भारतीय प्रबंध संस्थान बेंगलूर
INDIAN INSTITUTE OF MANAGEMENT
BANGALORE

WORKING PAPER NO: 430

Housing Markets in Spain and the US: Some Lessons for India

Amandeep Singh
PGP Student
Indian Institute of Management Bangalore
Bannerghatta Road, Bangalore – 5600 76
amandeep.iitk@gmail.com

Amrit Nanda
PGP Student
Indian Institute of Management Bangalore
Bannerghatta Road, Bangalore – 5600 76
amritnanda@gmail.com

Charan Singh
RBI Chair Professor
Economics & Social Science
Indian Institute of Management Bangalore
Bannerghatta Road, Bangalore – 5600 76
Ph: 080-26993818
charansingh@iimb.ernet.in

Year of Publication -November 2013

Housing Markets in Spain and the US: Some Lessons for India[1]

Abstract

India suffers from severe housing shortages, especially for the economically weaker sections of the society. And the house prices have been booming for nearly a decade. The markets are opaque, price indices have not been developed, market suffers from absence of regulator and there is no redressal mechanism in place. The procedure for constructing and purchasing a house in India is varies across the country, legal practices are unclear, and laws pertaining to acquiring of land or a house are neither transparent nor uniform. Therefore, housing markets have not developed in India.

The paper seeks to learn from the experience of housing sector in Spain and the USA that have developed over decades. The housing markets in both the countries are well developed, and more significantly have created transparent systems for the convenience of citizens. The procedures are standardized and there is transparency in the pricing of products, procedures to be followed and availability of legal recourse. India needs to put in place a number of systems, laws and institutions to ensure that housing sector develops in a balanced fashion.

Keywords: Housing, Real Estate, Housing Loan, Corruption.

[1] The authors would like to thank Mr. G.T. Velu (CEO, Max India Developers), Mr. Pankaj Kapoor (Founder and MD, Liases Foras) and Mr. Ashutosh Limaye (Head Research, Jones Lang Lasalle) for their inputs. They are also grateful to Ms. Meenal Mishra, Mr. Kanad Chaudhari and Mr. Souvik Saha, as well as other participants of the internal seminar att IIMB for their suggestions. The WP originated as a term project for the first two authors, PGP students at IIMB.

Introduction

It is widely believed that the Housing sector is closely connected to the economy, with a vibrant housing market considered good for the domestic economy. The housing market absorbs a significant portion of individual savings, especially in India where owning a house could also consume lifetime savings.

A booming housing market helps the economy in a number of ways. The National Association of Home Builders (NAHB), USA reports that "building 100 average single family homes generates more than 300 jobs and nearly $9 mn in tax revenues for state, local and federal governments that support schools and communities". In addition to jobs and revenue, more houses mean more insurance sales, and more sales for furnishing and other utility needs. This results in a trickle down effect, which spread business growth, hiring and consumer spending among all industries. NAHB estimates that housing averages 17 percent of the GDP for the USA.

Thus, it can be seen that the housing sector is in many ways a mirror of the economy. On the other hand, the recent financial crisis had its roots in the US real estate industry. Mismanagement of sub-prime lending, along with weak underwriting practices, coupled with the growth of the housing bubble led to the events that resulted in a few major financial institutions defaulting, a few others requiring bailing out by national governments, and such a crisis that the world is still recovering from. On the other hand, government budget deficits have led to repeated boom-bust cycles in Spain. Housing is believed to have had a major role to play in the crisis, mainly due to issuance of 40-year loans, coupled with a sharp decline in construction, leading to bailouts.

The paper examines the US and Spanish markets, specifically examining the operational aspect of transparency and standardization of procedures in the housing sector.[2] This paper supplements the work presented in Singh (2013a) that examines the macro-aspects of housing markets in Spain and the US. A brief review of literature examining the relationship between housing markets and macro-economic policies is presented in Section 2, followed by an in-depth analysis of the housing markets in Spain and the USA in Sections 3 and 4 respectively.

[2] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2260240

Thereafter, in Section 5, some related issues for India have been presented. Finally, Section 6 provides summary and conclusions. This study has been enriched through interactions with professionals from various parts of the housing and real estate industry.

Section 2: Brief Review of Literature

The financial crisis and its roots in the housing sector have renewed interest in the study of the possible linkages. The fact that the real estate and housing sector impacts the economy in various ways makes it all the more important. A number of related industries depend on the housing sector. Not only does it have implications for the fiscal and the monetary policy of a nation, but also as evident from the crisis, it has far reaching implications for the financial institutions of a country.

The real estate industry has often been termed the 'Engine of Growth' of the economy. Investment in the real estate sector, both residential and commercial, leads to subsequent demand in multiple industry segments that derive their demand from real estate such as steel, heavy machinery, cement, power generation etc. The real estate sector directly and indirectly affects 269 separate activities according to the United States department of labor. According to Song, Liu and Langston (2006), in most developed and developing countries, housing ranks among the top 3 in terms of linkage effect in the economy. This linkage effect is particularly more in case of the steel and the cement industry, as evident in the Government of India Economic Survey (2002-03). In the context of a developing country like India, for every rupee spent on real estate and infrastructure, 78 paise gets added to the GDP.[3] This is because of the 'Keynesian multiplier' arising out of a single investment in the real estate sector and the large number of industries and jobs it affects. Arku (2006) analyzes the economic and social benefits of real estate and construction activities in Singapore, Hong Kong, Japan and few other East Asian countries as to how investment in the real estate sector can be a driver of growth and also a macroeconomic stabilizing factor in case of recessions. Green (1994) observes that investment in housing is a lead indicator of all business cycles. In terms of contribution to

[3] "Housing for All" by Niranjan Hiranandani, President, Indian Merchants' Chamber, p. 5.

economic growth, investment in housing and economic development, are closely related according to a study by Strassman (1970). According to Sethuraman (1985), in case of developing countries, the construction sector contributes between 3 to 8 percent to the GDP.

Igan and Loungani (2012) argued that more than the increase in the personal income or the decrease in the interest rates, it is the monetary and fiscal policy and the resulting macro economy that has a larger effect on boom-bust cycles in housing. In essence, the more conducive the taxation policy for housing and easier it is for buyers to obtain credit, more the housing sector will boom. However, it is these policies formulated during the boom years, which will govern how long and deep the recession will be and how painless the recovery will be. Loungani (2008) states that over the period 1960-2008, recessions in developed economies that are associated with house price busts are longer and more prominent than otherwise. The duration of the recession is at least one quarter longer in the case of a housing bust, total output lost is higher, and this is accompanied by unemployment rate rising more rapidly and for longer duration.

Igan and Loungani (2010) argue that unlike past recoveries, there appeared to be less hope of a continuous upside boost to the economy from the real estate sector. Moreover, in economies where real estate markets were still declining, the drag on real activity would continue. In economies where house prices and residential investment were rebounding, concerns about bubbles is eliciting policy actions that will temper any short-term boost to economic activity. And thus housing prices could go even lower.

The fiscal benefits from the development of the real estate sector are many. The revenue receipts increase due to property tax, stamp duty, capital gains tax and taxes on industry profits. The expenditure side consists of government investment in infrastructure, housing and amenities as well as stimulus packages, as suggested by Naylor (1967). According to Crowe, Dell'Ariccia, Igan and Rabanal (2011), most of the pre-crisis research was of the view that there was little correlation between the fiscal tax policies and the investment in the real estate sector, with most of the blame being put on the easy monetary policy of the US Federal Reserve and the greed of the bankers in selling subprime mortgages. Monetary and fiscal policy changes were seen as a consequence rather than a cause of the depressed housing markets.

However, Pozdena (2010) argued that "the current recession, like most prior recessions in history, did not arise because of endogenous problems in the housing sector but rather because of policy interventions that set the housing market up for a fall". The paper goes on to state that by the early 1990s various financial innovations such as mortgage backed securities, allowing spousal income to be included in loan qualifications and longer-term loans had led to a decline in the influence of monetary policy on the real estate market. The 1980s and 1990s brought in a new phase of prosperity for the United States where inflation and high interest rates of the Jimmy Carter era were replaced by declining interest and inflation rates. This coupled with the Reagan era tax rate cuts led to a period of boom in the housing and real estate sector. In addition to these tax cuts, the government under President Bill Clinton encouraged 'democratization of credit', wherein banks were specifically asked to lend to weaker groups of the society; people who would previously not have qualified for credit for housing. However, this fuelled a period of housing boom and when the fed increased interest rates, these subprime borrowers could not meet their debt repayment obligations and defaulted en-masse leading to the 2008 real estate bubble burst.

The linkages between the housing sector and monetary policy are also interesting to note. Taylor (2008) tries to establish a more direct relationship between the loose monetary policy and the 2008 crisis. He showed that since the 1980s, the monetary policy was in line so as to respond proactively to inflation, thereby ironing out the boom-bust cycles. This changed in the years preceding the crisis, where interest rates were perhaps not managed that well. This, coupled with poor credit-check quality, particularly on subprime mortgages was responsible for the real estate boom, and the eventual bust.

