

## **CHAPTER 1**

# **Housing Finance Systems and Regulations of Housing Finance in India**

## 1.1 Introduction

The three basic needs to lead a decent human life are food, clothing and shelter. According to Article 25 of Universal Declaration of Human Rights, United Nations, 10<sup>th</sup> December, 1948 “Everyone has the right to standard of living adequate for the health and wellbeing of himself and his family, including food, clothing, housing....” Also, Article II, International Covenant of Economics, Social and Cultural Rights, 1966 has recognized housing as a human right along with food and clothing, to have an adequate living standard. And, Article 19(1) (e) of Indian constitution states “All citizens shall have the right to reside and settle in any part of the territory in India.” The quality of housing, the citizens of a country resides in is an indicator of its status of human development. The housing condition in a nation is thus directly related to its Human Development Index (HDI) status. “The quality of housing and material resources were tied to HDI status in that they were higher in all high-HDI countries and lower in all low-HDI countries” (Bradley & Putnick 2012). Therefore, housing being an important component of quality living is an indicator of a nation’s progress.

The existing theories suggest that, an individual feels satisfied if the person can achieve the kind of housing he/she desires. According to “Housing Needs Theory” proposed by Rossi (1955), as human being passes through different stages of life, their housing needs and desires changes. If the current housing condition does not fit with the desired, it causes dissatisfaction and they goes through relocation to fill the gap. Morris and Winter (1978), through “Housing Deficit Theory” stated that, an individual always tends to compare one’s actual housing status with the desired housing situation subjective to one’s cultural and societal standards. At the event of miss-match between the two, they are dissatisfied referred to as Housing Deficit. To reconcile the desired and actual housing conditions, they may either modify their own needs and desires, or they may look forward to improve the housing conditions, or they may relocate themselves. As proposed by Galster (1985) via “Psychological Construct Theory” an individual evaluates one’s actual residential situation on the basis of a reference point. If the actual residential condition is found to be at par or better than the referred residential situation, then the individual will be satisfied; or else will be unsatisfied. In the second case, the individual will either adapt to the current housing condition by redefining his own desires, or will continue to stay

dissatisfied. Though not always supported by low income, later they will try to alter and improve their residential conditions.

However, house ownership and satisfaction derived there from is primarily dependent upon having access to finance, whether it is from the owners' own pocket or from lending institutions. The size, design, architecture, location and type of residential accommodation are all dependent on the availability of finance. Hence, in-depth analysis of housing finance systems and study of perceptions and behavior of home loan borrowers are of vital importance in this context.

### **1.1.1 Housing for an Individual – Fundamental Need, Social Stability & an Investment**

Housing portrays one of the fundamental needs to lead a civilized life. According to the International Committee on Economic, Social, and Cultural Rights, every person has a right to adequate housing. For an individual, housing facilitates privacy, comfort, sound health, social stability and security, which are the essential requisites for confirming the existence of a decent human life. Many existing literature suggests that poor housing is directly related to poor health, both physical and mental (Krieger & Higgins, 2002 and Hood, 2005). Better housing ensures less stress among occupants and behavioral normality among children, along with improved health conditions. And, a physically and mentally healthy individual is expected to be more efficient and productive. Further, home ownership increases community engagements as the home represents the occupants' stake in the community. Hence, home ownership brings social recognition. Furthermore, housing is also an excellent investment asset for the long run offering financial security (Krulický & Horák 2019). Being an asset, housing brings social stability and security as the property gets transferred from one generation to other. As an asset housing provides security especially during the old age, by enabling rent free housing. In addition to obtaining these services housing can yield attractive returns as well (for example, in the form of rent). Realizing the indispensability of these essential services derived from housing and the durability of a house, an individual always wants to get the best one, given his/her affordability.

### **1.1.2 Housing for the Economy – Boosts Productivity, Generates Employment & Income**

Ensuring improved physical and mental health conditions, housing raises the productivity and efficiency level of the occupants. Moreover, increased housing stock implies increased construction activities. Literature provides many positive empirical evidence of interdependence between construction activities and GDP (Chiang, Tao & Wong, 2015). According to CREDAI, Real Estate Digest, November 2016, in the state of West Bengal real estate activities contributes largely towards GDP and employment generation. Being economic in nature, both constructional and transactional activities related to housing have multiplier effect. Construction activities also boost demand for various types of labour. Hence, generates employment opportunities. By placing demand for construction materials and equipments (which forms approximately half of the cost of housing), employment opportunities are created in linkage industries as well. And, in India there are additional 250 linkage industries to real estate. According to ADB working paper on Housing and Housing Finance-A Review of the Links to Economic Development and Poverty Reduction, August 2013, “One estimate for India indicates that 1 million rupees invested in construction creates 22,000 unskilled, 23,000 skilled and semi-skilled, and 9,000 managerial and technical person days”. Housing sector provides employment to around 33 million people either directly or indirectly; and it is estimated that it will grow more than double during next decade. Housing also contributes to the economic development by promoting the small business. In one hand housing facilitates the physical structure to carry on small business, and thus contributes to the economy. On the other, it may serve as collateral to obtain business loan. Moreover, these economic activities also generate revenue for the government in the form of taxes at local, state and central level.

## **1.2 Housing Finance – Concepts and Necessity**

Given the growing population, housing has assumed a greater importance. And, need for housing assigns importance to the issue of housing finance. “Housing Finance”, also known as “Home Loan” refers to long-term institutional finance for owning a

property by way of purchase, construction, improvement, or extension; generally against the same property pledged as security.

Housing facilities can be derived from either renting or by owning a housing unit. But, in order to derive all kinds of services which can be availed from owning a housing unit, households prefer to possess one. However, acquiring a property requires huge financial resources. And, given the availability of finance as one of the most important determinants of owning a house, the task of buying a house is easier said than done. The requirement of finance can be met either from own savings or borrowings. But, if the cost of purchase or improvement is incremental in nature, which is so due to continuous rise in property prices, the rate of savings will not be sufficient enough. Further, accumulation of savings will postpone property owning to distant future. Consequently, housing finance has become a prerequisite for owning a house earlier.

