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Financing Affordable Housing for the Low-Income in Urban India

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PART I: INTRODUCTION

Introduction

With vast investment and employment opportunities, India's urban areas have already become the engine of the country's development, drawing in everyone from the global real estate firm to the displaced marginal farmer. The World Bank estimates that urban areas currently house 32 percent of India's population of 1.2 billion, the highest proportion in Indian history.¹ There is no doubt that the future of India's growth will continue to lie in its cities. As over 70 percent of net new job opportunities will be generated in urban areas, a further 218 million people are expected to inundate urban India between 2011 and 2030.² This implies that every minute during the next two decades, thirty Indians will leave rural India to find a home in its sprawling cities. The rural exodus is the equivalent of adding the entire population of Brazil to Indian cities in just twenty years.

Thus, a massive, urgent, and most fundamental question urban India faces is how to house this accelerating population concentration. Understanding this pivotal need, one of the first promises the new Narendra Modi government made was "housing for all by 2022." The Constitution describes India as a "sovereign socialist secular democratic republic," a mandate that has commanded the government to remain heavily involved in promoting the social and economic well being of its citizens. By the time India celebrates its 75th Independence Day, the government wants each Indian to have a proper roof over his or her head. In addition to administering existing schemes, the ambitious rhetoric will require the Indian welfare state to devote a larger proportion of its expenditures towards developing strategic ways to address the housing needs of the low-income. Yet the poor country must tackle a host of other immediate issues with life versus death repercussions, from malnutrition and food inflation to poor sanitation.

"Housing for all by 2022" will therefore necessitate a dynamic public-private partnership. Private sector firms have shown a burgeoning interest in the lower-income housing landscape, mostly in the urban context because of the inevitable demographic trends discussed above. Global consulting firms like Monitor Deloitte have written several studies on the low-income housing market and created innovative models on how to facilitate financing to increase homeownership among the low-income. Jones Lang Lasalle, an Anglo-American real estate investment management company, has also discussed in detail how to develop India's urban affordable housing sector. Housing finance corporations and developers in India have begun forming new ventures that deal exclusively with the urban low-income, many supported by capital from Western corporations and international financial institutions.

Both these private-sector trials and the government's housing schemes have been important in getting the ball rolling. Yet the challenge is immense. Plagued by a complete supply-demand mismatch, urban India has thus far been unable to provide adequate housing to the overwhelming majority of its lower-income population. While the government and private

¹ "Urban Population (% of Total)." Data. January 1, 2014. Accessed August 27, 2014.

² Aarti Dhar, "India will see highest urban population rise in next 40 years," *The Hindu*, April 7, 2012, <http://www.thehindu.com/news/india-will-see-highest-urban-population-rise-in-next-40-years/article3286896.ece>

sector tout ownership, the rental market for low-income urban Indians has been languishing for the past few decades and needs a strategic stimulus.

The crux of the question on how to ease the urban housing crisis for lower-income Indians lies in securing finance. Raising capital to fund this massive need touches all players in the low-income housing space, from builders, to borrowers, to lenders. Though legal quagmires, land scarcity, inflation, and other systemic problems are serious roadblocks to developing a more robust low income housing market and will briefly be addressed in the paper, they all exacerbate the financing crisis, where financing is the oil that slicks the entire operation. This paper gives an overview of the low-income housing market in urban India, focusing primarily on opportunities and roadblocks in housing finance for developers, consumers, and providers of capital.

How is income defined in the housing context?

The Ministry of Housing and Urban Poverty Alleviation, which will be discussed in great detail later, categorizes Indian households in the context of housing policies by their income. There are four categories: The Economically Weaker Sections (EWS), LIG (Lower Income Group), MIG (Middle Income Group), and HIG (Higher Income Group). Before 2013, including when the 2012 Report of the Technical Group on Urban Housing Shortage discussing in the subsequent section and other reports addressed later in this paper were written, the National Housing Bank defined the LIG segment as households earning between Rs.60,000 and Rs.120,000 per year. As of the end of 2013, NHB redefined the LIG sector as households earning between Rs.100,000 and Rs.200,000 annually. The EWS sector was expanded to include those earning less than Rs.100,000 a year. In accordance with current governmental definitions, this report will use the term low-income households to mean those earning between Rs.8,333 and Rs.16,667 per month. Individuals who make up the low-income populations of Indian cities often earn a living as rickshaw drivers, tea stall operators, general shopkeepers, etc.

Why low-income?

As India's real estate boom has catered almost exclusively to the upper middle class and elite, who have become richer over the past few decades, it is obvious that the "all" in the "Housing for all by 2022" naturally translates to India's lower-income population. In fact, the 2012 Report of the Technical Group on Urban Housing Shortage found that urban India suffers from an 18.78 million housing shortage, and low-income Indians disproportionately bear the brunt of the deficiency. The Economically Weaker Sections (EWS) segment shoulder 56.2 percent and the LIG (Lower Income Group) segment 39.4 percent of the urban housing shortage³. *In fact, 95.6 percent of urban India's lack of adequate housing is shouldered by households eking out a living on less than Rs.10,000 (\$167) a month.* This means that the MIG (Middle Income Group) and HIG (Higher Income Group) segment of urban India, consisting of households who earn more than Rs.10,000 a month, only account for 4.4 percent of the shortage.⁴

³ "Annual Report 2012-2013." Ministry of Housing & Urban Poverty Alleviation, Government of India. January 1, 2013. Accessed August 1, 2014. http://mhupa.gov.in/pdf/annual-reports/Annual_Reprot_English_2012-13.pdf.

⁴ Annual Report 2012-2013.

PART II: OVERVIEW

The Creation and Growth of the Urban Housing Market

It is important to understand a brief history of urban development in India, which provides the context needed to more richly discuss the current role the government must play in the affordable housing space and the role demanded of the private sector. The private sector was virtually nonexistent in the 1947 India that had just emerged from British colonization. It was up to the government to facilitate the creation of everything from cement manufacturers and construction companies to institutional lenders. Since India was pre-dominantly an agricultural and rural economy for much of its history, the newly independent Indian government did not see urban development and housing as crucial to the progress of the nation. As the current Ministry for Housing and Urban Poverty Alleviate writes, “the positive aspects of cities as engines of economic growth in the context of national economic policies were not much appreciated and, therefore, the problems of urban areas were treated more as welfare problems and sectors of residual investment rather than as issues of national economic importance.”⁵

Policymakers naturally devoted more resources to rural regions where most of the Indian populace worked and lived. However, there was no doubt that the cities, which were growing as major population centers throughout the 1950s and 1960s, needed attention. To prevent the pressure of population concentration in large cities, the Fourth (1969-1974) and Fifth (1974-1979) Plans promoted balanced urban growth by supporting the creation of smaller towns. Various schemes, managed by the Ministry of Urban Development at that time, were also designed over the next decade to better habilitate urban areas dealing with unsupportable growth. These included the delivery of proper water supply and sewerage to slums (Scheme for Environmental Improvement of Urban Slums), construction of roads, bus stands, markets, etc. in small and medium towns (Integrated Development of Small and Medium Towns), and provision of land for the construction of low and middle income housing (Urban Land Act).⁶

Despite these concerted efforts, it became clear that the government could not facilitate urban development and housing alone, especially as urban areas drew greater hordes of people. The Seventh plan (1985-90) stressed the need for the private sector to take a lead in housing construction. Accordingly, a three-fold role was assigned to the public sector, which pertains to this day, “mobilisation for resources for housing, provision for subsidised housing for the poor, and acquisition and development of land.”⁷ In 1988, the National Housing Policy was announced, which stated the government’s goal to end homelessness, improve the housing conditions of those housed inadequately, and provide a minimum level of basic services to all. According to MHUPA, this watershed new policy conceived the government role “as a provider for the poorest and vulnerable sections and as a facilitator for other income groups and the private sector by the removal of constraints and the increased supply of land and services.”⁸ The government would act as the facilitator in order to support the private sector’s efforts, but would still maintain responsibility over the poorest urban Indians. It is through these lenses to view existing government schemes for affordable housing that will be discussed later.