The crisis of 2008 doomed a few major financial institutions across the globe. IMF estimated that the valuations of large US and European banks went down by around $1 trillion as a result of the losses accumulated due to toxic assets from bad loans, in the period from January 2007 to September 2009. Over 100 mortgage lenders went bankrupt during 2007 and 2008, whereas large institutions like Lehman Brothers, Citigroup, Merrill Lynch, Fannie Mae and Freddie Mac were either acquired or had to take government aid. This was not restricted to funding providers, but also insurance giant AIG had to be bailed out by the US government. Mei and Saunders (1997) analyzed the performance of banks' real estate investments and sought to establish whether the investments are in line with ex-post performance or betting on ex-ante odds. Demyanyk (2011) established that the quality of loans went down consecutively for 6 years before the crisis and that those making securitized products were aware of it to a large extent. However, it is widely believed that the global crisis resonated since the problems were not restricted to the US market, but various other countries like Spain and Ireland, as researched by Allen and Carletti (2009).

House ownership in Spain is primarily credited to government policies in the 60s and the 70s that encouraged home ownership. According to Pidal, Lampe and Roses (2011), the Spanish housing property market can be divided into three phases: one from 1985-1991 when property prices nearly tripled, the second from 1992-1996 when the property price remained relatively stable and the third from 1996-2006 when the property prices grew steeply again. However, the housing sector suffered a huge meltdown coinciding with the 2008 recession. Smyth and Rob (2013) estimated that on an average, the property prices in Spain had fallen 30 percent from its peak of 2007 and will further fall by at least 50 percent from the 2007 peak in 2015.

Buiter (2008) showed that changes in house prices are only redistributions of wealth and so, do not have much impact on the aggregate wealth of a society. However, they do affect individual consumption through relaxation of constraints on collateral. Also, Muellbauer (2008) showed that the development of credit market and its deregulation results in changes in house prices having a medium-run liquidity effect on consumption patterns in the US.

Section 3: Real Estate Market in Spain

Policies and Instruments

The real estate sector in Spain does not have a national central regulatory agency, unlike many other real estate markets in the European Union. Legislation regarding the property market is made by the Ministry of Public Works and the Ministry of Infrastructure, Transport and Housing which form the *Ministerio De Fomento*. However an agency called API (*Agentes de la Propiedad Inmobiliaria* or 'real estate agents') is the recognized real estate regulatory body in Spain. API issues certifications to real estate agents by providing them with training and monitoring their actions. The API certification is backed by the *Ministerio De Fomento*. However there are various associations formed by the property agents and developers in various regions such as the LPA (Leading Property Agents) in Costa del sol which act as umbrella bodies in enforcing regulations and also lobbying on behalf of their members.

The Spanish Financial markets however are divided into three parts, each having its own regulator:

- Investment sector regulator - Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores* or CNMV)
- Insurance sector regulator (life and general) - *Direccion General de Seguros* (DGS)
- Banking sector regulator - *Banco de España* (BdE)

These regulatory institutions, along with the *Ministerio De Fomento* promoted policies starting from the mid 1970s till 2007, which encouraged home ownership and discouraged renting. This, in addition to the various instruments such as long property mortgages (40 - 50 year tenures); Property Investment Funds (PIF) and Real Estate Investment Trusts (REIT) fuelled the individual and institutional investments in the property market. In addition, there were various tax concessions, such as 15 percent of mortgage payments deductible from income tax, as well as VAT subsidies for homebuyers. This resulted in the boom that ultimately led to the property bubble of 2007. The Interesting thing to note here is that Spain, with 16.5 million families had 22-24 million houses in 2007 with 3-4 million of them empty. This happened because as the Spanish real estate sector was booming, foreign investors, REITs and PIFs started investing heavily in the Spanish market with quarter of the demand coming from foreign investors, who expected high returns either in terms of capital gains or as rental income from tourists coming into Spain. Also the Spanish government continues a policy where a non-EU resident who buys a property with value greater than 500,000 Euros in Spain is granted citizenship. In hindsight, such investments were a major driving force for the property price increases.

The importance of these asset prices for the monetary policy of Spain is evident from the fact that real estate assets comprised up to a quarter of the loan books of major Spanish banks. Further, the liberalization of the financial sector in Spain had increased the Loan-To-Value (LTV) ratio for real estate loans, giving banks little elbow room for bad loans and write downs. Hence, maintaining the asset quality and price was important for the Spanish financial sector as otherwise the major banks would have suffered and the entire economy would have collapsed.

However, one notable factor, and probably the reason why the Spanish Banking sector still survived the real estate meltdown even after one major bank and many regional banks went down was the relatively stronger credit criteria that limited the number of bad mortgages and also the discouragement of refinancing in houses, which perhaps saved millions of borrowers from bankruptcy. Also, the fact that Banks had recourse to recover their debt from Spanish home buyers aided to the fact that home buyers could not just throw up their hands and walk away from their mortgages which were declining in value.

Building/ Buying a New House[4]

While building a house in Spain, a person has to go in for an assessment of income and eligibility from banks if he is availing a mortgage loan. Based on the disposable income of the applicant and the LTV ratio, an upper limit on the amount of financing that one can avail is fixed and this acts as a cap for property selection.

Subsequently, a person chooses the type of land that he wants to build on. All land is classified as rural or urban. In case of rural land, the plot is either classified as protected land (*Suelo no urbanizable protegido*) on which no residential construction can happen or unprotected land

[4]Guide to Building Construction in Spain--http://spain.angloinfo.com/housing/buying-property/building-construction/

(*Suelo no urbanizable común*) on which residential construction can happen. There are some development rights restrictions that apply on rural projects such as: the plot size should be a minimum 10,000 square meters and the maximum building size should be 2 percent of the plot size and can have a maximum of 2 floors up to a total height of 7 meters. Also, the regional building style must be adhered to.

In case of urban properties, the plots are serviced with amenities like roads, drainage, electricity and water already provided. Normal plot sizes vary between 850 square meters to 1500 square meters with about 20 percent being allowed for construction. One can ask for urbanization certificate (*certificado urbanistico*) of the plot and this document is signed by the agency of urban planning, which confirms the type of plot, the purpose of occupation, building space and building type. A property should not be purchased without this document.

After the land has been selected, a building permit (*licencia*) has to be obtained from the town hall. There are two separate types of permits:

1. Permit for minor works (*licencia de obra menor*) – in which case one should submit to the town hall a small description of the work to be undertaken and an estimation of the costs, and obtain a *licencia de obra menor* so that taxes (normally 4-6 percent of the construction value) can be calculated and paid at the end of the job.

2. Building permit (*permiso de construir*) – where one should submit to the town hall, the permit application (*solicitud de licencia*) signed by the architect, the contractor and the site manager.

The applications are processed in a time bound manner with an upper cap of 2 months. If no reply is received after 2 months, the application is deemed to have been accepted. After the application has been accepted, one is given an application number through which one can track application progress and the details of application will be posted on the notice board.

The Spanish Building Act of 1999 (*Ley de Ordenación de la Edificacion*), assigns some responsibilities to all parties involved in the construction process of the building. The third party and contractual entities, such as lawyers, architects etc. are contractually liable to the owners and third party buyers in case of any issues arising from their work. The builder is responsible for any structural defects that make the building unstable for a period of 10 years, any defect in construction material and services that make the building unusable for 3 years, and for any defect arising from construction and finishing for a period of 1 year, from the date of possession/ construction, whichever is earlier. The builder/ developer is liable directly for any damages caused to the buildings due to defects that arise from lack of skill, negligence or non-compliance with the obligations of the construction manager, lack of professional or technical qualification and negligence or non-compliance of other individuals or legal entities reporting to them. The builder will be directly liable for the damages incurred due to defects in execution of the tasks or services by the subcontractor, irrespective of the recourse that builder has to the subcontractor. To ensure that damages are recovered, a property damage surety insurance policy is taken out.

There is no formal grievance redressal authority for the Spanish housing market. However there are certain community and customer associations that take up issues with the builders/ government.

The time taken to build an average house in Spain, once all the land and permits are in place is 16-18 weeks. However to deal with the various permits, approvals and plans that one has to prepare and the formalities associated with buying land, a total time of 6-8 months is not uncommon[5].

Buying an Existing Property

1. On choosing the property, the buyer has to get a fiscal number (*numero de identificacion de extranjeros*) and retain the services of a lawyer. For an off-plan purchase the buyer is required to pay a small upfront fee and sign an agreement after which the property is taken off the market for 30 days. This allows for legal checks to be carried out and a property sale deed be drawn. The initial payment is usually 10 percent of the property price and non-refundable.

[5] The Building Process--http://www.accom-consulting-spain.com/Construct_Property_Spain_Building_Process.htm

2. Once the legal due diligence has been completed in the above step, then various fees and taxes are payable, and the property is then registered at the Land Registry. Sometimes property sellers ask the client to under-declare the value of the property to save on capital gains taxes and lower municipal taxes. Sellers could seek to take cash under the table but such actions are illegal and are liable for prosecution.

3. Spanish property buyers should expect to pay out 10 percent to 14 percent of the purchase considerations for the various fees as detailed below:

    - 1-2 percent of the purchase consideration is legal fees.
    - 7 percent of the purchase consideration is the IVA (similar to VAT).
    - 0.5-1 percent of the purchase consideration of a new property is paid as stamp duty.
    - 6-7 percent of the purchase consideration of a resale property is paid as stamp duty.
    - 1 percent of net purchase consideration is paid as fees for the notary and registration.

