PAHLE INDIA FOUNDATION
FACILITATING POLICY CHANGE

DISCUSSION PAPER

Affordable Housing – The Next Steps

July 2017
PIF/2017/EEUS/DP/09

By
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EXECUTIVE SUMMARY

The housing sector is an important contributor to the economy. It is the second-largest employment generating sector after agriculture, contributing about 5 per cent to 6 per cent to India's GDP share and capital formation.Supply of affordable housing is the biggest challenge in India's urbanisation. The economically weaker section (EWS) and the low-income group (LIG) category together account for more than 95 per cent of the housing shortage in urban India. It was this stark reality of growing shortage that formed the genesis for the vision of "Housing for All" by 2022 and other similar government initiatives.

Budget 2017 finally granted the long standing demand for infrastructure status to the affordable housing segment. Granting infrastructure status is likely to drive down the costs of construction, but it will have little impact for the end consumer or the target group for affordable housing. In this context HFCs have been at the forefront in catering to the financial needs of the section of the society that struggle to get loans from banks.

India's housing finances sector remains relatively underpenetrated compared to other advanced economies. The mortgage-to-GDP ratio is as low as 9 per cent as on March 2015, one of the lowest in the world. In sharp contrast, developed economies have ratios between 80-90 per cent of GDP. Over the years, HFCs specialised as lending institutions for housing because of their strong origination skills, focused approach, niche marketing, customer service orientation, diverse channels of sourcing business and last mile connectivity. HFCs are better positioned in acquiring customers who might actually be unattractive to banks. HFCs require greater policy attention. Targeted policy and taxation stimuli can help HFCs to grow considerably.

Policy Impetus

1. New Differentiated Banks – Mortgage Banks

The Reserve Bank of India (RBI) has been pragmatic in crafting a new category of differentiated banks. At its core, differentiated banks are meant to further financial inclusion. If this is indeed the underlying reasoning for differentiated banks, then it is time for RBI to consider a new kind of differentiated bank – Mortgage Banks. Mortgage banks play a significant role in housing finance. Internationally, a mortgage bank is an entity that originates, processes, underwrites, closes/funds and services mortgage loans. In India, banks and HFCs are the two types of financial institutions that currently provide housing finance in India. A differentiated bank such as a Mortgage Bank will combine the lending expertise of HFCs with borrowing advantages of banks and eliminate any regulatory arbitrage.

2. National Housing Bank –The New Development Organisation

The refinancing responsibility of NHB is closely linked to the development objective. Currently, the regulator functions of NHB mirror those of RBI on most counts. The subtle differences between the two create unfavourable regulatory arbitrages between HFCs and banks. Having a single regulator for housing finance will ensure better growth for the housing finance sector. The role of NHB however is important. NHB must transition from being a regulator to becoming a single point development institution for housing finance. Converting NHB from a regulator to a development organisation will ensure a more coordinated, cogent and structured approach to affordable housing. A development institution will also be crucial in facilitating better public private partnership models for affordable housing.

3. Resource Flows into HFCs

The affordable housing sector certainly stands to gain because of the new infra status. However, the benefits of this announcement must also extend to loans of HFCs that go towards funding affordable housing. This means, relaxing all existing caps for bank lending to HFCs, This will also mean allowing HFCs to access the ECB market for lending to affordable housing. Similarly, growth in mortgage backed securities (MBS), their securitization, allowing for mutual funds to invest in these instruments will all aid HFCs. Resource flow from banks to HFCs may be uninhibited as the two play a complimentary role in meeting the demands of housing sector. While HFCs can focus more on origination, banks can provide the requisite strength to funding the growing asset size.

4. Enriching the Target Consumer

The process of acquiring an affordable house must be simplified. Creating standard operating guidelines in terms of documentation, legal approvals and other beneficiary related paperwork to ensure that loan approvals and disbursements and home ownership is a seamless process for the EWS and LMI group. Stakeholders must explore various PPP models for cluster approach towards developing large resettlements of informal housing, especially urban slums. These PPP models should proactively involve developers, urban local bodies and HFCs for end to end solutions to affordable housing that work in tandem.

5. Strengthening Reporting Systems and Data Flows

Policy measures area based on data – data provided by third party agents, but mostly based on data collected by the regulator by way of mandated reporting systems. While NHB has made a start, it can play a major role in developing the policy framework through modernising and digitising data collection. Changes in the current framework will have to be made. For example, the net flow of institutional credit to home finance is often a distorted figure. This is because the effect of balance transfers are not taken into account. Incorrect information flow can have unintended consequences on policy direction. A closer look at this specific example of balance transfers and pre-closures is important in itself.

Tax Incentives

Tax incentives have always been used as a successful instrument for attracting investors and for deepening and broadening markets.

