U N C L A S S I F I E D

AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D. C. 20523

PROJECT PAPER

INDIA: Housing Finance System
Program (386-HG-003)

September 20, 1988

U N C L A S S I F I E D

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)

Amendment Number

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: INDIA

3. PROJECT NUMBER: 386-HG-003

4. BUREAU/OFFICE: ASIA AND NEAR EAST

5. PROJECT TITLE (maximum 40 characters): HOUSING FINANCE SYSTEM PROGRAM

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM DD YY

7. ESTIMATED DATE OF OBLIGATION (Under "B" below, enter 1, 2, 3, or 4)

A. Initial FY 88 B. Quarter 4 C. Final FY 93

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 89 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	330	70	400	2,265	635	2,900
(Loan)						
Other U.S. 1. HG LOAN					50,000	50,000
Other U.S. 2.						
Host Country		10,240	10,240		53,000	53,000
Other Donor(s)						
TOTALS	330	10,310	10,640	2,265	103,635	105,900

9. SCHEDULE OF AID FUNDING ($000)

A. APPRO-PRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan HG	F. LIFE OF PROJECT 1. Grant	2. Loan HG
(1)	720	810	866	2,900			50,000	2,900	50,000
(2)									
(3)									
(4)									
TOTALS				2,900			50,000	2,900	50,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 819

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

PROMOTE THE DEVELOPMENT OF A FINANCIALLY SOUND, SELF-SUSTAINING HOUSING FINANCE SYSTEM WHICH MAKES LONG-TERM SHELTER FINANCE AVAILABLE TO A WIDE RANGE OF HOUSEHOLDS, PARTICULARLY THOSE BELOW THE MEDIAN INCOME.

14. SCHEDULED EVALUATIONS

Interim MM YY 06 90 | MM YY | Final MM YY 06 93

15. SOURCE/ORIGIN OF GOODS AND SERVICES: 000 / 941 / Local / Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

APPROVED BY

SIGNATURE

TITLE : CONTROLLER

DATE SIGNED 09/20/88

17. APPROVED BY

Signature

Title: DIRECTOR, USAID/INDIA

Date Signed MM DD YY 09 20 88

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION

MM DD YY

GUARANTY AUTHORIZATION

No. 386-HG-008

PROVIDED FROM: Housing Guaranty Authority

FOR: India - Housing Finance System Program

Pursuant to the Foreign Assistance Act of 1961, as amended (FAA), and the Delegations of Authority issued thereunder, and the specific delegation of Authority to the Mission Director, USAID/India, contained in 88 State 155515, I hereby authorize the issuance to eligible U.S. investors (Investors) acceptable to A.I.D. of guaranties pursuant to section 222 of the FAA of not to exceed Twenty Five Million United States Dollars ($25,000,000) in face amount. The guaranties shall assure against losses (of not to exceed one hundred percent (100%) of loan investment and interest) with respect to loans, including any refinancing thereof, made to finance housing projects in India. These guaranteed loans shall be made to the National Housing Bank of India, or such other financial institution as A.I.D. may otherwise agree, (borrower) to provide long-term financing for low income housing through the National Housing Bank of India.

These guaranties shall be subject to the following terms and conditions:

1. **Term of Guaranty:** The loans and any refinancing thereof shall extend for a period of up to thirty (30) years from the date of disbursement and may include a grace period of up to ten (10) years on repayment of principal and may include such terms and conditions as shall be acceptable to A.I.D. The guaranties of the loans shall extend for a period beginning with the first disbursements of the loans and shall continue until such time as the Investor has been paid in full pursuant to the terms of the loans.

2. **Interest Rate:** The rate or rates of interest payable to the investor pursuant to the loans shall not exceed the allowable rate of interest prescribed pursuant to Section 223 (F) of the FAA and shall be consistent with rates of interest generally available for similar types of loans made in the long term U.S. capital markets.

3. **Government of India Guaranty:** Prior to disbursement of any loan amounts pursuant to this guaranty authorization, a written guaranty to indemnify A.I.D against all losses arising by virtue of A.I.D.'s guaranties to the Investor or from non-payment of the guaranty fee shall be provided in a form satisfactory to A.I.D. by the Government of India or a financial institution authorized by the Government of India to provide such a guaranty and approved by A.I.D.

4. **Fee:** The fee of the United States shall be payable in dollars and shall be one-half percent (1/2%) per annum of the outstanding guarantied amount of the loans plus a fixed amount equal to one percent (1%) of the amount of the loans authorized or any part thereof, to be paid as A.I.D may determine upon disbursement of the loans.

5. **Other terms and conditions:** The guaranties shall be subject to such other terms and conditions as A.I.D. may deem necessary.

Robert N. Bakley
Director
USAID/India

20 Sept 88
Date

386-HG-008

Guaranty Authorization

Clearances:		
	DD: DPfeiffer	Date 9-20-88
	DPP:CDCrowley	Date 9-20-88
	CO :GAEidet	Date 9-20-88
	PRJ:SFreundlich	Date 9-20-88
	TDE:RWBeckman	Date 20 Sep 88
	RHUDO/Asia:DPainter	Date 9/20/88
	GC/PRE:MKitay (By Phone)	Date 9/20/88

Abbreviations

ADB	Asian Development Bank
CRISIL	Credit Rating Information Services of India
DFC	Department of Financial Companies
EDI	Economic Development Institute
GIC	General Insurance Corporation
GOI	Government of India
GRUH	Gujarat Rural Housing Finance Corporation
HDFC	Housing Development Finance Corporation
HFC	Housing Finance Company
HG	Housing Guaranty
HSMI	Human Settlements Management Institute
HUDCO	Housing and Urban Development Corporation
ICICI	Industrial Credit and Investment Corporation of India
IDBI	Industrial Development Bank of India
IHFD	India Housing Finance & Development Ltd.
KfW	Kreditanstalt fur Wiederaufbau
LIC	Life Insurance Corporation
MBS	Mortgage-backed securities
MOF	Ministry of Finance
NHB	National Housing Bank
ODA	Overseas Development Administration
RBI	Reserve Bank of India
RHUDO	Regional Housing and Urban Development Office
TA	Technical Assistance
UNCHS	United Nations Centre for Human Settlements
UTI	Unit Trust of India

Fiscal Year

NHB July 1 - June 30

Currency

Rs.14.00 = $1.00
Rs.1 lakh = Rs.100,000
Rs.1 crore= Rs.10,000,000

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I. SUMMARY AND RECOMMENDATION

A. INTRODUCTION AND PROGRAM HISTORY

Since 1981, the Housing Guaranty (HG) program in India has focused support on the Housing Development Finance Corporation (HDFC), a joint sector mortgage lender which started operations in 1978. Under the Government of India's (GOI) highly regulated financial system and its use of directed credit, HFDC, as a market-oriented housing finance institution, was at a severe disadvantage in mobilizing resources fo lending to household borrowers.

The HG support to HDFC has consisted of total HG authorizations of $125 million, of which $90 million have already been disbursed to reimburse HDFC for eligible mortgages, i.e., that portion of their porfolio which represents loans to households having incomes below the median. The program, whose intent was to strengthen HDFC's ability to provide housing finance to lower income households, has been successful. It provided critically needed lending capital to the institution in its early years, and HDFC's success in market-oriented lending on sound commercial principles has attracted other private and joint sector companies to housing finance. It has also attracted funding from other international sources, such as the German KfW and the World Bank, which has just approved a $250 million loan to HDFC.

As the current HG program comes to a close, the Government of India (GOI) has indicated that it wishes any future HG program to take new directions. Similarly, USAID/New Delhi, recognizing that the role of HDFC in advancing the goals of the housing program has largely been fulfilled, intends to use the experience of the current program to expand the market-oriented housing finance system by directing HG support to the new private and joint sector (firms owned jointly by public and private entities) housing finance companies.

The program will seek to develop a system of market-oriented housing finance companies by (1) providing critically-needed lending capital to meet near- and mid-term needs of eligible companies serving a number of geographic areas; (2) fostering a relationship between recent entrants to the sector and the newly established National Housing Bank in order to improve the new firms' ability to mobilize resources, manage their portfolios, increase lending to low income households, and operate more effectively within the existing public policy environment; and (3) addressing a number of sectoral constraints on expanding the system, through technical assistance, training and policy dialogue. In its focus on a market-oriented system to serve low income households, the program presents an innovative approach to housing finance within the Indian financial and political context. By directing support to a number of private and joint sector companies, rather than to a single well-established joint sector company, the program continues to break new ground in the Indian housing sector.

B. SUMMARY OF PROBLEM TO BE ADDRESSED

GOI credit policies, affecting both public and private sector investment, have directed funds away from the housing sector. At the same time, India's population has continued to grow at high rates, 3-4% in urban areas over the last two decades, and urban migration has increased with industrialization and economic growth. Not surprisingly, then, an enormous deficit in housing units has built up, estimated at over 7 million urban units in 1988. Population growth alone results a need for about 1.5 million new units annually over the next decade. (See Section II.A.)

Concurrent with the rise in the housing deficit has been a deterioration in the condition of the housing stock, characterized by overcrowding, inadequate per capita floor space, and a decline in owner-occupancy. Although access to water and sanitary facilities has improved in urban areas, the proportion of people living in slums has increased.

Due in part to constraints on the formal housing finance system, described in greater detail in Section III.A, the vast majority of the demand for housing is being financed by the informal sector. This means that savings and investments that might enter the formal finance system via the housing sector are effectively lost to the capital market; it also means that poor households who must borrow on the informal market are likely to be paying much higher rates of interest for much shorter periods than the formal system could offer if it had sufficient lending capital.

The GOI has recognized the need for private as well as public involvement in meeting the demand for housing finance, and the national housing policy promulgated in 1988 addresses the need for mobilizing resources for public, cooperative and private financing institutions.

The commercial market, meanwhile, seeing HDFC's success, has already responded to the possibilities for tapping the potentially huge market by producing a number of private and joint sector housing finance companies, whose potential is assessed in this paper.

C. SUMMARY PROGRAM DESCRIPTION

The Housing Guaranty program is designed to expand and deepen the market-oriented housing finance system by directing HG-003 support to a group of private and joint sector housing finance companies. The program will channel funds through an intermediary, the National Housing Bank (NHB), which will on-lend rupees to housing finance companies that meet eligibility requirements: principally, adherence to sound commercial and financial practices and lending to households below the median income.

The NHB, or its designee approved by the GOI and AID, will borrow dollars on the U.S. market, utilizing the AID guaranty. It will generate an equivalent value in rupees which will be used to capitalize a loan fund for the participating companies, which will be able to obtain advances based on their needs for funding mortgages for households below the median income.

The funding required over the five year life of project is estimated at $50 million. An analysis of the demand for funds by the primary lenders indicates an absorptive capacity sufficient to utilize at least this amount. $25 million of program resources will be reserved for firms which are entirely in private ownership. In order to achieve a broad-based dispersion of funds, no single company will be able to receive more that 25% of the total amount of HG funding without the express consent of AID.

The commercial risk of the rupee transactions will be borne by NHB, which will review funding requests from candidate companies according to lending standards agreed with AID based in part on financial ratios applicable specifically to housing finance. The foreign exchange risk of the dollar transaction will be borne by a financial institution designated by the GOI and approved by AID. As intermediary, NHB will assume primary responsibility for program implementation. AID will not approve or disapprove individual on-lending transactions except to verify that they conform to the eligibility requirements contained in the Program Implementation Agreement agreed between NHB and AID. AID's monitoring of the program will be designed to ensure conformity with the program's conditions and covenants agreed with NHB: e.g., all HG eligible mortgages provided to borrowers with below median income, standards for eligibility of primary lenders, minimum funding for private sector companies, affordability criteria, resource mobilization efforts.

Technical assistance and training are an important component of the program. TA and training will be directed both at NHB, to enable it to administer housing finance programs, and at the primary lenders, to enable them to function efficiently and, most importantly, to help them mobilize resources in addition to HG funds.

While the major thrust of the program is development of the commercially-oriented primary mortgage market, a related activity involves assessment of the potential for development of secondary market facilities. While actual HG support would be premature, laying the foundations for a secondary market at this stage is prudent, given the market's need for increased liquidity.

D. ISSUES IDENTIFIED DURING PID REVIEW

There were no issues identified by the ANE Project Review Committee which would prevent project development. However, there were several comments in the PID approval cable (Annex 1) which have been taken into consideration as project design has progressed:

1. The relationship of the HG program to the Mission's CDSS is more fully described in Section II.B.4. Briefly, the HG program most directly addresses USAID's efforts in poverty alleviation, by increasing the resources available to low income households for improvement of their shelter situation. Indirectly, increasing the amount of investment in financial assets will contribute to overall economic growth, though this effect will be too small to be measurable, at least during the life of the project.

2. The policy agenda to be advanced by the program addresses the need of the fledgling housing finance system for liquidity and, simultaneously, to support the GOI's own policy initiatives. There are several policy areas where the GOI is currently moving ahead, and where AID resources can support its efforts. These include the mobilization of additional domestic resources for housing, extension of the benefits of housing finance to lower income households and to wider geographic areas, and strengthening sustainability of the system by laying the groundwork for development of a secondary mortgage market.

Regarding the existence of other constraints to the growth of commercial financing of housing for low income households, the needs for increased liquidity in the system are so overwhelming that project developers do not consider it feasible or, indeed, necessary to try to use a $50 million program to address other constraints (such as urban land prices, tenure and titling problems, inadequate urban infrastructure, etc.). An urban sector assessment to be completed during the course of HG-003 implementation will take a closer look at other constraints and how best to address them.

Section II.C of the Project Paper describes the financial and administrative requirements which NHB will apply to primary lenders. Domestic savings mobilization will be a subject of technical assistance, and evidence of effort in this area will be a condition of future year disbursements to mortgage lenders. However, reviewers should clearly understand that the array of GOI policies affecting the ability of housing finance companies to mobilize institutional resources cannot be directly affected by the HG program.

3. The technical assistance and training components of the program have been expanded upon in Section IV.B and Annex 7.5.

4. The Project Paper reserves $25 million for primary lenders in exclusively private ownership.

5. The NHB, or its approved designee, will be the borrower of HG dollars and will provide the guaranty of repayment in dollars.

6. See Section IV.D for the monitoring and evaluation plan.

E. RECOMMENDATION

The program design team recommends that the Mission Director (1) approve a $50 million Housing Guaranty Loan to support the India Housing Finance System Program and (2) authorize the guaranty of a $25 million loan to the National Housing Bank in FY 1988. A subsequent authorization of $25 million will be contingent on evidence of adequate progress toward program goals and on the demonstrated financing needs of the participating companies.

II. PROGRAM RATIONALE AND DESCRIPTION

A. THE HOUSING SITUATION IN INDIA

India's urban population is estimated to be about 208 million in mid-1988, and is projected to increase to 314 million by 2000, an average increase of almost 9 million people a year. This implies a need for about 1.5 million new houses annually, for the increase in population alone. Official estimates of the housing deficit - 29 million units in 1988, of which about a quarter are for urban households - demonstrate the magnitude of the country's housing problem. The statistics also provide an indication of the potential size of the market for housing in a country as large and diverse as India.

There are many reasons for the high and continuing deficit, among which are high prices for land, infrastructure and housing construction. These in turn result to a large extent from inappropriate government standards, regulations and controls. The inadequate supply of institutional finance has been identified as one of the more serious constraints on the development of the housing sector by a series of GOI policy statements, from a Planning Commission Task Force (1983), through the Seventh Five Year Plan (1985) to recent ministerial statements to the press (Annex 7.3).

It is symptomatic that the share of housing investment in GDP has fallen from 5% in the 1960s to around 3% in the 1980s and that housing investment has fallen from 34% of total investment in the First Plan to 10% in the Seventh Plan.

Indicators of housing condition suggest that the deficit has been growing at a similar rate to that of the urban population, and that housing conditions have generally been deteriorating in the last intercensal period. For instance,

- overcrowding has increased;
- the average per capita floor space is low and declining;
- in most metropolitan cities there has been a fall in rates of owner-occupation; but
- on the other hand, access to water and sanitation have been improving: by 1985, 73% of the urban population had access to "safe water supply", and 28% to "sanitation".

The proportion of households living in slums has increased, to the extent that the National Buildings Organisation estimates that in 1988 slum dwellers form 32% of the population in Delhi, 38% in Bombay and 42% in Calcutta. The same study finds that almost 70 per cent of Delhi's population lives in sub-standard conditions. (See article "Acute Housing Shortage in Major Cities", reproduced in Annex 7.3.)

The housing finance system is itself constrained by a number of factors, predominantly by a shortage of capital at a readily acceptable price. Most formal financial resources are mobilized from institutions and capital markets under a system of allocated and controlled credit: closely parallelling the structure of the financial sector as a whole. Certain minor reforms and realignments of interest rates have been achieved in the recent past, but structural change remains a priority. There are signs of increasing strain in the markets as financial resources become increasingly scarce and of higher cost.

The inefficiencies of the present finance system are such that about 80% of capital for new housing derives from informal sources. Only a small proportion of finance is provided by the public sector, and most of this is subsidized and used ineffectively. The private housing finance system has been growing rapidly in recent years, but meets only a tiny proportion of total need, and is perceived to be better positioned to meet the needs of upper-middle income households than of the urban poor.

Other problems relating to housing finance include credit risk (mortgage lenders are effectively unable to foreclose on defaulters), the absence of a system of mortgage insurance, the lack of any effective regulatory system, the poverty of current research into most aspects of housing finance, and inadequate training facilities.

B. PROGRAM STRATEGY AND OBJECTIVES

1. Government of India Shelter Policies

Certain objectives have marked India's development strategy since Independence, and continue to influence the logic of the GOI housing policy. Most notably, these include:

> "Reduction in inequalities...
> Development of a mixed economy with a strong public sector, especially in key areas of the economy...
> Promotion of balanced regional development..." (Ahluwalia, p.346)

From the time of Independence in 1947 it was taken as a principle of faith that the public sector must play a direct role in the provision of housing, particularly for low income households. Attempts to address the problem on the public side have concentrated on the direct financing of housing construction via the Housing and Urban Development Corporation (HUDCO) by various public housing boards at the state level. Cost recovery on these programs has been so poor as to serve as an effective subsidy for households which are often of middle income or even higher.

Recent years have, however, witnessed a marked move towards restructuring the economy through a process of liberalization and increased reliance on market mechanisms in a number of areas, including shelter. There is a gradually widening understanding among policy makers, practitioners and academics that the public sector is not necessarily either the correct or the best medium for the provision of housing units. For instance, the national housing policy states that

> "Housing agencies and area development authorities in the public sector will ... be reoriented to act more as promotors and facilitators of housing activity rather than builders of housing units..."

A recent seminar co-sponsored by the Ministry of Urban Development confirmed that public sector institutions should take as their primary responsibility the creation of an "appropriate and enabling environment so that other partners in the housing sector can successfully add to the national housing stock...". At the same time, it was made abundantly clear that, although the role of the private corporate sector is recognized, the greater part of the responsibility for construction is envisaged to be assumed by the household and cooperative sectors. Similarly, although there was seen to be a role for the private sector in the provision of mortgage finance, it was not seen as appropriate for it to take a leading role. (See article, "Housing Policy", in Annex 7.3.)

The importance of housing finance as a component of the housing delivery system was recognized in the 1970s, first with the creation of HUDCO and then in 1977, of HDFC. It was, however, not until the mid-1980s that any systematic attention was given to the development of a housing finance system. This attention was first articulated in the *Seventh Five Year Plan* (1985-90), published in October 1985, which indicated clear support for a more diversified and responsive housing finance system. The thrust of the Plan was that the supply of funds available for housing finance should be increased by tapping household savings rather than by increasing budget allocations. Without spelling out how this would occur, the creation of a national housing bank was seen as an essential precondition for resource mobilization and system development.

Subsequently, the Reserve Bank of India (RBI) established a committee to examine the institutional framework for housing finance. That committee confirmed its support for an apex housing bank, which would have the functions of coordination and regulation of the industry, the provision of financial support to housing finance companies, and would have an advisory and policy making role. It recommended that there should be "local level institutions to mobilise household savings and provide home loans"; and proposed the establishment of new institutions "of the HDFC type".

Legislation to establish the National Housing Bank (NHB) was approved in December 1987, giving it the authority to undertake a wide variety of activities, as envisaged by the RBI committee. Annex 4.1 describes the extent of the powers given to the NHB. Parliament authorized the provision of Rs.100 crores of capital for the Bank, with an additional Rs.100 crores to be used exclusively for providing finance for rural housing.

By September 1988, the Chairman of the Bank and a number of staff had been appointed and policy papers were being drafted for consideration by the Board. It is clear that the relevant GOI ministries (Urban Development, and Finance) regard the NHB as the ultimate authority for coordinating activities in the sector. There is no doubt but that it will have the power to shape the future of the housing finance industry.

Other sectoral developments in the recent past include examples of a desire to address legal constraints to housing development, the urban land ceiling legislation and rent control legislation in particular; the formation of a working group to establish a mortgage insurance system; expressions of intent to expedite the foreclosure processes; and increasing interest shown in the development of a secondary mortgage market in India.

2. Program Goal and Purpose

The sector goal is to improve the housing conditions of low income households. The program goal is to increase the availability of formal housing finance to low income households nationwide.

The purpose of the proposed program is to promote the development of a financially sound, self-sustaining, housing finance system which makes long-term shelter finance available to a wide range of households, particularly those below the median income.

3. Program Strategy

AID has determined that the best way to achieve the program's goal and purpose is to foster the development of a number of small, market-oriented housing finance companies (HFC), both private and joint sector. By making an additional $50 million (Rs.70 crores) immediately available for households below the urban median, by demonstrating that lending to such households is commercially viable and by assisting emerging HFCs to develop socially productive lending programs, AID's strategy will increase the number of low income households having access to mortgage credit. By strengthening several HFCs, the strategy will encourage competition and its associated efficiencies and simultaneously will permit specialization and innovation. By offering technical assistance, including funding for research and workshops, and training for housing finance, the strategy will support GOI initiatives for development of the housing sector.

The most important constraint on the growth of these companies is lack of access to lending capital. This is reiterated by the management of the various HFCs, and confirmed by AID's own review of the financial operations of the companies. The loan fund to be established by the HG program will address this immediate need by providing a line of credit to be used by companies to support mortgage lending to below-median income households. At the same time, companies will be assisted and required to find ways to mobilize other resources to ensure the long term sustainability of the system. The program will do this by conditioning HG capital assistance on active efforts by the HFCs to develop other sources of funding, both institutional and household, and by providing technical assistance and training in resource mobilization. The program structure will be utilized to offer assistance to strengthen and develop related components of a fully-functioning market-oriented housing finance system. It will promote appropriate research, offer technical assistance for sector development, and provide limited training for senior housing finance professionals. Additionally, the NHB will be instrumental in conducting a policy dialogue with the GOI to develop a public policy environment which treats housing finance in a more balanced way than hitherto.

Another concern in developing the network of companies is the longer term need for standardization in lending and appropriate levels of regulation, first to ensure a viable system in which the public has confidence and second, to form a sound base for possible future secondary market activity, which could serve to increase the flow of resources into the housing sector as well as strengthen the capital markets.

The program will achieve these ends by seeking the participation of private and joint sector companies which conform to standard eligibility criteria. These include using sound underwriting practices, operating on market principles, implementing adequate collections procedures, and lending to households below the median income. Because firms need the HG capital, they will adjust their current lending and management practices to conform to certain minimum standards. The program will thus encourage the system to become self-sustaining.

