# Financing Affordable Housing

*Charan Singh*

***...as housing finance is an important issue for national economy, there is need to strengthen housing related institutions like HUDCO, NHB and NBO, and encourage them to undertake extensive research on housing developments in India. Similarly, the Central and state governments need to prepare plans for housing finance as a booming housing sector can ensure a strong national economy while a bust leads to recession, unemployment and disaster***

Housing is an important sector for any economy as it has inter-linkages with nearly 270 other industries. The development of housing sector can have direct impact on employment generation, GDP growth and consumption pattern in the economy. To help develop housing in the country, there is need to have a well-developed housing finance market. In India, housing finance market is still in its nascent stage compared to other countries. The outstanding amount of housing finance accounts for around 8 per cent of GDP in India as compared with 12 per cent in China, 29 per cent in Malaysia, 46 per cent in Spain and 80 per cent in the US.

The housing finance market is expected to increase with urbanization. In India, urbanization is progressing rapidly and is expected to increase from 31 per cent in 2011 to nearly 41 per cent in 2030 or a little more than 600 million persons would be living in urban areas from about 360 million people in 2011. Therefore, a major policy concern for India is widening gap between demand and supply of housing units and consequent need of housing finance solution. Affordable housing is critical for the country for a balanced and sustainable funding model. The existing market oriented model largely caters to high income segments. In contrast, for economically weaker sections (EWS) and low income group (LIG) as well as slum dwellers, access to institutional sources of finance are almost lacking.

In India, housing finance market is very complex when analyzed in context of demand and supply of housing units, especially in face of scarce land in urban areas. The demand for housing expands with increasing level of economic prosperity. The supply of houses have to come from builders, developers and construction companies scattered widely across country, both in private and public sector. The government, both at Centre and states, is a facilitator and is assisted by two regulators, Reserve Bank of India (RBI) and National Housing Bank (NHB). The housing finance market is dominated by commercial banks, both domestic and foreign. In addition, there are cooperative banks and housing finance companies, self-help groups, micro-finance institutions, and NGOs. The RBI regulates commercial banks and partially cooperative banks (which are mainly governed by State Governments) while NHB regulates housing finance companies.

## Affordable Housing in India

The affordable housing policy in India dates back to rehabilitation of refugees immediately after independence. In 1957, village housing programme was introduced to provide loans to individuals and cooperatives.

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Later, in early 1970s, housing-sites-cum-construction assistance was introduced which was transferred to state governments in 1974. Indira Awas Yojana formally introduced in 1985 had its origin in earlier schemes of rural and landless employment launched in 1980 and 1983, respectively. The Central government recently launched *Housing for All by 2022* (HA-22) on June 25, 2015. The target is to provide 2 crore additional houses by 2022 in urban areas. In rural areas, HA-22 was launched on April 1, 2016 with the objective to support nearly 3 crore pucca houses by 2022.

Affordable housing includes Pradhan Mantri Awas Yojana (PMAY) for rural and urban India. It includes - *in-situ* rehabilitation of existing slum dwellers using land as a resource through private participation; credit linking subsidy for EWS and LIG (Box–1); affordable housing in partnership with private or public sector including parastatal agencies; subsidy for beneficiary-led individual house construction/enhancement for individuals of EWS. PMAY is being implemented by providing central assistance to urban local bodies and other implementing agencies through states and union territories.

## Role of Institutions

The role of Government has switched from that of a provider of housing units to more of a market facilitator. Historically, Five Years Plans starting from 1951 had assigned housing sector a prominent place in the economy. Therefore, National Buildings Organization (NBO) was established in 1954 and Housing and Urban Development Corporation Ltd. (HUDCO) in 1970 to comprehensively deal with problems of housing shortages. National Housing Bank was established in 1988 to function as a principal agency to promote housing finance institutions.

The Central and state governments have been offering tax concessions for housing sector. Several state governments have passed legislations to safeguard interest of lessors, encouraging construction of properties for rent. The government has also opened up real estate sector to Foreign Direct Investment (FDI), wherein 100 per cent of FDI in townships, built-up infrastructure, construction development projects and real estate through automatic route has been permitted.

