Housing Finance for Lower Income Groups in India

"A step toward social well-being through an easy access to housing finance for lower income groups."

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Contents

Executive Summary

Population pressures in metropolitan areas across the world have been growing as a result of rapid industrialisation. Rising population pressure in emerging countries, combined with a scarcity of accessible resources such as land, has resulted in skyrocketed housing prices. As a developing country, India has experienced a significant growth in the number of migrations from rural to urban regions, resulting in increased demand for housing in metropolitan areas. However, there is insufficient supply of housing units to accommodate growing population, leading rise in housing costs in megacities such as Mumbai, Delhi, and Kolkata. Consequently, housing affordability has become a significant issue for low-income populations. Therefore, the purpose of this research study is to investigate the challenges that lower income groups experience in obtaining home loans, as well as to evaluate the housing finance industry in India.

The research is based on secondary data collected from government website, RBI database and world bank database. This data is analysed using statistical tool such as regression model that is employed in determining the relationship between lending interest rate on home loans (dependent variable) and Housing Price Index (HPI) in India. The inverse relationship between HPI and Lending rate implies that the lower income groups can borrow money from banking and non-banking institutions at a lower rate. This regression analysis can further be used to estimate the future values of lending rates based on housing prices.

From the data analysis and secondary information available, it is found that lower income groups lack awareness about housing finance facilities available to them and they also find it difficult to avail home loans due to inconvenient loans sanctioning processes that involves multiple stages. Therefore, it is recommended that the government needs to take appropriate measures to improve housing loans facilities available to LIGs through increasing funding amounts, convenient loan sanctioning process, use of technology in increasing awareness and improving loan disbursement process and so on.

Chapter 1

Housing Finance: Introduction

1.1. Background of the study

Affordable housing is a universal phenomenon since it is one of the major challenges faced by the population around the globe. Developed countries are facing housing shortages due to rising migration for finding better employment opportunities (migration to United States in MI-year 2020 was 50.6 million) [1] whereas housing supply shortages in developing countries is mainly due to rising population pressures. Developing countries like India, Nigeria, etc. have insufficient resources to increase housing supply to accommodate rising population. Thus, housing shortage is one of the major challenges faced by almost all the countries in the world. The shortages in housing supply leads to skyrocketed prices in urban areas making them unaffordable for lower income groups. In developing countries like India, most of the population belongs to lower income group and thus, they find it difficult to manage their housing expenditure[2]. Therefore, there is need of housing finance so that lower income groups can manage to buy houses according to their income and expenditure.

1.1.1. Housing Finance:

The term housing finance lacks universal definition. However, housing finance means providing finance for residential housing purposes and should ideally not include finance for non-residential purposes like commercial real estate. This implies that the housing finance systems aim at availing finance to households for residential construction. As per the revised regulatory framework of RBI, the term *'Housing finance' means financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units which would include (a) loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units, (b) loans to individuals or group of individuals for purchase of old dwelling units, (c) loans to individuals or group of individuals for purchasing old/ new dwelling units by mortgaging existing dwelling units, (d) lending to builders for construction of residential dwelling units, (e) loans to corporates/ government*

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[1] United States has the largest number of migrants till 2020 mainly due to the better employment opportunities and better education as well as health facilities. Source: ("International Data" 2021).

[2] Housing expenditure covers all the costs related to housing including rentals, mortgage repayments, utilities, and maintenance costs. See: Priyaranjan, S. A. (2018). Affordable Housing in India.

agencies for employee housing, etc.[3] *"* This broad definition explains that housing finance comprises loans to individuals or groups for residential housing including new construction, purchase of new land or housing units etc. Housing finance is not only for individual borrowers, but it also means financing real estate developers for construction of residential dwelling units.

1.1.2. Housing Loans:

In India, major source of housing finance is home loans. *Home loan is an amount that can be borrowed from bank or other money lending institutions at a certain interest rate which is to be paid with EMI every month.* [4] Thus, home loan is the money amount that an individual or an institution borrows from banking or non-banking financial institutions at a certain rate of interest. There are different types of home loans based on the purpose of the borrowing as well as the type of money lending institutions. Borrowers of home loans repay borrowed amount at a certain rate with EMI. This rate is known as rate of interest on home loans. There are different types of interest rate viz. fixed, floating and hybrid interest rates.

Types of home loans-

In India, the home loans are differentiated based on two main categories viz. (i) based on purpose (ii) based on type of lending institution.

i. Types of home loans based on the purpose of the borrower:

- **Loans for purchase of land**

Several institutions provide loans for the acquisition of land. Buying land is a versatile choice; the buyer may save money and build a house whenever his finances allow, or he can keep the land as an investment. Lenders such as private banks lend up to 85 percent of the cost of the land.

- **Loans for purchase of house**

The loan for the purchase of a new or used house is the most common form of home loan. This loan is also widely available and is given in a variety of forms by various institutions.

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[3] In the new regulated framework of Reserve Bank of India, the housing finance is clearly defined. *See:* ("Key Aspects of The Revised Regulatory Framework for Housing Finance Companies - Real Estate and Construction - India" 2020)

[4] *See:* ("What Is Home Loan, Types of Home Loans | Bajaj Finserv" 2021).

The interest rate can be either floating or fixed, and it typically varies between 9.85 percent and 11.25 percent. Many banks now provide loans for up to 85 percent of the entire amount.

- **Loans for construction of house**

This financing is specifically created for those who want to build a home according to their specifications rather than purchasing a pre-built home. The approval process for this sort of loan is unique in that it considers the cost of the land as well. When applying for a house construction loan, the most significant requirement is that the plot be acquired within a year for the plot cost to be included in the loan amount. The loan amount is determined using an approximate estimate of the building cost. The funds may be disbursed entirely at once or in instalments.

- **Loans for expansion or improvements in house**

Some banks also provide loans for house extension, which includes alterations to the existing structure and the building of new rooms. The HDFC Home Extension loan and the Bank of Baroda's house improvement loan are prominent in this category. External and internal repairs, painting, the building of an above water tank, and electrical restoration will all improve the appearance of your home. However, if you do not have the funds for repairs and renovations, institutions such as Union Bank of India, ICICI Bank, and Vijaya Bank provide specialist home improvement loans.

- **Home conversion loans**

People who have previously taken out a home loan and purchased a property with it but wish to move to a different home can take advantage of home conversion loans. Borrowers can fund the purchase of a new property while without having to repay the prior home loan by transferring the present debt to the new home. While it is convenient, this type of house loan is also quite costly.

- **NRI home loans**

The procedures and application procedure for this type of loan are different from the others since it is specifically designed to assist non-resident Indians in purchasing a residential property in India. In general, most commercial, and public sector banks provide NRI loans as part of their home loan portfolio.

- **Bridged loans**

Bridged Loans are short-term loans meant for existing homeowners looking to acquire a new house. It assists borrowers in financing the purchase of a new home until a buyer for the previous property is found. This sort of loan often involves a bank mortgage on a new home and is for a period of less than two years. Bridged loans are available from several institutions, including Vijaya Bank and HDFC Bank.

- **Stamp duty loans** [5]

Stamp duty loans, a relatively unknown type of house loan, are available to offset stamp duty expenses incurred after the acquisition of a property.

