



# Dynamics of Housing Finance in Karnataka

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## Abstract

This paper attempts to study how **Dynamics of housing finance in Karnataka is governed by** banks and **housing finance** companies and housing market has been instrumental in driving the economy of the state. Housing is a basic necessity. Yet a large number of households do not have access to decent housing, particularly in a developing country like ours. In view of the importance of housing, a key element of public policy in many countries has been to encourage house ownership largely through fiscal incentives and better availability of housing finance. At the same time, the demand for housing finance has encouraged financial innovations, at times resulting in financial crisis like the recent one. While development of housing finance in advanced countries has a long history, the expansion of housing finance by the formal financial sector in India is of relatively a recent origin. Keeping in view the demand-supply gap, our favourable demography, increasing urbanisation and better growth prospects, the demand for housing finance will continue to grow. The challenge, therefore, is expansion of housing finance to a wider section of the population with the necessary safeguards to preserve financial stability.

Housing is a crucial sector for the economic growth **in Karnataka** due to its multiplier effect for driving the demand, especially for several ancillary sectors. The growth of the sector is dependent on numerous factors, the key being housing finance. This play a significant role as it helps bridge the gap between the financial constraints and aspiration of buyers. Additionally, housing finance strongly influences house prices. It is the direct or indirect lending of funds, which enable borrowers to purchase, rebuild or expand their houses. There are several types of housing finance instruments. These primarily differ in purpose for use of funds, but overall serve the purpose to help borrowers purchase or remodel their abodes.

*Key words: Democracy, politics, participation, Islam, India, Muslims, General Elections*

## Introduction

In Karnataka developments in housing markets and house prices have drawn considerable attention in both academic and policy circles in the aftermath of the global financial crisis. The recent global crisis emanated from the sub-prime segment of the US housing market. While the crisis has spread and become broad-based across the globe, the post-crisis recovery has also been predicated on the prospects of the housing sector in many advanced economies.

As emphasized, there are different channels through which housing affects the economy: First, housing wealth constitutes a significant portion of total wealth of households in the advanced economies. For instance, housing wealth accounted for about one-half of household net worth in the US and over two-thirds in the euro area. Hence, any variation in it may have significant impact on households<sup>TM</sup> consumption and thereby aggregate demand in the economy. Second, housing markets have implications for the supply side of the economy as labour mobility and employment is affected by the housing economy. Third, house prices, like any other asset prices being interest rate sensitive, affect transmission of monetary policy. Finally, boom and bust in house prices have implications for business cycles and hence financial stability.

In Karnataka the moderation in growth of housing credit after 2006 could be attributed to the following factors: First, some slowdown in housing credit growth could be expected after the initial catch-up phase as the pent up demand is met. Second, GDP growth also moderated following the global financial crisis which dampened the demand for housing. Third, the tightening of prudential norms of increasing risk weights to a range of 50-125 per cent, higher provisioning against standard housing assets and prescription of LTV norms to mitigate risks could also have led to some moderation.

Notwithstanding tighter prudential standards, direct housing loan of up to Rs. 2.5 million and indirect bank finance to government agencies for rehabilitation of slum dwellers, and to housing finance companies (HFCs) for rehabilitation of slum dwellers as well as for construction of individual dwelling units of up to Rs. 1.0 million are treated as priority sector loans. Government also allows deduction from income up to Rs.0.1 million per annum for principal repayment and Rs. 0.15-0.25 million for interest component for income tax purposes. In addition, there are several specific government schemes for housing for the underprivileged. While these measures have incentivised house ownership, there is a huge gap between demand and supply besides affordability. Real estate prices are conceptually somewhat different from the prices of goods and services. While prices are generally determined by supply and demand, real estate prices additionally reflect market<sup>TM</sup>s expectations of future prices. As experience shows, if expectations are belied there could be dramatic adjustments in prices raising stability concerns. Compilation of house price indices is challenging not only because of difficulty of gathering accurate price data but also due to quality changes in the construction of similar size of houses even in the same locality. To overcome these challenges, various methods for measuring house prices such as hedonic prices, repeat sales, median prices and sale price appraisal ratio have been developed. It is therefore not feasible to construct a single index that would satisfy all the requirements. The choice of a method therefore is largely influenced by the ease of regular availability of data and the characteristics of the housing market.