⁵ "Housing and Urban Policy in India." Ministry of Housing & Urban Poverty Alleviation, Government of India. January 1, 2014. Accessed August 1, 2014. <http://mhupa.gov.in/policies/index2.htm>.

⁶ "Housing and Urban Policy in India."

⁷ "Housing and Urban Policy in India."

⁸ "Housing and Urban Policy in India."

Finally, the last important shift in the government's mindset towards the urban poor formed part of the Eighth plan (1992-97), which "for the first time explicitly recognised the role and importance of urban sector for the national economy," especially as the absorber of increasing labor.⁹ A predominant problem of rapid urbanization, in addition to inadequate infrastructure and the growing number of poor, was the "accumulated backlog of housing shortages, resulting in proliferation of slums and squatter settlements."¹⁰ As critical objectives of subsequent plans were to promote economic growth while controlling population growth, how to house this increasing population has been a central question for the last two decades.

In 2004, after undergoing various title changes throughout its history, the Ministry of Urban Development split into two, the Ministry of Urban Development and the Ministry of Urban Employment and Poverty Alleviation. The latter was subsequently changed to the Ministry of Housing and Urban Poverty Alleviation. Currently, the Ministry of Housing and Urban Poverty Alleviation (MHUPA) is the "apex authority" of the Government of India concerning all issues of urban poverty, housing, and employment. MHUPA formulates policies and coordinates the various activities of the Central and State governments. Its efforts to promote low-income housing will be discussed later in the paper.

Evolution of Housing Finance

Formal housing finance in India began with the foundation of the Housing and Urban Development Corporation (HUDCO) in 1971, which was created to fund the government's housing and urban development programs spearheaded by the Ministry of Urban Development. HUDCO is a public sector company that now falls under the Ministry of Housing and Urban Poverty Alleviation. With the unique motto of "profitability with social justice," HUDCO mainly aims to serve low-income groups by allocating over half of its housing finance portfolio for the LIG and EWS groups. HUDCO provide financial support to State Housing Boards, development authorities, municipal corporations, state governments, etc. for the construction of houses and execution of housing schemes.¹¹ Through HUDCO's schemes, urban development entities receive financial assistance through lower interest rates, longer repayment schedules, and higher loan components for lower cost units for these various.¹²

In this regard, the main issues HUDCO focuses on are land acquisition and development, housing construction, slum rehabilitation, repairs and renewal of existing housing stock, and public/private sector housing projects. It also finances some shelter construction and upgrading for poorer households through lending financial support to NGOs. Through all its efforts, HUDCO has thus far supported 5,677,000 urban residential units.¹³ HUDCO also provides major technical and financial help to support reconstruction of areas devastated by natural disasters like earthquakes, floods, tsunamis, etc, with a focus on rehabilitation for the poor.

⁹ "Housing and Urban Policy in India."

¹⁰ "Housing and Urban Policy in India."

¹¹ "Housing and Urban Development Corporation Ltd. (HUDCO)." Ministry of Housing & Urban Poverty Alleviation, Government of India. January 1, 2014. Accessed August 2, 2014. <http://mhupa.gov.in/ministry/associates/psu/hudco.htm>.

¹² Loic Chiquier and Michael Lea. "Structure and Evolution of Housing Finance Systems." In *Housing Finance Policy in Emerging Markets*. Washington, DC: World Bank, 2009.

¹³ "Urban Housing." Housing and Urban Development Corporation. January 1, 2014. Accessed August 2, 2014. <http://www.hudco.org/Site/FormTemplete/frmTemp1PLargeTC1C.aspx?MnId=24&ParentID=23>.

Emergence of Housing Finance Corporations

Banks are currently involved in the housing finance landscape in three ways: direct lending to consumers, indirect lending by lending to State Housing Boards or housing finance institutions, or investments in mortgage backed securities, which is currently in its incipient stages in India. However, historical reluctance on the part of both public and private banks to take on a greater responsibility in the housing sector and the resulting unsatisfied demand for housing finance necessitated a specialized role for housing finance companies.

The first specialized mortgage company in India was the Housing Development and Finance Corporation, which was founded in 1977. HDFC began as a public-private partnership to offer long-term housing loans to low and middle-income customers with the goal of promoting homeownership.¹⁴ As India's largest housing finance company (HFC), HDFC has financed over 4.4 million units in its history. The company also provides construction finance to real estate developers, in addition to providing lease-financing facilities to companies and development authorities for infrastructure and other assets¹⁵. It also launched HDFC Bank in 1994, one of India's largest and most successful private sector banks. The World Bank calls HDFC a pioneer in housing finance in India because it has led most housing finance advances in India, such as the first Adjustable Rate Mortgage (ARM) in 1999, securitization in 2000, and Internet loan approval in 2001.¹⁶

In the late 1980s, the number of housing finance companies (HFCs) like HDFC grew, from private limited partnerships and bank-sponsored companies to joint ventures with state governments. HFCs finance both the consumer and the developer side of the equation, either lending long-term for the development of housing projects or the purchase of units. The position of HFCs has continued to grow in the last decade. In 2005, 25 percent of total housing credit was originated by HFCs and 75 percent by banks.¹⁷ Just six years later, HFCs originated nearly 32 percent of all home loans disbursed in India. From the 2008-2009 economic slowdown, HFCs have consistently experienced a much faster growth in housing sector credit than institutional banks have.¹⁸

Creation of National Housing Bank

The proliferation of such HFCs led to the need for an overall supervisory agency. Thus, the National Housing Bank (NHB) was formed as a subsidiary of the Reserve Bank of India (RBI) in 1988. NHB requires HFCs to pass through various stages of registration, classification, and recognition. In order to gain recognition by NHB, the main intention of HFCs must be to provide long-term credit for the construction or purchase of residential properties in India. Though HFCs do provide financing for the repair or remodeling of homes, NHB does not allow this to be their main activity.

¹⁴ Chiquier.

¹⁵ "HDFC:Natl India Stock Quote." Bloomberg. August 17, 2014. Accessed August 17, 2014. <http://www.bloomberg.com/quote/HDFC:IN>.

¹⁶ Chiquier.

¹⁷ HR Khan. "Enabling affordable housing for all- issues and challenges," Inaugural address by Shri H R Khan, Deputy Governor of the Reserve Bank of India, at the International Conference on "Growth with stability in affordable housing markets", organized by the National Housing Bank and the Asia Pacific Union for Housing Finance, New Delhi, India, January 30, 2012.

