UNIT 16 HOUSING FINANCE

Objectives

After going through this unit, you will be able to:

- understand the nature and significance of housing finance;
- understand the distinguishing features of home loans;
- familiarise yourself with the institutional framework for housing finance;
- describe the role of National Housing Bank;
- describe the role of Primary Lending Institutions; and
- understand the meaning and procedure of securitisation of housing loans.

Structure

16.1 INTRODUCTION

Food, clothing and shelter are the three basic and essential needs of human beings. While food and clothing satisfy the physiological needs, shelter (or housing) meets the need for safety and security. The need for housing is an ever-expanding one in the present context. With rising incomes, better educational facilities leading to higher standard of living and growing population, need for houses, rather better houses, is being felt increasingly. The fact cannot be denied that the quality of life of the people largely depends upon the quality of housing facilities available to them. Their economic well-being is the resultant of healthy and hygienic housing conditions.

Housing has great economic significance as well. Housing sector is of paramount importance to the economy of the country from the viewpoint of investment and employment generation in many other sectors of the economy. House construction activity stimulates and gives a boost to investment and production in a host of other industries which provide essential inputs for construction activity. In the cost of construction of houses, about 18% goes to the cement sector, 9% to steel sector and 73% to other industries like brick-manufacturing, timber, electrical, ceramic, sanitary ware, paints, hardware and many informal sectors. The construction sector ranks 4th among 14 sectors in terms of backward linkage and 3rd in terms of total linkage effect with other sectors of the economy in India.

House construction, like any other economic activity, needs finance, which is essentially for medium to long term. In the past, in the absence of institutional sources of finance for housing, individuals used to depend on their own accumulated savings and borrowings from friends and relatives only for this purpose. But during the recent past, various institutional sources of finance have emerged for house building activity. Insurance companies, banks, housing finance companies, cooperative institutions are the main sources for finance for the housing sector.

Housing finance is to be clearly distinguished from finance (loans) against house property. In the latter case, loans are provided against the security of house property for any purpose, not necessarily for the construction/purchase of houses. On the other hand, housing finance connotes finance (or loans) for meeting the various needs relating to housing, namely,

a) purchase of a flat or house

b) acquisition of a plot, and construction of a house

c) construction of a house

d) extension of a house

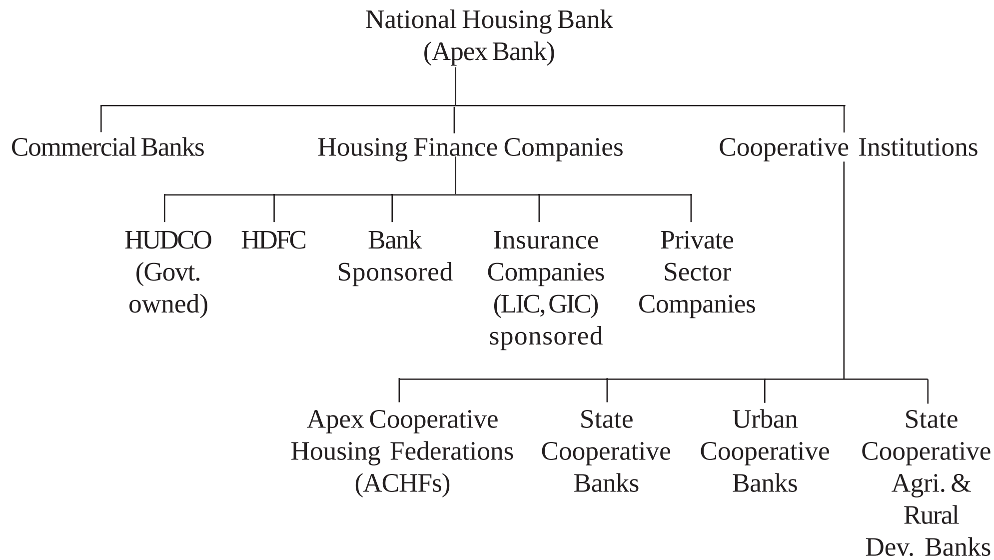
e) repairs, renovation and upgradation of a house/flat

f) taking over housing loans from other banks/housing finance companies.

Housing finance has a wider connotation and includes both direct and indirect finance made available for this purpose. **Direct Finance** includes finance made available to individuals, group housing societies, government agencies or employers who undertake construction of houses. **Indirect Finance** includes investments in/loans given to the agencies which provide housing finance, e.g., investment in the bonds issued by National Housing Bank, HUDCO, etc.

16.2 INSTITUTIONAL FRAMEWORK FOR HOUSING FINANCE : AN OVERVIEW

Realizing the significance of the housing sector in the economy of the country a fine institutional framework has been set up in India during the last two decades. The establishment of National Housing Bank in 1988 as the apex bank in this area marked a new era in housing finance in India. This landmark event was followed by the entry of commercial banks and housing finance companies in a big way. At present the institutional framework for housing finance is as depicted below:



National Housing Bank performs the functions as re-financing agency and also as the regulatory authority for the housing finance companies. Besides, it also provides direct financial assistance to the state and public sector authorities for undertaking housing and allied projects.