The role of the NHB will be to evaluate the candidate companies, to select those which meet the criteria for participation, and to carry out actual implementation activities. In addition, the NHB will play the key strategic role of conductor of a policy dialogue with the GOI regarding housing finance policy.

4. Relationship to the CDSS

The Mission's CDSS for 1989-94 was completed in June 1988. It recognizes that India's primary challenge in the next decade will be to sustain and accelerate its recent economic achievements in the face of massive poverty, a persistently high population growth rate and increasing strain on its financial, institutional and natural resources. Only by increasing the productivity and efficiency of its resources and investments across the board will India be able to maintain a growth path to middle-income status in the next twelve-fifteen years. The strategy aims to support such an evolution by addressing the critical constraints to increased growth and productivity while ensuring complementary, well-targetted actions against poverty among India's most vulnerable groups.

The housing finance system program is entirely consistent with and supportive of this strategy. The program will lower the cost of housing finance to below-median income households, who must currently raise capital at high cost from informal sources. It will thereby directly contribute to the Mission goal of poverty alleviation. At the same time, by increasing the housing stock and thereby reducing the demand for subsidized housing by households who are able to afford market rates, the program will also improve the accessibility of the poorest households to affordable housing. The growth of a formal housing finance system may be expected to increase the rate of financial savings of households and thereby to contribute to accelerating national economic development. Through assisting the development of a secondary mortgage market and other means, the program will also address the issue of raising the level of efficiency in financial markets.

C. PROGRAM DESCRIPTION

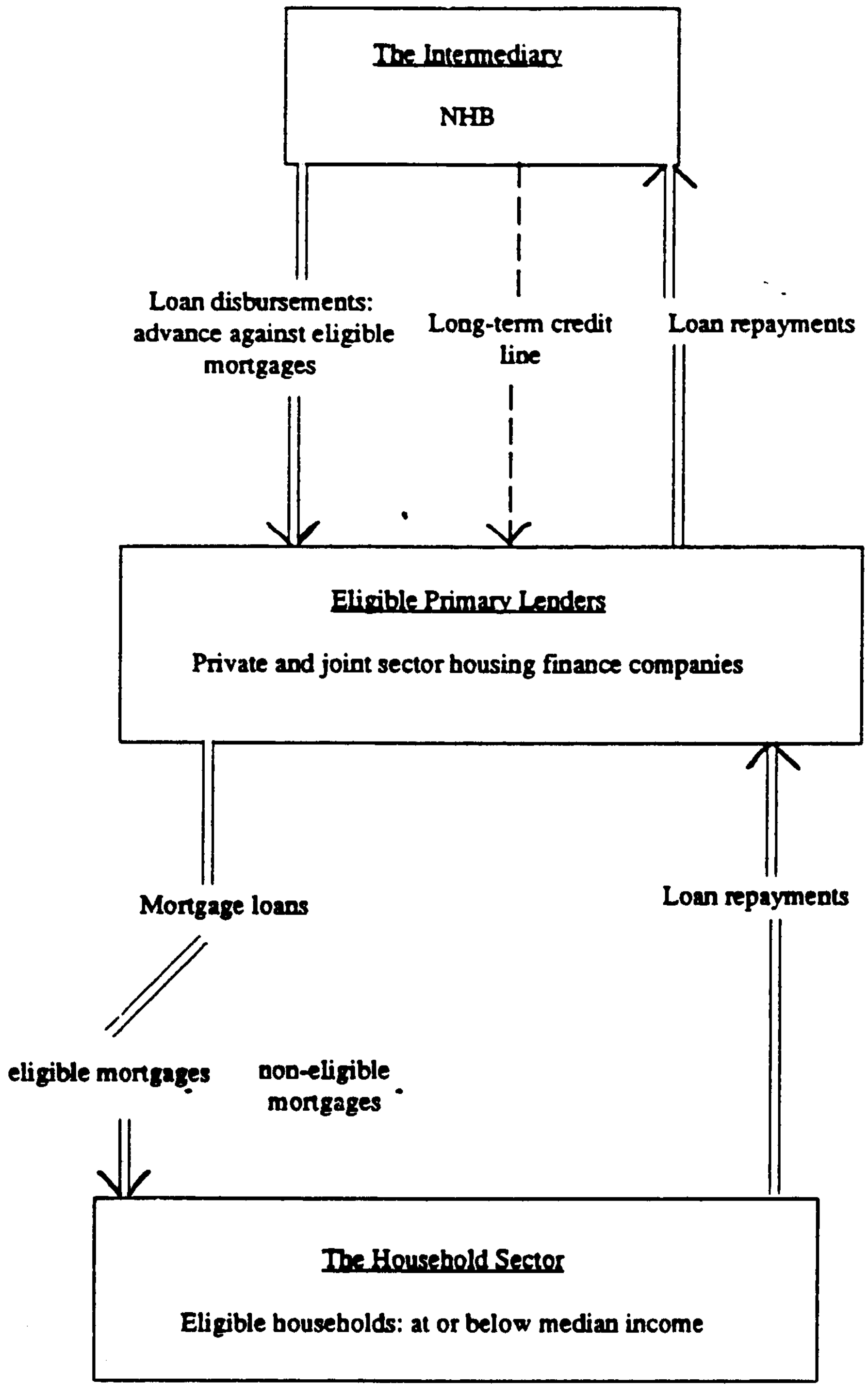
1. Overview of the Program

The current Housing Guaranty Program is designed to expand and deepen the market-oriented housing finance system by directing HG support to a group of private and joint sector housing finance companies. The program will channel funds through an intermediary, the National Housing Bank (NHB), which will on-lend rupees to housing finance companies that meet eligibility requirements. (See "Eligible Borrowers", paragraph 3b below.) The NHB, or its approved designee, will borrow a total of $50 million which will be used to generate an equivalent value in rupees (Rs.70 crores) which, in turn, will be used to capitalize a loan fund for the participating housing finance companies (HFCs). The loan fund will be managed by the NHB.

The funding required over the five year life of the project is $50 million. An analysis of the demand for funds by the primary lenders indicates an absorptive capacity well able to utilize this amount (Annex 6.4). Reconsideration of the level of funding may be warranted as the program progresses, however, since projections are difficult to make at

Figure 1

Flow of Project Funds



the current time for newly-established organizations. Figure 1 presents a schematic overview of the flow of funds between NHB, its primary lenders and eligible households.

Within the limits of HG resources, the program seeks to broaden the geographical and institutional base of commercially-oriented housing finance activities to the maximum extent possible. HDFC, government and cooperative housing finance institutions will not be eligible, nor will closely held organizations established solely to support contractor activities. Rather, by encouraging private and joint sector companies, many of which are small and recently established, the program hopes to enhance confidence in the system, thereby enabling these firms to mobilize additional funding on an ongoing basis. Some companies have already mentioned possible USAID support in their promotional materials, in the belief this will attract other investors. Also, having an established relationship with NHB, the apex bank for housing finance, will provide security for potential investors. Evidence of efforts to mobilize additional resources on the part of participating housing finance companies will be a criterion for continued HG support to the HFCs and will be embodied in the on-lending agreements between them and NHB, and NHB will monitor progress. (See "Line of Credit between NHB and Primary Lenders", paragraph 3h below.)

$25 million of program lending will be earmarked for private sector companies. In addition, AID will discuss with NHB possible mechanisms for achieving the broad-based dispersion of funds discussed above; these will include a maximum loan disbursement of 25% of the total HG program to any single primary lender unless AID otherwise agrees. Participating borrowers will apply to NHB for loan funds according to agreed-upon principles regarding lines of credit and advances against eligible mortgages (paragraph 3h below). The commercial risk of transactions between NHB and its borrowers will be assumed by NHB. NHB will review the requests according to standards of commercial lending agreed with AID, including assessment of capital, asset quality, liquidity, earnings and management. NHB has agreed to consider utilization of an established organization with expertise in credit rating in order to develop appropriate criteria and mechanisms for this. In addition, NHB will adopt appraisal procedures with key financial ratios pertinent specifically to housing finance (paragraph 3(b) below).

NHB will assume responsibility for implementation of the program. AID will not approve or disapprove individual on-lending transactions. Rather AID's monitoring and evaluation of the program will be designed to ensure conformity with conditions and covenants established between AID and NHB and the framework of the agreements between NHB and the primary lenders. These conditions, including preparation of a Master Program Implementation Plan, will establish (1) standards regarding eligibility of primary lenders, (paragraph 3b) (2) standards regarding minimum funding of private sector companies and disbursement (paragraph 3c) (3) affordability criteria and standards for eligible beneficiaries (paragraph 3d), (4) provisions regarding loan servicing, program evaluation, audit and so forth (paragraph 3h). Within this general framework, NHB will specify lending terms and conditions, reporting requirements, suggest training requirements and organizational improvements, and review plans by the primary borrowers to mobilize additional resources (paragraphs 3f and 3g).

Technical assistance and training are an important component of the program. This is particularly true for the primary lenders who can be expected to benefit from a wide range of resource development programs including management and control, strategic planning, information systems, appraisal, mortgage origination, resource mobilization, and outreach for low income lending. NHB will identify the training needs of its borrowers and recommend to AID how best to secure needed training. In addition, NHB will work with AID to design and implement a program of technical assistance and training for the NHB itself with the objective of developing the NHB's capability to play its central role in the Indian housing finance system. As discussed below, NHB's appraisal and monitoring procedures will be designed to meet the requirements of on-lending to housing finance institutions. Resource mobilization and introduction of new lending instruments that assist in increasing the affordability of lending terms to low income households are also topics for technical assistance and training.

While the major thrust of the program is development of the commercially oriented primary mortgage market, a related activity involves assessment of development of secondary market facilities. It is widely agreed that serious structural constraints continue to hinder the development of the primary market, including the lengthy and cumbersome foreclosure procedures and the lack of mortgage insurance. AID will continue to address these issues through whatever technical assistance and research is deemed advisable. It is also prudent, however, to begin efforts to lay the foundations for a secondary market. Despite the current immaturity of the primary market, its potential is enormous. Provision of incentives for adherence to sound commercial principles and lending practices can help improve the marketability of low income mortgages, and eventually mortgage refinancing facilities could help address one of the market's major problems - lack of liquidity. (For further discussion of the potential for secondary market activity, see Annex 5.)

2. The Intermediary

a) Housing Guaranty Loan Borrower: The NHB will be the intermediary for the program. Either the NHB or another financial institution agreed by the GOI and AID will be the borrower of HG funds. The National Housing Bank Act of 1987 permits the NHB to undertake foreign borrowing under the terms of Chapter IV, section 16 which states:

> "16.(1) Notwithstanding anything contained in the Foreign Exchange Regulation Act, 1973 or in any other law for the time

> being in force relating to foreign exchange, the National Housing Bank may, for the purpose of making loans and advances under this Act, borrow in such manner and on such conditions as may be prescribed in consultation with the Reserve Bank and with the previous approval of the Central Government, foreign currency from any bank or financial institution in India or elsewhere.
>
> "(2) The Central Government may, where necessary, guarantee any loan taken by the National Housing Bank under sub-section (1) or any part thereof as to repayment of principal and the payment of interest and other incidental charges."

Although the NHB is permitted to undertake foreign currency borrowing, its operations will be conducted in rupees and will not produce foreign currency earnings. For that reason it will be necessary for either the GOI, or a financial institution approved by the GOI and AID, to carry the foreign exchange risk associated with the HG loan on behalf of the NHB. This may be done through any mechanism mutually agreed by the GOI and AID including the designation of another financial institution that would enter into the HG loan on behalf of NHB and provide NHB with the rupee equivalent of the HG loan on appropriate terms.

As permitted in the National Housing Bank Act of 1987, the GOI will guarantee indemnification of AID for any losses incurred under AID's guaranty to the U.S. investor. The mechanism for providing the GOI guarantee will be agreed between the GOI and AID before the first HG borrowing is started.

b) Role of the NHB: The NHB is the GOI's principal agency for promoting housing finance institutions by providing them with financial, technical and training assistance. As such, the NHB is ideally placed to operate as the intermediary for the HG-003 program. However, the NHB has only recently (July 1988) begun to become operational.

In order to function successfully as the intermediary for the HG-003 program, NHB has agreed to develop policies and procedures for providing loans to private and joint sector HFCs. NHB will recruit and train the staff necessary to carry out credit analysis (with AID assistance as appropriate). The Industrial Development Bank of India, IDBI, has offered technical assistance to NHB in any field of its operations. NHB will also establish means for identifying the technical assistance and training needs of emerging HFCs. Programs will be established to address these needs, again with AID assistance if necessary.

By providing a source of long-term funds for HFCs the NHB is in a position to strongly influence the development of the Indian housing finance system. The NHB will also develop a capacity to monitor and regulate the system while advising the GOI on relevant policies and programs. NHB's intermediary role in the HG-003 program will help to focus their attention on the special needs and capabilities of the private and joint sector HFCs.

c) Program Administration and Funding: In consultation with AID, NHB will determine appropriate internal organizational and administrative arrangements for managing the rupee proceeds of the HG loan. NHB has undertaken to establish a management unit to administer the HG program. It may also propose to establish a Housing Finance Companies Fund. Resources for this Fund would not be limited to HG loan proceeds, and other international or domestic resources could be tapped for this purpose. Although AID will expect to be kept informed on the source and use of other capital used by NHB for housing finance, use of these other funds would be entirely at the discretion of NHB.

3. Program Structure

a) Agreement between NHB and AID: The agreements established between AID and NHB will seek to create an administrative environment in which NHB is free to undertake appraisal, lending, and monitoring activities according to jointly agreed standards. An Implementation Agreement will be negotiated by NHB and AID, describing the program to be financed; loan disbursements; conditions precedent to disbursement; special covenants; eligible lenders and beneficiaries; loan servicing and fees; training and technical assistance; and reporting, monitoring, audits and evaluations.

b) Eligible Borrowers: Companies which may apply to NHB for inclusion in the program include private and joint sector companies, including those with HDFC participation, which have received RBI recognition as housing finance companies. Government companies and cooperatives will not be eligible because of their access to other institutional sources of capital. Because of GOI and AID concerns that the HG-003 program broaden the housing finance market, and because of HDFC's access to other major sources of lending capital, HDFC will not be eligible to borrow. Housing finance companies closely held and organized primarily for supporting the activities of one developer will not be eligible.

Companies will be required to demonstrate to NHB that they conform to certain minimum standards which indicate their financial integrity and soundness. These standards are as follows:

- Liquid assets equivalent to at least 10% of deposit liabilities, on a day-to-day basis;
- equity capital to be at least 5% of total assets;
- total outstanding balance of loans past due thirty days or more not to exceed 7% of the total mortgage loan portfolio;
- underwriting policies to be determined such that debt service responsibilities of individual borrowers normally do not exceed 30% of gross income;
- interest coverage ratio to be at least 1.2:1.

In addition, standards will be determined for companies to maintain a reserve for bad debts, at least equivalent to the value of loans outstanding for twelve months and more; and to maintain an adequate spread between cost of borrowings and return on loans.

Companies which fulfill these conditions will then be subject to appraisal by NHB. They will be eligible to borrow under the HG program subject to (1) satisfying NHB's own criteria for assessing commercial risk and (2) other conditions specified in the implementation Agreement, as summarized in the following paragraphs.

c) Disbursements to Eligible Primary Lenders: In order to ensure a balanced development of the market and because of the difficulties faced by the exclusively private companies in attracting lending capital, $25 million of HG funds over the life of the program will be reserved for private sector companies. Loans to a single primary lender will not exceed 25% of HG funds over the life of the program, unless AID otherwise agrees. This provision will ensure that one or two companies do not absorb a disproportionate share of the funds and that increased competition is fostered.

d) Eligible Beneficiaries: The HG program is designed to expand the opportunity for low income households to obtain housing finance. Mortgages eligible for HG financing include those made to households at and below the urban median income. For the current program, the urban median income is defined as Rs. 2,000 per month per household (Annex 7.1). This estimate was established as of June 1988; adjustments will be made by AID according to changes in the consumer price index for industrial workers, or other appropriate indicators.

e) NHB Relationships with the Primary Lenders: The "institution building" aspects of the project are of major importance to the future viability of the housing finance companies. NHB will act as a developmental lender, helping the primary borrowers to improve both their management practices and resource mobilization. Through infusion of sound commercial practices and training and technical assistance, small companies can be assisted to mature as rapidly as possible.

f) Training and Technical Assistance: NHB will determine what its borrowers require to enhance management performance, outreach and lending to low-income households, and mobilization of additional resources. With AID's assistance, NHB will also assess its own needs with regard to staff training and development and utilization of existing training facilities in housing finance. NHB will inform AID of the requirements for both its borrowers and itself in the knowledge that AID will assist with funding for appropriate training initiatives. Training in housing finance offered by HDFC is available for this program. (For more information on TA and training, see Section IV.B. and Annex 7.5.)

g) <u>On-Lending Terms and Conditions</u>: NHB will assume the commercial risk inherent in on-lending to its eligible borrowers. Subject to conditions regarding eligibility of primary lenders, distribution of funds to primary lenders, and eligibility of beneficiaries, NHB will have full approval rights over transactions and terms involved in on-lending HG resources.

Mortgage lending eligible under the HG program encompasses direct financing of new construction, acquisition of existing dwellings, and home improvements or expansion. Corporate borrowing within these terms would also be eligible, as long as individuals hold title to the house.

NHB on-lending rates will reflect market conditions, be positive in real terms, and provide a reasonable spread over the cost of funds employed. The spread will reflect due consideration of both incentives and profitability. The HFCs currently lend to households at a variety of rates but, for loans appropriate to this program they cluster between 13.0% and 15.0% (see Section III.B.6, "Lending Terms"). With spreads typically of 2.5%, the companies are looking for funds costing no more than 12.5% if they are to maintain their present structure of lending rates.

The term of the loan repayments by HFCs to NHB will be consistent with the term of the HG loan itself; and the HFCs, in turn, would be expected to offer loans to beneficiary households on equivalent terms.

NHB's on-lending terms will be subject to agreement by AID. Ceiling rates for lending to households, will not, however be established.

h) <u>Line of Credit between NHB and Primary Lenders</u>: NHB will establish with its primary lenders a long-term line of credit designed as an advance system. The line of credit will be established after NHB appraisal of the primary lender and completion of agreements on the terms of their relationship and key program parameters. The agreements will address the following items:

- use of HG funds exclusively for borrowers below the urban median income;

- explicit plans for resource mobilization, including mobilization of deposits and other institutional sources of capital;

- maintenance of key financial ratios;

- cash flow projections, including projections of disbursements, sources of funds and key financial ratios;

- training and technical assistance plans for such topics as management and strategic planning; outreach to low income borrowers, including women; loan origination and underwriting practices; and automated information systems;

- offering couples applying for mortgages the option of titling in both spouses' names.

The first disbursement to an HFC will be made on the basis of (1) eligible mortgages made since October 1, 1987 (the beginning of the fiscal year of HG-003 authorization), (2) eligible loans currently sanctioned but not yet disbursed, and (3) projected cash flow needs for the next quarter. To the extent that this disbursement is not covered by eligible mortgages, it will be treated as an advance. Subsequent disbursements can also be made on an advance basis where justified by loan sanctions and cash flow projections. They will also depend on satisfactory managerial and financial performance, and on evidence of efforts, by the HFCs to mobilize other lending resources. All advances to HFCs will be liquidated against presentation of eligible mortgages.

NHB will monitor the primary lenders according to standard procedures, to include key ratios and parameters applicable to the housing finance industry (paragraph 3b above).

Finally, the primary lenders will supply NHB with their distribution of loans by income level and location in order to provide monitoring according to beneficiary eligibility. (For further detail on reporting requirements, see Section IV.D.)

III. PROGRAM ANALYSIS

A. THE INSTITUTIONAL FRAMEWORK FOR HOUSING FINANCE

1. The Financial Framework

An overriding feature of financial intermediation in India is government presence and control. The GOI directly and indirectly affects the flow of funds into the housing finance sector, from both public and private sources, by means of a complex network of policies, taxes and regulations. Direct sectoral controls are exercised by the GOI by means of instructions to public institutional investors, much of whose funds must be invested in specified places such as state governments, central government debt instruments and HUDCO debentures. Since 1951, GOI has used these policies to direct credit towards certain priority sectors such as agriculture and heavy industry and therefore away from housing.

Most credit channelled to housing goes to public housing finance agencies at below-market rates of interest. A significant volume of credit available to HDFC - and thus in principle to all private and joint sector housing finance companies who can compete for it - is also directed and subsidized. GOI interest rate policies directly establish lending rates for commercial banks, insurance entities and other public participants in the capital markets, and private lenders must raise substantial portions of their lendable resources from these sources. To this extent GOI interest rate policies influence both the cost of liabilities and the return on assets of private lenders. Although neither private nor joint sector HFCs are subject to any direct controls on interest rates they charge for retail mortgage lending, there is a widespread belief that the HFCs would be penalized if they deviated significantly from the norms established by HDFC.

The GOI also has strong controls over the sectoral distribution of capital through direct instructions to government financial institutions. Thus, LIC is required to devote 25% of its annual new accretions to central government debt instruments, 25% to state governments, and 25% to other approved uses (e.g. government-guaranteed debentures such as those issued by HUDCO and the like). The limits are particularly important because the LIC is the largest provider of funds to the housing sector. GIC and the Army Insurance Fund also invest in the shelter sector and are subject to similar controls. For example, the GIC is required to invest 35% of its incremental funds in housing.

Similarly, GOI exercises detailed control over lending by commercial banks by setting targets for lending to priority sectors and by determining interest rates. For instance, until recently, banks were directed to lend Rs.150 crores ($110 million) annually for housing. Various other financial requirements and directives, however, severely limit the freedom of bank management to allocate this credit according to market principles. At least 50% of the Rs.150 crores is earmarked for direct or indirect lending to members of the Economically Weaker Sections and Scheduled Castes or Tribes, under special credit schemes (carrying 4.5% interest) designed to benefit disadvantaged members of society. Another part of the allocation for housing is made available as credits to bank employees. 40% of the Rs.150 crores has to be utilised as subscriptions to guaranteed bonds or debentures of specified public sector agencies - of which HUDCO is the largest - in order to fulfill GOI's reserve requirements, typically earning 9% interest. Any remaining credit is available to HDFC (or other borrowers), at 12.5%. The 1988 budget raised the lending target for commercial banks to Rs.225 crores in the current financial year, and to Rs.300 crores annually thereafter.

2. The Institutional Structure for Housing Finance

The Ministry of Urban Development is the central government's principal vehicle for the development of housing policy and programs. Insofar as housing policy is strongly influenced by GOI's financial policies, however, it is the Ministry of Finance (MOF) which has the more effective controls over the volume and terms of lending for housing. As noted above, legislation has been passed to establish a National Housing Bank, although the scope of its practical functions are still a matter to be further defined by the recently appointed Chairman and Board of the NHB. The NHB is a wholly-owned subsidiary of the RBI, and will thus be the administrative responsibility of MOF. NHB is discussed in some detail in Section III.C.

Of the GOI institutions which provide indirect financing for housing, the most important is the Life Insurance Corporation. By the end of FY 1986, LIC had invested Rs.1,300 crores in housing, primarily through loans to apex housing cooperative finance societies, public housing boards and HUDCO.