¹⁸ Khan.

The National Housing Bank not only regulates the housing finance market by patrolling HFCs, but it also tries “to stimulate HFCs serving the small man.”¹⁹ NHB’s principal obligation is to the lower income sections of society, with a mission “to harness and promote the market potentials to serve the housing needs of all segments of the population with the focus on low and moderate income housing.”²⁰ It strives to “mobilize household savings, facilitate easy access to institutional credit for housing, increase the supply and improve the use of scarce land and building materials, and keep housing affordable for different income groups.”²¹

The major role of the NHB is to promote HFCs by providing them with financial support. It extends refinancing facilities to HFCs to expand the flow of funds to India’s housing sector. It furthers its mission of stimulating housing finance for lower-income Indians by also specifically extending refinance support to HFCs lending to low-income households. Another primary function of the NHB has been to finance public housing projects, chiefly slum redevelopment schemes for the LIG and EWS groups. NHB can raise funds by issuing bonds, borrowing from the RBI and other government institutions, or borrowing from foreign agencies like the World Bank.

¹⁹ Peer Smets, "Private Housing Finance in India: Reaching Down-market?" *Habitat International* 21, no. 1 (1997).

²⁰ "Genesis." National Housing Bank. January 1, 2014. Accessed September 1, 2014.

http://www.nhb.org.in/AboutUs/about_us.php#Genesis.

²¹ Smets.

PART III: OPPORTUNITIES

Government's Current Housing Focused Schemes

Economic liberalization starting in 1991 opened up India's once planned and insular economy. As regulations loosened, capital markets developed and foreign investment surged. For example, FDI into India grew from barely \$132 million in 1991–92 to over \$5.3 billion in 1995–96. Cities naturally attracted the bulk of foreign investment, which helped establish information technology, industry, and service center hubs. With economic investment in urban areas came greater population growth, but the government no longer had the mandate or the funds to make sure each low-income household living in urban India had access to clean water, food, shelter, education, sanitation facilities, healthcare, employment, etc. Liberalization shifted the Indian government's role away from being the sole provider of social welfare. Instead, as discussed above, the new government's role was to provide basic services for only the poorest and to otherwise lay the groundwork to facilitate the private sector to serve other income groups.

This legacy drives policy efforts to achieve “Housing for All” today. The Government's chief housing strategies in the last several years have been through the Affordable Housing in Partnership scheme, which, according to MHUPA, “aims to encourage private sector participation in creation of affordable housing stock, recognizing that mere efforts of Government would be insufficient to address the housing shortage.”²² The scheme was first introduced under the Basic Services for the Urban Poor sub-mission of JNNURM and then also under the Rajiv Awas Yojana in 2011. According to government data, programs like the Jawaharlal Nehru National Urban Renewal Mission, Rajiv Awas Yojana, and affordable housing partnership have enabled the construction of only 220,741 houses in urban areas²³.

The Ministry of Urban Development launched the Jawaharlal Nehru National Urban Renewal Mission scheme to improve infrastructure of cities, deploying \$20 billion dollars over the 2005-2012 period. One of the program's sub-mission focused on infrastructure development, including waste and water management facilities. The other sub-mission of the program was the Sub-Mission for Basic Services to the Urban Poor, which is where Affordable Housing in Partnership funds were deployed to address the integrated development of slums. Among other goals related to poverty alleviation, part of the second sub-mission strove “to encourage State governments to make provision for land to meet the acute shortage of affordable housing.” State governments were allotted with laying the groundwork to enable the entry of private developers to the affordable housing space, by granting zoning related incentives such as land use conversion and extra FAR for the construction of low-income housing. States could also reduce costs of housing construction for developers further by reducing the charge of the stamp duty or lowering tax rates on inputs for affordable housing. The Government additionally launched the Interest Subsidy Scheme for Housing the Urban Poor (ISHUP) in 2008 as part of JNNURM, which offers the poor a subsidy on the interest they pay for loans taken to buy or construct houses. In 2012, the upper ceiling of the loan for EWS was extended to Rs. 3 lakh and for LIG extended to Rs. 5 lakh. Both segments are given a five percent interest subsidy through the scheme.

²² "Affordable Housing in Partnership: Scheme Guidelines." *Ministry of Housing & Urban Poverty Alleviation*, December 1, 2013.

²³ "Realtors Keep of Government's Low Cost Housing Bus on Low Returns." *Economic Times*, August 10, 2014.

The second major affordable housing scheme currently in effect is the Rajiv Awas Yojana (RAY). MHUPA states, “RAY envisions a ‘Slum Free India’ with inclusive and equitable cities in which every citizen has access to basic infrastructure, social amenities and decent shelter.”²⁴ The Affordable Housing Partnership aspect of RAY seeks to contain the growth of slums. Through this program, the central government offers financial support to the private or public sector in the construction of either rental or ownership units for the EWS and LIG segment. State governments implement the schemes, by offering the monetary support to government institutions like state housing boards or private developers. The scheme also gives funds to local governments to create dormitories for the most common urban newcomers—poor migrant laborers.

Developers in the Low-Income Market

The mission of the government in the affordable housing space and the schemes of the government discussed above mean that any public effort to facilitate low-income housing must inherently dovetail with the private sector. Thus, it is important to understand to what extent developers are involved in the low-income housing market. Some upstart developers do realize they must find a way to penetrate the largely untapped market, because they cannot go on ignoring the over 13 million households that earn below 10,000 a month.

According to those in the developer industry, the price tags of “affordable housing” units can go up to Rs. 50 lakh. On the other hand, “low-income housing” is considered any project that sells an apartment for under 10 lakh. *Economic Times Magazine* surveyed several Indian developers and housing finance companies, estimating that “between 100,000 and 150,000 apartments costing under Rs. 10 lakh are in various stages of construction across the country.” These projects are often geographically concentrated in the peripheries of cities like Ahmedabad, where over 20,000 such apartments are being constructed.

In addition to the income-based definition of affordable or low-income housing discussed here in the context of developers and in a preceding section in the context of the government, the government also stipulates affordable houses by size to guide developers building low-income units. An affordable house for the EWS segment should be around 300 square feet, for LIG around 500 square feet, and for MIG between 600 and 1200 square feet. Actual private low-income housing often pertains to apartment units for sale that are around 500 square feet and cost approximately 5 lakh. Private developers have been begun building single-family homes for upper LIG, low MIG customers, which do fall into the industry standards of “low income housing.” For example, Tata first ventured into the low-income segment with its Shubh Griha brand of homes, priced between Rs. 3.9 and Rs. 6.7 lakh. In early August 2014, the real estate wing of Mahindra Group, Mahindra Lifespace, announced its first low-income housing project. They plan to construct 1200 units in Avadi, an industrial suburb of Chennai. One bedroom apartments will sell for 9.9 lakh and two bedroom units will sell for up to 16.5 lakh.²⁵

²⁴ “Affordable Housing in Partnership: Scheme Guidelines.”

²⁵ “Developers Bet on Sub-Rs 10 Lakh Homes; but Low-margin Environment Tough to Operate in.” *Economic Times*, August 10, 2014.

