

Prudential Regulation of Housing Finance in India

1995 – 2011

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Summary:

There are two distinctly identifiable sub-periods in the history of prudential regulation for housing finance in India between 1995 and 2011. The first period (1995 – 2001) comprised numerical restrictions (in the form of leverage restrictions on financial intermediaries, as well as an explicit interest rate ceiling on payments to depositors) for housing finance. The second period (2001 to the present) witnessed a shift to the prudential regulation framework outlined in the Basel – II norms, with risk weights and provisioning being the primary instruments of regulatory policy. As these broader changes occurred, a system of priority sector lending (PSL) norms remained in place throughout this period to target lending towards sectors designated by the government as socially important, one of which is housing finance. These norms took two forms, the first of which is a quantity restriction, i.e., compulsory allocation of credit in the system for housing loans, which was in place throughout the period. The second is a price subsidy, i.e., an interest subsidy (or subvention) element for small loans, and this arrangement was in place towards the end of the period under consideration.

The Reserve Bank of India (RBI) regulates bank lending to housing and the National Housing Bank (NHB) regulates lending to housing by Housing Finance Companies or HFCs. Some of the regulations imposed by the RBI on banks also impact HFCs indirectly – such as priority sector lending targets. Figure 1 (which is identical to Figure 4 in Campbell, Ramadorai, and Ranish (2012)) summarizes changes in regulation, across time, type of firm (banks or HFCs) and regulators.

The rest of the appendix is organized as follows: Section 1 summarizes various regulatory changes vis-à-vis housing loans provided by Banks, divided across two regulatory periods and with respect to rules regarding definition and treatment of non-performing assets. Section 2 summarizes regulation in the same order for housing loans provided by HFCs. Section 3 describes subsidy schemes in place for small and micro loans, including the priority sector lending norms.

1. Housing Finance by Banks

1.1 Period 1: 1995 – 2001

The RBI introduced Basel – I norms for banks in India in April 1992. Under this system, risk weights were assigned to balance sheet assets, non-funded items and other off-balance sheet exposures as prescribed by the Narasimham Committee (1991). However these risk weights did not change over this early period for any assets (see Table 1).² Under this regime, the risk weight for housing finance was a constant 100%, as housing finance was categorized as “Other advances” under the sub- heading ‘real estate and other investments’.

Banks were expected to maintain an unimpaired minimum capital fund as a percentage of aggregated risk-weighted assets on their balance sheets. The phased introduction involved compliance with these norms at different points in time. Indian banks with branches abroad had to comply with an 8 per cent norm by March 31, 1994. Foreign banks in India were expected to comply earlier, by March 31, 1993. Indian banks catering only to domestic requirements had an intermediate target of 4 per cent by 1993³ and expected to achieve 8 per cent by March 31, 1996. Compliance with this requirement was the predominant concern throughout this decade.⁴

1.2 Period 2: 2001 – 2011

The second Narasimham Committee in 1998⁵ recommended several measures to strengthen the capital adequacy framework for banks in India. During this period, the RBI first considered prudential norms set by way of exposure limits to “sectors particularly sensitive to

² Note that many loans to housing (some types of which were defined as priority sector lending only after 1998) were guaranteed either by the Government of India, or State governments. The broader point here is that in a highly nationalized banking sector, the taxpayer implicitly backs loans. For example, the state of Andhra Pradesh established the State Housing Corporation Limited (APSHCL) in 1979 to “formulate, promoter and execute” housing schemes for weaker sections of society. Loans under the scheme were completely guaranteed by the Government of Andhra Pradesh. See *Housing for the Poor in India*, CGG Working Paper 4/2003 ([Annex 1](#)). Accessed at: <http://goo.gl/PlmXr> on: Dec 21, 2011.

³ Report on Trend and Progress of Banking India: 1991-92, Reserve Bank of India, p.54 read with RBI Circular No. DBOD.No.BP.BC.129/21.04043-92 titled Income Recognition, Asset Classification, Provisioning and Other Related Matters, issued on 27 April, 1992.

⁴ The provisioning requirements on non-performing assets (NPAs) did not change between 1995 and 2000, in any of the categories, for large loans. However, small loans, less than Rs. 25,000 witnessed a rise in these requirements from 7.5% in 1994-95 to 10% in 1995-96 and another hike to 15% in 1996-97.

⁵ *Committee on Banking Sector Reforms*, 1998. Hereinafter Narasimham Committee–II.

asset price fluctuations such as stock markets and real estate”.⁶⁷ While risk-weights on sectors came into existence much later, the powers to set them were vested with the RBI in February 1999 by way of a circular.⁸

This committee also recommended that, “[t]he risk weight for a Government guaranteed advance should be the same as for other advances. To ensure that banks do not suddenly face difficulties in meeting the capital adequacy requirement, the new prescription on risk weight for Government guaranteed advances should be made prospective from the time the new prescription is put in place.”⁹ Consequently, a March 31, 2000 circular by the RBI brought into force such a change.¹⁰ Table 2 summarizes the regulatory changes in this period.