HUDCO is India's apex public housing finance institution. It borrows from LIC and GIC, and has had the advantage of a number of loans from international agencies (the German KfW and British ODA). It generates additional revenues through government-guaranteed debentures which can be used by commercial banks as part of their reserve requirements. HUDCO onlends for specific projects, primarily in the public sector. By early 1988, it had made available Rs.2,700 crores ($2 billion) for housing projects since it started operations in 1970. 90% of the dwellings financed by it were intended for the economically weaker sections of the community.

At the state level, HUDCO's funds and other public resources are used by state and municipal housing agencies - Development Authorities, State Housing Boards, Slum Clearance Authorities and the like. Three states have well-advanced proposals to set up state housing finance companies, which would address a complementary market to that served by HDFC and other independent housing finance companies. Their establishment depends on receipt of approval of the National Housing Bank.

Cooperatives are another important source of housing finance in India. The cooperative housing sector has a two-tiered structure, organized around 'primary' and 'apex' societies. Primaries are organized at a local level by individuals or by private developers who gain certain advantages (taxation, and access to capital) from the coop form. Apex societies operate at the State level; of India's 31 states and union territories, 22 have such state-wide cooperative finance institutions. By 1987, there were 39,000 housing cooperatives, with almost 3 million members. Although cooperatives have long been part of India's social and economic fabric, and housing societies have played an important role in shelter provision, they have not been fully integrated into the larger finance system, nor have they been successful in mobilizing their own resources outside of the GOI's directed credit system.

3. Private and Joint Sector Housing Finance Companies

The existing private and joint sector housing finance sector is dominated by the Housing Development Finance Corporation (HDFC). The company was formed in 1977, began operating in 1978, and was a beneficiary of a series of HG loans from 1981. In the period since then, with the support and assistance of AID, HDFC has been extremely successful in delivering housing loans to a wide range of income levels, including below-median income households. It has had a consistent annual loan growth rate of 38%, by value, between 1981 and 1987. It has pioneered many innovative savings and loan instruments, and, by the development of some 18 branch offices, provides services to all geographic regions of the country. It is also providing financial and technical assistance to several new housing finance companies in the joint sector. HDFC has succeeded in prospering despite a financially restrictive domestic climate that has not favored the development of housing finance companies. It has become the role model for South Asia and further afield. Because of its domestic success, it has been able to influence public policy affecting housing finance and, in the last few years, to have attracted a number of competitor companies to the sector.

Some thirty firms have been identified as emerging housing finance companies, all having been established since 1984. They broadly fall into three groups.

The first is of private sector, independent companies: public limited and private companies, quoted on the stock exchange.

The second group is of joint sector companies, established either as a subsidiary of one of the public sector banks or otherwise with a substantial shareholding by a public sector company. They are managed as for-profit companies on conventional commercial principles. The managers may or may not be public sector employees.

These two groups are discussed in detail in Section III.B.

A third group comprises companies whose primary business is not housing finance, and those which have been established exclusively to finance the inventories of single developers, by mortgage or other forms of loans. Several of these companies use questionable financial and marketing techniques, and their stability may be dependent only on the success of pyramid selling techniques. Other companies in this group are non-banking finance companies which do not specialize in housing finance but which have sought to offer housing loans as part of a process of diversification. Several operate on the fringes of legality; at least two have failed recently.

The third group would not be eligible for inclusion in this HG program. Except where it is explicitly stated otherwise, the discussion in this paper of emerging housing finance companies refers only to companies in the first two groups.

The principal constraint faced by the market-oriented housing finance companies in expanding their operations is a shortage of loanable funds. At present, they rely to a considerable extent on three means of mobilizing resources: (1) the issue of equity capital; (2) savings and deposits from individuals and corporate entities; and (3) bank loans. Whereas structural reform in the shape of deregulation of the financial system is needed to address the broadest issues of resource allocation and mobilization, there are a number of other reasons for the difficulty faced by the industry in increasing its mobilization of domestic resources.

The resource mobilization activity of the emerging companies contrasts with that of HDFC, particularly in its early years. HDFC did not rely on the personal sector for most of its funding, but successfully accessed the corporate sector and other financial intermediaries. The emerging housing finance companies do not have the same opportunities and, by virtue of their immaturity, are at a disadvantage to HDFC in competing for a circumscribed volume of institutional funds. To a large extent, therefore, they will be obliged to diversify the number and type of investors and depositors from which they borrow, in a market which has already been exploited with some thoroughness by HDFC itself. On the other hand, liberalization and innovation in India's financial markets are promising to offer new opportunities of resource mobilization.

A major problem is that investing individuals and institutions do not always have full confidence in the financial integrity of the smaller housing finance companies. Robert Buckley et al (April 1985) noted that:

> "...HDFC operates much more like an investment banker that trades on its credibility in the financial markets, than a traditional housing finance institution that just collects small deposits from households and packages them into bigger mortgage loans. A very important feature of its operations is the overall value of services it offers, as well as the credibility that it will indeed be able to provide future services for present deposits. This kind of context suggests that institutional credibility is a very important consideration in resource mobilization."

Both for reasons of developing public confidence and, more generally, to maintain sound financial management, it is clear that there is a need for regulation of the housing finance industry, similar to the existing regulatory system of commercial banks by the Reserve Bank of India. The creation of the National Housing Bank will permit the establishment of a regulatory system for housing finance. The history of financial regulation in India suggests, however, that it will be necessary to strike a careful balance between regulation which will create an environment for growth, and regulation which could stifle operation of market forces (Annex 4.2).

An effective regulatory structure should also address certain non-financial constraints. For instance, companies should no longer be required to obtain RBI permission every time they advertise, a time-consuming procedure.

Quality of management also affects resource mobilization. Although various evaluations (by the PP team and others: see Wilson, 1988, for instance) have found that the small housing finance companies are competently managed, there is a relative dearth of skilled and motivated managers. This is evidenced by the length of time taken to recruit Managing Directors for the Gujarat Rural Housing Finance Corporation and for the Housing Promotion and Finance Corporation. As noted in the Project Paper Amendment for HG-002, "Senior managers are difficult to find because they should combine a technical background in lending with the sorts of political savvy and connections that are essential to entrepreneurial success in India... The economy generally produces some managers with the needed political sophistication. The difficulty in the still young housing finance industry is finding candidates who combine both..."

In comparison with other intermediaries, the market-oriented housing finance companies face several competitive disadvantages in attracting household savings. One of these disadvantages - households saving for housing enjoyed lower tax reliefs than those investing in UTI - was overturned by the 1988 budget. Others remain. For instance, housing finance companies are prohibited by the RBI from offering certain kinds of deposit instruments, and can therefore not effettively compete with commercial banks.

There is considerable interest shown in the opportunities for resource mobilization through the growth of a secondary mortgage market. Liquidity in the primary mortgage market could be enhanced by linking primary lenders with the capital markets by packaging and selling mortgages, or by developing a market for some form of mortgage-backed securities. The consensus of opinion, however, is that the primary market is as yet too small, immature and saddled with serious constraints for India yet to actively pursue development of any secondary facilities. (But see Annex 5 for recommendations for laying the groundwork for development of a secondary mortgage market.)

It is thus not clear that the smaller housing finance companies are in a position to take full advantage of existing and emerging opportunities for capital mobilization. Nor are they fully aware of the potential for developing the range of services offered. This points to a need for assistance and training to the housing finance industry.

There is consequently some urgency for the provision of financial and technical assistance to the emerging HFCs. This is a formative period in the development of India's housing finance system, and it is timely that the GOI's initiatives be supported by assistance in critical areas. The financial resources of the HG program will enable the participating companies to maintain a solid growth rate in their early years. This is essential if they are to be successful over the longer run in maintaining confidence in themselves and in the system and, thereby, to attract additional domestic resources. Equally, confidence in individual HFCs will be enhanced by the financial disciplines imposed by NHB, which is particularly relevant in the context of recent failure of finance companies. (See article, "Smooth Scam", in Annex 7.3.) As importantly, the future pattern of HFC lending activities may be molded by requiring and demonstrating that innovation, outreach to lower income households and geographic outreach are consistent with commercial viability.

Other constraints are faced equally by HDFC and the emerging finance companies. Foremost among these is the default risk by households. The legal system is such that a default on mortgage payments may take many years to resolve. It is also a concern of housing finance companies that welfare considerations could override purely judicial issues if a default case were brought to court, creating an uncomfortable precedent. This is one reason why the existing laws of foreclosure are rarely tested. Policy makers are well aware of this problem, and are currently seeking ways of strengthening foreclosure legislation.

Another of the problems faced by the Indian housing finance industry is of interest rate risk. Loan maturities generally range up to 15 or 20 years, while the longest maturity on a time deposit is 5 years. Long term borrowings are not available to housing finance companies at rates they can profitably invest. The result is long term assets financed by shorter term liabilities, leaving a maturity gap which is sensitive to changes in interest rates.

Other problems include a web of public constraints on development which create unnecessary cost for consumers. These include rent control acts, controls over ownership and use of land under the Urban Land Ceiling Acts, and inappropriate building and planning controls.

B. PRIMARY LENDERS

1. Introduction

Over the last four years, a number of market-oriented housing finance companies have started operations: some have been progeny of the highly successful HDFC, others have attempted to compete with it; some have the support of large public sector commercial banks and financial institutions, others are in entirely private ownership; some have been well and prudently managed, others have been fly-by-night exploiters in an unregulated market or for other reasons have failed to survive; some perceive their market to comprise higher income households others - including those described below - understand the social and commercial importance of targeting lower income households.

AID, while monitoring the course of HDFC's implementation of the HG-002 program, has also monitored the progress of other housing finance companies which have entered the marketplace. In addition to collecting basic data on lending terms, ownership, etc., it has conducted a detailed study of the structure, management and financial health of some of the companies which seemed to be sound and offer good prospects for growth (Wilson, 1988). This study used the information gathered to explore options for regulating the new industry in hopes of providing some input into the National Housing Bank's role, as yet not precisely defined.

The project design team relied on this report, on the reports of USAID/New Delhi's housing advisor, and on a series of field visits to five private and joint sector companies in designing the HG-003 program. The team emphasizes that neither the list of companies visited nor the information gathered are exhaustive: time and resource constraints prevented visiting all the new HFCs in India. The companies were selected for the team visit due to the history of on-going contacts with them and due to their records of sound management and business practices. There are other viable HFCs known to AID and, doubtless, others of which the team is unaware. The project concept allows for the entry of new companies into the program. Nevertheless, the companies visited are believed to be typical of those which will participate in the program. They have provided a considerable amount of information on their operations, which should reduce the initial assessment burden on NHB, at least for these companies, and which has given the team a valuable view of how the market is now functioning.

The following sections describe the results of the various surveys of the five HFCs:

Private sector	Dewan Housing Development Finance Ltd. ("Dewan")
	India Housing Finance & Development Ltd. (IHFD)
	Residency Housing Finance Ltd. ("Residency")
Joint sector	Gujarat Rural Housing Finance Corporation Ltd. (GRUH)
	CanFin Homes Ltd. (CanFin).

2. Company History

All the companies are relatively new. Dewan is the senior entrant, commencing operations in 1984. All the others began in 1987 and 1988. As a result, the lending histories are too limited to provide an accurate gauge of either current capacity or potential for expansion, making projections difficult. Together, the five HFCs have sanctioned loans totalling over Rs.15 crores ($1.1 million), about a third of which is by the two new joint sector companies. Much of this business have been done in the very recent past: a "constructed year's business" (Annex 6.4) has almost Rs.20 crores of loan sanctions by the five companies.

3. Equity Capital Structure

All of the institutions are adequately capitalized, although the private companies have not yet been able to significantly leverage their capital with deposits or borrowings. None of the companies experienced problems in raising capital.

The amount of equity capital, however, varies widely, from Rs.83 lakhs ($600,000) for the smallest to Rs.5 crores ($4 million) for the largest, the private companies tending to have a smaller amount of equity than the joint sector companies. CanFin and IHFD are planning to increase their paid-in capital very substantially in the near future to accommodate expansion; they do not anticipate difficulty in doing so. The ability of the other companies to increase their capitalization is unknown.

The Reserve Bank of India does not have specific capital standards for HFCs, but RBI officials say their goal by 1990 is that equity should be at least 2.5% of total assets, compared with a goal of 6% set by the Federal Home Loan Bank. Leasing companies now can leverage capital up to 10 times their equity, according to IHFD.

All tne companies sell shares to the public. The joint sector companies also have capital from HDFC and such sources as Canara Bank, UTI and ICICI - see Table 1 of Annex 6. One of the other joint sector companies not included in the survey is also owned in part by HDFC and a public sector commercial bank.

4. Lending Funds--Debt Capital

The most critical issue facing the housing finance companies, both private and joint sector, is the extreme difficulty in obtaining debt capital in a sufficient amount to allow them to meet current demand and to expand their markets. Adequate lending capital is essential to assuring public confidence, hence developing other debt capital sources (e.g., deposits), maintaining adequate cash flows and reserves, and generating the profits necessary for long term viability.

Without an on-going source of such funds, the companies have been limited in their lending to their paid-in capital, mortgage repayments, loans from commercial banks and what deposits they have been able to attract. This situation inevitably leads to cash flow problems, low liquidity and reduced profits.

5. Deposit Programs

In recognition of their debt capital deficiency, the companies have attempted to develop different deposit schemes as a source of lending funds (Table 2 in Annex 6). Unlike all other non-banking companies in India, there are no legal restrictions on amounts of deposits that HFCs may take. However, restrictions on the type of deposits and the fact that there is no government securing of the accounts reduce their competitiveness with public sector banks. Interest rates are similarly not controlled, and they range from 9.0% to 14.0% for fixed deposits, depending on the length of the term and on whether the HFC has received GOI approval for application of income tax exemption to depositors' interest earned. HDFC, by way of comparison, pays from 9.5% to 12.0% for comparable schemes. Most companies are introducing loan-linked deposit schemes as a way of attracting funds.

It is not yet clear whether attracting household savings can provide an adequate flow of lending capital. (A recent AID study - Struyk and Friedman, 1988 - finds that housing-linked contract savings schemes do induce additional savings, but the amounts involved are relatively modest.) CanFin Homes, which has been the most successful in attracting deposits, despite offering interest rates lower than its competitors, has drawn funds mainly from institutional sources.

6. Lending Terms

Table 3 of Annex 6 summarizes the lending terms for the surveyed HFCs, and compares them with the terms offered by HDFC.

The companies make loans to individuals for construction of houses or flats, extension or substantial rehabilitation of existing houses; and some, not all, will finance the purchase of an existing dwelling. They also lend to companies for the construction of housing units.

All the companies recover the majority of their loans via equal monthly payments. GRUH, however, which specializes in lending in rural areas, offers borrowers the opcion of making a single annual payment in lieu of monthly payments to better accommodate agricultural cash flows. CanFin offers a graduated payment loan, a "telescopic repayment facility", with repayments increasing quinquennially over a 20 year period. Residency, by contrast, has payments reducing in the later years of 12 and 15 year loans.

Loan sizes range from Rs.7,500, which is only sufficient to improve or expand an existing dwelling, to a "normal" maximum of Rs.200,000, and an absolute ceiling of Rs.300,000. Most of the five companies' lending, however, is concentrated in the Rs.30,000 to Rs.100,000 range. Assuming loan repayments to be 30% of household income, the maximum loan affordable to households below the median income varies with interest rate and term but, by and large, is around Rs.50,000. The maximum term now offered by any of the companies is 20 years, though at least one company indicated an interest in 30 year mortgages, if it could secure similarly long term loan funds.

All the HFCs visited charge 0.75-1.5 points application fee. Their rate structure runs from 12.0% to 16.5%, larger loans carrying higher rates. For a loan of Rs.50,000, the rate varies by company from 13.0% to 16.0%. The companies have a 1.5 to 2.4 percentage point spread between their cost of funds and their lending rates. This means that to continue lending to the target population under their current rate structures, the cost of funds to the lowest-priced HFC should not exceed 11.5%.

Maximum loan-to-value ratios fall into the range of 70% - 80%. Figures were not available on actual downpayments received on the portfolios to date.

7. Underwriting Policies and Procedures

The companies' existing underwriting policies are in the main conservative and minimize risk in such a way that should produce an acceptable level of delinquency. All of the companies except one have default and delinquency rates well below U.S. standards, but most have been in business for too short a time to conclude that these rates will be maintained. The one company with a relatively high delinquency rate attributes it to poor underwriting in the early lending period and states that more recent loan activity has a much lower rate.

The practice of some of the companies includes lending to individuals "sponsored" by employers who deduct mortgage payments from salaries and send them directly to the housing finance companies. Sometimes the employer will "guarantee" repayments, at least while the borrower is employed by that organization. This practice minimizes risk to a significant extent and also reduces collection costs. This payment method still provides for individual homeownership, and title resides with the individual and not the employer. The obligation to repay the mortgage loan remains with the individual, whether or not employed.

GRUH, which works in rural areas, also works through employment-related groups such as the teachers' unions and agricultural organizations to market mortgages in the field, saving borrowers the time and expense of travel to their offices. The organizations provide the opportunity to meet with many borrowers simultaneously, and assist in the application and selection process, verification of the application data, and in collections.

Although not enough time has passed with respect to the entire portfolio to establish firm delinquency projections, nevertheless, existing procedures and practices indicate that the companies have conservative and rational underwriting approaches that should be adequate to minimize risk. The loan-to-value ratios, the payment-to-income ratios, the requirement for a third party guarantee, the process of sanctions (loan approvals), disbursements and collections are designed to assure loan repayments, yet permit participation by households below the median income. The companies' affordability ratios are based, in the main, on net income after deductions, including other debt (Annex Table 6.3). All salary and other application information is completely verified and applications are, with a few exceptions, adjudicated by committees.

Loans for new construction are disbursed only after the buyers have first used their equity money to begin construction; disbursements are then made in installments based on construction progress. The engineers of the finance company approve the construction plans prior to the sanctioning of the loan, and they monitor the progress of contruction through completion. This disbursement process follows the generally accepted practice of prudent lenders in the United States.

Collection policies are generally unwritten, and are not so timely as those in the U.S. For instance, although policies vary, direct contact with the customer is made anywhere from one to three months after a payment is due.

The underwriting policies of the companies primarily look to the creditworthiness of the borrower and his guarantors, and only secondarily to the security of the property as the basis for mortgage approval. All the companies required title to the mortgaged property and documentation of income, but those companies operating in states in which there is a Tenancy Act stated that the legal procedures necessary to take title to and dispose of the property in the event of default are so lengthy as to render this remedy virtually worthless. In addition, there is a reluctance to undertake the foreclosure and eviction process in a country which has a strong tradition of protection for householders and tenants. (There is the further consequence that mortgages not secured by the underlying property are not marketable n a secondary market.)

8. Geographic Distribution

Though small, the companies are rapidly establishing a presence over a wide geographical area. GRUH covers the northwestern state of Gujarat. Residency, CanFin, and IHFD cover southern India and Delhi, with the latter headquartered in Madras and the former two in Bangalore. Dewan serves the Bombay and Delhi suburbs. Almost all the companies visited had established or were in the process of setting up branches in many parts of India.

Other housing finance companies are preparing to serve Calcutta, eastern and northeastern India (Housing Promotion and Finance Corporation) and the northern states (Punjab National Bank Housing Finance). Private housing finance companies - which may or may not be eligible for participation in this program - are also being formed to serve central and northern India.

GRUH was established by HDFC to serve the rural areas HDFC does not market to. It defines "rural" somewhat broadly, as towns and villages below 50,000 in population. IHFD plans to set up a new rural company which will also serve towns and villages below 50,000, beginning in June 1988. Since most of the companies market their loans to the low to middle range of housing prices (in part because of constrained lending capital), they are somewhat limited in their ability to serve expensive urban centers like Bombay and Delhi. At this stage of their development, it seems prudent to focus on secondary urban areas and suburbs which offer a deeper market demand that these companies can address.

9. Management and Staffing

While staffing size, experience, depth of management and personnel background differ for the five HFCs, the various teams which have visited and interviewed them in the course of project development have found the companies to be well managed and adequately staffed, though some personnel may need additional training or experience in housing finance. Most are pursuing expansion plans, in spite of the immediate shortage of lending capital, in the expectation of being able to mobilize additional funds, either from the HG program, other resources of the newly created National Housing Bank, deposit accounts or other institutional investors.

Staff sizes of the companies range from a low of 15 to a high of 100. Both private and joint sector companies have relied on their larger institutional backers for staff support, particularly at the managerial levels. Managers often have strong financial experience, even if it is not in housing finance per se. In addition to top management, technical disciplines represented on the HFCs' staffs generally include legal, engineering, accounting, architectural, underwriting and appraisal skills.

Training is generally ad hoc. Most companies have an orientation program, and the joint sector companies utilize their relationship to HDFC to benefit from training there. As the staffs grow and the companies increase in complexity and specialization, both on-the-job and classroom training will be necessary. The World Bank loan to HDFC (Section III.D) specifically supports HDFC training and technical assistance to new housing finance companies.

The companies are moving towards computerization of their application, monitoring and collection systems. Two of the companies have at least partial systems in place, and one is in the process of automation. Use of microcomputers should be a subject for program-related technical assistance and training, as it will allow for an expanded volume of loan activity in a sound and cost-effective manner.

All of the companies have independent, external, audit as required by law. Some of the companies also employ an internal auditor; others, due to their size, rely on the external audit supplemented by management reviews.

10. Construction Subsidiaries

Three companies have construction subsidaries, and one plans to create one in the near future. The HFCs plan to fund individual loans for the purchase of houses or flats constructed by their subsidiaries. The finance companies argue that this approach will enable them to control the quality and cost of construction. (Not incidentally, the use of construction subsidiaries enables the firms to take advantage of their State government's write-down of the costs of land for the housing developments without jeopardizing the advantages of their status as exclusively housing finance institutions.)

Similar subsidiaries are common in the United States savings and loan industry. So long as (1) good underwriting standards are strictly adhered to, and (2) the subsidiaries' loans are not the only loans funded by the parent finance company, then the subsidiaries can reduce risk and cost and can therefore be useful in achieving their goals of affordability and financial soundness.

11. Low Income Lending

Present loan activity clearly demonstrates that the companies can effectively meet the objective of providing market-rate loans affordable to household below the urban median income of Rs.2,000. Many of the companies thus far seem to be making loans to an equivalent or somewhat lower income group than is served by HDFC.

The HFCs are reaching the target group in a variety of ways: e.g., as noted above, some are lending in smaller urban areas and rural areas where housing costs are low and have aggressive outreach programs; most offer terms of at least 10 and often 20 years, and one is introducing low-start mortgages, reducing the monthly payment burden; and spreads are reasonable, indicating their operations are efficient.

12. Demand for Funds

An analysis, described in Figure 2 and detailed in Annex 6.4, calculated the demand for Housing Guaranty program funds over the next four years. The calculation took into account: (1) the surveyed companies' own estimates of what they could lend to below-median income households; (2) an estimate of how much growth could be reasonably expected to be accommodated by all eligible companies over the life of the program; and (3) an estimate of take-up of HG funds.