Other private sector innovations can also take place to stimulate the low-income housing sector. For example, customer financing can be linked towards developer financing. In a 2010 report, Monitor Deloitte created a model for a company specializing in micromortgages to Indians. In it, their model micromortgage company could disburse loan payments on behalf of the customers to the developer, in “tranches linked to the project development status” to finance the developer’s working capital needs.²⁶ Customers would pay some monthly installments prior to actually living in the flat so that the developer would have the liquidity to finish construction.

Housing Finance Corporations in the Housing Finance Market

The mortgage to GDP ratio in India is only around 7 percent, contrasting sharply with the United States where the mortgage to GDP ratio is over 51 percent²⁷. In Southeast Asia, which may be a more apt comparison for India, the same figure ranges from 15 to 20 percent. Access to mortgage finance for an economically diverse array of households is important for a robust housing market. Recognizing the need to promote long-term asset creation for all sectors of society who can afford formal financing if given the chance, HFCs have been making notable strides in figuring out how to serve the lower-income and informal sector customers.

A. Informal Sector Customers

With more than 70 percent of urban Indians employed in the informal sector, there has been increasing enthusiasm to extend services to these self-employed and/or unsalaried individuals. Housing finance in India cannot ignore the reality and must instead cater to it. HFCs and banks have slowly realized they must adapt formal financial documentation processes to serve a more typical “Indian” customer, especially because the guidelines and customs of finance were established in Western countries where most citizens do not depend on the informal sector for their livelihoods. Many of these HFCs began their alternative forays into the upper-income, informal sector, consisting of customers who could be small business owners or doctors running their own practice. Institutions like Dewan Housing Finance Limited have successfully developed this market. Now, a few HFCs have decided to tap into the low-income informal sector, which is where most Indians find work. Lower income informal sector workers could serve as tea stall operators, construction laborers, rickshaw drivers, or shopkeepers.

Instead of trying to fit lower-income households into their current financial paradigm, some HFCs have begun applying novel approaches to bring finance to the underserved by customizing their tools to the low-income borrower. The innovations in customer financing will be discussed in a subsequent section, but an introduction to the HFCs in the low-income space is given here. One company engaging in this field is Dewan Housing Finance Limited (DHFL), which is now the second largest private sector HFC. DHFL has a strong legacy in the middle and lower middle-income population but recognizes the need to serve those further down the market that have been neglected by conventional HFCs.

With a \$4.5 million equity investment from the International Finance Corporation, DHFL recently set up Aadhar Housing Private Limited, which exclusively focuses on the lower-income segment. Aadhar offers mortgages and microloans for house improvements and construction to

²⁶ Aditya Agarwal, Vikram Jain, and Ashish Karamchandani, "State of the Low-Income Housing Market Encouraging Progress & Opportunity to Realize Dreams of Millions." *Monitor Deloitte*, July 1, 2013.

²⁷ Khan.

low-income families earning Rs.60,000 to Rs.350,000 a year. This target population covers the higher EWS, full LIG, and lower MIG segments. Aadhar specializes in working with informal sector customers, such as small business owners and daily wage laborers. The maximum loan limit has been fixed to Rs.120,000 to narrow in on this group. According to Aadhar, “this channelized approach would result in dedicated, undiluted attention to this segment which would mean faster and greater growth for the segment thus impacting the nation as a whole.”²⁸ It issued around 2,500 mortgages and home improvement loans from 2011-2013 in the most low-income states of India. Though these numbers are small, the hope is that they will rise in the coming future.

Another pioneer in the space is Gruh Finance, which began as a joint venture with the Gujarat state government and HDFC in 1988. Gruh Finance is an important player that has developed an esteemed legacy of serving the low-income, informal sector. Gruh began by serving farmers in rural areas, but has diversified into working with urban Gujarat’s factory workers, shopkeepers, roadside cobblers, and tea vendors. Nearly 30 percent of Gruh’s loan disbursement is to individuals employed in the informal sector, the rest to salaried professionals and small businessmen. For a borrower that has no proof of income, Gruh has developed new models to identify his or her repayment threshold and charges an additional 2 percent risk premium on interest.²⁹ Gruh’s loan disbursement doubled in the five years between 2008 and 2012, from \$119 million to \$280 million. Its stock has risen more than five times in the last five years, indicating its risky venture into the low-income loan field is paying off.³⁰ Loan asset quality has also improved—Gruh’s non-performing assets are down to 0.52% from 5% in the late 1990s.

Some HFCs are also starting to finance Government-led housing for LIG customers. A perfect example of the type of public-private partnership that should be replicated in the Indian low-income housing space is the Government of Rajasthan’s alliance with Micro Housing Finance Corporation, an HFC that specializes in lending to the low-income and informal sector. The Rajasthan government initiated several low-income housing projects under the Central Government’s 2009 Affordable Housing Policy, which was discussed previously. It followed the public private partnership model by allying with private developers to construct housing complexes, such as one Bhairav Township 25 kilometers from Jaipur. In this complex, 1BHK flats are 325 square feet and were sold at Rs. 240,000 for the EWS group and 500 square feet and were sold at Rs.375,000 for the LIG group.³¹ Despite being able to construct the flats, the Rajasthan Housing Board faced difficulties in making the homes built through these mass-housing projects affordable to the target segment, so it partnered with MFHC and other down-market HFCs to make financing available to the low-income.³² Through this alliance, a scrap collector with two sons making Rs.15,000 a month, a processing unit supervisor with a family of four earning Rs.8000 a month, a cycle rickshaw driver netting Rs.10,000 a month during peak tourism season, and 4,000 more EWS and LIG households were able to buy their own homes in Bhairav Township. In addition to allying with Rajasthan Housing Board, Micro Housing Finance

²⁸ "About the Company." Aadhar Housing Finance Ltd. January 1, 2014. Accessed June 27, 2014. http://www.aadharhousing.com/about-us_new.html.

²⁹ Samar Srivastava, "Building Homes the Gruh Finance Way," *Forbes India*, March 6, 2013.

³⁰ Srivastava.

³¹ Srivastava.

³² Agarwal et al.

Corporation has in total given out loans worth Rs.250 crore to over 5000 customers, with an average loan size of only Rs. 5 lakh.

B. Process of loan origination for low-income, informal sector customers

So how do HFCs deploy their financial services to the low income and informal sector? HFCs specializing in small ticket loans such as Aadhar, Gruh, and MFHC are deploying their services to a few thousand lower-income, informal sector customers across India. Such HFCs recognize that informal sector individuals are not high risk but instead unknown risk, the degree of which they assess through detailed, field-based verification as opposed to formal financial documentation.

