Unit – 3

Housing Finance

Introduction

- Financial arrangements made by the housing finance companies t housing requirements is called housing finance
- There were about 24million houses short in 1997 most of whi urban areas and among poor and low income people.
- This background led to the formulation of National Housing a Policy (NHHP) in 1998. **Stressing :**
- Removal of barriers in housing finance
- Treating housing finance in par with priority sector
- Creation of surplus in housing
- Providing quality and cost effective shelters to the vulnerable groups

- Draft National Urban Housing and Habitat policy 2005 further rec need to enhance flow of funds into the sector and highlighted th need of shelter in the years to come.

Need for Housing Finance:

- Social stability
- Economic development

Role of Housing Finance

- Creation of equitable economic growth throug reduction of poverty and prevention of slum prolif
- Housing has highly significant social implication provides the shelter for family
- Plays an intermediary role between economy housing system
- It drives the real estate business in India
- It is an avenue to mobilise domestic savings in Ind
- It develops innovative instruments to mobilise do savings
- Plays an important role in creating employment, ma health, social stability and decent human life.

Types of Housing Finance

- Home purchase Loans: Basic home loans offered by banks housing finance companies for purchasing new house
- Home construction loans
- Home extension loans
- Home conversion loans
- Land purchase loans: for both construction or investment pu
- Stamp duty loans:
- Bridge loans: offered for selling the existing house and purch another house
- Balance transfer loans: where the balance outstanding is tra another loan either from the same bank or another bank to ava interest rates
- Re-finance loans: banks can get housing loans re-financed fr financal institution
- NRI home loans: meant for non-residents who wish to build house in India

Institutions offering Housing Finance

- Housing and Urban Development Corporation of India (HUDCO)
- LIC Housing Finance Limited (LICHFL)
- GIC Housing Finance Limited (GICHFL)
- Dewan Housing Finance Corporation Limited (DHFCL)
- Can Fin Homes Limited (CFHL)
- Providend Funds

Banks offering Housing Finance

- Scheduled Commercial banks
- Scheduled co-operative banks
- Regional Rural banks
- Agricultural and rural development banks
- Housing Development Finance Corporation Limited (HDFC)
- State Bank of India Home Finance (SBI)
- IDBI Home Finance Limited (IHFL)
- PNB Housing Finance Limited PNBHFL)
- National Housing Bank NHB)

Interest Rates

Depends:

- Upon interest rate cycle
- loan amount
- Tenure of loan
- Profile of the borrower
- Credit history
- Credit score (CRISIl, CIBIL, CARE etc.
- Lending bank

Types of interest rates:

Fixed interest rates - interest rate remains fixed thro tenure of loan. E.g. HDFC

Floating interest rate - rate of interest changes depe upon changes in repo rates by RBI or any change in ~~of the bank. Generally floating rates are lower. E.g. S~~

Housing Finance Schemes

- Home loan
- Rural housing
- Refinance schemes
- National Housing and Habitat policy
- National Urban Housing and Habitat policy
- National Rural housing and habitat policy
- Golden Jubilee Rural Housing Finace scheme
- Indira Awaas Yojana

Hybrid interest rate: Fixed in the initial years and floating for the re
years.

- Prepayment of loan lender can not levy any penalty as per the guide RBI
- Borrower can shift from fixed to floating interest rate without any
- Interest rates are expressed as certain points above Base rate and ce above or below PLR popularly known as Spread.
- Repayment by EMI, which includes both Principal and interest
- EMI (Equated monthly installments)

$$\textbf{EMI} = \frac{(p(1-dp)r)\,(1+r)n}{(1+r)n - 1}$$

Where, dp= percentage of down payment
p= principal amount
r= interest rate
n= time

Or

$$\textbf{EMI} = (\text{Loan amount} * \text{interest}) \frac{(1+\text{interest})n}{(1+\text{interest})n - 1}$$

For e.g 1,00,000 loan repayment in 10 years having interest rate of 8%
compounded monthly. Down payment 10%. Calculate EMI.