Housing Finance Companies have been set up by leading commercial banks, Life Insurance Corporation of India, General Insurance Corporation of India, besides the private sector. Government of India has set up another corporation named Housing and Urban Development Corporation, while HDFC has been set up by banks and other financial institutions. Some of the leading commercial banks directly undertake housing finance also in a big way. Thus, a very competititve environment has emerged for providing housing finance.

Cooperative institutions are also providing housing finance but to limited extent only.

Housing finance provided by all these institutions falls in two broad categories, viz. (i) loans to individuals, and (ii) project finance. Project finance is provided by the National Housing Bank, HUDCO, HDFC etc. to the Government sponsored bodies for undertaking projects relating to land development, infrastructure, slum re-development etc. However, the major portion of refinance provided by the National Housing Bank was in respect of loans to individuals. HUDCO, of course, provides the bulk of its assistance for urban infrastructure development schemes.

16.3 HOME LOANS : DISTINGUISHING FEATURES AND MAIN TERMS AND CONDITIONS

Home loans to individuals are mainly provided by banks and housing finance companies in India. These institutions have formulated their own schemes of financing and laid down their own terms and conditions, which differ from each other in respect of details. But the underlying features of all home loans are basically the same. The special features of home loans and main terms and conditions as prescribed by HDFC, a leading housing finance company, are as follows:

1) **Eligibility for Loan:** As housing loans are essentially for medium to long periods, and are repayable out of the future savings of the borrower, the latter's earning capacity and his ability to save is an important eligibility criterion. For this purpose, salaried people and others with regular incomes are preferred. Their present income and saving capacity is taken into account for this purpose.

Lenders take into account the age of the borrower also. They insist that the salaried employees should have at least 5 years of service left and businessmen, professionals and self-employed must not be beyond a certain age, say 55 or 58 years. The remaining period of service or professional career indicates their income earning capacity in future to repay the loans. If the property is going to be purchased by more than one person, the proposed owners of the property to be purchased are required to be co-applicants.

2) **Amount of Loan:** The lenders allow the maximum amount of loan upto a certain percentage of the cost of the property including the cost of the land, say upto 85% or 90%. The remaining amount is required to be provided by the borrower himself.

   Subject to the above, the amount of the loan is determined according to repayment capacity of the borrower. For doing so, factors such as income, age, qualifications, number of dependents, spouse's income, assets, liabilities, stability and continuity of occupation and saving history are taken into account.

3) **Security for Loan:** Security for the loan normally is first mortgage of the property to be financed and/or such other collateral security as may be necessary. Interim security may be required, if the property is under construction. Insurance policies, guarantees from sound parties, pledge of shares and other investment may be the collateral or interim security.

4) **Fees and Charges:** (i) A processing fee @ 0.5% of the loan amount applied for is payable at the time of application, (ii) an administrative fee @ 0.5% of the loan sanctioned on acceptance of the offer, and (iii) an early redemption charge @ 2% of the amount being pre-paid.

5) **Interest Rates:** Lenders give an option to the borrowers to choose either a fixed rate of interest or a floating (or adjustable) rate of interest. A fixed rate of interest is fixed for the entire period of the loan, while a floating rate is re-set periodically, as the interest rates in general move. Floating interest rate is fixed 0.5% to 0.75% lower than the fixed interest rate. Floating interest rate is linked to the Retail Prime Lending Rate of the Bank/HFC. This rate is revised every three months from the date of first disbursement, if there is change in the Retail Prime Lending Rate. If the interest rate is changed, the amount of Equated Monthly Instalments will not change — the interest component in an EMI increases and the principal component reduces, resulting in an extension of the loan period and *vice versa*, if the interest rate is reduced.

   Most of the Banks/HFCs charge differential interest rates, based on the length of the loan period. As the period of loan increases, the rate of interest also increases. For example, the State Bank of India at present charges 8.5% on loans for 1 to 5 years, 9% on loans for 6 to 15 years and 9.25% on loans for 16 to 25 years. Some lending institutions charge differential rates based on the amount of the loan itself. For example, HDFC and ICICI charge 8.75% on loans upto Rs. 10 lakh and 8.50% on loans exceeding Rs. 10 lakh. Most of the institutions charge interest on monthly rests basis, while a few charge on daily or annual rests basis.

   Some lenders give an option to the borrowers to avail part of the loan under fixed rate and the balance under variable rate. An option is also given by some of the institutions to switch between the two options, after paying a nominal fee.

6) **Disbursement of the Loan:** Loans are disbursed after the property has been technically appraised, all legal documentation has been completed and the borrower has invested his own contribution in full.

   The loan may be disbursed in lump sum or in instalments depending upon the need of the borrower, and stage of construction. If the loan is for purchasing a house, loan may be disbursed directly to the seller of the property.