The process for extending loans to informal sector customers utilizes conventional financial metrics but incorporates innovative assessment methods. After pre-screening to remove obvious bad assets, the risk assessment method for informal sector customers require credit officers to visit customer homes and businesses to gather financial information. It is necessary to paint a picture of the household's monthly income and seasonal fluctuations in that figure, actual free cash flow after accounting for food, medical expenses, etc., and other sources of debt to limit defaults. By further interviewing family members, neighbors, and colleagues, the credit officer can glean a better picture of the customer's ability and willingness to pay back a loan. The process is tremendously detailed. As Gruh states, "each borrower has a lengthy file that notes information on him."³³

Micro Housing Finance Corporation claims that it has "mastered its customer income and credit assessment models" by acquiring a solid understanding of each type of customer. In an interview with the *Economic Times*, the Chairman of MHFC Madhusudhan Menon stated, "Today, if a barber claims that he makes Rs 40,000 a month, we know that he is exaggerating. His income is likely to be between Rs 15,000 and Rs 20,000."³⁴ Accumulated knowledge prevents the "unknown" aspect of an informal customer's riskiness from translating into dangerous risk. For example, Gruh may appraise the family based on "their everyday living habits, the consistency of daily sales, the existence of an active bank account, the ability to provide a guarantor for the mortgage, and their savings."³⁵ It also sometimes attaches the loan to all male members of a family instead of just one, in effect adding additional guarantors to the loan.³⁶ There has been talk of small-ticket housing loan companies allying with NGO groups, who could serve as strategic partners to aid the understanding of customers better with their detailed, historical knowledge of this customer group.

After thoroughly checking the customer case file, the HFC can decide on loan approvals and limits. This "storyboarding and verification" process converts the undetermined risk into understood risk. Further, sales incentives for the micromortgage HFC employees can be linked to quantity of loan originations as opposed to ticket size of each individual loan as it is conventionally done. With all this talk about mortgages, it is imperative to keep in mind that households require a slew of other services to abet the actual financing so that they can stay in

³³ Srivastava.

³⁴ "Developers Bet on Sub-Rs 10 Lakh Homes; but Low-margin Environment Tough to Operate in."

³⁵ "Gruh Finance: Serving the Underserved in the Housing Sector." Knowledge@Wharton. November 20, 2012. Accessed August 27, 2014. <http://knowledge.wharton.upenn.edu/article/gruh-finance-serving-the-underserved-in-the-housing-sector/>.

³⁶ "Gruh Finance: Serving the Underserved in the Housing Sector."

their home. If the government is interested in spreading finance to lower-income people sustainably, they must encourage HFCs to provide loan counseling and legal or technical advice that helps mortgaged homeowners keep their homes in times of trouble.

This type of loan to modest, informal sector workers is what consulting agency Deloitte Monitor calls micromortgages. Micromortgages crucially differ from microfinance loans in that they are secured loans, because the customer's house serves as collateral. The 2002 SARFAESI Act stipulates that HFCs can recover housing assets from customers in the case of default, reducing the risk of write-offs. Further, micromortgages command a ticket size roughly 40 times greater than microfinance loans³⁷. Monitor Deloitte finds that low per-rupee transaction costs and lower financial risk mean that a company exclusively giving out micromortgage, i.e. a microfinance counterpart for the housing sector, could offer a loan at the affordable rate of 12-14%, as opposed to the 18-36% most MFIs charge. Further institutionalizing the types of innovations discussed here may have the potential turn the few thousand low-income housing finance customers served into a few million.

³⁷ Nishant Lalwani, Kushagra Merchant, and Bala Venkatachalam, "Micromortgages: A Lacro Opportunity in Low-Income Housing Finance." *Monitor Deloitte*, October 1, 2010.

PART IV: PROBLEMS

Roadblocks for Developers

The contraction of the real estate market following the 2008-2009 economic slowdown initially drew developer attention into the lower-income sector. India's largest developer for example, Delhi Land & Finance (DLF), announced in 2009 that it would build 100,000 units across large cities in the under Rs.20 lakh category. However, for developers like DLF, the interest was only temporary. In a recent interview with the *Economic Times*, the executive director at DLF stated, "such projects are not viable anymore. In 2009 there was a downturn in the global economy ... but now prices have gone up and it does not make much business sense to launch such projects." As Jones LaSalle Group writes, "In India, private developers primarily target luxury, high-end and upper-mid housing segment, since it fetches a premium over low-income housing. Not surprisingly, RBI's House Price Index finds that house prices have nearly doubled since 2008-2009.³⁸ These market realities pose a systemic hurdle to bridging the gap between cursory interest in and actual execution of the construction of low-income housing units. These dynamics have naturally contributed to the 18.78 million housing shortage urban India is currently grappling with. Deloitte Monitor found that nearly 40 percent of the total market potential is between 4-6 lakh, but only around 10% of projects are offering houses at this price point, because the money is still in higher income markets.³⁹

The smallest units being built by conventional developers in an average urban area fit the government's definition of affordable housing for the LIG segment—500 feet. Yet they are priced at over Rs. 5 lakh. Using a price to annual income ratio of around 3.5, Monitor Deloitte discovered that a household earning Rs. 11,000 (\$183) a month, which was above the cutoff for an LIG household at the time of its study, could barely afford such housing even if it received financing.⁴⁰ As the income distribution of India is heavily skewed towards the bottom, Monitor also found that over 80 percent of India's urban households earn less than Rs.11,000 per month.⁴¹ Recall that low-income housing includes any housing below 10 lakhs, which is double the price point that is unaffordable for 80 percent of Indians.

The implications of this reality are the crux of the affordable housing crisis India faces. Firstly, it is crucial to remain vigilant as to what the private sector markets as housing for the low-income or affordable housing, because low-income housing projects are often intentionally too expensive to serve anyone but the middle income. Secondly, as over 80 percent of India's urban population is completely priced out of the current real estate market even with some financing, housing finance innovations for the customer must be supplemented by encouraging developers to actually build proper low-income units that can be bought by the LIG segment. Progress in only one front is insufficient to tackle the vast housing market shortages low-income Indians are currently grappling with.

³⁸ Deepak Mohanty. "Perspectives on Housing Finance in India," Remarks by Shri Deepak Mohanty, Executive Director, Reserve Bank of India, at the International Conference on "Housing: An Engine for Inclusive Growth" organized by the National Housing Bank, New Delhi, India, April 12, 2013.

³⁹ Agarwal et al.

⁴⁰ Ashish Karamchandani, Madhavi Soman, Smarinita Shetty, and Bala Venkatachalam, "Brick by Brick- Making a Market in Low-Income Housing." *Monitor Group India*, 2010.

⁴¹ Karamchandani et al.

Yet the battle is not only enticing developers to the low-income housing space, but also convincing them to stay. *Economic Times* cautions, “Many large players have also left this space as it’s tough to operate in the low-margin environment.”⁴² Affordable housing projects have margins 15-20 percent lower than conventional development projects. A huge factor for the low margins is land prices. In a 2013 study, Monitor Deloitte found that over half of surveyed developers stated the availability of affordable land was one of their top two business challenges⁴³. If the land itself is so expensive, even well intentioned developers have little incentive to truncate their profit margins by catering to low-income Indians through building small, affordable units. The scarcity of affordable land linked with local transport in Indian city centers means that the LIG segment is consistently getting outcompeted by prospective MIG and HIG homeowners and renters. The few low-income housing projects stand upwards of seventy-five to one hundred kilometers away from cities.

Another costly hindrance is the Indian bureaucracy. According to the Indian consulting firm KPMG, due to several varieties of approvals demanded by the municipal, state, and central bodies, it can take up to three years for a developer to begin construction after entering into a land purchase agreement when it should ideally take no longer than a few months.⁴⁴ KPMG estimates that project approval delays could add between 25 and 30 percent to the project cost⁴⁵. These delays add unnecessary project costs to affordable housing projects that further stall their already slow progress. India’s notorious bureaucracy has reasons for its slow churn—there are numerous interests to balance and protect in such a populated, multi-class, multi-ethnic nation. However, the multiple statutory approvals required, some rooted in bribery and corruption, is prematurely choking vital housing supply. At the state and municipal level, the government must bring efficiency in the market for land approval processes.

