# Housing Finance System in India and China - An Exploratory Investigation

Saravanan Palanisamy and Nagarajan Ramamoorthy

Goa Institute of Management, Ribandar, Goa, INDIA

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Palanisamy Saravanan
Associate Professor,
Finance and Economics,
Goa Institute of Management,
Ribandar, Goa 403 006
Email: ps@gim.ac.in
Phone: +91 – 832-2490351
Fax: +91-932-2444136

and

R.Nagarajan
Associate Professor,
Finance and Economics,
Goa Institute of Management,
Ribandar, Goa 403 006
Email: rnagarajan@gim.ac.in
Phone: +91 – 832-2490341
Fax: +91-932-2444136

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## -An Exploratory Investigation

**Introduction:**

Housing is one of the fundamental demands for living. Access to acceptable housing is one of the elementary human needs as well as one of the keys to peace and happiness. In every country, resolving housing issues has political, social and economic significance. To solve housing issues, every country has formulated its own specific housing development program and developed its unique program operating mechanisms . Many countries have especially drawn up the development program of public housing to assist low and middle-income groups solve their particular housing-related issues.

During the last one decade, Asia Pacific economies have made significant progress in developing private housing market and market based systems for financing home purchases. Government sponsored housing finance strategies have become more and more non-viable due to budget constraints. Post 1997, Asian financial crisis, the respective Governments in Asia stepped up their effort to improve the structure of the housing finance system. Many countries even in other parts of the globe have experienced the waves of financial liberalization and deregulation. House prices have increased in most industrialised and emerging economics and in many countries housing debt per capita and house prices have reached new all-time highs (BIS, 2006).

The key factors triggering the progressive growth on the demand side are declining interest rates over a period of years, rapid increasing in income levels, tax benefits extended to borrowers whereas from the supply side the emerging competition in the housing finance sector between lenders, an increasing number of new entrants to the housing finance market, the introduction of several new products by lending institutions to meet the needs of a wide variety of customers and increasing collaboration between lending institutions and housing developers. Introduction of home loans at floating rates become popular among borrowers in Asian countries especially in India, China and Sri Lanka as the perception among the borrowers is that they could enjoy lower short-term rate which is comparatively less than long-term fixed rate (Piayasiri, 2006).

**Global Trends in Housing and Housing Finance Markets**

Housing is an integral measure of a country's development, and the way a society houses its people is an important determinant of its development and progress (Parekh, D, 2006). Housing has traditionally been one of the most important assets for households in Asia (Haibin Zhu, 2006). The cities of Indus Valley Civilisation, Harappa and Mohenjodarao are the exemplary examples for the same. Now, let us have a look at the evolution and trends in housing and housing finance markets in selected countries.

**China**

Land in this country has been nationalized and owned by the State since the formation of People's Republic of China in 1949. State Owned Enterprises (SOE) in turn provided housing to their employees as part of compensation. After the open door policy in late 1970s and the beginning of 1980s where the privately owned residential units (commodity houses) formed the basis for the private residential property market. Chinese housing policies underwent a series of changes in the 1990s. But the most interesting one happened in 1998, according to the policy, the practice of providing houses by SOE is stopped and government began to encourage workers to buy their own homes. Since the land is nationalised , home purchasers could hold legal rights to occupy the building for a specific period ( typically the tenure for residential property is 70 years; commercial building 30-50 years; and industrial property, 20 years) and could transfer the title to another party. People's Bank of China issued the guidelines to others banks in the country on granting housing loans. The new policies speeded up the privatization of residential housing and led to the full-scale development of the primary mortgage market. By the end of 2005, the majority of the residential units were traded at market prices, and the subsidized segment accounted for less than 10% of the private housing market (Haibin Zhu, 2006).