- Currently, 20 per cent of profit from housing loan business is exempted U/S 36(i)-(viii) of Income Tax. A special reserve is created out of profit of HFCs every year. Such Special Reserve forms part of Net Worth or NOF. As per the Income Tax Act, HFCs need to provide deferred income tax liability against this exempted Special Reserve. When the above said profit is exempted from Income tax there should be no need to provide a deferred tax liability.
- In order to attract institutional investors into the market, withholding tax on infra bonds, masala bonds and green bonds must be abolished.
- In order to attract the retail investor, infra and green bonds must be made tax free and can be brought under 80(c).
- Similar income tax exemptions on deposits of HFCs may also be made.
- Currently, special provisions relating to tax on distributed income by Securitization Trusts given to its investorsis chargeable at 30 per cent on the income distributed to persons other than an individual or HUF. This too must be abolished.

1. Housing Sector Overview

The housing sector is an important contributor to the economy. It is the second-largest employment generating sector after agriculture, contributing about 5 per cent to 6 per cent to India's GDP share and capital formation. It is perceived as the third-most impactful industry in India in terms of its effects on other industries, as it directly impacts over 250 ancillary industries such as cement, steel, transport, construction, paint, brick, building materials, and consumer durables. It is expected to soon overtake other industrial sectors in terms of GDP contribution.

The Nation's demographic is heavily skewed towards younger people, with 600 million people who are younger than 24. Only around 2050 will India's population start to stabilise. These factors combined with increasing preference towards nuclear families, double income families and rising incomes will lead to an increasing demand for housing in India.

The rapid pace of urbanization is another driver of demand for housing. According to Census 2011, approximately 377 million Indians, i.e. about 31 per cent of the country's population live in urban areas. Urban population is expected to increase from 340 million in 2008 to 590 million in 2030, which means that approximately 40 per cent of India's population is expected to reside in urban areas. It has also been projected that by 2030, there will be atleast 70 cities with more than a million inhabitants as against 53 as per the 2011 census. Yet, there is very little discussion on how we plan to handle this shift leading to growth of slums in and around cities and an escalating housing shortage (Appendix 1).

2. Affordable Housing – Objective and Evolution

That there is a shortage of housing in India is not in contention. Clearly, despite a considerable increase in the housing stock it is the supply of affordable housing that is the biggest challenge in India's urbanisation. Type of housing is broadly classified into economically weaker sections (EWS), low income group (LIG), middle income group (MIG) and high income group (HIG). As land and housing are State subjects the classification of income groups varies from State to State.

Table 1: Classification of Income Groups for Maharashtra

Classification	Income
EWS	Up to Rs. 16,000 per month.
LIG	Rs. 16,001 to Rs. 40,000 per month
MIG	Rs. 40,001 to Rs. 70,000 per month
HIG	Above Rs. 70,001 per month

The EWS and LIG category together account for more than 95 per cent of the housing shortage in urban India. For LIG, an "affordable house" would cost (on the higher side) INR 25 lakhs, approximately 5 times the gross income of the income group, making it infact not very affordable resulting in increased dependence on either subsidies or government constructions as a means of bridging an ever increasing affordable housing gap. China's mega-cities have seen a five-fold increase in property prices over the past decade. Yet despite these astounding increases, property prices in Beijing and Shanghai are still only half those of their Indian counterparts of New Delhi and Mumbai; without comparable infrastructure.

India's excessively high property prices reflect a combination of two archaic practices: reserving large parcels of valuable urban land for government use and outdated and overly rigid building codes that discourage concentrated development of commercial activity and housing in the core of cities. This pushes development to the outer suburbs, making it difficult to realize the agglomeration benefits that drive productivity gains. Correspondingly, people have to either commute huge distances for work or live in expensive and sub-par housing or slums as these are illegal colonies, they do not have any civic amenities like drinking water, sewage, electricity etc. It was this stark reality that formed the genesis for the vision of "Housing for All" by 2022 (Appendix 2) and other similar government initiatives in affordable housing (Appendix 3).

3. Budget 2017 and Infra Status

Budget 2017 finally granted the long standing demand for infrastructure status to the affordable housing segment. Infrastructure status grants special borrowing privileges to borrowers in accessing banks. For starters, it provides for more relaxed financing in terms of debt-to-equity ratio, repayment periods, and moratorium period for loans. It would also mean developers get an income tax benefit on their profits for 10 assessment years. Direct impact of this is on four fronts, all of which will impact cost of construction (Appendix 4).

3.1 Access to Credit

The ease of access to loans from banks is due to compliance concessions given to banks, like banks being allowed to raise long term capital by issuance of bonds to finance infrastructure projects.

- These bonds are exempt from computation of NDTL and are therefore not subject to CRR/SLR requirements.
- These bonds are also exempted in the computation of adjusted net bank credit (ANBC) for calculation of PSL.

Credit exposure to a single borrower can exceed the exposure norm of 15 per cent of the bank's capital funds by 5 per cent (i.e. up to 20 per cent) provided the additional credit exposure is on account of extension of credit to infrastructure projects. Credit exposure to borrowers belonging to a group can now exceed the exposure norm of 40 per cent of the bank's capital funds by an additional 10 per cent.

