R Gandhi: Real estate and housing – a sensitive sector or Samvriddhi sector?

Speech by Mr R Gandhi, Deputy Governor of the Reserve Bank of India, at the "NAREDCO CONCLAVE – Banking & Investment Reforms: Housing for all by 2022", Mumbai, 20 August 2014.

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1. Shri Navin Raheja, Chairman, National Real Estate Development Council, Shri Sunil Mantri, President, NAREDCO, members of NAREDCO, Ladies and Gentlemen, a warm good evening to all of you. I am very happy to be addressing you all at this valedictory session of the NAREDCO Conclave on Banking & Investment Reforms.

Real estate and our economy

2. The term "real estate" is defined[1] as land, including the air above it, the ground below it, and any buildings or structures on it. It is also referred to as realty. It covers residential housing, commercial offices, trading spaces such as theatres, hotels and restaurants, retail outlets, industrial buildings such as factories and government buildings. Real estate involves the purchase, sale, and development of land, residential and non-residential buildings. The real estate sector is a major employment driver, being the second largest employer next only to agriculture. This is because of the chain of backward and forward linkages that the sector has with the other sectors of the economy, especially with the housing and construction sector. About 250 ancillary industries such as cement, steel, brick, timber and building materials are dependent on the real estate industry. While it is difficult to estimate the exact contribution of the real estate sector to gross domestic product (GDP) as it appears in a disaggregated and dispersed form in the National Accounts Statistics, in view of what is stated above, lot of importance has been placed on the development of real estate in the country by the Government.

Finance to real estate

3. Real estate and Housing sectors are unique in one respect. It is in these sectors the financing thereof is contributed by every possible source – be in the central government, the state governments, banks, NBFCs, HFCs, MFIs, private capital – formal or informal, or individuals – has a hand in it; still it is insufficient, given the massive magnitude of the needs for housing and real estate sectors in the country.

4. The Government of India has taken several important policy decisions over the years in the areas of affordable and low income housing. It has played an important role in ensuring that the affordability component merges well with the overall sectoral strategy. Two factors that have clearly emerged as key drivers in the Indian housing market are: (1) a wider group of stakeholders and a multiplicity of institutions, and (2) enhanced confidence in the housing finance industry of all stakeholders.

5. The National Housing and Habitat Policy 2007 lays emphasis on development of affordable housing and elimination of acute housing shortage among the poor. Accelerated supply of serviced land, expansion of housing finance market and facilitating the private sector participation in the sectoral growth are also emphasized in the Policy. With the establishment of individual home loan financing through commercial banks & housing finance

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[1] Tenth Five year Plan document of the Planning Commission

companies, access to home loan finance has expanded considerably. However, access to finance for the very poor and those working in informal sector, to fulfil their affordable housing needs, still needs to go a long way.

6. Recognising the importance of housing and real estate sectors, the Union Budget for 2014–15 included several announcements such as –

- ₹ 8000 crores allocated to the Rural Housing Fund run by NHB.
- ₹ 7,060 crores allocated for development of 100 new smart cities in the country.
- Relaxation of FDI norms in the real estate sector.
- ₹ 4,000 crores allocated for low-cost housing and ₹ 50,000 crores for urban housing.
- Slum development to be treated as Corporate Social Responsibility (CSR) activity.
- Real estate investment trusts (REITs) introduced. SEBI has since issued guidelines in this regard.
- Increase in deduction limit on interest paid on home loans.

7. State Governments have also played an important role in promoting affordable housing for the lower segments of the population. Many of the State Governments have initiated programmes aimed at eradication of slums and provision of formal housing to the lower income segments. These programmes, which are at various stages of execution, have given to the people, hopes for a better life and hopes for a brighter tomorrow. Other policymakers such as the Reserve Bank of India and the National Housing Bank are also playing their part in promoting growth through housing. It is heartening to note that the housing finance sector, which was in its infancy just two decades back, is now a thriving and vibrant part of the overall financial sector, is well integrated with the other segments of the economy and is equipped to take on the challenge of extending access to formal housing finance system to the less privileged segments of the society.