With house loans becoming the standard when it comes to owning a property, it is equally vital to assess the needs of borrowers and apply for the appropriate sort of home loan. It will not only minimise paperwork and streamline the loan approval procedure, but it will also help borrowers to obtain a loan with lower interest rates. Also, house loan EMI calculator can be utilised to determine your payment timeline and better organise your budget.

ii. Types of home loans based on the category of money lending institution:

In India, there are majorly two types of money lending institutions, banks, and non-banking finance companies (NBFCs). In banks there are public sector banks as well as private sector banks. Housing Finance Companies are NBFCs which are established with an aim of providing credit to housing sector. Therefore, home loans can be availed through banks as well as non-banking institutions.

1. Home loans from Banking Institutions.

Under RBI Banking Act, 1956, banking institutions were formed to provide housing loans to individual as well as institutional borrowers. These banking institutions are mainly classified as public sector banks like State Bank of India, Punjab National Bank, as well as private sector banks like HDFC, Axis Banks, etc. These two types of banks have different clauses mentioned in *RBI's Master Circular on Housing Finance*. The PSBs offer better transmission of RBI rate cutes which means they can well absorb the future rate cuts in interest rate by RBI. On the other hand, private sector banks are slower in passing on future rate cuts by RBI. During 2019-2020, the public sector banks have passed on 0.94 percent of future rate

[5] *See:* ("Types of Home Loan in India" 2021).

cuts as compared to 0.54 percent by private banks. [6] This affects the changes in interest rate on home loans provided by public as well as private sector banks.

Since it was formed under RBI Banking Act, Interest rates on home loans provided by banks fluctuate according to the fluctuations in the macroeconomic indicators in the economy. Therefore, these rates are based on Marginal Cost of Funds based Lending Rate (MCLR)[7]. In banking institutions, borrowers need to have higher CIBIL score to avail home loans.

2. **Home loans from non- banking finance companies (NBFCs)**

Non-Banking Financial Companies (NBFCs) like Housing Finance companies were established under Companies Act, 1956 to provide credit facilities to housing sector. Housing Finance Companies like LICHFL, IIFL, etc. provide home loans to individual as well institutional borrowers based on Primary Lending Rate (PLR)[8]. Therefore, the interest on homes loans provided by NBFCs are comparatively higher than banking institutions. However, NBFCs also provide home loans to individuals or groups with a lower CIBIL score. Therefore, home loans sanctioning becomes convenient for home loan borrowers.

1.1.3. Interest Rates on Home Loans:

As mentioned previously, interest rates on home loans differ as per the types of institutions. Mainly there are two types of interest rates on home loans viz. floating rates and fixed rates. Following are types of rates of interests on home loans**:**

1. **Floating Interest rates on home loans:**

The interest rates that fluctuate in consonance with the changes in macroeconomic changes can be termed as floating interest rate on housing loans. Banking institutions for housing finance lend money based on Marginal Cost of funds Lending Rate (MCLR) which are floating interest rates. These rates change as per the changes in the economy. For instance, during the pandemic central bank adopted expansionary monetary policy where it reduced the lending rates so that people can borrow more. The Indian economy adopted low-interest regime on home loans for aiding revival in housing demand that has been hit badly during the last two

[6] *See:* Motiani, Preeti. 2021. "Should You Take Home Loan from Public or Private Sector Bank?", Economics Times.
[7] According to RBI, Marginal Cost of Funds based Lending Rate (MCLR) is the minimum lending rate below which a bank is not permitted to lend.
[8] According to RBI, Prime Lending Rate is the interest rate below which housing finance companies are not permitted to lend.

months due to a second wave of the COVID pandemic[9]. This implies that unprecedented events have impact on economy and this, in turn, impacts lending rates on housing loans.

2. Fixed interest rates on home loans:

The interest rate on housing loans which are fixed for a certain period can be termed as fixed rate of interest on home loans. Such rates are usually charged by housing finance companies because they are established under Companies Act, 1956. Therefore, these rates tend be higher than interest rate on housing loans by banking institutions.

In brief, home loans are the major source of housing finance which are categorised based on the purpose of borrowing as well as various lending institutions. Also, the interest rates charged by banks as well housing finance companies differ. Based on this, interest rates on home loans can be classified as floating rates and fixed rates.

1.2. Literature reviews

Karuppannan (2002), reviewed the role of the state, the market, and the non-the governmental organisations (NGOs) in provision of housing for lower income groups. According to the descriptive study, formal housing organisations in both the public and private sectors are neither building quickly enough to satisfy demand, nor are they building affordably enough to serve the poor. Therefore, the informal housing sector like slum development has risen in nearly all Indian cities. The study concludes that inefficient the government policies and poor implementation of measures taken by the government for proving housing to lower sections of the society have resulted into the practice of unauthorized occupation of land for shelter (In Mumbai, 50% of buildings do not have occupation certificate)[10]. This research implies that even though the the government has strengthened the housing finance sector over time, the beneficiaries are mostly the middle and higher-income groups; the poor continue to struggle with access to affordable and formal home financing. The public sector has now realized that private agencies should be encouraged to augment their efforts.

Yadav (2016), conducted an analytical study on housing finance in India with special reference to HDFC and LIC Housing Finance Limited. Researchers studied the impact of age, education qualification, profession, yearly income (independent variables) on home loan amount applied for and on the home loan amount which is sanctioned by the banks (dependent variables). The

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[9] *See:* "Low Home Loan Interest Rate Regime to Continue: Realtors on RBI Policy". 2021. Business-Standard.Com.

[10] Source: 50% buildings have no OC, but BMC can’t do much. (2021)

association between the days taken for sanctioning of home loans and the types of banks. From the analysis, it was concluded that Strong retail loan growth, stable margins and steady asset quality were the key performance indicator of private banks like HDFC. These indicators show that private banks are performing well in housing loan finance whereas housing finance companies like LICHFL have shown lower than expected gains since 2010.

Rana (2016), examined core issues and challenges of affordable housing in India. Researchers classified housing problems in four types which are land related, governance related, finance related, developer and construction related problems. Land related problems include availability and cost of land, land monetisation[11], etc. Governance related issues include delay in approvals or clearances, corruption, lack of clarity, Rent Control Act [12] is deterrent for rental housing and so on. Financial problems such as high cost of capital for builders, formal sector not very comfortable in lending to private sector, high NPA and credit risk, availability of home loans for EWS/LIG also contribute to housing problems in India. Developer & Construction related issues are comprised of lack of transparency and credibility of builder, lack of skilled manpower, standardization of building components/ materials, delays in project delivery, etc. Researchers also found that certain restriction imposes by Ministry of Environment and Forests Limit the use of land in urban areas for housing purposes, resulting in lack of supply and thus higher pricing. These problems can be resolved by constructing models comprising of a myriad of agencies from public and private sectors to work together for the development of affordable housing.