3.2 Tenor of Credit

Banks are allowed to have an amortization period up to 80 per cent of the concession in case of infrastructure projects. Financing can be raised for a maximum tenor up to 25 years with option to refinance the same at the end of 5 years (once the project viability has been established).

3.3 External Commercial Borrowing (ECB)

The 2015 ECB policy permitted infrastructure companies from borrowing in foreign currency in the external market but specifically prohibited usage of funds for real estate or onward lending to other entities for use in real estate or purchase of land. With the classification of affordable housing as "infrastructure", this restriction is removed. For infrastructure and greenfield projects, funding up to 50 per cent (through ECB) is allowed. Borrowers can use 25 per cent of the ECB to repay rupee debt and the remaining 75 per cent should be used for new projects. NBFC - IFCs and NBFC - AFCs are allowed to raise ECB only for financing infrastructure. ECB limit under the automatic route is 75 per cent of their owned funds, including the outstanding ECBs.

3.4 Financing Options

The most significant outcome of the conferred infra status is the access to long term finance that will be made available. Insurance and pension funds and alternate investment funds (AIFs) will now be able to deploy money into the affordable housing sector.

Money raised by way of infra bonds can also be used for financing affordable houses. Builders can now raise money by issuing infra bonds for financing their building costs. Withholding tax for these bonds will now be only 5 per cent.

4. The Role of Housing Finance Companies

Granting infrastructure status is likely to drive down the costs of construction, but it will have little impact for the end consumer or the target group for affordable housing. The cost of acquiring a home continues to be high. The objectives of Housing for All cannot be met without a robust housing finance sector. Financing for the end consumer must be considered along with financing for affordable houses. If the former does not take place, the objective of the latter is completely lost.

In this context, non-banking financial companies (NBFCs) have played a vital role in the Indian economy over the years and HFCs have been at the forefront in catering to the financial needs of the section of the society that struggle to get loans from banks. This is true for both rural and semi-urban areas. Over the years, HFCs specialized as lending institutions for housing. They have gained a significant market share at the expense of banks and have emerged as one of the major players in the mortgage market in India. Despite banks showing healthy growth in their lending portfolios, HFCs have been able to gain market share due to their strong origination skills, focused approach, niche marketing, customer service orientation, diverse channels of sourcing business and last mile connectivity.

The Indian housing finance industry is growing fast. Mortgage lending is a strong driver of growth. HFCs have witnessed an increase in total outstanding loans with a CAGR of 26 per cent between 2009-2010 and 2014-2015. During the same period, the growth in total loans outstanding in the industry, both banks and HFCs, was approximately 20 per cent.

Despite strong growth in outstanding housing loans in India in recent years, India's housing finances sector remains relatively underpenetrated compared to other advanced economies. The mortgage-to-GDP ratio is as low as 9 per cent as on March 2015, one of the lowest in the world. In sharp contrast, developed economies have ratios between 80-90 per cent of GDP. India's Asian peers have also performed much better. Sadly, the mortgage penetration in India lags behind her regional peers by almost a decade.

Figure 1: India's outstanding housing finance loans (2009-2015)

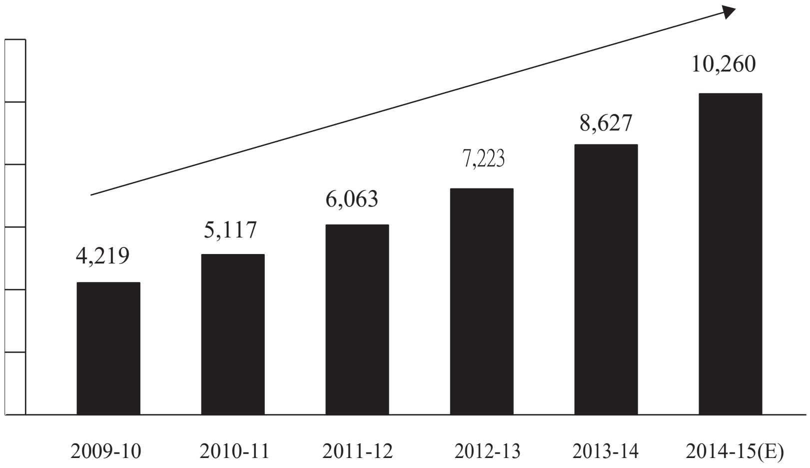
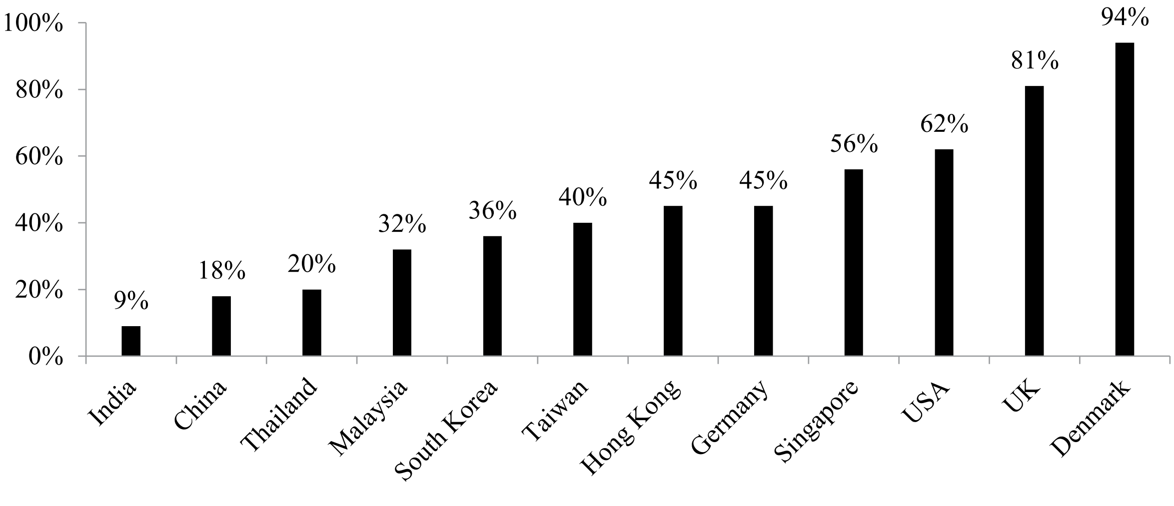


