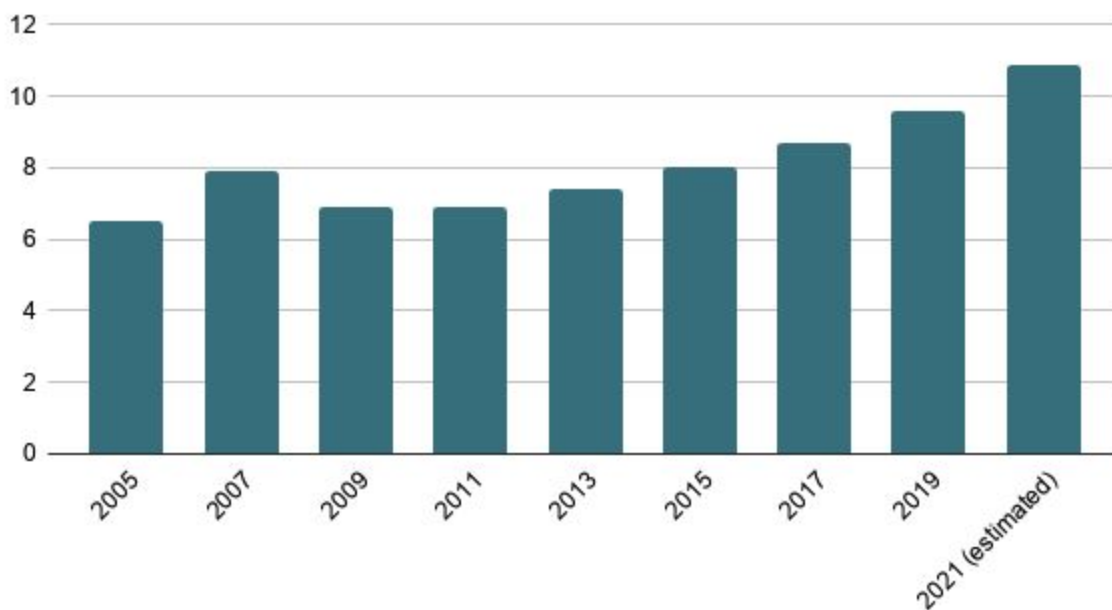




Evolution of Housing Finance in India

Retail home loans or mortgages are lent directly to consumers and not to real estate developers, corporates or other banks.¹ Consumers borrow these home loans to buy, build or modify a property. They are a type of housing finance.² It is important for an economy to have a vibrant mortgage market to ensure that housing remains affordable.

India's Mortgage to GDP Ratio (2005 to 2021), in %



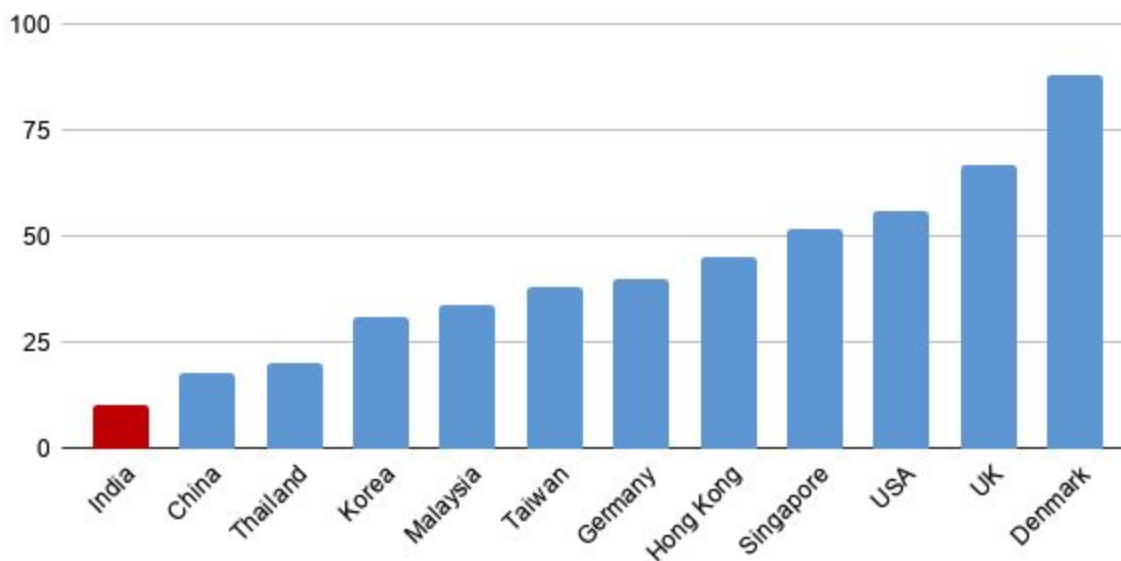
Source: Reserve Bank of India (2019): Report of the Committee on the Development of Housing Finance Securitisation Market

*India's mortgage-to-GDP ratio has increased steadily over the last ten years.