Risk weights changed for different loan categories defined both by loan size and loan-to-value (LTV) ratio. Loan to value ratio excludes any taxation due (such as stamp duty and local land taxation), registration, and documentation charges that may apply to a mortgage transaction. However, a majority of Indian mortgage providers have been found by the RBI to interpret LTV regulations as those that apply to loan-to-cost ratios (LTC) that include all costs of the transaction.¹¹ This was clarified much later, in February 2012, well after the sample period under study. Thus, LTC and LTV cannot be differentiated from one another until February 2012.

A few other notable changes were introduced in the mid-term review of monetary and credit policy by the RBI in 1999.¹² The minimum capital to risk ratio was raised from 8 to 9 per cent. This was effective from March 2000. Importantly, the time period for classifying debt as doubtful was shortened to the international standard of 90 days from 180 days. This was brought into force in 2004 for Banks.¹³ The next section deals with the classification of assets

⁶ *Committee on Banking Sector Reforms (Narasimham Committee – II) – Action Taken on the Recommendations*, October 2001. Accessed at: <http://goo.gl/O2z6S>. on Dec 22, 2011. (See [Annex 5](#))

⁷ *Narasimham Committee – II*, Chapter 3, Paragraph 3.40

⁸ RBI Circular: DBOD.No.BP.BC.9/21.04.018/99 dated 10.02.99 as reported in *Narasimham Committee – II – Action Taken on Recommendations (Annex 5)*

⁹ *Narasimham Committee – II*, Chapter 3, Paragraph 3.12

¹⁰ RBI Circular: DBOD.NO.BP.BC.103/21.01.002/98 dated 31.10.98 as reported in *Narasimham Committee – II – Action Taken on Recommendations (Annex 5)*

¹¹ See RBI Clarification DBOD.No.BP.BC. 78 /08.12.001/2011-12 dated 03 February 2012 http://rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=6984 and <http://goo.gl/NFtHa0>

¹² RBI Midterm review of Monetary and Credit Policy (MMCP), 1998-99. Accessed at: http://www.rbi.org.in/scripts/BS_ViewMonetaryCreditPolicy.aspx?Id=1 on Dec 23, 2011. (See [Annex 6](#))

¹³ NHB Directions 2010 Notification No. NHB.HFC.DIR.1/CMD/2010 (See [Annex 2](#)) and RBI Circular No. UBD.PCB.MC.No.3/09.14.000/2010-11. (See [Annex 7](#))

as non-performing in greater detail.

1.3 Non-performing Assets regulation

In 2004, RBI redefined an asset that is ‘non-performing’ as an asset, “in respect of which, interest has remained overdue for a period of ninety days or more”, reducing the number of days from 180 to 90 days for banks.¹⁴

The definition of assets as non-performing has been changing over time. In particular, the period of delinquency in order to be so classified has been steadily reducing since 1993. In essence, an asset became ‘non-performing’ when it ceased to generate income for the bank for specific time duration. This duration was 4 quarters from 1993 to 1994, 3 quarters between 1994 and 1995 and 2 quarters ‘past due’ between 1995 and 2004. In May 1998, the Narasimhan committee mooted the idea of reducing this time period to 90 days. The RBI addressed this in a speech made by the Governor on 24 April 2001¹⁵, and followed it with a regulatory notification on 30 August 2001 that the definition for a non-performing loan will be reduced to 90 days.¹⁶ This change was binding on banks since 31 March 2004, where a ‘non-performing’ asset was one where interest and/or principal remained overdue for a period of more than 90 days in respect of a Term Loan.¹⁷ These were followed up by the NHB, and definitions were changed to match those issued by the RBI, albeit with a lag.

The classification of an asset as an NPA incurs additional provisioning norms. On sub-standard assets (those classified as NPAs up to 12 months prior), banks were required to make a general provision of 10 percent on total balances outstanding. Following the 12 month period, the asset would then be regarded as a “doubtful asset,” and 100 percent of the unsecured component, and between 20 and 50 percent on the secured component (depending on the duration of the asset being classified as doubtful) were required from banks.¹⁸ This range moved to 20 - 100 percent from March 2005.¹⁹

Another important change to the treatment of non-performing assets that came into force at

¹⁴ RBI Notification No. UBD.PCB.MC.No.3/09.14.000/2010-11 accessed at <http://goo.gl/EYAHk> on Mar 14, 2012. (See [Annex 16](#))

¹⁵ For details, see speech by Governor Reddy on <http://www.bis.org/review/r010425c.pdf>

¹⁶ http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?Id=449&Mode=0

¹⁷ For details, see RBI Master Circular on Prudential Norms (UBD.BSD.IP.MC.No.15/12.05.05/2004-05) accessed at <http://goo.gl/d8r1a> on Mar 14, 2012. (See [Annex 17](#))

¹⁸ RBI Notification No. DBOD No. BP.BC/20/21.04.048/2001-02. See [Annex 32](#).

¹⁹ RBI Notification No. DBOD No. BP.BC. 15/21.04.048/2006-07. See [Annex 33](#).

this time was the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, which made non-performing asset reconstruction and repossession easier. We discuss this Act and its implications more fully in Section 2.3 below.