Figure 2: Mortgage-to-GDP ratio of certain countries in (2015)



The most important role that HFCs play is in being able to reach out to the un-banked, rural or LMI customers who require customised products and services. Banks often do not cater to these customers mostly because cost of acquisition is high. Furthermore, the bank does not always have the wherewithal to offer nuanced products to these customers. Hence, banks end up serving more customers in the upper strata of the socio-economic canvas (especially in urban areas) who are more profitable on account of lower distribution costs and higher ticket sizes. This allows banks to offer more competitive rates of interest for housing finance, and herein lies the irony. Urban, high income customers who have access to banks enjoy the benefits of lower rates of interest, while HFCs who cater to the low and middle income customers are forced to charge a higher rate of interest to those who should rightfully have access to lower interest rates, only because regulatory arbitrages between banks and HFCs have not resulted in any reduction in cost of operations for HFCs.

Nevertheless, HFCs are better positioned in acquiring customers who might actually be unattractive to banks. HFCs are also better placed to serve these customers as their specialisation allows them to develop a deeper understanding of the needs and risks in lending to these customers. That HFCs have lower NPAs when compared to banks, despite over 50 per cent of HFCs' lending being to individuals who belong to the less than INR 25 lakhs category, is testament to this fact. For these reasons alone, HFCs require greater policy attention.

5. Way Forward

The growth of HFCs are crucial to the success of affordable housing. Affordable housing is a necessary and important initiative undertaken by past and incumbent governments. With rapid urbanization and increasing rural to urban migration, it is necessary to contain the spread of slum dwellings and ensure decent dwelling units for citizens. While the incumbent government has taken many initiatives to push for affordable housing, the results have not been very encouraging. This may be attributed to the lack an integrated approach to affordable housing. While policy initiatives are aimed at stepping up the supply of affordable housing, little has been done to step up the demand. For the target group of affordable housing, the houses are not really affordable. Availability of housing finance helps bridge this gap.

Both, HFCs and banks disburse housing finance. The difference is that the core competency of HFCs is

Table 2: HFCs vs Banks

Years	Proportion of Housing loans to total outstanding loans of HFCs	Proportion of houusing loans to total bank credit
2012	73.66%	8.21%
2013	74.43%	8.83%
2014	74.98%	8.85%

housing finance, and very often to a population that is not served by banks, while for banks, housing finance is a small part of a larger loan portfolio. Targeted policy and taxation stimuli can help HFCs to grow considerably.

5.1 Policy Impetus

5.1.1 New Differentiated Banks – Mortgage Banks

The Reserve Bank of India (RBI) has been pragmatic in crafting a new category of differentiated banks - Small Finance Banks and Payment Banks - to cater to niche requirements of the economy (Guidelines for Licensing of Small Finance Banks in the Private Sector issued on November 27, 2014). Universal banks play an important role in the economy, but it is the differentiated banks that cater to specific requirements of a section of the population, more often those who have limited access to universal banks. At its core, differentiated banks are meant to further financial inclusion.

If this is indeed the underlying reasoning for differentiated banks, then it is time for RBI to consider a new kind of differentiated bank – Mortgage Banks. Internationally, a mortgage bank is an entity that originates, processes, underwrites, closes/funds and services mortgage loans. They may fund these loans with their own capital or through a warehouse line of credit. Interaction between mortgage banks and borrowers of mortgage loans happens in the primary market to negotiate terms and make transactions. By contrast, the purchase and sale of mortgage loans by investors takes place in the secondary market. The secondary market consists of private investors and government entities.