5) **Repayment Period:** Housing loans may be repaid over a maximum period of 20 years. But repayment is ordinarily not extended beyond the age of retirement (if the borrower is employed) or on attaining the age of 65 years, whichever is earlier.

6) **Equated Monthly Instalments:** Loans are usually repayable in monthly instalments of equal amounts, called Equated Monthly Instalments (EMIs). Each EMI has two components – interest and principal amount. As each instalment is paid, interest component is reduced and the component of principal increases. EMI is calculated using a formula that considers loan amount, interest rate and loan period as variables. Longer the loan period, smaller is the EMIs. Similarly, higher the rate of interest, higher is the EMIs.

   For the purpose of calculation of interest, lenders rely upon either monthly rest basis or annual rest basis. Under the monthly rest option, interest is calculated on monthly rest and principal repayments are credited at the end of every month. Under the annual rest option interest is calculated on annual rests. Principal repayments are credited at the end of the financial year.

7) **Repayment Options:** The lender often offers the following repayment options also to the borrower:

   a) ***Regressive Repayment Scheme:*** The borrower pays larger amounts in the initial years and lower amounts in latter years. Such a scheme suits those who have to retire from service after a few years.

   b) ***Ballon Repayment Scheme:*** Under this scheme, the borrower pays a lower EMIs in the initial years and a ballon repayment (as high as 30-40% of the loan) in latter instalments. Thus the major burden of repayment is shifted to latter years when the borrower expects higher earnings.

   c) ***Pre-payment:*** If pre-payment clause is inserted, the lender allows pre-payment of loans, after paying a fee or charge.

8) **Insurance of the Property:** The borrower is required to ensure that the property is duly and properly insured against fire and other appropriate hazards during the pendency of the loan. The lender should be the beneficiary of the Insurance Policy.

Application Form

An applicant for loan is required to submit a detailed application on the perscribed form, along with the required supporting documents. Application form for individual loans requires the following information:

1) Personal and Employment details of the applicant and co-applicant.
2) Amount and Type of loan requested, with option for interest rate.
3) Purpose of loan.
4) Estimated requirement of funds and sources to meet the same.
5) Financial information regarding:
   a) Savings, investments, etc.
   b) Loans availed/proposed.
   c) Bank account details and credit card details.
   d) Details of property (to be purchased/constructed).
6) General information.
7) Names and addresses of two referees.

Supporting Documents

In the case of salaried employees

1) Verification of Employment Form.
2) Latest original salary slip/certificate showing all deductions.
3) Updated original Pass Book/Bank Statements.
4) Photocopy of Form 16 for the last assessment year.
5) Employer's consent to deduct EMIs from salary.

In case of self-employed persons

1) Balance Sheet and Profit and Loss Account with copies of Income Tax Returns for the last 3 years.
2) Note on the nature of business/profession, form of organisation.
3) Copies of Individual Tax challans for last 3 years.
4) Copy of Advance Tax challan.
5) Updated Bank Pass Book.

All applicants

1) Allotment letter of the Cooperative Society/Association (if applicable)
2) Copy of approved drawings of proposed construction/purchase.
3) Agreement for sale/sale deed/detailed cost estimates for the property to be purchased/constructed.
4) Proof of residence.
5) Proof of identity.
6) Applicable Processing fee.
7) Other information regarding repayment capacity.

Need for Uniform Set of Norms

During recent years providing home loans has become quite attractive to the housing finance companies and the banks with the result that stiff competition prevails in this sector. To find the customers, and beat the competition many players deviate from standard practices and give loans to the risky borrowers. Realizing the urgency of avoiding such competition, the National Housing Bank appointed a Working Group which has suggested a uniform set of norms for all housing finance companies. Consequently, the National Housing Bank has started a process for bringing about standardisation and transparency in the housing loan sector. NHB will introduce a standard set of norms for giving home loans.

The report of the Working Group has attempted to standardise the three Cs of mortgage underwriting — Collateral, Credit reporting and Capacity of the borrower to repay. The main suggestions of the Working Group are as follows:

a) The maximum loan to a borrower should not exceed 85% of the purchase price as indicated in the Sale Agreement. Presently many banks give loans upto 95% to 100%.
b) The loan amount should include stamp duty and registration cost also.
c) The instalment to income ratio should not exceed 35% for medium income groups and 40% for higher income groups.

d) A methodology is proposed for fixing the floating rate of interest at certain periodicity, determining the cost of pre-payment of loan and the additional interest in case of default.

In its opinion uniform standard will help in the evolution of securitisation of home loans also, which will increase the supply of funds to home loan sector.

16.4 FISCAL INCENTIVES FOR HOUSING FINANCE

In order to give incentive to the construction of houses, Income Tax Act provides for deduction of interest payable on capital borrowed with the object of acquiring, constructing, repairing, renewing or reconstructing any house property as follows. Even interest on unpaid purchase price is allowed as deduction:

i) ***In case the property is let out,*** 100% deduction is allowed. The unabsorbed interest will be set off against income from any other head of income in the same year. If still it remains a loss, it shall be carried forward to subsequent 8 years to be set off against income from House Property.

ii) ***In case of self-occupied property***, the general deduction for interest is limited to Rs. 30,000. But if the capital was borrowed on or after 1st April 1999 and acquisition/construction is completed upto 31 March 2005, interest payable is allowed as deduction upto Rs. 1,50,000.

