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Housing Finance and Market in India

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ABSTRACT

House prices in India are rapidly rising due to lack of a well-developed market and a chronic shortage of housing, estimated at 18.8 million units in 2012, mainly in urban areas. The shortage was broadly attributed to congestion (15 million) followed by obsolescence (2 million) and homelessness (1 million). This paper documents the characteristic and business practices prevailing in terms of determinants of house prices, role of lending institutions and their policies, drivers of credit flow, credit sources, interest rate regimes, regulators and housing indices in the Indian housing sector. In India, housing generally embodies lifetime savings of many individuals and therefore the government, state and Centre, needs to be sensitive to housing sector. In view of the fact that housing is a personal wealth, its demand is closely related to socio-economic strata of the population. Therefore, there is need to undertake in-depth research on housing for each specific state, assessing the housing requirements in different regions, climate and socio-economic strata of the society.

Key Words: Housing, House Price Indexes, Asset prices.

I. INTRODUCTION

Housing is an important sector for any economy as it has inter-linkages with nearly 269 other industries. The development of housing sector can have direct impact on employment generation, GDP growth and consumption pattern in the economy. To help develop housing in the country, there is need to have a well-developed housing finance market. In India, housing finance market is still in its nascent stage compared to other countries. The outstanding amount of housing finance from all sources accounts for less than 8 per cent of GDP when compared with 12 per cent in China, 29 per cent in Malaysia, 46 per cent in Spain and 80 per cent in the US. The demand for housing is increasingly being made by individuals and households given increasing level of income and prosperity. The supply of houses have to come from builders, developers and construction companies scattered widely across the country, both in the private and public sector when examined in the context of demand and supply of housing units, especially in the face of scarce land in the urban areas.

In India, housing finance market is very complex. The government, both at centre and states, is a facilitator and is assisted by two regulators, Reserve Bank of India (RBI) and National Housing Bank (NHB). The housing finance market is dominated by commercial banks, both domestic and foreign. In addition, there are cooperative banks and housing finance companies, self-help groups, micro-finance institutions, and NGOs. The RBI regulates commercial banks and partially cooperative banks (which are mainly governed by the State Governments under State Cooperative Acts) while the NHB regulates the housing finance companies. The others are not regulated by any authority in the country.

The financial sector reforms initiated in 1985 and 1991 unleashed development forces in the economy. This resulted in higher employment, increased income levels, faster urbanisation and higher demand for houses, especially in urban areas. Therefore, concerted efforts were made by the Government and the Reserve Bank to encourage housing during the 1990s. The long term goal of the National Housing Policy, announced by the Government in 1998, was to eradicate houselessness, improve the housing conditions of the poor and provide minimum level of basic services and amenities to all. Fiscal incentives were also granted, in general, to the housing sector.

The government has been initiating as well as strengthening measures to extend housing to the weaker sections of the society. A number of measures were announced from 2001 but a concerted effort was made in 2006 after some fears were expressed that there was a housing bubble developing in India which could eventually burst. It was then recognized that role of housing could be critical in India and therefore measures announced thereafter aimed to improve business environment in the country. The material on India, presented in the paper, in view of lack of data series and literature on India, is based not only on published material but also that collected from interaction with commercial banks, real estate agents, builders and select housing research firms in India.

BRIEF REVIEW OF LITERATURE

Housing is an important activity in any economy. Housing related activities in the country like construction, renovation, maintenance and those related to trading, financing, mortgage banks, real estate agents, appraisers, movers and notaries, are generally estimated to account between 5-10 per cent of GDP. These activities are significantly affected by house prices. A number of empirical studies establish that key determinants of housing prices are income levels, interest rates, supply conditions, demographic changes, number and size of households, maintenance costs, property taxes, and speculative pressures (Poterba, 1984, Allen et al, 2002 and OECD, 2005).