Mortgage banks play a significant role in housing finance. However, in countries like the United States of America and United Kingdom, the mortgage banking industry is very well established. The crisis during the 1980s provided an opportunity for a new type of lender, the U.S. mortgage banks, who originate and warehouse loans for a short period before reselling them. In 1990, the mortgage banks were responsible for around 35 per cent of residential mortgage originations; by 1996 the figure had risen to around 55 per cent. The US mortgage market is dominated by mortgage banks. The rise of mortgage banks was triggered by the Savings & Loans crisis where the lack of capital induced institutions to remove loans from the balance sheet through securitisation. Mortgage banks sell their loans into a secondary market, primarily to USA government-sponsored enterprises.

On the other hand, European mortgage banks are portfolio lenders, which are strongly regulated, funding their mortgage assets to a large extent through the issue of mortgage bonds (on balance sheet instruments). In Nigeria, the Federal Mortgage Bank of Nigeria was established to encourage the emergence and growth of a viable secondary market, to link the mortgage market to the capital market for sustainable long tenured funding, to mobilise domestic and foreign funds into the housing sector and to manage the National Housing Funds. Apart from meeting their targets, mortgage banks ensured greater financial inclusion in Nigeria and a significant learning for India.

In the context of India, mortgage banks are a novel concept. Banks and HFCs are the two types of financial institutions that currently provide housing finance in India. They differ in their business models as well as governing regulations. In their current forms, banks and HFCs alone will be unable to bridge the housing gap. The exclusive focus on housing finance, has resulted in HFCs developing deep capabilities and robust processes for customer acquisition and servicing, loan processing, and risk management for the housing finance business. HFCs have demonstrated greater desire and ability to serve a broader range of customer segments, including the low and middle income (LMI) customers. Banks, on the other hand, have been able to grow their housing finance portfolios by offering competitive rates of interest. A differentiated bank such as a Mortgage Bank will combine the lending expertise of HFCs with borrowing advantages of banks and eliminate any regulatory arbitrage. A specialised financial institution as this will help in financing the end consumer of affordable houses.

5.1.2 National Housing Bank – The New Development Organisation

The National Housing Board (NHB) is tasked with regulating and developing the housing finance sector. The refinancing responsibility of NHB is closely linked to the development objective. NHB is also tasked with only regulating HFCs. RBI on the other hand regulates banks. The Financial Sector Legislative Reforms Commission (FSLRC) has already spoken of creating a unified regulator. The merger of SEBI and FMC was the first step towards this. The merger of NHB and RBI also seems imminent. Currently, the regulator functions of NHB mirror those of RBI on most counts. The subtle differences between the two create unfavourable regulatory arbitrages between HFCs and banks. Having a single regulator for housing finance will ensure better growth for the housing finance sector.

The role of NHB however is important. NHB must transition from being a regulator to becoming a single point development institution for housing finance, much like how IIFCL is structured. While IIFCL offers development support, credit guarantees and credit enhancement to large scale infrastructure products, NHB can cater to the housing market, especially the affordable housing market. Housing, unlike traditional infrastructure projects, are scattered across the country and are of variable scale. Furthermore, it also involves multiple urban local bodies, financing companies and end consumers. Local bodies and infra companies are occupied with raising finance which happens at the cost of developing affordable houses.

NHB can help with raising capital through long term infra bonds, green bonds and masala bonds, which can in turn be used for funding affordable housing and for refinancing of HFCs. Converting NHB from a regulator to a development organisation will ensure a more coordinated, cogent and structured approach to affordable housing. A development institution will also be crucial in facilitating better public private partnership models for affordable housing.

There is already a regulator and regulation for housing finance in the form of RBI. What the sector desperately requires and lacks is a financial institution that can focus purely on developing the housing finance sector and it is this gap that NHB can fill admirably.

5.1.3 Resource Flows into HFCs

The infra status proffered upon affordable housing is crucial. The affordable housing sector certainly stands to gain, as do banks who are willing to fund these projects. However, the benefits of this announcement must also extend to loans of HFCs that go towards funding affordable housing. This means, relaxing all existing caps for bank lending to HFCs. This will also mean allowing HFCs to access the ECB market for lending to affordable housing.

The growth in mortgage backed securities (MBS) will be important for HFCs. This will permit them to securitise their retail home loan through an appropriate legal and taxation framework. Concomitantly, allowing for mutual funds to invest in these instruments will further deepen the market. Similarly banks must also be allowed to actively participate in this market by incentivising through SLR. Credit enhancement and credit guarantee will also be crucial to the development of the secondary market for securitised home loans.

Infra bonds, masala bonds and green bonds are all excellent way of raising money for long term funding. Tax incentives (discussed later) will certainly help in attracting both retail and institutional investors. Additionally, Budget 2017, has announced the expansion of basket of financial instruments into which investments may be made for receiving an exemption on capital gains tax arising out of sale of property. Infra bonds and green bonds can immediately be added to this basket of financial instruments. This will not only ensure an immediate inflow of retail funds, but also long terms funds for funding affordable housing and even for refinancing HFCs.

Resource flow from banks to HFCs may be uninhibited as the two play a complimentary role in meeting the demands of housing sector. While HFCs can focus more on origination, banks can provide the requisite strength to funding the growing asset size.