In addition, the considerable amount of non-marketable urban land owned by the government inflates land prices and exacerbates land shortages. These land parcels should be deployed to better use, such as low-income housing units. City governments should likewise establish zoning amendments to promote high-density housing, which ameliorates the pressure of costly land acquisition, and create zoning policies to devote areas in a city exclusively for Low-Income housing. Though the Central Government recommends states reserve 20-25 percent of developed land for EWS or LIG housing in every Government or privately built residential project, only a handful of states (mostly in southern India) have executive instructions to this effect.

Financial Challenges for HFCs

In a study conducted by Monitor Deloitte in 2013, nearly 70 percent of the HFCs surveyed cited either the cost of debt or access to debt as a top business challenge.⁴⁶ Many HFCs face a higher cost of funds than commercial banks do. Monitor Deloitte’s survey found the cost of debt to be between 9.5 percent and 14 percent for HFCs, quite higher than mainstream

⁴² “Developers Bet on Sub-Rs 10 Lakh Homes; but Low-margin Environment Tough to Operate in.”

⁴³ Agarwal et al.

⁴⁴ “Bridging the Urban Housing Shortage in India,” KPMG, 2012.

⁴⁵ “Bridging the Urban Housing Shortage in India.”

⁴⁶ Agarwal, et al.

financial institutions.⁴⁷ At the 2012 International Conference on “Growth with stability in affordable housing markets,” the Deputy Governor of the Reserve Bank of India discussed how a major constraint to the housing sector is the need for a long-term debt market. He states, “As debt markets are not very deep, access to long-term funding for housing finance institutions is difficult.” If HFCs are themselves unable to access financing because of a lack of robust capital market, they cannot provide lower cost mortgages to consumers.

The financing challenge HFCs must confront is further exacerbated by the fact that the HFC business model is susceptible to issues of having no choice but to borrow short and lend long. Most Indian banks create an asset liability mismatch by using their short-term funds from deposits to fund long-term housing loans. This has led many housing experts such as the Deputy Governor of RBI to suggest that India must allow suppliers of long-term capital, such as pension funds, provident funds, and insurance companies, to invest in housing finance and match the long-term nature of home loans.

Finally, financial access for HFCs has also increased talks about developing India’s nascent securitization market. The RBI Deputy Governor further states, “to tide over the paucity of funds, it is imperative to develop the secondary mortgage market [because] securitisation ensures recycling of funds.”⁴⁸ Securitization eases financing pressures on financial institutions, because it increases their lending capacity without requiring them to attract more deposits or capital. It also addresses certain asset-liability mismatches because securitization “offers flexibility in structuring and timing cash flows to each security tranche.”⁴⁹ Obstacles to the creation of such a market in India include legal hindrances, high stamp duties on financial assets (between 3-14 percent), and the lack of uniformity in underwriting norms. RBI has allowed banks to enter the RMBS market, but has restricted HFCs from doing so. With the US’s subprime mortgage crisis on its mind, the Reserve Bank of India is warily looking into the market for residential mortgage backed securities.

Feasibility of Micromortgages for Low Income Households

Though the private sector’s foray into the low-income housing space should be celebrated as exciting progress, it is vital to take a deeper look into whom private affordable housing efforts are actually serving and which income group’s shortage they are actually addressing. Because the conventional real estate market in India is currently so skewed to the upper income echelons, it is easy to get caught up in the hype of inclusive housing reports by firms like Monitor Deloitte and Jones Lang LaSalle; they amplify the degree to which lower-income Indians are being served and can be served with the types of minor financial innovations discussed in the Part III: Opportunities section. As Sahil Gandhi writes in the Economics of Affordable Housing in Indian Cities, the skewness of the income distribution towards the lower-income groups poses a fundamental challenge for affordable housing. When breaking down the low-income household’s budget, it becomes evident how cheap low-income housing units must be priced in order to actually be accessible to the majority of Indians.

⁴⁷ Agarwal, et al.

⁴⁸ Khan.

⁴⁹ Khan.

A. Dissecting the Monthly Expenditures of the Low-Income

The National Sample Survey sheds light on what low-income households look like by estimating the monthly per capita expenditure (MPCE) of a typical urban household, which would likely be placed in the LIG or lower MIG category. In the 2012 survey, NSS found that the average urban Indian household directs 42.6 percent of its consumption towards food, 6.9 percent for education, 6.7 percent towards fuel and light, 6.5 percent towards transportation, and 6.4 percent for clothing and footwear⁵⁰. The MCPE excludes housing costs for owner-occupied dwellings, because so many have been self-constructed and do not count as monthly expenditures⁵¹. Rental calculations are also unreliable because such numbers are subject to immense variation in India, where informal payment arrangements between tenants and owners, squatting, and frequent displacements are common. The figures portrayed above mean that theoretically, the average urban family can deploy at most around thirty percent of its consumption expenditure towards rent or mortgage payments. This simple calculation more or less corroborates the lower side of the government's definition on what constitutes housing that is affordable instead of cost burdening. MHUPA describes affordable housing for EWS, LIG, and MIG as one where the equated monthly installment (EMI) or rent does not exceed 30-40 percent of a resident's gross monthly household income, but even this may be pushing it as seen from the MCPE findings.⁵²

B. Taking a Second Look at Micromortgage Innovations

After discussing how the average Indian household spends nearly 70 percent of its monthly expenditures on simple survival necessities including food, transportation, and fuel, it is time re-evaluate the structure of the micromortgages discussed by Monitor Deloitte and other groups. Recall that the current government categorization of the low-income group includes households earning between Rs.8333 and Rs. 16667 per month. One of Monitor's earlier studies referenced in a preceding section itself found that because over 80 percent of India's urban households earn less than Rs.11,000 per month, nearly 80 percent of Indians could not afford a 5 lakh house even with financing. Yet at the same time, Monitor Deloitte clubs all the the 23 million houses earning below Rs.25,000, which is over double that, as low-income households. This must take up close to 90 percent of India's total population, which clearly cannot all fall into a national definition of a low-income group. It is important to refocus the lens of study by scrutinizing the actual income breakdown in the context discussed above.

Monitor does sketch what a micromortgage would look like for a potential lower-income household. Monitor describes this potential mortgage for a household with a monthly income of 16,667, which would be an LIG household on the cusp of entering the MIG segment. The target home would be priced at 5.9 lakh, which is definitely on the lower side of private low-income housing project that were defined by the industry in a preceding section as below 10 lakh. Monitor writes that an affordable equal monthly installment would be 35 percent of the household's income, which would be 5833. However, as households in Monitor's survey spent

⁵⁰ "Key Indicators of Household Consumer Expenditure un India, 2011-12," Government of India Ministry of Statistics and Programme Implementation National Sample Survey Office, June 20, 2013.

⁵¹ O.P. Sharma and Carl Haub, "How People in India 'Really' Live," Population Reference Bureau, December 2008.