2. Housing Finance by HFCs

The NHB is a wholly owned subsidiary of the RBI and propagates norms that apply to all registered HFCs.²⁰ HFCs in India can be sub-classified into deposit-taking and non-deposit-taking institutions. Deposit-taking HFCs must currently comply with the following rules: -

1. No HFC can accept / renew public deposits unless it has an investment grade rating for fixed deposits on a yearly basis.²¹
2. The ceiling on public deposits stands at some stated multiple (currently five times) of the HFCs' net owned funds (NOF).²²
3. No HFC can accept / renew deposits repayable on demand unless the maturity of the deposit is more than 12 months²³ and less than 84 months.²⁴
4. An HFC must comply with interest rate regulation on such deposits as prescribed by the NHB.²⁵

2.1 Period 1: 1995 – 2001

The NHB Directives in 1989, a year after the establishment of the regulatory body, do not explicitly state a framework for prudential regulation.²⁶ However, prudential norms imposed on banks by the RBI have been imposed on HFCs, albeit with a lag. This lag has been shrinking over time.²⁷ Until September 1997, the main instruments of prudential regulation

²⁰ The Housing Finance Companies (NHB) Directions (Herein after NHB Directions,), 2010, I (1) 2 (See [Annex 2](#)).

²¹ NHB Directions, 2010. II (3) 1 (i). (See [Annex 2](#))

²² NHB Directions, 2010. II (3) 1(ii). These directions also define NOF in I (2u): “[‘]net owned fund[’] means net owned fund as defined under section 29A of the National Housing Bank Act, 1987 including paid up preference shares which are compulsorily convertible into equity capital.”

²³ The minimum maturity period was reduced from 24 to 12 by way of an amendment on 14 December, 1993. See: [http://www.nhb.org.in/Regulation/Dir-5/Dir.5\(Eng\).pdf](http://www.nhb.org.in/Regulation/Dir-5/Dir.5(Eng).pdf) Accessed on: 23 Dec 2011. (See [Annex 3](#))

²⁴ NHB Directions 2010, II, 4(a,b).

²⁵ NHB Directions 2010, II, 11(1(a)).

²⁶ NHB Directions, 1989. Accessed at: <http://www.nhb.org.in/Regulation/Dir-1/Dir.1,1989.pdf> on Dec 23, 2011.(See [Annex 4](#))

²⁷ NHB Directions 2010, III lays the foundation for prudential norms for HFCs. Read with RBI Circulars and

were the interest rate ceiling on deposits with HFCs (see Table 3), as well as leverage restrictions on aggregate borrowings by HFCs (Table 4).

Since September 1997, HFCs were expected to maintain a certain percentage of assets in specified instruments. At least 5 per cent had to be placed either as a deposit with NHB, subscription to NHB bonds, or as a deposit with a scheduled commercial bank. Additionally, no less than 5 per cent of assets were required by law to be invested in “unencumbered approved securities” as listed by the NHB.²⁸ HFCs were also required to hold a reserve fund of not less than twenty per cent of their net profits per year before dividend declarations.²⁹ Compliance was to be reported daily to the NHB and lack of compliance attracted a penalty of 3 per cent over and above the bank rate.

The RBI directives in 1999 also restricted lending to HFCs by banks. The directives differentiated Non-Bank Financial Companies (NBFCs) registered with the RBI from the remainder. As HFCs were registered with the NHB and not the RBI, and since the directive called for restriction on lending to NBFCs that were registered with the RBI, banks were not restricted on lending to HFCs.

2.2 Period 2: 2001 – 2011

The NHB signaled a new chapter for prudential norms for HFCs in December 2001.³⁰³¹ These directives were very similar in structure and implications to those issued by the RBI for banks. The income recognition framework, classification of income from investments, accounting standards, asset classification (standard, sub-standard, doubtful and loss assets), provisioning requirements for NPAs and other such sub-parts of the prudential regulatory framework were all virtually identical to those for banks.³²

Notifications (as done later in this analysis), they do not look different except for its timing.

²⁸ *NHB Directions*, 1997 I (3)(11)

²⁹ *NHB Directions*, 1997 (3) 11(A,B).

³⁰ RBI Circular DOS.FID.No.17 / 01.02.00/96-97 in June 1997 set forth credit exposure norms for all banks in India (See [Annex 8](#)). A consequent clarification was issued in August 2001 vide circular DBS.FID.No.C-3/01.02.00/ 2001-02 that these were applicable to refinancing institutions as well. (See [Annex 9](#))

³¹ *NHB Directions*, 2001, III(28)(1)(i,ii,iii) accessed at [http://www.nhb.org.in/Regulation/Dir.1\(Eng\).pdf](http://www.nhb.org.in/Regulation/Dir.1(Eng).pdf) on Dec 23, 2011. (See [Annex 10](#))

³² HFCs cannot lend more than 15 per cent of its fund to any single borrower and 25 per cent of its fund to any group of borrowers. Furthermore, HFCs cannot invest in shares of any one company in excess of 15 per cent of its funds, and shares in a single group of companies exceeding 25 per cent of its owned funds. It cannot lend and

Until 2001, there were explicit restrictions on the extent of borrowings HFCs could undertake. However, with the new framework, all HFCs were mandated to maintain a minimum capital ratio of 10 per cent on or before March 31, 2001 and 12 per cent on or before March 31, 2002 on aggregate risk-weighted assets.³³ Risk weights were further classified and defined in the NHB Directives in 2001. Table 6 summarizes regulatory changes since 2001 for HFCs.