Housing finance

8. The housing finance market witnessed significant expansion in late 1990s and early 2000s with the entry of scheduled commercial banks in a big way. The housing loan portfolio of both SCBs and HFCs has grown significantly over the years due to supportive policies initiated by Government of India and RBI. On the one hand, fiscal concessions were provided by GoI (under sections 80 C and 24 of I.T.Act) while on the other hand, housing loans upto ₹ 25 lakh given by SCBs were brought under Priority Sector Lending. NPAs being very low and supported by SARFAESI Act, has prompted the financial institutions to make available housing loans at competitively affordable and comparatively lower rates. Besides, GoI has also implemented Interest Subvention Schemes like 1% Interest Subsidy Scheme, Interest Subsidy Scheme for Housing the Urban Poor (ISHUP) and Rajiv AwasYojana (RAY), etc., in order to make housing loans affordable for the targeted segments. These measures have resulted in improving the demand for housing loans. Recently, RBI has carved out Residential Project loans out of the purview of Commercial Real Estate arena to boost financing of project loans for increasing the supply of housing stock. The housing loan portfolio of financial institutions (SCBs and HFCs) has increased from ₹ 4.60 lakh crores in 2010 to ₹ 8.90 lakh crores in 2014 thereby registering CAGR of about 18% over 2010–2014.

9. However, housing loans as a percentage of GDP in our country has remained quite low at around 9 per cent which is significantly lower than the levels achieved in most of the developed countries. Further, the housing shortage in the urban areas was estimated, as of 2012, at 18.78 million units while in rural areas it is estimated to be more than 40 million units. The situation is alarming with 95 per cent of the housing shortage pertaining to the Economically Weaker Section (EWS) and Low Income Group (LIG) categories which do not seem to be getting translated into economic demand due to lower affordability by the poor.

The ever increasing demand for housing due to increased migration from rural to urban areas has continuously led to development of slums and unhygienic living conditions dragging down the productivity of the city and its potential contribution to economic growth. This definitely indicates the extent of opportunity for deeper penetration of this market.

10. The housing market in India is influenced by both demand and supply side constraints. The growing middle class, income levels of the people, cyclical conditions, urbanization are demand drivers which have impacted the housing sector. The major supply side constraints include the lack of availability of land, finance at reasonable rate, infrastructure, legal and regulatory framework and the limitations of the private and other stakeholders to provide low income housing.

11. Banks and financial institutions consider lending to the poor a risky business. To renew the interest of the lending agencies in the financial sector towards extending housing finance to this segment of the population the Government of India has been taking a number of steps like the establishment of the Credit Risk Guarantee Fund Trust for Low Income Housing, Rajiv Rin Yojana, etc. The Hon'ble Finance Minister in his budget of 2014–15 has given impetus to the mission of "Housing For All" by allocating a sum of ₹ 8000 crore towards the Rural Housing Fund, ₹ 4000 crore towards affordable housing to the urban poor/EWS/LIG segment. He has also extended additional tax incentive on home loans under Sections 80 C and 24 of I.T.Act, to encourage people, especially the young, to own houses amongst others.

Regulatory approach

12. Despite the significance of the real estate and the housing sectors for the economy as a whole, their contribution to and further potentials for economic growth, and their critical role in poverty alleviation, these sectors have been globally considered by regulators as volatile and prone to formation of asset bubbles, requiring special regulatory attention to protect the interest of lenders and even the borrowers. Many a financial crisis in the world has been caused by the excesses in these sectors. Most recent global economic and financial crisis of 2008–09 has also been caused by these excesses. Therefore the regulatory approach to these sectors has been highly sensitive.