For computation of income from House Property for Income Tax purpose, the annual value of one self-occupied house is taken as nil. Thus, the above deduction of interest on borrowed capital from such nil value results in a loss from self-occupied house property which can be set off against other incomes of the house owner, thus reducing his tax liability.

Repayment of Loan

The repayment of loan taken from the specified institutions and agencies, for the construction of house (including the cost of land) is eligible for rebate under Section 88 of the Income Tax Act, upto Rs. 20,000 in a financial year.

16.5 ROLE OF NATIONAL HOUSING BANK

National Housing Bank was set up in July 1988 under the National Housing Bank Act, 1987 as the apex bank in the field of housing finance. It is a wholly owned subsidiary of Reserve Bank of India. It is the principal agency to promote housing finance institutions at regional and local levels and to provide financial and other support to such institutions. It is vested with wide powers to regulate the housing finance companies in India.

The functions undertaken by the Bank are divided into the following three categories :

1) Promotion and Development,
2) Financing, and
3) Regulation and Supervision.

1) **Promotion and Development**

The promotional role of NHB includes the development and establishment of housing finance institutions at local and regional levels in the private and joint sectors by providing them financial and other support.

To meet the growing need for trained personnel for housing finance sector, the Bank conducts training programmes for the housing finance companies. The Bank has also provided financial assistance and faculty support to the National Cooperative Housing Federation for organising training programmes in the field of housing cooperatives.

2) **Financing**

National Housing Bank provides both direct finance and indirect finance to the housing sector. *Direct finance* is granted to public agencies and local bodies. *Indirect finance* is provided by way of refinance to commercial banks, housing finance companies and cooperative institutions.

3) **Regulation and Supervision**

National Housing Bank is the regulatory authority for the housing finance companies. It is vested with the following powers by the National Housing Bank Act:

i) *Power to Inspect*: The Bank is empowered to cause an inspection to be made of any housing finance company to which it has granted any loan or assistance (Section 24).

ii) *To regulate or prohibit issue of Prospectus or Advertisement* soliciting deposits of money and to specify conditions subject to which any such prospectus/advertisement may be issued (Section 30).

iii) *To collect information from housing finance companies and to issue directions* (Section 31).

16.5.1 Statutory Provisions Regarding Regulation

The Act contains other provisions also for regulation over housing finance companies. These are as follows:

a) **Registration of Housing Finance Companies**

A housing finance company is required to obtain a certificate of registration from the National Housing Bank for carrying on the business of housing finance. It must also have net owned funds of Rs. 25 lakh or such higher amount as may be fixed by the Bank. Net owned funds mean the aggregate of the paid up capital and free reserves as reduced by (i) accumulated balance of loss, (ii) deferred revenue expenditure, (iii) other intangible assets, (iv) investment in the shares of subsidiary companies, and (v) excess of book value of debentures, bonds, outstanding loans to subsidiaries over a prescribed percentage.

The National Housing Bank issues certificate of registration after it is satisfied that the conditions specified under Section 29A are fulfilled. These conditions include its solvency, satisfactory conduct of its operations, adequate capital structure, character of management, etc.

The Bank may grant a certificate imposing certain conditions also and may cancel the same if the company fails to fulfil any of the prescribed conditions.

In February 2002 the Bank raised the minimum requirement of net owned funds from Rs. 25 lakh to Rs. 2 crore for new companies seeking certificate.

b) **Maintenance of Liquid Assets**

Section 29B requires every housing finance company to maintain liquid assets as follows:

i) Invest in *unencumbered approved securities* an amount which shall not be less than 5% of the deposits outstanding at the close of business on the last working day of the second preceding quarter. It shall be maintained on a daily basis. The Bank may increase the above percentage up to 25%. Securities are to be valued at a price not exceeding their current market value.

ii) Invest in *term deposits* or certificates of deposit with a scheduled bank or deposits with National Housing Bank or invest in its bonds or partly in all of these, a sum which shall not be less than 10% (including the investments in approved securities described in (i) above) of deposits outstanding at the close of business on the last working day of the second preceding quarter. This percentage may also be raised to 25% by the Bank.

The Bank may also impose penalties in cases of defaults.

c) **Reserve Fund**

Housing finance companies are required to transfer at least 25% of their net profits to the Reserve Fund every year.

d) **Power to Issue Directions**

Under Section 30A, the Bank may determine the policy and give directions to housing finance companies relating to income recognition, accounting standards, provision of bad and doubtful debts, capital adequacy and deployment of funds.

e) **Power to prohibit Acceptance of Deposits**

The Bank may prohibit any housing finance institution from accepting deposits if it fails to comply with any direction or order of the Bank or any provision of the Act. Bank may also prohibit any sale or transfer of its assets without its prior permission.

f) **Power to Conduct Special Audit**

The Bank may order that a special audit of the accounts of the housing finance institution be conducted in relation to any transaction/class of transaction.

g) **Power to Order Repayment of Deposit**

If a housing finance company defaults in repaying a deposit, the Bank may direct it to make its repayment.

h) **Power to file Winding up Petition**

The Bank may apply for the winding up of the housing finance company in case the company is unable to pay its debts or a prohibition on accepting deposits has been in force for 3 months or continuance of company is considered against public interest.