¹ [Central Bank of India- Cent Home Loan Scheme](#)

² Other examples of housing finance are loans for construction of commercial and residential property for real estate developers or Lease Rental Loans available by tenants.

Cross-Country Comparison of Mortgage to GDP Ratios in 2017, as %



Source: Reserve Bank of India (2019): Report of the Committee on the Development of Housing Finance Securitisation Market

However, when compared to other large economies, India's formal mortgage penetration is still low.

Evolution of housing finance between 1947-1970

India did not have an official national-level housing policy until 1988. However, some provisions for supplying subsidised housing to targeted beneficiaries were made through the Five-Year Plans³ of the Planning Commission in the early years post-independence. The focus of these Five-Year Plans was on providing finished housing to beneficiaries, as the state viewed housing as a welfare good and not an economic good.⁴

The foundations of a housing finance market were also laid during this period. For instance, the First Five Year Plan (1951-1956), proposed that a National Housing Board and Regional Housing Boards be set up for financing and implementing housing schemes.⁵ During the Second Five

³ The Five Year Plans were economic and social growth programmes to plan public spending for equitable growth.

⁴ Pritika Hingorani, Indian Institute for Human Settlements (IIHS), 2011- Revisiting Low Income Housing: A Review of Policies and Perspectives

⁵ From 1960 onward, state governments started setting up their housing boards, with Gujarat establishing the Gujarat Housing Board on 1st May, 1960.

Year Plan, in 1957, the Minister for Works, Housing and Supply proposed the institution of state development corporations to provide loan finance for housing projects. In both these cases, 'financing' referred to the advancing of money to public agencies for implementing the housing schemes and not to home buyers.

Mortgages through housing schemes

Some central government schemes offered loans to targeted beneficiaries for building houses. In 1954, for instance, home loans were given to individuals who had an annual income of less than ₹6,000 per annum through the **Low-Income Group (LIG) Housing Scheme**. Loans up to 80 percent of the cost of building a house were given to beneficiaries, subject to a cap of ₹ 8,000. In 1959, through the **Middle-Income Group (MIG) Housing Scheme**, loans were provided to individuals whose income was between ₹ 6,000 to ₹ 12,000 per annum. **The scheme brought in the Life Insurance Corporation (LIC) of India to provide loans to individuals through co-operatives.**⁶ Loans to the extent of up to 80 percent of the cost of the house were provided, subject to a cap of ₹ 16,000 to those beneficiaries who possessed land. The cap was ₹ 20,000 for those beneficiaries who would have to buy land.⁷ The loans were advanced to individual borrowers through the State Governments at the rate of 5 per cent per annum. **Loans were sanctioned for 3,600 applicants through this scheme, and about 500 houses were constructed through them across the country.**⁸ Another program was launched through the Third Five Year Plan, which gave loans to Dock Labour Boards to build housing for their workers.⁹

Mortgage lending between 1947-1970

The penetration of retail lending in all sectors was very low till the 1970's. This was primarily due to the non-availability of adequate assets with prospective borrowers which made it difficult for people to approach banks to borrow retail loans,¹⁰ including mortgages. Around 10 percent of the houses were built or purchased through mortgages from institutional agencies, while the remaining 90 percent were built or purchased using people's own savings and informal sources such as moneylenders or friends.¹¹