**Table No 1**
**Year to Year Growth of Real Estate Loans and Investments in China**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|---|
| Growth of real estate loans | 39% | 117% | 35% | 42% | 37% | 23% |
| Growth of real estate investment | 14% | 19% | 27% | 24% | 30% | 28% |

Source: Chang Jian Sheng, 2005

It is evident from the above table that the growth of real estate loans and investments are in an increasing trend though the year 2000 witnessed a huge hike comparing to 1999 in terms of loans. Commercial banks are currently the dominant lender in the primary mortgage market, supplemented by the Housing Provident Fund (HPF) scheme established in 1990. The HPF scheme, which follows the Singapore model, requires compulsory saving by employees (plus contributions from employers) for entitlement to a housing loan in the future. Currently, HPF loans represent approximately 12% of total mortgage balances outstanding.

## Hong Kong

Hong Kong is considered as one of the most developed mortgage market in Asia. Housing constitutes an important component of household assets and mortgage loans accounts for 25-30% (approximately) of bank loans (Haibin Zhu, 2006). The government has played a significant role in the housing market from the very beginning. On the supply side, it runs a large public housing (which includes low-cost housing and public rental units) that takes care of almost half of the country's population. Apart from this the land ownership and land restrictions by the government often restrict the adjustment of housing supply to changing demand. On the demand side, the government affects the availability of housing finance by setting limits on bank's exposure to mortgage loans and maximum loan-to-value (LTV) rations. Hong Kong Mortgage Corporation was established by the government in 1999 to promote mortgage loan securitization and to provide mortgage insurance programme for the high LTV loans. As there is no government run-housing loan bank in Hong Kong, commercial banks are the predominant source of housing finance.

## Indonesia

The law of the land in Indonesia regarding the ownership of land can be classified as follows: ownership rights, the right to build, the right to exploit and the right to use. From the beginning of 1970s housing development policy of the government has focused on providing low-cost housing for low-income householders and this is done by imposing compulsory "1:3:6" rule for developers. Accordingly, for every high cost house, developers must build minimum three middle-class houses and six simple or very simple houses. Through this rule, the government provided subsidized loans for low-cost housing through state owned mortgage banks. In terms of sales value medium and high cost houses, which represent just 10% of the housing units, have dominated the market in terms sales value. Many domestic banks and one foreign bank have been actively involved in housing finance for high-end houses.

**Korea**

Prior to 1991, Korea's housing and housing finance system used to be heavily regulated. But post 1991, due to the interest rate liberalization and financial deregulation this sector witnessed major changes. Accordingly, price controls on new apartments were abolished and market based-housing finance emerged and later by 1996 commercial banks were allowed to provide long-term mortgages. In the year 1997, Korea Housing Bank, which used to be the major player which was subsidized by the State, was privatised. After a decade of rapid growth, housing banks and commercial banks have become the major source of mortgage loans for medium and high-cost houses. For low-income homebuyers, National Housing Fund (NHF) still remains the primary funding source.

**Singapore**

Singapore's home-ownership is segmented into private and public housing markets. It is interesting to note that public housing in Singapore can be purchased by upper-or middle-income groups and hence it is not at par with the low-cost housing in other countries. The public housing sector is dominant and accounts for 84% of the total households and this is being done under the Housing Development Board which plays a major role in the demand and supply sides of the housing market and housing finance. But from 1990 onwards, the government has taken steps to encourage the development of private housing and the share of private housing has increased rapidly. With reference to housing finance there exist two systems. One is through the HDB and the other one is private mortgage system. Under the HDB system, for the first time homebuyers, the HDB grants subsidized loans or second time homebuyers who upgrade to another HDB flat. A majority of households use Central Provident Fund Scheme, a mandatory social security saving plan, to finance their home purchases.

**Thailand**

Thailand's real estate sector developed well during 1980s, a period when the Thai economy performed remarkably well. In 1986, the government issued guidelines to encourage commercial banks to participate more actively in mortgage lending. Currently, commercial banks and the Government Housing Bank (GHB) are the two dominant mortgage lenders with a combined share of 80–90%. The GHB is the leading mortgage financial institution with a market share of 39% of all residential mortgages and 48% of new mortgage originations in 2005 (Haibin Zhu, 2006).