House prices are an important determinant of household sector's gross and net wealth and thereby of consumption and savings. In many countries, including India, house property is the household's largest asset and price developments in housing markets can impact growth directly but mainly through credit channel since real estate can serve as collateral for consumer borrowing (Kiyotaki and Moore, 1997 and Bernanke and Gilchrist, 1999). Furthermore, housing cycles can influence economic activity through wealth effects on consumption and private residential investment mainly due to changes in profitability and the impact on employment and demand in property related sectors.

And if house prices are not aligned with the fundamentals, they can threaten the economic and financial stability of the country mainly because of the macro-financial linkages, as empirical evidence demonstrates. One of the most important causes of financial crises was collapses in real estate prices, either residential or commercial or both (Reinhart and Rogoff, 2009). There have been cases where such collapses have taken place after bubbles in the real estate prices and both, the financial sector and the real economy are adversely affected after the bubble bursts. The current crisis can be taken as an example, wherein decline in the real estate prices led to a drastic drop in securitized asset prices in 2007. Further, the instability which followed impacted balance sheets of many financial institutions as was predicted by Feldstein (2007). The financial crisis then got carried forward to the real sector.

Allen and Carletti (2009) argue that the main cause of the recent wide-spread financial crisis was not that there was a bubble in real estate in the U.S. but also because of them in a number of other countries such as Spain and Ireland. Housing sector is impacted by both, monetary and fiscal policy, macro prudential norms and labour policy prevalent in the economy (Hilbers et al, 2008). To explain the recent crisis, a generally accepted argument was that the loose monetary policy and excessive availability of credit were the causes for the real estate bubble in these countries. As argued by Taylor (2008) these levels of interest rates were lower than in previous U.S. recessions relative to the economic indicators at the as time captured by the "Taylor rule".

The low interest rates encouraged borrowing and buying of houses. While Spain had one of the largest deviations from the Taylor rule, this country also had the largest housing boom (measured by the changes in housing investment as a share of GDP). Sweden's Central bank, the Riksbank is one of the rare central banks that have taken the approach of targeting real estate prices. Policy of the Riksbank is to look at property prices during decisions about interest rates (Ingves, 2007). In comparison with larger countries, the smaller ones have a stronger monetary transmission through the housing channel but a robust financial system is an imperative requirement for such a transmission to be successful.

In 2011, IMF observed that shocks to disposable income, mortgage interest rates and prices play an important role in short term consumption. In comparison with equity price busts, housing price bursts involve more serious macroeconomic developments. Housing price booms put forward noteworthy risks. Some of the factors which appear to account for the greater severity of housing price busts as compared with equity price bursts are:

(i) Wealth effects on consumption are larger in case of housing price busts than in the case of equity price busts;

(ii) (ii) In comparison with the equity price busts, unfavourable effects of the housing price busts on the banking system (capacity and willingness of the banking system to lend) were stronger and 7 faster;

(iii) (iii) Link between boom and bust is more powerful for housing prices, than for equity prices. Probability of housing prices busts being preceded by a boom were higher in the case of housing prices busts; and

(iv) (iv) Housing price busts were associated with tighter monetary policy than equity price busts. Following Bianco and Occhino (2011), IMF estimated that improved house prices could significantly strengthen consumption. Following Klyuev (2008), avoiding 1 million foreclosures would raise aggregate prices by 3-4 per cent over five years in the US.

INSTITUTIONS IN HOUSING MARKET AND HOUSING FINANCE IN INDIA

A number of institutions have been instrumental in developing the housing finance market in India. These mainly are the Central and State governments, RBI and NHB. The flow of credit to housing sector and housing finance markets are also discussed in the section.

Government

The role of the Government in recent years has switched from that of a provider of housing units to more of a market facilitator. The Five Years Plans starting from 1951 had assigned housing sector a prominent place in the economy. The National Buildings Organization (NBO) was established in 1954 under the Ministry of Housing and Urban Poverty Alleviation for technology transfer, experimentation, development and dissemination of housing statistics. NBO was further restructured in 1992 and 2006 with the revised mandate keeping in view the current requirements under the National Housing Policy, and various socio-economic and statistical developments connected with housing and building activities. The setting up of Housing and Urban Development Corporation Ltd. (HUDCO) on April 25, 1970 to comprehensively deal with the problems of growing housing shortages, rising number of slums and for fulfilling the pressing needs of the economically weaker section of the society was one of the significant steps in the series of initiatives taken by Government.