Udagi & Olekar (2018), examined the challenges and issues in housing finance in India. This paper is an attempt to reveal challenges and issues in respect to housing finance companies in general and housing finance customers related to LICHFL in Kalaburagi City. Researchers collected data through primary survey of home loan borrowers in Kalaburagi, Karnataka.From the study, it was found that the major challenges in supply side of housing finance sector in India are inadequate availability of lending funds, risk of default, asset-liability mismatch, high stamp duties, backward legal system to settle default cases. The major issues faced by demand-side of housing finance sector includes inadequate assistance, collection of documentation, fluctuating home loan interest rates, lack of flexibility in payments of loan instalments, hidden

[11] Land monetization means generating revenue through utilizing the non-revenue generating land. Monetisation of land is one of the most viable options for government or local bodies for generating the much-needed funds for upgradation or development of required infrastructure without burdening the state or the Central government in the form of grants, etc. See: Monetization of land owned by government bodies – Future and implications. (2021).

[12] Rent Control Act: Rent Control Act was a method by the Government of India to eradicate the abuse of tenants by landlords. Rent legislature tends in providing fair rents to the landlords and protection of tenants against eviction. But the tenants are paying fixed rates as rents since 1947. (Basics and Analysis of Rental Laws, 2021)

costs like processing fees, late payment charges, interest rate conversion charges, lack of reliable information regarding housing finance sector, etc. These are the major challenges in housing finance sector in India.

1.3. Research gap- why this research is necessary

Previously conducted studies emphasized that one of the major challenges in affordable house ng market in India is housing finance. Banks and housing finance companies are major lending institutions for housing sector. Private banks are found to have better performance in housing finance sector than housing finance companies whereas housing finance companies have showed lower gains in recent years. Though there are various lending institutions that finance housing sector, lower income groups find it difficult to avail housing finance. Therefore, this research paper attempts to analyse the challenges faced by lower income groups in availing housing finance in India.

1.4. Research Objectives:

- To examine the housing finance market in India.
- To address the issues faced by lower income groups in availing the housing finance in India.
- To provide recommendation for solving the housing finance issues of lower income groups.

1.5. Methodology:

This research paper is based on secondary information collected from government websites, RBI journals as well as previously published research papers. The secondary data on Housing Price Index (HPI) is collected from *RBI.org* and data on lending rate in India is collected from *WorldBank.org*. The regression model is used to analyse this data. This research is exploratory research that describes the housing finance sector in India and addresses the issues of lower income groups in availing housing finance.

Chapter 2

Housing Finance Sector in India

In India, the housing finance market is on a high growth trajectory. Over the last ten years, it has grown exponentially from Rs.4,630 Crores in 1996-97 to an estimated Rs.42,000 Crore in 2003-2004, this makes it one of the fastest growing industries in the country, with a growth rate of over 37% per annum. [13] This growth is due to the fiscal measures adopted by central and state governments as well as monetary measures taken by Central Bank. Banks and NBFCs play a vital role in providing financial assistance to housing sector.

2.1. Role of central and state government

To overcome colossal housing shortage in India, the Indian government started putting efforts since 1986 through formulation of National Housing Policy (NHP) which got recognition since 1994. The policy was implemented for development of institutions that provide housing finance, development of land acquisition and infrastructure development structure, provision of easier and affordable access to institutional finance. According to RBI, *the banking institutions are required to play an important role in providing credit to housing sector in consonance with the National Housing Policy.* This implies that banking institutions were given a major responsibility of providing housing loans. *Banks could deploy their funds under the housing finance in any of three categories, i.e., (i) Direct Finance, (ii) Indirect Finance, (iii) Investment in bonds of NHB/HUDCO, or combination thereof.* NHP was revised in 1998 and it was then extended to National Urban Housing and Habitat Policy (2007).

National Housing Bank is an apex financial institution for housing which supervises Housing Finance Companies. However, the regulation of HFCs lie with the central bank, i.e., Reserve Bank of India. The Government of India has also taken measures to improve housing finance sector through provision of higher budgetary outlays for housing, tax incentives to housing finance beneficiaries, etc. The Government of India's Ministry of Housing and Urban Poverty Alleviation has created a Credit Risk Guarantee Fund Trust to provide guarantees for low-income housing loans. The Trust provides a credit risk guarantee to lending institutions against housing loans up to Rs. 5 lakhs granted to borrowers in the Economically Weaker

[13] Source: *Lib.Unipune.Ac.In*

Section (EWS)/Lower Income Group (LIG) categories in urban areas without requiring any collateral security and/or third-party guarantee under the scheme.[14]

2.2. Role of central bank

Central bank in India, i.e., Reserve Bank of India (RBI) is an apex institution that regulates public sector banks, commercial banks as well as non-banking financial institutions that lend money to housing sector in India. RBI acts as a banker to commercial banks and therefore, the lending rates of commercial banks are controlled by the central bank. RBI also regulates HFCs. Housing finance companies were previously regulated by National Housing Bank. However, the 'Infrastructure Leasing and Financial Services Limited', one of the housing finance companies defaulted in its debt payments and therefore, the central bank took over the regulation of housing finance companies in India. HFCs came under the purview of the RBI through Section IIIB of the RBI Act.[15]

As mentioned previously, housing finance companies were formed with an objective to provide finance to housing market in India. However, Housing finance companies have faced declining importance when commercial banks entered housing finance arena aggressively. (1998). Commercial Banks started aggressive lending to the housing sector only since 1998 following a directive from the central bank of the country viz. Reserve Bank of India (RBI) in 1998 to set aside 3 percent of their incremental deposits for lending to housing sector. Thus, commercial banks took over market of housing finance companies. This led to merging of some of the housing finance companies with parent banks due to their declining performance in financing housing sector. For instance, on January 7, 2019, Bandhan Bank acquired HDFC Ltd promoted *Gruh Finance*, Housing finance company[16]. Such mergers of housing finance companies with commercial banks resulted into gradual increase in mortgage to GDP ratio [17] in India from 3.4 percent in 2001 to 7.4 percent by 2008 (RBI, 2009 a).

[14] *See:* ("Credit Risk Guarantee Fund Scheme for Low Income Housing CRGFS" 2021)
[15] *Source*: ("Why Did the RBI Take Over the Regulation of Housing Finance Companies From The National Housing Bank?" 2021).
[16] Merger of Bandhan bank and Gruh Finance is assumed to create one of the largest rural and semi-urban lending platforms in the country. *See*: ("Hitting Four Birds with One Bullet: Bandhan Bank and Gruh Finance Merge | M&A Critique" 2019)
[17] Mortgage to GDP ratio: Defined as the share of total mortgages in the economy, the mortgage to GDP ratio is a key indicator of the state of housing finance in a country.

2.3. Role of banks and Non-Banking Financial Companies

In India, banks and non-banking institutions are prime lending institutions to hosing sector. Following table differentiates these two types of lending institutions.

Table 2.1: Differences in banking institutions and housing finance companies

	Banking Institutions	**Non-Banking Financial Institutions – Housing Finance Companies**
Registration under	RBI Banking Act, 1956.	Companies Act, 1956.
Demand Deposits	Accept demand deposits	Do not accept demand deposits
Loan Sanctioning	Dual sanctioning process in PSBs- In-principle sanctioning	Faster loan sanctioning process.
Rate of Interest	Lower as compared to NBFCs	Higher as compared to banks
ROI is based on	Floating interest rates based on MCLR which fluctuate as per the changes in RBI's policy/fluctuations in the economy.	Prime Lending Rate
Application process	Offline and time-consuming application process.	Convenient and Easier application process.
Processing Time	Longer processing time, 1-2 months, offline/physical mode of application, documentation, and other processes.	Lower processing time, sanction within 72 hours, online application facilities.