**India**

India is considered as the birthplace of the number zero. Home to roughly 1.1 billion people, India is the second most populous country after China and is expected to overtake it by 2030. About one in every sixth person on earth lives in India, and the growth rate of the population is still rapid.

**Table No 2**
**Population and Age wise Analysis of Selected Countries**

| Age Group | India | China | US | Japan |
|---|---|---|---|---|
| 0 – 14 | 32% | 23% | 21% | 14% |
| 15 – 29 | 28% | 24% | 21% | 19% |
| 30 – 44 | 20% | 25% | 22% | 20% |
| 45 – 64 | 15% | 20% | 24% | 28% |
| Above 65 | 5% | 8% | 12% | 19% |
| Population(million) | 1066 | 1291 | 290 | 127 |

Source: Mckinsey Report 2005

It is evident from the above table that one in every three Indians is under the age of 15, and only one in three is older than 35. When comparing with other countries such as China, USA and Japan, India have the unique advantage of the higher level of middle aged and lower level of aged people. Indian GDP has grown at 6% for the past 10 years and 8% for the last 3 years and interestingly service sector accounts for 60% of GDP (Parekh, D, 2006).

**Table No 3**
**House Mortgage as a percentage of GDP**

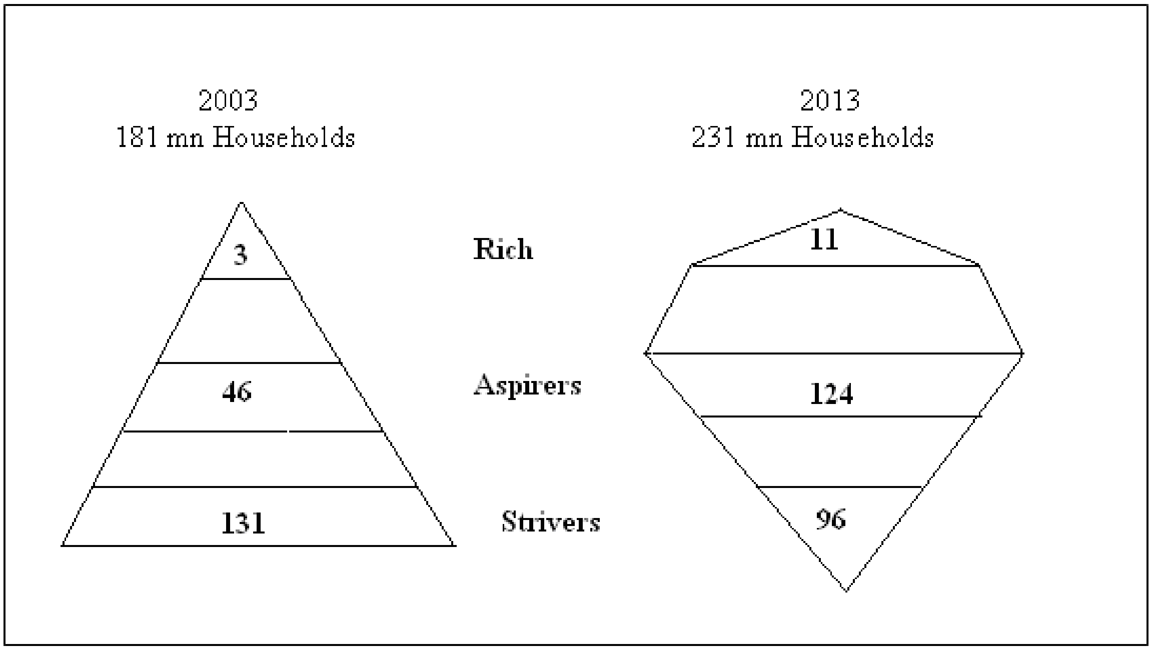
| Country | Percentage of GDP as House Mortgage |
|---|---|
| India | 4% |
| Korea | 14% |
| Thailand | 18% |
| Malaysia | 23% |
| Taiwan | 37% |
| Hong Kong | 60% |
| Germany | 52% |
| Singapore | 68% |
| USA | 86% |
| UK | 72% |
| Demark | 90% |

Source: www.economywatch.com

It could be seen from the above table that inspite of the merits highlighted in the preceding paragraphs, house mortgage as a percentage of GDP, India stands the lowest. Amongst the Asian countries, Hong Kong is the topper, followed by Taiwan, Malaysia, Thailand and Korea.