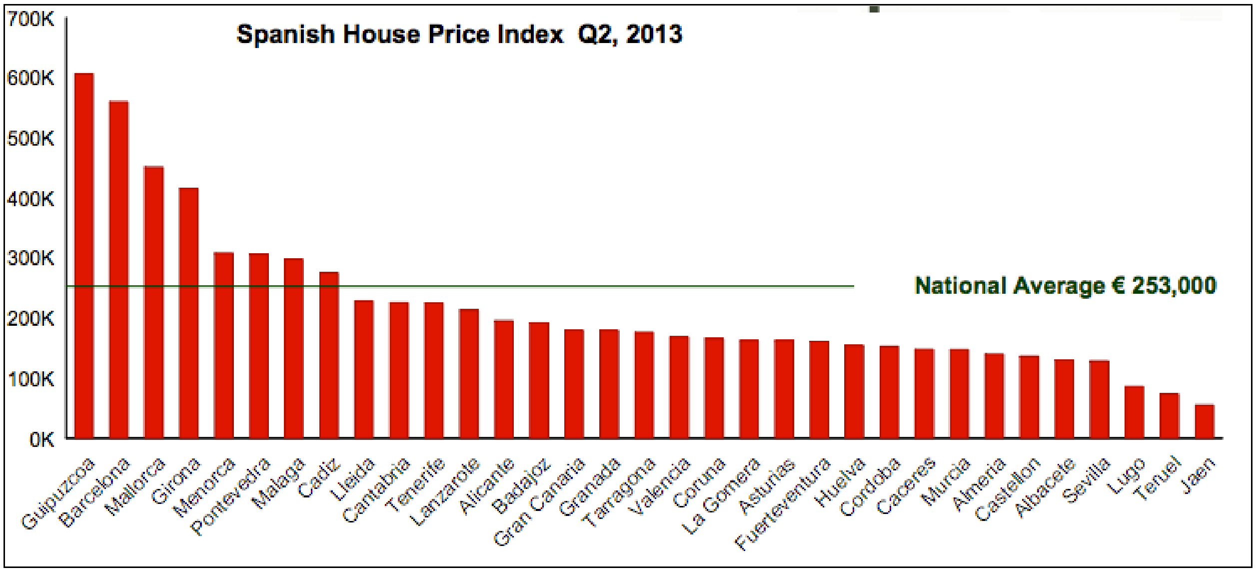
Price Indices

The main housing price index in Spain, the Housing Price Index (HPI), with base year 2007, has the objective of measuring the evolution of sale prices of free price dwellings, be they new or second hand, over time.

The information source used for the calculation of the HPI comes from the registered housing databases provided by the General Council of Spanish Notary Publics, from which the transaction prices of the dwellings are obtained, as well as the weightings assigned to each group of dwellings with characteristics in common. The sample used for these statistics comprises all dwellings registered during the reference quarter.

In addition, there are a few indices tracked by independent property dealers like the Kyero Index. The Kyero index uses a median calculation, which is more representative of a group of prices than is the more common mean calculation.

Fig 1: Kyero Housing Price Index



Source: kyero.com

Housing Prices and Personal Income

Housing costs take up a large share of the household budget and represent the single largest expenditure for many individuals and families. In Spain, households on average spend 20 percent of their gross adjusted disposable income on housing, slightly below the OECD average of 21 percent.[6]

The average household yearly income is $22,847 in Spain with the average housing mortgage value being $196,000 Adjusting for compound interest rate of 5 percent and an average payment of $9,138 per annum (at 40 percent of gross adjusted income) we get the average repayment period roughly to be 28 years.

Use of Building Materials

Most residential construction in Spain is masonry, with brick and cement being used to make the outer walls and the floors. However the roofing can be masonry but tiling is also used equally. Timber is also used to make the house frames, which are then filled with concrete. However, a lot of plasterboard and wooden floorings and fittings are used inside the typical

[6] OECD Better Life Index – Spain: http://www.oecdbetterlifeindex.org/countries/spain/

residential home. There has been a steady transition from solid wood to paper board and plaster board usage over the years. This shows that people are moving towards more ecologically sensitive choices and are using more of recycled and recyclable materials. Spain, being a cold country requires that a lot of thermal insulation is used in construction. Most of the material used in construction is pre-prepared and comes to the construction site to be directly used in the highly mechanized process used to build homes.

Further a lot of emphasis is being put on sustainability of the building in terms of energy usage and waste generation. In recent times, instead of building with bricks, consumers prefer to build with reinforced concrete blocks, which have better strength and are ecologically less damaging. For quicker construction, a lot of prefabricated materials like aluminum frames are also being used.

Older houses and mansions use substantial amount of woodwork, with tree trunks being used sometimes for support. The construction in such cases is more manual and uses a lot more amount of conventional materials than a normal residential unit. Further such houses use a substantial amount of stones.

Commercial complex construction is similar to other parts of the world, with steel beams being used as the underlying structure and using concrete, glass and prefabs to build the rest of the structure. The trend in commercial construction is shifting from art-deco construction styles to modern glass fronted buildings that are more energy efficient and easy to build and maintain.

Savings Resulting From the Usage of New Age Building Materials

The usage of pre-fabricated materials leads to savings in cooling and heating costs ranging from 9 percent to 30 percent of the cost of the pre-fab wall per year. At this rate, the prefab walls payoff their cost in 8 to 12 years and last for an average of 30 years.

Looking at the fact that Spain has extreme climate in many months of the year and needs heating and cooling during those periods, use of insulated prefab construction materials can lead to a substantial reduction in energy costs.

Cost of Land and House Prices[7]

Due to the large increase in prices of land in most part of Spain in the boom that lasted till 2008, land prices start from 50 Euros to 300 Euros per square meter and building area ranges from 700 to 1500 meters. So the maximum that land cost can contribute as a percentage of the total cost of the house ranges between 45-50 percent. This percentage is however much less in case of rural areas and small cities.

Loan Pricing

Loan to Value

Standard LTV ratio for Spain is up to 80 percent and is linked to the valuation of the property and not the purchase price.

Spanish Mortgage Product Ranges

Most mortgages in Spain are variable rate with a declining balance basis. The variable rate is linked to yearly EURIBOR and is reviewed yearly. There is an increasing move towards fixed rate mortgages, which have a slightly higher rate than the floating rate mortgages at present.

Equity Release and Re-mortgaging

Releasing an existing mortgage and remortgaging is available through select lenders in Spain. However the legal structure of Spanish mortgages makes it difficult to change the mortgage in any way post completion and any changes entail fees for bank, lawyers and notaries. Further the Bank of Spain sets the rates and the limits of refinancing. Hence the Spanish refinancing market is not as developed as the US loan refinancing market. Probably this was one of the major reasons why not many of the residential property loans did not turn sub-prime.

Term

Spanish mortgages have terms ranging from 5-40 years and are dependent on age and the financier chosen. Most banks expect the mortgage to be repaid by 70 years of age, however it is possible to obtain a mortgage till the age of 80.

[7] Building your own home -- http://www.justlanded.com/english/Spain/Articles/Property/Building-your-own-home

Costs

Spanish banks charge an arrangement fee and an opening fee while providing a mortgage financing. In addition various costs such as the mortgage tax, registry costs and purchase deed costs are deducted from mortgage in advance by the lender in advance. These costs added together can be up to 12 percent of the purchase price.

Currency

Capital provided by Spanish lenders is in Euro. However, offshore lenders can accept repayments in other currencies too.

Underwriting Criteria

Most mortgages in Spain are granted on a full status basis. Most banks will check the income, net of tax, and determine that the net monthly obligation does not exceed 1/3rd of net after-tax income. In some cases this is extended till 45 percent of the income.

Standard Documentation Required

The documentation required is standard and varies according to the profile of the buyer – employed or self-employed. (Annex 2)

Corruption

Corruption has been found to be widespread in the housing sector in Spain. A Transparency International working paper on Spain has found that up to 10 percent of the cost of the housing unit in Spain is due to the bribe cost.[8] This bribery can be traced to the fact that Spanish town halls had a large degree of freedom in granting licenses for real estate development. Corrupt officials and elected leaders took advantage of this independence and lack of oversight to take underhand money to grant licenses of development. In a way, this bribery was also responsible for the huge and disproportionate increase in the construction units as town officials, expecting

[8] "Corruption in the Land Sector" by Transparency International, 04/2011. Spanish judges cases of corrupt local government--http://www.citymayors.com/politics/spain_corruption.html

huge bribes, encouraged construction projects. In time, this became a vicious cycle with more developments increasing bribes and the resulting greed increasing development.

Affordable Housing

As explained above, the Spanish policies regarding housing starting in the 1970s promoted home ownership and discouraged renting. The management of affordable social housing is left to the autonomous regions of Spain. However, there is a scheme called *Viviendas de Protección Oficial* (VPO) that allows builders and contractors to build on public sites by reserving certain portion of the construction for affordable housing and assigning these to the local administration.