The above table shows the differences in banking and non-banking financial institutions in housing finance sector. Due to lower rate of interest, banking institutions attract more home loan borrowers than housing finance companies.

Why borrowers prefer home loans from private banks rather than public sector banks (PSBs):

In India, the recent trends in affordable housing segment showed that lower income groups prefer private banks like HDFC rather than National banks like State Bank of India (SBI) due to several reasons. There three major reasons behind this. First, lack of adequate funding. SBI provides 80% funding at first disbursement in affordable housing project and 20 % self-funding must be done by borrower to buy the house. However, affordable housing projects are mainly for LIGs and MIGs who find it difficult to pay 20% of the first disbarment. In contrary to SBI, private banks like HDFC, ICICI has better funding ranging from 90% to 95 %. Therefore, private banks attract more borrowers of home loans rather than nationalised banks.

Second, “In-Principal Sanction” rule in nationalised banks like State Bank of India (SBI).[18] In nationalised banks like SBI, borrowers need to follow two levels of sanctioning, in-principal sanction, and final sanctioning. There have been cases where SBI approved in-principal sanctioning letter but in the final sanction, the case is rejected due to CIBIL rating issues. In such cases, where home loans are declined, the homebuyer tends to cancel the plan to buy the house. Privat banks, on the other hand, have only one level of sanctioning which saves the time in home loans approvals and reduces the cases of cancellations of home purchases.

Third, nationalised banks like SBI do not have project APF (Approved Project Financials) number[19]. It is necessary for faster approval of home loans. Since SBI does not provide APF, the homebuyer needs to follow time-consuming process to get legal and technical approvals for getting home loans. Thus, home loans process is delayed. These delays further lead to delay in loan sanctioning which increase rate of cancellations in affordable housing segment. Therefore, borrowers tend to private banks or NBFCs for smooth sanctioning of home loans.

[18] In-principle approval is a process between a home loan borrower and a Bank (the lender). Under this process, the Bank assesses the financial status of the borrower. Based on this, the Bank will decide whether to approve the home loan. There is no remittance of the actual loan that takes place when the borrower gets the In-principle approval. It is a guarantee that the Bank will give you the loan when needed provided information and documents are verified successfully. See: ("In-Principal Approval of Home Loan" 2021).

[19] Every project of a developer is expected to have a valid APF number or a code. The APF Number is provided by banks or housing finance companies (HFCs). The APF Number/Code denotes that the project has received all necessary approvals, and that homebuyers can invest in the project without any fear about the credibility of the developer. See: ("What Is An APF Number In Real Estate?", 2019).

Chapter 3

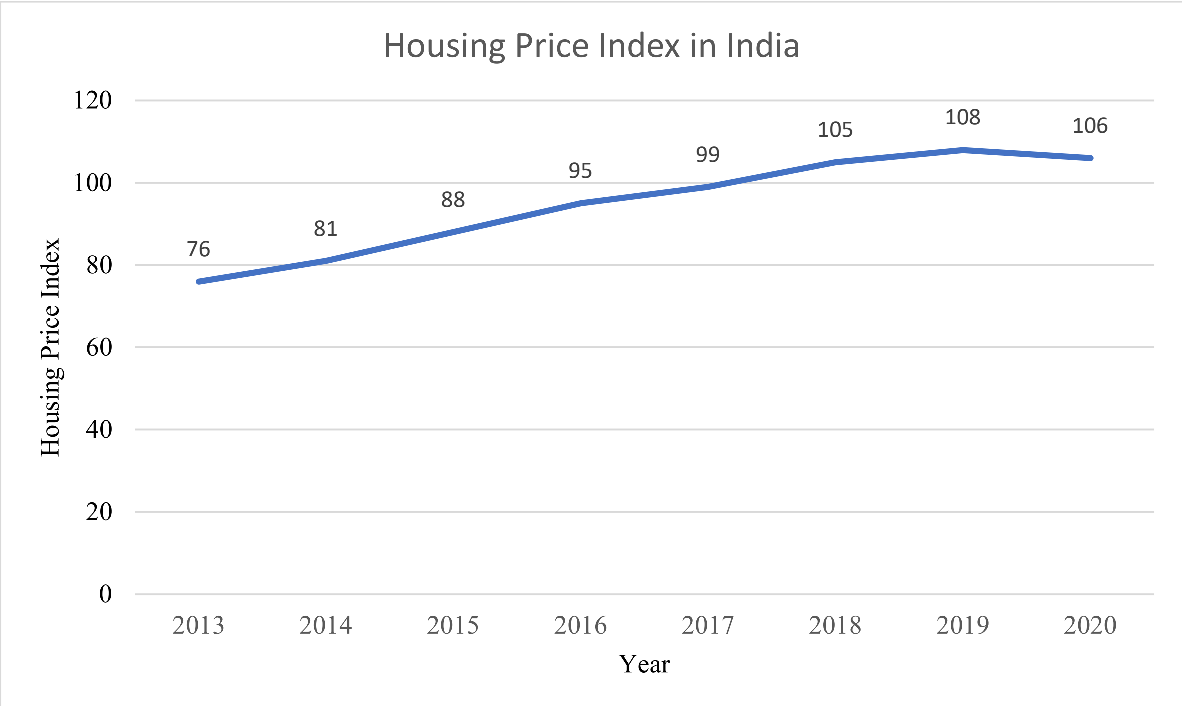
Housing Finance in India: Data Analysis

Skyrocketed housing prices in megacities like Mumbai, Delhi, Kolkata has caused the problem of housing affordability for lower income groups residing in the city. In Indian housing finance sector, housing price index is one of the important indicators of housing prices. According to RBI, *A house price index (HPI) measures the price changes of residential housing as a percentage change from some specific start date (which has HPI of 100).* Methodologies commonly used to calculate a HPI are the hedonic regression (HR), simple moving average (SMA) and repeat-sales regression (RSR). Another important variable in housing finance sector is lending interest rate on home loans. Therefore, this research analyses the association between two variables viz. Housing Price Index (HPI) and lending interest rate on home loans.

3.1. Analysis of Housing Price Index in India

The housing price trend in India can be analysed through the data available on Housing Price Index which published by RBI. The following graph depicts the housing price trends in India.

Fig. 3.1: Housing Price Index in India.



