Financing Rural Housing in India

(Excerpt)

6.1 Introduction

6.1.1 Indian economy has been growing at an impressive pace for last ten years but it remains predominantly rural. Three fourth of the population is still residing in the rural areas. Even with increased pace of urbanization and urban migration, as per trends, 65 % of the population will still be residing in rural areas in 2025.

6.1.2 Good rural infrastructure in these areas remains a challenge even after 60 years of independence. Housing, basic amenities of water, sanitation and domestic energy along with village infrastructure such as roads, village water supply, electrification, drainage and livelihood infrastructure etc. are the prominent requirements in this regard. As per estimates worked out in Chapter 3, the housing shortage itself in rural areas is more than 400 lakh, similar shortages in basic amenities and infrastructure have been highlighted in the Census.

6.1.3 A major reason for not being able to eliminate shelterlessness is shortage of financial resources. At the same time the lack of convergence of various programmes of village infrastructure run by various departments and ministries is another reason. At present, central and state budgetary allocation and institutional finance from Scheduled Banks is the mainstay of providing finance to rural housing sector. Central Government has been allocating funds to various states for implementation of Indira Awas Yojana, which is being operated on 75:25 basis between the Centre and the States. In addition, many of the state governments are also implementing their own schemes from their state budgets that are either Capital Subsidy Schemes and / or Credit-cum-Subsidy Schemes.

6.1.4 Funding rural housing would necessarily begin with Central Government increasing its budget for capital subsidy programme. Further the State Governments could be incentivised to increase their portion of share for Central allocations over and above certain minimum Central allocations.

6.1.5 Still, considering that subsidy schemes are limited by budgetary allocation while the demand for rural housing is huge and is limited not only to below poverty line (BPL) families, it is important to strengthen existing credit-related products and to introduce new products to cater to a wider spectrum of housing needs. Financial instruments that could facilitate both BPL and APL families to expand their houses, upgrade and repair the existing shelter and also mechanisms by which Panchayats could develop village infrastructure are required. This aspect was discussed in the meeting of the Working Group wherein it was felt that a multi-dimensional approach had to be adopted and the members suggested various possible interventions. In this regard, Chairman, National Housing Board submitted a paper with details of the alternative ways of financing rural housing.

6.2 A Paradigm Shift

Since there is limitation on the part of Government to eliminate housing shortage even in BPL segments solely through budgetary allocations, there is need of a paradigm shift in strategy through adoption of a multi-dimensional approach to ensure housing finance in rural areas for all segments of rural population. Also, it is important to make it affordable and accessible. Such a multi-dimensional approach would focus on:

- Targeting Government's capital grant assistance to extreme poor and destitute BPL families i.e. poorest among the poor and encouraging the marginally poor families to take housing loans from the banks with an element of interest subsidy.
- Targeting different segments of families with appropriate and customized housing loan products.
- Encouraging Government and Civil society partnerships to extend necessary support to BPL segments to improve their livelihood opportunities and income levels that will enable them in due course to invest in housing.
- Encouraging effective conversion of house asset as productive housing through appropriate schemes and institutional mechanism. NHB has already put in place a scheme called, 'Productive Housing in Rural Areas (PHIRA)' which is being implemented in partnership with banks and micro-financing institutions.
- Catalysing institutional finance as well as micro-finance for investment in rural housing.
- Capital market funds and multinational funds may be invested in rural habitat development in partnership with state government and civil society.

- Evolving and introducing appropriate risk mitigants with safeguards, including insurance of both the asset and the securitization of loans.
- Increasing overall volumes at accelerated pace through effective collaboration and partnership arrangements with various institutions.

6.3 Proposed Strategic Interventions

To implement the proposed multi-dimensional approach, it is necessary to have right kind of intervention programmes so that objectives laid out are achieved within the target time. Hence, the following strategic interventions are suggested: -

- Limit Government Capital subsidy to the extreme poor and destitute families under Indira Awas Yojana and /or any other Scheme.
- Introduce Interest Subsidy Scheme whereby borrowers in the category of economically weaker sections gets loan at concessional and affordable rates.
- To encourage primary lending institutions to enhance their credit flow to the rural populations and actively involve the existing institutional mechanisms of SHGs and microfinance institutions to extend loans to rural populations.
- To encourage new, flexible financial products through commercial banks geared to payback cycles of rural families to bring about a higher degree of inclusivity in institutional lending for rural housing
- To develop mechanisms that will focus on 'Productive Housing' i.e. house in rural areas to be used as a base for income generation which would lead to asset building, women empowerment, family development, hygienic housing, improved health facilities, better education for children leading to human capital formation as well as sound collateral for various finances.
- Encourage small and medium developers to take up housing in rural areas through a mix of fiscal incentives and business volumes after necessary environment and social impact assessments and clearances from the Panchayati Raj Institutions.
- To create institutional mechanisms to address the higher risk perception in rural areas.
- Consider housing at par with rural infrastructure as far as funding and concessions are concerned, in order to encourage investments in the sector.
- Based on the aforementioned multi-dimensional approach and strategic interventions, specific initiatives which can be taken up are listed below.