The NHB also mandated a minimum holding of liquid assets. These were defined similarly to those in its initial asset management framework. HFCs were expected to maintain no less than 6 per cent of public deposits (on a daily basis) in unencumbered approved securities. 12.5 per cent of public deposits were mandated either as deposits in a scheduled commercial bank, or as deposits at the NHB by way of bond subscriptions.³⁴

Another regulatory change that defined the HFC landscape was one of entry requirements. The RBI raised the minimum NOF to commence business for NBFCs from Rs. 2.5 million to Rs. 20 million. Consequently, NHB raised the bar to comply with RBI regulations. The RBI passed this notification in April 1999 and the NHB issued equivalent directives in January 2002.^{35,36}

2.3 Non-performing Assets Regulation

In 2002, the Indian legislators enacted the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act. As stated in the legislation, this act aimed to “improve recovery by taking possession of securities, selling them and reducing non-performing assets by adopting measures for recovery or reconstruction”.³⁷ Prior to its enactment, there were very few mechanisms that allowed for effective and swift

invest (loans and investment) exceeding 25 per cent of its funds to a single party and 40 per cent to a single group of parties. See NHB Directions, 2001, III (See [Annex 10](#)) read with RBI Master Circular DBOD No. BP.BC/ 20 / 21.04.048 / 2001-2002 accessed at

http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?Id=449&Mode=0 on Dec 23, 2011. (See [Annex 11](#))

³³ NHB Directions, 2001, III(26)(1). Accessed at [http://www.nhb.org.in/Regulation/Dir.1\(Eng\).pdf](http://www.nhb.org.in/Regulation/Dir.1(Eng).pdf) on December 23, 2011. (See [Annex 10](#))

³⁴ NHB Circular No. NHB.HFC.LA-1 / CMD-2001 accessed at:

<http://www.nhb.org.in/Regulation/Folder%202/DIR.1,2001/L.A1.pdf> on Dec 23, 2011. (See [Annex 12](#))

³⁵ NHB Circular BHB.HFC.REG1.1/CMD/2002 accessed at <http://www.nhb.org.in/Regulation/gazette%20-%208.1.2002.pdf> (See [Annex 13](#)) and read with RBI Circular DNBS (PD) No. CC.10/02.59/98-99 accessed at <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=33&Mode=0> ([Annex 14](#)) on Dec 23, 2011.

³⁶ NHB Circular NHB.HFC.DIR.2/CMD/2010, 27(A) accessed at <http://www.nhb.org.in/Regulation/DIR.2-CMD-2010.pdf> on Dec 23, 2011. (See [Annex 15](#))

³⁷ *Preamble*, SARFAESI Act, 2002.

recovery in the event of default.

The act provides two channels of recourse to financial institutions. A financial institution had the legal sanction to move NPAs off its books by way of sale to a new class of institutions called Asset Reconstruction Companies (ARCs) who then attempt recovery of such assets. The second channel for financial institutions such as Banks or HFCs is asset seizure and auction. This channel is also the one to be used by ARCs to recover debt. The right of the secured creditor, in our case the Banks or HFCs, did not allow them to enforce their security interest without the intervention of a court of law until SARFAESI Act, 2002 was brought into force. Even under the act, this can be done only after two conditions are fulfilled: The borrower should not have paid debt installments, classifying the asset as an NPA and the borrower fails to pay within sixty days from the first notice to fully discharge the borrower's obligations. The SARFAESI Act, hence, allowed for enforcement of security interest without going to a court of law. While there is no public evidence on the extent to which the first channel (transfer of assets to ARCs) has been used in the Housing finance sector, Banks and HFCs have enforced their security interest without going through a judicial process under this law.³⁸

The second important change is that the definition of an NPA was modified in 2004 (by RBI) and 2005 (by NHB) for banks and HFCs respectively. With effect from March 31, 2005, the NHB redefined a 'non-performing' asset as one, "in respect of which, interest has remained overdue for a period of ninety days or more", reducing the number of days from 180 to 90 days for HFCs.³⁹ However, as noted earlier, the RBI introduced this change a year earlier for banks.

3. Subsidies for the Housing Sector

Subsidies for the housing sector comprise mandatory lending, cash subsidies, and reduced interest rates on housing loans.

3.1 Priority sector lending (PSL)

Lending to small borrowers is an important political goal in India. Banks are subject to a

³⁸ While quantitative evidence is hard to come by on the extent to which this channel has been used, we observe that there have been media reports on its usage, and some Banks and HFCs have voluntarily disclosed recovery amounts using this method in their annual report. See [Annex 36](#), [37](#) and [38](#).