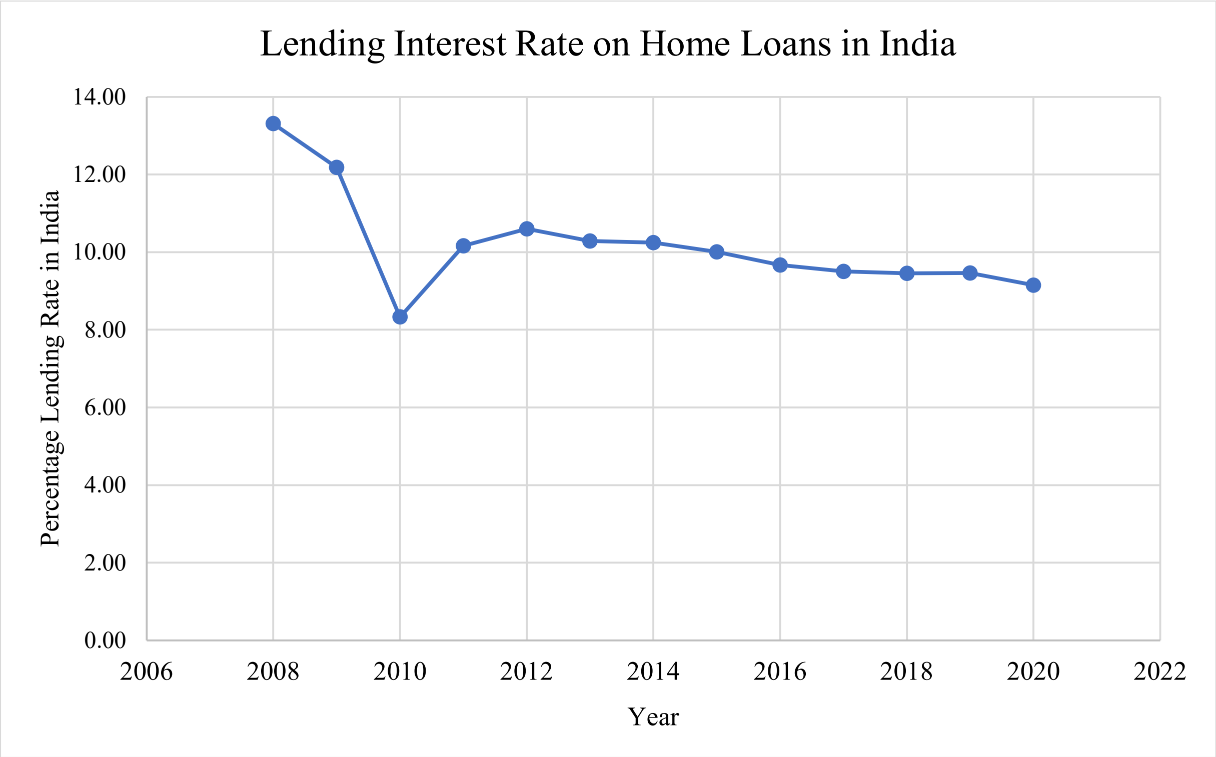
Source: Secondary data from *RBI.org* analysed in MS-Excel.

In fig 3.1, the upward trend in Housing Price Index (HPI) in India indicates that there has been rise in housing prices from 76 in 2013 to 106 in 2020. This rise is mainly due to the shortages in supply of housing units resulted from non-availability/ insufficient land for residential construction in megacities like Mumbai.

3.2. Lending Interest Rate on Home Loans

Lending rates on home loans in India depend upon the fluctuations in the economy. These rates determine the interest rate at which commercial banks or non-banking institutions lend money to the home loan borrowers. Therefore, it important to analyse the trends in lending rates to understand availability of housing loans.

Fig 3.2: Lending Interest Rate on Home Loans in India



Source: Secondary data from *WorldBank.org* analysed in MS-Excel

In fig 3.2, the downward sloping curve represents the fall in lending rate on home loans. This implies that there has been downward trend in interest rates on home loans. This contractionary lending rate policies can affect the housing finance available for home buyers especially those from lower income category. Declining lending rates decrease the cost of borrowing and, in turn, attract more borrowers.

3.3. Analysis of the relationship between Housing Price Index (HPI) and Lending Rate on Home Loans in India.

The analysis of two variables viz. HPI and Lending Rate enables the evaluation of housing finance sector in India. Therefore, regression analysis is used in evaluating the relationship between dependent and independent variables.

Hypothesis:

$\mathbf{H_0}$: There is no significant relationship between Housing Price Index and Lending Interest rate in India.

$\mathbf{H_1}$: There is a significant relationship between Housing Price Index and Lending Interest rate in India.

Data:

Table 3.1: Time Series Data on Housing Price Index and Lending Interest rate in India

Year	HPI	Lending Rate
2013	76	10.29
2014	81	10.25
2015	88	10.01
2016	95	9.67
2017	99	9.51
2018	105	9.45
2019	108	9.47
2020	106	9.15

Source: Secondary data from *RBI.org and WorldBank.org* analysed in MS-Excel

The above table contains time series data on housing price index and lending rate in India from 2013 to 2020. There has been rise in housing price Index from 76 in 2013 to 106 in 2020. However, the lending rate has shown decline from 10.29 percent in 2013 to 9.15 percent in 2020. This can be well explained through regression analysis of these two variables.

Regression Analysis:

The Following statistical table contains the results obtained from regression analysis of two variables which are Housing Price Index (HPI) and Lending interest rate on home loans.

Table 3.2: Regression Statistics

Regression Statistics	
Multiple R	0.958571257
R Square	0.918858855
Adjusted R Square	0.90533533
Standard Error	0.127264826
Observations	8

	Df	*SS*	*MS*	*F*	*Significant F*
Regression	1	1.1005	1.1005	67.9452	0.0002
Residual	6	0.0972	0.0162		
Total	7	1.1976			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	12.85	0.38	33.66	0.00000005	11.92	13.78	11.92	13.78
HPI	-0.03	0.00	-8.24	0.00017229	-0.04	-0.02	-0.04	-0.02

Source: Results obtained from Regression Analysis in MS-Excel.

Results:

In the above table, p-value is 0.00017229 < 0.05 which indicates that the null hypothesis (H_0) should be rejected. This implies that there is a significant relationship between the variables under study viz. Housing Price Index and Lending Interest Rate. From the given data, the regression model for the given data can be written as

$$\mathbf{Y_i = 12.85 - 0.03X_i + u_i}$$

Yi: Dependent variable- Lending Interest Rate on Home Loans in India.

β_1: Intercept = 12.85

β_2: Slope of the regression line = - 0.03. This value determines the rate of change in lending rate due to change in housing price index.

