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Low Income
Housing in Urban
India

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India unlikely to
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**AFFORDABLE
HOUSING
FOR ALL**



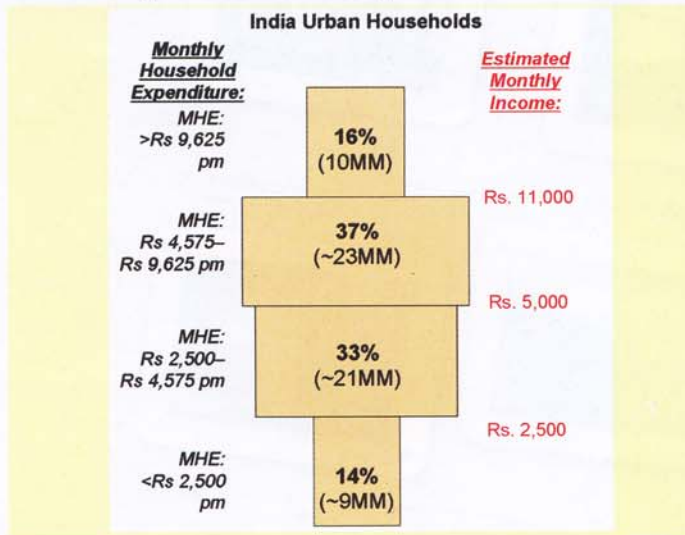


HELP THE COUNTRY WHILE MAKING HIGH RETURNS - LOW INCOME HOUSING IN URBAN INDIA

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The current market is not reaching lower income households

There is a vibrant housing market in urban India as illustrated by housing finance growing at a CAGR of over 36% for the past decade. But the smallest flats being built are around 500 square feet and cost Rs. 450,000 to 500,000. A household earning Rs. 11,000 or 12,000 per month can just about afford¹ such housing if they get financing. As seen from the income pyramid alongside, over 80% of India's urban households earn less than this and hence cannot afford housing in the current housing market.



The housing situation for lower income urban segments is quite poor. While they pay 20-25% of their income as rent, they typically live in dingy small single room units with shared toilets, have poor living conditions, are subject to constantly rising rents and are harassed by landlords, etc. The situation for the poor is even worse - many do not even have a house. The current deficit of urban housing is estimated at 24.7 million units (mostly the poorest segments of society), but given this deficit, the continued migration into urban areas, and its limited resources, it is unlikely that the Government can provide housing for lower income urban households.

¹ Using a price to annual income ratio of around 3.5.

Monitor Group is using market based solutions to create social change in India

Monitor Group is a management consulting and merchant banking group started by Michael Porter and a group of his colleagues at Harvard Business School. It has over 1200 professionals in 30 offices across the globe and has been in India since 1996. Recognizing that India's biggest challenges are in the area of social inequity (a large group of low income people are not benefiting proportionately from the overall economic growth in the country) and given its commitment to India and its global experience in social change, Monitor has made this a strategic focus area. It has identified market based solutions as a powerful route to social progress in India and is currently collaborating on multiple initiatives to facilitate this. Low Income Urban Housing is one of these initiatives.

A project by Monitor Group for National Housing Bank - with active support from the World Bank - explored the commercial opportunity to serve low income households.

Inadequate housing for low income households is a key priority for NHB and it is actively working in multiple ways to address this issue. One potential solution is through market mechanisms and this led to a project by Monitor Group, funded by FIRST Initiative with active support from the World Bank. The project recognized that current models are not working for low income households and hence conducted extensive field research across Urban India and involved international and local experts to develop innovative solutions. The fieldwork included investigation of property prices, interviews with over 1000 customers, 50 developers, 20 Financial Institutions, 10 micro-finance and specialized lending organizations and a broad range of over 100 stakeholders.

Even with current land prices and construction rates, it is possible to build housing that lower middle urban customers can afford

Private sector developers are currently building housing at Rs. 800 - 1,000 per sq. ft. in vibrant neighbourhoods within one hour of the city centre in most Metros, Tier I and Tier II towns. The smallest units they are currently building are 450 to 500 sq. ft. flats costing Rs. 400,000 to 500,000. However, many developers in cities like Ahmedabad, Jaipur, Mumbai, Hyderabad, Kolkata, Kolhapur and Vizag confirmed that they could build smaller flats, e.g, 250- 350 square foot apartments at Rs 250,000 to 320,000 which lower middle income customers could afford provided financing was available.