### **1.2.1 Housing Finance – Enhances Affordability**

According to the National Housing Bank (NHB) report, residential property prices in majority of the cities in India have witnessed an increasing trend since 2007. But, it is the growing housing finance market and a wide range of home loan products brought in by housing finance companies (HFC) and banks, which has made the process of getting a housing loan easier than before and dream of buying a home feasible. According to the report of the technical group (11th Five Year Plan: 2007-2012) on Estimation of Urban Housing Shortage (2006), availability of housing finance affects the affordability of better housing units by the households. So, the demand for housing finance is directly related to the demand for housing stock. Furthermore, earlier an individual used to finance housing generally from sale of other assets, own savings, borrowings from friends or relatives, or from unorganized money lenders. Also, they used to acquire a residential property towards the end of their working life. It has only been recently, that individuals want to possess their own dwelling unit soon after being settled with a regular and permanent source of earning. Besides, nowadays individuals have more acceptance and openness towards credit culture. Consequently, many players entered into the flourishing market of housing finance.

### **1.2.2 Housing Finance – A Buyers’ Market**

There are different categories of financial institutions which offer housing finance. The two major categories of institutions competing for greater hold of housing finance market are, housing finance companies and scheduled commercial banks. The property developers, consumers, banks and housing finance institutions are also some of the causes for the positive changes in housing finance industry, like attitude of consumers towards borrowed funds, professional attitude of housing developers, and changing profile of the institutions, new policies and role of the government (Lea Michael, 2008). The conversion of housing finance market from sellers’ to buyers’ one pulled down the interest rates as the Primary Lending Institutions (PLIs) are competing aggressively to tempt the potential home seekers. According to industry estimates, considering all tax breaks the average cost of borrowing fund in the market was 10% per annum, which came down further. In order to stay in competition many lenders are also coming up with ‘zero down payment home loan products’ for those who cannot afford to pay even the minimum down payment of 15% of the property value. In favour of such cases hundred percent funding is provided for selected properties. These lucrative offers allure people to opt for home loans. Hence, a wide range of home loan products offered by the HFCs and banks have dealt with every customer’s necessity.

### **1.2.3 Housing Finance – A Tax Reduction Tool**

Moreover, home loans are a good means to avail tax benefits for the salaried employees. An individual can avail a deduction up to Rs. 1.5 lacs under Section 80 C on payment basis, for repayment of principal amount of home loan. Also, an individual may reduce his or her income by the amount of interest paid on home loan for residential house, subject to the maximum of Rs. 2 lacs under Section 24. Earlier, the deductible amount was Rs. 1.5 lacs, and it was suggested in the Union budget 2014 to increase the amount against interest payment on housing loan from Rs. 1.5 lacs to Rs. 2 lacs. Further, an additional deduction of Rs. 50,000 under Section 80 EE has been suggested in Union Budget 2016 to first time home buyers for interest on home loan, if the loan has been sanctioned between 1<sup>st</sup> April, 2016 and 31<sup>st</sup> March, 2017, given the value of property is less than Rs. 50 lacs and the amount of loan is within Rs. 35 lacs. Thus, these tax

incentives by the Government of India (GOI) are also one of the factors for rapid growth of housing finance in India.

### **1.2.4 Housing Finance – A Mode of Long-Term Savings**

Home loans are a useful tool for ordinary man to have long-term savings in addition to possess a roof over his head. Hence, home loan should be availed even if one can afford to buy home with one's own money. As per to NHB Trend and Progress Report 2015, home improves household savings and generates opportunity for long-term investments.

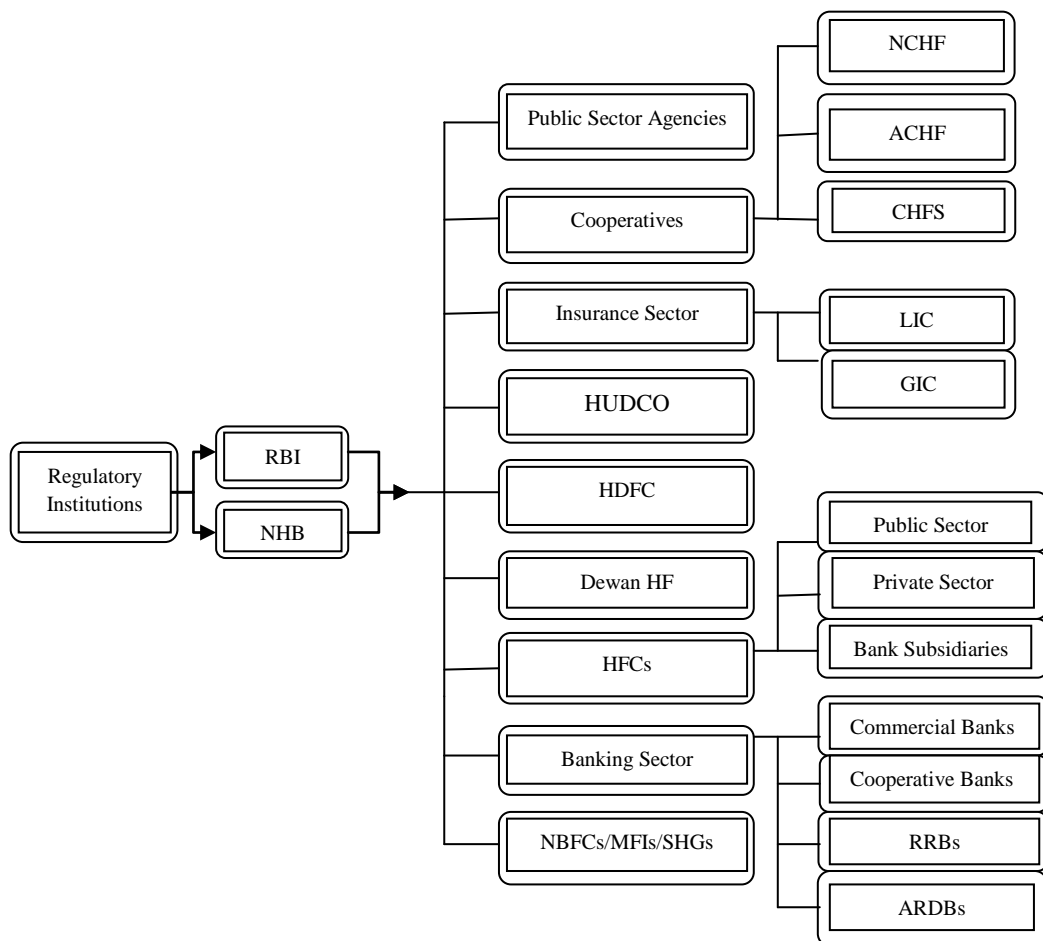
## **1.3 Housing Finance Systems in India – A Bird's Eye View**