Methods of calculating EMI

Flat rate system: interest is calculated on the initial loan amount fo
loan period and principal and such interest is divided equally into
repayment installments. Reduction in the Principal amount as and
installment is paid is not taken into account. This makes effective i
quite expensive.

Reducing balance system: interest is charged only on the outstandi
of the loan after deducting the principal repayment. Here amount of
less.

E.g. A loan of Rs. 2,00,000 with a flat rate of interest of 10% p.a. for

Installment of Rs. 60,000 p.a 5,000 per month

Total paid Rs. 3,00,000. leading to an interest rate of 17.27%.

**Reducing Balance with same example Total amount paid will b
instead of 3,00,000 in flat rate system.**

Types of reducing balance system

Daily reducing balance method: principal is r
as and when the principal is repaid and the int
calculated on remaining balance.

Monthly reducing balance method: Principal
is reduced when repayment is made at the end
month and interest is calculated on the balance.

Annual reducing balance method: At the end
year the accumulated principal component is d
from the original loan amount and the interest
next year is calculated on the reduced loan amou

Income Tax Implications

Deduction under Sec 80C – Deduction upto 1,5
for principal repayment

Section 24 – Deduction for interest payment

Section 80EE – additional deduction for interest.

Reverse Mortgage

- A Reverse Mortgage is a loan available to senior citizen
- Reverse mortgage, as its name suggests, is exactly oppo typical mortgage, such as home loan
- It is a home loan product designed for the senior cit converting their fixed assets-their home or in banking te equity in any housing property into an income channel i any requirement.

How Reverse Mortgage works in India

- When the home is mortgaged to the bank, the bank arriv fair value of the property based on condition of th demand for the property, location, current prices, etc.
- Once the fair value is determined, the bank disburse amount in the form of periodic payments – monthly, c etc. The margin and interest costs are also factored in to like any other loan.

Guidelines for Reverse Mortgage

- **Loan Amount:** Up to 60% of the property value
- **Tenure:** Generally 10-15 years (Some banks offer tenure)
- **Periodicity of Payments:** Monthly, Quarterly, A Lump sum loan payment
- **Property Revaluation:** Undertaken once every 5 y
- If valuation has increased the borrowers can incr loan amount. An incremental lump sum is paid.
- **Equity:** The equity or individuals interest in th decreases as they receive more payments. This is opposite of home loan where equity increases w and more principal payments.

Providers of Reverse Mortgage Loans in I

- State bank of India
- Bank of Baroda
- Dewan housing finance limited
- Punjab national bank
- Union Bank of India

- **Interest rate:** Interest rates on reverse mortgage loans in I from 12-15%. State Bank of India has a loan scheme t fixed interest rate of 12.75%.

Features of Reverse Mortgage

- Dealing Parties
  - Borrower
  - Lender
- Security for the lender
- Payment of loan to the Borrower
- Repayment of Reverse Mortgage loan
- Home value Falling short
- Home value in Excess
- Freeing the property from reverse mortga

Eligibility Criteria

- **Age:** House owner's age should be above 60. I
  is a co-applicant, she should be above 58 ye
- **Ownership and Clear Title:** The property title
  be clear and be free from encumbrance
  prospective borrower should be the owner
  property.
  - **Life of the property:** Should be minimum 20
    - **Property should be self acquired and occu**
- **Property should be the permanent and p**
  residence : The property can be either a re
  house or a flat located anywhere in India. In ad
  the above each bank or lender could have ad
  criteria in accordance with their lending norms.

Reverse Mortgage Advantages

- No prepayment penalty
- If one borrower dies his or her spouse can continue to stay ir
- Regular Income
- No Repayment worries
- Utilizing Locked Savings
- Avoid Sale or renting
- Financially Independent

Dis-advantages

- Pledge the property to loan lender means officially gi provider the right to sell the house to recover the loan. If the a house is willing to transfer the ownership to someone aft death then this loan is not to be considered as a source of inc
- High rate of interest compared to other loans.
- Variation in interest rates and loan amount during the valuation can turn into serious problems at times.