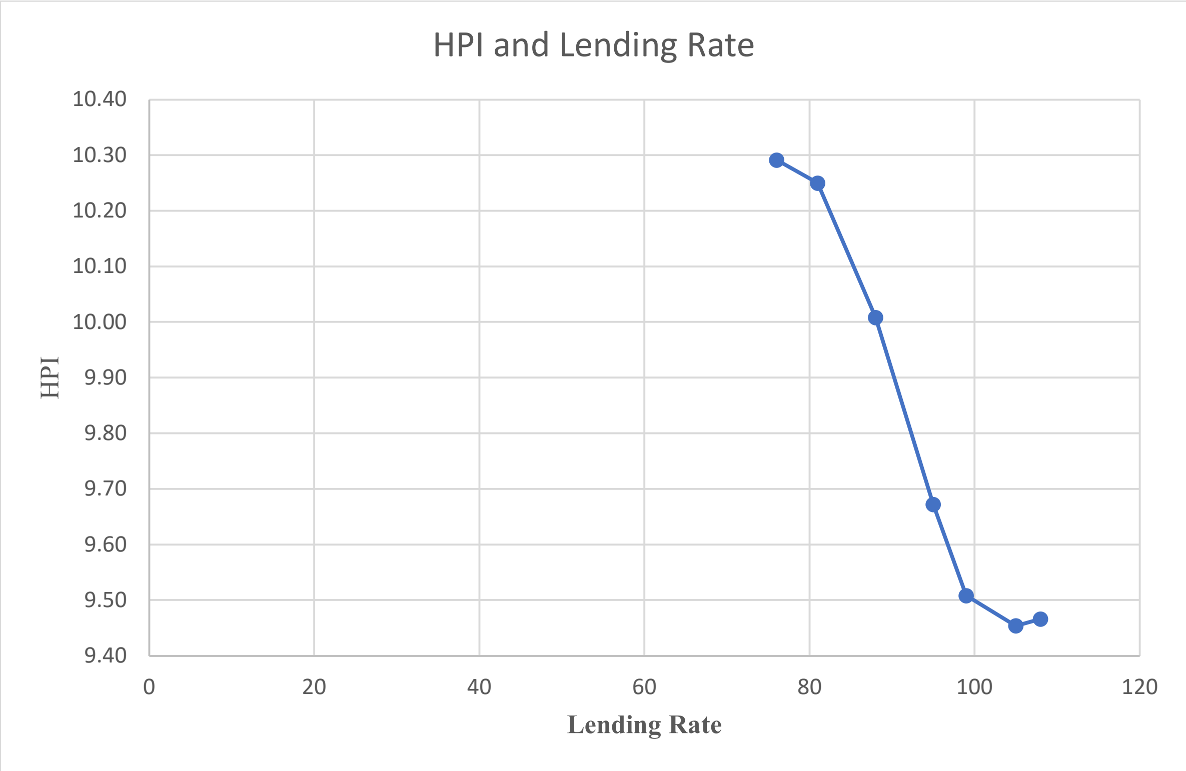
Xi = Independent variable- Housing Price Index in India.

u_i= Error term or disturbance term.

The significant relationship between housing price index and lending rate can be well explained with the value of the slope of the regression line. The negative value of slope (β_2 = -0.03) indicates that there is an inverse or negative relationship between dependent and independent variables. This implies that when the value of HPI increases the lending rate decreases.

In regression statistics, R-square value is 0.9188 which implies that the given model is the model of best fit to the given data and thus, it can be used to predict future values of lending interest rate on home loans. For instance, a unit change in housing price index will lead to decline in lending rate by 3 percent. Thus, the regression model can be used to predict lending interest rate on home loans from the given values of Housing Price Index (HPI).

Fig 3.3: Relationship between HPI and Lending Interest Rate



Source: Secondary data from *RBI.org* and *WorldBank.org* analysed in MS-Excel

In the above graph, the downward sloping line indicates the negative or inverse relationship between housing price index and lending interest rates on home loans. This implies that the lending rate can be affected by the housing prices. In India, due to shortages in supply of houses the housing prices have risen from 2013 to 2020 (Fig 3.2). However, lending rate has not shown significant rise (Fig 3.3). This can have positive impact on the purchasing power of the homebuyers from Lower Income Groups since the prices are rising whereas lending rate has shown downward trend in the time series analysis. Therefore, LIGs can get enough funding from banking or non-banking institutions to buy houses at lower interest rates.

Briefly, the above time series analysis indicated that there has been rise in housing price index since 2013 to 2020. However, the lending rate on home loans has not risen as much as housing prices. Lower lending rate means lower cost of borrowing for home loan borrowers.

Chapter 4

Major Challenges and Opportunities in Housing Finance in India

4.1. Major Challenges & Opportunities in Housing Finance in India

1. **Shortages of supply in Housing sector and therefore cost of land is more than cost of construction:**

Due to rising population in urban areas, there is disequilibrium in housing market. The demand for housing units is rising whereas supply of housing units cannot be increased as much as its demand. These shortages in supply of housing units are leading to rise in prices of housing units making them unaffordable for LIGs in Urban areas. The land prices in Bombay, Calcutta and Delhi are more than those in the western cities like London and Washington D.C. In fact, in the prevailing market rates for housing in Bombay, at Rs. 400 per square feet to Rs. 20,000 per square feet, 97% constitutes the cost of land and 3% the cost of construction.[20] Therefore, innovative strategies are needed for increasing the land available for construction through land reclamation, utilization of salt pan lands for construction and other similar strategies.

2. **Availability of fund**

In Indian housing market, public sector banks like State Bank of India are major lending institutions regulated by central bank, i.e., Reserve Bank of India. However, these banks fund 80-85percent of the agreement value and rest of the amount must be self-funded by home loan borrowers. In case of LIGs and EWS, they find it difficult to fund 20-25 percent of agreement value on own. This lack of sufficient fund availability is one of the major obstacles in housing finance sector in India. Therefore, there is opportunity for PSBs in India to expand funding to low value housing units.

3. **Psychological aspect:**

Debt averse behaviour- People belonging to LIG are usually cautious about their major expenditure like housing expenditure. Higher interest rates on home loans can increase their burden of housing expenditure and therefore they might prefer not to have home loans. This debt averse behaviour of LIGs is another issue in housing finance sector in India. People, nowadays, are also quality conscious. While buying housing units they also look for amenities

[20] Source: Research paper on "Housing Finance in India"- Pune University.

for the convenient life as well as transportation facilities so that the travelling costs can be minimized.

4. **Higher NPAs of banks due to home loan defaulters**

One of the major challenges in supply side of the housing finance sector is higher number of non-performing assets (NPAs) of banking institutions. This leads to withdrawal of lending institutions from housing finance market causing shortage of supply of credit in housing finance. Therefore, action needs to be taken by the government to reduce the withdrawal rates of lending institutions form the market.

4.2. Recommendations:

1. **Awareness about Housing Finance Schemes:**

In previously conducted research, it has been observed that people are not aware about the government schemes available for housing finance such as Housing linked savings scheme, Credit linked subsidy scheme under Pradhan Mantri Awas Yojana (PMAY-U)[21], etc. Lack of knowledge about such schemes discourage lower income groups to apply for home loans since the cost of home loans is unaffordable. Subsidies on interest rates on home loans can reduce cost of home loans to the borrower.

2. **Long term subsidised funding from National Banks.**

National banks like State Bank of India, Punjab National Bank should provide home loans on subsidised interest rates to LIGs. Since the lending rate of the national banks depend upon the fluctuations in the economy, LIGs face challenges when there are fluctuations in the interest rates. This might increase their housing expenditure along with inflation that reduces their purchasing power. Thus, national banks need to provide long term subsidised funding for low value housing units. To improve the long-term funding for low value housing units, innovative housing credit schemes are needed.

