Charter for Affordable Housing in India
-Learning from past mistakes

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Contents

Indian residential real estate: Encouraging times ahead

The Indian real estate sector continues to be the most sought after destination for global investors. Urbanisation will surge in the coming years, which, coupled with growth in employment, education and health care, will push the demand for residential and commercial space.

Increasing migration to the cities by the upper class will drive this demand. Stable housing demand will be a big boost for the Indian economy in 2015, and the industry will focus on meeting this demand. The sector can also anticipate a rise in sales of housing property following the recent stock market rally and a slew of optimistic RBI rules to allow foreign banks into the country's greatly regulated banking ecosystem.

It is a well established fact that demand from tier-II and tier-III cities will act as a catalyst for the real estate market in India. With rapid land and infrastructure development in smaller cities and towns, backed by bank loans, higher earnings and improved standards of living will give a boost to housing and construction demand here. The BJP government's aim of constructing 100 smart cities in India is a perfect move to ease migration burden on tier I cities and accommodate the rising numbers of floating population with adequate facilities. With a budget allocation of Rs 7,060 crores, these cities will be developed as satellite towns of larger cities through modernization of existing mid-sized cities. The rapid development of tier II cities like Jaipur, Chandigarh, Lucknow and Kochi bear testimony to the fact that with appropriate infrastructure, employment facilities and connectivity, even smaller cities can emerge as important real estate destinations in the country. Smart cities can be a catalyst for growth in the commercial real estate segment as these would require more of IT/ITES enabled companies to cater to its the technology needs.

Robust infrastructural framework and a sound development in real estate go hand in hand. Delay in approvals and weak policies in infrastructure has crippled the full-fledged development of India since long. Unless there is a marked progress on this front, real estate growth will be stifled. However, with new government policies, the time to come is likely to see a major improvement on these fronts. Modi Government's maiden budget focuses on boosting infrastructure through the PPP mode. An institution to provide support to mainstreaming PPPs (public-private-partnerships) called 3P India will be set up with a corpus of Rs 500 crores. Schemes for development of airports in Tier-I, II cities have also been proposed. The Finance Minister announced enhancing present corpus of pooled municipal debt obligation facility with participation of several banks to finance infra projects in urban areas on shared risk basis to Rs 50,000 crore. This provides the much needed stimulus to real estate sector because realty is directly dependent on the progress in infrastructure. Also, with more and more developers turning towards tier-II cities, the development of airports there will only boost their prospects as potential destinations.

In the Union Budget 2014-15, the Government has taken some concrete steps to boost affordable housing. It allocated Rs. 4,000 crores for low-cost housing schemes. Along with this, the Government has also relaxed FDI norms for the affordable housing sector. With concrete steps like this, the real estate sector can be highly hopeful of diminishing the gap between demand and supply for low-cost housing. Also, Government has emphasized on the importance of availability of cheap credit to make housing affordable for the Economically Weaker Sections (EWS), Lower Income Group (LIG) and Medium Income Group (MIG) segments of the population. Housing loans will be eligible under priority sector lending by the RBI and also housing loans to individuals upto Rs. 50 lakhs for houses of values upto Rs. 65 lakhs located in the six metropolitan centres viz. Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad and Rs. 40 lakhs for houses of values upto Rs. 50 lakhs in other centres for purchase/construction of dwelling unit per family.

The recent move to introduce REITs, or Real Estate Investment Trusts, is quite a progressive one as well. REITs have great potential to tap cash flow into the Indian economy, and help smaller investors to access income-generating real estate assets, without having to invest a large amount. It will help both developers and investors, through better financing and investment options. Providing tax incentives to REITs for investment in housing, especially the affordable housing sector, will increase chances of its success.

The real estate sector has been grappling with the burden of high construction cost since long which is also a primary reason for high home prices in most micro markets. Construction cost has almost doubled in two years, while government’s imposition of taxes and premiums has also shot up significantly. Recent development such as rise in sand prices due to ban on sand mafia and closure of quarry mines in Tamil Nadu have accentuated the pressure. Coupled with this the hike in cement and steel prices is bound to halt construction progress across the country. This leaves no option for the developers but to raise the apartment prices. Unless the government is forthcoming with its policies and easing the bottlenecks, this will bog down the realty sector and eliminate scope of reduction in prices.