A new plan called *Plan Estatal Español de Vivienda y Rehabilitación para el Período* (2009-2012) was put forward by the Zapatero government in Spain to make a million home available for public housing by relying on refurbishment of unused houses and new construction where required.

Financial Innovations

The Spanish financial sector has developed, securitization and the resulting Mortgage Backed Securities (MBS) market where banks offload the interest rate and default risk that they carry on their books by means of MBS to investors in the market. This allows banks to provision less for defaults and also incur lesser interest rate risks, thus driving down the borrowing costs.

Competition

There is considerable competition in the Spanish housing market with a large number of builders who compete for customers both online and offline. The increase in online property forums and marketplaces has reduced the disparity in property prices within regions and has brought some degree of transparency to the system. The lenders in the financial system used to compete among themselves to provide mortgage loans thus providing better terms and lower rates to buyers. However, this competition has reduced after the 2008 recession.

Scams

Scams are not uncommon in the Spanish housing market, with the most recent one being the fake property certificate scam that defrauded many foreign investors in the Spanish housing market by giving them fake property certificates for non-existent property.[9]

First Hand Account of The Situation In Spain[10]

The understanding gained from a brief travel across southern and central Spain is that the country is currently in the throes of an economic and social crisis, stemming from the economic meltdown of 2008. The unchecked real estate boom, bankrolled by bankers using public savings, has left scars that are still visible today. Evidence of this are boarded up windows, repossessed houses, ghost townships, stations and airports across the country. The common people of the country perceive the politicians and bankers to be responsible for this crisis.

Pre-fabricated building materials are widely used across Spain as it aids in improving the speed of construction and also helps home owners do some of the construction themselves. Most of the older buildings have regular brick and mortar construction for the exterior but pre-fabricated materials are used for much of the interior. Most of the newer constructions have pre-fabricated materials used for both interiors and exteriors. Trends in ecologically sensitive construction and energy savings have gained popularity in Spain, with eco-friendly and energy saving measures such as activity sensors for rooms to switch off unnecessary electricity usage, solar panels, and recyclable materials being used widely. Energy efficiency certificates have recently been made mandatory for long term lease or sale of property.

[9] http://www.citymayors.com/politics/spain_corruption.html; "The Causes of Corruption – A Cross National Study" by Daniel Treisman, Department of Political Science, UCLA. p 3.
[10] Information gathered by one of the authors, while travelling through Spain during Oct-Nov 2013,

Section 4: Real Estate Market in the USA

Policies and Instruments

The mission of the United States Department of Housing and Urban Development (HUD) is 'to create strong, sustainable, inclusive communities and quality affordable homes for all'. HUD is working to improve the housing market, which in turn would improve the economy. It also seeks to protect consumers, meet the need for quality affordable rental homes, and thereby utilize housing as a way for improving quality of life of the people. In addition, HUD looks to build inclusive and sustainable communities ensuring equality of living conditions.

To meet these ends, the US Congress passed the Real Estate Settlement Procedures Act (RESPA) in 1974. The main aims of RESPA[11] are:

1. To help consumers make better choices for housing
2. To eliminate greasing and referral fees that unnecessarily increases the costs

In agreement with the above purposes, the various requirements of RESPA are:

a) Borrowers receive disclosures at various times. Some disclosures spell out the costs associated with the settlement, enlist lender servicing and escrow account practices and describe business relationships between service providers.

b) Prohibition on certain practices that increase the cost of settlement service. It prohibits a person from giving or accepting anything of value for referrals of settlement service business related to a federally related mortgage loan. It also prohibits a person from giving or accepting any part of a charge for services that are not performed.

RESPA requires disclosures to be made at various stages of the process. They are:

At the time of loan application

When someone applies for a mortgage loan, brokers and lenders must supply them with:

- A Special Information Booklet, containing information on different settlement services.

[11] http://www.hud.gov/offices/hsg/ramh/res/respa216.cfm

- A Good Faith Estimate of settlement costs, enlisting the charges the buyer is expected to pay at settlement. The difference between the estimated costs (GFE) and actual costs at settlement (known as the HUD-1 settlement statement) are subject to tolerance levels, depending on the service level selected. On breaching the tolerance levels, the borrower may file to get a refund from the lender. The borrower must be supplied with a list of settlement service providers at the time of the GFE by the loan originator.
- A Mortgage Servicing Disclosure Statement, which discloses if the lender intends to transfer the loan to another lender, or not.

Also, RESPA does not penalize the failure to provide the Special Information Booklet, Good Faith Estimate or Mortgage Servicing Statement explicitly. However, banking regulators may go on to impose fines or penalties on lenders who fail to comply.

Before settlement/closing occurs

There is the requirement of an Affiliated Business Arrangement (AfBA) Disclosure when a customer is referred to a third party by a service provider involved in a RESPA covered transaction, with which he has a beneficial interest. In such a scenario, the referring party must give the AfBA disclosure to the consumer at or prior to the referral. The disclosure needs to clearly specify the kind of arrangement between the two parties and benefits involved.

These can be relaxed, however, when a lender refers a borrower to an attorney, credit reporting agency or real estate appraiser to represent the lender's interest in the transaction. But the consumer is not bound to use the provider being referred, and is free to choose any other.

The HUD-1 Settlement Statement is a standard form that transparently shows all charges imposed on borrowers and sellers in connection with the settlement. It also contains a chart that can be used by the borrower to compare the charges disclosed on the GFE and the actual charges listed on the HUD-1.

At settlement

The HUD-1 Settlement Statement contains the settlement costs of the loan transaction. The borrower and the loan-seller need to fill separate forms. The Initial Escrow Statement itemizes the lists the taxes, insurance premiums and other charges that need to be paid from the Escrow Account, for a period of the first 12 months of the loan. The lender has 45 days from settlement to deliver the statement, though it is prescribed that it should be given at the time of settlement.

After settlement

Post settlement, the borrowers must be provided an escrow statement by the lenders on an annual basis. This summarizes all escrow account deposits and payments during the past year. It also notifies the borrower of any shortages or surpluses in the account and provides advice on the course of action being taken.

The National Association of Home Builders (NAHB) is an association of more than 800 local bodies. Their aim is to develop, in association with the legislators and these members, building codes, standards, and regulations and enforce legislation in the construction area. These codes pertain to structural design, materials, energy conservation, fire safety, electrical, plumbing, heating/cooling/ventilation, accessibility, safety, disaster migration, environmental friendliness and any other issue that might be pertinent. NAHB also holds educational programs for builders that teach them on basic frameworks and complete concepts on various topics related to construction, from start to finish. They also run a TV channel called ‘Housing Now TV’ that provides information on the latest trends in the housing industry, and other information.

Building/ Buying a New House

The steps identified by the HUD are as follows:

1. Analysis of affordability depending on annual income, credit history, monthly expenses, ability to make a down payment and the current interest rate. There are brochures available on the HUD website that directs prospective buyers to the home buying programs in their respective states. These have details of nearby housing counseling

agencies, educational information about buying and maintaining a home as well as warnings about predatory lending schemes of various lenders.

2. The second step informs people about their rights as a homeowner. Firstly, this promotes the notion of Fair Housing for all, across America's diverse culture. This educates people about the Real Estate Settlement Procedures Act, the Mortgage Borrower's Rights as well as against predatory lending and loan frauds. It can be seen that post the financial crisis, education and information plays a very important role and the HUD has taken up this initiative.

3. The next step is comparison of various lenders and access to brochures that give their terms and conditions. A whole section called "Let FHA (Federal Housing Authority) Help You" gives information on various aspects of mortgages, as well as again warning against becoming a victim of predatory lending.

4. Prospective homeowners are also informed about "good neighbor next door", which provides available listings of people like teachers, firefighters, officers etc. in localities where one might be looking to by a house. It also has special sales programs for evacuees of natural disasters.

5. After selecting the property, FHA provides inspectors for the property, whose service can be availed at a cost, evaluating the physical condition of the house, identify repairs/replacements and estimate the remaining life of the systems. The prospective buyers can interview an inspector of their choice, although there is no formal guarantee on the inspector's report. In addition to inspection for the buyer, the lenders can also get an appraisal done which estimates the value of the house, makes sure that the property meets the standards set by FHA, and makes sure that the house is a marketable property.

6. Once the offer meets the expectations of the seller, the HUD facilitates the closing of the deal. It provides help on selecting a broker, selecting a notary (attorney), finalizing the terms of the sale, looking for a loan, securing of the title, understanding various

disclosures, and helping the buyer understand his rights. There are also specific guidelines on settlement.

There are some other terms mentioned by HUD under the Terms of Agreement of Sale. (Annex 3)

The time taken to build an average house in USA, once all the land and permits are in place is about 3 months. However to deal with the various permits, approvals and plans that one has to prepare and the formalities associated with buying land, it usually ends up to a total time of 6-8 months. This can be about 2 months in case of closing a deal on a resale house.

Buying an Existing Property

1. The counsel of a reputed lawyer is sought to make sure that the documents are in order, especially regarding payments of real estate tax, building permits, etc.
2. A home energy audit is suggested strongly, to help figure out how much it would take to heat and cool the house.
3. Once the offer is accepted and signed, the escrow officially begins. This means that the buyer has committed to buy the house or else stands to lose the entire deposit (usually $5,000-$10,000). However, this is relaxed if he is unable to get get final mortgage approval. During escrow (typically 30 to 90 days), the lender arranges for purchase financing and finalizes the mortgage.
4. A lawyer specializing in real estate should be hired to review closing documents. Lawyers may charge $200-$400.