16.5.2 Housing Finance Companies (NHB) Directions, 2001

In exercise of the powers conferred upon it under the National Housing Bank Act, 1987, the National Housing Bank has issued the directions to the housing finance companies on 27th September 2001. The salient features of these directions are as follows:

Acceptance of Public Deposits

The acceptance of public deposits by housing finance companies are subject to the undermentioned regulations. But public deposits exclude the followings:

i) Amounts received from the Central Government or a State Government or from any other source and whose repayment is guaranteed by the Central/State Government or amounts received from a local authority or any public housing agency or a foreign government or any other foreign citizen, authority or person.

ii) Amount received from National Housing Bank or any other Financial Institution in India or from a bank, Cooperative bank, Regional Rural bank.

iii) Amount received by a housing finance company from another housing finance company.

iv) Amount received by way of subscription to shares, stocks, bonds or debentures pending their allotment.

v) Amount received from a director of housing finance company or any amount received by a private housing finance comp;any from its shareholders.

vi) Amounts raised by the issue of bonds or debentures secured by the mortgage of any immovable property or with an option to convert them into shares.

vii) Amount brought in by the promoters as unsecured loans (subject to certain conditions.

viii) Any amount received from a Mutual Fund.

ix) Any amount received as hybrid debt or subordinated debt.

Restrictions on Acceptance of Deposits

Housing finance companies having net owned funds of Rs. 25 lakh and above are permitted to accept public deposits upto the following limits:

i) *5 times of its net owned funds*, if the housing finance company has obtained credit rating for fixed deposits not below A grade from any credit rating agency at lease once a year and it is complying with all the prudential norms (discussed ahead).

ii) If the housing finance company's fixed deposits have not been given the above mentioned rating, upto *2 times of its net owned funds*, or *Rs. 10 crore, whichever is lower*, subject to:

   a) it is complying with all the prudential norms, and

   b) it has achieved capital adequacy ratio of not less than 15% as per its last Balance Sheet.

The total amount of (i) public deposits, (ii) loans or other assistance from National Housing Bank, and (iii) the amount referred to in Section 45I(bb) (iii) to (vii) of Reserve Bank of India Act, 1934, should not exceed 16 times of the net owned funds of the housing finance company.

If the credit rating is downgraded to below A grade, the housing finance company shall report it to the National Housing Bank within 15 days and shall stop accepting fresh public deposits, if the deposits are in excess of the above limits and to reduce excess public deposits to the permissible limit within 3 years.

If a housing finance company fails to repay a public deposit in accordance with the terms and conditions of such deposits, it shall be prohibited from granting loans or making investments or creating any other assets as long as the default continues.

Housing finance companies are prohibited from accepting public deposits repayable on demand or on notice. The maturity period should not be less than 12 months and more than 84 monts from the date of acceptance or renewal.

Rate of Interest and Brokerage

Housing finance companies are permitted to determine their own rates of interest on public deposits, but within the maximum rate prescribed by the National Housing Bank. Interest may be paid or compounded at rests which shall not be shorter than monthly rests.

Brokerage or commission to the broker shall not exceed 2% of the deposits. Reimbursement of expenses not to exceed 0.5% of the amount of deposit.

Prepayment of Deposits

Housing finance companies are not permitted to repay a public deposit within a period of 3 months from the date of its acceptance. No interest shall be payable for premature repayment before six months. Thereafter interest shall be paid after a deduction of upto 1%.

16.5.3 Prudential Norms

National Housing Bank has prescribed the following Prudential Norms for the housing finance companies:

1) **Income Recognition:** Income on non-performing assets shall be recognised when it is actually received. Income from dividends on shares of companies and units of Mutual Funds shall be taken into account on cash basis. Income from bonds and debentures of companies and from Government securities or Government guranteed securities may be taken into account on acrrual basis, if interest is serviced regularly.

2) **Asset Classification:** Every housing finance company shall classify its assets into four categories, namely Standard, Sub-standard, Doubtful and Loss Assets. The meaning of these categories is the same as given in the prudential norms prescribed by Reservce Bank of India for banks and financial institutions. These companies shall make provisions also like the banks.

3) **Concentration of Credit/Investments:** The exposure norms for housing finance companies have been prescribed as follows:

   i) An HFC can lend to any single borrower upto 15% of its owned funds and to a single group of borrowers upto 25% of its owned funds.

   ii) An HFC can invest in the shares of another company upto 15% of its own funds and in the shares of a single group of companies upto 25% of its owned funds.

   iii) For lending and investing together these limits are 25% and 40% respectively.