The National Housing Policy was announced in 1988 which had a long term aim of eradicating houselessness, improving the conditions of the inadequately housed and providing a minimum level of services/amenities to all. National Housing bank was established in 1988 under an Act of the Parliament to function as a principal agency to promote housing finance institutions and to provide financial and other support to such institutions. The National Housing and Habitat Policy, 1998 was formulated after a thorough review of the earlier policy. In 2007 another National Urban Housing and Habitat Policy was formulated in view of the changing socio-economic parameters of the urban areas and growing requirement of shelter and related infrastructure.The government is also considering repealing of the Urban Land Ceiling Act in most states across the country. Opening up the real estate sector to FDI has also had positive impact on the housing finance in India.

National Housing Bank

National Housing Bank has been playing an important role in regulating and supervising the housing finance companies. In recent years, especially since 2001, a number of new players have entered the housing finance market with competitive offerings which have helped increase the demand for housing loans. These housing finance companies/banks have been passing on the benefit of lower cost of funds to customers. Most of these financing institutions, besides simplifying the process of availing loans, have also introduced new products and variants targeted at specific customer segments.

Reserve Bank of India

Asset prices are very important for monetary policy, because when bubbles, big or small, burst, the cleaning up of the mess, is a long and unhappy experience. The Reserve Bank has initiated several measures in the housing sectors. Commercial banks are required to lend 3 per cent of the incremental deposits towards the priority sector, in which housing is an important component. The Reserve Bank also includes investment made by banks in the Mortgage Backed Securities (MBS) since 2004 as flow of credit to housing; assigning lower risk weight to housing and benign interest rate environment has contributed to increase in housing loans. Growth in housing loans has also been assisted by the comfort of relative safety of such assets given the tangible nature of the primary security and the comfort obtained from the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 and the amendment in December 2012.

Flow of Credit to Housing Sector

The need of long term finance for the housing sector in India is catered by scheduled commercial banks (SCBs), financial institutions, cooperative banks, regional rural banks (RRBs), Housing finance companies (HFCs), agriculture and rural development banks, non-banking finance companies (NBFCs), micro finance institutions (MFIs), and self - help groups (SHGs). The largest contributor to housing loans by virtue of their strong branch network and customer base are SCBs, accounting for the major share of housing loan portfolio in the market followed by HFCs.

Scheduled Commercial Banks

The outstanding housing loans by the SCBs increased from Rs. 15,317 crore on March 31, 2001 to Rs.1,62,562 crore on March 31, 2006 and to Rs.4,64,372 crore on March 31 2013, including priority sector lending. Significant growth in

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housing credit in the recent years was witnessed on the back of strong demand for housing as the economy expanded its trajectory of output growth. The commercial banks have been directly lending substantial amounts of loans to the household sector, though some portion is lent to the cooperative sector too (Table 1).

Table 1: Outstanding Credit of Scheduled Commercial Banks – Sectors

	Mar 2001	Mar 2006	Mar 2011	Mar 2013
Co-operative Sector	3427	39572	11813	5727
Household Sector - Individuals	11890	1222990	319295	458645

Source: RBI

The largest amount of housing loans by commercial banks are extended on long term basis though the share of medium term loans and overdraft has also been rising in the recent years (Table 2).