13. Reserve Bank's regulations have also been directed towards containing excessive/rapid flow of credit towards the sector, prescribing prudential norms for banks and NBFCs for lending towards real estate activities. However, India needs special attention and support for housing. Therefore, the policy approach has been so fine-tuned facilitating affordable housing for weaker sections and growth of the residential real estate sector. National Housing Bank's regulations for the Housing Finance Companies also follow similar approach.

Banks and CRE & housing

14. CRE and Housing finance as a financial service is relatively young in India and has witnessed massive growth particularly over the last twenty years. Banks became major players in the Indian mortgage market only from the late 1990' and are now one of the largest mobilizers of households' savings and housing finance. The Indian banking sector has an expansive reach and is well geared to serve all segments of the society, including the underprivileged.

15. Our circular DBOD.BP.BC.No.42/08.12.015/2009–10 dated September 9, 2009 on "Guidelines on Classification of Exposures as Commercial Real Estate (CRE) Exposures" prescribes that for an exposure to be classified as Income Producing Real Estate (IPRE) / Commercial Real Estate (CRE), the essential feature would be that the funding will result in the creation / acquisition of real estate (such as, office buildings to let, retail space, multi-family residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment would depend primarily on the cash flows generated by the asset. Additionally, the prospect of recovery in the event of default would also depend primarily on the cash

flows generated from such funded asset which is taken as security, as would generally be the case. The primary source of cash flow (i.e. more than 50% of cash flows) for repayment would generally be lease or rental payments or the sale of the assets as also for recovery in the event of default where such asset is taken as security.

16. This circular also states that it is possible for an exposure to get classified simultaneously into more than one category, as different classifications are driven by different considerations. In such cases, the exposure would be reckoned for regulatory / prudential exposure limit, if any, fixed by RBI or by the bank itself, for all the categories to which the exposure is assigned. For the purpose of capital adequacy, the largest of the risk weights applicable among all the categories would be applicable for the exposure. The rationale for such an approach is that, while at times certain classifications / categorizations could be driven by socio-economic considerations and may be aimed at encouraging flow of credit towards certain activities, these exposures should be subjected to appropriate risk management / prudential / capital adequacy norms so as to address the risk inherent in them. Similarly, if an exposure has sensitivity to more than one risk factor it should be subjected to the risk management framework applicable to all the relevant risk factors.

17. In view of the volatility in prices of commercial real estate (CRE), higher risk weight and provisioning norms have been prescribed by us for the CRE Sector. We have prescribed differential Loan to Value (LTV) Ratio, risk weights and provisioning for individual housing loans in order to differentiate the risks involved in low value and high value home loans. In order to support the residential housing sector, we have carved out (vide circular dated June 21, 2013) a separate sub-sector out of CRE viz. CRE-RH (Commercial Real Estate – Residential Housing). The circular defines CRE-RH as below:

> *CRE-RH would consist of loans to builders / developers for residential housing projects (except for captive consumption) under CRE segment. Such projects should ordinarily not include non-residential commercial real estate. However, integrated housing projects comprising of some commercial space (e.g. shopping complex, school, etc.) can also be classified under CRE-RH, provided that the commercial area in the residential housing project does not exceed 10% of the total Floor Space Index (FSI) of the project. In case the FSI of the commercial area in the predominantly residential housing complex exceeds the ceiling of 10%, the project loans should be classified as CRE and not CRE-RH*.

18. Carving out of CRE-RH was done with the intention of providing regulatory support to lending towards residential housing projects by allowing lower provisioning and risk-weights. Apart from this, different slabs of LTV ratios, risk weights and provisioning have been prescribed to support housing loans for lower income groups while stressing the need for higher stake of home buyers in high cost houses.