**Exhibit No.1**

**Rising Consumption Pattern in India**




Source: NCAER 2005

It could be inferred from the above exhibit that the consumption pattern in amongst Indian population is expected to change as indicated above by 2013. The strivers are less but aspirers and rich are significant higher comparing to the 2003 status.

The housing finance sector in India has undergone unprecedented change over the past two decades. Exhibit No.2 depicts clearly the existing housing finance system and Exhibit No.3 indicates the transitions.

## Exhibit No 2

## Housing Finance System in India

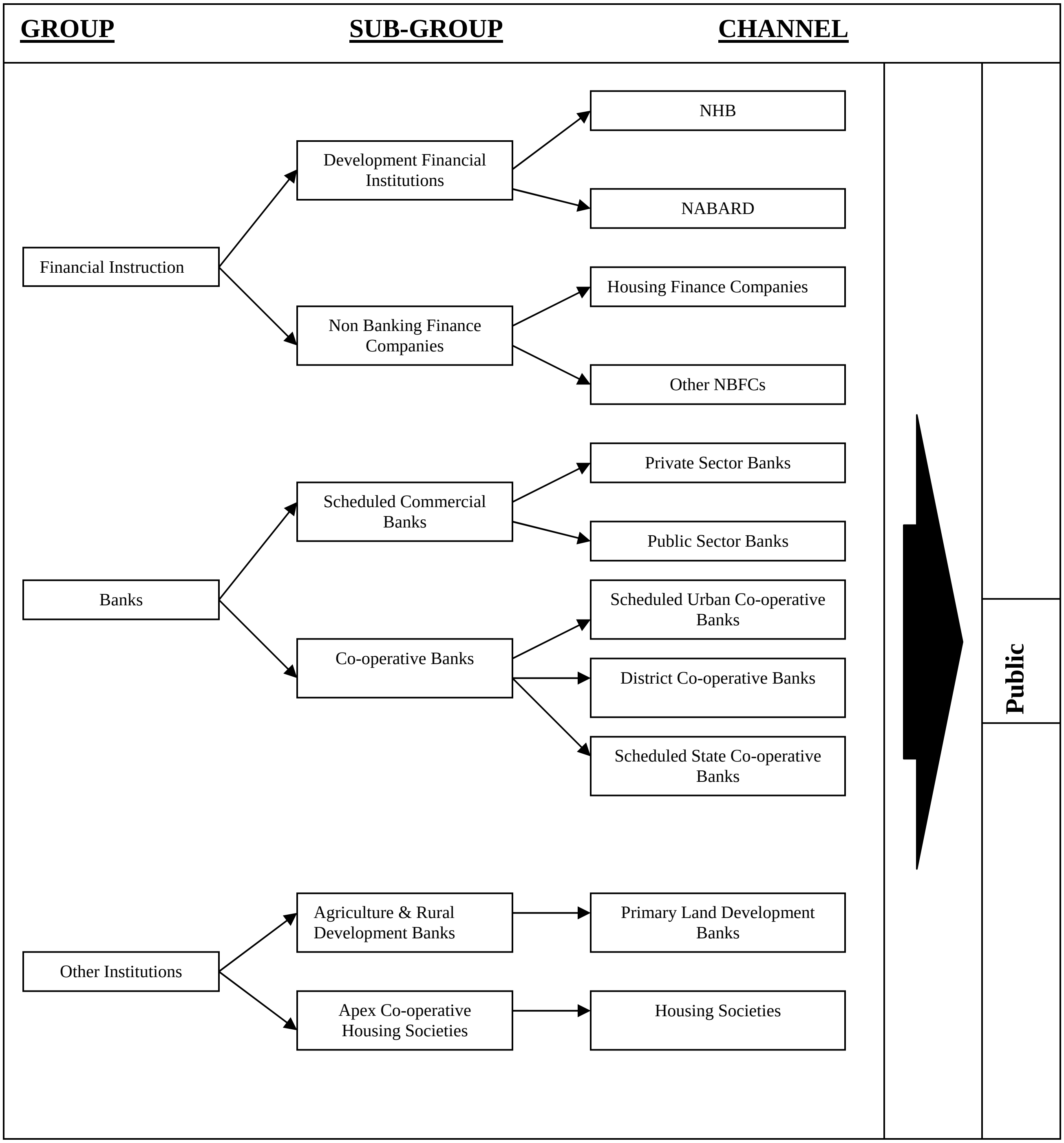


**Exhibit No 3**

**Housing Finance Market in India**

| Up to late 1990's | 1998 – 2003 | 2003 onwards |
|---|---|---|
| Phase I | Phase II | Phase III |
| Specialized Lenders Housing Finance Companies (HFCs) | Aggressive entry of Bank HFCs loose market share | Oligopolistic market structure |
| Bank / Insurance Co sponsored HFCs | Irrational competition | Top 3 key players have over 80% of incremental market share |
| Builders promoted HFCs | Rapid disbursement | More rational market |
| Company Promoted HFCs | Credit quality issues | Sustained mortgage growth at 25% |

The importance of the housing sector in India can be judged by the estimate that for every Indian rupee (INR) invested in the construction of houses, INR 0.78 is added to the gross domestic product of the country and the real estate sector is subservient to the development of 269 other industries. The real estate sector is also the second largest employment generator in the country. The government's support to housing had traditionally been centralised and directed through the State Housing Boards and Development Authorities. In 1970, the state set up the Housing and Urban Development Corporation (HUDCO) to finance housing and urban infrastructure activities. In 1977, Housing Development Finance Corporation (HDFC) was the first housing finance company in the private sector to be set up in India.