Table 2: Outstanding Credit of Scheduled Commercial Banks – Tenor

	Mar 2001	Mar 2006	Mar 2011	Mar 2013
Overdraft	0	0	17316	31260
Medium Term Loans	0	201	46249	38278
Long Term Loans	15316	162262	267543	395173
Total Amount Outstanding	15316	162563	331108	464711

Source: RBI

The range of interest charged by the SCBs on housing loans is wide and changes over the years. In 2001, housing loans attracting less than 10 percent were 4.9 percent of the portfolio which increased to 85.5 percent by 2006. Since then, due to rise in the interest rates, the share of outstanding loans below 10 percent declined to 17.5 percent by March 2013. In contrast, share of loans above 13 percent rate of interest declined from 50.5 percent of outstanding loans in 2001 to 7.3 percent by 2013.

INCREASING DEMAND FOR HOUSING IN INDIA

India has recorded increased demand for housing in recent years, mainly in urban areas, consequent to the financial sector reforms in 1991 resulting in higher growth rates and income levels. The increased demand is based on increasing levels of income and savings, urbanisation, emerging of a younger earning age group, decrease in the average size of household and nuclearisation of families.

India has a low total household debt, but the mortgage lending has been growing fast and accounts for a significant share of the total (Fig. 1). The house prices rose rapidly across most of the Asian countries during the last decade but the prices in Indian housing market increased enormously compared to other countries (Fig. 2).