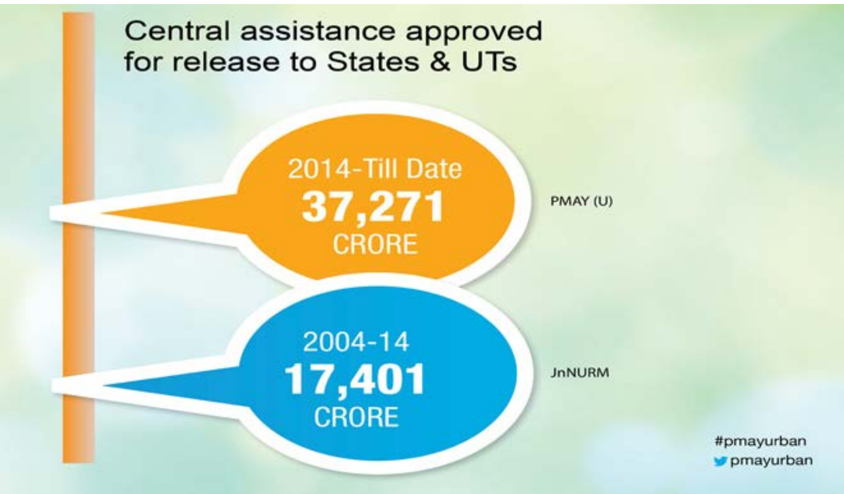
The RBI has initiated several measures in housing sector and requires commercial banks to lend a stipulated amount of incremental deposits to housing under priority sector which includes financing individuals and others, including co-operatives. The RBI also reckons investments made by banks in bonds issued by specific housing companies under priority sector lending. Other measures like investment made by banks in Mortgage

### Box - 1: Credit Linked Subsidy Scheme

In line with PMAY's (Urban) HA-22 mission, a Credit Linked Subsidy Scheme (CLSS) has been launched for EWS and LIG, as well as middle income group (MIG). The CLSS aims to augment demand for houses in India. The scheme aims at construction or acquisition of property or incremental addition of rooms, toilets and kitchens to existing residences. It provides an interest subsidy of 6.5 per cent in case of EWS / LIG and 4 per cent in case of MIG with income less than Rs. 12 lakh (MIG 1) and 3 per cent for MIG with income ranging between Rs. 12 – 18 lakh (MIG 2). The maximum amount of loan for subsidy calculation is Rs. 6 lakh for EWS / LIG, Rs. 9 lakh for MIG 1, and Rs. 12 lakh for MIG 2.

While the scheme aims at boosting home ownership and offering affordable housing options to not just low income, but middle income citizens as well, it is also attempting to promote ownership amongst female population and weaker sections of society. For example, CLSS for EWS / LIG is given in name of household with female head or for a joint name between the male head and his wife. In case of MIG scheme, overriding preference is given to widows and single working women. In case of CLSS for EWS / LIG, preference would also be given to manual scavengers, transgender and persons with disability. The scheme operates on the intention of lowering burden of building a house while at same time, offering this benefit to a larger section of the society.

*Source: Ministry of Housing and Urban Poverty Alleviation, Government of India*




*Source : Ministry of Housing and Urban Affairs*

Backed Securities (MBS) since 2004 as flow of credit to housing, assigning lower risk weight to housing, and benign interest rate environment has contributed to increasing housing loans.

International agencies are also supporting the cause of *Housing for All*. UNDP is committed to work closely with the government on affordable housing. In case of India, World Bank has channeled resources through National Housing Bank to expand access to sustainable housing finance for LIG.

## International Experience

The housing sector has been held responsible, by a number of empirical studies, to be an important cause of recent financial crisis in the US and Europe. Housing finance has direct relationship with financial stability in the country and housing booms and busts are often associated with systemic financial stress. The recent experience of the USA, Spain, Ireland, and UK substantiates that unsustainable housing booms have led to substantial output losses and banking crisis. In fact, the trend is similar in both advanced and emerging markets. Given that housing busts are more severe and result in recession, housing finance markets deserve special evaluation.

In advanced countries housing finance markets have a history of more than 200 years like Danish mortgage lending system which dates back to 1795 and German system to 1769. In contrast, in emerging markets, housing finance is a recent development. In advanced countries main features of housing finance are covered bonds, and mortgage backed securities, with LTV ratios of 80 per cent and above, and loan term of 20 years and above. In most cases, interest rates on housing loans are flexible with pre-payment penalties. In most advanced countries, except the USA, government has a formal mandate to provide affordable housing for LIG. However, in continental Europe, there is a unique system where contractual savings are subsidized for housing loan purposes.