³⁹ NHB Directions 2010, Notification No. NHB.HFC.DIR.1/CMD/2010 accessed at <http://goo.gl/8ol4E> on Mar 14, 2012. (See [Annex 2](#))

quantity target for Priority-Sector Lending (PSL), which includes loans to agriculture, small businesses, export credit, affirmative action lending, educational loans, and -- of particular interest to us -- mortgages for low-cost housing. The PSL target is 40% of net bank credit for domestic banks (32% for foreign banks), and there is a severe financial penalty for failure to meet the target, namely, compulsory lending to rural agriculture at a haircut to the repo rate.⁴⁰ In addition, since 1998, 3% of net new deposits of public sector banks must be allocated to housing.⁴¹

PSL requirements have been binding on banks in India. For the public sector banks in India, priority sector lending has fluctuated between 36% and 45% of credit outstanding over the past one and a half decades (Table 6)

These regulations do not directly apply to HFCs, but bank lending to an HFC qualifies for the PSL target to the extent that the HFC makes mortgage loans that qualify, i.e., are below the specified nominal PSL threshold. The overall effect of the PSL system is to provide a strong incentive, directly for banks, and indirectly for HFCs, to originate small mortgages that finance low-cost housing purchases.

Housing has been a priority sector in India since 1970.⁴² Unlike other micro-subsidy schemes, PSL was a creation of the RBI rather than the Government of India. The intention of priority sector lending is to focus on sectors that “impact large segments of the population & the weaker sections, which are employment-intensive”. Housing loans for individuals and commercial real estate intended towards construction of houses were covered under this scheme. Over time, the definition of loan size that qualifies for PSL has changed. While the size differed across urban and rural areas, currently, loans up to 25 lakhs, irrespective of

⁴⁰ An RBI committee to re-examine related issues to PSL norms suggest this as the mechanism to determine the rate of interest at which PSL non-compliant banks will lend. See [Annex 33](http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FRNC210212F.pdf). <http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FRNC210212F.pdf>

⁴¹ The RBI issued a circular (IECD.No.(HF)24/03.27.25/98-99) in 1998 and began the sub-target for the housing sector for commercial banks in India. Further, it issued a notification on 11, August 2000, which raised the ceiling to 3% of incremental deposits (See [Annex 35](#)). While we do not have an electronic copy of the original 1998 circular, it has been referred to by the Reserve Bank in the August 2000 notification. The RBI also states that this is the "minimum" required of commercial banks and that they are free to go beyond this requirement should they wish to. The annex to this notification (also in [Annex 35](#)) provides details on loans that cannot be included under this category, directly referring to the prevailing PSL targets and norms.

⁴² The Housing and Urban Development Corporation (HUDCO) was set up in April 1970 by the Government of India as an apex “techno-finance” corporation. HUDCO has ever since been one of the instruments through which the National Housing Policy is implemented. Subsequently, the National Housing Bank was established in 1988 with a view to creating a refinance organization for Housing Finance in India. For more, see <http://goo.gl/dNSj7> (accessed on Mar 24, 2012, See [Annex 18](#)).

location constitute the priority sector for housing.

Beyond quantitative ceilings, PSL regulation also governs other provisions such as penal interest, services and inspection charges, waiver of insurance against risks on underlying assets, repayment schedule, and interest rate calculations.⁴³

3.2 Interest rate on housing credit

A federal government budget announcement in the financial year (FY) 1997-98 stated that where, “[l]oans up to to Rs. 2 lakhs will be given for building houses in freehold land in rural areas at normal rates of interest, subject to the borrower putting in one-third of the value of the house. NHB has been requested to prepare a scheme in which other organizations will also participate.”⁴⁴

The NHB followed this up with an expansive scheme called the “Golden Jubilee Rural Housing Finance Scheme” (GJRHFS), where the objective was to provide institutional credit at ‘normal rates of interest’ for housing in India. While what constitutes normal rates of interest has been left vague in the policy documents, banks followed guidelines issued by the RBI. Such guidelines, in addition to what has been documented above, involve categorization of loans under various schemes. The “Differential Rate of Interest” scheme is one such scheme, in which banks lend up to a ceiling (subject to change) per dwelling unit at an interest rate of 4 per cent per annum.⁴⁵ It is important to note that this rate of interest has not changed since 1977. Another such scheme, introduced in 1996, was the Indira Awas Yojana (IAY)⁴⁶, which public sector banks were advised to fund under the “Differential Rate of Interest” scheme.⁴⁷

Until 2009, the government simply decreed the (immutable) rates at which very small housing

⁴³ See <http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/73748.pdf> ([Annex 31](#)).

⁴⁴ NHB, accessed at: <http://goo.gl/RQCXM> on Mar 24, 2012 (See [Annex 19](#)).

⁴⁵ This is a scheme in existence since 1977 (RBI circular DBOD No B. P. 1900/C.453 (U) – 77 dated July 6, 1977 – See [Annex 20](#)), under which financial assistance needs to be extended at a concessional rate of 4 per cent to low income groups and is implemented (in some instances) by all commercial banks and mandatory for all public sector banks. The government also sets targets for lending under this scheme, and is from time to time revised by way of notification by the RBI.

⁴⁶ The IAY has been in place since 1996 as a standalone scheme. It is a cash subsidy program, under which assistance is provided to rural BPL families for constructing dwelling units. Both federal and state governments fund this program in the ratio of 75:25. See <http://goo.gl/JnyIG> (accessed on Mar 24, 2012, See [Annex 21](#)).

