial assets from most of the household sector of the economy.

A host of suggestions have been made to impart dynamism into the housing finance

sector. These include the tapping of the capital market, securitisation of mortgages, down-marketing of housing finance, strengthening and promotion of the contractual saving scheme, expansion of the fiscal incentive base, and bringing about a level playing field between the HFIs and other financing institutions. Through these initiatives, it is argued, the HFIs could take advantage of the vibrancy of the Indian capital market and create such conditions as would help to develop the secondary mortgage market; then they could no longer depend on budgetary allocations and the "allocated credit system."

It is argued that since housing is a special and not a generic product and has vastly different characteristics, requiring a long-term financial relationship between a borrower and a lender, it may need different kinds of financial instruments. Again, due to the special nature of the product, a case is made out for fiscal incentives. Progress in respect of the above suggestions has, however, been slow.

What has stalled the progress in putting into effect a dynamic housing finance system in the country? To what extent can it be attributed to the functioning of the housing finance market and the policies that laid down the rules and assumptions? A review of the Indian scene in this regard would point to several reasons.

Sheltered Growth of Housing Finance Institutions

The housing finance institutions form the core of the finance system in the country. They have depended substantially for resources on the banking system; they have tapped neither the retail market, i.e., domestic savings, nor the capital market for augmenting and strengthening the resource base. As a consequence, the share of housing investment financed by the formal financial intermediaries continues to be very small.

As M. J. Pherwani observed, "This is in part due to less than dedicated efforts in marketing the schemes (contractual savings schemes) even though such schemes have intrinsic limitations on account of inflation." The housing finance institutions (HFIs) also have not made any efforts to tap the capital market, notwithstanding the vibrancy and depth it has displayed over the years. There has hitherto been little motivation for HFIs to seek capital market resources, given the historical levels of allocated credit. Moreover, the routine lending operations of the HFIs do not create the possibility of capital appreciation which is considered essential for those who invest in them. Also, the HFIs have almost entirely focused on households above the median level, raising issues of their outreach to the economically weaker and poorer sections.

Non-Traceability of Mortgages

Mortgage financing is the principal mode of transaction in the housing finance market in the country. Households rely on mortgages because it is the cheapest way to issue debts and not because of what the debts may explicitly finance. In its present form, mortgages have locked up vast sums of capital and assets for long periods, often for as long as 25–30 years. Further, mortgage finance is handicapped by the fact that a majority of the loans are based on fixed-interest rates and found to be disadvantageous to lending institutions in the event of rising interest rates and to borrowers in the case of falling interest rates.

Absence of Innovations

There is an absence of other innovative financing mechanisms, particularly those that will reach out to the poor households and link up formal and informal sources of financing. On the grounds that these are problems of repayment capacity being below the amount necessary to purchase a housing unit,

increased frequency of late payments and default, difficulty in establishing clear titles and lack of credit record, no attempt has been made to downmarket housing finance so as to reach households falling below the median income level. Subsidized credit is still viewed as the principal instrument to reach out to the poorer households.

Archaic Laws and Regulations

The environment on both the demand and supply side of the housing market in India is heavily distorted by onerous legislation and time-consuming procedures. Local authorities have imposed their own regulations through municipal and development rules. Urban land policies that restrict the supply of available land for housing construction, and rent control legislation which protects existing tenants at the expense of all future-potential tenants by eliminating rental markets from functioning have further distorted the supply response. New housing can not develop and existing housing stock remains unutilized for fear of loss of possession, exacerbating the supply inelasticity.

In this context the issue of developing a dynamic housing finance system needs to be once again considered. As pointed out earlier, the housing financing requirements in the country are very large. Provision of finance on this scale—approximately US \$8 to 10 billion annually for eliminating the housing deficit and meeting the incremental demand—will mean using 10–12% of the annual domestic savings for several years. If account is taken of other linked investment such as land development and essential off-site infrastructure, the overall financial requirements will be even larger.

Meeting this scale of financial need will be a stupendous task. As the process of reform deepens, the financial system in the country will increasingly operate without any system of preferential or dedicated credit and with-

out any interference with the interest rate structure. The housing finance institutions will need to face this environment and compete for resources together with other, equally demanding sectors. In order to be viable, they will need strong marketing and devices for tapping domestic savings and the vibrant and competitive capital market.

The future strategy for housing finance will need to rest on three planks.

Development of a Secondary Mortgage Market

Mortgage finance will continue to be the principal mode of housing finance transactions. It is evident, however, that by itself it will not be able to meet the growing demands of housing finance. It will be necessary to initiate comprehensive steps to make mortgages "traceable." This would necessarily involve a series of complementary actions, such as standardization and tightening up of foreclosure laws.

Downmarketing of Housing Finance

Meeting the demand for housing finance for families below the median income will be an important objective of the housing finance system. The nature of this demand is very different, as it is designed to deal with small amounts, flexible terms of repayments and imperfect collateral. While the conventional mortgage finance approach may be suitable for some of the households in the downmarket, others with specific circumstances would require some intermediation to be reached.

The nongovernmental organizations and the cooperative network are two potential bridges for the HFIs to downmarket their operations. Downmarket offers a vast potential for meeting the needs of households below the median level. It would imply shifting the emphasis from the lower interest rates which

have been the mainstay of low-income housing finance in India to supporting the development of financially viable community-based finance systems.

Affordability of Housing

Affordability of housing is a key issue even if housing finance were more widely available. It would mean not only a reasonable cost of finance but a complete overhaul of current regulatory land and rental policies, stamp duties on transfer of property and fiscal treatment of property income.

CONCLUSION

Housing finance has come of age in India. Today, over 20 major housing finance companies have a mortgage loan portfolio of over Rs 100 billion. The total flow of funds for housing from all major institutions, including the insurance companies and provident funds, is estimated to be about Rs 194 billion over the period 1992–97.

In all likelihood, housing finance in India will undergo a second revolution where specialized lenders will continue to play an important role for a number of years, though commercial banks will gradually emerge as mortgage lenders. Indeed, this seems to be the only real path in the long run to ensuring that the housing industry across the country can tap into a resource base through an institutional structure that is widely distributed.

As financial systems develop, commercial banks typically have emerged as term lenders to housing in many developing economies of East Asia (notably Malaysia, Thailand and Indonesia). Even in developing economies, the post World War II period saw the rapid development of the housing industry as countries rebuilt their damaged or destroyed infrastructure. It continued into the 1960s and 1970s when the number of householders increased greatly as a result of the postwar baby boom.

In a larger part of the developing world, revitalization of the housing sector is emerging as a major component of the process of economic renewal. The housing industry is being viewed as an engine of economic growth with a major role to play in the distribution of economic resources. With recent developments in the financial sector, there is need in the country to think carefully on the overall direction of reform in the housing finance sector, focusing on expansion of financial intermediation, development of secondary mortgage markets, downmarketing of housing finance on market-based terms, and overhaul of the legal and regulatory system.

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