Price Indices

There are quite a few major indices tracking house prices in the USA. The main is the Housing Price Index (HPI), formulated by the US Federal Housing Finance Agency. It is published quarterly and is a broad measure of the movement of houses owned by single families. It is a weighted repeat-sales index, measuring the average price changes in repeat sales and refinancing on the same properties.

The most well known index is the S&P Case Shiller Index that tracks the repeat sales of houses using modified weighted-repeat sales wherein it adjusts according to the decrease in quality of old houses. It is a monthly index, with an average lag time of 2 months.

The CoreLogic HPI is a repeat sales index that measures the increase and decrease in sales price for the same homes over time.

The IAS360 HPI is a localized monthly index that works on neighborhood data. It tracks the monthly changes in the median sales prices in more than 15000 neighborhoods, which is then accumulated across 360 counties, 9 census divisions, 4 regions and finally, for the whole country. It treats each county as an independent market.

Also, there is the Zillow Home Value Index, which gives the median estimate valuation for a particular geographic area on a given day.

Table 1: US Housing Price Indices

Index	House Type	Nature	Frequency
HPI	Single-family	Weighted, repeated sales indices, includes refinancing	Monthly
Case Shiller	Single-family	Modified weights, excludes refinancing	Quarterly
IAS360	Single-family	Price-trends at county level	Monthly
Corelogic HPI	Single-family	Repeat sales trends for the same homes over time	Monthly
Zilow	Single-family	Estimate valuation for a given geography	Monthly

Source: various publications

Housing Prices and Personal Income

Housing costs take up a large share of the household budget. Housing accounts for the single largest piece in the expenditure for many individuals and families. This is further enhanced by addition of basic amenities like rent, gas, electricity, water, furniture or repairs. For an average American household, housing represents 34 percent of all expenditure and 26 percent of all income.[12]

[12] Consumer expenditures in 2011, US Bureau of Labor Statistics, Report 1042, April 2013; p. 3

The average household yearly income is $51,144 with the average home price and the average mortgaged of housing being $272,900 (2010). Adjusting for compound interest at the rate of 5 percent, and considering that 26 percent of income goes into housing, it will take an average of about 26 years for a family to pay off their housing loan.

Use of Building Materials

Most residential construction in USA is masonry, with brick and cement being used to make the outer walls and the floors. However, the roofing can either be masonry or tiling. A prominent feature of houses in the US countryside is the heavy usage of timber, which is also seen in the northern colder areas, like Alaska. Substantial amount of woodwork, with tree trunks is also being used sometimes for support. The construction in such cases is more manual and uses a lot more amount of conventional materials than a normal residential unit. A lot of plasterboard and wooden floorings and fittings are used inside the typical residential home. Being a large country where the northern and eastern parts are predominantly cold and the southern and western parts are warm, internal fittings range from floor heating to air-conditioning. There has been a steady transition from solid wood to paper board and plaster board usage over the years.

The major trends being followed now include moving towards more ecologically sensitive choices and using recycled and recyclable materials. Systems that recover energy through heat wheels and occupancy sensors are becoming vital. A lot of emphasis is being put on sustainability of the building in terms of energy usage and waste generation. In recent times, instead of building with bricks, consumers prefer to build with reinforced concrete blocks, which have better strength and are ecologically less damaging. Also, traditionally, engineering documents were created and then given to the contractor to re-draw. Now, there is a shift to have it all in-house, from engineering to coordination, creating a one-stop shop.

Commercial complex construction is similar to other parts of the world, with steel beams being used as the underlying structure and using concrete, glass and prefabs to build the rest of the structure. The trend in commercial construction is shifting from art-deco construction styles to modern glass fronted buildings that are more energy efficient and easy to build and maintain.

Savings Resulting From the Usage of New Age Building Materials

Prefabricated walls have quite a few benefits. The most important benefit is the reduction in construction time, resulting in a quicker return on the capital invested. In addition, thermal and acoustic insulation, as well as air-tightness can be achieved using advanced materials such as sandwich-structured composites. This leads to savings in cooling and heating costs of about 25 percent of the cost of the prefabricated wall per year.[13]

Cost of land and House Prices

There is a lot of variation in the value of land price as a percentage of the house price. In the major cities like New York, Los Angeles and Chicago, this number is usually around 40-60 percent but in smaller cities, it is usually around 20-30 percent.[14] There are two opposing forces acting here, wherein the house can be manufactured at a lower cost in smaller cities, but at the same time, the value of the land is also less. Many cities saw a marked decrease in the value of land, post 2008 crisis.

Loan Pricing

Loan to Value

Standard Loan-to-Value (LTV) ratios for USA are up to 80 percent for loans conforming to the Fannie Mae and Freddie Mac[15] underwriting guidelines. Conforming loans above 80 percent are allowed but must include private mortgage insurance.

US Mortgage Product and Term Ranges

Most mortgages in USA are Adjustable Rate Mortgages (ARMs), where the rate is some benchmark (LIBOR, COFI) plus margin. Fixed Rate Mortgages, as well as Hybrids are also popular. The fixed rate mortgage term is usually up to 30 years, although longer terms are also offered in certain circumstances.

---

[13] LaFarge Precast Solutions FAQ: http://www.lafarge-na.com/wps/portal/na/en/3_E_2_11_4-FAQ
[14] Lincoln Institute of Land Policy – Metro Area Land Price Data, Q1, 2013
[15] Evolution of Freddie Mac and Fannie Mae is presented in Annex-1.

Underwriting Criteria

Underwriting takes place based on the analysis of the credit report, income and the collateral being placed. Depending on the nature of occupancy and type of collateral, the lender decides the extent of risk it is confortable taking. Many lenders underwrite their conditions only based on guidelines, but to ensure the eligibility to be purchased by Fannie Mae and Freddie Mac, underwriters utilize what is referred to as "automatic underwriting". This helps them identify the amount of risk involved and helps them figure out the amount of documentation required.

Corruption

Corruption has been found to be widespread in the housing sector in the US. Findings from a Transparency International survey in 2009 suggest that service-level bribery is prevalent in the government entities in-charge of overseeing the real estate sector. [16]

Affordable Housing Schemes

The criterion to define an affordable house in the USA is that the annual spending on housing should not exceed 30 percent of the household's gross income. Households exceeding this limit are considered to be living under a burden that might affect their general standard of living. The US government gives subsidies to make housing more affordable. Mortgage interest is tax-deductible in the US. Housing assistance in the US is of 3 types:

a) Tenant based: subsidies to individuals
b) Project based: subsidies to owners whose rental clients are lower income households
c) Public housing: operated by the government

The "Home" program seeks to provide housing to individuals having low incomes, through grants to individual states. In 1990, the Home program was made a part of a law titled Cranston-Gonzalez National Affordable Housing Act. To date, over 450,000 affordable houses

[16] Consumer Advocates in American Real Estate (CAARE) is a non-profit organization dedicated to safeguarding consumers' interests by providing a fair atmosphere for them to make deals. They seek to remove conflicts of interest from the residential real estate process.

have been developed and over 84,000 renters have been provided assistance under this program.

Another program called the Self-Help Ownership Program (SHOP) has empowered various non-profit organizations to develop infrastructure in order to setup affordable housing for low-income families.

Also, the Home-ownership Zone program helps communities develop vacant land in order to rehabilitate low-income families.

Competition

There is considerable competition in the US housing market with a large number of builders who compete for customers. A firm called 'O'Brien Homes' recently came up with a lottery system to allocate houses in a recent development in California,[17] as a result of intense demand for houses. There have been many IPOs by real estate developers in the recent past, signaling intense competition and a possible return to bullish real estate markets, particularly in the state of California. The lenders in the financial system used to compete among themselves to provide mortgage loans thus providing better terms and lower rates to buyers.

Scams

Scams are mostly common in the rental market in the US, with bogus houses being advertised on popular sites like craigslist.com. The US government has had to issue an advisory to the citizens, asking them to beware of such schemes.[18] The schemers lookup the information about the property and list it on their own site, mostly at a lower rate. There is usually some kind of small token amount involved, which is said to be refundable. In addition, there are foreclosure and mortgage rescue scams, which ask for a counseling fee for modification of a delinquent loan. Again, the US government has issued detailed advisory to help people not get trapped in such schemes.

[17] "Builders hold lotteries for eager new homebuyers" – CNN Money, April 30, 2013
[18] Office of the Comptroller of the Currency Consumer Tips for Avoiding Mortgage Modification Scams and Foreclosure Rescue Scams, April 21, 2009

Land Use Laws

Land-use changes have important economic and environmental implications for any society. Urban land area quadrupled from 1945-2002 in the USA, increasing at double the rate of population growth in this period. There are major laws that restrict the usage of land for residential purpose. These are:

1. National Historic Preservation Act, 1966 – This is mainly focused at preserving historic and archaeological sights, stating that the areas included in the National Register of Historic Places and the list of National Historic Landmarks cannot be used for any private development.
2. National Environmental Policy Act, 1969 – This has set up procedural requirements for all government agencies to provide the impact on the environment for any approved project.
3. Forest Reserve Act, 1891 – Areas designated as “wilderness” by the US Congress prohibits logging, mining, road and building construction and cannot be leased.