⁴⁷ The limit of housing loan under this scheme was revised from Rs 5000 to Rs. 20000 per beneficiary from FY 2007-08 (RBI RPCD. SP. BC. No 101/09.07.01/2006-07 accessed at <http://goo.gl/ZUdwk> on March 30, 2012 - See [Annex 22](#)).

loans should be made. Since 2009, subsidy schemes were changed to provide reductions in the prevailing market interest rates. From October 2009, a 1 per cent interest-rate subvention on the first 12 months was announced for qualifying loan sizes.⁴⁸ In this scheme, it is also important to note that, “[i]n case account turns NPA [non- performing asset, or default] after 12 months, subsidy would not be returned, as Scheme provides 1% interest subsidy for 12 months only.”

An urban interest subsidy scheme has also been in place since 2009, in which small urban loans (of less than Rs. 1 lakh) qualify for a subsidy of 5 per cent per annum on the principal of the loan, for the entire period of the outstanding loan.⁴⁹

3.3 Quantum of housing credit and cash subsidy

These low interest-rate schemes in many cases were augmented by directives on the amount of credit to be provided for housing. Three major schemes launched by the Government of India, together with the NHB, namely the IAY, GJRHFS and the Credit-cum-Subsidy Scheme were prevalent at some point or the entire period under discussion.⁵⁰

The IAY focuses on the amount of credit to be given to each beneficiary of the scheme, with per unit assistance varying over the years.⁵¹ The GJRHFS is based on the total number of units financed and these targets are in turn sub-allocated to implementing agencies (banks, HFCs and other smaller financial institutions in rural areas). In the year of introduction (FY 1997-98), the target was 50,000 units and has steadily risen over the years to 350,000 units in FY 2007-08.

The Credit-cum-Subsidy Scheme for Rural Housing was launched in April 1999, where the policy targeted families with annual income up to Rs. 32,000 for a subsidy of Rs. 10,000. The maximum loan that can be availed of is Rs. 40,000 (25 per cent more than the annual income

⁴⁸ Loans smaller than a certain threshold size, in the first instance, up to Rs. 10 lakhs, currently raised to Rs. 15 lakhs, for both banks and HFCs qualified for the subvention. See <http://goo.gl/c2gqt> (Annex 23) and <http://goo.gl/TxJU8> (Annex 24), both accessed on Feb 20, 2012.

⁴⁹ See <http://goo.gl/X1o32> (Annex 25, accessed on Feb 21, 2012).

⁵⁰ There are other schemes run by state governments too. For example, the state of Andhra Pradesh established the State Housing Corporation Limited (APSHCL) in 1979 to “formulate, promoter and execute” housing schemes for weaker sections of society. See *Housing for the Poor in India*, CGG Working Paper 4/2003 (Annex 1) Accessed at: <http://goo.gl/Plmxr> on: Dec 21, 2011.

⁵¹ At present, Rs. 35,000 is the sanctioned assistance for units in plain areas and Rs. 37,500 for housing in hilly and difficult areas. See <http://goo.gl/JnyIG> (Annex 26, accessed on Mar 24, 2012).

of the borrower).⁵²

3.4 Other schemes

The NHB is the nodal agency for refinancing housing loans in India.⁵³ Over and above standard refinancing undertaken by the agency, several schemes relating to refinancing housing loans were available during this period.⁵⁴

Individual financial institutions have limits up to which refinancing is available. Some schemes redefine the ceiling on loan slabs that are eligible for refinance, while others define direct pass-through of 100 per cent of principal for refinancing. The first such scheme underway, within the time period of concern, was in FY 2000-01. This concerned revision of general loan slabs and also those under the refinancing scheme that went together with the GJRHFS.

In FY 2000-01, the government directed NHB to refinance banks and HFCs to construct 150,000 houses under the GJRHFS. Refinancing was used, in effect, as a tool of reducing the interest rate charged by financial institutions for housing loans. Another scheme, introduced in 2006, was designed as a composite loan for income generating activity and housing, where the NHB provided the housing loan component by way of 100 per cent refinancing.⁵⁵

More recently, in 2008, loans up to Rs. 15 lakhs for housing construction and up to Rs. 5 lakhs for extension and renovation to 'weaker section of society' (direct and indirect)⁵⁶ are eligible for 100% refinance from the NHB at a rate specified from time to time. The sum has to be repaid in 3 to 7 years by financial institutions making the loan. Currently, the rate of refinancing is set at 8 per cent.⁵⁷

Refinancing assistance from NHB is constrained by various factors like the net owned fund

⁵² See <http://goo.gl/l2RmT> (Annex 27, accessed on Mar 24, 2012).

⁵³ The preamble of the National Housing Bank Act, 1987 describes the basic functions of the NHB as "... to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support to such institutions and for matters connected therewith or incidental thereto..." NHB has, right since inception, taken up refinancing actively.

⁵⁴ Several schemes, from time to time, were in place due to exigencies and natural disasters. Such schemes have been left out of the purview of this document.