### **1.3.1 Institutional Development**

In India government acts as a provider for the poorest and vulnerable sections and as a facilitator for other income groups by establishment of a formal housing finance system. Initially, housing finance was offered by only some public sector agencies to take up housing construction and development activities. Also, some Cooperative Housing Finance Societies (CHFS), Apex Cooperative Housing Federations (ACHF), and National Cooperative Housing Federation (NCHF) were operating at primary, state and central level respectively to offer home loans to their members. During late fifties, after nationalization of the insurance sector Life Insurance Company (LIC) and General Insurance Company (GIC) were directed to invest at least a certain percentage of their funds towards societal activities including housing. For the salaried individuals, Employees Provident Fund (EPF) was also a source to avail finance for housing. It was only in 1970 a specialized central government enterprise came into existence by the name of Housing and Urban Development Corporation (HUDCO), to finance housing and urban development activities. In 1977 Industrial Credit and Investment Corporation of India (ICICI) and International Finance Corporation (IFC) sponsored HDFC came up in the private sector to offer housing finance, followed by Dewan Housing Finance (DHFL) in 1984. The formal housing finance system in India evolved with the establishment of

National Housing Bank (NHB) in 1988. Since then many HFCs came up and being in its core operation area, HFCs were the market leaders for a long period of time. Scheduled Commercial Banks (SCBs) entered into the Housing Finance domain in 1990, after Reserve Bank of India (RBI) mandated SCBs to earmark minimum 3% of their incremental deposits for extending to the housing sector at Prime Lending Rate (PLR) minus 150 basis points. Subject to upper limit constraints, primary cooperative banks are also permitted to loan housing schemes. After establishment of NHB, several states enabled Agriculture and rural development banks (ARDBs) to lend for housing in the rural areas. At present the institutions which are involved in providing long term finance for housing are Scheduled Commercial Banks (SCBs), Cooperative Banks, Regional Rural Banks (RRBs), Housing Finance Companies (HFCs), Agriculture and Rural Development Banks (ARDBs), Cooperative housing finance companies and some NBFCs. Among these institutions SCBs and HFCs holds a major portion of the market share, leaving nearly negligible share for the rest.

**Figure: 1.1 Housing Finance Institutional Set-Up**



*Source: Compiled and drawn by the researcher*

### **1.3.2 Housing and Urban Development Corporation (HUDCO)**

With the object to improve housing conditions of Lower Income Group (LIG) and Economically Weaker Sections (EWS) in India and to undertake urban development programs; HUDCO, a wholly owned Government of India (GOI) enterprise was set up on 25<sup>th</sup> April, 1970. Later, after establishment of NHB, HUDCO was recognized as a HFC. Though HUDCO is not involved in direct retail lending, it benefits masses by providing financial assistance through state housing boards, rural housing boards, development authorities, municipal corporations, improvement trusts, local bodies, cooperative societies, NGOs, etc. Other than GOI's equity support, HUDCO also mobilizes resources from many institutional agencies like, banks, LIC, GIC, etc. Other than housing and urban development programs, HUDCO also provides consultancy services and technical assistance to the borrowing agencies.

### **1.3.3 Insurance Sector**

Insurance organizations like GIC, supports housing activities through direct lending as well as indirectly by subscribing bonds floated by state housing boards and HUDCO as per their statutory requirement. Earlier, the insurance corporations like LIC, used to grant housing loans for constructing public sector companies' staff quarters and to states for rural housing programs. But, by establishing subsidiaries like LIC Home Finance Limited in June 1989, and GIC Housing Finance Limited in July 1990, both LIC and GIC entered into direct retail lending market. And, with the advantages of having a wide network and access to inexpensive funds LIC Home Finance Ltd. has got hold of a considerable share of housing finance market.

### **1.3.4 Banking Sector**

There are two players in the banking sector which cater to the needs of housing finance.

#### ***1.3.4.1 Commercial Banks***

Initially commercial banks' loan portfolio didn't have any special housing loan product. It is only after the submission of R.C. Shah Working Group report in 1978, on Role of Banking System in Providing Finance for Housing Schemes, and recommendations given by Rangarajan Study Group in 1987 scheduled commercial banks (SCBs) were compelled to enter the housing finance market by allocating a certain minimum percent of their incremental deposits towards housing finance disbursement every year. As per RBI guidelines, 50% of that amount is to be used to subscribe HUDCO and NHB bonds, thus financing housing sector indirectly. 30% of the amount could be advanced as loan to HFIs, HFCs, public housing agencies and private builders. But, 20% of the amount has to be employed for direct lending to individuals, out of which half of the amount, i.e. 10% of the total amount must be advanced in rural and semi-urban areas.

#### ***1.3.4.2 Cooperative Banks***

Cooperative banks are mainly engaged in providing financial assistance to cooperative housing societies and housing boards to carry out housing projects to benefit Economically Weaker Sections (EWS), Lower Income Groups (LIGs), and Middle Income Groups (MIGs).

### **1.3.5 Specialized Housing Finance Institutions (HFI)**

There are some specialized financial institutions which focus only on the housing sector. The specialized HFIs can be broadly classified into HFCs and Cooperative Housing Finance Societies. HFCs can further be classified as public sector HFCs, private sector HFCs and bank subsidiaries.