HFCs are also subject to CSR rules. A Deloitte study on affordable housing has suggested that CSR funds of HFCs may be used for purchasing and extending free credit guarantees for EWS home loans.

5.1.4 Enriching the Target Consumer

The process of acquiring an affordable house must be simplified. One must remember that the target group for affordable houses are often those with limited or no knowledge of finance. Copious paperwork and complex procedures can be very intimidating and quite often acts as deterrent to home ownership for this target group. It is therefore important to create standard operating guidelines in terms of documentation, legal approvals and other beneficiary related paperwork to ensure that loan approvals and disbursements and home ownership is a seamless process for the EWS and LMI group.

Stakeholders must explore various PPP models for cluster approach towards developing large resettlements of informal housing, especially urban slums. These PPP models should proactively involve developers, urban local bodies and HFCs for end to end solutions to affordable housing that work in tandem.

Drawing from the experience of initial phase of credit linked subsidy scheme (CLSS) under PMAY, the model with its improved features announced by Hon'ble Prime Minister on 31st Dec 2016 will need to be executed in a more focused manner. The CLSS will be more effectively implemented if it is transmitted through housing projects and segments rather than in a standalone manner. Execution through affordable housing projects will ensure better and surer reach to the end consumer.

5.1.5 Strengthening Reporting Systems and Data Flows

Policy measures area based on data – data provided by third party agents, but mostly based on data collected by the regulator by way of mandated reporting systems. While NHB has made a start, it can play a major role in developing the policy framework through modernising and digitising data collection. Changes in the current framework will have to be made. For example, the net flow of institutional credit to home finance is often a distorted figure. This is because the effect of balance transfers are not taken into account. Incorrect information flow can have unintended consequences on policy direction. A closer look at this specific example of balance transfers and pre-closures is important in itself.

Big data analytics can easily provide information across home loan segments, project demand supply gaps in the housing sector across geographies and income groups and also help evaluate the impact of various policy measures and announcements. This will certainly help improve the efficacy of policy interventions. NHB's data flow can become an important source for decision making by investors and multilateral agencies.

5.2 Tax Incentives

Tax incentives have always been used as a successful instrument for attracting investors and for deepening and broadening markets. The following tax incentives will do the same for the housing finance market.

Currently, 20 per cent of profit from housing loan business is exempted U/S 36(i)-(viii) of Income Tax. A special reserve is created out of profit of HFCs every year. Such Special Reserve forms part of Net Worth or NOF. As per Income Tax Act the HFCs need to provide deferred income tax liability against this exempted Special Reserve. Moreover such deferred tax liability cannot form part of Net worth or NOF. This is self-defeating. When the above said profit is exempted from Income tax there should be no need to provide a deferred tax liability because this liability is not going to occur in the future If such deferred tax liability is provided out of profit then such deferred tax liability should be considered as part of Net Worth in tandem with treatment of Special Reserve.

In order to attract institutional investors into the market, withholding tax on infra bonds, masala bonds and green bonds must be abolished. This will immediately spur investments into these instruments. When withholding tax was reduce from 20 per cent to 5 per cent for infra bonds, India witnessed significant issues of and collections from these bonds. As new instruments for financing affordable housing, they have large potential to attract external inflow of funds.

In order to attract the retail investor, infra and green bonds must be made tax free and can be brought under 80(c). With volatilities in the equity market persisting, retail investors are more open to investments in bonds. The recent DHFL bond issue and its over subscription is a case in point. Tax free status to these bonds and bringing them under the 80 (c) bracket, or at the least, providing for an additional income tax exemption (as was done before for infra bonds) will go a long way in attracting the retail investor.

Similar income tax exemptions on deposits of HFCs may also be made. It would also help to widen the scope of 80 (c) to include these deposits. This would help HFCs in their financing requirement.

Currently, special provisions relating to tax on distributed income by Securitization Trusts given to its investors is chargeable at 30 per cent on the income distributed to persons other than an individual or HUF. This has come as a big setback to securitization market. If this is abolished banks and insurance companies will participate freely thereby bolstering the MBS market.

APPENDICES

Appendix 1: Shortage in Housing

India faces an enduring housing shortage which was estimated to be 24.6 million units in 2015 in urban areas (Housing for All, 2014). Furthermore, 95 per cent of this shortage was in the economically weaker sections and the low-income groups. In addition to this, it is estimated that 80 million urban Indians live in sub-standard housing.

The Report of the Technical Group on Urban Housing Shortage calculated the housing shortage in urban India as 19 million units. By 2022, it is estimated that an additional 28 million houses would be needed in urban centres (KPMG, 2014). Similarly, The Working Group on Rural Housing for the 12th Five Year Plan estimated total rural housing shortage at 43.5 million units. According to McKinsey Global, 2010, by 2025 India will add 215 million people to its cities which will raise the urban population share to 38 per cent. Mumbai and Delhi, will become number two and three in the world ranking with a population of 26.4 million and 22.5 million respectively.