6.4 Interest Rate Subsidy Housing Loan Scheme for the poor

6.4.1 Many civil society members generally argue that the rate of interest on housing loans in the rural areas is higher compared to urban areas and that the benefits of liberalisation have not percolated to rural areas. Though the rate of interest (ROI) charged by lending institutions is the same in the urban and the rural areas, the effect of fiscal concessions reduce the effective rate of interest by about 2.5% - 3% per annum for the urban households who file Income Tax returns and claim the benefits. However, in the rural areas, the same is not happening and therefore, the effective ROI remains high compared to urban areas. Hence, there is a need to bring down the ROI to that extent in rural areas specially for the poor.

6.4.2 As the effect on ROI is happening at the individual level and the lending institutions operations are market oriented, the lending institutions will not be able to offer the reduction in ROI lower than their market costs. Therefore, there is need to provide Interest Subsidy to make the loan effectively affordable. The interest subsidy could be restricted to the initial 7 years with phased reduction and thereafter, the subsidy could be completely withdrawn. The borrower could then pay the regular equated monthly instalment or seasonal payment cycles depending on occupational patterns of the rural borrower, as it is assumed that the borrower's income will increase on a year to year basis. The Interest Subsidy could bring down the ROI at affordable level in line with the agricultural loans, as well as enthuse the lending institutions to operate under prevailing and competitive market conditions.

6.4.3 This interest subsidy could be extended to credit for construction using energy efficient and cost-effective construction technologies. The certification of use of such construction technologies could be provided by appropriate regional institutions designated and linked to the lending institutions at the district and block levels.

6.4.4 Fiscal incentives could be extended to producers of cost effective and energy efficient building materials to encourage them to promote these in rural habitat development

6.5 National Rural Shelter Fund

NHB could be allowed to create the National Rural Shelter Fund for providing financial assistance to primary lending institutions (PLIs) to enable them to lend to ultimate rural borrowers at lower interest rate. The proposed fund would act as the main vehicle for financing borrowers having repaying capacity as well as for schemes like "Productive Housing in Rural Areas" i.e. housing loan scheme with livelihood. There would be no direct subsidy from the Ministry of Rural Development, GOI for the purposes as in case of agriculture lending. However, NHB could be allowed to access the funds through:

a. Floatation of Capital Gains Bonds under Section 54E of IT Act (on tap)

b. Access to Rural Infrastructure Development Fund (RIDF) by expanding the activities covered under it to include rural housing.

6.6. National Rural Housing Consortium

A consortium could be created comprising of nodal organisations such as NHB, NABARD, nationalised and premier commercial banks and apex micro-finance institutions to provide equity and debt for rural housing for small and marginal farmers, small village artisans, self employed, etc. MoRD could play the role of a "Key Facilitator". The broad functions of the consortium would be as follows:

a. Participation in the equity of housing projects for small and marginal farmers, self employed, etc.

b. Participation in the rural development projects especially the infrastructure projects for basic amenities through equity and loan.

c. Participation in the institutions / organizations undertaking projects towards linking Rural area (products) to semi-urban markets for increased benefits of market developments through equity, loan and grants.

d. Participating in the programmes undertaken by various agencies for capacity building of rural masses especially towards cost effectiveness and use of local materials for housing and housing related activities.

e. Participation in PURA projects, Bharat Nirman and other integrated rural area development projects.

f. Convergence with various infrastructure development plans as proposed under the Bharat Nirman in order to bring the under one umbrella the development of rural habitats in toto.

6.7 Incentivising Lending Institutions

Presently, housing finance companies (HFCs) registered with NHB, are allowed to create a Special Reserve to the extent of 40% out of the income earned through the long term mortgage financing (mortgage loans for more than 5 years) under Section 36(1) (vii) of the I.T. Act. This fiscal incentive is however, not available to banks, who are presently the leaders in the housing finance market. At present, the rural housing loan portfolios of banks and HFCs, comprise only 10-12% of their total housing loans. Therefore, there is need to incentivise these institutions to increase their lending in rural areas. It is therefore, proposed that the limit under this provision be increased from the present level of 40% to 60% for HFCs, banks and NHB. The additional 20% provisions will exclusively be for lending in rural areas. As banks have wider net-working in rural areas and have been providing other credit in rural areas, they should also be allowed the benefit under this section. Therefore, it is proposed that banks may also be allowed to create the Special Reserves on the lines of HFCs, for long term mortgage financing in rural areas. This will encourage banks and HFCs to aggressively lend for housing in rural areas. Self Help Groups and Micro finance institutions could also be encouraged to actively involved in extending housing loans

6.8 Securitisation of Rural Housing Loans

Encouraging Securitisation of rural housing loans to help garnering surplus resources from the market for investment in housing. This requires the following measures:

a. Rationalisation of stamp duty across all the states on the instruments of mortgage backed securities on the lines of Maharashtra, Tamil Nadu, Karnataka, Delhi, Andhra Pradesh etc.
b. Treating mortgage backed securities as "Trustee Securities" under the Indian Trust Act, 1882.
c. Treating these securities as "Approved Securities" for investment purposes by Provident / Pension and Insurance Funds.