Criticisms of Reverse Mortgage

- It is expensive
- Customers are confused while entering into them
- Since no monthly payments are made by the borro reverse mortgage, the interest that accrues is treate advance
- Each month, interest is calculated not only on the amount received by the borrower but on the interest p assessed to the loan.
- Recent reports seem to indicate that a very small perc senior citizens only seem to have taken advantage of th
- The Indian Banking industry caps the available loan am lakh instead of providing for an equitable percenta property's value and limits the loan period to a tenure o

Non-Banking Financial companies

- Began in 1960 to meet the existing need by the Inv
- Started with accepting Fixed deposits from inv work out leasing deals
- 1980s and 1990s began to attract large number of i
- Activities expanded to underwriting, stock investment banking, asset management, p management

" The financial institution which provide the variou facilities but are not termed as banks because they d the banking license" are called NBFCs.

- Registered under Companies Act 1956
- Governed by the directions issued by RBI

•NBFCs undertake services like equipment lea purchase, housing finance, investment, loan, stock-b

RBI (Amendment Act) 1997 defines NBFC as

- A financial institution which is a company
- Principal business is receiving deposits or lendin manner.

Company carrying on any of the following activit principal business is not NBFC:

- Agricultural operations
- Industrial activity
- Purchase or sale of any goods or providing services
- Purchase, construction or sale of immovable proper

RBI - A company can be treated as NBFC:

- If its financial assets are more than 50% of its total
- Income from financial assets is more than 50% of income.
- A company can not carry on business as an NBFC u registered with RBI.

Components of Non-banking sector

Non-banking financial companies

- Principal business is accepting deposits and lending in an
  - Insurance/Stock-broking/Housing Finance
  - EL/HP/LC/IC/Mutual benefit finance company/ Mi non-banking company

Residuary non-banking company(RNBC)

- Receives deposits under any scheme by way of contr subscriptions or by sale of units or certificates or other in

Non-banking non-financial company

- Is an industrial concern
- Principal activity is agricultural operation or
- Trading in goods and services or
- Construction or sale of real estates
- Not classified as financial or non residuary non-banking c

Role of NBFCs

- Promotes utilisation of savings
- Provides easy, timely and unusual credit
- Financial super market
- Investing funds in productive purpose
- Provides housing finance
- Provides investment advice
- Increase the standard of living
- Accepts deposits in various forms
- Promotes economic growth

Growth of NBFCs

- 1980-90s NBFCs grew fast owing to public money through and IPOs
- 1981 had 7063, 1990 had 24009, and 1995 saw 55995
- 1991-97 saw deposits growth of 88.6% owing to high rates o NBFCs
- Growth could not be sustained as loans extended turned stick to several NBFCs to default on deposit repayments.
- 1997-98 saw RBI coming out with stringent regulations wh them difficult to raise deposits. Banks also turned wary of l NBFCs leading to increased cost of funds to NBFCs. Private b posed competition to NBFCs. Many exited business.
- 2001-02 saw recovery and strong growth
- Competition picked up again leading to decline of NBFCs 12740 by June 2009. NBFCs started depending upon b debentures as against public deposits.
- There has been further reduction in number of NBFCs and asset management companies basically by way of re-classifi these companies.

Functions of NBFCs

- Brokers of loanable funds
- Mobilisation of savings
- Channelisation of funds into investments
- Stabilise the capital market
- Provide liquidity

Types of NBFCs

- Equipment Leasing Companies
- Hire purchase finance companies
- Housing finance company
- Investment company
- Loan company
- Miscellaneous non-banking company
- Mutual benefit finance companies
- Residuary non-banking company
- Non-banking non-financial company

RBI guidelines for NBFCs

- Registration with RBI
- Inter-corporate deposits
- Maintenance of liquid assets
- Period of deposit for residuary NBFCs
- Accounting standards issued by Institute of Chartered Accou
  India to be followed

Prudential norms for NBFCs

- Income recognition
- Income from investments
- Accounting standards
- Accounting for investments
- Provision requirements
- Disclosure in balance sheet
- Constitution of audit committee
- Capital adequacy requiremnets

Link for you tube video

https://www.youtube.com/watch?v=YL10H_EcB-E