⁶ Ibid

⁷ NITI Aayog- 3rd Five Year Plan

⁸ Ibid

⁹ Ibid

¹⁰ RBI (2008) Evolution of Banking in India

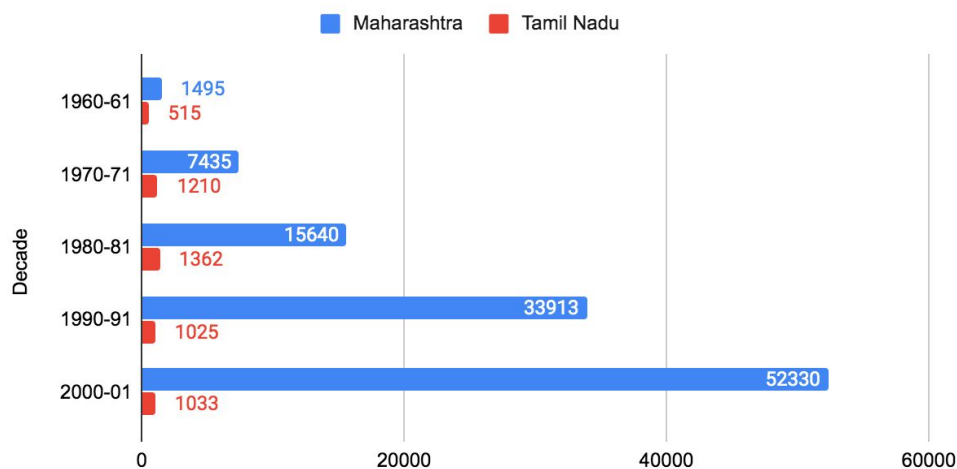
¹¹ Competitive Dynamics of Housing Finance Industry (2009)

Role of housing credit co-operatives

Only housing co-operative credit societies lent for retail housing finance during the first three Five Year Plan periods.¹² The first housing co-operative credit society was the Bangalore Building Cooperative Society which was established in 1909, after the enactment of the Cooperative Credit Societies Act in 1904. Thereafter, with the enactment of the Government of India Act in 1919, which aimed at devolving powers to the provincial governments, the provinces started enacting their own Co-operative Societies Acts. The Bombay State Cooperative Societies Act was first enacted in 1925. Some types of housing co-operatives, such as **house mortgage societies**, arranged loans for their members.

Before independence, co-operatives were mainly concentrated in the Bombay and Madras Presidencies. They continued to grow in the cities of Bombay and Chennai post-independence, although they grew at a greater rate in Bombay than Chennai.¹³ The chart below shows the relative proliferation of housing co-operatives since the 1960s in Maharashtra (mainly Bombay) and Tamil Nadu (mainly Chennai).

Growth of Housing Cooperatives in Maharashtra and Tamil Nadu



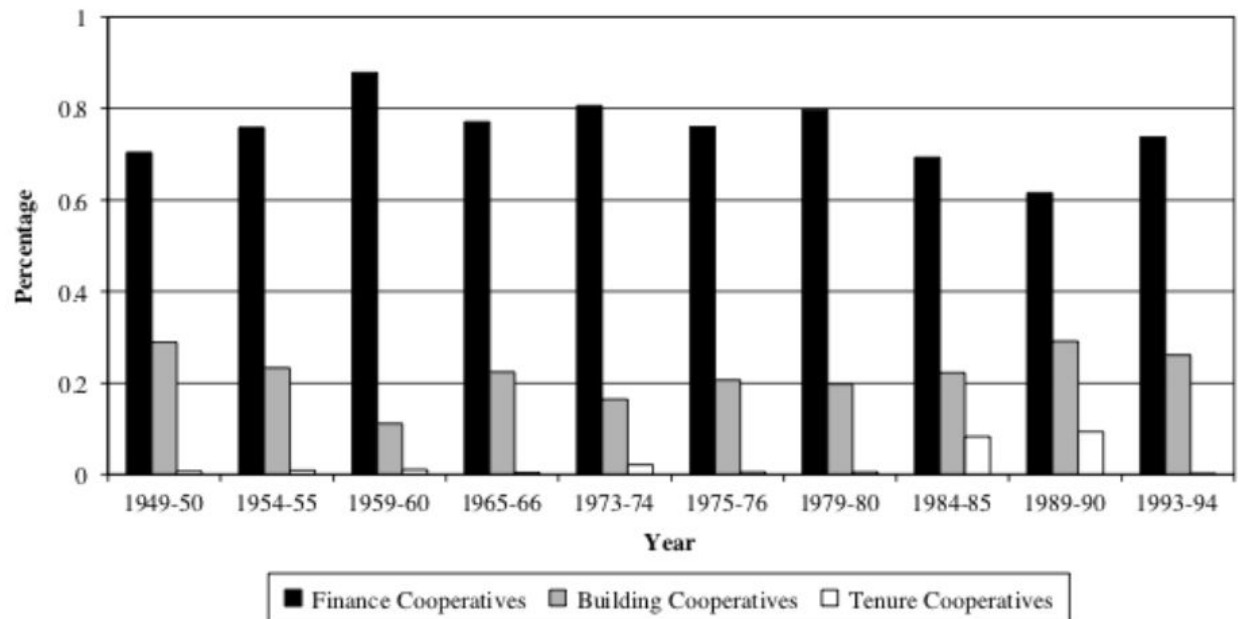
Source: Data from a study by Sukumar Ganapati in Housing Studies Journal (2012) titled 'A Century of Differential Evolution of Housing Co-operatives in Mumbai and Chennai'