Lower middle income customers can afford, and are very interested in, purchasing the type of housing described above

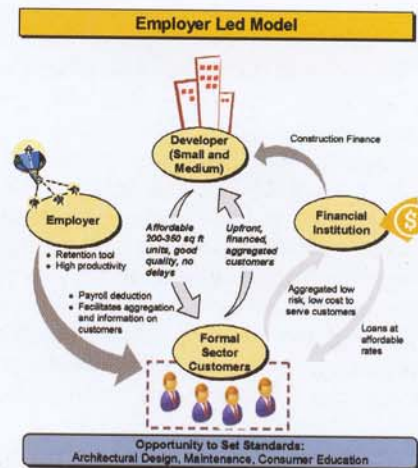
A majority of such families live in poor quality rental housing (typically a single room of 100-250 sq. ft. with a shared toilet and bath, often poorly ventilated and lit, and in "bad" neighborhoods). They face constantly rising rents, unreasonable demands from landlords and pressure to move every two or three years. While some of these households prefer to stay in the same neighborhoods, many are very interested in moving to more distant suburbs if they can buy the 200 - 350 sq. ft. flats described above - flats that will have some safe common spaces and will be in neighborhoods that have schools, shops, access to health care and most importantly are well connected by public transport. The customers see this as an economic opportunity to convert rent to ownership and as a chance to significantly improve their quality of life. They can afford such housing if they get financing at current mortgage rates².

Financial institutions are concerned about financing such customer

Conceptually some financial institutions recognize the potential of this segment, but they are concerned about costs of serving them. They are also worried about increased credit risk when looking at low income customers, and even more so in the informal sector (both salaried and self employed).

Innovative business models were developed to address these issues

Monitor developed a set of new business models to address the concerns of different stakeholders. The first model (see attached graphic description) is aimed at organized sector employees and uses the employer to aggregate customers and facilitate processing including payroll deduction. Employers are very interested in this as it helps with retention and performance improvement³. Since this model lowers cost and reduces risk, financial institutions are keen on financing such groups of customers. Developers are very keen on providing housing to these



agglomerated pre-financed customers as it reduces their marketing cost, selling risk and also enables construction finance.

The second model is analogous, except that it targets the informal sector and uses a micro finance organization to do the aggregation, qualification and collection, thereby lowering cost. The second model also uses an external credit guarantee to reduce risk and make the customers attractive to the financial institution. The third model is for financial institutions that have existing customers in this target segment (or which specifically focus on new customers in this segment), and again uses an external guarantee to reduce risk. Review of these models with a broad range of stakeholders including the government has confirmed that these models address their concerns.

Pilots To prove the feasibility of these models, Monitor is facilitating a series of pilots having 200 to 500 flats each in Ahmedabad, Mumbai and Hyderabad. In each case, Monitor is identifying a developer interested in this opportunity and supporting him through the actual process - getting him customers, getting the customers financed, helping the developer secure construction finance, facilitating development of cost-efficient unit designs and overall complex layouts, etc. One of the developers has constructed a 229 square foot mock flat (see attached unit plan and photographs), and the general reaction to the unit has been that (a) "this is much bigger than 229 square feet" and (b) "this is too good to be low income housing". The reason for these reactions is that the unit has been carefully designed (e.g., effective utilization of space, visually attractive proportions, high ceilings, good ventilation) with a few key amenities leading to a feeling of space and quality while managing costs.



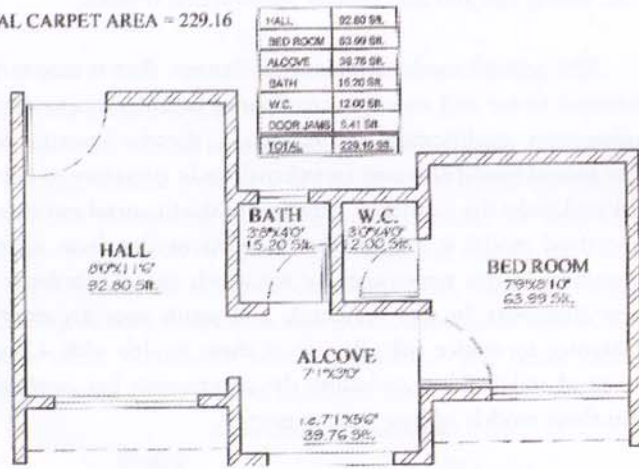
² Current mortgage rate for the retail customer is 12%

³ Employers see better housing as leading to better morale, less absenteeism, etc. They also know the interest in owning housing and hence see this as an effective retention tool.