Zoning

Zoning is a technique used in most developed countries to promote effecting land usage in urban areas. It incorporates designating permitted uses of land based on zones as defined by the district authorities (councils and municipalities). These zones separate one set of land uses from another. Practically, zoning is done to prevent new developments from interfering with existing residents or businesses. In the USA, land held under the federal government is off limits for the state planning commissions.

In the USA, residential zones are sub-categorized as:

1. Residential places containing units where the occupants are transient in nature (boarding houses, hotels, motels)
2. Residential places containing units where the occupants are permanent in nature (apartment houses, boarding houses, convents, dormitories)

3. Residential places where the occupants are permanent in nature and not classified (adult care facilities for five or fewer persons for less than 24 hours)
4. Residential places where the buildings are arranged for occupancy as residential care/assisted living facilities including more than five but not more than 16 occupants

Zoning in the USA has evolved over years. There are four major approaches to zoning:

1. Euclidean Zoning: Segregation of land into separate geographic areas, with limitations on development activity in each district. This is more effective, easy to implement and has a long-standing legal precedent.
2. Performance Zoning: Uses performance-based or goal-oriented approach to zoning. It is known to be a more rational approach, with higher transparency and accountability.
3. Incentive Zoning: It uses a reward-based system that rewards developments that meet predefined goals. It establishes minimum requirement criteria and then rewards the developers that go over and above it. It was first used in Chicago and New York City.
4. Form-based Zoning: It does not regulate the type of land use, but the form the land may take in future. It is known to be the most flexible system.

Section 5: Some Related Facts on India[19]

India suffers from a chronic shortage of nearly 19 million units in 2012 mainly in urban areas as per the estimates prepared by the Government of India. The shortage is mainly for the economically weaker section of the society and due to congestion of existing dwelling units and partially due to homelessness. The shortage has been acute since 2001 owing to increase in levels of income younger earning age group, rapid urbanization, and nuclearization of families in India. The shortage has reflected significantly in the prices of houses across the country. The housing price indices released by the National Housing Bank and the Reserve Bank of India cover only a few cities and are limited in scope. The country also has incomplete information in the Indian housing market as there is lack of data base about mortgages, transparency in transactions, proper loss on land and land transferability and utilization of scarce urban land. There is also lack of research on appropriate housing material required to build houses given different environment, geographical locations, soil types and climate zones in the country.

The last two sections have focused on the US and Spain and based on the experience of these two countries some lessons can be drawn for India. This section examines the existing housing market, infrastructure and identifies gaps where some reforms can be undertaken.

Development of a Housing Complex

Land use in India is divided into three types, agricultural, residential and industrial with each having its specific use. Conversion from one land type to another can be done in most cases by paying a fee to the government.

The land records are kept in a document called “khata” which is usually obtained from the government in a process lasting 90 days usually. After the land records have been retrieved and the land converted to appropriate use type, the decision for outright development or joint development is taken. The plan is subsequently prepared and submitted to the appropriate local body. For high-rise buildings (classified as 3 or more floors) special permission has to be taken from water and electricity authorities separately.

[19] This section has benefitted from discussions with real estate researchers, agents and builders in Bangalore.

Depending on the road width that adjoins the property, the developer is granted a certain Floor Area Ratio (FAR) for the plan. For example if there is a 30 feet road adjoining the property, the developer is granted a FAR of 1.75 of the plot area. The developer is expected to adhere to the plan entirely. As there are a multitude of licenses to be obtained from various statutory bodies, even the delay in obtaining one of these licenses can stall a project, wrecking a builder financially.

The time taken to complete a residential project depends on the size and complexity of the project. For the smallest project of sizes ranging from 75000 to 1 lakh square feet, a time of 12-18 months is usual. For a project ranging from 1 lakh to 2 lakh square feet, 18-24 months is the time usually taken and the for projects above 2 lakh square feet 2-4 years is the usual time duration.

Post-development Procedures and Sales

After the project is completed, the authority of the area concerned issues the mandatory occupancy certificate after undertaking usual inspections. The authorities concerned provide amenities such as sewerage and electricity. Without the occupancy and fire safety certificates, no “khata” will be issued for the property.

Sales and marketing of the project happens in three ways:

a. Direct sales by the builder - the client deals directly with the builder and pays as per project completion.

b. Sales through agents - agents bring in the prospective buyer and receive a 2 percent commission on the purchase consideration from the builder and the client pays the amount as per project completion.

c. Sales through underwriting - these are entities who have financed the project initially; the underwriter receives a pre-determined number of flats at a pre-agreed price and sells them to get his profit; low and mid end projects are usually financed through banks and high end projects are financed through underwriters.

Price indices

At present, RBI and NHB develop indices for housing prices. Also, the index is being developed only for residential housing sector. However, at a later stage, based on experience of constructing this index for a wider geographical spread, the scope of the index could be expanded to develop separate indices for commercial property and land, which could be combined to arrive at the real estate price index.

NHB's RESIDEX is based on data of housing prices being collected from real estate agents by commissioning the services of private consultancy/research organizations of national repute; in addition data on housing prices is also being collected from the housing finance companies and bank, which is based on housing loans contracted by these institutions. It now covers six new cities from the quarter January-March, 2013, taking the total to 26 cities. The proposal is to expand RESIDEX to 63 cities, which are covered under the Jawaharlal Nehru National Urban Renewal Mission to make it a truly national index, in a phased manner. It is envisaged to develop a residential property price index for select cities and subsequently an all India composite index by suitably combining these city level indices to capture the relative temporal change in the prices of houses at different levels.

The indices released by the two regulators sometimes indicate contradictory signals to the market, which probably could be explained by difference in coverage or methodology. The RBI's HPI based on registration prices has some limitations. There is a perception that registration price is not the actual price paid by a buyer. It is argued that registered prices of houses are in general underestimated due to high registration fees and stamp duty; obligations for the payment of property tax; and time gaps between the actual transactions and registrations also do not always follow the similar pattern across different states. Moreover, registrations of the properties are done taking into account different criteria in different states, which necessitates further work with respect to bringing them into a common format.

Innovations in the Indian Housing Market

In India, the MBS market is almost absent and hence banks keep carrying interest rate risk on their books leading to greater spreads and hence higher interest rates. However, the Indian MBS market is slowly picking up.

A recent trend has been the initiation of collective buying schemes. Many buyers are coming together, mostly through social platforms and websites,[20] and demanding better deals and better services from developers.

Moreover, real estate Private Equity firms are forming joint ventures with developers and actively funding projects. This also works on the confidence of the buyer and acts as a positive signal of a good project.

Use of Building Materials

India has historically been very conventional in terms of the construction of buildings, but this is rapidly changing. As the country is developing and more and more awareness is spreading regarding the importance of eco-friendly practices, the construction industry is seeing a paradigm shift. Also, the use of pre-fabricated building material is increasing, as this is cheaper and leads to quicker completion of projects.

Prefabricated materials such as wall and terrace blocks, panels, steel frames and plaster boards are being extensively used, along with accompanying technologies like dry-wall technique. Entire buildings are being designed using advanced software and are being subjected to various tests in simulated environments. Prefabricated materials, though around 15-20 percent costlier,[21] offer higher efficiency, less wastage, lower maintenance costs and most importantly, lower air-conditioning costs. They also eliminate the need for plastering, electrical wiring and plumbing as these are done at the casting site itself.

Many banks, including the National Housing Bank are offering incentives on loans for investment in certified eco-friendly buildings.

---

[20] SnapGhar.com, GrOffr.com, etc.

[21] "Ready-made homes". Business Today magazine, February 2012.

Cost of land and housing prices

Land being an important component of housing is scarce in the urban areas. According to anecdotal estimates cost of land as a percentage of final price of house, ranges widely between different cities, and even between cities, generally accounting for about 50 per cent in cities like Surat, 80 per cent in Bangalore and 90 per cent in Mumbai. The price of land can have substantial variance within the city and across the country (Chakravorty, 2013). There is a lack of land records, and titling system.

Housing Finance

Liability of banks is essentially short term in nature but the assets that they have are long term in nature. Specialized housing finance companies like LIC-HFL (biggest player in India), HDFC and DHFL have both the asset and liability books that are long term. Thus, it is widely believed that banks and housing finance companies should not be brought under one-size-fits all regulator.

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.

The Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI), a Government Company licensed under Section 25 of the Companies Act, 1956 has been incorporated for the purpose of operating and maintaining the Central Registry under the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The objective of setting up the Central Registry is to prevent frauds in loan cases involving multiple lending from different banks on the same immovable property. This Registry went operational on March 31, 2011. All transactions involving creation of equitable mortgage by deposit of title deeds, asset reconstruction and creation of security interest made on or after March 31, 2011 were registered with CERSAI.

Information furnished to CERSAI includes particulars of the property, nature of encumbrance, institution with which property is mortgaged, etc.