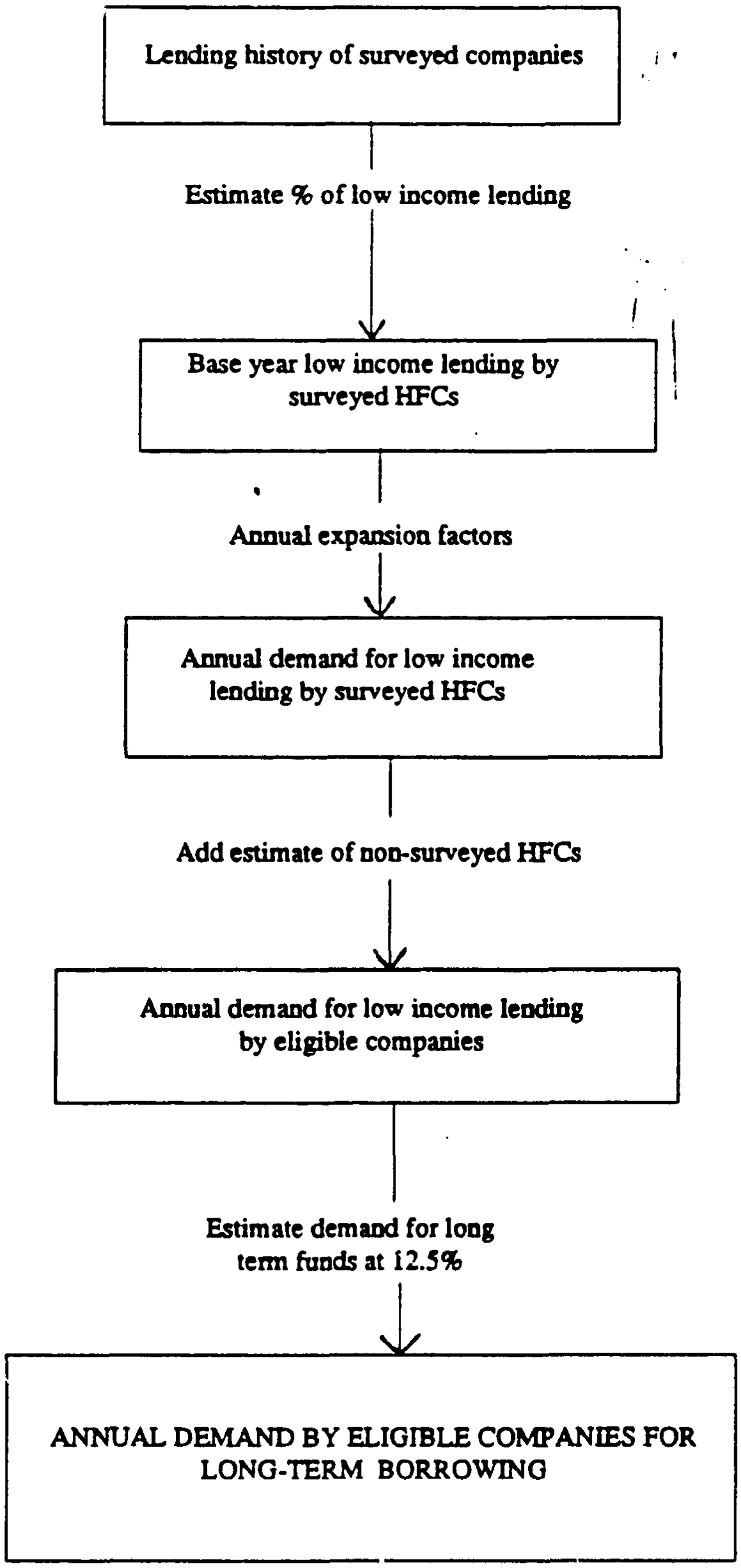
The analysis finds, cautiously, that, if there were no constraints on the availability of funds, low income lending by eligible companies could be in the order of $83 million over four years ($22 million for the private sector and $61 million for the joint sector companies). Not all of these companies, however, would be able and willing to borrow market-rate funds (assumed, for purposes of this analysis, to cost 12.5%). Taking this into account, the demand for long-term market borrowing was estimated at $79 million over four years. A cost of rupee funds higher than 12.5% would considerably reduce this level of demand. Of this $79 million, $22 would be demanded by the private HFCs. Making allowance for inflation - which has not been done in the analysis - would raise private sector demand above $25 million; total program demand would therefore exceed $50 million.

13. Commentary

The joint sector companies tend to have deeper institutional support than the private companies. Not only do they have HDFC backing, but large public sector commercial banks are providing management support as well as equity capital. These public sector links have enabled them to attract other public institutional loans, which are not readily accessible to the private sector companies.

Figure 2

Methodology for Assessing Demand for Long-Term Borrowing



Both joint and private sector companies perceive the need to provide financing for at least some low income housing, but the joint sector companies appear to be better positioned to reach such households by virtue of their greater resources and institutional stability.

Now that the National Housing Bank is becoming operational, it is not unreasonable to expect that the joint sector companies will be influential clients, due to both their public sector ties and to the volume of their lending activity. Whether or not directly linked to HDFC, these companies should not be underestimated as channels by which housing finance policy may be affected. Although in semi-public ownership, their market orientation includes them in the "private" sector to which the GOI's newly-articulated housing policy looks for solutions to the housing crisis in India.

C. ADMINISTRATIVE AND TECHNICAL ANALYSIS OF NHB

1. Overview of the NHB

Section II.B.1 described the evolution of the concept of the NHB. It was first envisaged in the Seventh Five Year Plan, was created by the National Housing Bank Act in December 1987 and, by the appointment of its Chairman, became operational in July 1988. The legislation is sufficiently broad to permit the Bank to play a number of roles, and it will be for the new Board and management to determine more precisely what its objectives and priorities will be. It is, however, clearly understood that it will be an "apex bank", with the responsibility for financing housing, promoting housing finance, and regulating the housing finance industry.

The NHB is a wholly-owned subsidiary of the Reserve Bank of India (RBI). It is effectively an autonomous Development Finance Company, legally subject only to RBI directives. The RBI itself has historically undertaken a number of initiatives to develop the country's financial system. Among other institutions which were started by the RBI are the Unit Trust of India and the Industrial Development Bank of India (IDBI). In this tradition, RBI is committed to the institutional development of NHB, though the provision of technical assistance, secondment of staff, use of common service facilities and, where appropriate, financial support.

2. Objectives and Priorities

The functions of the NHB are listed in the National Housing Bank Act, and are reproduced in Annex 4.1. The Bank management confirms that, although it is permitted to "transact all or any" of these functions, it intends to represent them all. Staff are currently drafting Position Papers on different aspects of policy, for ultimate guidance from the Board as to relative priorities. Guidance is also to be taken from an

Expert Committee on housing finance priorities which has been meeting under the chairmanship of Dr. C. Rangarajan, Deputy Governor of the RBI.

Senior management of the NHB understands that its objectives should necessarily be consistent with other aspects of national policy, including the recently articulated National Housing Policy (see Section II.B.1). They have also stated their commitment to giving priority in all aspects of their operations to households below the median income.

Two objectives are to the fore in the Bank's immediate planning: mobilization of additional domestic resources for housing finance; and the promotion of "base level financial institutions", as envisaged by the report of the High Level Working Group on the National Housing Bank (February 1987).

One specific scheme formulated to meet these objectives is to be announced in mid-September. This is for commercial banks throughout the country to mobilize households savings for mortgage lending through a contract savings scheme. It is proposed that deposits made by individuals under this scheme would be exempted from the RBI's normal Credit Reserve Ratio and Statutory Liquidity Ratio, and so would be eligible to earn an attractive rate of return for the banks. The banks, simultaneously, would be permitted to offer depositors rates of interest above the normal maxima prescribed by the RBI. Mortgage lending, with funds thus generated, would take place in selected banks in each district in India, only after expiry of the initial contract savings period.

While it was agreed that the intent of the HG program described in this paper is to support the development of private and joint sector HFCs, AID recognizes that the NHB also considers it a high priority to develop the involvement of commercial banks and cooperatives in housing finance. During the course of program implementation, AID and the NHB will explore the possibility of expanding the program to incorporate activities with private commercial banks and cooperatives.

3. NHB Lending Policies and Procedures

The NHB is still in the process of formulating its lending policies and procedures as of mid-September 1988. However, senior management described the broad outlines of how NHB will approach its credit operations.

The NHB will operate much like other development finance companies in India. It will be an institutional lender, i.e. it will provide credit to other institutions in the public, joint, and private sectors, which will undertake mortgage lending to households. NHB loans will be based on credit analysis of the borrowers and their agreement to fulfill conditions and covenants on financial management and lending policy. NHB management agreed to investigate the possibility of getting expert advice from IDBI or the Credit Rating Information Services of India (CRISIL) in developing their credit analysis and lending operations.

The NHB will concentrate on providing long-term credit, although the interest rates and terms of their lending have not yet been defined. The NHB may operate several different kinds of lending programs for different types of borrowing institutions and different household target groups. Work is already under way to develop a "Deposit Linked Loan Scheme" that would be implemented with public sector commercial banks.

NHB management is fully committed to increasing the access of families with below median income to housing loans. In that regard, the use of HG resources to finance mortgages with borrowers below the median income is consistent with NHB policy. They also agreed that HG-related loans to private and joint sector HFCs should specify interest rates that reflect market conditions, are positive in real terms, and provide a reasonable spread over the cost of NHB funds employed.

4. NHB Accounting and Auditing

The NHB's legal advisor has drafted the "General Regulations" of the Bank, which include the specification of a basic accounting structure. These regulations need to be approved by the Board of Directors and will be presented at their first meeting. In the meantime, a chief accountant is being recruited along with several officers for the accounting section. These officers should be in place by the end of October 1988 to begin establishing the NHB's accounting system. Until then, the RBI is providing accounting services to the NHB.

NHB management intends to maintain a separate account for HG-related funds. This will permit adequate accounting for the use of those funds.

The accounts of the NHB will be audited annually by auditors retained by RBI. In addition, the GOI may, at any time, appoint the Controller and Auditor General of India to review the NHB accounts. The NHB has not yet decided if it will also maintain an internal audit function.

5. Monitoring of Housing Finance Companies

HFCs are presently regulated by the Department of Financial Companies (DFC) of the Reserve Bank of India. The Registrar of Companies notifies the DFC of the existence of a company engaging in housing finance, for the purpose of determining whether it should be classified as a Housing Finance Company. The DFC does not have approval authority if the company meets the statutory criteria, which are verified during inspections. In effect, there is free entry into the system. The DFC does, however, have authority over the deposit acceptance activities of HFCs in order to provide a degree of protection to depositors' funds and as an adjunct to monetary and credit policy. In exercising this authority, the DFC carries out annual inspections of the HFCs, to review asset quality, earnings, liquidity, capital and management.

The NHB will take over these regulatory functions from the DFC as soon as its Regulation & Inspection Division is adequately staffed.

In discussions, the NHB management has recognized the desirability for the Bank to exercise tighter regulatory control over HFCs, particularly to ensure financial integrity and public confidence in the system. (Options for regulatory control were described in a recent AID paper - see Annex 4.2). NHB will be investigating these options after assuming the statutory obligations summarized above.

6. Assistance to Housing Finance Companies

By exercising its obligation of annual inspection of HFCs, and other supervisory functions, the NHB will have the opportunity of discussing issues with HFC managements and boards of directors. This is the current practice of the DFC, which NHB has indicated that it intends to continue.

The NHB management also believes that there is a need for HFCs to receive various forms of training, and has indicated interest in facilitating technical assistance missions to HFCs. The NHB intends to assess the needs of the HFCs and to explore the capabilities and interests of various training institutions. This function is expected to be the responsibility of the Policy & Planning Division of the Bank, although there are presently no firm plans for provision of specific assistance to HFCs.

AID's preliminary assessment of the training and technical assistance needs of HFCs is included in Annex 7.5.

7. Organization and Staffing

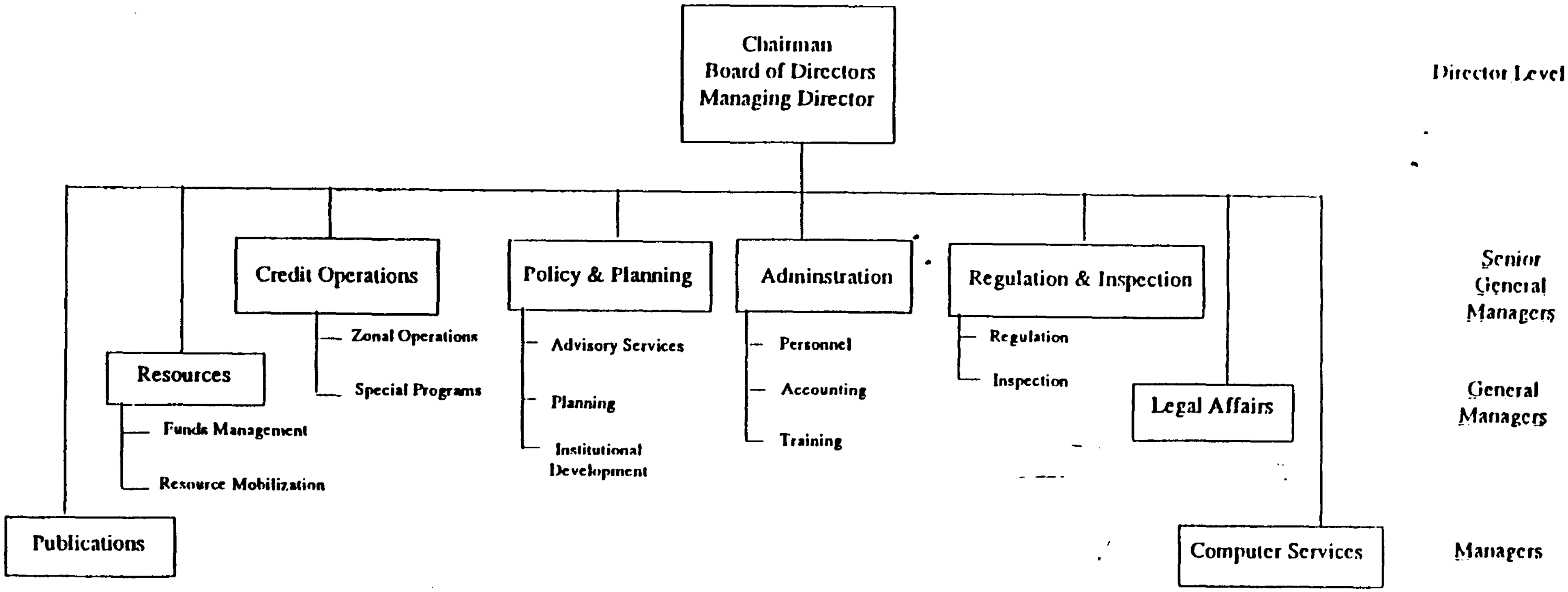
The NHB has two offices. The headquarters is in New Delhi and the second office is in Bombay. Although the organizational structure of the NHB has not yet been finalized, senior management outlined the structure presented in Figure 3.

The NHB is currently directed by the Chairman who is also the Managing Director. The National Housing Bank Act calls for a Board of Directors totalling 15 positions (see Annex 4.3). The remainder of the Board is expected to be appointed in the near future. Although the NHB will have directors appointed by RBI, as well as by central and state governments, the Bank can be expected to retain the same kind of autonomy accorded other GOI development finance companies.

Senior management intends to maintain a lean organization, of approximately 40-50 professional staff. As of September 1988 the NHB is only two months old and has twelve staff members, including the Chairman. An additional six staff members are under recruitment to be in place within the next few months. High priority is placed on obtaining a chief accountant and his initial staff. The current personnel are drawn

FIGURE 3.

DRAFT ORGANIZATION PLAN OF THE NATIONAL HOUSING BANK



NOTE : This organization plan, developed in Sept 1988, is not official until approved by the Board of Directors.

heavily from the RBI and appear to be of high quality. Not surprisingly, there is a lack of housing finance experience since this is a rare commodity in India. This weakness is recognized by NHB senior management and they are prepared to explore various staff training options with AID assistance.

Overall, the organizational plans of the NHB appear sound and well suited to fulfilling the bank's assigned responsibilities. Adequate progress has been made in staffing, considering the newness of the organization. Further progress in organizing, staffing, and training will be necessary before the NHB is ready to implement the HG loan program, but NHB senior management is fully committed to this priority. NHB is also willing to explore cooperative arrangements with IDBI which has offered to assist the NHB in starting up its operations.

8. Financial Considerations

The NHB is funded with capital of Rs.100 crores ($70 million), fully paid-up by the RBI. The National Housing Bank Act contains the provision for this capital to be increased to Rs.500 crores, which would also be subscribed by the RBI.

The source of additional funds was undetermined at September 1988, although the NHB was confident of being able to access two specific domestic sources, as follows.

Parliament has authorized that the NHB should receive Rs.100 crores exclusively to benefit rural housing, but has not specified the source of funds. In the event, the RBI has agreed to make Rs.50 crores available for this purpose, from its National Housing Credit (Long Term Operations) Fund. This would be a loan to the NHB, the terms of which are presently still under consideration. Precedent suggests, though, that the interest rate is likely to be between 6% and 8.75%, the loan to be repaid over 15-20 years.

The second source of funds is expected to be a bond issue. NHB anticipates receiving permission from RBI to borrow perhaps Rs.20-25 crores, some time in its first financial year (up to June 30, 1989). The bond issue would be long-dated, with a 9% tax-free return. The volume, terms and timiing of the issue would be subject to agreement with the RBI.

The NHB Act permits the Bank to make a variety of domestic borrowings, and to borrow in foreign currency "in such manner and on such conditions as may be prescribed in consultation with the Reserve Bank and with the previous approval of the Central Government". Both domestic bond issues and foreign currency borrowings may be guaranteed by GOI. The original NHB Bill contained a provision whereby the GOI would automatically assume the foreign exchange risk on foreign currency borrowings; this provision was deleted from the approved Act, but the GOI has undertaken that the foreign exchange risk of any HG borrowing will not be borne by the NHB.

As a wholly-owned subsidiary of the RBI, NHB effectively has the unconditional financial backing of India's central bank. The RBI itself is responsible for monetary and credit policy, for management of the liquidity reserves of credit institutions and supervision of their operations, and it regulates all transactions in foreign exchange. The RBI's balance sheet, and its profit and loss account, for the year ending June 30, 1987, are attached as Annex 4.4.

The financial position of NHB cannot be formally assessed at the present time, since it is only now becoming operational. However, given the competence of its staff, the institutional support readily available from the RBI, and the financial relationship between NHB and the RBI, there should be no doubt about the adequacy of the NHB's financial position.

9. Management of the HG Program

NHB senior management has carefully reviewed an earlier draft of this project paper. They understand the responsibilities which the NHB will have to assume during implementation of the HG program. As noted elsewhere in this review of NHB, senior management has assured AID that their intent is to take the measures necessary to perform their role as intermediary in the HG program.

Although the NHB is not in a position to start implementing the HG program at this moment, it appears feasible for them to begin within six months. It is anticipated that it will take approximately that long to prepare, negotiate, and sign an Implementation Agreement. In the interim, the existence of an authorized HG program with the NHB will provide a compelling rationale for GOI approval of training and technical assistance which AID could provide to NHB for pre-implementation activities.

NHB senior management has proposed establishing a special Program Management Unit within the NHB to implement the HG program. This unit would initially consist of one manager, plus the part-time assistance of one or two additional staff as the work load requires. The Program Management Unit would be directly supervised by one of the NHB's senior general managers. The NHB is exploring the possibility of collaborating with IDBI to establish the Unit. IDBI has experience operating a long-term credit program for leasing companies which could be directly relevant to implementing the HG program. As noted previously (III.C.4) NHB senior management also plans to establish a separate account for the HG program that could form the basis for a Housing Finance Companies Fund within the NHB.

A number of steps will need to be taken by the NHB to prepare for the implementation of the HG program. Ultimately these steps will require approval by the NHB Board, but they are consistent with our current understandings with the NHB Chairman who has full authority to act on behalf of the bank until the Board is fully constituted.

a) Organizing. NHB will define the responsibility, authority, and management procedures of a Program Management Unit for the HG program. Staff for the Unit will also be assigned.

b) Accounting. NHB will establish an account that will provide the basis for financial information on the HG program and the Housing Finance Companies Fund. Staff will be made available to keep accounting data up-to-date.

c) Policies and Procedures. NHB will draft lending policies, terms, and procedures to be applied to the HG loan program for discussion with AID.

d) Training. NHB will arrange training for the staff of the Program Management Unit in credit analysis as it applies to Housing Finance Companies. The staff will also be trained in NHB policies and procedures. (If so desired, USAID will provide assistance in credit analysis training.)

e) Contact. NHB will begin to contact private and joint sector HFCs to learn about their operations and identify constraints which inhibit their development.

f) Model Loan Agreements. NHB will develop a model loan agreement between NHB and HFCs for discussion with AID. The model agreement will need to be flexible enough to accommodate the specific terms and conditions that will apply to individual HFCs based on the results of credit analysis.

g) Loan Negotiation. After an Implementation Agreement is signed with AID, NHB will commence credit analysis of selected HFCs and negotiate specific loan agreements that will become a part of the HG program.

D. DONOR ASSISTANCE

The World Bank is the largest of the international development agencies working in the urban and shelter sectors in India. Presently 13 urban projects have been completed or are in course of implementation, with a total Bank commitment of $1,015 million. With the significant exception of the most recent, all are public sector projects, whether for a single metropolitan area or for urban centers throughout a state. Development assistance generally focuses on site and service projects, and settlement upgrading schemes. The more recent projects have emphasized components intended to improve urban management and resource mobilization capabilities. Through its urban program, the World Bank is also making efforts to curtail central government subsidies in public service provision: in the Calcutta project, for instance, municipal lending programs are tied to grant system reforms.

The single housing finance sector project financed by the World Bank is the Housing Development Finance Corporation Project, approved and signed in 1988. This project entails a loan of $250 million to HDFC, guaranteed by GOI, to help finance the company's mortgage lending program. Among other things, the loan is intended to help stabilize HDFC's "short-term lending program during a transition period in the capital markets". The loan is to be repaid over 20 years, including 5 years grace, at a variable interest rate.

The loan is to be disbursed over a 3 1/2 year period, and is conditional on HDFC mobilizing other resources such that the Bank loan represents no more than 30% of the company's lending program. 50% of the loan proceeds must finance mortgages for households below the urban median income, which was estimated to be Rs.1,700 per month in 1986-87. Using the proceeds of the loan, HDFC will offer mortgage terms up to 20 years, contrasted with its present usual maximum of 15 years. The project Appraisal Report estimates that the loan will directly benefit about 70,000 households.

The loan is to be disbursed in two tranches, of $150 and $100 million respectively. Disbursement is tied to conditions relating to "(1) the initiation of a regulatory environment for housing finance; and (2) the promotion of competitive resource mobilization, and the formulation of measures to reduce mortgage credit risk". Conditions for disbursement of the first tranche are said to have been met : namely, that "GOI has already taken satisfactory steps ... to initiate the sector enabling environment" - presumably, by passing legislation to establish the National Housing Bank.

There is a substantial technical assistance component to the project. It includes assistance with HDFC's own institutional development, in particular, with the computerization of all branches, the development of training systems (curricula, development of training modules, training of trainers) and for overseas study trips "to study sector policy issues". The technical assistance component also allows for HDFC to provide staff training and management assistance (development of operating systems, operational assistance during start-up) to new housing finance institutions. The institutions identified for assistance include, but are not necessarily limited to the following:

- Housing Promotion and Finance Corporation (HPFC)
- Gujarat Rural Housing Finance Corporation (GRUH) and
- CanFin Homes.