19. The LTV ratio – Risk weight matrix for housing loans as also CRE and standard assets provisioning for both Housing as also CREs are tabulated below:

Category of Loan	LTV Ratio (%)	Risk Weight (%)	Standard Asset Provisioning (%)
(a) Individual Housing Loans			
(i) Up to ₹ 20 lakh	90	50	0.40
(ii) Above ₹ 20 lakh and up to ₹ 75 lakh	80	50	0.40
(iii) Above ₹75 lakh	75	75	0.40
(b) CRE-RH	N A	75	0.75
(c) CRE	N A	100	1.00

20. The restructured housing loans should be risk weighted with an additional risk weight of 25%. In view of the higher risk associated with housing loans at teaser rates i.e. at comparatively lower rates of interest in the first few years, after which rates are reset at higher rates, we have prescribed higher standard asset provisioning on such loans at 2.00 per cent from December 2010. The provisioning on these assets would revert to 0.40 per cent after 1 year from the date on which the rates are reset at higher rates if the accounts remain "standard".

21. We have also advised banks vide circular dated February 3, 2012 that they should not include stamp duty, registration and other documentation charges in the cost of the housing property they finance so that the effectiveness of LTV norms is not diluted. These charges overstate the realisable value of the property and consequently the margin stipulated gets diluted.

22. In order to ensure adequate credit flow to infrastructure sector as also towards the affordable housing needs of the country, by encouraging banks to optimally utilize the long-term financing avenues already available to them to finance their lending to these sectors, the extant prudential guidelines on this issue have been reviewed with a view to minimize certain regulatory pre-emptions. RBI vide its circular dated July 15, 2014 allowed banks to issue long-term bonds with a minimum maturity of seven years to raise resources for lending to (i) long term projects in infrastructure sub-sectors, and (ii) affordable housing. The circular has defined lending to affordable housing as housing loans eligible under priority sector lending by the RBI and also housing loans to individuals upto ₹ 50 lakhs for houses of values upto ₹ 65 lakhs located in the six metropolitan centres viz. Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad and ₹ 40 lakhs for houses of values upto ₹ 50 lakhs in other centres for purchase/construction of dwelling unit per family. RBI will periodically review the definition of affordable housing on account of inflation.

NBFCs and real estate

NBFCs primarily into housing finance – Housing Finance Companies (HFC):

23. NBFCs that are primarily into housing finance are regulated by National Housing Bank. At present, around 60 Housing Finance Companies are registered with NHB, of which around 18 are deposit taking ones. As per the NHB report on trend and progress of housing in India 2013, the share of HFCs in the total housing loan portfolio of the country was 46 per cent for 2012–13. Total outstanding housing loans of HFCs as on March 31, 2013 stood at ₹ 2,90,427 crores.

NBFCs other than HFCs:

24. Regulation on lending to / investment in real estate by NBFCs registered with Reserve Bank cover the following:

i. Deposit taking NBFCs are not permitted to invest in land or building, except for its own use, beyond an amount exceeding ten per cent of its owned fund.

ii. Since September 2011, deposit taking and non-deposit taking NBFCs with asset size of ₹ 100 crores and above are required to furnish data on their exposure to real estate.

iii. While granting finance to housing / development projects, NBFCs also should stipulate as a part of the terms and conditions that the builder / developer / owner / company would disclose in the Pamphlets / Brochures / advertisements, etc., the name(s) of the entity to which the property is mortgaged and that they would provide No Objection Certificate (NOC) / permission of the mortgagee entity for sale of flats / property, if required.

iv. The risk weight currently applicable to real estate exposures is 100 per cent. For loans guaranteed by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH), NBFC-MFIs may assign zero risk weight for the guaranteed portion.

v. Every non-deposit taking NBFC with asset size of ₹ 100 crores and above shall disclose its exposure to real estate, both direct and indirect.

vi. Mere extension of date of commencement of commercial operation (DCCO) in the case of CRE projects would not be considered as restructuring, if the revised DCCO falls within the period of one year from the original DCCO and there is no change in other terms and conditions.