3. **Waiving stamp duty fully for low value housing:**

In India, Stamp Duty Registration Charges (SDR) are around 1% - 5% of the housing price. This increases the burden on the home buyer specifically from EWS/LIG category. Therefore, the government should provide waivers on stamp duty for low value housing. The

[21] Credit Linked Subsidy Scheme is a part of Pradhan Mantri Awas Yojana under which citizens from economically weaker section and lower income groups can avail home loans at subsidised interest rate.

reports published by National Housing Bank showed that the net revenue gain to the state of Karnataka from waiving stamp duty fully for low value housing is Rs. 103 cr. in financial year 2020-21. This implies that even with full waivers on stamp duty for low value housing, the state could maintain its revenue gain to the optimum level. Therefore, government should make provisions for waiving SD fully for low value housing in order to make them cost-effective for EWS/LIG category.

4. Abolition of In-principle sanctioning in Public Sector Banks (PSBs):

Due to the in-principle sanctioning rule, the cases might get accepted in the first disbursement but in the final sanctioning the cases get rejected due to CIBIL rating issues. These two levels of sanctioning are time-consuming and cost ineffective. This leads to rise in cancellation of housing units by the customers in affordable housing market. Therefore, two levels of sanctioning should be removed from the approval process of public sector banks like SBI, PNB, and so on. This can make the housing finance easier and time saving for the borrowers of home loans and can also the reduce the rate of cancellations in affordable housing projects.

5. Provision of Approved Project Financial Code in Public Sector Banks (PSBs):

Approved Project Financials (APF) codes are given by banks and non-banking financial companies (NBFCs). APF is provided by banks and other financial institutions to authorized builders. APF assures homebuyers of sound legal and technical credentials of the project. If APF code is not given the project, this implies that the project lacks legal and technical credentials, that is, it lacks all necessary legal approvals. In such cases, homebuyers need to follow a longer procedure to get information about legal and technical credentials of the project. Therefore, public sector banks should also provide APF code to builders of affordable housing projects so that the sanctioning of home loans can be made easier and convenient for homebuyers in the affordable housing segment.

6. Online portal for second disbursement

It has been observed during the primary data collection on home loans that for the part disbursement, the borrowers of home need to follow the documentation process again and again, that is, they need to visit PSBs frequently to submit physical documents. This process is time-consuming and expensive and therefore, homebuyers in affordable housing market do not prefer to take home loans from PSBs. This problem can be solved through creation of online portal for fulling the documentation criterion in part disbursement of home loans in affordable housing market.

4.3. Conclusion

In India, rising population has generated instability in the housing market as a result of rapid urbanisation. This has a significant impact on lower income groups and has exacerbated the problem of home affordability. Therefore, this study analysed the challenges faced by lower income groups in availing housing finance and examined the housing finance sector in India. Indian housing finance sector has been expanding since the establishment of Housing Finance Bank. Various banking and non-banking institutions are providing home loans to homebuyers. However, the benefits have not reached to lower income groups. They find it difficult to avail home loans at lower interest rates due to lack of knowledge about housing finance sector. Therefore, government needs to take appropriate measure to increase awareness among LIGs about housing finance.

The Government needs to understand the association between housing price index and lending rate which can further help in framing appropriate fiscal and monetary policies aimed at improving availability of home loans to lower income people. Longer and inconvenient sanctioning process is another critical issue faced by lower income groups. Therefore, the government should take necessary steps for improving the sanctioning process of home loans. Thus, countering the challenges faced by LIGs in housing finance sector will enable them to buy homes.

In a nutshell, appropriate policies and successful implementation of such measures can aid in resolving housing difficulties for lower-income populations. As a result, affordable housing for lower income groups will contribute to societal well-being by elevating the impoverished sections of the country.

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Annexures

Annexure 1: Tables

Table 2.1: Differences in banking institutions and housing finance companies.

	Banking Institutions	**Non-Banking Financial Institutions – Housing Finance Companies**
Registration under	RBI Banking Act, 1956.	Companies Act, 1956.
Demand Deposits	Accept demand deposits	Do not accept demand deposits
Loan Sanctioning	Dual sanctioning process in PSBs- In-principle sanctioning	Faster loan sanctioning process.
Rate of Interest	Lower as compared to NBFCs	Higher as compared to banks
ROI is based on	Floating interest rates based on MCLR which fluctuate as per the changes in RBI's policy/fluctuations in the economy.	Prime Lending Rate
Application process	Offline and time-consuming application process.	Convenient and Easier application process.
Processing Time	Longer processing time, 1-2 months, offline/physical mode of application, documentation, and other processes.	Lower processing time, sanction within 72 hours, online application facilities.

Table 3.1: Time Series Data on Housing Price Index and Lending Interest rate in India

Year	HPI	Lending Rate
2013	76	10.29
2014	81	10.25
2015	88	10.01
2016	95	9.67
2017	99	9.51
2018	105	9.45
2019	108	9.47
2020	106	9.15

Source: Secondary data from *RBI.org and WorldBank.org* analysed in MS-Excel

Table 3.2: Regression Statistics

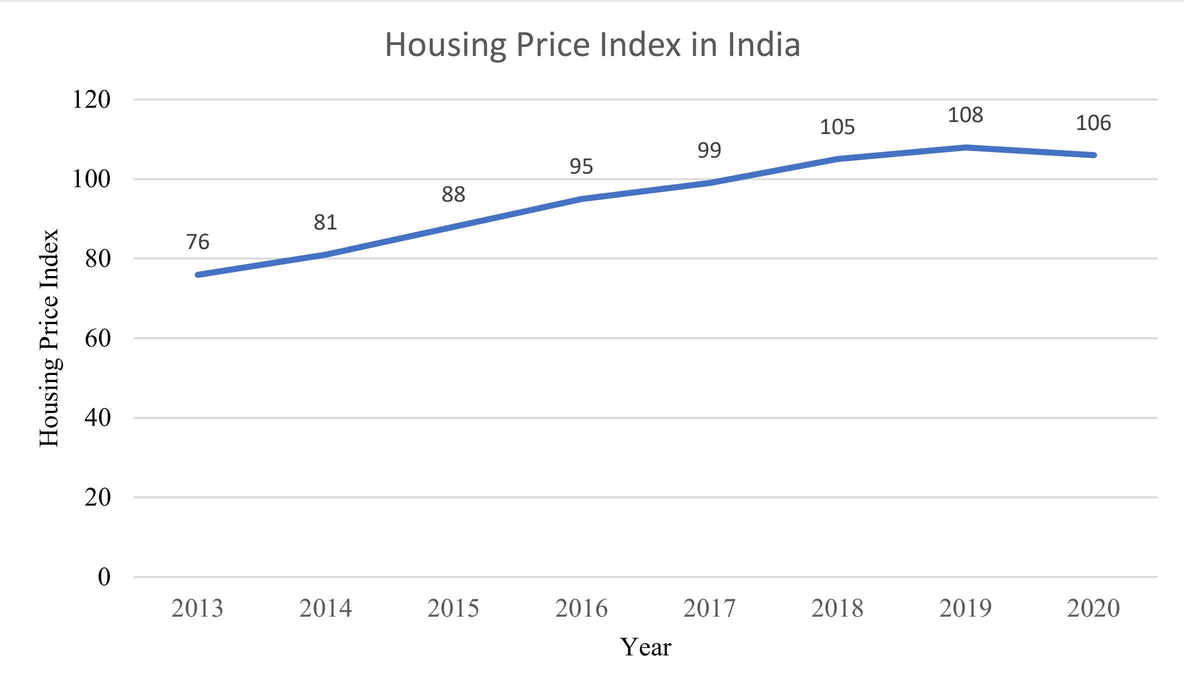
Regression Statistics	
Multiple R	0.958571257
R Square	0.918858855
Adjusted R Square	0.90533533
Standard Error	0.127264826
Observations	8

ANOVA								
	df	*SS*	*MS*	*F*	*Significance F*			
Regression	1	1.1005	1.1005	67.9452	0.0002			
Residual	6	0.0972	0.0162					
Total	7	1.1976						
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	12.85	0.38	33.66	0.00000005	11.92	13.78	11.92	13.78
HPI	-0.03	0.00	-8.24	0.00017229	-0.04	-0.02	-0.04	-0.02

Source: Results obtained from Regression Analysis in MS-Excel.