All of these companies are potential borrowers under the present HG Program.

The magnitude of TA to new companies is estimated at Rs.2.1 million over the life time of the project.

Other than direct project financing, the World Bank assists with training of urban sector professionals through programs of the Economic Development Institute (EDI). In December 1987, for instance, EDI, together with the United Nations Centre for Human Settlements, UNCHS (Habitat), co-sponsored a workshop and seminar in India on urban finance and management for South Asia. USAID and ADB personnel attended the seminar as resource persons.

UNCHS currently has no projects in India, but is a frequent sponsor of workshops and conferences in the housing sector.

Other international donors active in the urban sector in India include the British, Dutch, Soviet, German and French Governments. Yet other bilaterals are providing financial and technical assistance for rural housing. By contrast, the PP for HG-002 (May 1984) identified only the British and Germans as having an interest in India's urban sector.

The British Government's program has two main components. The larger is of financial assistance for slum upgrading and community development. A well-received demonstration program is currently being completed in Hyderabad, and is soon to be extended to Visakhapatnam and other towns in east and central India. This program contrasts with the projects assisted by the World Bank in that the British program focuses more upon community infrastructure than on the upgrading of individual units; and does not require the full direct recovery of costs from beneficiaries.

The second part of the British program is of training: direct grants for urban training in the U.K.; sponsorship and management of training programs in India; technical assistance to the Human Settlements Management Institute in establishing short-term professional courses in financial management, basic sanitation and solid waste management; long-term financing of a resource person at the School of Architecture and Planning, Madras; and, most recently, a Training Needs Assessment Study for human settlements in India.

The Netherlands Government provides training assistance and research funding to India through the Institute for Housing Studies (IHS; formerly Bouwcentrum). Dutch funded advisors are attached to the Human Settlements Management Institute to direct the research program, provide advisory services and assist with the development of new training programs. A new collaborative arrangement was negotiated with IHS in 1988 whereby HSMI will benefit from exchange with certain other training institutions in the region (Indonesia, Thailand, and Sri Lanka).

The German Government, through the Kreditanstalt fur Wiederaufbau (KfW), is financing a program of loans to HUDCO. By 1987, these had totalled DM50 million ($30 million), and a further project proposal consisting of rural housing, basic sanitation and slum upgrading was being negotiated. KfW has also announced that it is to offer a line of credit of DM25 million ($15 million) for HDFC to on-lend to households with incomes below Rs.700 per month, "at a special rate of interest".

The French and Soviet Governments are currently offering technical assistance to GOI in the fields of construction technology and physical planning.

E. SOCIAL ANALYSIS

1. Project Beneficiaries

Approximately three quarters of India's 800 million people live in rural areas. Over the last decade, however, the urban population has been growing at an annual rate of about 4%, reaching about 208 million in 1988. By 2000, the urban population will have grown to 314 million, one third of the total. In addition to urban-rural differences, India's great plurality of cultures, religions, and languages, exacerbated by increasing communalism in some areas, presents a complicated context for a nationwide program which aims at geographic dispersion at the same time as standardization of lending practices. For example, lenders with branches in different areas must produce loan documents in several languages. Head office management and monitoring also becomes difficult with an increasing network of branches due to inadequate telephone and transportation networks.

This diversity causes more fundamental problems as well. Past efforts of the GOI to promote equal opportunity and affirmative action for scheduled castes and members of religious groups have met with great hostility and sometimes violence. In urban India, women appear to have made a fair amount of progress in public and private sector employment, but discrimination continues to be a major inhibitor of economic advancement of women throughout India.

The HG program proposed in this paper accommodates diversity through geographic dispersion of lenders, while fostering standardization of lending practices through its use of a single centralized intermediary institution. Its beneficiary population in all cases will be households below the median income. Although HDFC has been able to do a substantial amount of lending to such households, it has only recently begun to undertake the kind of outreach that could eventually alter the way housing is financed in India. But, more importantly, HDFC cannot do it alone. The size of the country and the huge low income population needing to be served make it imperative that market-oriented housing finance networks be developed and strengthened.

The private and joint sector companies surveyed for this paper serve both urban and rural areas; they have indicated that a substantial proportion of the loans in their their current portfolios represent mortgage lending to households below the median income. In fact, it appears that the more recent entrants to the market have deliberately focused on a segment of the population having somewhat lower incomes than the typical HDFC borrower. Most of the companies have stated policies that their target population is the low to middle income household, and their maximum loan amounts are broadly consistent with this policy. Interest rates vary with loan amount, so that lower rates apply to smaller loans, another means of favoring lower income borrowers.

The program will directly benefit about 25,000 households, by providing mortgage loans averaging Rs. 40,000 each, over its four year life.

2. Program Affordability

Two objectives of the HG program are (1) to deepen the primary mortgage market by expanding its liquidity, its institutional base and geographic coverage and (2) to provide mortgage loans to households at or below the median income. The analysis of primary lenders in Section III.C above, and the experience of HDFC, suggests that the objectives are feasible. A high proportion of the portfolios of the primary lenders visited during project design consist of households whose incomes are at or below median. In 1986/87, above 35% of HDFC's portfolio was held by households at or below median income (then defined as Rs.1,700 per month). Finally, the future growth plans of several of the potential primary lenders continue to bolster the expectation that the affordability targets are feasible, since they plan to expand in smaller urban areas where purchase prices of homes are lower.

Annex 7.2 addresses the question of how market-oriented HFCs are able to reach below-median income households. The median income of Rs.2,000 would typically support a loan of about Rs.50,000: with a loan-to-value ratio of 0.45, this could purchase a unit costing Rs.110,000. Housing at or below that price is readily available outside the large metropolitan centers.

However, it should be understood that, given the interest rate structure prevailing in India, commercially viable lending for housing cannot reach the lowest of the low income population. It can reach below the median, however, and the provision of long-term financing under the HG program will enable the companies to offer terms that can perhaps extend even farther down the income scale than at present. The introduction of more flexible financing instruments such as graduated payment mortgages is another means of making housing finance more accessible to lower income households. Technical assistance, where needed, will be provided to foster such innovation.

3. Impact on Women

The position of women in India is very complex, involving as it does a wide range of religious, cultural, legal and social prescriptions. All of the major religions discriminate in many different ways against women with regard to property rights, inheritance rights, etc. Civil laws do, however, provide some protections of relevance to the HG program. One of those is the provision for joint ownership of property between husband and wife; another is the provision enabling women to hold title to property as individuals. Instances of both were found in the loan portfolios of the companies visited during Project Paper preparation.

All the companies visited consider a wife's income in determining loan eligibility. All stated that single women are eligible to apply for mortgages and that if they were given the loan, the title to the property would be in their own names. One firm noted that they had a number of couples who preferred to put the property only in the wife's name in the (mistaken) belief that there were tax advantages to the strategem.

India's recently-articulated national housing policy identifies widows, single women, and women-headed households among the priority groups to be provided access to shelter. The GOI clearly perceives that women are at a disadvantage in securing adequate housing. The HG program proposed cannot address the underlying causes of this disadvantage, but it can ensure that women, whether married or not, have equal access to the benefits of the program. At this point, there is no evidence that the HFCs discriminate against women in determining credit eligibility. Nevertheless, the Implementation Agreement between AID and the NHB will include a provision that, particularly in cases in which a woman's income is considered in determining the mortgage amount, the option of joint titling of the property should be offered by the primary lender receiving funds from the intermediary.

F. THE ECONOMIC EFFECTS OF THE HOUSING GUARANTY PROGRAM

The Housing Guaranty Program is ideally timed and suited to assist the GOI in its current efforts to increase overall housing investment, increase market-oriented housing finance, and facilitate increased growth and efficiency in the private sector. Although the HG program is small in terms of the enormity of housing needs, the institutional and regulatory framework created under the program is expected to foster increased mobilization of resources and thus continued growth of market-based credit.

The availability of formal credit at market rates should lower financing costs: in the absence of a housing finance system, low and moderate income households have had to convert assets (likely to be costly), undergo long periods of saving (frequently at negative rates of interest), and/or borrow at high informal sector rates and short terms in order to obtain housing. Also, the ability to finance housing can encourage households to place their savings in financial form, thereby increasing the funds available for development, although the magnitude of this shift is uncertain.

The economic benefits of increased investment in housing can be addressed from several viewpoints. Although housing has been viewed in the past as a social, or non-productive, sector, the strong multiplier (or backward linkage) effects on income and employment are now well accepted. The World Bank has estimated a multiplier of two for housing construction globally, with employment generated directly in the provision of superstructures and associated infrastructure, and an equal volume of employment generated by secondary and other inter-industry effects.

Forward linkage effects (the provision of space for commercial and rental activities and the impact on production of housing related durables and furnishings) are also important. In addition, however, there is increased evidence that the links between housing and the macro-economy have been underrated and underestimated. This is explicitly recognized in India's National Housing Policy statement, which spells out how housing is a "productive investment [which] promotes economic activities".

Regulatory policies, pricing, and policies affecting the financial sector have greater influence on the housing sector and on the way in which the sector's performance affects the macro-economy. The Housing Guaranty program, including technical assistance regarding regulatory and financial policies, speaks directly to these issues.

Assessments of India's debt servicing capability over the past year by several U.S. based financial institutions and USAID have concluded that India is an excellent credit risk over the medium term. The basic assumption underlying these assessments is that India will continue to be a prudent borrower in international capital markets. The HG loan has been deemed to be a suitable form of assistance by RHUDO and by USAID, which has prepared the more detailed risk assessment included in Annex 8.

IV. PROGRAM IMPLEMENTATION, MONITORING, AND EVALUATION

A. CONDITIONS AND COVENANTS

The Condition Precedent to investor selection will include the following:

AID and GOI will agree in writing to the process by which loan funds guaranteed under the Project Authorization will be guaranteed and disbursed to NHB. AID proposes that the Implementation Agreement specify:

(a) that the foreign exchange risk be borne by the GOI, through a mechanism to be agreed with AID, not by the NHB or the HFCs;

(b) that the GOI, or a financial institution authorized by the GOI and approved by AID, will guaranty repayment of the dollar loan;

(c) that the NHB, or its approved designee, will be the borrower of record having authority to receive, hold, use, or disburse the proceeds of AID guaranteed loans;

(d) the criteria and procedures to be employed by NHB for appraising and selecting primary mortgage lending companies for participation in the HG program (see Section II.C.3b);

(e) the parameters for on-lending agreements to be executed between NHB and the primary mortgage lenders (e.g., on-lending terms, underwriting standards, security required, resource mobilization efforts, eligible mortgage definition) (see Section II.C.3g and h);

(f) key program requirements: domestic resource mobilization efforts on the part of the primary lenders, $25 million set-aside for private mortgage companies, 25% cap on lending to any one HFC.

In addition, the NHB will demonstrate that it has adequate staff as well as administrative and accounting systems to manage the HG program.

As a Condition Precedent to the first disbursement, NHB will prepare a Master Program Implementation Plan for AID approval. The Plan will:

(a) establish an organizational unit to operate the HG program;

(b) describe the operations of the line of credit to be set up for primary lenders;

(c) specify monitoring and reporting responsibilities of NHB and the primary lenders;

(d) contain cash flow projections for the first year and forecasts, for the remainder of the program, to be updated annually;

(e) specify affordability requirements and documentation to be required from primary lenders regarding lending to below median income beneficiaries;

(f) describe how technical assistance and training needs will be identified and met; and

(g) include the text of a standard on-lending agreement between NHB and the HFCs.

Before subsequent disbursements from the HG loan, NHB will update the Master Program Implementation Plan, will document progress towards meeting domestic resource mobilization objectives, and will verify lending volumes to the target population.

B. TECHNICAL ASSISTANCE AND TRAINING

Long and short term technical assistance will be provided under the program. A RHUDO-funded resident adviser is currently responsible for on-going program monitoring, and this position would be continued under the HG-003 program, with funding eventually being taken over by USAID, most likely under the Technical Assistance and Support Project. The resident adviser will be the key liaison between USAID and NHB, coordinating all program implementation activities for USAID and RHUDO. USAID is also now recruiting a local professional, who will provide program support under the direction of the resident adviser.

Technical assistance and training will be directed at NHB, as the intermediary institution, and at the primary lenders. NHB will develop policies and procedures to appraise candidate projects for funding, determine appropriate funding levels, and monitor projects under way. TA and training will focus on parameters related specifically to housing financial analysis and on underwriting policies and procedures to enable NHB to evaluate HFCs. In addition, TA and training will be used to familiarize NHB with procedures for standardization across housing finance portfolios (see Section II.C, Program Description). Early in the program NHB and AID will collaborate on an assessment of the broader institution building efforts needed to enhance the NHB's capacity to perform its role in the Indian housing finance system. This assessment will define a mutually agreed program of technical assistance and training to be implemented during the course of the program.

Technical assistance and training to the primary lenders, on the other hand, will be directed at long-term growth and strengthening of the institutions. The support will focus on three levels: top management, mid-level professional and managerial, and technician level. By calling upon specialized expertise from RBI, NHB will be able to identify training and technical assistance needs at the latter two levels, most likely in such areas as underwriting procedures, automated management information systems, record-keeping, collections procedures, accounting, etc. Assistance to top management will be especially critical in the areas of strategic planning and resource mobilization. Participation in seminars and information exchanges with counterparts elsewhere in the region and trips to the U.S. and third countries to observe and study similar successful housing finance operations will also be a part of support to HFC management. Managers of the more successful companies could also serve as providers of advice to non-competing firms within India or to HFCs elsewhere in the region.

A major area for assistance to the primary lenders will be in helping the companies to mobilize additional resources, both for current lending activity and for replacing HG resources over the longer term. Resource mobilization includes attracting individual deposits, but the companies need even more to be able to secure public and private sector institutional funding, as HDFC has done. Technical assistance in mortgage insurance and in mortgage refinancing instruments will also be needed.

In addition to training and technical assistance to program participants, the broader needs of the housing sector will require some short-term support via training to other actors in the sector such as the Ministry of Finance, and the Ministry of Urban Development. Because of the great influence on the sector of these institutions, an investment in training for them could have direct benefits to the on-going program.

Funding for research will be another component of the program. Local institutions can provide low-cost studies on particular issues such as the operation of the informal housing finance system, land tenure and titling, public and private sector institutional investment practices, etc. U.S. based assistance is expected to be required to carry out studies such as of the demand for mortgage credit. (Annex 7.4 lists recent AID-sponsored research in housing finance in India.)

Some of the required technical assistance and training can be provided by sources within India, among which HDFC and the Bankers' Training College are already providing training to staff of associated companies. Expatriate assistance, however, will also be required and will be provided via the existing contract with the Urban Institute, the above-mentioned Technical Assistance and Support Project, and the Development Management and Training (DMT) Project. The DMT Project has been amended to earmark $500,000 for training in support of the present program, in addition to un-earmarked funds for other training for the urban and shelter sectors. These sources will also be used to fund a mid-term and final evaluation by an expatriate consultant team.

Training and technical assistance is discussed at greater length in Annex 7.5.

C. AID MANAGEMENT

Management and administration of the program will be the responsibility of RHUDO/Asia and will be accomplished through periodic visits to the intermediary and to those other places in India where project activities are being implemented. RHUDO will serve as USAID/New Delhi's technical support office for housing programs by providing briefings to the Mission on program progress and by seeking policy guidance from the Mission. The Mission has designated the Directorate of Technology Development and Enterprise as the Mission's liaison with RHUDO/Asia for this program. The Mission's resident Urban Adviser (managed by RHUDO in consultation with the Mission) will provide day-to-day support for program development and administration.

D. PROGRAM MONITORING AND EVALUATION

AID will rely on NHB for actual monitoring of the primary lenders. At this time, the details of how NHB will monitor and report to AID have not been negotiated, but basic indicators to be tracked by NHB and reported to AID by company, probably on a quarterly basis, would include: loan amounts, status of applications received, loan approvals and disbursements by location, distribution of borrowers by income groups, prices and sizes of units financed, age and sex of title-holder(s), arrearages and defaults, and actual loan-to-value ratios.

Two program evaluations will be conducted, one during the second year of program implementation and one final evaluation at the end of the program. Expatriate consultants will conduct the evaluation jointly with AID and NHB. Of particular interest to evaluators will be the volume, both absolute and relative, of lending to below median income households, default rates and arrearages, rates of disbursement of the private vs joint sector firms, efforts to mobilize other resources, and support provided by the intermediary to primary lenders. This information will be obtained from NHB records and by examination of the records of a selection of both private and joint sector primary lenders.

E. NEGOTIATING STATUS

Pursuant to approval of this Project Paper, AID will authorize a $25 million HG loan and send a Letter of Advice to the GOI and the NHB. A program Implementation Agreement will then be negotiated and signed with the NHB and, after all Conditions Precedent have been met, the NHB, or its approved designee, will seek guidance from its investment advisor on the best time to enter the capital market. The NHB will keep the Office of Housing informed of every development and the timing of its borrowing. The Office of Housing will facilitate the process, to the extent permitted by AID policy, and will encourage U.S. lenders to participate in the program.

The contracts to be executed in connection with this project are:

1. The Implementation Agreement between AID and NHB.
2. The Loan Agreement between the U.S. lender and the NHB, or its approved designee.
3. The Guaranty Agreement between AID and the U.S. lender.
4. The Host Country Guaranty Agreement between AID and GOI.

F. PROGRAM IMPLEMENTATION SCHEDULE

Sections IV.A - E above have presented a narrative description of program implementation. Assuming prior approval by GOI of NHB's participation in the HG program, the anticipated sequence of events is outlined below:

1. Approval of $50 million project paper; authorization for $25 million HG signed.	By September 30, 1988
2. Office of Housing issues Letter of Advice.	By September 30, 1988
3. NHB technical staff receive short term orientation training.	By December 31, 1988
4. Draft Implementation Agreement prepared by AID and sent to NHB.	By November 30, 1988
5. NHB initiates consultations with HFCs.	By December 31, 1988
6. AID recruits local professional for program support.	By December 31, 1988
7. Signing of Implementation Agreement by AID and NHB.	By March 31, 1989
8. Negotiation and signing of Loan Agreements between NHB and individual HFC's.	By June 30, 1989
9. NHB processes first disbursements to HFC's.	By July 15, 1989
10 Completion of legal opinions, Master Program Implementation Plan and other CPs to Investor Selection.	By September 30, 1989
11. NHB, or its approved designee, seeks U.S. investor.	By October 31, 1989

12. HG Loan and Guaranty Agreements negotiated and signed.	By December 31, 1989
13 NHB draws down authorized disbursement of HG loan.	By December 31, 1989
14. NHB prepares short-term Training Plan.	By December 31, 1989
15. Mid-term evaluation of the program by external consultants.	By June 30, 1990
16. Master Program Implementation Plan updated.	By August 31, 1990
17. Authorization of second tranche.	By September 30, 1990
18. NHB, or its approved designee, draws down and disburses remainder of first tranche of $25 million.	By December 31, 1990
19. Draw-down of second tranche completed (possibly in more than one disbursement).	By December 31, 1992
20. Final evaluation of program.	By June 30, 1993

V. FINANCIAL PLAN

A. FINANCING OF THE PROGRAM

The program involves several distinct activities, to be financed by different mechanisms for the five year life of the project. The entities involved are as follows:

a) The U.S. Lender, which will finance the $50 million loan to the NHB, or its approved designee;

b) NHB, which will provide technical and managerial support for the program. Its annual costs of administering the program will rise from about Rs.0.3 crores ($0.2 million) in the first year to about Rs.1.7 crores ($1.2 million), which will be recovered through the charges made to participating HFCs. Administrative costs over the first five years are estimated to be about Rs.4.2 crores ($3.0 million);

c) The participating HFCs, which will supply staff time, offices and equipment in order to on-lend to beneficiary households;

d) Individual households, which borrow from the HFCs, will contribute their own funds as downpayment for the purchase or improvement of their homes. Assuming that HFCs achieve an average loan:value ratio of 0.5 under this program, then the matching household contribution will be the equivalent of $50 million (currently, Rs.70 crores);

e) AID will provide resources (a) to guaranty the HG loan; (b) to manage and administer the program; (c) to provide training to NHB, participating HFCs and other national housing finance institutions; (d) to provide short-term technical assistance for sectoral development; and (e) for evaluation of the program.

The AID grant funds will predominantly be provided from two sources;

a) The Development and Management Training (DMT) Project, as amended, which will finance the training component;

b) The Technical Assistance and Support Project (TASP), which will finance the greater part of the cost of the long-term advisors, technical assistance and evaluations.

Funds availabe from RHUDO will be available to support the project in its initial months until funding is accessible under DMT and TASP. An on-going contract funded by USAID/New Delhi is available for a part of the TA requirements for the first year.

Information on cost estimates by sources, use and year of expenditure is given in Tables 1 and 2.

B. COST OF THE PROGRAM

1. Housing Loan

The HG loan of $50 million will be matched with individual households' savings equivalent to about another $50 million, and with NHB's contribution of administrative expenses equivalent to about $1.2 million annually.

2. Advisors

One expatriate and one local (FSN) advisor will be contracted to USAID/New Delhi for the duration of the program (see Section IV.C). Illustrative costs for the first year are as follows. In estimating the life of program budget, salary costs have been escalated at 5% per annum.

	Expatriate	FSN
Salary, etc.	$110,000	$6,000
Travel and transportation	28,000	7,000
Other direct costs	4,000	0
Total	$142,000	$13,000

3. Training

The precise components of the training program can only be determined as the program proceeds (see Section IV.B). The following life of program costs have been estimated for illustrative purposes.

	Incountry	US or Third Country
30 participants attending 3-week training programs		$210,000
Special courses in mortgage lending		$120,000
Overseas study trips: 12 trips of 2 weeks duration		$120,000
Attendance at regional seminars: 16 trips of 1 week duration		$ 30,000
Fees and costs for local training courses (360 man-weeks)	$180,000	
Institutional support: documents and equipment	$100,000	
Total	$280,000	$480,000

4. Technical Assistance

An illustrative cost of the technical assistance program over the life of the project is as follows:

5 seminars (foreign exchange cost only)	$ 60,000
Short-term technical assistance and studies: expatriate consultants (150 man-weeks)	$940,000
Local research studies	$100,000
Total	$1,100,000

5. Evaluation

The costs for the two major evaluations will be $60,000 and $75,000 each. This will cover salaries, travel, per diem and all miscellaneous costs.

6. Contingencies

A 10% contingency allowance has been added to all costs identified above excepting the $50 million HG loan and equivalent Host Country contributions.

Table 1
Summary Cost Estimate and Financial Plan
(US $'000)

	AID		Host Country		HG	TOTAL
	FX	LC	LC(1)	LC(2)	LC(3)	
1. Housing loan			50,000	3,000	50,000	103,000
2. Advisors	445	200				645
3. Training	480	280				760
4. TA	1,000	100				1,100
5. Evaluations	135					135
6. Contingencies	205	55				260
Total	2,265	635	50,000	3,000	50,000	105,900

Note (1) Matching household contribution: see Section V.A.
(2) Annual administrative costs of NHB over 5 year life of program.
(3) Rupee equivalent of the HG dollar loan.