The public sector insurance companies – Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) were also mandated to support housing finance activities, both directly through their housing subsidiaries (both established in 1989) and indirectly through a mandated requirement to invest a certain proportion of their annual accretion in socially oriented schemes which includes housing. In 1988, the National Housing Bank (NHB) was established as a 100% subsidiary of the Reserve Bank of India, (the central bank of the country), to promote housing finance through a refinance mechanism to banks, housing finance companies (HFCs) and other institutions and also to function as the supervisory and regulatory body for housing finance firms.

Currently there are 29 HFCs approved for refinance assistance from NHB. Although commercial banks were the largest mobiliser of savings in the country, traditionally banks were rather reluctant to lend for housing as they preferred financing working capital needs of industry. Several banks had set up housing finance subsidiaries which functioned as independent units with little support or interest from their parent bank.

Towards the end of the 1990s, against the backdrop of lower interest rates, industrial slowdown, sluggish credit off-take and ample liquidity, and financial deregulation commercial banks shifted their focus from the wholesale segment to retail portfolios. The lower interest rate regime, rising disposable incomes, stable property prices and fiscal incentives made housing finance attractive business. Further, housing finance traditionally has been characterised by low nonperforming assets (NPAs) and given the vast demand for housing loans, almost all the major commercial banks plunged into the business of housing finance.

In this context, the policy makers are really concerned with the increase in housing prices and household indebtedness. They need to assess whether the financial sectors or household are taking on too much risk and how this might be reflected in the macro economic development. In addition to the above, banks and financial institutions fast approaching the levels of finance beyond which it may not be prudent to take further commitments, so these institutions would necessarily have to move to semi-urban and rural areas where housing is still affordable though debt service may exhibit similar characteristics of strain as in metros and urban areas.

**Objectives of the Study:**

The current work revolves around the following major objectives.