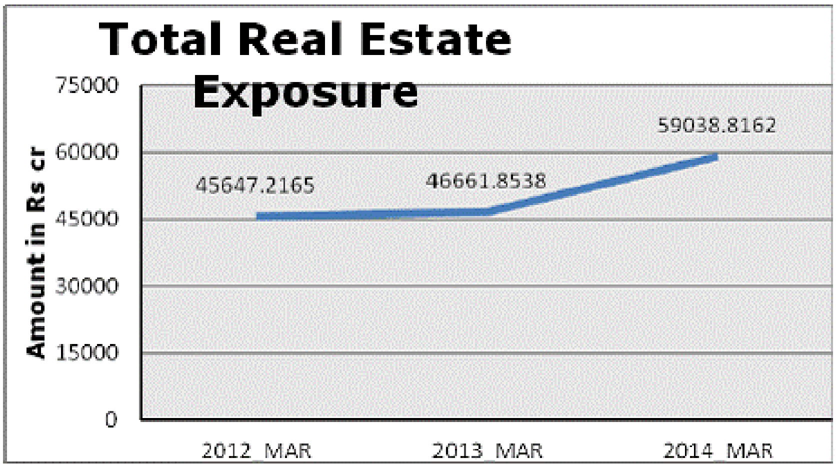
vii. Further, the general instructions with regard to prudential norms including exposure norms are also applicable to NBFCs' exposure to real estate.

NBFCs – Real estate exposure

25. As on March 31, 2014, the real estate exposure of NBFCs registered with the Bank at around 4.1 per cent of the total assets of the sector is not significant as may be observed from the table below. Further, only few NBFCs are reported to have relatively high exposure to real estate. The number of such NBFCs having exposure of more than 40 per cent of their assets was around 14. As compared to previous years, the exposure shows a rising trend, though.

	Amount in ₹ crore					
	2012 MARCH	**2013 MARCH**	**2014 MARCH**	**2012 MARCH**	**2013 MARCH**	**2014 MARCH**
Assets	1151675	1296081	1443977	% to total assets		
A. Direct Exposure						
1. Commercial Property	7507	10922	15284	0.7%	0.8%	1.1%
2. Land & Building Developers (Commercial)	11802	8645	14522	1.0%	0.7%	1.0%
3. Mortgages other than individual Housing Loans	8346	12658	15033	0.7%	1.0%	1.0%
4. Housing Loans	8816	5613	6548	0.8%	0.4%	0.5%
5. Others	8026	7943	6871	0.7%	0.6%	0.5%
6. Investments in Real Estate	0	0	3	0.0%	0.0%	0.0%
B. Indirect Exposure						
Fund based and non-fund based exposures on National Housing Bank (NHB) and Housing Finance Companies (HFCs).	1149	881	777	0.1%	0.1%	0.1%
Total Real Estate Exposure	45647	46662	59039	4.0%	3.6%	4.1%

*Data pertains to deposit taking NBFCs, and non-deposit taking NBFCs with asset size ₹ 100 crore and above and as reported to RBI



Mortgage Guarantee Companies (MGC)

26. A mention may also be made here with regard to mortgage guarantee companies. An MGC is a company which primarily transacts the business of providing mortgage guarantee. Reserve Bank regulates them towards since 2008. The concept of MGC was mooted, as announced in the Union Budget Speech 2007–2008, to give greater comfort to banks and housing finance companies that lend against mortgages. So far only one MGC has been registered with the Bank. Certain bottlenecks identified as reasons for the concept not picking up are being addressed by the Reserve Bank.

National housing bank's refinance initiatives

27. NHB extends refinance assistance to primary lending institutions (PLIs) in respect of their lending for housing. There are different schemes for catering to the requirements of different segments such as rural housing, urban low income housing, housing for women, energy efficient housing, etc. Since inception, the Bank has provided cumulative refinance assistance to the tune of ₹ 1.20 lakh crores under its various schemes.