#### ***1.3.5.1 Housing Finance Companies (HFCs)***

HUDCO was the first HFC, set up by the GOI in 1971, followed by HDFC, which is still a leading housing finance provider operating in the private sector, which was established in 1977. Many other HFCs started to come up during 1980s, and especially after the

commencement of financial sector reform. At present there are 59 HFCs operating in India holding almost 33% share of the housing finance market. Though HFCs were the leading players of the market initially, it is because of the perceived potential of real estate market SCBs took a competitive advantage over HFCs and went ahead since 2002 grabbing a major share (currently more than 65%) of the housing finance market. The major leading HFCs operating are;

**Public Sector** – HUDCO, LIC Home Finance Ltd., GIC Housing Finance Ltd., etc.

**Private Sector** – HDFC, Dewan Housing Finance Corporation Ltd., Sundaram Home Finance, Gruh Finance, Maharishi Housing, etc.

**Bank Subsidiaries** – SBI Home Finance, ICICI Home Finance Co. Ltd., PNB Housing Finance Ltd., IDBI Home Finance Ltd., Can Fin Homes Ltd., etc.

### ***1.3.5.2 Cooperative Housing Finance Societies***

Like HFCs, Apex Cooperative Housing Federations (ACHFs) also deals in disbursement of housing loans only. ACHFs are involved in direct lending to individuals, and also channelize housing loans through primary cooperative societies. All ACHFs are members of National Cooperative Housing Federation of India (NCHF), which has been entrusted with the task of supporting and guiding all housing cooperatives. The major providers of funds for ACHFs are HUDCO and LIC. Besides, they also raise funds from deposits with primary cooperatives, borrowings from NHB, state governments and banks, and also by floating debentures.

## **1.4 Role of Government in Indian Housing Finance System**

Housing is an important issue for economic development. The housing system is needed to be strengthened because, “a healthy housing sector can ensure a strong national economy” Singh (2013). And thus, the central planning model of government has always accorded due priority to improve the quality of life via housing by introducing various social housing schemes. And, to exercise control over the housing finance industry

government came up with various housing policies from time to time. Government of India (GOI) has also focused on 'efficient institutional arrangements' which was inevitable for boasting a well-established housing finance system. The government has set up Housing and Urban Development Corporation (HUDCO) in 1970 to finance urban housing and development programs. Besides, NHB, a wholly owned subsidiary of RBI was set up in 1987 to operate as an apex institution for housing finance industry. Further, in order to encourage home ownership, GOI also gives many lucrative tax incentives to individuals under Section 80 C, Section 24, and Section 80 EE.

### **1.4.1 Housing in Central Planning Model**

As a part of the **First Five Year Plan (1951-56)** Government of India focused on institution-building and housing for weaker sections of society. According to the planning commission, the first five year plan had a provision of Rs. 38.5 crores for subsidizing industrial housing scheme, low income group (LIG) housing scheme, and housing scheme for plantation workers. During this planning period more than one-third allocation of funds was made towards the housing sector.

During the **Second Five Year Plan (1956-61)** the programs introduced during first planning period were expanded substantially. Also, three new programs were taken up for rural housing, middle income group housing, and slum clearance. Village housing scheme was launched in 1957, which was the first housing program for rural India.

With the objective to meet the needs of Lower Income Groups (LIGs), the **Third Plan (1961-66)** emphasized on coordinating the efforts of all agencies. According to UN-HABITAT 2008, 'fifties and sixties were the decades of direct involvement of the state'. GOI came up with a scheme to offer loan to the state government for land acquisition and development to make building sites available in adequate number.

A special program was launched during the **Fourth (1969-74) and Fifth (1974-79) Five Year Plan** named "Crash Scheme" for landless agricultural labourers, under which free house sites were provided to the beneficiaries along with construction assistance. Also, HUDCO was established to undertake urban development plans.

Furthermore, Urban Land (Ceiling & Regulation) Act was enacted to relieve the strain on increasing urbanization.

The **Sixth Plan (1980-85)** refocused its all attention on shelter for the poor plus provision of services. During this planning period focus was on efficient utilization of public sector resources so as to maximize the benefit for the shelter-less people. Many HFCs also came into existence during this period.

During **Seventh Planning Period (1985-90)** housing problem was given high priority and thus National Housing Policy (NHP) was announced in 1988 with the goal to “eradicate houselessness”. Moreover, a new beginning was marked with establishment of NHB to promote Housing Finance Institutions (HFIs), in order to set up a stable housing finance system. Also, Rs. 36 crores were spent during that era for making available housing place to 0.72 million households.

The **Eighth Plan (1992-97)** stressed on shelter for homeless and footpath occupants. It also emphasized on institution building, housing information system, etc. in order to ensure a self-sustainable housing finance system.

With the agenda of “shelter for all” Indira Awaas Yojana (IAY) was launched during **Ninth Planning period (1997-2002)** to deal with the problem of homelessness in rural areas. IAY is a hundred percent subsidy scheme sponsored by the government, both centre and state on 80 : 20 basis. Also, the new Housing and Habitat Policy came up in 1998, with the key objective to create Public-Private Partnership (PPP) to address the problem of housing shortage.

**Tenth Five Year Plan (2002-2007)** proposed free housing to landless SC/ST families and credit-cum subsidy scheme for other Below Poverty Line (BPL) families. National Common Minimum Program (NCMP) focused on housing for poor and vulnerable section in rural areas. A total of Rs. 7.26 trillion was invested in the housing sector during this period. The housing loan disbursement has also increased during this planning period from Rs.42,027 crores in 2002-03 to Rs.1,00,000 crores in 2006-07.

**Eleventh Five Year Plan (2007-2012)** begun with the target to reassure quality living in urban areas via development of new housing stock, improvement of existing housing stock, and improvement of slums. The total investment for housing during this

planning period was Rs.8.83 trillion. It was aimed to construct 60 lacs houses to end shelterlessness under Bharat Nirman Program, which was implemented in parallel with IAY. The target group was poorest of the poor, with other interventions to address the problem of remaining housing shortage.

## **1.4.2 Housing Policy**

In India, government controls the Housing Finance industry through Housing Policy. During initial post-independence period the nature of Housing Policy was more of social, when government was playing direct role as a provider. In due course the role of the government got transformed. Though it continued to perform as a provider to the poorest sections, its role became more of a facilitator to the other segments of the society. Eventually, in 1988 GOI tabled its first National Housing Policy (NHP) before the parliament.