In case of emerging countries, main lenders in housing markets are banks, and covered bonds don't exist except in Czech Republic, Hungary, Poland, and Russia. Mortgage backed securities are rare except in Chile, Malaysia and Mexico while LTV ratios range between 60-110 per cent, and interest rates are flexible. Government support is available in most cases in terms of subsidies, tax deductions, and early withdrawals of the provident funds.

In case of advanced and emerging countries, government intervention is regular to promote home ownership. In the USA, Japan, South Korea and Germany, government supports housing finance market through subsidies. In Malaysia, government provides special mortgage liquidity facilities. In Brazil, China, Indonesia, Singapore and Thailand, government institutions are major players in mortgage market.

In different countries different schemes, instruments and policies are used to finance affordable housing projects. In countries like Denmark, Singapore and Sweden, aim is to make housing affordable for entire population. In contrast, in countries like Malaysia, Canada and US, affordable housing is meant for LIG that are excluded from traditional housing market for various reasons. In the US, federal government provides funds for all affordable schemes while in Canada, local authorities have a greater role in financing such projects. In the US, affordable housing is incentivized by government by permitting the developer to dedicate proportion of property for inclusionary housing. The market based incentives like beneficiary bonus, permit and permit waivers, and expedited application processing are offered to those developers who participate in the scheme. In Canada, government provides waivers of developmental charges as well as priority in permit for non-profit developers. In Netherlands, government has set up a special fund which acts as guarantors and provides security to housing associations. Again, in Netherlands, low income housing assistance is provided only in terms of subsidized rent while in Spain ownership of property is also subsidized.

In Singapore, government sponsors a saving scheme to finance affordable housing initiative. In Bangladesh, government supports resettlement camps, in addition to Grameen Bank and other microfinance institutions, providing housing credit in rural areas. In Mexico, mandatory contribution from salary of workers are used for affordable housing.

## Conclusion

In India, there is a gap in housing finance market which is being addressed mainly by the Central government. In recent years, financing to housing sector has been liberalized by the Government and RBI. There are a number of players in housing market but some of them are neither regulated nor supervised. The global experience suggests that house prices and housing credit are related. There is also positive relationship between LTV ratio and magnitude of house price busts confirming the fear that high leverage can adversely affect house price dynamics. However, if housing loans are originating in unregulated sector then risk is greater. Therefore, it is important that best practices, and stiff standards of supervision, regulation and risk management are established for players in housing finance sector.

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

There is also an urgent need to plan for future. India, under PMAY, would need to build/support nearly five crore houses in next five years. The CLSS scheme initiated recently is expected to generate substantial demand for houses in EWS/LIG/MIG category. This requires planning for financial resources and consideration whether substantial amount of lending would continue from banks or replaced by other sources. If other sources, then what would be these sources and who would regulate and supervise them? In this context, role of micro finance institutions and local bodies would also need to be examined. Further, this would also imply planning for production and supply of other materials like cement, steel, sand, iron, electrical fitting, wood, etc. Further, in states like UP and Maharashtra, where shortage of houses is maximum, availability of land for affordable housing would also need to be assessed.

Finally, as housing finance is an important issue for national economy, there is need to strengthen housing related institutions like HUDCO, NHB and NBO, and encourage them to undertake extensive research on housing developments in India. Similarly, the Central and state governments need to prepare plans for housing finance as a booming housing sector can ensure a strong national economy while a bust leads to recession, unemployment and disaster. ❑

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I am a regular customer of Yojana magazine published by G.O.I. I have been reading it for the last year and not a single edition I have missed till date. This magazine not only provides us information on various issues of society which are interlinked with our daily routine life but also brings awareness against many unforeseen issues which affects our life directly or indirectly and also prepares to cope up with upcoming situations with great clarity. Your recent edition on GST and other edition on demonetization introduced us to steps taken by G.O.I to augment the financial and economic condition of India in a very layman language.

I would like to request you to bring an edition on the working principle of RBI and economic system of India in a lucid manner, so that common people can understand various aspect of the same easily and grasp them without much hurdle.

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### Response from Yojana Team

Thanks for your valuable feedback on the contents of our journal. It is your appreciation that encourages and motivates us in our work.

We will definitely try to incorporate your suggestions in our journal whenever possible.

Thanks once again