Rural Housing Fund

28. Central Government has set up a Rural Housing Fund (RHF) to enable primary lending institutions to access funds for extending housing finance to targeted groups in rural areas at competitive rates. The corpus of the Fund is contributed by those Scheduled Commercial Banks (SCBs) which have been unable to fulfil their priority sector targets during the preceding year. The quantum of funds to be contributed by each SCB and the applicable interest rate are determined by the Reserve Bank of India depending upon the priority sector shortfall of the respective SCB. The funds are made available to NHB for a period of 7 years. The corpus of the Fund for 2008–09 was ₹ 2000 crore, which was enhanced by ₹ 2000 crore during 2009–10, ₹ 2000 crore for 2010–11, ₹ 3000 crore for 2011–12, ₹ 4000 for 2012–13 and by a further amount of ₹ 6000 crore for 2013–14. A total amount of ₹ 12,778 crore was received by the Bank under the Fund in the first five years, and was deployed in full towards refinance for rural housing for the target groups. For the year 2013–14, an allocation of ₹ 6000 crore was made, out of which an amount of ₹ 3527 crore has been deployed for refinance till date. The Union Budget for 2014–15 has made an allocation of ₹ 8000 crore towards RHF.

Urban Housing Fund

29. The Urban Housing Fund (UHF) was announced in the Union Budget for 2013–14 with an initial outlay of ₹ 2000 crore to provide refinance assistance with a view to mitigating the

housing shortage in urban areas. The UHF refinance scheme covers urban housing loans upto ₹ 10 lakhs (where the annual household income of borrower is upto ₹ 4 lakhs and the unit cost is ₹ 16 lakhs or unit size is upto 60 m2). Out of an allocation of ₹ 2000 crore under UHF, an amount of ₹ 890 crore has been deployed till date.

Special refinance scheme for urban Low Income Housing (LIH Scheme)

30. The LIH scheme has been designed with the objective of augmenting the flow of institutional housing finance to the low and moderate income segments in urban areas. The scheme provides refinance at fixed concessional rates for long tenures in respect of housing loans extended to target beneficiaries in urban areas.

What more

31. There are several more things to ensure that the real estate and housing sectors grow at the desired pace and direction. First, to be effective and efficient, housing finance systems need to be supported by explicit legal institutions and instruments. These are not only necessary to acquire and transfer ownership rights in real estate, but also represent the foundation for the orderly functioning of mortgage lending. Legal arrangements must also take into account the additional layers of complexity raised by the mobilization of collateral in the secondary mortgage market.

32. Secondly, there is also a felt need for financial innovation with respect to the loan products. One such product could be savings induced home loan or a home loan deposit. The willing consumers may be induced to generate a savings balance by way of monthly or periodic deposits. This will enable creation of a track record for repayment of a future home loan product. Once the customer reaches a threshold balance, the financial institutions can consider sanctioning of a housing loan. The balance in the account could act as collateral or the margin. The amount deposited every month would act as the base to assess the repayment capacity of the customer for the purpose of calculating the monthly repayment instalments.

33. Thirdly, the credit risks originating in the housing sector, particularly low ticket housing segment, should also be internalized through proper insurance schemes for banks and other lenders. The various stakeholders should aim at timely completion of projects, delivery of houses/flats to target segments without cost escalations and with valid titles and all necessary clearances.

34. Fourthly, we need to develop an elaborate system for collecting data on real estate and housing activity. Statistics on housing starts, house sales – new and old, housing prices, etc., so that our policy decisions can be fully informed and guided by research.

Conclusion

35. To conclude, we recognise that housing is integrally related to a host of outcomes for the individuals, communities and society more broadly beyond those that are financial or material. Quality housing can facilitate psychological and social outcomes such as security and a sense of control over one’s life. Although commendable progress has been made over the years in the real estate and housing sectors, there is room for a great deal more. Availability of adequate housing units in the affordable segment and improved home ownership coupled with access to formal housing finance for the lower income segments, continues to be a policy priority for contributing significantly to all round economic growth.

36. In short, a comprehensive and holistic approach involving easy availability of land, accessible financing, supportive legal framework and innovative technology continues to be the fulcrum required for realising the full potentials of these sectors.

37. Thanking everyone for your patient attention.