### ***1.4.2.1 National Housing Policy (NHP) 1988***

In line with the goal of HABITAT II of ‘Adequate Shelter for All and Sustainable Development of Human Settlements’, GOI declared the same as its goal for the NHP was tabled before the parliament in 1988. The purpose of the policy was to assist the poor, homeless and vulnerable section of the society in acquiring an affordable shelter for them. In order to do so, the National Housing Policy (NHP) was released in 1994 with several objectives to supply developed land for housing, to develop infrastructure for improving the residing environment, to provide required financial support to the needy for improving their housing situation, to expand investment in housing, to control speculation in housing by ensuring equal distribution of houses, etc. Therefore, the housing sector began witnessing a reform post 1990.

### ***1.4.2.2 National Housing and Habitat Policy (NHHP) 1998***

During 1997 the total housing shortage was estimated to be 13.66 million, which was calling for an approximate investment of Rs.1,51,000 crores. And, the subsequent

version of NHP, National Housing and Habitat Policy (NHHP) was formed in 1998 with the national agenda of 'Housing for All'. An estimation was made by the urban ministry that by the year 2001 64.4 million housing units will be required, which will demand an investment of Rs.2,35,000 crores. Hence, NHHP considered the involvement of private and cooperative sector inevitable along with the public sector for meeting this challenge. Consequently, Public Private Partnership (PPP) was permitted for building up housing projects. It was targeted to create surplus housing stock by constructing 2 million cost effective and quality shelters; 1.3 million in rural areas and 0.7 million in urban areas. Also, many fiscal concessions were offered to the entrepreneurs for development of housing projects.

#### ***1.4.2.3 National Urban Housing and Habitat Policy (NUHHP) 2007***

With the aim of "Affordable housing For All", National Urban Housing and Habitat Policy (NUHHP) was devised in 2007 with a view to solve the problem of growing requirement of dwelling unit and related infrastructures, due to socio-economic changes in urban areas. NUHHP states that, the role of the central government will be to act as 'facilitator' and 'enabler'; and also as an advisor to the state government to adopt and implement NUHHP within a given time frame. The State Government is to form State Urban Housing and Habitat Policy (SUHHP) and to act as 'facilitator' and 'enabler' together with the NGOs, Co-operative Sector, Private Sector, etcetera, for Slum Development and Integrated Town Development Projects. Under NUHHP, GOI amended NHB Act, 1987 and enabled provision for undertaking the Residential Mortgage Backed Securitization (RMBS) activities to enable flow of funds from the capital market into the housing sector for greater access and affordability to the borrowers of housing loans.

### **1.4.3 Housing Regulatory Bodies**

Housing sector has the ability to generate high returns on investments, hence it is considered as engine of economic growth. Considering this fact, GOI has taken many measures to reform the housing sector. Through National Housing Policy (1988) GOI considered housing as a primary need, and undertaken many policies from the social

perspective of providing affordable housing. Subsequent version of NHP was formulated in 1998 with national agenda of 'shelter for all'. National Housing Bank, a wholly owned subsidiary of RBI was set up in 1987 by the act of parliament. NHB formulates schemes to support all agencies extending housing finance, to develop a healthy and self-sustaining housing finance system in the country.

#### ***1.4.3.1 Reserve Bank of India (RBI)***

Being an apex institution, RBI was involved directly in the Housing Finance sector earlier. Later, National Housing Bank (NHB) was set up as a fully owned subsidiary of RBI in 1988, to operate as a multifunctional Development Financial Institution (DFI) for the housing finance sector; whose key job was to promote and establish HFIs and also to provide refinance facilities to the HFIs and SCBs. The SCBs entered to housing finance market after RBI mandated them to earmark at least 1.5% of their incremental deposits to be financed for housing either directly or indirectly, at Prime lending Rate (PLR) minus 150 basis points (bp). Through a circular dated 16<sup>th</sup> August, 2004, RBI also permitted the primary cooperative banks to lend towards housing schemes with some upper limit constraints.

#### ***1.4.3.2 National Housing Bank (NHB)***

National Housing Bank (NHB) is the apex multifunctional Development Financial Institution (DFI) for the housing finance sector, which was established in July 1988, under the NHB Act, 1987 to promote housing finance institutions, and to develop a sound and sustainable housing finance system in India. With the vision of "Promoting inclusive expansion with stability in housing finance market" NHB boosts the flow of housing credit in the country through its refinancing mechanism, under which it refinances the primary lending institutions (PLIs). The PLIs roofed under NHBs refinancing scheme are specialized Housing Finance Companies (HFCs), cooperative sector which includes state level Apex-Cooperative Housing Finance Societies (ACHFS) and state cooperative Agricultural and Rural Development Banks (ARDBs), and schedule banks including commercial banks, state cooperative banks, primary urban cooperative banks and

Regional Rural Banks (RRBs). Other than financing activity, NHB has also engaged itself for promotion and development of market infrastructure to facilitate expansion of the scope of affordable housing for the MIGs and LIGs. Furthermore, NHB also performs regulatory and supervision activities for Housing Finance Companies (HFCs). The Regulatory & Supervisory function of NHB is one of its main functions. Still being at the developing stage, Indian Housing Finance System needs solidity in resource, policy and institutional development. The HFCs are to get themselves registered U/S 29 A of NHB Act 1987 before commencing their business as an HFC. NHB has proper guidelines to recognize the HFC's eligibility for availing financial assistance, and also for dispensing financial assistance to them. NHB also regulates their deposit accepting activities. Moreover, it issues many guidelines for framing prudential norms regarding their asset management.

#### ***1.4.3.3 National Cooperative Housing Federation of India (NCHF)***

National Cooperative Housing Federation of India (NCHF) was founded in September, 1969, under the Ministry of Urban Development and Poverty Alleviation, as a national level organization to promote, develop and coordinate the doings of housing cooperatives in India. NCHF works out solution of technical, financial and practical problems faced by housing cooperatives. For promoting Apex Cooperative Housing Federations, NCHF also guides State Governments and Union Territory Administrations in setting up Apex Cooperative Housing Federations and Housing Cooperatives. After NCHF came into existence, the number of Apex Cooperative Housing Federations increased from 6 to 26, which operates at state level. NCHF also helps Apex Cooperative Housing Federations to raise funds from NHB, HUDCO, LIC, and other agencies. But, if the number of completed constructions by the help of NCHF is considered, it depicts an insufficient growth of cooperative movement for housing in the country.