   Investments in debentures are treated as credit and not investment for this purpose.

4) **Capital Adequacy Requirement:** Every housing finance company is required to maintain a minimum capital adequacy ratio (consisting of Tier I and Tier II capital) not less than 12% of its aggregate risk-weighted assets and of risk adjusted value of off balance sheet items. Tier II capital shall not exceed 100% of Tier I capital. The method of ascertaining the capital adequacy requirement is the same as is applicable to commercial banks.

16.5.4 Financing Activities of National Housing Bank

The National Housing Bank provides finance (i) directly to projects and (ii) by way of refinance to the primary lending agencies. It maintains two funds for this purpose, e.g. the General Fund and Slum Improvement and Low Cost Housing Fund. Refinance is provided mainly out of the gneral fund while direct finance is disbursed out of both the funds, though largely out of the general fund.

Refinance

National Housing Bank grants refinance to (i) Housing finance companies, (ii) Scheduled banks, and (iii) Cooperative sector institutions.

For obtaining refinance these primary lending institutions should fulfil the eligibility conditions, as stipulated by the Bank. Under the Liberalised Refinance Scheme effective February 2003, banks/HFCs have the option to choose either fixed interest rate or floating interest rate. Repayment period shall be between 2 years and 15 years at the discretion of the borrowing institution. In case of fixed rate of interest, the Bank will have the option to review and revise the rates on completion of 3 years. Interest rates range was 6.9% to 8.55% in case of fixed rate option and 6.7% to 7.95% in case of floating rate option as on June 30, 2003. In case of housing finance companies, the rate of interest depends on their respective internal credit rating. The borrowing institution shall have the option to switch over from fixed to floating rate and *vice versa* on payment of a fee. The refinance may be pre-paid also after giving two months' notice along with a nominal fee.

The following table shows that about three-fourth of the refinance provided by National Housing Bank was availed of by housing finance companies.

Cumulative Refinance Disbursements by National Housing Bank upto 30th June 2004

Institution	*Amount* (Rs. crore)
Housing Finance Companies	9164.87
Scheduled Banks	2516.63
Cooperative Sector Institutions	1543.76
Total	13225.26

HFCs have preferred floating rate borrowings while the scheduled banks have shown preference for fixed rate borrowings.

Short Term Financial Assistance to Housing Finance Companies

NHB has introduced a scheme to provide financial assistance to HFCs for their short term liquidity requirements. The assistance is granted for a minimum period of 15 days and maximum period of 90 days. The loan under the scheme is unsecured and repayable in one instalment.

Golden Jubilee Rural Housing Finance Scheme

The Government introduced this scheme in the year 1997 to promote housing finance in the rural sector. Under this scheme housing finance is provided by the above mentioned primary lending agencies in the rural areas. Against such finance, these institutions get refinance from the National Housing Bank.

To promote rural housing the National Housing Bank introduced a concession in the interest rate of 25 basis points in September 2003 for refinance in respect of rural housing loans disbursed by the primary lending agencies under the scheme. During the year refinance of Rs. 1700 crore was made by the Bank in respect of housing loans disbursed by primary lending agencies under this scheme. This constituted above 52% of the total refinance disbursement of Rs. 3253 crore during the year.

Refinance Scheme for Apex Cooperative Housing Federations (ACHFs)

National Housing Bank has introduced a refinance scheme to Apex Cooperative Housing Federations under which the interest rates are linked with the maturity of loan and the recovery performance. Loans given directly to individuals in addition to loans given through primary societies are eligible for being refinanced. The borrowing institution must be a profit making institution during the preceding three years.

Direct Financing by National Housing Bank

National Housing Bank provides financial assistance through direct lending to public agencies and local bodies set up by the Central/State Governments for the following purposes:

a) Land Development and Shelter Projects,

b) Infrastructure Projects, and

c) Slum Re-development Schemes

Under direct financing, the National Housing Bank provides financial assistance for undertaking various types of housing projects. Till June 2004, 144 projects were financed through direct finance window under both General and Special Funds. Rs. 385.35 crore was disbursed under these projects out of which Rs. 91.69 crore was out of Slum Improvement and Low Cost Housing Fund.

To broaden the project finance portfolio National Housing Bank introduced Project Finance Loan Policy in September 2003 to include private sector and joint sector entities also as eligible borrowers. Thus, the Bank is expected to play more meaningful role with regard to the provisions of projects for housing construction particularly in the area of Slum Improvement, economically weaker sections and low income group segments.

Activity 1

Identify the housing finance schemes offered by two/three housing finance institutions.

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16.6 ROLE OF PRIMARY LENDING AGENCIES

16.6.1 Commercial Banks

Commercial Banks commenced lending for house construction at the initiative of the Reserve Bank of India during recent years. Initially, Public Sector banks entered housing finance by establishing Housing Finance subsidiaries, e.g., SBI Home Finance, CanFin Homes Ltd., Central Bank Home Finance. After the Reserve Bank of India included housing finance in the priority sector advances, all banks commenced participation in housing finance in a big way. Reserve Bank of India required the commercial banks to allocate at least 3% of their incremental deposits as on the last reporting Friday of March over the corresponding figure of the preceding year's last reporting Friday figure, for the housing sector.