The rising population and migration will put immense pressure on Indian cities for improved infrastructure and greatly increase the demand of housing stock. The total housing shortage in India stands at 80 million units. It is projected that by 2022, the total housing shortage will touch approximately 130 million units of which roughly 47 million units will be in urban areas.

The housing shortages are not restricted to urban centres. In the last decade economic activity is rural India has shown steady increase. Rural India accounts for 55.6 per cent of the nation's total income, higher than urban India's contribution of 44.6 per cent. Rural markets have become a powerful economic engine. Since 2000, per capita Gross Domestic Product (GDP) has grown faster in rural areas than the urban centres. Between 2009 and 2012, spending in rural India reached USD 69 billion, significantly higher than the USD 55 billion spent by urban India.

Similar to urban centres, the housing sector has been unable to keep pace with growth in economic activity in rural areas. The Working Group on Rural Housing for the 12th Five Year Plan estimated the rural housing demand at 43.13 million units in 2012, of which more than 90 per cent, again, lies with lower income and marginalised groups. In effect, the total current housing shortage in India stands at approximately 80 million units and is likely to increase to 130 million units by 2022.

Housing would not be a major problem in urban India if there was no mismatch between the actual house prices and affordability. However, the increase in the number of vacant houses and aggressive advertising by builders in major cities clearly point to a lack of demand from the target audience. In such a scenario, the buyers of new housing stock would already be living in acceptable houses and either plan to upgrade or to move from a rented place to a self-owned one. On the other hand, those living in congested households or slums do not have the income or access to finance to be able to be able to move into these developments.

Table A1: Urban Housing Demand in 2012

Urban Demand, 2012	# in millions
Non-serviceable Houses	0.99
Obsolescent Houses	2.27
Congested Houses	14.99
Homeless	0.53
Total	**18.78**

Table A2: Rural Housing Demand in 2012

Rural Demand; 2012	# in millions
Homeless	1.48
Temporary Houses	26.69
Congested Houses	30.28
Obsolescent Houses	3.55
Total	**62.01**

Appendix 2: The Pradhan Mantri Awas Yojana (Gramin and Urban)

The origin of Pradhan Mantri Awas Yojana can be traced back to the wage employment programmes - National Rural Employment Programme (1980) and the Rural Landless Employment Guarantee Programme (1983) - under which construction of houses was allowed. The Pradhan Mantri Awas Yojana was launched on June 25, 2015 and has become a flagship programme for the incumbent government. The Scheme has two components, Pradhan Mantri Awas Yojana- Gramin (PMAY-G) and Pradhan Mantri Awas Yojana- Urban (PMAY-U).

Affordable housing for all has been an important policy agenda of the incumbent government, as it seeks to create an enabling and supportive environment for expanding credit flow and increasing home ownership. This will help create an ecosystem of opportunities for every potential home buyer. The ambitious target is to construct 20 million houses in urban India and 40 million houses in rural India by 2022 in three phases of implementation.

- Phase 1: Under the phase one, housing units will be created in the selected 100 cities in the period from April 2015 to March 2017.
- Phase 2: The next phase will cover about 200 cities for housing development between April 2017 and March 2019.
- Phase 3: The final phase of Pradhan Mantri Awas Yojana will be implemented in the remaining cities between April 2019 and March 2022.

This means investments of more than USD 2 trillion by 2022 (current investment stands at approximately USD 120 billion), which calls for immediate and improved financing mechanisms. Of this, 85-90 per cent of the total investments would be required for Urban Housing. The bigger challenge is meeting the requirement of 1.7 to 2.0 lakh hectare of land for urban housing needs by 2022 and hence in June 2015, the National Mission for Urban Housing was launched to address the issue of affordable housing in urban areas.

Appendix 3: Other Government Initiatives in Affordable Housing

It was in the Union Budget 2016 that the details of the Housing for All scheme was outlined. The guidelines allowed for a 100 per cent deduction of tax on profits on undertaking housing projects for builders. It was also the first time that affordable housing had been defined on the basis of size of house and not on the value, which allowed for greater flexibility to builders. By way of tax incentive to home buyers, a deduction of additional interest of INR 50,000 per annum for loans up to INR 35 lakh was sanctioned in 2016-17 for first time home buyers, in cases where the cost of house does not exceed INR 50 lakh. The policy also introduced an interest subvention scheme for housing loans implemented through scheduled commercial banks and housing finance companies (HFCs). This came under the purview of the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) programme under the Ministry of Urban Development.

During FY 2013-14, projects worth INR 417,231.3 million were sanctioned by the National Housing Bank (NHB) for building 1,569,000 houses for economically weaker and lower income portion of the population. In addition, the government also promoted for rural housing finance in the low and middle income (LMI) segment through the Rural Housing Fund, Golden Jubilee Rural Housing Refinance Scheme and Special Refinance for Urban Poor Scheme.