Purpose of this paper

The purpose of this paper is to look into the reforms needed in the real estate industry at grass root level, and also to draw focus on learning from the past mistakes. The paper looks into our existing urban setting and price setting, amidst which, the Government has envisaged a noble mission, "Housing for All" by 2022. This paper covers the facts; the state of real estate industry, the state of unproductive prices, the rising inventories, increasing numbers of vacant houses, declining sales and cash strapped state of developers.

Why is a country with an acute housing shortage going through such an anomalous phase?

Is it that the current systems and processes are abusing the need or fulfilling it? Let us try to understand the problems and what we need to correct to meet the housing for all agenda.

Chapter 1 - Current Phase of Real Estate Industry

Real Estate industry is going through a slump. The prices have peaked and impacted the sales adversely. Despite the state of stagnancy lasting for more than a year, there is no improvement in sales. The inventory has peaked, suggesting that there are more commitments (construction commitments), however current prices are not generating enough sales and the cash to meet these commitments.

Despite all these factors, there is little or no correction in the prices. The gap between affordability and prices is not reducing.

Caught between unaffordability and cost crises, realty is in a state of extreme inefficiency. While the consumers can't afford prevailing prices, the escalation in the cost has also reduced the scope of their correction. Thus, bringing the industry on the brink of an extremely unproductive state.

The State of Rising Inventory and slow sales in Tier I cities[1]

Tier I Cities (Figures in Unit)	**2009**	**2010**	**2011**	**2012**	**2013**	**2014** (Till Sept 2014)	**CAGR** (till 2013)
Sales[2]	171,895	199,664	200,591	232,094	216,695	166,347	6%
Supply Introduction[3]	134,992	292,145	251,481	292,261	308,264	250,127	23%
Unsold Stock at end of year[4]	240,186	332,667	442,115	502,282	593,851	677,631	25%
Months Inventory[5]	17	20	26	26	33	36	

(Source :Liases Foras)

In past five years, new supply have outgrown consumption in almost all the Tier I cities of the country, resulting in inventory overhang. Markets, which used to maintain 17-20 months of inventory in 2009-10 are now hovering at around 36 months. All cities except Pune and Kolkata have inventory in excess of 36 months. Please note that the efficient market maintains inventory levels that takes not more than 8-12 months to get sold at the current rate of absorption.

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[1]**Tier I cities** includes Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru, Chennai, Kolkata, Pune, Hyderabad and Ahmedabad. For Ahmedabad and Kolktata data is available only from Sept 2011 quarter.

[2]**Sales** is primary market sales during the calendar year.

[3]**Supply Introduction** is new launches during the year

[4]**Unsold stock** indicates the unsold inventory with developers at the end of calendar year.

[5]**Months Inventory** indicates the number of months required to sell the existing unsold stock at current pace of sales. Efficient market maintains 8-12 months of inventory.

Months inventory across Tier I cities

City	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
MMR	11	11	15	17	20	23	28	36	39	36	44	40	37	39	39	40	48	58	46	43	45	50
NCR	43	17	13	15	18	19	25	21	30	37	31	23	32	28	38	31	38	41	39	39	51	83
B'lore	22	44	22	21	16	16	26	19	27	26	15	20	10	10	15	18	21	30	18	20	19	41
CHN	65	16	21	21	30	17	19	21	20	26	15	20	24	22	36	28	30	24	22	20	26	50
HYD	18	55	23	23	23	30	29	22	20	19	16	38	39	25	25	49	26	32	32	42	53	38
Pune	26	9	9	10	17	15	11	15	12	13	12	14	16	12	15	16	23	31	22	20	23	23
AHD										28	23	23	30	30	31	39	49	50	43	35	28	35
Kolkata										21	24	23	29	33	31	22	29	18	23	26	28	31

B'lore- Bengaluru| CHN- Chennai| HYD- Hyderabad | AHD- Ahmedabad (Source :Liases Foras)

NCR, MMR and Hyderabad markets are in a state of inefficiency for more than 2 years. Other markets such as Bangalore and Chennai too have recently become inefficient.

