IDFC INSTITUTE

Briefing Paper Series

IDFC-U Roundtable on "Facilitating an Easy Market for Affordable Housing Development"

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The IDFC Institute Briefing Paper Series aims to help share knowledge among researchers and practitioners, and to provide a platform to showcase work for feedback and discussion.

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IDFC Institute hosted a private roundtable on “Facilitating an Easy Market for Affordable Housing Development in India” with developers, financiers, policy experts, and academics.

This Briefing Paper summarises the key points raised, supporting the need for a more rationalised, consistent, and efficient regulatory environment.

This paper is not a comprehensive summary of all issues and perspectives related to affordable housing. It summarises perspectives of certain people from the industry, with the goal of sharing knowledge and encouraging debate.

IDFC Institute has been set up as a research-focused think / do tank by IDFC Ltd to investigate the political, economic and spatial dimensions of India's ongoing transition from a low-income state-led country to a prosperous market-based economy. Broadly, we support the notion of well–regulated free markets, and support inquiry into practices that result in greater, more efficient and equitable development.

Introduction

- Market solutions are required to make affordable housing sustainable and scalable. However, housing for Economically Weaker Section (EWS) members needs government intervention because high land costs price homes out of the reach of EWS members.

- Many of the solutions required for affordable housing pertain to the real estate sector in general, because of systemic issues with the real estate industry.

- Value Budget Housing Corporation (VBHC) estimated that the price point at which housing is provided can reduce by 30% without impacting margins of developers, if the government takes measures such as rationalising laws and making approval processes quicker.

Estimating and targeting demand

- A range of benchmarks are used for affordable housing across the country, from about 200 to 450 sq ft carpet area units that cost between 6 lakh and 20 lakh rupees. Some developers also felt that at the 3-5 lakh rupee price point, many investors tend to purchase units that are then rented out.

- Developers have found that demand for affordable housing units tapers off if restrictions are placed on end-users, such as requiring income certificates. Eliminating these restrictions opens affordable housing units to investors, after which units tend to be oversubscribed.

- In small cities, large stocks of thousands of units of affordable housing usually do not receive sufficient demand.

- Affordable housing is more effective when planned around mass transit. However, high land costs are driving many developers to build in areas that are disconnected from city centres. Some of these projects have low occupancy rates of between 10-20%, and instead receive high demand from investors. To effectively target affordable housing units, low travel costs and times must be considered.

Approvals

- Approval times for housing projects need to be predictable and shorter, to a maximum of 3 months. In the current scenario, developers do not know how much capital cost to factor in, and approval delays can raise capital costs exponentially. Although single window clearances may be difficult to implement at this stage, the number of windows through which clearances are obtained should be reduced.

- PS Jayakumar, MD of VBHC, suggested raising the official approval rate from one rupee per square foot to 100 rupees per sq ft, so that there would be funding for more adequate regulatory processes. However, this measure needs to be complemented with a streamlined approval process, because even in places where approval rates are high, corruption and inefficient bye-laws impede the market.

- VK Phatak, Former Principal Chief of the MMRDA’s Town & Country Planning Division, suggested instituting a “Green Channel” wherein certain housing types, such as row houses and small units, go through a simplified approval process with deemed approval after set periods, as such units have fewer chances of structural irregularities.

- Provisions for deemed approval have been made, for instance, in Maharashtra and Gujarat. However, such approvals are not universally relied on, because Occupancy Certificates may still not be granted and developers need to be confident about adhering to hundreds of complex and sometimes subjective regulations. Hence, simpler rules and confidence in the government will boost the use of deemed approvals.

Building bye-laws

- VBHC estimated that 6% housing costs are due to inefficient bye-laws that are outdated, unnecessarily restrictive, vary significantly across states, and are difficult to understand and comply with. In Bangalore, for instance, three authorities regulate construction with three different sets of rules. Laws are often subjective, increasing uncertainty risks. Rules often change during the construction process leading to heavy losses of investments already made, so laws need to be made clearer, with changes impacting only future projects.

- Many cities require developers to build a car park for each apartment, regardless of whether the occupant has a car, whether he or she can afford a car, or if the building is situated near mass transit. Basement car parks often cost half the amount that housing does, and- especially in the case of affordable housing projects- parking lots often remain empty, while driving up the cost of housing.

- Regulations on unit sizes change often within cities, and vary across cities. This prevents scaling operations that would make construction cheaper. Some argue that it is important to retain flexibility across the country, but it was noted that there are only so many ways that a 300 sq ft apartment can be built.

- While bye-laws need changing for all housing types, at least affordable housing can receive an initial push by differentiating bye-laws for affordable housing and high-end units, and allowing for standardisation of affordable housing units. However, factors such as geographic and climatic conditions need to be carefully factored when allowing for standardisation.

- Brotin Banerjee, MD and CEO of Tata Housing, explained that inconsistencies in bye-laws in certain parts of India with respect to FSI and car parks, including visitors' car park requirements and density norms, are out of sync with the affordable housing intent of government. This adds a huge cost burden on customers without significant utility. He argued that DCR norms need to be relaxed for affordable housing projects, and should be uniform across India.