#### ***1.4.3.4 State Housing Boards***

State Housing Boards were formed in most of the states to boost up housing projects in the country. State housing boards plays an important role in implementing different

housing schemes in respective states, launched by the government for EWS, LIGs and MIGs. The board also advances long-term loan for construction to housing cooperative societies as well as individuals. The board formulates self-financing schemes for Middle Income Groups (MIGs) and High Income Groups (HIGs), and provides reasonably priced accommodation to the needy. Further, the board constructs dwelling units to allot them by categorizing as HIG, MIG and LIG. For financial resources, the board also builds commercial complexes and leases those out at rent. West Bengal Housing Board (WBHB) is one of the main housing boards of the country, which was established as a statutory organization under the Act XXXII, 1972 under the department of housing, Government of West Bengal takes various initiatives for housing and urban development in the state. The government has also formed five joint-sector companies among WBHB and private sector to meet the accelerating demand for dwelling units, which is otherwise not possible for the state government and its agencies unaccompanied. The WBHB is in operation from 1973, and till the year 2015 it has created nearly 35,000 housing units for various categories of people. Clearly, the scale of operation by WBHB, considering its more than forty years of functioning is unsatisfactory.

## **1.5 Role of the State Governments**

The function of state government in Indian Housing Finance System is to implement the programs and schemes launched by the central government. Central government facilitates monetary assistance to the state government by way of loans and subsidies to execute the programs initiated. Thus, the state government acts as 'implementing agencies'. Besides, like central government, state governments also provide house building loan to their employees. The state governments also launch their own schemes to provide housing facilities to the poor and backward classes. In state of West Bengal the housing department governs public services and provides housing stock through various social housing schemes for state government employees (on rental basis), EWS(ownership / rental basis), LIGs (ownership / rental basis), MIGs (ownership / rental basis), HIGs (ownership / rental basis), working women hostel (on rental basis), industrial workers, old age home, etc. However, the housing stock provided by the government and its agencies are insufficient to meet the massive housing demand in the state. Therefore, the government encouraged Public-Private Partnership (PPP) to cater to the increasing

demand for dwelling units. Gitanjali, Amar Thikana, Nija Griha Nija Bhumi (NGNB, Housing Schemes under the Backward Region Grant Fund (BRGF), LIG Housing Schemes, MIG Housing Schemes, and Adhikar are the housing schemes currently active in the state.

## **1.6 Identification of Problems**

Although there is strong growth in housing loans by financial institutions in India, we are still lagging behind the developed countries in terms of housing loans to GDP ratio. In India it was around 2.5% compared to 57% in the UK and 54% in the US (Rao, 2010). According to Deepak Parekh, Chairman HDFC Ltd. in India mortgage-to-GDP ratio is currently hovering around 11%, which is still comparatively lower than China at 18% and United States at 52% (as reported by Economic Times on November 1, 2022).

### **1.6.1 Housing Finance Inaccessible to Low Income Group (LIG) & Economically Weaker Section (EWS)**

According to 2011 census, India had a population of 1,210 million (1.21 billion). In mid-2015, world population was estimated at 7.3 billion, out of which India contributed 1.31 billion. It has been projected that, by 2022 it will go up to 1.4 billion, which will further increase to 1.5 billion by 2030 and 1.7 billion by 2050. Out of total population of 1,210 million as per 2011 census, 377 million lived in urban areas (i.e. 31.2% urbanization), which was 27.8% in 2001. The growth in total urban population was estimated at 2.8% from 2001 to 2011. By 2021, Indian urban population is expected to be about 500 million, which will account for 35% of total population. And, according to the planning commission, by 2031 urban India's population will reach about 600 million, which will result into an increase of 59% from 2011. In West Bengal, the rate of urbanization was 22.97% in 2001, which grew to be 31.89% by 2011.

Given the growing population and increasing rate of urbanization, urban housing shortage is obvious to expect. The urban housing shortage in India (18.78 million), as estimated in 2012 by the Technical Group on Urban Housing Shortage is majorly (nearly

60%) contributed by seven states, namely Uttar Pradesh (3.1 million), Maharashtra (1.9 million), West Bengal (1.3 million), Andhra Pradesh (1.3 million), Tamil Nadu (1.3 million), Bihar (1.2 million) and Rajasthan (1.1 million). From 2012 urban housing shortage was expected to grow at a compound rate of 6.6% for ten years. “According to the 'White Paper - Indian Housing Industry' by research and consultancy firm RNCOS, it is expected that the urban shortage will reach to 34.1 million units by 2022” (ET, Feb 16, 2015). The Technical Group on Urban Housing Shortage reported a shortage of 18.78 million as of 2012, out of which 10.55 million (56.18%) is from EWS, 7.41 million (39.44%) from LIG, and 0.82 million (4.38%) from MIGs and upper sections. It implies that nearly 96% of total urban housing shortage is from EWS and LIG. According to the projections made by CREDAI, Kolkata, West Bengal will face a housing shortage of 2.68 million by 2030, 99% of which will be from EWS and LIG. This situation can be explained by the fact that PLIs mostly lend to the MIG and upper section of the society; as, having a stable source of income it is comparatively less risky to lend them and also, they can meet the mortgage requirement; which is not so in case of EWS and LIG. According to a Deloitte report published in 2013, low income segment in housing will roughly comprise of 22 million households requiring an investment of Rs 11,00,000 crore (\$245 billion).