State of Inventory Tier II cities

Tier II	2012	2013	2014 (Till Sept 2014)
Sales	24,625	35,770	40,644
Supply Introduction	95,446	43,126	92,565
Unsold	81,168	88,524	140,445
Months Inventory	40	30	41

(Source :Liases Foras)

Market condition of Tier II cities is equally bad. Most of Tier II cities have monthly inventory in excess of 36 months. City wise months inventory for Tier II cities is mentioned below

Cities	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Chandigarh	25	20	25	60	66	73	94	40	55
Cochin	10	12	19	21	22	12	30	23	29
Goa	15	27	14	23	20	36	30	14	18
Indore	37	27	59	26	26	23	22	41	48
Jaipur	25	19	41	25	19	16	18	25	45
Nagpur	33	21	90	110	82	89	75	68	58
Nashik	14	23	36	27	20	58	35	17	45
Surat	28	26	56	51	40	14	22	22	41
Vadodara	12	29	59	66	34	17	23	17	30
Coimbatore		7	18	14	12	8	11	24	21
Kanpur		39	71	52	46	43	38	32	35
Lucknow		13	41	45	55	48	37	32	34
Mangalore		14	28	33	15	22	17	23	23
Thiruvananthapuram		19	11	11	9	13	24	9	15
Bhopal								37	36
Bhubaneswar								15	25
Patna								38	63

(Source :Liases Foras)

Economic imbroglio of unproductive prices and escalating cost

The real estate prices are unproductive, mostly across all the urban centers. The weighted average price all over India have doubled from 2009. A closer look at the situation, tells that along with the increase in the price, the developers are also facing cost crises. This has been led by increasing tax/premium burden and land prices, which is over and above the inflation stricken construction cost.

Increasing Ready Reckoner prices across all the cities, also suggest that perhaps government has failed to take notice of the state of unproductive prices.

Economic Viability at Current Prices and Prevailing Sales Velocity

Lower Parel	2009	2014
Fund requirement in Cr	31	81
Land Cost in Cr	30	77
Profit in Cr	22	121
RoE	22%	12%
NPV in Cr	5	(12)
Time line (months)	36	106
NPV/Equity	15%	-16%
Sales Velocity/ month	3%	0.97%
Selling Price PSF	11,000	28,000
Land Cost (Ready Reckoner)/ PSF	6,134	16,914

At the prevailing sales prices and land prices as per Ready Reckoner, and by considering the prevailing sales velocity in Mumbai, the above analysis argues that the projects are not viable, unless land prices are reduced by 35%.

Crux of Problems

We need rationalization both in demand as well as on supply side, more importantly we need the rationalization in our price setting.

Problems in Demand Side

- Unaffordable prices at convenient distance and affordable housing possible at peripheral, inconvenient and undeveloped locations
- Pro-Investor Polices- Less incentive to end users

Problems in Supply Side

- Costly raw material – prevailing land prices across nation are unproductive
- Costly Capital promoting cheaper housing, albeit it is making housing more costly
- Approval Delays creating vicious spiral of slow down, which creates cost crises.

Not only would we need supply and demand side efficiencies, we would need to take corrective measures to help industry attain an economic balance.

Chapter 2 – Demand Side Problems

Shortage & Consumption Gap - Demand Imbalances

Government's plan to provide housing for all appears to be an enormous challenge. Despite rising inventory and ample supply, the current yearly consumption is catering to only 1.1% of total shortage. At the current rate of consumption, we would need CAGR growth of over 70% to attain the "Housing for all by 2022" goal.

	Shortage as per NHB	Being Met Annually (Sales in 12 months)	% Demand Met
EWS & LIG	17,841,000	60,729	0.3%
MIG& Above	820,000	146,262	17.84%
Total	**18,661,000**	**206,991**	**1.1%**

(Source :NHB, Liases Foras)

Why is it so, that even though we are catering to only 1.1% of shortage, still developers are claiming lack of demand in their projects along with rising inventories in cities. Problem is not of supply. It is the spatial price setting has created a mismatch between demand and supply. The price setting of the city has pushed the affordable housing to the periphery of the city. Located far away from the place of work, end users are not inclined to move. Most of such locations at 80-90 Km from city centers are undeveloped and not livable.

- Vectors/ locations, which are livable, are too costly!
- Eligible Vectors-locations to provide affordable housing are too far
- The low cost housing is available so far away from the city, from where people can't travel to their place of work

Below table discusses the average flat cost each of Tier I cities at various distance points from the city center. Ahmedabad, Pune and Hyderabad have been able to provide affordable housing within habitable distances. Detailed analysis of each city is mentioned in Annexure II.