In Bombay, 'tenure housing co-operatives' constituted the bulk of the housing co-operative societies. They were of two types: (1) tenant co-partnership and (2) tenant ownership. In the first type, the co-operative owned both land and building; members held shares in the

¹² Thingalaya et al., IIBF (2012)- Housing Finance: A study of the Experience of Commercial Banks

¹³ Sukumar Ganapati, Housing Studies Journal, (2012)- A Century of Differential Evolution of Housing Co-operatives in Mumbai and Chennai

co-operative and had occupancy rights to their dwelling unit. In the second type, the co-operative owned the land, and members leased housing units from the co-operative. In Chennai, the 'finance co-operative housing societies' constituted more than 60 percent of the housing co-operatives in the city. Until independence, they lent mortgages to their members for the construction of houses, and occasionally for the purchase of land and building materials. After independence, however, their activities were confined to primarily lending to their members for developing land which the members possessed and for house construction.¹⁴



Source: Study by Sukumar Ganapati, *Housing Studies Journal* (2012) titled 'A Century of Differential Evolution of Housing Co-operatives in Mumbai and Chennai'¹⁵

Mortgage lending between 1971-1987

Establishment of HUDCO

On 25th April 1970, the Housing and Urban Development Corporation Limited (HUDCO) was incorporated under the Companies Act, 1956. HUDCO is a public sector enterprise fully owned by the Government of India. It was established to provide long-term finance for the construction of houses for residential purposes and finance housing and urban development programmes in the country.¹⁶ However, HUDCO's role was that of a wholesaler which financed

¹⁴ Ibid

¹⁵ Ibid

¹⁶ [Housing and Urban Development Corporation website](#)

the public housing agencies such as housing co-operatives, rather than individuals. It did not, thus, lend mortgages.

Establishment of HDFC

In 1977, the Industrial Credit and Investment Corporation of India (ICICI) in collaboration with the Aga Khan Fund, set up the Housing Development Finance Corporation (HDFC), incorporated under the Companies Act, 1954. It was the first housing finance institution which specialised in lending mortgages to retail borrowers. HDFC also lent to housing co-operatives.

Imposing and increasing limits on lending for housing by banks

In May 1979, the Reserve Bank of India (RBI) issued guidelines to scheduled commercial banks (SCB) to provide housing finance to the extent of ₹67 crore per annum, which constituted 0.5 percent of the total advances of commercial banks. RBI periodically increased this limit. In 1982, SCBs extended housing finance up to ₹150 crores, and in 1989 it extended housing finance up to ₹300 crores.¹⁷ SCBs were given the freedom to decide to lend under these limits either directly to home-buyers through retail mortgage loans or to lend to intermediaries such as real estate developers.

Regulatory developments between 1988-2019

Establishment of National Housing Bank

The first National Housing Policy, in conjunction with the Seventh Five Year Plan (1985-90) recommended the setting up of a National Housing Bank as an apex institution to regulate housing finance in 1988. The National Housing Bank (NHB) was established on 9th July 1988, under the National Housing Bank Act of 1987. The Reserve Bank of India (RBI) contributed the entire paid-up capital in NHB.

Entry of Housing Finance Companies (HFCs)¹⁸

From 1988, more HFCs began to proliferate under the direction of the NHB, starting with LIC Housing Finance Limited (LICHFL) and then GIC Griha Vitta Limited. They were both incorporated in 1989 for lending mortgages. LICHFL and GIC Griha Vitta Limited were promoted by LIC and General Insurance Corporation (GIC), respectively.