Planning Methods

- Shirish Patel, Founder of SPACPL, suggested eliminating FSI and instead prescribing densities. Some developers observed that they found fewer people staying in their affordable housing units as compared to their high-end units. Laws that limit densities per hectare already exist, and these may be expanded to provide more accurate estimates of required infrastructure. Densities need to be commensurate with roads, open spaces and other amenities available in the locality.

- Patel also suggested that we can consider eliminating affordable housing as a separate category, and instead look at building townships with a range of housing categories catering to the spectrum of all income groups with locationally-specific pricing for different housing categories. In this way the higher income groups subsidise the lower income groups in regard to cost of land by paying more for good locations accessible by car than is paid for inferior locations difficult for motor traffic, within the same development.

- Low income home owners can construct incrementally to manage costs, particularly in regard to additions to floor space, including additional floors, whenever they can afford it.

Rental Housing

- Apart from outright purchase, there are several forms of housing access that need attention. Hostels, shared accommodation, dormitories, and rental housing form important parts of the ladder, and may be far more suitable and desirable for much of our population.

- Several factors impede the rental market, which could provide housing access to a large part of the target population for affordable housing. Other countries have moved to second-generation rent control laws, but India still has first generation regulations in place. Rent is fixed to one-thousandth of the market rate in some cases.

- Rental yields in India are low, and so developers have to wait for longer to break even on projects if they rent units rather than sell them. This issue is exacerbated by the fact that developers often have to use their own equity to buy land because of lending restrictions on purchase of land. Today, rent is fixed at around half the inflation rate, whereas rentals should be allowed to increase at double the inflation rate.

- Eviction is big cultural and political issue, and laws in India prevent the eviction of tenants in possession. The SARFAESI Act provides for leave-and-license for 11 months, and permits eviction without going through the procedures of the Rent Act. This has been used effectively, and such provisions should be extended to rental units as well. Currently, there is a strong fear of rental evictions becoming politicised, which deters developers from entering the space. This fear also existed when housing was securitised, but passing strong and amenable laws helped to overcome this. This needs to be replicated in the rental market.

- Low rental yields, along with difficulties with eviction and rent increases, makes it unviable for professional rental management companies or institutional investors (such as pension funds) to participate, which is how much of rental accommodation across Europe is managed.

- Selling to investors is regarded as a failure of affordable housing, but investors can play an important role in increasing the stock of rental housing, if policies are amenable.

- An informal market for affordable rental housing already exists, but structural changes are required to make it mainstream. Taxes on rent need to be changed so as to incentivise investors to rent.

- Even if regulations change, the current interest rate scenario does not permit building for rental. The current model relies on capital appreciation for real estate returns, which should change as the market matures and the cash economy declines.

Infrastructure

- In places where water, electricity, and road connections are not provided up to the doorstep of the township, developers need to invest in these provisions, pricing more of the population out of its reach. Hence, external infrastructure facilities that lead up to affordable housing projects need to be provided by the government.

Finance

- VBHC estimated that 12% of housing costs are capital costs, which rise because of long approval times and higher financial costs associated with uncertainty.

- VBHC estimated that roughly 33% of the cost of housing consists of taxes. There is hope for the GST to resolve this issue once it is rolled out, but the GST should not be set at a high rate, such as 25%.

- Anjalee Tarapore, Deputy General Manager at HDFC Ltd., noted that the RBI prohibits banks and housing finance companies from financing land, so NBFCs and private equity companies finance land at high interests rates, which can be upwards of 22%. Extending debt for land will significantly lower costs, especially since land can account for about 60% of housing costs. However, there was also the fear that if small players are permitted to finance land through debt at a project level, instances of speculation will rise.

- Concessional rates can be targeted to first time buyers and to developers who are selling units to the first time, in order to facilitate the creation of new housing stock.

- It was felt that, in practice, nationalised banks do not lend to customers with lower income or social standing, such as security guards and chauffeurs. Banks only find it unviable to finance households who can afford housing in the 3-5 lakh segment, the lowest denominator. Dhaval Monani, CEO of First Home Realty Solutions, estimated that about 90% of demand for affordable housing comes from people who can afford it, but have no access to finance. Yet, financing for the informal sector has picked up dramatically, with a spread of about 2-4%, so most of the financing is at 12.5%".

- To address this gap, Brotin Banerjee, MD of Tata Housing, said that the company tied up with financial institutions to lend to people in the informal sector. After this step, it did not see significant increases in default rates for affordable housing payments, even during the previous 18 months, which had been a tough period for the real estate industry.

- Some felt that the National Housing Bank does not extend enough finance to the affordable housing sector, but instead focuses too much on resale of property at higher prices. In fact, many of the end-users of the affordable housing sector have been categorised as 'risky', contributing to the mindset that leads to higher interest rates for such customers. The National Housing Bank can take measures such as changing the 15 year refinance line to a 4 year refinance line, as this period is sufficient to establish the credit history of customers, so that funding can subsequently be raised at lower costs.