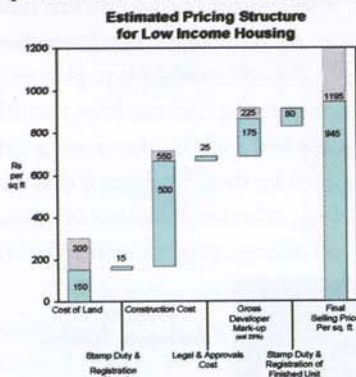
Prashant Choksey exemplifies a forward thinking modern developer. An engineering graduate from the University of Southern California, his entry into the construction business was driven by a combination of economic opportunity and a need for better quality construction, especially in the middle income market. "We have a chemical's business and we know the improvement in quality with just marginal more cost through materials like waterproofing and good site supervision, but this is woefully inadequate today". Choksey Construction is currently building high quality middle income housing (attached photographs of analogous project, Shreeji Park) and is actively expanding into low income housing (first Mumbai pilot).

Unit Plan of first Mumbai Plot

TOTAL CARPET AREA = 229.16



Economic returns for developers. In addition to demonstrating the overall feasibility of using market based solutions to meet the housing needs of low income households, the pilots are also highlighting the commercial value of the opportunity to developers. The return on investment is in the 50% to 120% range (pretax IRR) based on factors like time to get clearances, selling price escalations, etc. The reason the returns are so attractive is because (1) the land cost is low and hence the customers down payment covers all or a large part of it, (2) there is no other large outgoing for the developer as construction finance has been arranged and (3) the timeframes are short (as the customers are arranged and financed before the project is even started).



Phased Development of the Overall business opportunity. About 40% of households earning Rs. 5,000 to 11,000 per month work with large employers⁴. It is estimated that 70% to 90% of these households live in rented housing or in multi-family units. Given the willingness of employers to facilitate housing and the financial institutions' comfort with this segment,

⁴ Organizations with more than 100 employees.

these will be the easiest customers to start with. Even with a 20% market share in the formal salaried segment of this income band, the business opportunity is Rs 60,000 crore. Serving this segment will lead to a significant supply of appropriately priced and located housing. It is expected, that in parallel, given the fact that this is a collateralized loan, financial institutions will get more comfortable lending to the informal sector and this combined with increasing supply could lead to the market serving the entire space of households (organized and unorganized) earning Rs 5,000 to 11,000 per month - an opportunity of over Rs. 600,000 crores.

Pure market based solutions may not be able to serve households earning less than Rs 5000 per month, but it may be possible to facilitate delivery to these segments through a combination of market based solutions, policy initiatives and subsidies - a market of over Rs. 320,000 crore.



Government can help facilitate market based housing for lower income households and many such interventions may not have a financial cost

"Affordable housing for all" is a priority for the Government and market based solutions can help make this a reality. A key long term facilitator is increasing the supply of affordable land. The government may be able to institute policy changes that provide this without any subsidies or financial support (e.g., higher FSI for lower income housing). Financing is also critical and RBI and Government can introduce guidelines/incentives - which may be bereft of subsidies/financial support - to get financial institutions to serve this market and compensate for the related entry cost. In the longer term, given the depth of the market and using customized business models such as those tested by Monitor, the profitability of providing scores of small mortgages seems ensured.

Potential to create immense economic and social impact.

The financial impact of such market based solutions can be enormous both at the aggregate level (as mentioned earlier, it is a Rs 600,000 crore opportunity for just households earning Rs 5,000 to Rs 11,000) and at the individual level. It will not only financially transform the lives of the customers but also have huge social implications - enhancing quality of life, emotional security of a home and a safety net, etc. It could also have a systemic impact on urban development by providing a potential benchmark for slum rehabilitation and options for housing that in the long term may help in slum prevention.