⁵² "What's Holding Back Affordable Housing in India," Knowledge@Wharton, October 18, 2012.
<http://knowledge.wharton.upenn.edu/article/whats-holding-back-affordable-housing-in-india/>

an average of 10-12 percent of their MHI on rent, the jump to 30-40% of MHI on their mortgage's EMI may be too much to ask. Regardless of whether the household somehow managed to factor such a large monthly payment out of its income, it would surely require the family to reallocate and reprioritize expenditures that are overwhelmingly already based on needs. Next, for a twenty-year loan, this example household could potentially qualify for a loan for 4.7 lakh at 14 percent interest. Recall that 14 percent interest is ten percent higher than the average rate in the US, which is 4.125 percent.

The example mortgage would also require a down payment of 1.2 lakh. It is important to assess how much low-income individuals save in order to assess the feasibility of financing that requires such large down payments. In a 2008 study, Monitor group found that most respondents with a monthly income below Rs.12,000 claimed they were unable to save on a monthly basis.⁵³ Those with monthly incomes between Rs.12,000 and Rs.25,000, which cuts well into the MIG segment, could save at most between Rs.2000 and Rs.4000 per month. If this example MIG household was able to muster saving Rs.2000 a month and devoted its entire savings to this down payment, it would take a five full years for a family to reach that goal. Most of the Housing Finance Corporations that cater towards lower-income Indian customers only give out mortgages with a Loan to Value (LTV) ratio between 60-80 percent, as opposed to the Federal Housing Authority loans in the US for low-income and first time homebuyers that have an LTV of 97 percent. As most of India's lower income households either do not save or are in this meager savings position, where would this down payment come from without burdening them with more informal debt from a relative or moneylender?

Furthermore, financial documentation methods for the low-income are much more difficult and nuanced than Monitor makes it seem. Even though the preceding section under Part III: Opportunities discussed how a handful of HFCs have been adapting their business model to cater to the informal sector, with regard to poor individuals who are in the formal sector, the prospects are less than promising. Monitor states that when dealing with low-income formal sector customers, HFCs can adapt conventional processes with a few tweak, i.e. "the process will continue to rely on standard documents such as pay slips, income tax returns, and bank account records."⁵⁴ However, conventional methods are still fraught with many difficulties for the formal low-income and that is why players have mainly stuck with the informal sector.

Many such workers often do not have accessible bank accounts. Just half of Indians have a savings account, and this number is much lower in Northern, Central, and Eastern India where financial exclusion is omnipresent.⁵⁵ Further, many lower-income Indians listed as having savings accounts either do not know how to access them or choose not to. Financial inclusion is a chief concern for the Central government because of the pivotal nature of having the whole population have bank accounts. The future of housing finance will largely rest with the government's new drive for financial inclusion, but until then bank account records are not a viable documentation method for accessing a mortgage for the low-income. With regard to taxes, the lower MIG households only pay 10% of their income above Rs.2 lakh as taxes. All EWS and

⁵³ Karamchandani et al.

⁵⁴ Lalwani et al.

⁵⁵ "Just Half of Indians Have a Savings Bank Account," *Business Standard*, June 28 2013. http://www.business-standard.com/article/economy-policy/just-half-of-indians-have-a-savings-bank-account-113062800037_1.html

LIG households are income tax-exempt, so using income tax returns to document the low-income's financial health is also impossible. The exceeding optimism of such consulting firms, who represent both government and private sector interests, seem to be clouding some basic truths and should not be taken at face value.

C. The Repercussions of Inflation

The last, most pervasive caveat is inflation. It is important to keep in mind that the 30-40 percent of income benchmark may be way too precarious for the people of a country like India, who both spend nearly half of their income on food and fuel related expenses and are simultaneously tackling persistently high inflation in those very categories. In November 2013 for example, food prices were up 18.2 percent from a year before⁵⁶. In a country where prices for the most basic ingredients of survival, food and fuel, are perpetually rising and in flux, it may be difficult to ask customers to overpay for a mortgage or rent like is the norm in the United States. When Americans go to the bank to obtain a mortgage, they do not have to worry about inflation eroding their wages or diminishing the value of their hard-earned savings. Indians very much do. India's macroeconomic environment must be kept in mind when assessing the feasibility of private sector financing plans for low-income customers.

Not only are consumers punished by inflation, but so are developers, landlords, lenders, and most players in the housing finance market as well. Developers are hit particularly hard. According to KPMG's *Bridging the Urban Housing Shortage in India*, construction costs form nearly 50 to 60 percent of the total selling price in affordable housing projects, because land prices play a smaller role in project costs the further outside the city developments are.⁵⁷ The prices of raw materials such as steel, bricks, cement, sand, etc. have climbed by 20-50 percent in the last few years. Between 2010 and 2011, cement prices increased on average by 35 percent and labor costs by 30 percent.⁵⁸ Inflationary pressure on the Indian economy, and both the increasing expense and the variable risk this places on long-term development projects, threatens the housing supply for low income Indians. Thus, housing finance both for the consumer and developer is very much linked to the macroeconomic stability of the Indian economy.

⁵⁶ Neha Bagri, "Food and Fuel Prices Push Indian Inflation Higher," The New York Times, Nov 14, 2013. Accessed August 30, 2014. <http://www.nytimes.com/2013/11/15/business/food-and-fuel-prices-push-indian-inflation-higher.html>

⁵⁷ "Bridging the Urban Housing Shortage in India."

⁵⁸ "Achieving Sustainable Growth in Reality," KPMG-CREDAI, December, 2011.

PART V: MOVING FORWARD

All the innovations groups like Monitor discuss are extremely important and that is why they have been discussed in this report. It is a true testament to the size and potential of the lower-income market that global consulting firms and real estate developers have devoted significant, consistent attention to modeling the market. It is possible that the growing HFC market's interest in lower middle class individuals will trickle down to the low-income eventually. The interest in this lower-middle class market also takes pressure away from the government in having to handle the needs of too many urban Indians, so it can focus on deploying subsidies to the truly low-income, as is its first mandate.

However, it is crucial to remain wary of the publicity associated with catering to this segment, because the numbers alone depict what a challenging and selective task it is to absorb LIG households into the conventional housing finance sector. Amitabh Kundu, professor at the school of social sciences at the Jawaharlal Nehru University and a member of the High Level Task Force on Affordable Housing for All constituted by MHUPA, states that in the name of affordable housing, “everyone is being included, including the middle and the upper class. People are using the vehicle of affordable housing to open the housing market. But just by facilitating the housing market you are not going to help the poor. We need to have strong enabling policies and very clear targeting.” The truth is that both the government and private sector housing initiatives have actually served only a small percentage of low-income Indians properly. To actually tackle “Affordable Housing for All,” the government will have to strategically ramp up its second mandate— to lay the groundwork to facilitate private sector involvement in the actually low-income housing space.