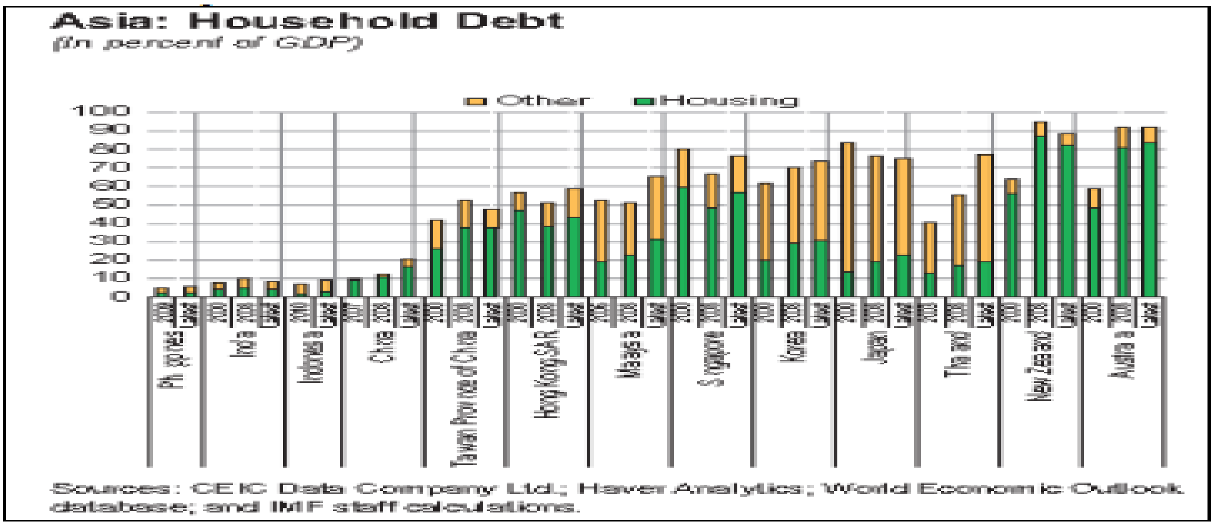

Fig. 1

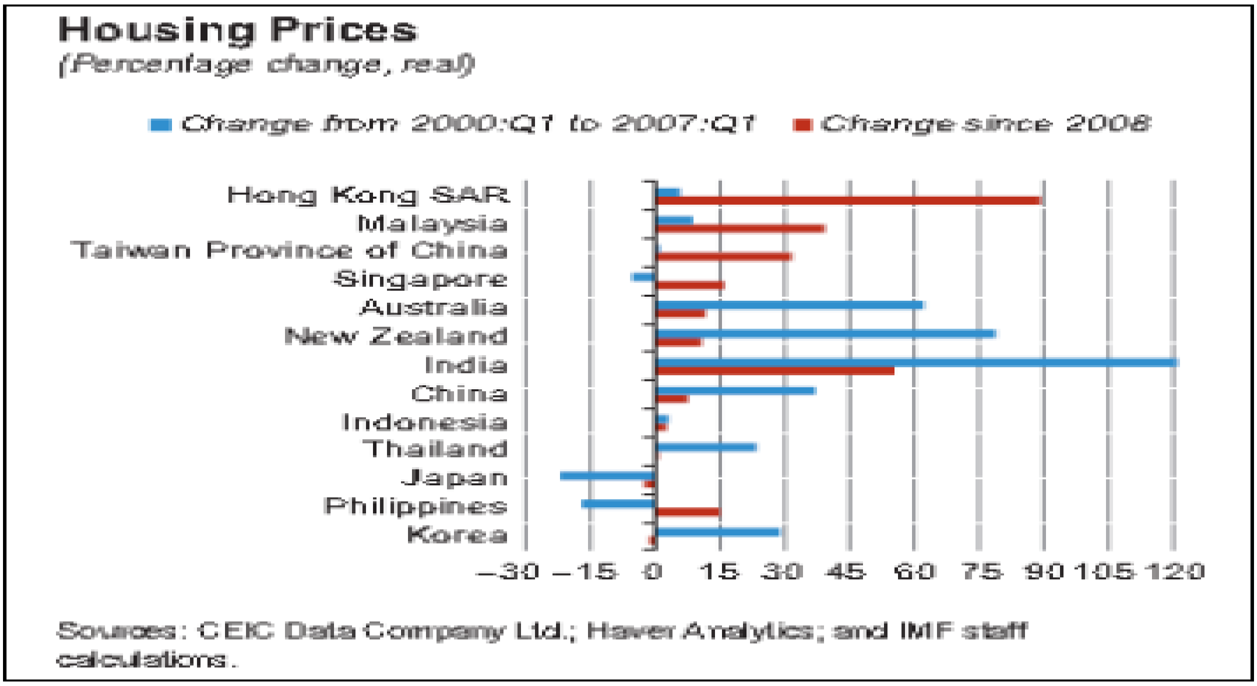

Fig. 2

There was increased demand for commercial and residential space in metro/surrounding areas due to phenomenal growth in sectors like retail, information technology (IT); IT enabled services (ITES) and business process outsourcing (BPO) services. This boom in demand was aided by easy availability of housing finance, and favorable tax regime. The flow of money through foreign direct investment (FDI) and from non-resident Indians (NRIs) also contributed to the growth of the sector. The increase in prices was not only restricted to urban areas but was also existent in rural areas, where prices of land close to the highways and city limits recorded phenomenal increases. Similarly, prices of productive land, like that in rural Punjab, increased substantially over the period.

In 2001-02, the banking sector had surplus liquidity with low credit off-take. On the basis of security available in housing loans, in view of the rising pressure to maintain high quality of credit, banks identified this as a thrust area from early 2000s.The drivers for increase in credit to real estate were low interest rates, increase in property prices, and relatively low inflation. The increased demand was facilitated by availability of lendable funds with the banking system. Buyers from Canada, China, Mexico, India, and the United Kingdom accounted for half of the international sales in United Sates home sales market. The survey data on the type of financing (Graph 2) of international buyers reveals that buyers from Canada and China rely largely on cash financing, whereas buyers from India use mortgage financing.