Table 2

Projection of Expenditure by Fiscal Year
(US $'000)

Fiscal Year	AID	Host Country	HG	Total
1989	400	10,240		10,640
1990	500	15,600	10,000	26,100
1991	750	15,960	15,000	31,710
1992	750	11,200	15,000	26,950
1993	500		10,000	10,500
Total	2,900	53,000	50,000	105,900

C. BORROWING PROCEDURES

NHB will be the implementing institution and the borrower of record for the HG loan will be the NHB, or its approved designee. AID proposes that the Government of India guarantee the borrowings. The procedures will be agreed upon by AID, NHB, RBI and the GOI prior to NHB's seeking a U.S. investor.

D. APPROVALS AND DISBURSEMENTS

NHB, using agreed upon lending procedures, will approve and disburse loans to primary mortgage lenders for the financing of mortgage loans affordable to households below the median income. Subject to agreement with NHB, AID will approve borrowings to reimburse NHB for funds loaned to the primary lenders for eligible mortgages. It is anticipated that the first tranche of the borrowing by NHB will be of $10 million, subject to agreement by AID and NHB.

Advances to HFCs will be made based on eligible mortgages made since October 1, 1987, those sanctioned but not disbursed and on projections of quarterly cash flow requirements. Advances will be liquidated against the volume of lending by the primary mortgage lenders to households below the median income.

As discussed in Section II.C, AID will not approve in advance NHB disbursements to HFCs. It will approve the terms of the agreements between NHB and the companies.

Disbursements under the AID grants for training and technical assistance will be according to the negotiated conditions of the specific projects under which they are made. Disbursements for advisors, evaluations and U.S. technical assistance will be made by direct payments according to AID contracting and payment procedures. Disbursements for in-country training and technical assistance will be made on a case-to-case basis.

For the training components, AID will finance 100% of the charges made to the participating institutions. AID will also finance 100% of the cost of the advisors, evaluations, short-term technical assistance and foreign exchange cost of seminars held in India. In the latter case, AID will seek co-sponsors, who will normally be expected to finance all local, rupee, costs. AID will be willing to meet 100% of the cost of appropriate local research studies, but will seek co-sponsorship for these, whether from India or overseas donor sources.

E. AUTHORIZATION IN PHASES

This $50 million program will be authorized in two phases. $25 million will be authorized in FY 1988, along with approval of this project paper. The second tranche will be authorized in FY 1990 or 1991, depending on program funding needs, following a positive recommendation of the mid-term evaluation.

(12) ACTION: AID-3 INFO AMB DCM POL ECON-2 SCI FAS-2 CHRON

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PP RUEHNE CN: 09045
DE RUEHC #5515/01 1350224 CHRG: AID
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FM SECSTATE WASHDC
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Grant 386-HG-003

AIDAC

E.O. 12356: N/A
TAGS: N/A
SUBJECT: HOUSING FINANCE SECTOR PROGRAM (HG 003)

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CHRON

REF: NEW DELHI 10093

THE PID FOR THE SUBJECT PROJECT WAS REVIEWED BY THE PROJECT REVIEW COMMITTEE (PRC) ON APRIL 26. AN ANPAC WAS NOT CONSIDERED NECESSARY. THE PID WAS STRAIGHT FORWARD AND WELL-WRITTEN. THERE WERE NO ISSUES IDENTIFIED BY THE PRC WHICH WOULD PREVENT MISSION FROM MOVING TO THE PP STAGE. AA/ANE HEREBY APPROVES THE PID AND DELEGATES AUTHORITY TO THE MISSION DIRECTOR TO (1) APPROVE THE PP FOR UP TO U.S. DOLS 50 MILLION IN HOUSING GUARANTIES (HG) AND DA RESOURCES UP TO U.S. DOLS 1.0 MILLION OVER THE LIFE-OF-PROJECT AND (2) AUTHORIZE U.S. DOLS 25 MILLION HG IN FY88 ALONG WITH THE FIRST TRANCHE OF DA. PRECISE TEXT OF GUARANTY AUTHORIZATION ALONG WITH FM'S CERTIFICATION OF FUNDS AVAILABLE WILL BE CABLED TO USAID NEW DELHI PRIOR TO AUTHORIZATION.

THE FOLLOWING COMMENTS/GUIDANCE SHOULD BE TAKEN INTO ACCOUNT IN THE DEVELOPMENT OF THE PP.

THE HIG SHOULD BE FULLY CONSISTENT WITH YOUR NEW CDSS. HOW THE HOUSING SECTOR POLICY AGENDA AND THE HIG PROGRAM IN PARTICULAR RELATE TO VARIOUS THEMES IN THE MISSION'S UPCOMING CDSS STRATEGY, EG. POVERTY ALLEVIATION AND PRIVATE SECTOR, SHOULD BE FULLY DESCRIBED IN THE PP.

2. POLICY AGENDA:

PRIOR TO PP AUTHORIZATION THE MISSION SHOULD DEFINE IN DETAIL THE POLICY AGENDA TO BE ADDRESSED TO CLARIFY THE CONSTRAINTS THE PROJECT WILL ADDRESS TO SUPPORT THE GROWTH OF PRIVATE SECTOR FINANCIAL INSTITUTIONS. THIS COULD BE DONE IN THE PP OR IN OTHER DOCUMENTS FOR THE RECORD. THE NEED FOR LIQUIDITY AND A REGULATORY FRAMEWORK WERE ADDRESSED IN THE PID, BUT THERE MAY BE OTHER CONSTRAINTS WHICH REQUIRE ATTENTION. THE PP SHOULD DESCRIBE THE FINANCIAL AND ADMINISTRATIVE REQUIREMENT(S) WHICH THE INTERMEDIARY WILL APPLY TO SUB-BORROWERS TO ASSURE THAT FINANCIAL AND INSTITUTIONAL

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CONCERNS AS MENTIONED IN THE ANNEX OF THE PID ARE INCORPORATED INTO THE STRUCTURE OF THE PROGRAM. A SPECIFIC CONDITION PRECEDENT (CP) TO SUBSEQUENT YEAR DISBURSEMENTS TO ASSURE THAT THE OBJECTIVE OF DOMESTIC SAVINGS MOBILIZATION IS REALIZED SHOULD BE CONSIDERED. THE INTENT HERE IS NOT TO REQUIRE CONDITIONALITY BUT TO ESTABLISH A LOGICAL POLICY SCENARIO TO ENCOURAGE ADOPTION OF APPROPRIATE HOUSING FINANCE POLICIES IN THOSE AREAS WHERE CHANGES ARE CONSIDERED NECESSARY.

3. TECHNICAL ASSISTANCE:

THE PP SHOULD OUTLINE HOW THE PROPOSED TECHNICAL ASSISTANCE (TA) AND TRAINING WILL ADDRESS THE POLICY AGENDA AND SHOULD PROVIDE ADEQUATE SUPPORT TO ACCOMPLISH PROJECT PURPOSES. THE PRC DID NOT FIND THE U.S. DOLS 500,000 A CREDIBLE LEVEL OF SUPPORT FOR THE KINDS AND TYPES OF ASSISTANCE NECESSARY TO ADDRESS THE POLICY AND INSTITUTIONAL DEVELOPMENT ISSUES IMPLIED IN THIS PROGRAM. WE REALIZE THIS IS A SENSITIVE AREA IN INDIA BUT URGE MISSION TO RECONSIDER THE LEVEL OF TA AND TRAINING. PP SHOULD EXPLAIN HOW YOU PLAN TO FINANCE ADDITIONAL TECHNICAL ASSISTANCE AND TRAINING, EG, BILATERAL FUNDS, PRE/H FUNDS ETC.

4. PRIVATE SECTOR ENTITIES PARTICIPATION:

WE FULLY SUPPORT MISSION'S INTENTION TO DEVOTE TECHNICAL AND FINANCIAL ASSISTANCE IN THIS PROJECT TO PRIVATE

AND FINANCIAL ASSISTANCE IN THIS PROJECT TO PRIVATE
PRIMARY LENDERS. TO INSURE THAT THE FLEDGLING 100 PERCENT PRIVATE SECTOR ENTITIES RECEIVE A SHARE OF THIS PROJECT'S RESOURCES, THE PP SHOULD ESTABLISH A SET-ASIDE MECHANISM, EG. PERCENTAGE OF FINANCIAL RESOURCES FOR THIS PURPOSE.

5. IDBI AS THE INTERMEDIARY INSTITUTION:

PID APPROVAL IS CONTINGENT ON THE USE OF IDBI AS THE INTERMEDIARY, SUBJECT TO IT OBTAINING NECESSARY AUTHORITY, WITH OPTION OF UTILIZING THE NATIONAL HOUSING BANK WHEN IT BECOMES FUNCTIONAL AND A MORE APPROPRIATE VEHICLE FOR THE OBJECTIVES OF THIS PROJECT. IF SUCH AUTHORITY IS NOT OBTAINED, THE PRC WOULD LIKE TO REVIEW AND APPROVE SELECTION OF ALTERNATIVE INTERMEDIARY.

THE PID AND NEW DELHI 12293 IMPLIES THAT THE IDBI WILL BE THE BORROWER AND WILL PROVIDE THE GUARANTEE OF REPAYMENT IN U.S. DOLLARS. MISSION SHOULD CLARIFY THIS ISSUE BEFORE UPCOMING PROGRAM WEEK. ALTHOUGH IDBI HAS BEEN APPROVED BY PRE/H AS A SWAP PARTNER IN PREVIOUS HG

LOANS, AN UPDATED ANALYSIS OF IDBI'S CAPACITY IS REQUIRED. IF SOME OTHER BORROWER GUARANTOR ARRANGEMENT INVOLVING IDBI AND THE GOI IS CONTEMPLATED, IT SHOULD BE CAREFULLY DESCRIBED AS OUTLINED IN THE SCOPE OF WORK FOR THE PP ATTACHED AS ANNEX D TO THE PID AND COMMUNICATED TO AID/W.

6. PROJECT EVALUATION:

THE PP SHOULD INCLUDE A MONITORING AND EVALUATION PLAN WHICH IDENTIFIES: KEY PROGRAM INDICATORS TO BE TRACKED THROUGHOUT THE IMPLEMENTATION; THE LOCUS AND MEANS OF DATA COLLECTION ON THESE KEY TRENDS; AND THE MEANS BY WHICH SUCH INFORMATION WILL BE FED BACK INTO USAID NEW DELHI PROGRAM REVIEWS AND STRATEGY. (SEE A.I.D.'S "GUIDELINES FOR DATA COLLECTION, MONITORING AND EVALUATION PLANS FOR A.I.D. - ASSISTED PROJECTS," APRIL 1987.) IN CONNECTION WITH ANY MIDTERM OR FINAL EVALUATIONS, THE MISSION SHOULD INCLUDE INTERVIEWS, SAMPLE SURVEYS OR RAPID LOW-COST STUDIES TO DETERMINE IF PRIVATE AND JOINT-SECTOR PRIMARY LENDERS ARE ADOPTING ACCEPTABLE PRACTICES SUITED TO THE NEEDS OF LOW INCOME LOAN APPLICANTS. THIS INFORMATION MAY BE USEFUL IN DESIGNING SIMILAR PROJECTS IN THE FUTURE. THE RESULTS OF THE MONITORING AND SPECIAL STUDIES COULD ALSO BE USED TO ENCOURAGE THE SELECTED HOUSING REGULATORY BODY TO DEVELOP NATIONAL HOUSING POLICIES THAT ARE APPROPRIATE

FOR LOW INCOME CONSUMERS OF HOUSING LOANS AS WELL AS POLICIES THAT ARE APPROPRIATE FOR PRIMARY LENDERS. FINALLY, A SPECIFIC BUDGET LINE ITEM FOR EVALUATION COSTS SHOULD ALSO BE INCLUDED IN THE PP. SHULTZ
BT
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ANNEX

THE HOUSING GUARANTY PROGRAM

STATUTORY CHECKLIST

INDIA

PROJECT NO. 386 -HG- 003

	ANSWER YES/NO PUT PP PAGE REFERENCES AND/OR EXPLANATIONS WHERE APPROPRIATE
A. General Criteria Under HG Statutory Authority.	
Section 221(a)	
Will the proposed project meet the following criteria.	
(1) is intended to increase the availability of domestic financing by demonstrating to local entrepreneurs and institutions that providing low-cost housing is financially viable;	Yes
(2) is intended to assist in marshalling resources for low-cost housing;	Yes
(3) supports a pilot project for low-cost shelter, or is intended to have a maximum demonstration impact on local institutions and national policy; and,	Yes
(4) is intended to have a long run goal to develop domestic construction capabilities and stimulate local credit institutions to make available domestic capital and other management and technological resources required for effective low cost shelter programs and policies.	Yes
Section 222(a)	
Will the issuance of this guaranty cause the total face amount of guaranties issued and outstanding at this time to be in excess of $2,158,000,000?	No
Will the guaranty be issued prior to September 30, 1988?	Yes

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Section 222(b)

Will the proposed guaranty result in activities which emphasize:

(1) projects providing improved home sites to poor families on which to build shelter and related services; or — No

(2) projects comprised of expandable core shelter units on serviced sites; or — No

(3) slum upgrading projects designed to conserve and improve existing shelter; or — No

(4) shelter projects for low-income people designed for demonstration or institution building; or — Yes

(5) community facilities and services in support of projects authorized under this section to improve the shelter occupied by the poor? — No

Section 222(c)

If the project requires the use or conservation of energy, was consideration given to the use of solar energy technologies, where economically or technically feasible? — N/A

Section 223(a)

Will the A.I.D. guaranty fee be in an amount authorized by A.I.D. in accordance with its delegated powers? — Yes

Section 223(f)

Is the maximum rate of interest allowable to the eligible U.S. Investor, as prescribed by the Administrator, not more than one percent (1%) above the current rate of interest applicable to housing mortgages insured by the Department of Housing and Urban Development? — N/A

Section 223(j)

(1) Will the proposed Housing Guaranty be coordinated with and complementary to other development assistance in the host country? Yes

(2) Will the proposed Housing Guaranty demonstrate the feasibility of particular kinds of housing and other institutional arrangements? Yes

(3) Is the project designed and planned by A.I.D. so that at least ninety percent (90%) of the face value of the proposed guaranty will be for housing suitable for families below the median urban income for housing in urban areas, in the host country? Yes

(4) Will the issuance of this guaranty cause the face value of guaranties issued with respect to the host country to exceed $25 million in any fiscal year? No

(5) Will the issuance of this guaranty cause the average face value of all housing guaranties issued in this fiscal year to exceed $15 million? No

Section 238(c)

Will the guaranty agreement provide that will cover only lenders who are "eligible investors" within the meaning of this section of the statute at the time the guaranty is issued? Yes

B. Criteria Under General Foreign Assistance Act Authority.

Section 620/620A

(a) Does the host country meet the general criteria for country eligibility under the Foreign Assistance Act as set forth in the country eligibility checklist prepared at the beginning of each year? Yes

(2) Is there any reason to believe that circumstances have changed in the host country so that it would now be ineligible under the country statutory checklist? | No

AID 1020-28 (1-71)

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY
Total U.S. Funding
Date Prepared

Project Title & Number:

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: Sector Goal: To improve housing conditions of low income households. Project Goal: To increase the availability of formal housing finance to low income households nationwide.	Measures of Goal Achievement: Increase in the amount of funds lent for housing by the formal sector. Increased borrowing for housing by low income households.	Special financial sector studies. Project records.	Assumptions for achieving goal targets: That increased availability of formal housing finance will result in increased borrowing by low income households. That increased borrowing will improve housing conditions of low income households.
Project Purpose: To promote the development of a financially-sound, market-oriented housing finance system which makes long-term shelter finance available to a wide range of households, including those below the median income.	Conditions that will indicate purpose has been achieved: End of project status A network of financially sound market-oriented HFCs serving households below the median income as well as those above.	Monitoring of number and distribution of commercial HFCs and their branches; studies of: financial structure, soundness; market shares; loan collection rates; terms of loans and types of facilities; volume of lending to low income households; etc.	Assumptions for achieving purpose: That the formal financial sect will permit new HFCs to operat in a financially sound manner. That sufficient demand exists the target population to suppor system expansion.
Outputs: 1. Increased capital available for unsubsidized home purchase. 2. Increased geographical coverage by HFC branches. 3. New deposit and mortgage facilities. 4. Improved management practides of new and recent entrants to market.	Magnitude of Outputs: 1. Increased loan volume by project HFCs. 2. Substantial increase in branches of eligible HFCs. 3. Introduction of GPMs,ARMs or other creative instruments. 4. Improved compliance with intermediary's criteria; reduced management costs.	1. Project reporting requirements as specified in IA 2,3,4. Mid-term and final evaluations.	Assumptions for achieving outputs: That lack of capital is a major reason for present limited activity of HFCs. That HFCs will be willing and able to adopt sound practices. That HFCs will be willing and able to lend to low income households.
Inputs: 1. HG loan. 2. Grant funds for TA, training and evaluation. 3. Staff time, office and equipment from primary lenders 4. Technical and managerial support from intermediary.	Implementation Target (Type and Quantity) 1. US $50 million guaranty authorization, with disbursements over 3-4 years. 2. $2.9 million in grant funds. 3,4. In-kind contributions from implementing organizations.	1. Project records 2. Project records 3,4. Availability of staff and resources of implementing organizations to absorb TA, training and implement project.	Assumptions for providing inputs: 1. That NHB assigns adequate staff and other resources to program. 2. That necessary agreements between A.I.D. and NHB, and NHB and HFCs are concluded. 3. That HFCs meeting eligibilit criteria apply for program participation.

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ANNEX 4.1

THE NATIONAL HOUSING BANK: FUNCTIONS

The intention to create a new National Housing Bank (NHB) was announced in parliament in 1987; and the legislation was passed in December 1987. The Bank is to be owned by the Reserve Bank of India, and is to receive equity capital of Rs.100 crores. The National Housing Bank Act permits the NHB to "transact all or any" of the following kinds of business:

"(a) promoting, establishing, supporting or aiding in the promotion, establishment and support of housing finance institutions;

(b) making of loans and advances or rendering any other form of financial assistance whatsoever to housing finance institutions and scheduled banks;

(c) subscribing to or purchasing stocks, shares, bonds, debentures and securities of every other description;

(d) guaranteeing the financial obligations of housing finance institutions and underwriting the issue of stocks, shares, bonds, debentures and securities of every other description of housing finance institutions;

(e) drawing, accepting, discounting or rediscounting, buying or selling and dealing in bills of exchange, promissory notes, bonds, debentures, hundies, coupons and other instruments by whatever name called;

(f) forming, promoting and managing subsidiaries for carrying out all or any of its functions under this Act;

(g) undertaking research and surveys on construction techniques and other studies relating to or connected with shelter, housing and human settlement;

(h) formulating one or more schemes, for the purpose of mobilisation of resources and extension of credit for housing;

(i) formulating one or more schemes, for the economically weaker sections of society which may be subsidised by the central government or any state or any other source;

(j) organising training programmes, seminars and symposia on matters relating to housing;

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(k) providing guidelines to the housing finance institutions to ensure their growth on sound lines;

(l) providing technical and administrative assistance to housing finance institutions;

(m) co-ordinating with the Life Insurance Corporation of India, the Unit Trust of India, the General Insurance Corporation of India and other financial institutions in the discharge of its overall functions;

(n) exercising all powers and functions in the performance of duties entrusted to the National Housing Bank under this Act or under any other law for the time being in force;

(o) acting as agent of the Central Government, the State Government or the Reserve Bank or of any authority as may be authorised by the Reserve Bank;

(p) any other kind of business which the Central Government may, on the recommendation of the Reserve Bank, authorise;

(q) generally, doing of all such matters and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Act."

ANNEX 4.2

SUMMARY OF REPORT "THE NATIONAL HOUSING BANK: REGULATORY OPTIONS AND ASSESSMENT FACTORS", KAREN J. WILSON, THE URBAN INSTITUTE FOR USAID/NEW DELHI, JANUARY 1988

Successful development of a private housing finance system will be dependent upon the financial integrity of the institutions in the system, and the development of public confidence in these institutions. The National Housing Bank (NHB) was recently created to promote housing finance institutions, provide financing, provide guidelines to promote sound growth and provide technical assistance, as well as to serve several other functions. The purpose of the study was to analyze various options available to the NHB in establishing guidelines and performing its oversight functions.

The scope of work performed included analysis of four housing finance institutions currently in operation. The analysis took in a review of financial information, discussions with management and a review of policies and procedures.' Plans were also discussed with other prospective housing finance companies.

The report discusses the three primary roles of a regulator of housing finance: licensing, oversight of companies' operations, and the closure of institutions. Each section describes:

- o current regulation by the Department of Financial Companies of the Reserve Bank of India;
- o assessment factors generally used by regulators;
- o options for the fole of the NHB; and
- o practices of the Reserve Bank of India and US regulators.

In the area of licensing, options discussed include allowing free entry to all companies, restricting entry to the system and allowing access to the NHB to a restricted group of institutions. If entry to or use of the NHB is to be restricted, four primary factors can be used to assess those qualified for entry: the background of the organizers or ownership, management, market needs and financial viability.

Currently there is free entry into the system. Companies are required to register and the RBI is notified, but there are no capital or other requirements to be met. As a result, HFCs can range in size and sophistication from one man operations to the largest institution, HDFC, which has assets of Rs.615 crores. The institutions reviewed were started by well known respected business and government people. Discussions with a representative of RBI's Department of Finance Companies indicated that HFCs are sometimes used as a vehicle for persons lacking integrity or as a means to avoid taxes or other government limitations. A prerequisite to building depositor confidence in HFCs is to establish the integrity of these institutions.

The report recommends that, in assessing the financial condition of various operations, five factors should be considered. These are: liquidity and funds management, capital, asset quality, earnings and management. In the discussion on liquidity, the report summarizes ways in which the NHB could help to mobilize additional funds for housing finance companies. Options identified include direct loans, purchase of mortgages, guarantees and the development of new mortgage instruments.

The methodology for making assessments in these areas is discussed. Methods that can be used include analysis of financial and non-financial information, on-site inspections and auditor certification. As follow-up to the findings of such oversight, the NHB could be vested with authority to provide a variety of supervisory and enforcement actions.

The report notes that the Department of Financial Companies currently performs a number of regulatory functions. In designing the role of the NHB, efforts should be made to avoid duplication. To the extent possible, regulatory oversight should be centralized in one institution.

The report concludes with a review of the companies visited, evaluated according to the assessment factors discussed in the report. The institutions reviewed were generally in sound condition. In the area of liquidity and funds management, one institution had sound policies, was maintaining adequate liquidity and had adequate funds to meet its commitments. Two others had problems in this area. Both had a low level of liquidity and lacked available funds to meet their commitments. The fourth institution had adequate liquidity for the present. All companies met the RBI's 10% reserve requirement.

Capital was adequate in all of the institutions reviewed. Only one institution had been able to adequately leverage its capital through borrowings and the acceptance of deposits.

Asset quality was generally good. Underwriting standards were generally conservative although one institution had a liberal debt service requirement. There were no past due loans at the two newer institutions. Past dues (over 30 days) ranged from 5.6% to 7.7% at the other institutions. Earnings at all of the institutions were good based on their return on assets, which ranged from 9% to 11%. At two companies the return on assets was unusually high, as capital was the primary funding source. The return on equity ranged from 1.2% to 21.5%. Those comapnies with a high level of capital had a poor return on equity.