### **1.6.2 Lack of Affordable Housing**

On account of high cost of construction and increasing land prices, the valuation of the newly constructed housing stock was reported to be high in 2013. Harsh Patodia, President, Confederation of Real Estate Developers' Associations of India (CREDAI) Kolkata, in a conversation with Magicbricks.com in December 2013 mentioned, “In the residential segment, prices have gone up by 15 per cent to 20 per cent mainly on account of the cost of land has increased and to offset some amount of construction cost price”. But, given the fact that the need/want for housing is mostly contributed by the EWS and LIG, these housing stock supplies are not matching with the affordability of these sections. Also, though a certain portion of housing shortage is from MIG and upper section, MIG might have placed demand for housing stock on account of their increased level of disposable income. But, this increase in income still may be insufficient to afford houses at the prices offered. Hence, this accelerating housing shortage and not resorting to

housing finance schemes may be attributed to the need/want/demand-supply gap, which got widened due to the increasing need of housing for EWS & LIG, demand placed by the working class (MIG) with a certain level of rising disposable income, and the supply side not matching their affordability.

To hunt for the solution of housing shortage, majorly contributed by EWS and LIG, the concept of affordable housing came into existence. Resultantly, the smaller HFCs grew by focusing on affordable housing finance. According to Indian Mortgage Finance Market Update for FY 2016 by Investment Information and Credit Rating Agency (ICRA), total outstanding housing credit in India as on 31<sup>st</sup> March, 2016 stood at Rs 12.5 trillion against Rs 10.5 trillion as on 31<sup>st</sup> March, 2015 marking a growth of 19%. Both SCBs and HFCs have grown at the same rate of 19%. The growth of SCBs may be attributed to their finer rates of interest, retail focus and balance transfer facility. In case of HFCs, the growth experienced by them is majorly contributed by smaller HFCs. The large HFCs (with > Rs 450 billion assets) grew at 15% only. But, smaller HFCs grew at 36%, pulling up the overall growth of HFCs at 19%. The growth of smaller HFCs may be attributed to better focus on affordable housing and the section of self-employed borrowers, and increase in the number of fresh HFCs. But, with the lack of affordable dwelling units, housing finance will not be availed much.

According to the Residential Asset Price Monitoring Survey by the RBI, housing affordability has further worsened. House price to monthly income ratio has been found to be 61.5 in March 2019, which was reported as 56.1 in March 2015. Also, the survey reports that median loan to income ratio has increased from 3 in March 2015 to 3.4 in March 2019 (As per RBI press release July 11, 2019).

### **1.6.3 Unawareness among Prospective Borrowers**

There is a possibility that a considerable number of the working class (MIG) is unaware about enhancing their affordability via home loans. The problem lies in the fact that though people are well aware that various financial institutions offer housing finance under different schemes, a large number of them are not aware of the characteristics of the schemes, i.e., the loan amount permissible, the interest slabs, the prepayment

mechanisms, the penalties for delinquency, conversion of inter-bank loans, tax benefits available, processing mechanisms and fees etc. It is often that a borrower does not know that Bridge loans, Home conversion loans, stamp duty loans, land purchase loans are also available along with home purchase and construction loan. Borrowers are often ignorant about the implications of floating and fixed rates of interests, calculation of EMIs, processing fees, pre-payment penalties etc. Also, the borrowers are barely aware of the rate of interest charged by other institutions offering home loan. In certain cases it has been found that, the borrowers' are not even aware about the rate of interest they are paying, especially in case of adjustable rate mortgages (ARMs). The reason could be difficulty in understanding the mechanism behind calculations, or not being informed properly about the mortgage terms. It's only when they see their peers paying less rate of interest than them in case of fixed rate mortgages (FRMs), or they experience large payments in case of ARMs, they start enquiring about the facts.

The problem of unawareness is worse among Lower Income Groups (LIGs) and Middle Income Groups (MIGs). In a presentation, Mr. Harshil Mehta, CEO – Aadhar (ADHFL), in Washington DC (October, 2013) stated that the major challenges faced by them while dealing with their clients is lack of financial awareness, no documentation habit, and lack of product knowledge. While serving the till now underserved population, it was found that the prospective borrowers lacks awareness about repayment of loan, documentation needed, eligibility for home loan, how to apply, etc.

Because of this unawareness, borrowers are often in a dilemma as to the source, amount and period for which finance should be availed. And if availed, these existing borrowers will be the source of information to many prospective borrowers. As a result, when those unaware borrowers act as a source of information relying on which their friends, colleagues and relatives takes their loan decision; this unawareness is passed onto them. And, the vicious chain of unawareness continues.

Due to lack of free-flow of adequate information the borrowers are encountering many problems. Only when they experience the problems and repent their decision, they resort to shift their home-loan to another lender. Due to this problem a whole new category of home-loan came into existence; namely, Balance Transfer. Agarwal, Chomsisengphet, Liu & Souleles (2015) made an effort to assess how systematic and costly are the mistakes made by consumers while choosing between different credit

contracts. They found that, a sizeable number (40%) of consumers have chosen a sub-optimal contract. But, later many of them switched to the favourable contract which proved to be optimum for them. However, few of the sub-optimal decision makers were found to continue in the same way without switching exceptionally.

But, while resorting to the option of switching, the borrowers losses a sum of money as fore-closure charges, as they are repaying the home-loan from the previous lender by availing a source other than own source. Because of frequency in occurrence of such events, Balance Transfer Loan forms a major share of total outstanding home-loan in many branches of lending institutions.

#### **1.6.4 Information Dissemination as per Fair Practices Code**

Whenever prospective borrowers plan to take home loan, they take recourse to getting information from office colleagues, friends, relatives and officers of financial institutions. However, there may be information asymmetry as the housing finance schemes keep changing and the information possessed by the friend or relative who had availed a housing loan five years back may not be pertinent in the current context of time. This leads to information asymmetry and results in taking wrong decisions by the borrower. Information asymmetry is a situation in which one party in a transaction has more or superior information compared to another. This often happens in transactions where the lender knows more than the borrower, although the reverse can happen as well. Potentially, this could be a harmful situation because one party can take advantage of the other party's lack of knowledge. Rao, (2013) made an effort to describe and analyze the perceptions and problems of housing finance beneficiaries in Andhra Pradesh. According to him, the home loan takers face many difficulties like, lengthy procedure; delay in processing and sanctioning of loan; high processing fee and pre-payment penalty; lack of communication regarding change in interest rates and reasons for rejection of loan application; transparency in lending practices; un-cooperative attitude of the staff members, etc.