¹⁷ Ibid

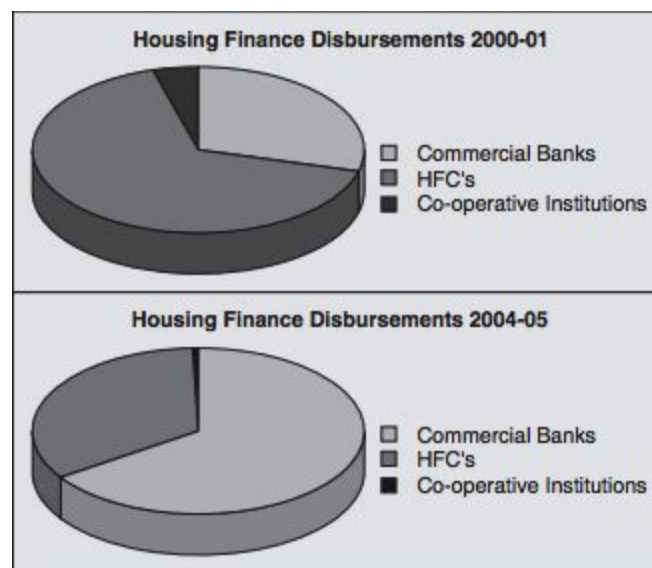
¹⁸ Housing Finance Companies are Non-Banking Financial Companies (NBFCs) incorporated under the Companies Act, 1954.

RBI recommendation to increase housing sector lending by commercial banks

In 1991, the RBI recommended that commercial banks allocate 1.5 percent of their incremental deposits annually to the housing sector, which included mortgage lending.¹⁹ The commercial banks started lending to the sector on a smaller scale. They were especially reluctant to lend mortgages because they considered lending mortgages a long-term venture when their resources were short-term maturity based. The bulk of their resources were channelled towards financing the working capital needs of the industry.²⁰

The mortgage market between 1988 and 2005

Although commercial banks had been permitted and encouraged to lend for housing, HFCs dominated the housing finance market up till 1999-2000. However, since 1999, commercial banks started increasing their lending to the entire housing sector (including home buyers) in the backdrop of industrial slow-down and greater demand for housing, along with an increase in people's disposable incomes. The share of commercial banks' lending to the housing sector increased from 29 percent in 1999-2000 to 66 percent 2004-05. **Meanwhile, an already diminished market share of Co-operative Housing Financing Agencies saw a more significant decline between 1999-2000 and 2004-05.**²¹



Source: N. K. Thingalaya et al., Institute of Management, Nitte (2009)- *Housing Finance: A Study of Experiences of Commercial Banks*

¹⁹ Mehta (1991)- Housing Finance System and Urban Poor

²⁰ Ibid

²¹ Ibid

Housing placed under priority sector lending

In 2014, RBI made housing a 'priority sector' for lending by commercial banks. In other words, banks are liable to lend a certain quantum of the loan amount to targeted beneficiaries. For instance, banks must lend loans up to ₹28 lakh to beneficiaries in metropolitan areas if they intend to dwelling units whose costs do not exceed ₹35 lakh per unit. The population in the metropolitan centres must be 10 lakh or more. Banks are also liable to lend loans up to ₹10 lakh for the construction of dwelling units for the rehabilitation of slum dwellers who have been displaced due to slum clearance projects.²²

RBI to take over regulation of HFCs

In 2019, 'Infrastructure Leasing & Financial Services Limited' (IL&FS), India's leading infrastructure development Non-Banking Financial Company (NBFC) defaulted on its debt payments. Housing Finance Companies, including HDFC, Dewan Housing Finance Ltd (DHFL), PNB Housing Finance Ltd (PNBHFL) and LIC Housing Finance Ltd (LICHFL), had high exposure to IL&FS. As a result, the crisis triggered a liquidity crunch in the housing finance sector. The RBI, therefore, proposed to take over the regulation of HFCs by amending the National Banking Act.