Management of the institutions was found to be good. Boards and senior management generally had good experiene. The smaller institutions generally lacked formalized systems such as written policies, MIS, training programs, and planning. Reliance on informal systems is currently acceptable given the size and lack of complexity of these institutions. All companies had an independent external audit as required by law. Two companies also employed internal auditors.

ANNEX 4.3

NHB BOARD OF DIRECTORS

C. (1) The Board of Directors of the National Housing Bank shall consist of the following, namely:—

(a) a Chairman and a Managing Director:

Provided that the same person may be appointed as Chairman and as Managing Director;

(b) three directors from amongst the experts in the field of housing, architecture, engineering, sociology, finance, law, management and corporate planning or in any other field, special knowledge of which is considered useful to the National Housing Bank;

(c) three directors, who shall be persons with experience in the working of institutions involved in providing funds for housing or engaged in housing development;

(d) two directors from out of the directors of the Reserve Bank;

(e) three directors from amongst the officials of the Central Government;

(f) two directors from amongst the officials of the State Government.

(2) The Chairman, the Managing Director and other directors excluding the directors referred to in clause (d), shall be appointed by the Central Government in consultation with the Reserve Bank and directors referred to in clause (d) shall be nominated by the Reserve Bank.

The National Housing Bank Act, 1987

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ANNEX 4.4

RESERVE BANK OF INDIA

BALANCE SHEET AS AT 30TH JUNE 1987

ISSUE DEPARTMENT

LIABILITIES	Rs. P.	Rs. P.	ASSETS	Rs. P.	Rs. P.
Notes held in the Banking Department	16,23,72,540.00		Gold Coin and Bullion:		
Notes in circulation	30917,42,85,343.50		(a) Held in India	274,27,76,380.65	
			(b) Held outside India	—	
			Foreign Securities	1564,05,75,253.50	
Total Notes issued		30933,66,57,883.50	Total		1838,33,51,634.15
			Rupee Coin		56,19,85,449.35
			Government of India Rupee Securities		29039,13,20,800.00
			Internal Bills of Exchange and other Commercial Paper		—
Total Liabilities		30933,66,57,883.50	**Total Assets**		30933,66,57,883.50

BANKING DEPARTMENT

LIABILITIES	Rs. P.	ASSETS	Rs. P.
Capital Paid Up	5,00,00,000.00	Notes	16,23,72,540.00
Reserve Fund	150,00,00,000.00	Rupee Coin	10,13,920.00
National Industrial Credit (LTO) Fund	3725,00,00,000.00	Small Coin	2,87,694.94
Deposits:		Bills Purchased and Discounted:	
(a) Government		(a) Internal	—
(i) Central Government	52,03,91,736.93	(b) External	—
(ii) State Governments	14,98,99,027.19	(c) Government Treasury Bills	3951,67,02,333.14
(b) Banks		Balances held abroad	3675,82,31,835.27
(i) Scheduled Commercial Banks	15853,38,34,875.88	Investments[1]	20058,44,36,934.27
(ii) Scheduled State Co-operative Banks	146,21,63,849.55	Loans and Advances to:	
(iii) Non-Scheduled State Co-operative Banks	8,38,38,937.03	(i) Central Government	—
(iv) Other Banks	27,01,46,455.41	(ii) State Governments[2]	79,98,00,000.00
(c) NABARD Deposit		Loans and Advances to:	
(i) NRC (Long-Term Operations) Fund	—	(i) Scheduled Commercial Banks	853,06,18,378.88
(ii) NRC (Stabilisation) Fund	134,87,20,915.61	(ii) State Co-operative Banks	30,77,59,000.00
(d) Others	4940,79,13,350.59	(iii) NABARD	949,68,16,000.00
Bills Payable	126,50,59,489.06	(iv) Others	107,50,00,000.00
Other Liabilities	9612,12,26,908.55	Loans, Advances & Investments from National Industrial Credit (LTO) Fund:	
		(a) Loans & Advances to:	
		(i) Industrial Development Bank of India	2875,29,80,500.00
		(ii) Export Import Bank of India	345,00,00,000.00
		(b) Investments in bonds/debentures issued by:	
		(i) Industrial Development Bank of India	—
		(ii) Export Import Bank of India	—
		Other Assets[3]	1852,71,76,409.30
Total Liabilities	34796,31,95,545.80	**Total Assets**	34796,31,95,545.80

(1) Includes Rs.2036,55,83,302.37 held abroad in foreign currencies.
(2) Includes Ways & Means Advances.
(3) Includes amounts advanced to or deposited with scheduled commercial banks under special arrangements.

Source: Annual Report of the Reserve Bank of India, 1986-87

(Contd......

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— Concluded

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30TH JUNE 1987

		Rs. P.
INCOME		
Interest, Discount, Exchange, Commission, etc.*		721,37,24,362.17
	Total	**721,37,24,362.17**
EXPENDITURE		
Establishment		137,98,79,616.13
Directors' & Local Board Members' Fees & Expenses		2,72,211.22
Auditors' Fees		9,28,056.24
Rent, Taxes, Insurance, Lighting, etc.		7,38,51,598.34
Law Charges		30,91,509.04
Postage and Telegraph Charges		2,25,05,794.17
Remittance of Treasure		7,87,31,709.85
Stationery, etc.		1,89,63,795.10
Security Printing (Cheque, Note Forms, etc.)		173,04,97,738.50
Depreciation, and Repairs to Bank Property		8,31,98,248.92
Agency Charges		163,64,17,443.29
Contributions to Staff Gratuity and Superannuation Funds		2,65,00,000.00
Miscellaneous Expenses		5,84,82,308.00
	Total	511,33,20,028.80
Net available balance		210,04,04,333.37
	Total	**721,37,24,362.17**
Surplus payable to the Central Government		210,04,04,333.37

*After making statutory contributions, and the usual or necessary provisions in terms of Section 47 of Reserve Bank of India Act, 1934.

RESERVE FUND ACCOUNT

		Rs. P.
Balance on 30th June, 1986		150,00,00,000.00
Transfer from Profit and Loss Account		—
	Total	**150,00,00,000.00**

K.G. PATKAR
Chief Accountant

Dated the 14th August, 1987.

R.N. MALHOTRA — Governor
A. GHOSH — Deputy Governor
C. RANGARAJAN — Deputy Governor
P.D. OJHA — Deputy Governor
P.R. NAYAK — Deputy Governor

REPORT OF THE AUDITORS

TO THE PRESIDENT OF INDIA

We, the undersigned Auditors of the Reserve Bank of India, do hereby report to the Central Government upon the Balance Sheet and Accounts of the Bank as at 30th June, 1987.

We have examined the above Balance Sheet with the Accounts, Certificates and Vouchers relating thereto of all Offices of the bank and report that where we have called for explanations and information from the Central Board, such information and explanations have been given and have been satisfactory. In our opinion, the Balance Sheet is a full and fair Balance Sheet containing the particulars prescribed by and in which the assets have been valued in accordance with Reserve Bank of India Act, 1934 and Regulations framed thereunder and is properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs according to the best of our information and the explanations given to us, and as shown by the Books of the Bank.

Dated the 14th August, 1987

M/s. BRAHMAYYA & CO.
M/s. C.C. CHOKSHI & CO.
M/s. S.R. BATLIBOI & CO. — Auditors
M/s. DASS GUPTA & CO.
M/s. VED & CO.
M/s. HINGORANI M. & CO.

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रजिस्ट्री सं. डी-(डीएन)-127 REGISTERED No. D.(DN)-127

भारत का राजपत्र
The Gazette of India

असाधारण
EXTRAORDINARY
भाग II—खण्ड 1
PART II—Section 1
प्राधिकार से प्रकाशित
PUBLISHED BY AUTHORITY

सं० 76] नई दिल्ली, सोमवार, दिसम्बर 28, 1987/पौष 7, 1909
No. 76] NEW DELHI, MONDAY, DECEMBER 28, 1987/PAUSA 7, 1909

इस भाग में भिन्न पृष्ठ संख्या दी जाती है जिससे कि यह अलग संकलन के रूप में रखा जा सके।
Separate paging is given to this Part in order that it may be filed as a separate compilation

MINISTRY OF LAW AND JUSTICE

(Legislative Department)

New Delhi, the 28th December, 1987/*Pausa* 7, 1909 (*Saka*)

The following Act of Parliament received the assent of the President on the 23rd Decemebr, 1987, and is hereby published for general information:—

THE NATIONAL HOUSING BANK ACT, 1987

No. 53 of 1987

[23*rd December,* 1987.]

An Act to establish a bank to be known as the National Housing Bank 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.

Be it enacted by Parliament in the Thirty-eighth Year of the Republic of India as follows:—

CHAPTER I

PRELIMINARY

1. (*1*) This Act may be called the National Housing Bank Act, 1987. Short title, extent and commencement

(*2*) It extends to the whole of India.

(*3*) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act and any reference in any provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

Definitions.

2. In this Act, unless the context otherwise requires,—

(a) "Board" means the Board of Directors of the National Housing Bank referred to in section 6;

(b) "Chairman" means the Chairman of the Board appointed under section 6;

(c) "director" means a director appointed under section 6;

(d) "housing finance institution" includes every institution, whether incorporated or not, which primarily transacts or has as its principal object, the transacting of the business of providing finance for housing, whether directly or indirectly;

(e) "Managing Director" means the Managing Director appointed under section 6;

(f) "National Housing Bank" means the National Housing Bank established under section 3;

(g) "notification" means a notification published in the Official Gazette;

(h) "prescribed" means prescribed by regulations made under this Act;

(i) "Reserve Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934; 2 of 1934.

(j) words and expressions used herein and not defined but defined in the Reserve Bank of India Act, 1934, shall have the meanings respectively assigned to them in that Act; 2 of 1934.

(k) words and expressions used herein and not defined either in this Act or in the Reserve Bank of India Act, 1934, but defined in the Banking Regulation Act, 1949, shall have the meanings respectively assigned to them in the Banking Regulation Act, 1949. 2 of 1934. 10 of 1949.

CHAPTER II

ESTABLISHMENT OF THE NATIONAL HOUSING BANK AND CAPITAL THEREOF

Establishment and incorporation of National Housing Bank.

3. (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established for the purposes of this Act, a bank to be known as the National Housing Bank.

(2) The National Housing Bank shall be a body corporate with the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property and to contract, and may, by that name, sue and be sued.

(3) The head office of the National Housing Bank shall be at Bombay or at such other place as the Reserve Bank may, by notification, specify.

(4) The National Housing Bank may establish offices, branches or agencies at any place in India, and with the previous approval of the Reserve Bank, at any place outside India.

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Capital.

4. The authorised and paid up capital of the National Housing Bank shall be one hundred crores of rupees and shall be subscribed by the Reserve Bank:

Provided that the Central Government may, in consultation with the Reserve Bank, by notification, increase the said capital up to five hundred crores of rupees and the capital so increased shall also be subscribed by the Reserve Bank.

CHAPTER III

MANAGEMENT OF THE NATIONAL HOUSING BANK

Management.

5. (1) The general superintendence, direction and management of the affairs and business of the National Housing Bank shall vest in the Board of Directors, which shall exercise all powers and do all acts and things, which may be exercised or done by the National Housing Bank.

(2) Subject to the provisions of this Act, the Board, in discharging its functions, shall act on business principles with due regard to public interest.

(3) Subject to the provisions of sub-section (1) and save as otherwise provided in the regulations made under this Act,—

(a) the Chairman, if he is holding offices both as the Chairman and the Managing Director, or

(b) the Managing Director, if the Chairman is absent,

shall also have powers of general superintendence, direction and management of the affairs and business of the National Housing Bank and may also exercise all powers and do all acts and things which may be exercised or done by the National Housing Bank and shall act on business principles with due regard to public interest.

(4) The Managing Director shall, in the discharge of his powers and functions, follow such directions as the Chairman may give.

(5) In the discharge of its functions under this Act, the National Housing Bank shall be guided by such directions in matters of policy involving public interest as the Central Government, in consultation with the Reserve Bank, or the Reserve Bank, may give in writing.

Board of Directors.

6. (1) The Board of Directors of the National Housing Bank shall consist of the following, namely:—

(a) a Chairman and a Managing Director:

Provided that the same person may be appointed as Chairman and as Managing Director;

(b) three directors from amongst the experts in the field of housing, architecture, engineering, sociology, finance, law, management and corporate planning or in any other field, special knowledge of which is considered useful to the National Housing Bank;

(c) three directors, who shall be persons with experience in the working of institutions involved in providing funds for housing or engaged in housing development;

(d) two directors from out of the directors of the Reserve Bank;

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(e) three directors from amongst the officials of the Central Government;

(f) two directors from amongst the officials of the State Government.

(2) The Chairman, the Managing Director and other directors excluding the directors referred to in clause (d), shall be appointed by the Central Government in consultation with the Reserve Bank and directors referred to in clause (d) shall be nominated by the Reserve Bank.

Term of office of Chairman, Managing Director and other directors, service conditions, etc.

7. (1) The Chairman and the Managing Director shall hold office for such term, not exceeding five years and shall receive such salary and allowances and be governed by such terms and conditions of service as the Central Government may, in consultation with the Reserve Bank, specify and shall be eligible for re-appointment:

Provided that the Chairman or, as the case may be, the Managing Director shall, notwithstanding the expiration of his term, continue to hold office until his successor enters upon his office.

(2) The directors referred to in clauses (b) and (c) of sub-section (1) of section 6 shall hold office for a term of three years:

Provided that any such director shall, notwithstanding the expiration of his term, continue to hold office until his successor enters upon his office.

(3) The Central Government may, in consultation with the Reserve Bank, remove the Chairman or the Managing Director, or any other director referred to in sub-section (2), at any time before the expiry of his term of office after giving him a reasonable opportunity of showing cause against the proposed removal.

(4) Notwithstanding anything contained in sub-sections (1) and (3), the Central Government, in consultation with the Reserve Bank, shall have the right to terminate the term of office of the Chairman or, as the case may be, the Managing Director, at any time before the expiry of the term specified under sub-section (1), by giving him notice of not less than three months in writing or three months' salary and allowances in lieu thereof and the Chairman or the Managing Director, as the case may be, shall also have the right to relinquish his office at any time before the expiry of the term specified under sub-section (1), by giving to the Central Government notice of not less than three months in writing or three months' salary and allowances in lieu thereof.

(5) The directors shall be paid such fees and allowances as may be prescribed for attending the meetings of the Board or of any of its committees and for attending to any other work of the National Housing Bank:

Provided that no such fee shall be payable to any director, who is an official of the Government or a director of the Reserve Bank.

Disqualifications.

8. No person shall be a director of the Board, if he—

(a) is, or becomes of unsound mind and has been so declared by a competent court; or (*b*) is or has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude; or

(*c*) is, or at any time has been, adjudicated as insolvent or has suspended payment of his debts or has compounded with his creditors; or

(*d*) has, for any reason, been removed or dismissed from the service of—

(*i*) the Government, or

(*ii*) the Reserve Bank, the State Bank or any other bank, or

(*iii*) any public financial institution, or state financial corporation, or

(*iv*) any other corporation owned or controlled by the Government.

Vacation and resignation of office by directors.

9. (*1*) If a director—

(*a*) becomes subject to any of the disqualifications mentioned in section 8; or

(*b*) is absent without leave of the Board for three or more consecutive meetings thereof,

his seat shall thereupon become vacant.

(*2*) Any director may resign his office by giving notice thereof in writing to the authority that appointed or, as the case may be, nominated him and on his resignation being accepted by such authority or if his resignation is not sooner accepted, on the expiry of three months from the receipt thereof by such appointing authority, he shall be deemed to have vacated his office.

Casual vacancy in the office of Chairman or Managing Director.

10. If the Chairman, or as the case may be, the Managing Director, is by infirmity or otherwise rendered incapable of carrying out his duties or is absent on leave or otherwise, in circumstances not involving the vacation of his appointment, the Central Government may, appoint another person to act in his place during his absence.

Meetings of Board.

11. (*1*) The Board shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings, as may be prescribed.

(*2*) The Chairman, or, if for any reason he is unable to attend a meeting of the Board, the Managing Director, or, in the event of both the Chairman and the Managing Director being unable to attend a meeting, any other director nominated by the Chairman in this behalf and in the absence of such nomination, any director elected by the directors present from among themselves at the meeting, shall preside at the meeting.

(*3*) All questions which come up before any meeting of the Board shall be decided by a majority of votes of the directors present and voting, and in the event of an equality of votes, the Chairman, or, in his absence, the person presiding, shall have a second or casting vote.

Executive Committee and other committees.

12. (1) The Board may constitute an Executive Committee consisting of such number of directors as may be prescribed.

(2) The Executive Committee shall discharge such functions as may be prescribed, or, as may be delegated to it, by the Board.

(3) The Board may constitute such other committees, whether consisting wholly of directors or wholly of other persons or partly of directors and partly of other persons as it thinks fit for such purposes, as it may decide and any committee so constituted shall discharge such functions as may be delegated to it by the Board.

(4) The Executive Committee or any other committee constituted under this section shall meet at such times and places and shall observe such rules of procedure in regard to transaction of business at its meetings, as may be prescribed.

Director of Board or member of committee thereof not to participate in meetings in certain cases.

13. Any director of the Board or any member of a committee, who has any direct or indirect pecuniary interest in any matter coming up for consideration at a meeting of the Board or a committee thereof, shall, as soon as possible after relevant circumstances have come to his knowledge, disclose the nature of his interest at such meeting and the disclosure shall be recorded in the mihutes of the Board, or the committee, as the case may be, and the director or member shall not take any part in any deliberation or decision of the Board or the committee with respect to that matter.

CHAPTER IV

BUSINESS OF THE NATIONAL HOUSING BANK

Business of the National Housing Bank.

14. Subject to the provisions of this Act, the National Housing Bank may transact all or any of the following kinds of business, namely:—

(a) promoting, establishing, supporting or aiding in the promotion, establishment and support of housing finance institutions;

(b) making of loans and advances or rendering any other form of financial assistance whatsoever to housing finance institutions and scheduled banks;

(c) subscribing to or purchasing stocks, shares, bonds, debentures and securities of every other description;

(d) guaranteeing the financial obligations of housing finance institutions and underwriting the issue of stocks, shares, bonds, debentures and securities of every other description of housing finance institutions;

(e) drawing, accepting, discounting or rediscounting, buying or selling and dealing in bills of exchange, promissory notes, bonds, debentures, hundies, coupons and other instruments by whatever name called;

(f) forming, promoting and managing subsidiaries for carrying out all or any of its functions under this Act;

(g) undertaking research and surveys on construction techniques and other studies relating to or connected with shelter, housing and human settlement;

(h) formulating one or more schemes for the purpose of mobilisation of resources and extension of credit for housing;

(i) formulating one or more schemes for the economically weaker sections of society which may be subsidised by the Central Government or any State Government or any other source;

(j) organising training programmes, seminars and symposia on matters relating to housing;

(k) providing guidelines to the housing finance institutions to ensure their growth on sound lines;

(l) providing technical and administrative assistance to housing finance institutions;

(m) co-ordinating with the Life Insurance Corporation of India, the Unit Trust of India, the General Insurance Corporation of India and other financial institutions, in the discharge of its overall functions;

(n) exercising all powers and functions in the performance of duties entrusted to the National Housing Bank under this Act or under any other law for the time being in force;

(o) acting as agent of the Central Government, the State Government or the Reserve Bank or of any authority as may be authorised by the Reserve Bank;

(p) any other kind of business which the Central Government may, on the recommendation of the Reserve Bank, authorise;

(q) generally, doing of all such matters and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Act.

Borrowings and acceptance of deposits by National Housing Bank.

15. (1) The National Housing Bank may, for the purpose of carrying out its functions under this Act—

(a) issue and sell bonds and debentures with or without the guarantee of the Central Government, in such manner and on such terms as may be prescribed;

(b) borrow money from the Central Government and from any other authority or organisation or institution approved by that Government on such terms and conditions as may be agreed upon;

(c) accept deposits repayable after the expiry of a period which shall not be less than twelve months from the date of the making of the deposit on such terms as may generally or specially be approved by the Reserve Bank;

(d) borrow money from the Reserve Bank—

(i) repayable on demand or on the expiry of fixed periods not exceeding eighteen months from the date of the making of loan or advance, on such terms and conditions including the terms relating to security and purpose as may be specified by the Reserve Bank;

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(ii) out of the National Housing Credit (Long Term Operations) Fund established under section 46D of the Reserve Bank of India Act, 1934 for any of the purposes specified in that section; 2 of 1934.

(e) receive for services rendered, such remuneration, commission, commitment charges, consultancy charges, service charges, royalties, premia, licence fees and any other consideration of whatever description;

(f) receive gifts, grants, donations or benefactions from Government or any other source.

(2) The Central Government may, on a request being made to it by the National Housing Bank, guarantee the bonds and debentures issued by the National Housing Bank as to the repayment of principal and the payment of interest at such rate as may be fixed by that Government.

Loans in foreign currency.

16. (1) Notwithstanding anything contained in the Foreign Exchange Regulation Act, 1973 or in any other law for the time being in force relating to foreign exchange, the National Housing Bank may, for the purpose of making loans and advances under this Act, borrow in such manner and on such conditions as may be prescribed in consultation with the Reserve Bank and with the previous approval of the Central Government, foreign currency from any bank or financial institution in India or elsewhere. 46 of 1973.

(2) The Central Government may, where necessary, guarantee any loan taken by the National Housing Bank under sub-section (1) or any part thereof as to the repayment of principal and the payment of interest and other incidental charges.

Power to transfer rights.

17. The rights and interests of the National Housing Bank (including any other rights incidental thereto) in relation to any loan or advance made, or any amount recoverable, by it, may be transferred by the National Housing Bank, either in whole or in part, by the execution or issue of any instrument or by the transfer of any instrument by endorsement, or in any other manner in which the rights and interests in relation to such loan or advance may be lawfully transferred, and the National Housing Bank may, notwithstanding such transfer, act as the trustee within the meaning of section 3 of the Indian Trusts Act, 1882, for the transferee. 2 of 1882.

Power to acquire rights.

18. The National Housing Bank shall have the right to acquire, by transfer or assignment, the rights and interests of any housing finance institution (including any other rights incidental thereto) in relation to any loan or advance made, or any amount recoverable by such institution, either in whole or in part, by the execution or issue of any instrument or by the transfer of any instrument or in any other manner in which the rights and interests in relation to such loan or advance may be lawfully transferred.

Power to impose conditions for accommodation

19. In entering into any transaction under this Chapter with any borrowing housing finance institution, the National Housing Bank may impose such conditions as it may think necessary or expedient for protecting the interests of the National Housing Bank.

20. Notwithstanding anything to the contrary contained in any agreement, the National Housing Bank may, by notice in writing, require any borrowing housing finance institution to discharge forthwith in full its liabilities to the National Housing Bank—

Power to call for repayment before agreed period.

(a) if it appears to the Board that false or misleading information in any material particular was given in the application for the loan or advance; or

(b) if the borrowing housing finance institution has failed to comply with any of the terms of the agreement with the National Housing Bank in the matter of the loan or advance; or

(c) if there is a reasonable apprehension that the borrowing housing finance institution is unable to pay its debts or that proceedings for liquidation may be commenced in respect thereof; or

(d) if for any reason, it is necessary so to do to protect the interests of the National Housing Bank.