⁵⁵ This scheme, titled "Productive Housing in Rural Areas" (PHIRA), provided a composite loan of Rs. 70,000 of which 25 per cent (Rs. 17, 500) should be used towards income generating activity and the remaining for construction of housing unit and work area. See <http://goo.gl/BP1f8> (See Annex 28, accessed on Apr 5, 2012).

⁵⁶ Indirect housing loan refers to investment by financial institutions into other financial companies that provide such loans.

⁵⁷ See <http://goo.gl/fnm9z> (See Annex 29, accessed on Feb 21, 2012).

restriction on the NHB (from the RBI), and borrowing power of HFCs. In order to assist HFCs to raise funds directly from the market, the NHB devised a scheme in FY 2001-02 to guarantee bonds floated by HFCs under certain conditions. The main thrust of this scheme is that HFCs pay a floating charge on the assets equivalent to 125% of the principal amount.⁵⁸

NHB's ability to refinance is also assisted by its ability to raise debts at lower cost than private financial institutions. With an average maturity of 3 years and an explicit government guarantee, NHB bonds trade at yields that are roughly 50 basis points lower than bonds issued by private institutions.⁵⁹

⁵⁸ Report on Trends and Progress of Housing Finance in India, 2002

⁵⁹ See Appendix 3 of Davies, Gyntelberg and Chan (2007). Accessed at <http://goo.gl/yDAT6> on Apr 13, 2012.

Figure 1: Regulation over time – RBI and NHB

The first panel of this three-part figure summarizes regulations that were applicable to banks imposed by the RBI. Most of the regulations are quantity based; however, mandatory interest on small loans and risk weights specific to housing are price based and mark the change in the regulatory landscape over time. The second panel summarizes various subsidy schemes administered either by the RBI or the NHB, on behalf of the Government of India. Many of these schemes are subsidies on the retail interest rate on housing loans to specific loan size and shape the housing finance policy landscape. The third panel summarizes change in regulation of HFCs. Since 2001, risk weights for specific loan sizes have been introduced. The definition of a non-performing asset (NPA), another feature of this policy landscape, has changed over time too, alongside a new legislation in 2002 (SARFAESI Act) that made asset seizure and repossession due to non-payment of debt easier in India.