SARFAESI's Central Registry does not operate as an effective, efficient notice of security interest. There are many disparate registries (Registrar of Companies, Patents Registry, Trademarks Registry, Motor Vehicle Registry, and Industrial Design Registry). The Central Registry does not replace these other registries. Moreover, registration at the Central Registry is not dispositive; a third party whose interest is registered in one of the other registries maintains rights to the collateral. Thus, a creditor must search several registries to ensure his rights.

Challenges

The greatest challenge is the process of price discovery. In India, in residential property, there is no dearth of demand. But, the price expectation of developers and affordability of buyers is not matching. Hence, according to experts, if developers reduce price and settle for a lesser profit, India will never have unsold residential inventory or oversupply. The actual scenario is very different. Developers keep expecting higher costs irrespective of market cycles and that is why they don't reduce the prices to keep their inventory at a higher cost.

The real estate and housing sector are largely unregulated, opaque, and marred with asymmetric information. The ad hoc pattern of real estate development, reflected in mushrooming of unregistered colonies, and unplanned utilization of scarce urban land have been some challenges of urbanization.

Loan Pricing

Loan to Value

Loan-To-Value ratio limited to 80 percent for residential loans; increase in risk-weights of housing loans (above Rs. 7.5 Million) to 125 percent.

Term

The maximum tenor for retail home loans sanctioned by banks varies from 20 years to 25 years while the minimum tenor varies between 1 year and 2 years with the average tenor ranging between 8 years and 16 years. A few banks extend loans to housing companies, co-operatives and building societies with a maximum tenor of 10 years. In the case of HFCs, the maximum tenure of loan is 15 years and for the cooperative sector is 5 years.

Interest Rates

The interest rates charged on home loans could be fixed or floating but in general HFCs charge higher rates of interest. There is no uniform reference rate for floating interest rates across the banks. In most banks, Prime Lending Rate (PLR) of the bank is the reference rate for the floating rate. In others, whenever there is a review of PLR and/or risk weights, floating rate on housing loans is also reviewed. These rates could be reset based on the cost of funds and reprised on a quarterly/semi-annual/ annual basis. In general, the rate of interest is decided on the basis of cost of funds, operating expenses and profit margin. Approximately, 80-90 per cent of outstanding housing loans are on floating rate basis, however the range varies widely between banks from 60 per cent to 90 per cent, and some banks grant loans to real estate only under floating rates.

Standard Documentation Required

There is no standardization of the documents that are required for seeking bank finance nor is there any regulator of housing. Consequently, list of required documents for securing loans from the financial institutions varies across banks, and also depends on the city/state and the type of property.

Corruption

A study by Transparency International in India estimates that about Rs. 3,126 crore worth of bribes are paid on an annual basis by users of the country's land administration services.[22] Up to 30 percent of the cost of a house is because of the bribing and greasing costs. These costs come at all levels: starting from plan approval, site approval, bank loan grant, building inspection, provision of amenities such as electricity, drainage and water till the registration and mutation in the name of the buyer. Also, many builders necessarily ask for some part of the down payment to be in cash, and it is a common practice to quote the amount less while the transaction is of a higher amount. This serves as an avenue for money laundering and helps save tax for both the builder but for the buyer as well.

Due to the complex approval process and procedure, everything comes down to time and if one leaves everything to happen the procedural way it might take forever to complete. The developers put some value on time and hence most of the money that goes underhand to get approvals in a timely manner and undoubtedly to get approval on a case-to-case basis for deviations and that is what adds to the project cost.

This greasing of palms discourages low cost housing as even for a low cost housing project, the bribe to be paid is the same as in a premium unit and hence builders make larger profits on premium constructions.

Land Use Laws

There is also lack of appropriate land laws for acquisition for the purpose of housing. In absence of appropriate laws for acquiring land for housing, there have been instances where government agencies have procured land from farmers at low rates and auctioned it to real estate developers at very high rates. This not only adds cost to housing but also leads to protracted litigation and delays.

---

[22] India Corruption Study to Improve Governance, 2005 by Center for Media Studies. Issued by Transparency International India, pp 13.

Section 6: Summary and Conclusions

Studying the development of the real estate markets of Spain and the USA, and comparing them with the Indian scenario, it is clear that the Indian market needs to develop. Most importantly, there is a clear need to standardize the procedures for transactions in housing, ensure transparency and uniformity in procedures, set up regulatory processes and develop institutions that can help develop the housing markets.

Some of the learning that might apply to the Indian market is as follows:

1. A lot of time is wasted in red-tapism and in addressing the legal aspects of the whole home building/buying process. In contrast to the developed markets, where things are mostly done in a systematic and time-bound way, time is not given that much importance in India, with the process for taking permits at various levels taking a lot of time.

2. 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 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.

3. The mortgage securitization market is not as developed in India. The securitized assets market in the US is about 20 percent of all debt outstanding, whereas for India, this figure is around 2 percent. Securitization can help the housing finance companies in India generate funds out of the MBS market and this will have a two-fold benefit: it will help them focus on business generation, and this will also help bring the loan rates down. To develop the financial markets, introduction of REITs would also be useful, as argued by Singh (2013b). There is also a need to develop housing indices as discussed in Singh (2013a and 2013c).

4. Prefabricated construction material is still not so common in India. In a country that suffers from extreme weather conditions, this can help in a number of ways. This will bring the construction time down, as well as provide saving on air-conditioning of the constructed houses. In times when "going green" is a mantra that is being followed widely, in addition to the government providing incentives to "green" projects, this can provide enormous economic benefit.

5. India could consider importing raw materials, pre-fabricated walls, doors, windows, ceramic products, and plumbing material through easily available shipping. In addition to raw materials, India could also consider importing wooden fittings, given that India has poor forest cover. India can also import technology and know-how to build 1,000 apartments in one building with centralized facilities, even if necessary, including air conditioning. The US also has experience in building affordable housing for the poor and India can take advantage of that too. This scheme can help in spurring growth in our economy.

6. The Housing Price Index is being released by NHB and the RBI. The index prepared by the NHB is more extensive though it comes with a lag. While the Index prepared by the RBI has an all-India figure, which NHB does not release. The indices released by the two institutions are not always similar and therefore, the usefulness to the consumer is impacted. There probably is a need to have a housing index by a single authority, like the wholesale price index, which is released faster than the Consumer Price Index and is indicative of the price trend.

7. Finally, the focus in real estate development in India has been on the development of houses, not communities. With the exception of a few prominent builders who take a holistic approach, most builders have been keen to construct just buildings. There have been problems of improper connectivity to those buildings with improper roads, which are usually waterlogged during the rainy season. Electricity and water supply are also major issues with every building having to arrange for generators and water tankers on a large scale.

References

Allen, F. and Carletti, E. (2009). *An Overview of the Crisis: Causes, Consequences and Solutions.* International Review of Finance, 10(s1), pp. 1-26.

Angloinfo – The Global Expat Network (2012). *Buying a home in Spain*.

Arku G. (2006). *The Housing and Economic Development Debate Revisited: Economic Significance of Housing in Developing Countries*. Journal of Housing and the Built Environment, 21, pp. 377–375.

Bordo D M and Jeanne, O. (2002). *Boom Busts in Asset Prices, Economic Stability and Monetary Policy*. BIS WP 8966.

Browning, L. (2010). *New Lending Guidelines from Fannie Mae.* NY Times Real Estate, 11/21/2010.

Buiter, W, H. (2008), *Housing wealth isn't wealth,* London school of Economics and Political Science.

Cardazo, P. D. (2011). *Housing The Engine Of Growth*. Can Fin Homes Limited Report.

CERA Week (2009). *Roubini, Rogoff and Behravesh Discussing the future of the Global Economy.*

Chakravorty, S. (2013), *A New Price Regime Land Markets in Urban and Rural India*, Economic & Political Weekly, Vol XL VIII No. 17.

Chen, J., Guo, F. and Zhu, A. (2011). *The Housing-led Growth Hypothesis Revisited.* Urban Studies, 48(10), pp. 2049-2067.

CMS Albiñana & Suárez de Lezo (2012). *Comparision of Main Tax and Regulatory Aspects Concerning Spanish Real Estate Investment Vehicles*. Company Report.

Congressional Budget Office (2010). *Fannie Mae, Freddie Mac and the Congressional Role in Secondary Mortgage Market.*

Crowe, C, G.D'Ariccia, D.Igan and P.Rabanal (2011), *How to Deal with Real Estate Booms: Lessons from Country Experiences*, IMF, WP/11/91.

Cuchi, A. and Sweatman, P. (2011). *A National Perspective On Spain's Buildings Sector - A Raodmap For A New Housing Sector.* Working Group For Rehabilitation "GTR" 11/2011.

Demyanyk, Y., and Hemert, Otto Van. (2008). *Understanding the Subprime Mortgage Crisis*. NYU Stern School of Business Working Paper, 09/2008.

Deniz, I and Loungani, P (2012). *Global Housing Cycles*. IMF WP 12/217.

Deniz, I and Loungani, P (2010), Dismal Prospects for the Real Estate Sector, WEO, IMF, October 2010.

Fagan, C. (2011). *Corruption In the Land Sector.* Transparency International WP 04/2011.