6.9 Livelihood – based Housing and Habitats

6.9.1 Credit schemes can offer more flexibility and increase the number of housing units that can be taken up in response to the demand, but their utility is limited on account of low credit-worthiness of the poor. If credit-cum-subsidy schemes are provided for construction of livelihood-based housing and habitats, these might enhance the credit-worthiness of the beneficiaries.

6.9.2 There is a strong case for people with identical occupations, like weavers, dairy farmers, etc., forming a habitat, which can house the entire range of facilities like water supply, sanitation, power, internal roads and common workshop, that contribute to the quality of life.

6.9.3 As far as possible, local manpower – skilled and unskilled must be employed in habitat development and house construction in villages. This will counter migration to urban areas.

6.9.4 Livelihood schemes can serve as the basis for housing and habitat development whereby the savings of SHGs could be mobilized as collateral for housing loans for members linked with banks.

6.9.5 The case for the development of livelihood-based housing and habitats can be strengthened by the involvement of Self-Help Groups (SHGs).

6.10 Risk Mitigants

Introduction of appropriate risk mitigants would provide further boost to PLIs in increasing their lending in rural areas as well as would be an effective tool for residential mortgage backed securitization for rural housing loans. Risk mitigants which could be introduced are as follows:

a. *Title Guarantee*: In a majority of the rural abadi areas a clear title of the land pertaining to the existing houses, is not available. In the absence of such clear titles, the PLIs find it difficult to provide housing loans on such property. Therefore, to cover the risk of default / defects in the title, a simple affidavit by the borrower being the legal heir of the house property duly signed by the village Panchayats or Land Revenue Officer, can be treated as a valid document for the purpose of creation of the mortgage.

b. *Rural Risk Fund*: Presently, the PLIs have high risk perception for lending to the poor. The risk fund will provide credit guarantee cover for loans up to Rs. 1 lakh taken by the BPLs. However, for effective operationalisation of such a fund, the Ministry of Rural Development could consider providing an initial corpus of Rs. 1000 crore to NHB to set up such a fund to be exclusively used for providing cover to PLIs for small loans say upto Rs. 1 lakh taken by the poor where the primary security i.e., valid collateral e.g., title deed is not available.

c. *Mortgage Credit Guarantee*: This would cover all loans given by PLIs i.e., in urban and rural areas with loans above Rs. 1 lakh. NHB with the other institutions will bring in the required corpus of initial funds and PLIs will be paying premium for the credit cover which may be shared between PLI and the ultimate borrowers Mortgage credit guarantee for rural micro-habitat finance for loans up to 1 lakh could be borne by the lending institution itself as a one time premium.

d. *Legislative Mechanism*: Appropriate legislative amendment allowing village panchayat certificate on land titles and borrower's affidavit attested by the village panchayat to be treated as sufficient documentary evidence for banks and financial institutions to lend can brought about. Amendments allowing mortgage of agricultural land as collateral for housing loan can also be thought of.

e. *Rationalisation of Stamp Duty*: Rationalisation of Stamp duty and Registration charges and bring them down to a minimum token amount (0.5%) in the case of rural housing to encourage registration of mortgages and building up proper land records.

6.11 Unit cost of Assistance for the IAY House

Based on the suggestions of the research studies, consultations with State Governments in review meetings, visits of monitors and area officers, the Ministry of Rural Development has reached a conclusion that for the IAY scheme to be meaningful, there is an urgent need to increase the unit cost from the present level of Rs. 25000/- for plain areas and Rs. 27500/- for hilly areas. The Working Group also felt that for revision of the unit cost assistance for the IAY houses would improve the quality of construction. To assess the revised unit cost of an IAY house, the Ministry of Rural Development had requested the four agencies viz., HSMI (HUDCO), Auroville Earth Institute, BMTPC and CBRI to assess the present unit cost of an IAY house in different regions. The Auroville Earth Institute have given three models of an IAY house between the rage of 90,000/- and 1.02 lakh. However, the HSMI in consultation with BMTPC, has intimated that the unit cost of a house with 25 – 30 sqm plinth area would be between Rs. 60000/- and 81900/- stating that proportionate amount may be reduced for a smaller plinth area. As per IAY guidelines, the IAY house should be of at least 20 sqm plinth area and hence its unit cost would range between Rs. 48000/- to Rs. 54000/-. Thus, after rounding off, assistance per unit for an IAY house can be taken as Rs. 45000/- for plain areas and Rs. 50000/- for hilly / difficult areas including those that have a consistent history of droughts, flooding, earthquakes, cyclones and other natural disasters. The Vulnerability Atlas developed by BMTPC should be updated and can be referred for delineation of difficult areas.

Extracted from the document from:
http://planningcommission.nic.in/aboutus/committee/wrkgrp11/wg11_rdhou.doc