Further, very closely related to this problem of information inadequacy or information asymmetry, is the choice between a Housing Finance Company and a

Commercial Bank to avail a loan. Substantial differences exist between the loan characteristics and loan procedures for these two types of institutions. Though Commercial Banks share about 62.62% of the housing finance market in India and HFCs share about 36.94% (Manoj, 2010), it is still not adequately researched why borrowers prefer Commercial Banks. There are many private sector banks and HFCs like HDFC, ICICI, PNB and SBI, which are targeting the middle-income group. But, nowadays many institutions like Micro Housing Finance Corporation (MHFC), Gujarat Rural Housing Finance Corporation (GRUH), Self Employed Women's Association (SEWA), Dewan Housing Finance Limited (DHFL), etc. are operating in the low-income segment. Still there is lack of availability of housing finance to the informal low-income group in urban India.

As per the guidelines of RBI, with the objective to ensure fair and transparent lending practices, lenders framed Fair Practices Code (FPC) to be complied by them. However, from the observations during interviews with the borrowers it appeared that there are loopholes in compliance of FPC. According to RBI's annual report on Ombudsman Schemes, the majority of complaints for the year June 30, 2020 are related to services at ATM or with Debit Cards, Mobile or Electronic Banking and non-compliance of Fair Practices Code (FPC). Also, the FPC framed by different lenders is not uniform, which makes it difficult to monitor its compliance.

### **1.6.5 Lenders' Service Quality**

Availing housing finance is not a onetime phenomenon; rather there is an element of long term continuity in accessing and using this service. The relationship between a borrower and a financier exists for a decade or more, because the borrower makes deferred payments to repay the principal and interest amount over a period extending from 60 months to 240 months in general. As such the quality of service provided by the financier assumes importance in every stage from the initial application of the loan, sanction and disbursement and repayment of loan. The housing finance providers adopt many strategies to get a greater hold of the market (Kaur, 2013). Due to lack of awareness and information asymmetry while availing the loan, the borrowers later may not perceive the service quality of lender pleasing. Consequently, at times they end up with transferring the loan to some other institution by paying some additional charges. Even worse, they

start to default not being able to manage large amount of payments during later periods in case of ARMs. In the recent past the frequency of transferring loan to other institutions became popular to such an extent that for some institutions it has become a major percentage of their business; which is itself an evidence of lack of awareness among the borrowers. Moreover, due to this increased frequency of loan transfer some institutions have also added “Balance Transfer” as one of the special loan products in their existing loan portfolio. According to Indian Mortgage Finance Market Update 2016 by ICRA, one of the reasons for the growth of banking sector’s housing credit during the FY2016 is balance transfer, which has been cheered by zero prepayment penalties. As such, perception of poor quality of service by the financier may deter a borrower to recommend housing finance to a prospective borrower.

### **1.6.6 Fluctuating Interest Rates**

The rate of interest on housing loan can be fixed, fluctuating, or partly fixed. In case of Fixed Rate Mortgage (FRM) the rate of interest remains unchanged for the full loan tenure. However, the rate of interest keeps on fluctuating in case of Adjustable Rate Mortgage (ARM). The rate fluctuates on the basis of changes in the reference rate. RBI introduced various reference rates from time to time. Currently Repo Linked Lending Rate (RLLR) System is operating since October 2019. Upward rising rates of interest affects affordability of prospective home owners adversely. Further, due to the difficulty in understanding the mechanism of computation of interest rates, and in absence of proper communication regarding changes in interest rates, the borrowers remain unaware regarding the rate of interest on their home loan product. With an increase in interest rate the loan tenure gets elongated if EMI is not revised upward. Being unaware about the same, the borrowers may end with messing up their financial planning due to increased loan tenure.

### **1.6.7 Growing NPAs**

Along with the increasing rate of growth of housing finance market, the NPAs in housing finance are also increasing. Recent data on housing shortage suggests that in spite of accelerating growth of housing finance sector, still now there is shortage of housing in

India. The reason may be the lack of awareness among the potential borrowers, or unaffordability. Hence, there is ample scope for improvement. And, a huge segment of the housing finance market is still unexplored and untapped. Therefore, the housing finance providing institutions are competing to get hold of a greater share of the housing finance market. SCBs are holding a large share presently, and HFCs in spite of being specialized housing finance providers, are lagging behind. But, many new small HFCs are coming up and growing at an accelerating pace by focusing on affordable housing. With the entry of fresh players the intensity of the competition increased, which is prompting the lenders to offer low interest loan to new borrowers, charge low processing fees, maintain easy lending terms, higher top-up loan, only just interest repayment initially, stepped EMIs, etc. But, these steps may adversely affect the profitability of HFCs. Also, by the inclusion of susceptible segment via affordable housing they are magnifying the risk of non-repayment. According to the reports of Residential Asset Price Monitoring Survey, the median loan to value ratio has increased from 67.7% in March 2015 to 69.6% in March 2019, which is indicating towards increased risk appetite of the lenders. To meet the objective of “Housing for all by 2022”, lending up to Rs. 50 lacs is to be incorporated in affordable housing. Further, Loan to Value ratio augmented to 90% for lending up to Rs. 30 lacs. According to Indian Mortgage Finance Market Update for FY 2016 by ICRA, as on 31<sup>st</sup> March, 2016 the gross NPAs of HFCs were 0.73%, which is expected to go up to 0.8-1.2%. The GNPA of HFCs has been reported to be 3.6% as on 30<sup>th</sup> June, 2021, which was 2.9% as on 31<sup>st</sup> March 2021 and 2.3% as on 31<sup>st</sup> March, 2020 (as reported by The Economic Times on November 08, 2021).

The problems identified above are multifaceted and requires deep investigation for coming up with solutions. An attempt has been made to delve into some of these problems, i.e. the awareness of home loan borrowers, compliance of fair practices code, interest rate fluctuations and service quality of housing financiers. The thesis has restricted investigation to these issues only considering their importance and maintaining frugality in time and cost in conducting surveys and gathering information from borrowers and financiers.

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