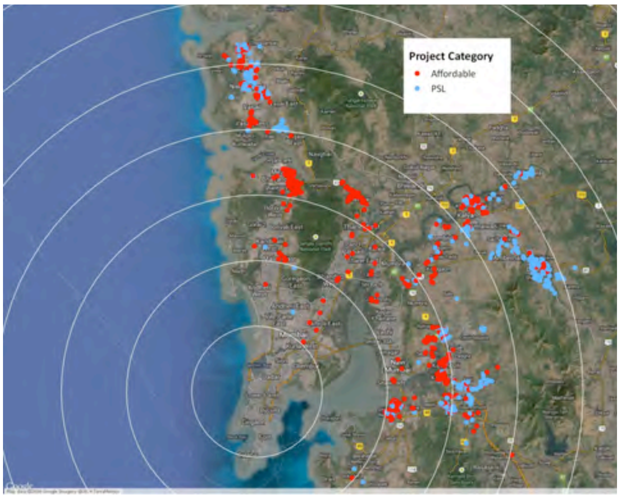
Average cost of Flat (Rs Lacs) in each of city at various distance points

Distance	Ahmedabad	Bengaluru	Chennai	Hyderabad	Kolkata	MMR	NCR	Pune
< 10 Km	48	166	119	75	146	731	560	135
10km- 20km	27	79	63	69	63	239	103	55
20km-30km	32	48	48	57	34	175	62	40
30km-40km	19	36	39	34	44	93	86	24
40km-50km		47	42	18	38	49	87	22
50km-60km			36		32	44	35	
60km-70km			23			31	39	
70km-80km			28			33	34	
80km-90km			21			18	26	
90km-100km							32	
100km-110km							19	

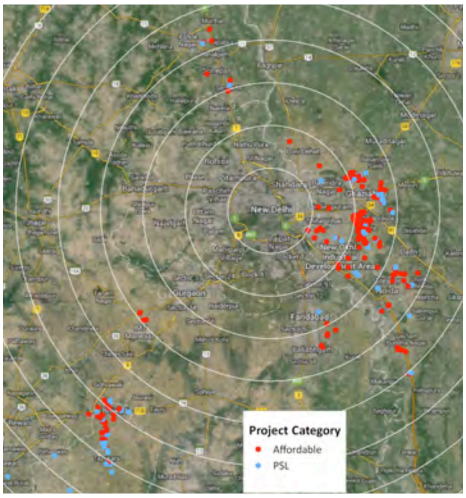
(Source : Liases Foras)

On the basis of these prices we have computed the monthly income required to purchase these units. An income of Rs 35,000 per month in MMR would allow a person to afford a house at distance of 80 Km from city center, where as at same income level, he can afford to live at 40 Km in Pune &Hyderabad.

Mumbai



NCR



Though only 19% of supply is catering to PSL category housing, the irony is most of these projects are dependent upon investor sales. Majority of such projects are plagued with investors; there are no or very little occupancies.

Pro Investor Policies

While all the policies so far drafted have highlighted the housing shortage, however the tax structure, suggest that there are lesser incentives for end user and far more for investors.

Current tax laws provided an added incentive for purchase of real estate for investment purpose than for end use. Section 24 of the Income Tax Act restricts the benefit of interest to Rs 2 Lacs for the self use; on other hand it provides the benefit of entire interest in case of investment purpose. Further due to low rental yield, real estate investment is currently being used as tax saving instruments. Below table illustrates the differential in Income Tax benefit of the same flat, due to change in usage from self-use to investment purpose

Purpose	**Self Use**	**Investment**
Home Cost	Rs 1 Crores	Rs 1 Crores
Home Loan	Rs 75 Lacs	Rs 75 Lacs
Interest Rate	10%	10%
Term	25 Years	25 Years
EMI per month	68,153	68,153
Interest for entire year	746,211	746,211
Rental Income pm (2.5% yield)		20,833
Rental Income pa		250,000
Income Tax Benefit on Interest on Home Loan	200,000	571,211

In this particular case, differential of benefit is in excess of 150%, which incentivises a person to purchase real estate for investment purpose.

Further, most states provides for registration of flat only after its completion. This has led to rampant trading of real estate; wherein property transacts multiple times before actual consumers come into picture. This results in prices rising beyond the affordable limits of an actual end user.

Impact of investors on real estate market

a. Increased prices – Due to market exuberance while there are investors with surplus income who were buying third and forth property fueling the price rise, the actual end users find it difficult to afford the house. In such a situation, it is ironical that developers blame the sentiments for the poor sales in a country having a massive housing shortage.
b. Increased Vacant Homes – As per census 2011, vacant census houses[6] in the urban areas have increased by 73% to 11 Mn houses in a decade.