Role of NHB and RBI in promoting housing finance

Since the RBI take over of the regulatory role of NHB as the chief regulator of the housing finance sector in 2019, NHB performs two primary functions as of date-

1. Formulation of schemes for the extension of housing credit, such as schemes for providing refinance assistance to HFIs for specific purposes like affordable housing or for extending concessional housing loans to households affected by natural calamity in the state of Kerala.²³
2. Acting as the Central Nodal Agency for the disbursement of loans under credit linked subsidy as part of the [Pradhan Mantri Awas Yojana \(PMAY\)- Urban](#).²⁴

The overall mandate given to the NHB is to make retail housing finance affordable to all sections of the society. The RBI, in November 2019, issued a notification withdrawing exemption given to HFCs which allowed the NHB to regulate them. HFCs came under the purview of the RBI through Section IIIB of the RBI Act.

²² [Arthapedia- Priority Sector Lending](#)

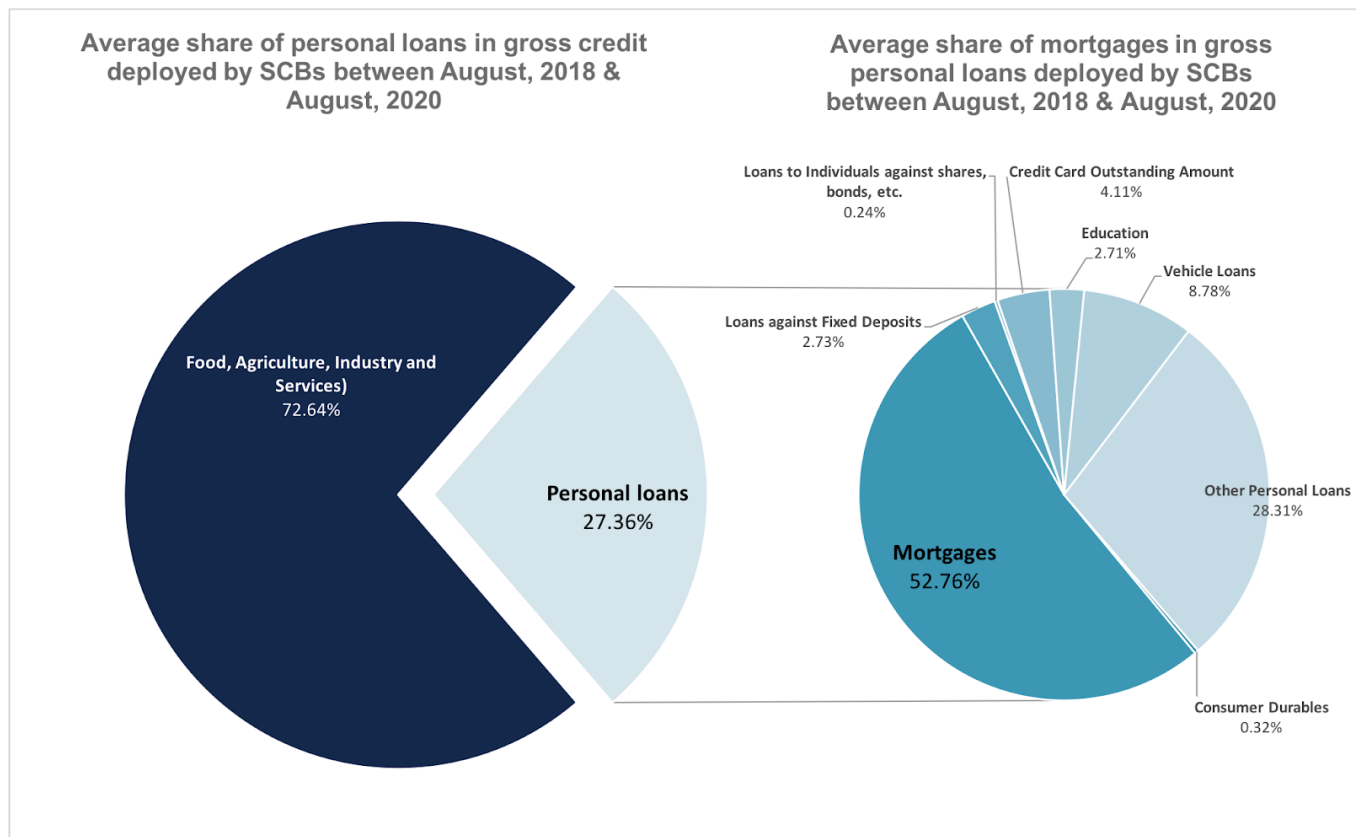
²³ [National Housing Bank \(NHB\) website](#)

²⁴ Under the Credit Linked Subsidy Scheme (CLSS) under PMAY- Urban, Economically Weaker Sections, Low Income Groups and certain categories of Middle-Income Groups will be able to avail home loan as subsidies on the purchase/construction/extension/improvement of their houses.