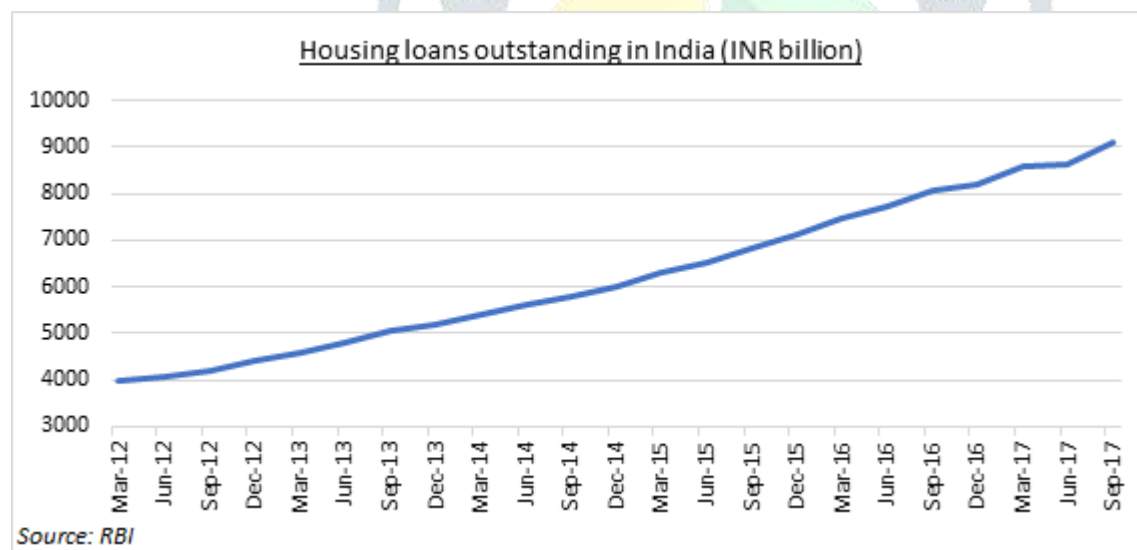
**Objective:**

This paper intends to explore and analyze housing finance in Karnataka is **fulcrum of economic progress**: Dynamics of the market steered by **lowest interest rates ever witnessed in India**. Also **scrutinise the** regulatory framework for **Housing Finance** Companies (HFCs)

**Housing finance growth and scope**

According to the 2011 census data approximately 67% of the occupied houses were in rural India. Moreover, roughly 87% families lived in owned units indicating a strong bias towards home ownership. Furthermore, around 73% households lived in dwellings with less than two rooms and an average household consisted five members, this points towards a constrained living space. India is the second most populous nation in the world and has a large young population, this implies a high demographic dividend. The migration from rural to urban areas has been picking up in recent years. This creates an ideal atmosphere for a supernormal growth of housing and a large proportion of the demand will be facilitated through housing finance.