Commercial banks can participate in housing finance in the following ways:

i) Direct housing loans to individuals.

ii) Indirect assistance, i.e. asistance given to housing finance companies, Government housing boards, etc.

iii) Investment in the bonds of National Housing Bank or HUDCO or both.

iv) Investment in the Mortgaged Backed Securities (MBS), which are classified as direct lending to housing within priority sector.

In order to further improve the flow of credit to housing sector, Reserve Bank has directed that housing loans upto Rs. 15 lakh, irrespective of location, are now included in the priority sector advances. Moreover, for meeting the Capital Adequacy Norm prescribed by the Reserve Bank, the risk factor in respect of housing loans has been reduced to 50%.

As a result of the above initiatives, housing finance provided by commercial banks has registered significant increase. Outstanding advances for housing increased from Rs. 22346 crore as on March 22, 2002 to Rs. 51981 crore as on March 19, 2004. Sanctioned housing finance stepped up by 55% during 2002-03 and 42% during 2003-04. These figures show commendable progress in banks' participation in housing finance in India.

Home Loan Account Scheme of National Housing Bank

This scheme was started by NHB in July 1988 and is implemented by public sector banks, private sector banks and selected State Cooperative banks and Scheduled Urban Cooperative banks. The objective of the scheme is to encourage individuals to save specifically for housing. Any Indian citizen who is not owning in his/her name a house/flat anywhere in India may open an account under the scheme. He is required to deposit a specified amount for five years. Thereafter he becomes eligible for a loan under this scheme. The depositor is entitled to receive interest on the amount deposited at a specified rate.

The accumulated amount can be withdrawn only for constructing/buying a house or a flat after the expiry of 5 years from the date of opening the account. An account holder is eligible for housing loan on the completion of the 5 year period. Amount of loan varies from 2 times to 4 times the accumulated savings based upon the built-up area of the house/flat.

While sanctioning the loan, the repayment capacity of the borrower is assessed. Generally the loan does not exceed 2.5 times of his annual income.

Borrower is not precluded from raising funds for construction of house from any other source. Only one house can be constructed/purchased under the scheme. The house cannot be sold for 5 years or till the loan is repaid, whichever is later.

16.6.2 Housing Finance Companies

Housing finance companies are required to obtain a certificate of registration from the National Housing Bank for commencing or carrying on housing finance business in India. Till the end of June 2004, the Bank received 165 applications from housing finance companies for granting of certificate of registration. Of these 46 companies have been granted the certificate and 106 applications have been rejected.

The housing finance companies are entitled to avail refinance assistance from the National Housing Bank. The Bank has also participated in the Equity capital of five housing finance companies. Broad financial information relating to housing finance companies approved for financial assistance from National Housing Bank as on 31st March 2002 is as follows:

Paid up Capital	Rs. 2243.93 crore
Free Reserves	Rs. 4596.86 crore
Net Owned Funds	Rs. 6667.83 crore
Public Deposits Outstanding	Rs. 11216.90 crore
Housing Loans Outstanding	Rs. 41678.43 crore
Housing Finance sanctioned during 2001-02	Rs. 17633.27 crore
Housing Finance disbursed during 2001-02	Rs. 14614.44 crore

16.6.3 Housing and Urban Development Corporation Ltd. (HUDCO)

HUDCO is a leading public sector institution in the field of financing housing and urban infrastructure development. It is wholly owned by the Government of India. HUDCO's financial assistance is available both for (i) housing programmes, and (ii) urban infrastructure development. During recent years it has paid special attention towards the latter sector. Loans sanctioned by HUDCO for urban infrastructure projects constituted about 75% of its total assistance sanctioned during 2002-03. In this sector HUDCO has assisted in the provision/rehabilitation of services needed for human settlements, viz. water supply, sewerage, drainage, low cost sanitation schemes. Besides it has financed area development projects, commercial schemes, transport schemes and social infrastructure covering educational institutions and medical facilities, etc. Recently HUDCO has extended its assistance to the power sector also by subscribing to the bonds of State Electricity Boards and has extended credit to TN Electricity Board.

In the field of housing, HUDCO has achieved significant progress by embarking upon a number of schemes covering both urban and rural areas. It has made significant contribution in providing houses to the economically weaker sections and lower income groups in rural areas.

HUDCO has also been actively involved in the rehabilitation efforts following the earthquakes, which caused widespread destruction of houses.

HUDCO has raised bulk of its resources through issuance of a series of bonds and debentures, Special Infrastructure Bonds and loans from various banking and financial institutions. It also solicits public deposits and has raised loans in foreign currencies also. It has raised funds through Tax Free Bonds also.