Fixing of interest rates of mortgages by banks and HFCs

HFCs follow an internal benchmark called Benchmark Prime Lending Rate (BPLR) while lending mortgages which are decided by the NHB. Banks follow the Marginal Cost of Funds-Based Lending Rate (MCLR), which is fixed by the RBI. It is tied to the marginal cost of funds, operating costs and Cash Reserve Ratio (CRR) decided by the RBI. This enables banks to pass on interest rate changes to borrowers faster than HFCs.²⁵

Mortgages lent by scheduled commercial banks (SCBs)



Source: Reserve Bank of India- Sectoral Deployment of Bank Credit in India²⁶

*Between August 2018, and August 2020, personal housing loans constituted 52 percent of the total personal loans deployed by SCBs. Personal loans constituted 27 percent of the gross credit deployed by SCBs.

The share of personal housing loans in the gross credit deployed by SCBs has increased since 2008. It was 8 percent in 2008, while in 2020, it is now 14 percent.²⁷

²⁵ [The Economic Times- Should you Opt for a Home Loan from Bank or Housing Finance Company?](#)

²⁶ Ibid

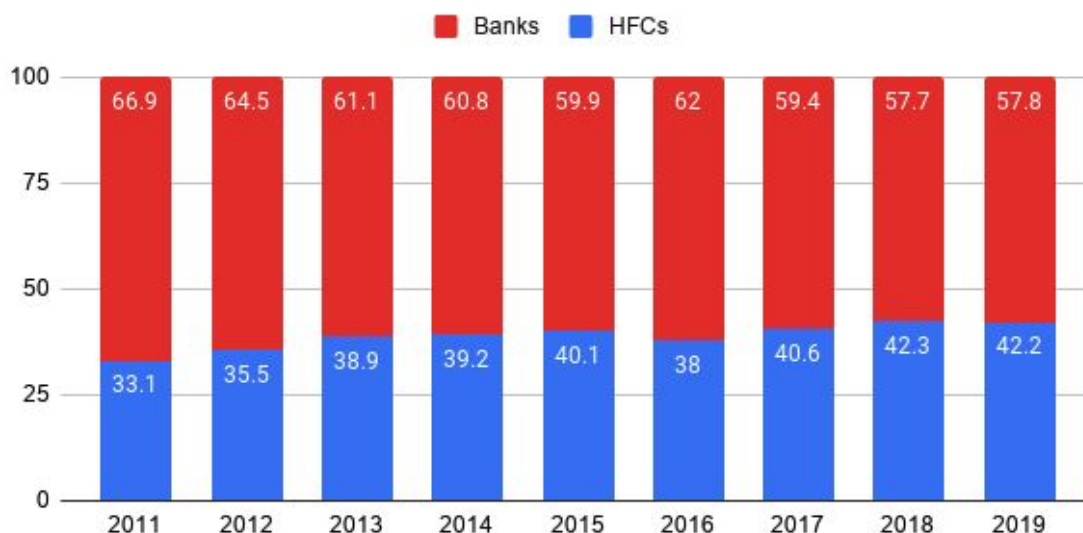
²⁷ [Reserve Bank of India- Sectoral Deployment of Bank Credit in India](#)

Share of banks and HFCs in mortgage lending

According to the 'Report of the Committee on the Development of the Housing Finance Securitisation Market',²⁸ a publication put out by the RBI, banks had a larger market share in the home loan market compared to HFCs from 2011 to 2019. In March 2020, banks had a market share of 61%²⁹. The trend of mortgage lending by banks compared to HFCs has continued since the 2000s.