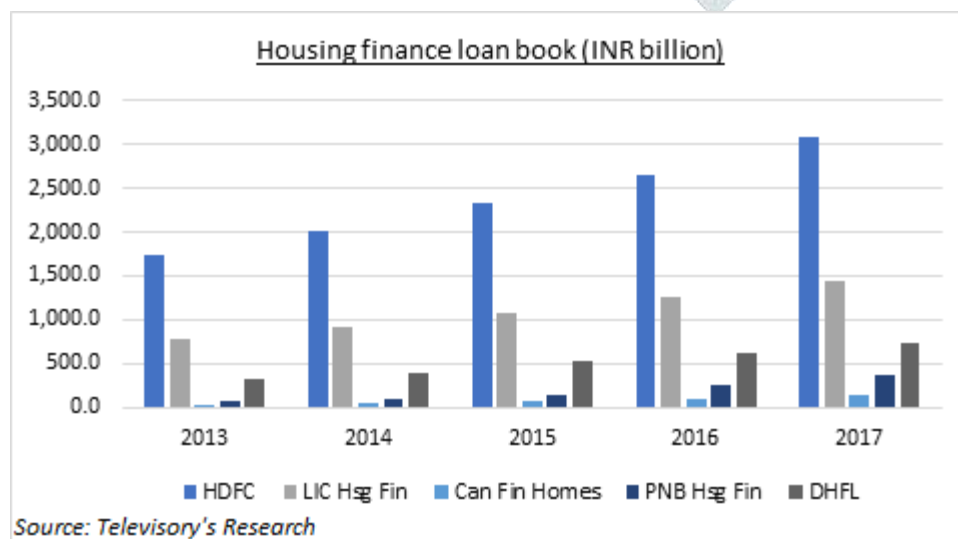
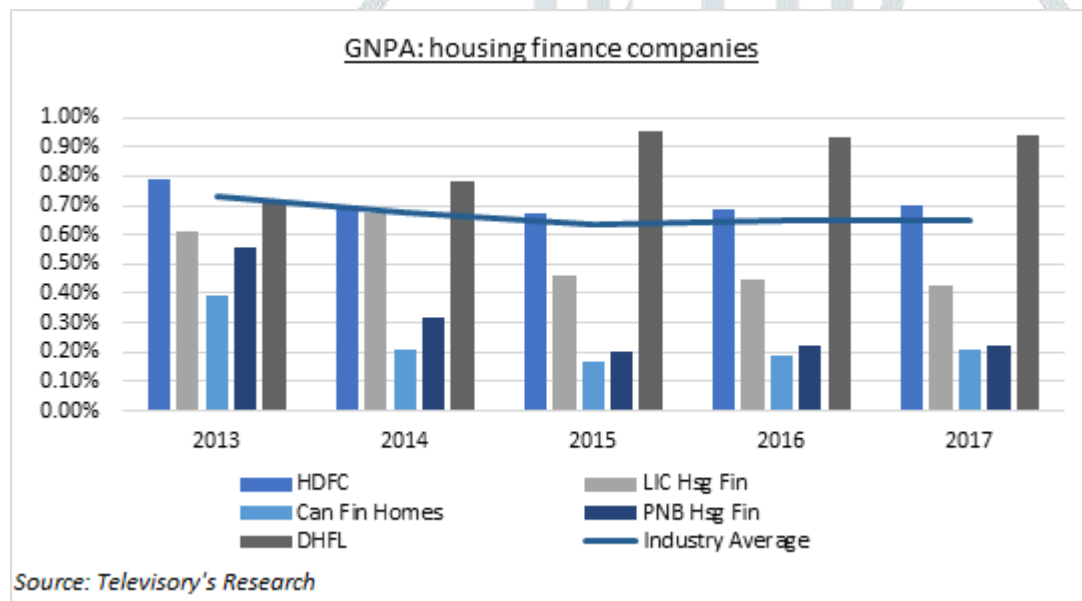
The housing finance industry in India saw a strong growth rate and the total loan book for all housing loans grew at a CAGR of 16.72% (2012-17). This growth was nearly double of the overall credit growth for the country and portrays a robust outlook for housing finance sector. The entire loan performance growth was led by a rapidly expanding economy, falling interest rates and low housing area per capita in relation to the developed economies. Hence, brisk economic development led to a creation of large middle class and people migrated to big cities. This drove the growth of housing finance and high per capita income increased the borrowing capacity of people.



In India, the housing finance market is dominated by the leading public and private sector banks and non-banking housing finance companies such as HDFC Ltd., LIC Housing Finance, Can Fin Homes, PNB Housing Finance and Dewan Housing Finance. The market has reached a stage of the intense competition where each player is competing for the market share.

### Housing Credit In Karnataka

In the wake of a favourable backdrop of the economy in Karnataka, several initiatives were launched by banks and housing finance companies to expand their loan book. The fall in interest rates (2013) from the high encouraged the demand for home loans and resulted in a larger growth. This was positively supported by healthy internals in the industry with very strong performance seen on the net and gross non-performing assets. The gross non-performing asset (GNPA) as a percent of total advance data from the top 5 housing finance companies indicate a stable to declining trend. In addition, against the same, the banking sector as a whole has been experiencing a significant rise in the GNPA to total advances from FY 2013 to 2017 period. The overall total GNPA for the banks in India increased by more than four times. This suggests that the housing loan market is more stable and housing finance companies are lending to borrowers with a good repayment capacity. The loans are backed by houses, these can be easily auctioned in an event of a default. This enabled companies to recover their funds with a good turnaround time. The financial institutions usually require a sizeable down payment, which is dependent on the credit rating of the borrower and help in the maintenance of a low and stable GNPA level.



The government's initiative to support the affordable housing segment is another step in the right direction for the industry and should further drive the growth as a whole. However, a bit of caution needs to be exercised particularly for sub INR 200,000 loans. The government's push of 'Housing for All' is targeting low-income groups though the ability of these borrowers to service the debt is yet to be examined. A substantial rise in home loans for this initiative could end up increasing the NPAs of housing finance companies. Thus, banks need to be prudent and ensure that lending is conservative and loans should be disbursed to individuals with a good credit rating to minimize NPAs.