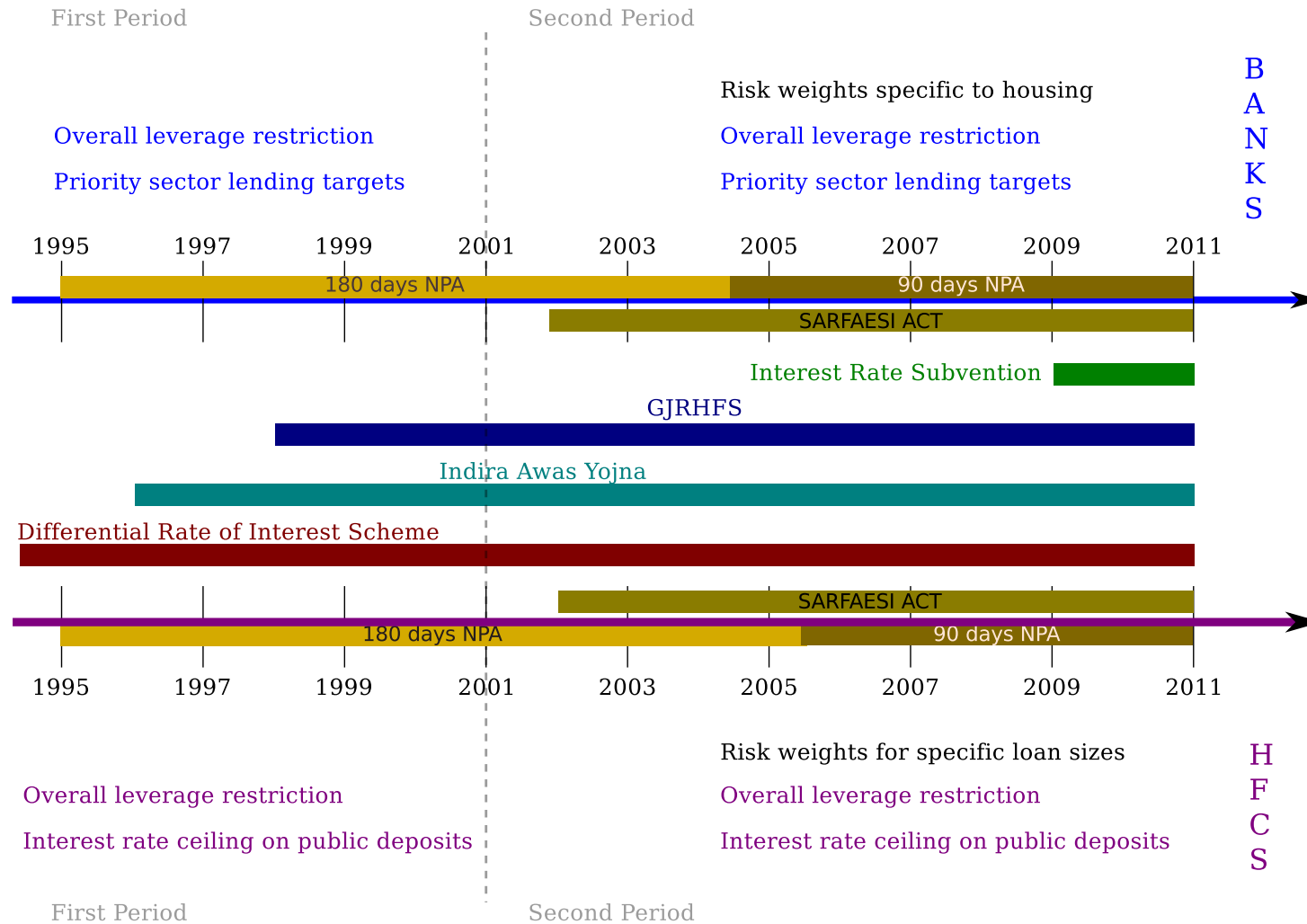


Table 1: Capital Adequacy Risk Weights (1994 – 1999)

	Risk Weights (%)
(A) Funded Assets	
1. Cash, balances with RBI	0
2. Balance with other Banks, Call money	20
...	...
6. Other investments	100
7. Advances	
(i) Loans Guaranteed by Govt. of India and State governments	0
(ii) Loans granted to PSUs of Govt. of India and State governments	0
(iii) All other advances	100

Source: Report on Trend and Progress of Banking in India, various issues & Capital Adequacy: Some Issues, Brinda Jagirdar, Economic and Political Weekly, March 1996.

Table 2: Risk weights for housing assets – RBI (2000 – 2011)

	2001*	2002	2004	2005	2006	2007	2008	2010
Overall Capital Adequacy	Provision (%)							
Tier I and II Capital	9	9	9	9	9	9	9	9
Risk-weight categories	Risk weights (%)							
Market-risk	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Below 7.5 million, LTV < 75%	100	50	75	75	75	75	75	75
Above 7.5 million, LTV < 75%	100	50	75	75	75	75	75	125
Below 7.5 million, LTV > 75%	100	100	100	100	100	100	100	100
Above 7.5 million, LTV > 75%	100	100	100	100	100	100	100	125

*By definition, till 1999, the weights were at 100 per cent as they were deemed as “other loans”.

Source: RBI Notifications, 2000 – 2011, various issues. Rs. Crore has been converted to Rs. million

Table 3: Interest rate ceilings on HFC public deposits (1989 – 2011)

	Interest ceiling (% per annum)
12 Aug, 1989	14
01 Nov, 1995	15
14 Mar, 1997	No ceiling
29 Dec, 2001	14
24 Apr, 2002	12.5
27 Mar, 2003	11
06 Jul, 2007	12.5

Source: NHB Directions, 1989 – 2010, various issues.

Table 4: Borrowing as multiple of NOF (1989 – 2011)

	Multiple of NOF for the HFC						
	1989	1993	1997	2000	2001	2001 – 2005	2006
Public Deposits							
Of maturity < 1 year	--	2	2	2	--	--	--
For all HFCs	--	--	--	5	5	5	5
< Rs. 2.5 mn	--	--	--	--	--	--	--
NOF (Firm Size) Buckets							
< Rs. 2.5 mn	--	--	3	3			
< Rs. 100	10	10	--	--			
> Rs. 2.5 < Rs. 100	--	--	10	10	Migration to Prudential Regulation 2001		
> Rs. 100 & < 200	12.5	12.5	12.5	11			
> Rs. 200	15	15	15	12			
All NOF	--	--	--	--	--	--	16

Source: NHB Directions, 1989 – 2010, various issues. The hyperlink for each year directs the reader to the underlying notification. Rs. Crore has been converted to Rs. Million in the table.

Table 5: Risk weights – NHB (2001 – 2011)

		2001	2002	2003	Oct 2005	Dec 2005	2006	2007	2008	2010
Overall Adequacy	Capital	Provision (%)								
Tier I and II Capital		10	12	12	12	12	12	12	12	12
	Non-Housing loan (standard assets)	--	--	--	--	--	--	0.4	0.4	0.4
	Housing loan (Teaser loans) ⁶⁰	--	--	--	--	--	--	0.4	2	2
Loan-to-value (LTV) Buckets		Risk weights (%)								
	Below 7.5 million, LTV < 75%	75	75	50	75	75	75	75	75	75
	Above 7.5 million, LTV < 75%	75	75	50	75	75	75	75	75	125
	Below 7.5 million, LTV > 75%	100	100	100	100	100	100	100	100	100
	Above 7.5 million, LTV > 75%	100	100	100	100	100	100	100	100	125

Source: NHB Directions, 2001 – 2010, various issues.

⁶⁰ Teaser loans are loans where housing loans begin with a teaser/special rate for the first few years and are reset at higher rates at a later stage.

Table 6: Priority Sector Lending (2000 – 2012)

	Percentage of Total Credit Outstanding
2000-01	40.3%
2001-02	43.7%
2002-03	--
2003-04	42.5
2004-05	43.2
2005-06	--
2006-07	--
2007-08	43.3
2008-09	44.64
2009-10	42.5
2010-11	--
2011-12	41.25

Source: RBI Statistical Tables Relating to Banking in India Reports, various issues