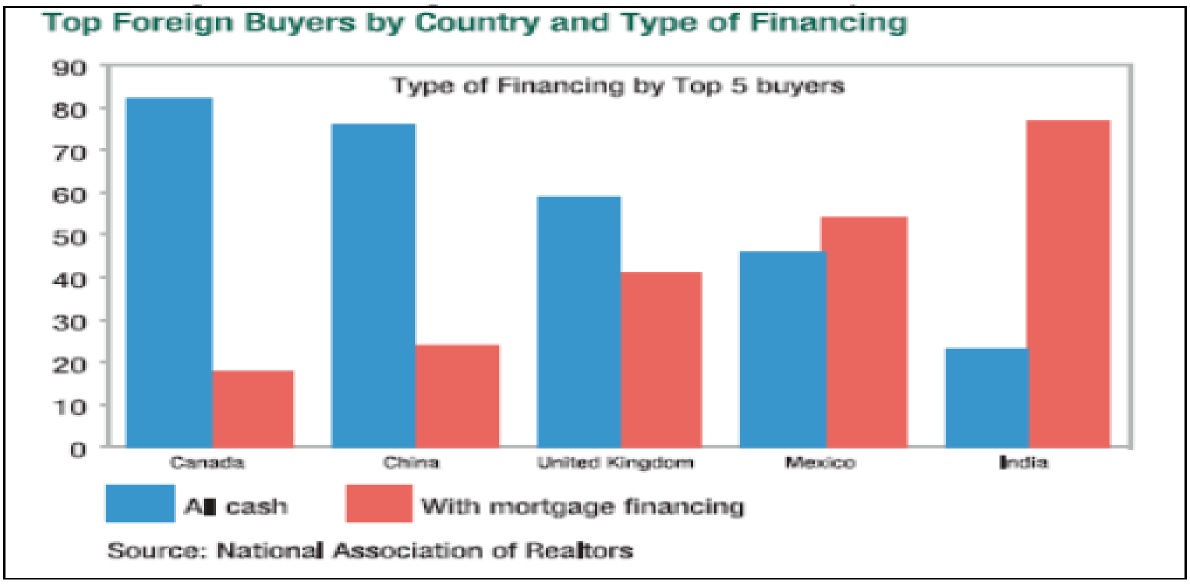

Fig 3: Financing of international home buyers in India

A GOI study concluded that there was a shortage of 18.8 million units in 2012 declining from 24.7 million in 2007, mainly in urban areas. The shortage was mainly on account of congestion (14.99 million) followed by obsolescence (2.27 million) and homelessness (0.53 million). However, the derivation of this shortage, including the congestion factor has some shortcomings. The congestion has been estimated on the basis of a few assumptions made by the technical committee but the factors are not explained in detail. To illustrate, it is mentioned that if a married couple does not have an exclusive room in the house, the household is deemed to be suffering from housing shortage and not a 'room" shortage. Another aspect, the reduction in housing shortage for the weaker sections of the society has not been explained by these committees.

The shortage at 10.5 million units is maximum for the Economically Weaker Sections (EWS) followed by the lower income groups (LIG, 7.41 million) and middle income group (MIG, 0.82 million). The size of houses for different groups varies between 300 to 1200 square feet.This severe shortage for the EWS and LIG is reflected in the large number of people living in slums. In 2001, nearly 75.3 million people (26.3 percent of the urban population)lived in slums which rose to 93 million in 2011.

CONCLUSION

The housing sector plays an important role in any economy. As extensively documented in empirical literature any shock to the housing sector significantly impacts consumption and economic growth. In India, there is a big gap in the housing finance market which is being addressed mainly by the Central government. In recent years, financing to the housing sector has been liberalized by the government and RBI. There are a number of players in the housing market and each player has a unique niche. These are commercial banks, housing finance companies, cooperative banks and non-bank finance companies. And then there are builders, developers and contractors, both in the private and public sector. Some of these market players are not covered by any regulator or supervisor while the financial aspects of many, but not all, are regulated by the RBI and NHB, who have been making concerted efforts to strengthen the housing market.

Housing generally embodies lifetime savings of many individuals and therefore the government, state and Centre, needs to be sensitive to housing sector. In the absence of any regulator/ supervisor for the housing sector, many practices in the housing sector, including financial, are non-transparent. There is need to bring parity in the housing market by having similar rules and regulations governing these players, and standardization of the products, including lease agreements that are being finally offered to the consumer. Housing, being a state subject, there is a need to make and strengthen the new and existing laws, preferably, at the state level. Thus, this would also imply that there is a need for a regulatory and supervisory body on housing sector both at the Center and States.

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