The overall growth of housing prices in Karnataka is another positive attached to the growth of the industry. While a very high increase in prices lead to speculative buying and creates headwinds for the industry in the long-run, the growth in India has primarily been respectable. Few of the overheated markets also witnessed time-wise correction in the past 1 to 2 year and provides additional stability for the housing market participants including banks, construction and real estate companies as well as buyers. In the four-year period from June 2013 to June 2017, the correlation between housing prices and housing finance market size stood at 0.98.

### Way Forward

Besides institutional finance, self financing from private sources, withdrawals from provident funds and loans from employers are important sources of housing finance. The available national accounts data on households<sup>TM</sup> investment in physical assets do not distinguish between pure households and propriety & partnership concerns. Hence, there is a need to develop a distinct component of pure households<sup>TM</sup> investment in residential construction for a more comprehensive measure of contribution of housing to households<sup>TM</sup> net worth.

Second, both the NHB-Residex and RBI-HPI, besides providing a cross-check on house prices, facilitate a comparison between final market prices and registration prices. The coverage of the cities needs to be expanded to develop a representative all-India urban house price index. Housing finance institutions has to spread out geographically while ensuring consistency in the processing and service standards. Presently Housing finance institutions are concentrating on the customers with secured monthly and annual income. Customers with irregular income and without income proof are still outside the purview of this sector. Government and Housing finance institutions must prepare some plans for these untapped customers to fulfill their Housing needs

Third, in order to enhance the information base of the housing finance market, the Reserve Bank should place in public domain its detailed database on house price monitoring system. Increasing Competition in the Housing finance sector has made the customers more informed about the various factors in this field. Only such institutions offering value added services with customized features will be able to capture the market. Housing finance institutions has to offer more sophisticated and tailor made housing finance products to suit customer needs. Differentiate and diversified housing finance products will become the factor to make a housing finance institution a market leader.

Fourth, keeping in view the recent moderation in expansion of institutional finance for housing, an important question is whether securitization would help in expanding housing finance and also address the problem of procyclicality, thereby stabilizing house prices. As the US experience with the sub-prime crisis shows, securitization could impart liquidity and enhance efficiency only when it leads to creation of simple structures easily understood by market

participants and regulators. Given our early stage of development of the mortgage market, there is scope for housing disintermediation both through more active involvement of apex refinancing institutions like the NHB and also through development of simple securitized mortgage products backed by adequate regulatory safeguards. Traditionally in India, most people used to depend on their provident fund and gratuity amounts received after retirement – while considering buying a home. However, with the emergence of housing finance as a major business in the country, an increasingly large number of people are going in for home loans. Earlier it was considered socially unviable to borrow funds but now situation has changed. The consumer today has a far more positive and open outlook on taking a loan. There is also a key change in the demographics of loan applicants. Earlier it was in the age of 45+ but now it is Under 30. There is a sea change in the social set up of Indian families. We are heading from joint family concept to nuclear family concept. Incomes of families are rising and their purchasing capacity as well as loan repaying capacities are going up. Surely this change will bring more demand for housing finance. According to a United Nations study (1995), by the year 2015, ten of the world's fifteen largest cities will be in Asia (excluding Japan); three of these will be in India. These projections suggest that demographic growth in India's large cities will be high, partly due to national population growth and partly due to immigration. These are some of the indications which signals bright future for the housing finance Industry. If we look at the Mortgage to GDP ratio it is up to 2% only where as in advanced countries it is up to 51%, so there is ample scope for growth in this sector.

Fifth, in order to mitigate risks in housing finance, besides application of macro-prudential regulations, there is a need to develop a fixed rate housing loan product of longer maturity.

## Conclusion

In Karnataka the growth in housing finance potentially results in a rise of housing prices and vice versa though this can also lead to speculative buying and lending. However, the housing market is showing signs of strong fundamentals despite a solid growth in lending and appreciation of prices. The nation is still away from facing a speculative frenzy caused by excessive mortgage lending like the western markets (2008-12).

Therefore, the big picture is that a rising housing demand, initiatives of the government to drive affordable housing, stable to falling interest rates, the demographic dividend, migration from rural to urban areas and the growth in personal disposable income indicates that the housing finance market can continue its current robust growth rate, enabling it to get more entrenched in the economy in long run.

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