	Urban India
Vacant Homes in 2011	11,124,125
Vacant Homes in 2001	6,440,252
Increase in Vacant Homes	4,683,873
% Increase in last decade	73%

(Source :Census 2011)

Government should look to atleast provide similar incentives to first time home buyers and provide subsidized home loans, while stricter provisions should be brought in for those who are buying multiple homes and should also come up with Vacant Home Tax. Such action has been taken recently in Singapore and China to curb the real estate bubble.

Further, the state governments should make registration compulsory at the time of sales, rather than registration after completion of project.

[6] Census house includes residential, shops, offices and other establishment. Census does not provide detailed of vacant houses in each of the category. However most of vacancy in urban areas is created due to investor participation

Chapter 3 – Supply Side Problems

Costly raw material – prevailing land prices across nation are unproductive

"Although there is ample land available, yet the price setting has created the scarcity."

Vast land parcels, held by city's traditionally large landowners, industrialists, politicians, local urban bodies, are lying undeveloped since several years. These locked pockets of land have led to limiting the spread of planned and sustainable urbanisation in addition to catapulting land values making it inefficient and unproductive. These plots should be put to use and made productive. Today, the cost of land has soared to such an extent that unless land prices come down by 30% -35%, projects cannot be financially viable.

An example given below highlights the impact of high land prices on project viability. In this case, apartment prices have increased from Rs 7,040 psf to Rs 14,000 psf in five years time, simultaneously cost of land has increased by three times during the same period. This has led to a reduced margin for the developer from 34% to 9%.

Example – micro market, Andheri East, Mumbai.

Andheri East Mumbai	2,009	2,014	% Change
Residential Price (PSF)	7,040	14,000	99%
Construction Cost	1,500	2,500	67%
Approval Cost	1,126	3,800	237%
Cost of Land	2,000	6,500	225%
Margins	2,414	1,200	-50%
Margin%	34%	9%	

Further, high apartment prices have slowed down velocity from 3% pm to 1.12% pm which has further increased the financing cost to the developers. Thus it is imperative to keep the land cost under control.

High cost of land is also forcing the people to live in far-off places and thus increasing the size of urban sprawl. Not only is it increasing travel time but also putting an enormous strain on creating additional infrastructure. The gestation period for economic as well urban development for such places, increases multifold, as they lack density and are far-off from current habitation.

Further, current prices of these undeveloped locations are in line with price of developed location in any other Metro. These prices should be prevalent for those locations which have existing population density of atleast 250-300 pph. Cost of land is dependent upon the urban productivity/density of people land and its distance from city center. However, the current prices are defying the logic. The undeveloped/ remote lands are priced much higher than they should be.

Land efficiency by unlocking the land

Government should not be locking the land and exploiting the land and selling at maximum achievable price. Instead of setting a price, which creates urban imbalance the focus should be to create price effieiecnes, where upon through PPP or any other model they should create cheaper housing stocks.

The focus of infrastructure development should be to release more land like trans-habour link in Mumbai can open 700 sqkm of land area within 25-45 minutes from city centre. This will help moderating the exorbitant real estate prices of Mumbai. And also would make city circular. However the focus of infrastructure till today has been linear, which has resulted into longer trips, congestions and exerted more pressure on infrastructure, and has also helped in creation of slums.

There is an obvious alternative for moderation, is by increasing the FAR/FSI. However it has been seen that the benefits of such incentives mostly go to the landlords and is not passed on to the consumers. Further, haphazard increase in the FAR/ FSI puts the pressure on the existing infrastructure. A planned FAR/FSI increase in conjunction with Vacant Land Tax would surely ensure reduced land prices and viable real estate projects.

Vacant Land Tax

It is imperative to release more and more land in close vicinity of human habitation. Therefore, we feel that to bring in the economic balance of in the current price setting, we need to impose **Vacant Land Tax**.

Necessity of paying tax encourages landowners to develop vacant and under used land properly or makes the way for others who will develop this land. Since vacant land tax deters speculative land hoardings, inner city land returns for the productive use, reducing the pressure to build on undeveloped sites, containing the growth in urban sprawl.

It is also a progressive tax, which paid mainly the by wealthy and would thus reduce economic inequalities.

Real estate bubbles can contribute to recessions, which damage the entire economy. Vacant land tax reduces the speculative elements in land pricing by ensuring more production, thus giving an impetus to our economy.