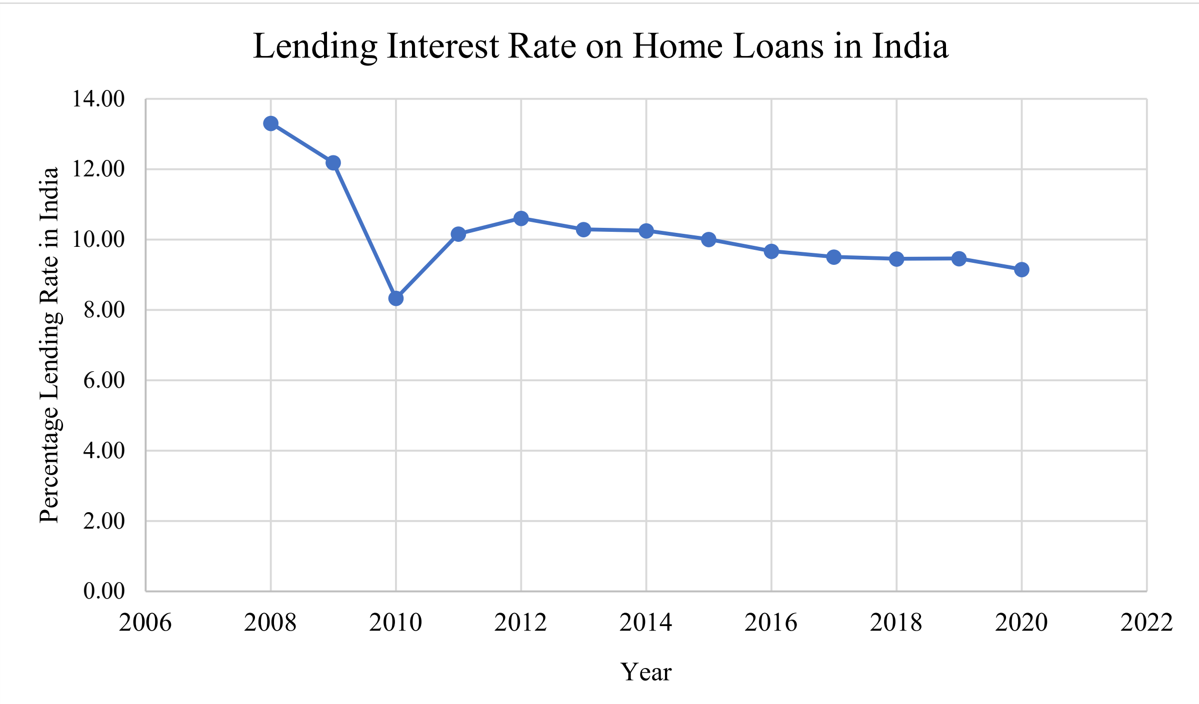
Annexure 2: Figures

Fig. 3.1: Housing Price Index in India.



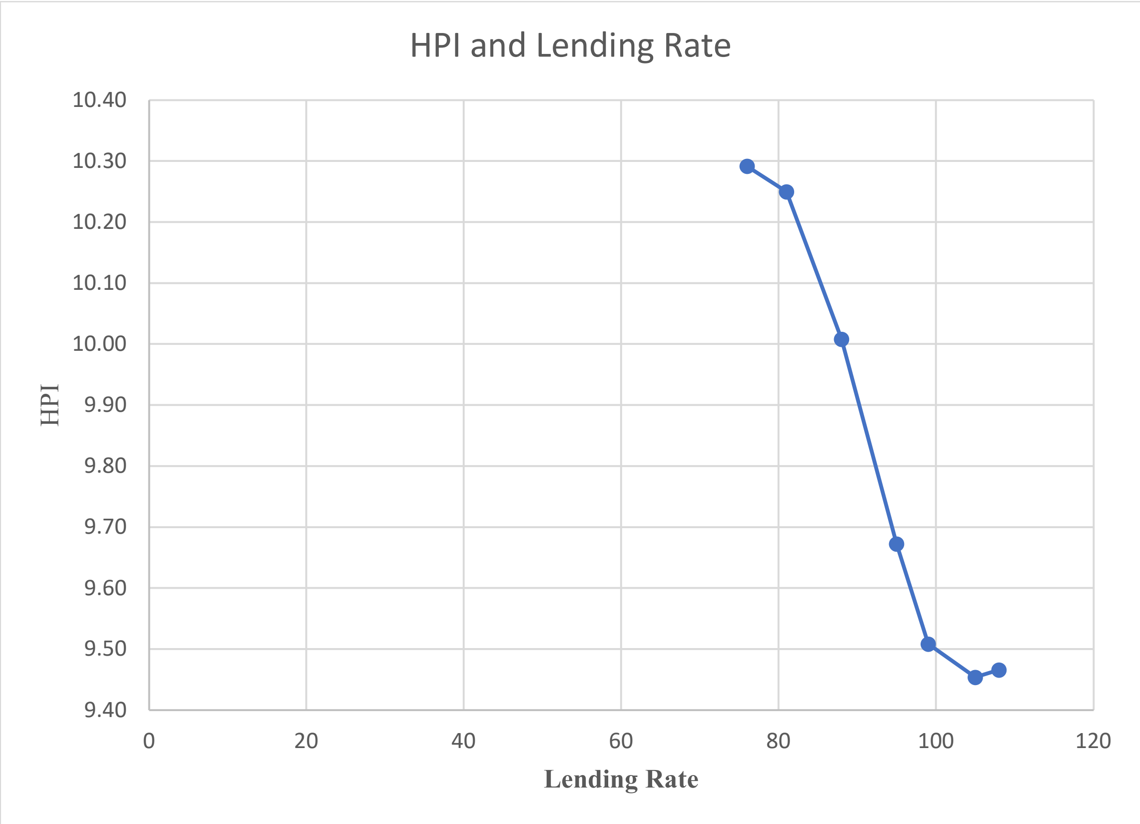
Source: Secondary data from *RBI.org* analysed in MS-Excel.

Fig 3.2: Lending Interest Rate on Home Loans in India



Source: Secondary data from *WorldBank.org* analysed in MS-Excel

Fig 3.3: Relationship between HPI and Lending Interest Rate



Source: Secondary data from *RBI.org* and *WorldBank.org* analysed in MS-Excel