Federal Reserve Bank of New York (2010). *Staff Report.*

Government of India. (2003). *Economic Survey, GOI 2002-03.*

Green, R. (1994). *Measuring the Effcts of Home Owning on Children.* Centre for Study of the Economy and the State – The University of Chicago WP no. 94, 02/1994.

Herrero, AG. (2003). *Financial Stability and the Design of the Monetary Policy.* Banco de Espana Report.

International Monetary Fund, (2011). *Housing finance and financial stability – Back to basics?* World Economic Outlook.

Jain, S. C. (2003). *Housing and GDP.* LIC Housing Finance Report.

Knight Frank. (2013). *Spain Paves the Way for Greater Foreign Investment in Property Market.* Global Briefing 06/2013.

Loungani, Prakash. (2008). *House Prices Compunding Crisis.* IMF World Economic Outlook, October 8, 2008.

McGraw Hill Smart Market Report (2011). *Prefabrication and Modularization: Increasing Productivity in the Construction Industry.*

Mei, J. and Saunders, A. (1997). *Have US Financial Institutions' Real Estate Investments Exhibited "trend-chasing" Behavior?* The Review of Economics and Statistics. Vol. 79, No. 2, May, pp. 248-258.

Muellbauer, J. (2007), *Housing Credit and Consumer Expenditure*, Federal Reserve Bank of Kansas City.

National Housing Bank. (2012). *Annual Report*, *NHB.*

Nasarre-Aznar, D. S. (2002). *The Funding of the Mortgage Loans in Spain by Issue of MBS and their Legal Structure.* Housing construction - an interdisciplinary task, pp. 347-354.

Naylor, Thomas H. (1967). *The Impact of Monetary and Fiscal Policy on the Housing Market.* Law and Contemporary Problems, 01/1967.

Phalgunan, P. (2013). *HFCs cannot be managed like Banks.* Outlook Money, pp. 24-25.

Pidal, C, J, M. Lampe and J. R. Rosés (2011), *Spanish Housing Markets during the First Phase of the Rural-Urban Transition Process,* Working Papers in Economic History, WP 11-08, Universidad Carlos III de Madrid.

Pozdena, R. (2010). *Housing and the Economy – a new paradigm?* Center for Real Estate Quarterly Journal, vol. 4, no. 3. Summer 2010.

PWC (2012). *Emerging Trends in Real Estate 2012.* PWC, Urban Land Institute.

Sethuraman, S. V. (1985). *Basic needs and the Informal sector: The case of low-income housing in developing countries.* Habitat International, 9(3/4), pp. 299–316.

Singh, Charan (2013a). *Housing Market in India – A Comparison with US and Spain.* IIM Bangalore WP No. 406, May 2013.

Singh, Charan (2013b). *REITs: A Need for developing Housing Markets in India.* IIM Bangalore WP, Nov 2013 - forthcoming

Singh, Charan (2013c). *Housing Price Indices in India – A need to reform.* IIM Bangalore WP, December 2013 - forthcoming

Shachmurove, T. (2011). *String of Defaults: Spanish Financial Crises through the Years*. The IEB International Journal of Finance No. 2 , 1-20.

Song, Y., Liu, C. and Langston, C. (2006). Linkage Measures of the Real Estate Sector Considering the Effects of Capital. International Journal of Strategic Property Management. 2006. Vol.10, Iss. 3.

Sridhar, V. (2002). *Securitization in India.* IIM Calcutta Discussion Paper.

Strassmann, W.P. (1970). *The Construction Sector in Economic Development*. Scottish Journal of Political Economy 17, pp. 391-409.

Taylor, John B. (2008). *Housing and Monetary Policy.* NBER Working Paper Series.

Ternes, Mark P. (1994). *Cooling Benefits from Exterior Masonry Wall Insulation*. Home Energy Magazine 04/1994.

Transperency International and Centre for Media Sudies (2005). *India Corruption Survey.*

Treisman, Daniel. (2000). *The Causes of Corruption: A Cross National Study.* Journal of Public Economics, 76, 3, June 2000, pp. 399-457.

US Census Bureau (2010). *Residential Vacancies and Home Ownership Report.*

US Department of Housing and Development (1997). *Buying Your Home.*

Wall Street Journal (2010). *Cut Your Closing Costs.*

Smyth, Sharon and Urban, Rob (2013). *Spanish Banks Cut Developers as Zombies Dying: Mortgage: Interview With Raj Badiani, Economist, IHS Global.* Bloomberg, 20 March 2013

Annexure 1

Timeline of Fannie Mae and Freddie Mac

Fannie Mae

- 1938 - Formed in 1938 as part of the "New Deal" to provide local banks with funds to finance mortgages, to promote affordable housing, thus creating a liquid secondary mortgage market
- 1954 - Partly privatized, followed by complete privatization in 1968 to remove its activities and debts from the federal budget; split into Fannie Mae and Ginnie Mae – still under government control and responsible for veterans' and farmers' mortgages
- 1970 - Authorized by the government to purchase secondary mortgages, along with competition from Freddie Mac
- 1992 - Mandated to meet "affordable housing" goals under Housing and Community Development Act
- 1999 and early 2000s - Under pressure from the Clinton government to meet requirements of low and middle income households by easing credit criteria
- 2007 – Shift towards riskier mortgages in order to maintain earnings levels of the times of very low interest rates, along with growth of private securitization and low regulation
- 2008 – Subprime mortgage crisis, shares of Fannie Mae tumbled 90 percent, US government considered takeover amidst bankruptcy fears as Fannie Mae and Freddie Mac had guaranteed about half of the $12 trillion mortgage market; Fannie Mae and Freddie Mac were placed into the conservatorship of FHFA
- 2010 – Stock delisted from NYSE, Obama government holds conference to discuss future
- 2013 – Announced $53.4 billion dividend to the US government, calls from financial institutions and industry to privatize

***Freddie* Mac**

- 1970 – Established, to provide competition to the newly privatized Fannie Mae and to make the housing loan market more liquid, through the Emergency Home Finance Act

- 1989 – Through the Financial Institutions Reform, Recovery and Enforcement Act, Freddie Mac's ties to the Federal Home Loan Bank System ended and it came under the supervision of the US Department of Housing and Urban Development
- 1990s and 2000s – Freddie Mac began providing easy loans and started buying subprime securities
- 2007 – Freddie Mac was ranked 50 in Fortune 500 and 20 in Forbe's 2000
- 2008 – Freddie Mac was put under the conservatorship of the US government after the subprime mortgage crisis hit the company hard
- 2013 – Freddie Mac reports profits for seven consecutive quarters, and reported its second largest profit in history for Q2, 2013

Annexure 2

Standard Documentation for Buying a House

Spain

- Employed Applicants:
  - 3 months’ pay slips
  - 3 month bank statements
  - Employer’s reference
  - Identity proof
- Self-Employed applicants:
  - Tax returns
  - Accountant’s reference
  - 3 month bank statements
  - Identity proof

USA

- Credit Report
- 1003 — Uniform Residential Loan Application
- 1004 — Uniform Residential Appraisal Report
- 1005 — Verification Of Employment (VOE)
- 1006 — Verification Of Deposit (VOD)
- 1007 — Single Family Comparable Rent Schedule
- 1008 — Transmittal Summary
- Copy of deed of current home
- Federal income tax records for last two years
- Verification of Mortgage (VOM) or Verification of Payment (VOP)
- Borrower's Authorization
- Purchase Sales Agreement
- 1084A and 1084B (Self-Employed Income Analysis) and 1088 (Comparative Income Analysis) - used if borrower is self-employed
- Tax returns
- Accountant’s reference
- 3 month bank statements
- Identity proof

Annexure 3

Terms under HUD Terms of Agreement of Sale in the US

- *Sales Price*: The sales price is the most important term, in addition to other non-monetary terms of the agreement.
- *Title:* "Title" refers to the legal ownership of the house. Ideally, it should be provided by the seller clear of all claims by others. Claims by others are known as "liens" or "encumbrances."
- *Mortgage Clause*: The agreement of sale should have a clause that the deposit would be refunded if the sale the buyer is unable to get a mortgage loan at a rate specified in the agreement, resulting in cancellation of the sale.
- *Pests*: The lender will require an all-clear certificate from a qualified inspector stating that the home is free from termites and other pests and pest damage. Further, the buyer needs to reserve the right to cancel the agreement or seek immediate treatment and repairs by the seller if pest damage is found.
- *Home Inspection*: An inspection should determine the condition of the basic amenities in the house like plumbing, heating, cooling and electrical systems. Moreover, the entire structure should be examined to assure it is of proper quality and to determine the condition of the roof, siding, windows and doors. In addition, it should be ensured that water does not drain toward the house and into the basement.
- *Lead-Based Paint Hazards in Housing Built before 1978:* In case of houses built before 1978, the buyer has a right covering lead-based paint and lead poisoning hazards. The seller must provide the buyer with the EPA pamphlet "Protect Your Family from Lead in Your Home" or other EPA-approved lead hazard information, and give him any relevant records or reports.
- *Other Environmental Concerns:* Most cities have laws requiring buyers or sellers to test for environmental hazards. These can range anywhere from leaking underground oil tanks, presence of radon or asbestos, lead water pipes, and other such hazards. The law requires cleaning up of any such hazards.