Benefits are enormous

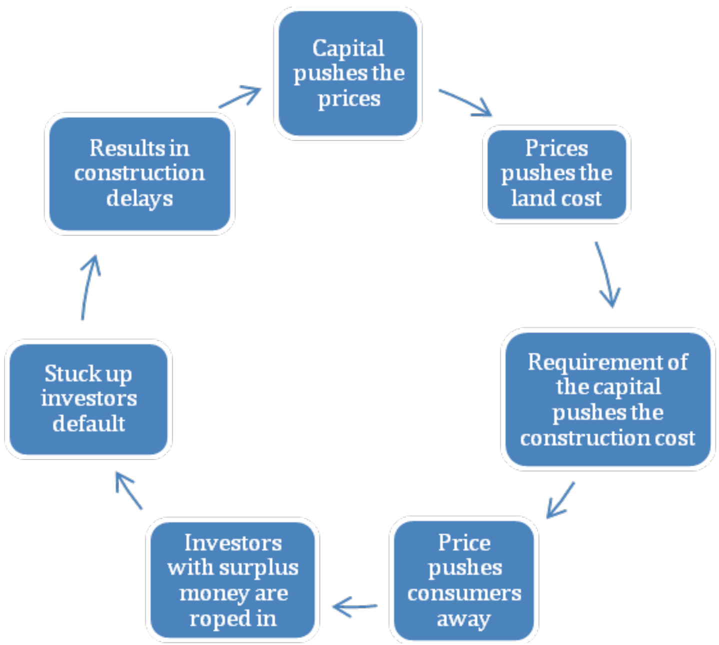
a. It will curtail the employment of black money in realty – Maximum amount of black money is being absorbed in lands, which not only helps in speculation of land prices but also lets these lands remain unproductive and unyielding for long time.
b. More supply of the supply of land will help in moderating the land prices.
c. Help in generating revenue for the city development and infrastructure projects.

d. Restrict the spread of urban sprawl; thereby the challenges in putting up infrastructure in new geography will also reduce. It will help in sustainable development.
e. Most importantly it would create economically viable model of growth since it ensures productivity of land and geographies and not just the wealth effect of land.

Costly Capital

Developer needs money for purchasing the land and initial approval cost. Residential projects are sold during the construction; consumer advances take care of most of construction cost. While the banks have been forbidden to fund the land purchase, developers resort to fund their land through either informal sources or private equity funding. Private Equity Funding is a costly capital demanding annual returns in range of 25% -30% pa. Economics of such returns doubles the property prices in three years, making it unaffordable. Very little portion of such money has actually created the affordable housing. Affordable housing needs cheaper capital. Since the need is for purchasing the land, the Government should acknowledge the need of the money. Instead of forbidding, it should create competitive environment for the capital. It should promote more ECBs and other low cost capital. Costly capital leads to a vicious circle which eventually serves no purpose.

Vicious circle of the costly capital



Speculation and investor participation increased

Another detrimental upshot of this occurrence is the proliferation of speculators and investors.

Streamlining Approvals Process

Delay in approval is affecting the country and the realty. It is important to streamline the approval process. Speedy approval will help reduce the cost. The cost of capital for affordable housing project increases to almost 10 folds if the approvals take around 30 month. The developers eventually pass this cost to the consumers.

Delay in approvals is also causing delay in the execution of the projects. Almost 42% of the existing supplies across major urban centers are running with more than 12 months of delay.

A broad estimation suggests that the loss of the economy due to the delay could be to the tune of 1.3% of the GDP.

Summary of Recommendations

Demand Side

- Incentivise first time homebuyers through Income Tax and other benefits.
- Curtail the involvement of Investors trading in residential houses.

Supply Side

- Affordable Housing needs cheaper capital
  - The capital aspiring to more than 20% annualized return cannot create affordable housing.
  - Allow Banks to fund to buy lands for projects - linked with delivery.
- Land Efficiencies are must
  - Cheaper Land and Commutable land is imperative.
  - Imposition of Vacant Land Tax
  - Urban Bodies focus should be on land productivity and not on the land monetization. The current approach of land monetization has created urban economic imbalances. Government should helps moderating land prices through PPP model, Higher FSI.
  - Housing Boards need to play a larger role to cater to the social housing requirements.
  - Connect more lands through augmenting infrastructure.
- Employable population within commutable distance is must to create economic hubs
  - Only those SEZs, which were close to or within city precinct, actually succeeded.
- Approval Delay cause economic loss, speedy approvals to reduce the capital cost
  - Incentivize timely execution of projects