Government Refinancing to HFCs

The primary tool NHB has to stimulate lending to the low-income is the refinancing facility it extends to registered HFCs. In August 2012, in order to encourage affordable housing finance, NHB already cut the interest rate on refinance to banks and HFCs on loans up to US \$9434 for low-income urban households.⁵⁹ The government must continue to ramp up the amount it disburses as refinancing to those HFCs serving the low-income sector successfully. As Aadhar's CEO stated after it applied for refinance facility from the NHB, by “getting refinance facility from NHB, Aadhar would be able to bring down the cost of funds which would then be passed on to [their low-income, informal sector] borrowers.”⁶⁰

NHB alone does not have enough capital to extend financing help to all eligible low-income borrowers, so it has been securing help from international institutions to widen its refinancing facility. In August 2013, NHB signed Loan and Project Agreements for 100 million USD from the World Bank for a Low Income Housing Finance Project. The project aims to increase the number of primary lenders active in the low-income segments and the number and volume of loans given to such borrowers. It does so primarily by using the funds to refinance

⁵⁹ “Gruh Finance: Serving the Underserved in the Housing Sector”

⁶⁰ “Aadhar Housing Finance to seek refinance from National Housing Bank,” *Economic Times*, August 6, 2014. Accessed August 10, 2014. http://articles.economictimes.indiatimes.com/2014-08-06/news/52514653_1_nhb-national-housing-bank-interest-rate

low-income housing loans made by qualified banks and HFCs.⁶¹ Focusing on HFCs with a successful track record in catering to the low-income, informal sector will strengthen the industry and increase quality loan disbursement to the LIG sector.

Priority Sector Lending to Banks

The government also must encourage banks to cater to the low-income, because banks are massive players in the housing finance market, as evidenced by the fact that they are responsible for two thirds of all housing credit in India.⁶² Though banks have overwhelmingly focused on middle/upper income households, there have been some low-income innovations like Axis Bank's recent "Asha Home Loan," which is a 30-year product offering loans between Rs 1 lakh and Rs 15 lakh in small towns and up to Rs 25 lakh in larger urban areas.⁶³ Even though other banks like ICICI have also been trying to extend housing loans moderately down market, the expansion of low-income housing finance will likely not be led by private and public sector banks in India, because most banks do not have the flexibility or drive of entrepreneurial HFCs to alter the paradigms of finance to serve most Indians. This neglect not only means low-income households are shut out of the market, but it places abstractly sound government schemes in jeopardy when it comes to actually getting results. For example, the ISHUP interest subsidy scheme discussed previously has failed to better facilitate the urban poor's access to long-term institutional finance, largely because of the lack of willingness on the part of banks to provide loans to the poor. As a result, there have been less than 9,000 EWS and LIG beneficiaries through the program and they are further concentrated in just some states: Andhra Pradesh, Karnataka, Tamil Nadu, Kerala, Madhya Pradesh, Chhattisgarh, Maharashtra, Rajasthan, and Uttar Pradesh.⁶⁴ This means that the majority of government funds that are supposed to be deployed as interest subsidies are sitting there unused.

That is why priority sector lending requirements, where the government incentivizes banks to not just serve the upper-middle class and wealthy, are extremely important when it comes to housing. In March 1994, housing finance was included in the priority sector lending criteria for banks, alongside other aspects of "all-rounded" development such as industry and agriculture. Currently, a direct housing loan cannot exceed Rs.1.5 million to qualify as priority sector lending.⁶⁵ The government has been expanding the number of borrowers reached by increasing priority sector lending for affordable housing. In July 2014, the RBI brought housing loans of up to Rs.50 lakh for houses worth up to Rs.65 lakh in large cities under priority sector lending. In slightly smaller Tier II cities, the new higher limit is loans up to 40 lakh for house worth up to 50 lakh.⁶⁶ Consumers might see a fall of 25-50 basis points in rates with these new norms in place. This move is a reflection of rapidly rising home prices in urban areas. Though the upper loan thresholds are much higher than what low-income Indians could even dream of affording, it is possible some benefits of easing rates for middle-income consumers will trickle down to poorer sections.

⁶¹ "India: Government of India and World Bank Sign \$100 Million Agreement to Help Low-Income Families Secure Housing Loans," *World Bank*, August 14, 2013.

⁶² Khan.

⁶³ "Developers bet on sub-Rs 10 lakh homes; but low-margin environment tough to operate in"

⁶⁴ "Housing subsidy scheme for urban poor revised," *Economic Times*, Feb 15, 2012. Accessed August 5, 2014. http://articles.economictimes.indiatimes.com/2012-02-15/news/31063332_1_interest-subsidy-lig-urban-poor

⁶⁵ Chiquier et al.

⁶⁶ Raghavendra Kamath, "Impact of RBI decision: Home loan borrowers, realtors to benefit," *Business Standard*, July 16, 2014.

PART VI: CONCLUSION

“Affordable Housing for all by 2022” is an immensely daunting challenge that will require the triangulation of government, international capital, and private sector efforts to even put a dent in the massive number of households that lack adequate homes. The challenge is also an exciting opportunity to inspire public-private partnerships that widely serve low-income Indians in their most fundamental needs.

Through analyzing consumer incomes and private sector pilot programs for the low-income, it seems that ownership through finance innovations like micromortgages may be possible for the highest income segment of the LIG population and the lower MIG population. In this space, the government’s enabler role is paramount. Its job will be easing land approval processes and making land less costly for private developers in the low-income market, while simultaneously extending refinancing facility to HFCs serving the low-income. If the government takes one further step, the middle rung of the LIG segment that make more than Rs.11,000 a month may be able to achieve ownership through home loans. For these households, government subsidies like the ISHUP interest scheme are theoretically the types of public policy tools needed to stimulate long-term housing finance. However, reality roadblocks, such as the fact that most banks refuse to cater to the low-income, blunt these schemes when in the execution phase.

Despite those dynamic opportunities for ownership, it seems fairly certain that all of the EWS segment and the majority of the LIG segment will be confined to the rental market or slum living. Not all low-income households with inadequate or nonexistent housing will be able to buy homes because of obvious income constraints. Affordable housing ventures will therefore have to address not only homeownership opportunities, but rental needs as well. In addition to building new rent-only units and reforming outdated rent control laws that have made the percentage of renters in urban India actually decrease over the last twenty years, the massive urban housing shortage will require rehabilitating existing units.

As 95% of the shortage is burdened by the low-income and poor, government efforts will have to meet them where they are, especially because historical rent controls rendered much of existing low-income rental stock neglected, overly congested, and dilapidated. The government will have no choice but to take on the unglamorous responsibility of adding toilets, fixing pipes, fitting roofs, and other basic, cost-effective renovations to existing infrastructure. The government must replace its facilitator hat with an actor hat for the poor and truly low-income group. As Peer Smets of Vrije Universiteit in Amsterdam states, “the poor are better helped by credit schemes for incremental building and shelter upgrading than by long term finance for ready-made shelter.”⁶⁷ This is an important truth that overly gung-ho consulting firms and real estate investment firms have not admitted.

Even if all the government schemes were free of leakages, even if banks and HFCs could be convinced to lend to the low-income, and even if private developers were persuaded to enter

⁶⁷ Smets.

the untapped low-income housing market, the final piece of the affordable housing puzzle does come down to financing, for all players in the unique low-income space. The Central government's financing facilities, particularly through NHB and RBI, will considerably aid in this regard in the coming future. Yet the sheer scope of the "Affordable Housing for All by 2022" challenge and size of the Indian market will demand both international capital and domestic investor interest. Only then will the market for low-income housing be bolstered to serve the millions of low-income urban Indians.