Many new initiatives specifically focused on lending for housing were also introduced. The biggest highlight was to bring housing loans of up to INR 50 lakh under priority sector lending (PSL), against loans of up to INR 25 lakhs earlier. The RBI also increased the limit of housing loans eligible for PSL categorization from INR 25 lakhs to INR 28 lakhs in metropolitan centers and from INR 15 lakhs to INR 20 lakhs in other centers. It also increased the limit of the house prices which are eligible to INR 35 lakhs and INR 25 lakhs respectively. This was heralded as a positive for the housing sector as it was expected to bring in many more dwellings into the ambit of PSL lending. The decision of the RBI to increase loan-to-value (LTV) ratio to 90 per cent for loans up to INR 30 lakhs or less was another positive step that enabled HFCs to lend more to LMI customers.

As tax incentives, the government abolished any pre-payment penalty on floating rate housing loans in 2014, aimed to be a shot in the arm for developers and to increase demand for housing. Increase in tax deduction limit on interest of home loans to INR 2 lakhs also provided prospective home buyers additional incentive. The rationalisation of taxes of Real Estate Investment Trusts (REITs) was hoped to provide another source of funds mobilisation for developers engaged in commercial real estate. The government also relaxed foreign direct investment (FDI) norms in construction and housing sector as well as easedthe exit process for global investors.

Appendix 4: Costs of Construction

Real estate developers usually concentrate on the luxury and high end segments owing to better margins but, high land prices, archaic building laws, delays in project approvals, and unfavourable banking regulations make low cost housing uneconomical. There are five possible reasons for high cost of construction of affordable houses.

Land Cost

The high population density of urban India puts a huge premium on land. Outdated regulations have restricted the availability of land and the amount of construction. While one often hears of lofty targets comparing Indian cities to international centres like Shanghai, what is often missed in these targets is that the tallest building in Shanghai is 632m tall while the tallest building in

India is 254m tall because a 1990s regulation restricts the maximum height of a building in India to 300m.

The floor space index (FSI) which defines the multiple of the ground area that can be constructed is abysmally low in India. The FSI in South Bombay is capped at 1.33 which means that at most a builder is allowed to construct one story above the ground. Developers have to go through multiple hoops to be able to build higher for example by constructing slum rehabilitation projects. This increases the cost of projects immensely.

Table A3: FSI in Various Cities in India

City	Area	FSI
Mumbai	South	1.33
Mumbai	BKC	4
New Delhi	Delhi	3.5
Bangalore	City	4
Kolkata	City	3
Kolkata	Salt Lake	5.95
Chennai	City	3.5

Table A4: FSI in Global Cities

Country	City	FSI
USA	New York	15
USA	Chicago	12
Bahrain	Bahrain	17
China	Hong Kong	12
China	Shanghai	13
UAE	Dubai	34

There is an immediate need to review many of the existing archaic regulations like the Rent Control Act for example, which deter development of rental houses and redevelopment of old properties. FSI, zoning, development plans and other regulations should also be revisited to increase the supply of housing in India thereby bringing down the cost of construction.

Funding

If a builder has to construct a building he has to go through multiple hoops. Financing continues to remain a major hurdle. Regulation prohibits bank lending for acquisition of land which forces builders to either use their own capital or seek funding from private equity players to finance land acquisition. Since the IRR requirements of private equity investors is higher than bank interest costs, the funding cost of housing projects are much higher than most traditional infrastructure projects which banks are willing or allowed to finance. Hopefully the newly bestowed infra status should provide some respite.

Approval Procedures

Once land is procured by a developer, the proposal for construction has to pass through more than 150 people in 40 departments from the local civic body to the central government (Corruption and Transparency in Realty, 2015). This process can take anywhere between 29-43 months. While the time taken to grant these approvals is in itself disturbing, it is not this, but the cost of incurred during this period that is a matter of serious concern. One must bear in mind that during the whole time of waiting for approvals, the developer is being financed by a private equity at interest rates that are as high as 20 per cent. This means that approvals account for 25-30 per cent of a project cost.

Input Costs

For affordable housing projects, construction costs account for about 50 per cent of the total selling price of a house. Raw materials like cement, sand and other input prices (except steel) have been rising in tandem with the inflation in India. Owing to the success of MNREGA, construction also faced a shortage of unskilled labour while labour costs increased and a floor was put at the MNREGA rate. The increase in costs of construction because of this was an unforeseen consequence.

Import Duties

Construction in the 21st century is not like construction in the previous century. Lighter and stronger materials and a greater proportion of steel and glass are used in construction. As land is scarce, one automatically looks to expand vertically rather than horizontally. However, vertical expansion requires hi-tech equipment which India does not currently manufacture therefore necessitating the import of heavy engineering equipment. The tax and duties charged on these equipment either make it impossible to import or drive the price of construction. in this regard is highly regressive. The actual taxes charged for construction equipment are:

- Landing charges (1 per cent CIF)
- Countervailing duty (30 per cent)
- CESS (3 per cent)
- Additional Countervailing Duty (4 per cent)
- CEX (Education & Higher Education CESS)

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