16.6.4 Housing Development Finance Coporation Ltd. (HDFC)

HDFC was set up in 1977 at the initiative of ICICI as the first formal institution in the private sector. Its share capital has been contributed by corporate bodies, banks, financial institutions, mutual funds, Indian public besides foreign institutional investors.

HDFC has mobilised bulk of its resources through loans, bonds and deposits. Loans have been obtained from National Housing Bank, Scheduled Banks and Life Insurance Coroporation. Foreign Currency loans have been raised from the World Bank, International Finance Corporation, Asian Development Bank and other institutions.

The prominent role of HDFC in the field of housing finance is evident from the fact that its total disbursements increased from Rs. 1906 crore during 1997-98 to Rs. 12,967 crore during 2003-04. Its net profit increased to Rs. 851.8 crore during 2003-04. Its non-performing assets continued to be at low level and were below 1% (0.89%) of the portfolio as on March 31, 2004.

16.6.5 Cooperative Institutions

At present there are 92000 housing cooperatives at the grass-root level, which are represented by 26 Apex Cooperative Housing Federations (ACHFs) at the State/ Union Territory level. All of them are members of National Cooperative Housing Federation of India (NCHF), which has been promoting, guiding and coordinating the activities of housing cooperatives at the national level.

The Apex Cooperative Housing Federations (ACHFs) borrow resources from L.I.C., National Housing Bank, HUDCO, State Governments, Banks and in the form of deposits and debentures. These ACHFs advanced an amount of approximately Rs. 750 crore a year for the construction of houses in the country. Till June, 2002, it had disbursed Rs. 7500 crore for this purpose. In turn, they avail of refinance assistance from National Housing Bank.

State Cooperative Agriculture and Rural Development Banks

These banks are also permitted to lend for housing. National Housing Bank subscribes to the Special Rural Housing Debentures floated by these banks backed by the mortgages originated by them.

State Cooperative Banks and Primary Urban Cooperative Banks

These banks are also eligible to avail refinance assistance from National Housing Bank provided they meet the recovery norms prescribed by the NHB. But not many banks have availed of refinance assistance from NHB.

16.7 SECURITISATION OF HOUSING LOANS

In order to mobilise more resources for the housing sector, National Housing Bank has taken a new initiative by undertaking securitisation of home loans granted by housing finance companies and banks. Securitisation by NHB involves purchase of home loans backed by mortgages from housing finance companies and banks (called the originators) and transfer of the same to the investors for consideration. NHB acts as trustee for such investors and issues Pass Through Certificates to the investors. As trustees, NHB arranges for collection of cash flows on the securitised loans and its distribution to the investors. It receives Trusteeship Fee for this purpose.

The process of securitisation called Residential Mortgage-backed Securitisation (RMBS) is beneficial to both the orginators and the investors. Originators augment their liquid resources immediately — they need not wait for long to realize the EMIs from their borrowers. Hence they can lend further on the basis of resources received on securitisation. For credit enhancement of the Pass Through Certificates (PTCs), orginators provide to the trustees a collateral in the form of cash deposit or bank gurantee.

The investors — institutions and individuals — get an additional avenue for investment of their excess funds with greater degree of security. The recovery of housing loans has generally proved to be very high and hence chances of bad debts are very insignificant. The investors get a return payable monthly.

Till 2003-04 the NHB has completed ten securitisation transactions involving 35116 individual home loans originated by 6 housing finance companies and one public sector bank, aggregating Rs. 663.92 crore. NHB has also invested a small sum in these PTCs. The average collection efficiency in each securitised pool ranged between 95% to 99%. The total collections from the pools were adequate to service the investors. Therefore, necessity was not felt to tap the collaterals.

16.8 SUMMARY

Housing is an essential need of human beings. Moreover, housing sector has great economic significance for the economy of a country. Therefore, various institutional sources of finance has emerged in India for this sector. We have discussed the salient features of such loans and the main terms and conditions on which such loans are granted by these institutions.

We have discussed the role of banks and housing finance companies which are the principal agencies for providing housing finance in India. HUDCO and HDFC are the two prominent institutions in this area. The National Housing Bank is the apex Bank and regulatory authority for housing finance companies. We have discussed the promotional, financing and regulatory role of NHB in detail. The main provisions of National Housing Bank Act, the directives issued by it regarding acceptance of public deposits and the prudential norms prescribed by it are discussed in detail. Lastly, the new innovation of securitisation of housing loans is also highlighted.

16.9 SELF ASSESSMENT QUESTIONS

1) What do you understand by Equated Monthly Instalments? What consideration is kept in mind while determining EMIs? Explain.
2) What do you understand by Floating Rate of Interest? How is it determined? Explain its significance.
3) What functions are undertaken by National Housing Bank? Discuss the powers vested in it to regulate and supervise the housing finance companies.
4) Explain the statutory provision for maintenance of liquid assets by housing finance companies.
5) What are the various ways in which the commercial banks may participate in housing finance?
6) What do you understand by securitisation of housing loans? Explain its procedure and significance.

16.10 FURTHER READINGS

Annual Report of National Housing Bank, 2003-04.

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