The share of HFCs is now increasing. The rising share can be attributed in part to HFCs offering simpler and faster procedures compared to banks because HFCs have lesser regulatory requirements. Compared to banks, they follow a less stringent documentation process while ascertaining the credit score of the borrower.³⁰ HFCs also have more diverse sources of funding, such as bond markets. Tapping into bond markets allows them to raise funds even after the introduction of liquidity-tightening measures by RBI. HFCs were thus able to secure finances in 2014.³¹ Moreover, NHB, through its role as a refiner, ensures liquidity for HFCs.³²

Market Share of Banks and Housing Finance Companies (HFCs) from 2011 to 2019



Source: Report of the Committee on the Development of the Housing Finance Securitisation Market

²⁸ Reserve Bank of India (RBI)- Report of the Committee on the Development of the Housing Finance Securitisation Market

²⁹ Brickwork Ratings- HFCs Redefining Their Business Model To Revive Growth in FY21

³⁰ Terra Economics and Analytics Lab- Home Loan Refinancing: Choosing Between Banks and HFCs

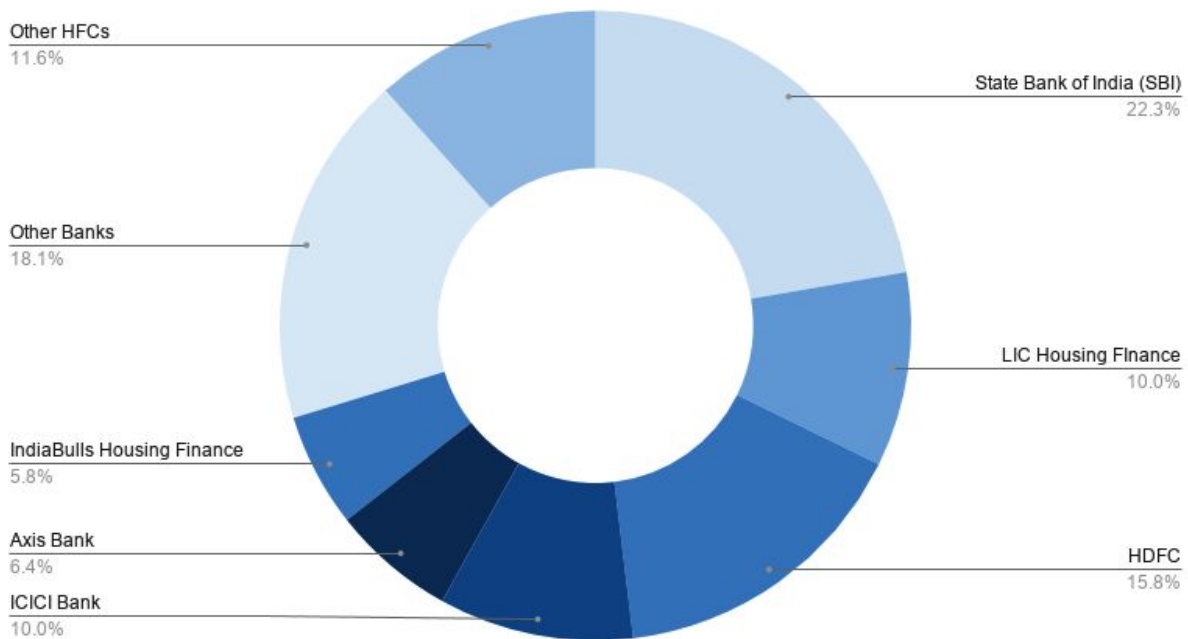
³¹ Outlook Money- Why HFC Stocks Are Doing Well

³² Ibid

Top mortgage lenders

In 2018, State Bank of India (SBI) was the largest lender of home loans with a 34% market share among, followed by ICICI Bank, which had a market share of 22.3%. Among HFCs, HDFC Limited led with a market share of 10%. It was followed by LIC Housing which had a market share of 10%.³³

Market Share of Top Banks and HFCs In The Mortgage Market in December, 2018



Source: Emkay (2019): BFSI Sector Update Report

Purchase of HFC loan books by banks

Banks often buy the loan books or mortgage portfolios of HFCs to inject liquidity into non-bank lenders and meet the priority sector lending shortfall.³⁴ In June 2019, for instance, Bank of Baroda purchased the mortgage portfolio of Dewan Housing Finance Corp. Ltd (DHFL) worth ₹3,000 crores to improve the quality of its loan book since the purchased loans are higher rated assets.³⁵ Besides Bank of Baroda, Punjab National Bank, Canara Bank and Andhra Bank are among DHFL's lenders.

³³ Deal4Loans- Best Home Loans in India July 2020

³⁴ Mint- Bank of Baroda buys ₹3,000 crore DHFL loans

³⁵ Ibid

Timeline of the Evolution of the Mortgage Market