(i) To study the structural characteristics of housing finance system such as housing market and housing finance, borrowing contract types, lending and funding and regulations across the countries.

(ii) To compare and contrast the evolution and recent trends in housing finance system in India and China.

(iii) To assess the potential risk implications including the default, recovery, non-performing advances in this sector, the reasons and the recovery.

**Research Design and Methodology:**

The proposed study employs collection of relevant secondary and primary data on the housing finance system pertaining to the various countries during the period 1990-2006. This means and includes data relating to home-loan disbursements, size, and tenure of housing loan, interest rates, default rates, reasons for default, recovery process and other relevant macro economic indicators such as GDP, per capita income, per capita housing loan, mortgage ratio and the like.

The collected data will be analysed using the suitable inferential statistical tools.

**Implications and value additions:**

The main implication of this research for scholars, banking and financial institutions and policy makers concerned with housing finance system is to recognize the development in this sector as well as identifying the possible risk associated and developing the risk mitigating policies and strategies.

## Annexure -I

## Cross Country Comparison on Mortgage Type, Tenure, Interest Rate, Loan to Value Ratio and Maximum Tenure of Loan

| **Country** | **Mortgage type** | **Tenure** | **Interest rate %** | **Loan to value ratio** | **Maximum tenure of loan** |
|---|---|---|---|---|---|
| USA | Fixed rate | 15 yrs | 5.36[a] | | 30 yrs |
| | | 30 yrs | 6.05[a] | 80% | |
| | Floating rate | 1 yr | 3.7[a] | | |
| China | Fixed rate | 1 – 5 yrs | 4.77 | 80% | 30 yrs |
| | | 6 – 30 yrs | 5.04 | | |
| Singapore | Fixed rate | Year 1 | 1.61[b] | 80% | 30 – 35 yrs |
| | | Year 2 | 2.72[b] | | |
| | | Year 3 | 2.89[b] | | |
| | | Thereafter | 3.75[b] | | |
| | Flexible rate | Year 1 | 1.59[b] | | |
| | | Year 2 | 2.38[b] | | |
| | | Year 3 | 2.92[b] | | |
| | | Thereafter | 3.40[b] | | |
| Canada | Fixed rate | 6 months | 5.45[c] | 75% | 25 yrs |
| | | 1 yr | 4.55[c] | | |
| | | 2 yrs | 5.08[c] | | |
| | | 3 yrs | 5.72[c] | | |
| | | 4 yrs | 6.22[c] | | |
| | | 5 yrs | 6.43[c] | | |
| | | 7 yrs | 7.53[c] | | |
| | | 10 yrs | 7.95[c] | | |
| | Variable rate | | 4.38[c] | | |
| Thailand | Fixed rate | 1 yr | 3.00[d] | 80% | 30 yrs |
| | | <u>2 yrs step up</u> | | | |
| | | Year 1 | 3.75[d] | | |
| | | Year 2 | 4.00[d] | | |
| | | <u>3 yrs step up</u> | | | |
| | | Year 1 | 3.25[d] | | |
| | | Year 2 | 4.25[d] | | |
| | | Year 3 | 5.25[d] | | |
| | | 5 yrs* | 7.00[d] | | |
| | <u>Floating rate loan Amt</u> | | | | |
| | Less than 200000 baht | | 6.00[d] | | |
| | 200000 – 300000 baht | | 6.50[d] | 80% | 30 yrs |
| | More than 300000 baht | | 6.75[d] | | |

a. Average of the mortgage rates offered by ASBC, Hong Kong, Singapore Finance, NTVC, DBS, May Bank and United overseas Bank Group in October, 2003.
b. Average of the mortgage rates offered by Royal Banks of Canada, HSBC and Apex Credit Union on October 2003.
c. Mortgage rates as on 24th February 2003.
d. Average of the offered by thrifts, commercial banks and mortgage lending companies for the week ended 16th October 2003 as published in the weekly mortgage rates release of Freddie Ma.

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