21. (1) The National Housing Bank shall have free access to all such records of any housing finance institution which seeks to avail of any credit facilities from the National Housing Bank and to all such records of any person who seeks to avail of any credit facilities from such housing finance institution, the perusal of which may appear to the National Housing Bank to be necessary in connection with the providing of finance or other assistance to such housing finance institution or the refinancing of any loan or advance made to such person by that housing finance institution.

National Housing Bank to have access to records.

(2) The National Housing Bank may require any institution or person referred to in sub-section (1), to furnish to it copies of any of the records referred to in that sub-section and the institution or the person, as the case may be, shall be bound to comply with such requisition.

22. Notwithstanding anything to the contrary contained in any other law for the time being in force, the validity of any loan or advance made by the National Housing Bank in pursuance of the provisions of this Act shall not be called in question merely on the ground of non-compliance with the requirements of such other law or of any resolution, contract, or any instrument regulating the constitution of the borrowing housing finance institution:

Validity of loan or advance not to be questioned.

Provided that nothing in this section shall enable any company or co-operative society to obtain any loan or advance where the instrument relating to the constitution of such company or co-operative society does not empower such company or co-operative society so to do.

23. The National Housing Bank shall not make any loan or advance on the security of its own bonds or debentures.

National Housing Bank not to make loans or advances against its own bonds or debentures.

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Power to inspect.

24. (*1*) The National Housing Bank may at any time and shall, on being directed so to do by the Reserve Bank, cause an inspection to be made by one or more of its officers of any housing finance institution to which the National Housing Bank has made any loan or advance or granted any other financial assistance, and its books, accounts and other documents; and the National Housing Bank shall supply to the housing finance institution a copy of its report on such inspection.

(*2*) It shall be the duty of every officer, employee or other person or persons in charge of the whole or part of the affairs of the housing finance institution to produce to any officer making an inspection under sub-section (*1*), all such books, accounts and other documents in his custody or power and to furnish within such time as the said officer may specify, any statements, information relating to the affairs of the housing finance institution as the said officer may require of him.

Power to collect credit information.

25. (*1*) The National Housing Bank may, for the purpose of the efficient discharge of its functions under this Act, at any time direct any housing finance institution to submit to it credit information in such form and within such time as may be specified by the National Housing Bank from time to time.

(*2*) Every housing finance institution shall, notwithstanding anything to the contrary contained in any law for the time being in force or in any instrument regulating the constitution thereof or in any agreement executed by it, relating to the secrecy of its dealings with its constituents, be bound to comply with any directions issued under sub-section (*1*).

(*3*) The National Housing Bank may, for the purpose of the efficient discharge of its functions under this Act, collect from the Central and State Governments, local authorities, the Reserve Bank, any bank or such financial or other institutions as the Reserve Bank may specify in this behalf, credit information or other information.

Explanation.—For the purposes of this section and section 26, credit information means any information relating to—

(*i*) the amount of loans and advances and other credit facilities granted for the purpose of housing;

(*ii*) the nature of security taken for such loans, advances or other credit facilities;

(*iii*) the guarantees furnished; and

(*iv*) any other information which has a bearing on the creditworthiness of the borrower.

Power to publish information.

26. The National Housing Bank, if it considers it in the public interest so to do, may publish any credit information or other information obtained by it under this Act, in such consolidated form or in any other form as it thinks fit.

Advisory services

27. The National Housing Bank may provide advisory services to the Central and State Governments, local authorities and other agencies connected with housing, in respect of—

(*a*) formulation of overall policies aimed at promoting the growth of housing and housing finance institutions;

(b) legislation relating to matters having a bearing on shelter, housing and human settlement.

CHAPTER V

PROVISIONS RELATING TO HOUSING FINANCE INSTITUTIONS RECEIVING DEPOSITS

Definition of deposit.

28. In this Chapter the term 'deposit' shall have the meaning assigned to it in section 45I of the Reserve Bank of India Act, 1934. 2 of 1934.

Chapter not to apply in certain cases.

29. (1) The provisions of this Chapter shall not apply to deposits accepted by a housing finance institution which is a firm or an unincorporated association of individuals.

(2) For the removal of doubts, it is hereby declared that the firms and unincorporated associations of individuals referred to in sub-section (1) shall continue to be governed by the provisions of Chapter IIIC of the Reserve Bank of India Act, 1934. 2 of 1934.

National Housing Bank to regulate or prohibit issue of prospectus or advertisement soliciting deposits of money.

30. The National Housing Bank may, if it considers necessary in the public interest so to do, by general or special order,—

(a) regulate or prohibit the issue by any housing finance institution of any prospectus or advertisement soliciting deposits of money from the public; and

(b) specify the conditions subject to which any such prospectus or advertisement, if not prohibited, may be issued.

Power of National Housing Bank to collect information from housing finance institutions as to deposits and to give directions.

31. (1) The National Housing Bank may at any time direct that every housing finance institution accepting deposits shall furnish to the National Housing Bank in such form, at such intervals and within such time, such statements, information or particulars relating to or connected with deposits received by the housing finance institution, as may be specified by the National Housing Bank by general or special order.

(2) Without prejudice to the generality of the power vested in the National Housing Bank under sub-section (1), the statements, information or particulars to be furnished under sub-section (1), may relate to all or any of the following matters, namely, the amount of the deposits, the purposes and periods for which and the rates of interest and other terms and conditions on which, such deposits are received.

(3) The National Housing Bank may, if it considers necessary in the public interest so to do, give directions to housing finance institutions accepting deposits either generally or to any group of housing finance institutions accepting deposits, and in particular, in respect of any matters relating to, or connected with, the receipt of deposits, including the rates of interest payable on such deposits, and the periods for which deposits may be received.

(4) If any housing finance institution accepting deposits fails to comply with any direction given by the National Housing Bank, under

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sub-section (3), the National Housing Bank may prohibit the acceptance of deposits by that housing finance institution.

(5) Every housing finance institution receiving deposits, shall, if so required by the National Housing Bank and within such time as the National Housing Bank may specify, cause to be sent at the cost of the housing finance institution, a copy of its annual balance-sheet and profit and loss account or other annual accounts to every person from whom the housing finance institution holds, as on the last day of the year to which the accounts relate, deposits higher than such sum as may be specified by the National Housing Bank.

Duty of housing finance institutions to furnish statements, etc., required by National Housing Bank.

32. Every housing finance institution shall furnish the statements, information or particulars called for, in such form as may be prescribed, and comply with any direction given to it, under the provisions of this Chapter.

Powers and duties of auditors.

33. (1) The auditor of every housing finance institution shall enquire whether or not the housing finance institution has furnished to the National Housing Bank such statements, information or particulars relating to or connected with deposits received by it, as are required to be furnished under this Chapter, and the auditor shall, except where he is satisfied on such enquiry that the housing finance institution has furnished such statements, information or particulars, make a report to the National Housing Bank giving the aggregate amount of such deposits held by the housing finance institution.

(2) Where, in the case of a housing finance institution, being a company, the auditor has made, or intends to make a report to the National Housing Bank under sub-section (1), he shall include in his report under sub-section (2) of section 227 of the Companies Act, 1956, the contents of the report which he has made, or intends to make, to the National Housing Bank. 1 of 1956.

Inspection.

34. (1) The National Housing Bank may, at any time, cause an inspection to be made by one or more of its officers or employees or other persons (hereafter in this section referred to as the inspecting authority) of any housing finance institution accepting deposits, for the purpose of verifying the correctness or completeness of any statement, information or particulars furnished to the National Housing Bank or for the purpose of obtaining any information or particulars which the housing finance institution has failed to furnish on being called upon to do so.

(2) It shall be the duty of every director or member of any committee or other body or any person for the time being vested with the management of the whole or part of the affairs of every housing finance institution accepting deposits or other officer or employee

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thereof to produce to the inspecting authority all such books, accounts and other documents in his custody or power and to furnish that authority with any statement and information relating to the business of the institution as that authority may require of him, within such time as may be specified by that authority.

(3) The inspecting authority may examine on oath any director or member of any committee or body or any other person for the time being vested with the management of the affairs of the housing finance institution accepting deposits, or any officer or employee thereof, in relation to its business.

Deposits not to be solicited by unauthorised persons.

35. No person shall solicit on behalf of any housing finance institution either by publishing or causing to be published any prospectus or advertisement or in any other manner deposits of money from the public unless—

(a) he has been authorised in writing by the said housing finance institution to do so and specifies the name of the institution which has so authorised him; and

(b) the prospectus or advertisement complies with any order made by the National Housing Bank under section 30 and with any other provision of law for the time being in force applicable to the publication of such prospectus or advertisement.

Chapter V to override other laws.

36. The provisions of this Chapter shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

CHAPTER VI

FUNDS, ACCOUNTS AND AUDIT

General Fund and other funds.

37. (1) With effect from such date as the Reserve Bank may specify, the National Housing Bank shall establish a fund to be called the General Fund and all payments by the National Housing Bank shall be made out of the said General Fund.

(2) The Board may, and shall, if so directed by the Reserve Bank, create a special fund or a reserve fund or such other funds as may be prescribed.

Preparation of balance sheet, etc., of National Housing Bank.

38. (1) The balance sheet and accounts of the National Housing Bank shall be prepared and maintained in such form and manner as may be prescribed.

(2) The Board shall cause the books and accounts of the National Housing Bank to be balanced and closed as on the thirtieth day of June, each year.

Disposal of surplus.

39. After making provision for bad and doubtful debts, depreciation of assets and all other matters for which provision is necessary or expedient or which is usually provided for by bankers, the National Housing Bank shall transfer—

(i) for a period of fifteen years, following the accounting year during which the National Housing Bank is established, the amount

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remaining (hereafter in this section referred to as surplus) such of the funds referred to in section 37 as the Reserve Bank may specify; and

(ii) after the expiry of the said period of fifteen years, the National Housing Bank shall, after making provision for the funds referred to in section 37, transfer the balance of surplus to the Reserve Bank.

Audit. **40.** (*1*) The accounts of the National Housing Bank shall be audited by auditors duly qualified to act as auditors under sub-section (*1*) of section 226 of the Companies Act, 1956, who shall be appointed by the Reserve Bank, for such term and on such remuneration as the Reserve Bank may fix. 1 of 1956.

(*2*) The auditors shall be supplied with a copy of the annual balance sheet of the National Housing Bank and it shall be their duty to examine it together with the accounts and vouchers relating thereto and they shall have a list delivered to them of all books kept by the National Housing Bank and shall at all reasonable times have access to the books, accounts, vouchers and other documents of the National Housing Bank.

(*3*) The auditors may, in relation to the accounts of the National Housing Bank, examine any director of the Board or any officer or other employee of the National Housing Bank and shall be entitled to require from the Board or officers or other employees of the National Housing Bank such information and explanation as they may think necessary for the performance of their duties.

(*4*) The auditors shall make a report to the National Housing Bank upon the annual balance sheet and accounts examined by them and in every such report, they shall state whether in their opinion the balance sheet is a full and fair balance-sheet containing all necessary particulars and properly drawn up so as to exhibit a true and fair view of the state of affairs of the National Housing Bank and in case they had called for any explanation or information from the Board or any officer or other employee of the National Housing Bank, whether it was given and whether it was satisfactory.

(*5*) The National Housing Bank shall furnish to the Central Government and the Reserve Bank within three months from the date on which the annual accounts of the National Housing Bank are closed and balanced, a copy of its balance sheet as on the close of the relevant year together with a copy of the profit and loss account for the year and a copy of the auditors' report and a report of the working of the National Housing Bank during that year, and the Central Government shall, as soon as may be after they are received by it, cause the same to be laid before each House of Parliament.

(*6*) Without prejudice to anything contained in the preceding sub-sections, the Central Government may, at any time, appoint the Comptroller and Auditor-General of India to examine and report upon the accounts of the National Housing Bank and any expenditure incurred by him in connection with such examination and report shall be payable by the National Housing Bank to the Comptroller and Auditor-General of India.

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41. The National Housing Bank shall furnish, from time to time, to the Reserve Bank such information and returns as the Reserve Bank may require. Returns

42. The National Housing Bank shall make an annual report to the Central Government and the Reserve Bank on the trend and progress of housing in the country and in that report may make such suggestions as it may think necessary or expedient for the development of housing and the Central Government shall, as soon as may be after the report is received by it, cause the same to be laid before each House of Parliament. Annual report on housing.

CHAPTER VII

MISCELLANEOUS

43. (1) The National Housing Bank may appoint such number of officers and other employees as it considers necessary or desirable for the efficient performance of its functions and determine the terms and conditions of their appointment and service. Staff of National Housing Bank.

(2) The duties and conduct, terms and conditions of service and the establishment and maintenance of provident fund or any other fund for the benefit of the officers and other members of staff of the National Housing Bank shall be such as may be prescribed.

(3) The National Housing Bank may depute any officer or any member of its staff for such period and on such terms and conditions as it may determine, to any institution including a housing finance institution.

(4) Nothing contained in this section shall empower the National Housing Bank to depute any officer or member of its staff to any institution on any salary, emoluments or other terms and conditions which is or are less favourable to him than that or those to which he is entitled to immediately before such deputation.

2 of 1934. (5) The National Housing Bank may, without prejudice to the provisions of section 54AA of the Reserve Bank of India Act, 1934, receive or take on deputation any officer or other employee from any institution including a housing finance institution for such period and on such terms and conditions as it may think necessary in the interest of the National Housing Bank.

44. (1) The National Housing Bank shall not, except as otherwise required by this Act or any other law, divulge any information relating to, or to the affairs of, its constituents except in circumstances in which it is, in accordance with the law or practice and usage customary among bankers, necessary or appropriate for the National Housing Bank to divulge such information. Obligation as to fidelity and secrecy.

(2) Every director, member of a committee, auditor, advisor, officer or other employee of the National Housing Bank or of the Reserve Bank, whose services are utilised by the National Housing Bank under the provisions of this Act, shall, before entering upon his duties, make a declaration of fidelity and secrecy in the form set out in the First Schedule to this Act.

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Defects in appointment not to invalidate acts, etc.

45. (1) No act or proceeding of the Board or of any committee of the National Housing Bank shall be questioned on the ground merely of the existence of any vacancy in, or defect in the constitution of, the Board or the committee, as the case may be.

(2) No act done by any person acting in good faith as a director of the Board or as a member of a committee of the National Housing Bank shall become invalid merely on the ground that he was disqualified to be a director or that there was any other defect in his appointment.

Protection of action taken under the Act.

46. No suit or other legal proceeding shall lie against the National Housing Bank or any director or any officer or other employee of the National Housing Bank or any other person authorised by the National Housing Bank to discharge any functions under this Act for any loss or damage caused or likely to be caused by anything which is in good faith done or intended to be done in pursuance of this Act or of any other law or provision having the force of law.

Indemnity of directors.

47. (1) Every director shall be indemnified by the National Housing Bank against all losses and expenses incurred by him in, or in relation to, the discharge of his duties, except such as are caused by his own wilful act or default.

(2) A director shall not be responsible for any other director or for any officer or other employee of the National Housing Bank or for any loss or expenses resulting to the National Housing Bank from the insufficiency or deficiency of the value of, or title to, any property or security acquired or taken on behalf of the National Housing Bank or the insolvency or wrongful act of any debtor or any person under obligation to the National Housing Bank or anything done in good faith in the execution of the duties of his office in relation thereto.

Exemption from tax on income.

48. Notwithstanding anything contained in the Income-tax Act, 1961, or any other enactment for the time being in force relating to tax on income, profits or gains, the National Housing Bank shall not be liable to pay income-tax or any other tax in respect of its income, profits or gains derived. 43 of 1961.

Penalties.

49. (1) Whoever in any return, balance sheet, or other document or in any information required or furnished by or under or for the purposes of any provision of this Act, wilfully makes a statement which is false in any material particular, knowing it to be false, or wilfully omits to make a material statement, shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.

(2) If any person fails to produce any book, account or other document, or to furnish any statement or information which, under the provisions of this Act, it is his duty to produce or furnish, he shall be punishable with fine which may extend to two thousand rupees in respect of each offence and in the case of a continuing failure, with an additional fine which may extend to one hundred rupees for every day during which the failure continues after conviction for the first such failure.

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[illegible]

(a) [illegible] in contravention of any direction given or order made under Chapter V; or

(b) issues any prospectus or advertisement otherwise than in accordance with section 35 or any order made under section 30, as the case may be;

he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine which may extend,—

(i) in the case of a contravention falling under clause (a), to twice the amount of deposit received; and

(ii) in the case of a contravention falling under clause (b), to twice the amount of the deposit called for by the prospectus or advertisement.

(4) If any other provision of this Act is contravened or if any default is made in complying with any other requirement of this Act, or of any order, regulation or direction made or given or condition imposed thereunder, any person guilty of such contravention or default shall be punishable with fine which may extend to two thousand rupees and where a contravention or default is a continuing one, with further fine which may extend to one hundred rupees for every day, after the first, during which the contravention or default continues.

Offences by companies

50. (1) Where an offence has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

(2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation.—For the purposes of this section—

(a) "company" means any body corporate and includes a firm or other association of individuals; and

(b) "director", in relation to a firm, means a partner in the firm.

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Cognizance of offences.

51. (*1*) No court shall take cognizance of any offence punishable under this Act except upon a complaint in writing made by an officer of the National Housing Bank, generally or specially authorised in writing in this behalf by the National Housing Bank, and no court other than that of a Metropolitan Magistrate or a Judicial Magistrate of the first class or a court superior thereto shall try any such offence.

(*2*) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, a Magistrate may, if he sees reason so to do, dispense with the personal attendance of the officer of the National Housing Bank filing the complaint but the Magistrate may in his discretion, at any stage of the proceedings, direct the personal attendance of the complainant. 2 of 1974.

Application of fine.

52. A court imposing any fine under this Act may direct that the whole or any part thereof shall be applied in, or towards payment of, the cost of the proceedings.

Bankers' Books Evidence Act 18 of 1891, to apply in relation to National Housing Bank.

53. The Bankers' Books Evidence Act, 1891, shall apply in relation to the National Housing Bank as if it were a bank as defined in section 2 of that Act.

Liquidation of National Housing Bank.

54. No provision of law relating to the winding up of companies shall apply to the National Housing Bank and the National Housing Bank shall not be placed in liquidation save by order of the Central Government and in such manner as it may direct.

Power of the Board to make regulations.

55. (*1*) The Board may, with the previous approval of the Reserve Bank and in consultation with the Central Government, by notification, make regulations not inconsistent with this Act to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

(*2*) In particular and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:—

(*a*) the fees and allowances that may be paid to the directors for attending the meetings of the Board or its committees under sub-section (*5*) of section 7;

(*b*) the times and places at which the Board may meet, and the rules of procedure that may be followed in regard to the transaction of business under sub-section (*1*) of section 11;

(*c*) the number of members that the Executive Committee may consist, the functions that it may discharge and times and places at which it shall meet and the rules of procedure that it may follow in the transaction of business under section 12;

(d) the manner and terms of issue and redemption of bonds and debentures under clause (a) of sub-section (1) of section 15;

(e) the manner in which and the conditions subject to which the National Housing Bank may borrow in foreign currency under sub-section (1) of section 16;

(f) the form in which the statements, information, etc., are to be furnished under section 32;

(g) the special fund, reserve fund and other funds to be created under sub-section (2) of section 37;

(h) the form and manner in which the balance sheet and accounts shall be prepared and maintained under sub-section (1) of section 38;

(i) the duties and conduct, salaries, allowances and conditions of service of the officers and other members of staff of the National Housing Bank under section 43;

(j) the establishment and maintenance of provident fund and any other fund for the benefit of officers and other members of staff of the National Housing Bank under section 43; and

(k) any other matter which is to be, or may be, prescribed.

(3) Any regulation which may be made by the Board under this Act may be made by the Reserve Bank, in consultation with the Central Government, before the expiry of three months from the date of establishment of the National Housing Bank, and any regulation so made may be altered and rescinded by the Board in the exercise of its powers under this Act.

(4) The power to make regulations conferred by this section shall include the power to give retrospective effect to the regulations or any of them from a date not earlier than the date of commencement of this Act, but no retrospective effect shall be given to any regulation so as to prejudicially affect the interests of any person to whom such regulation may be applicable.

(5) The Central Government shall cause every regulation made under this Act to be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation or both Houses agree that the regulation should not be made, the regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation.

Amendment of certain enactments.

56. The enactments specified in the Second Schedule to this Act shall be amended in the manner provided therein and unless otherwise provided in that Schedule, such amendments shall take effect on and from the date of establishment of the National Housing Bank under section 3.

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Power to remove difficulties.

57. If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, not inconsistent with the provisions of this Act, remove the difficulty:

Provided that no such order shall be made after the expiry of a period of three years from the commencement of this Act.

THE FIRST SCHEDULE

[*See* section 44(2)]

DECLARATION OF FIDELITY AND SECRECY

I,........................ do hereby declare that I will faithfully, truly and to the best of my skill and ability execute and perform the duties required of me as director, member of the .... committee, auditor, advisor, officer or other employee (as the case may be) of the National Housing Bank and which properly relate to the office or position held by me in or in relation to the said National Housing Bank.

I further declare that I will not communicate or allow to be communicated to any person not legally entitled thereto any information relating to the affairs of the National Housing Bank nor will I allow any such person to inspect or have access to any books or documents belonging to or in the possession of the National Housing Bank and relating to the business of the said National Housing Bank or the business of any person having any dealing with the said National Housing Bank.

Signed before me. (*Signature*)

THE SECOND SCHEDULE

(*See* section 56)

AMENDMENTS TO CERTAIN ENACTMENTS

PART I

AMENDMENTS TO THE RESERVE BANK OF INDIA ACT, 1934

(2 OF 1934)

AMENDMENTS

1. In section 2, after clause (ccc), the following clause shall be inserted, namely:—

"(cccc) 'National Housing Bank' means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987;".

2. In section 17,—

(i) after clause (4D), the following clause shall be inserted, namely:—

"(4DD) the making to the National Housing Bank of loans and advances and generally assisting the National Housing Bank in such manner and on such terms as may be determined by the Central Board;";

(ii) after clause (4G), the following clause shall be inserted, namely:—

"(4GG) the making of loans and advances to, and the purchasing of bonds and debentures of, the National Housing Bank out of the National Housing Credit (Long Term Operations) Fund established under section 46D;";

(iii) after clause (8A), the following clause shall be inserted, namely:—

"(8AA) the promoting, establishing, supporting or aiding in the promotion, establishment and support of any financial institution, whether as its subsidiary or otherwise;".

3. In the *Explanation* to sub-section (1) of section 42, in sub-clause (ii) of clause (c), after the words "or from the Reconstruction Bank", the words "or from the National Housing Bank" shall be inserted.

4. After section 46C, the following section shall be inserted, namely:— National Housing Credit (Long Term Operations) Fund.

"46D. (1) The Bank shall establish and maintain a Fund to be known as the National Housing Credit (Long Term Operations) Fund to which shall be credited every year such sums of money as it may consider necessary.

(2) The amount in the said Fund shall be applied by the Bank only to the following objects, namely:—

(a) the making to the National Housing Bank of loans and advances for the purpose of any business of the National Housing Bank;

(b) the purchasing of bonds and debentures issued by the National Housing Bank.".

PART II

AMENDMENTS TO THE BANKING REGULATION ACT, 1949

(10 OF 1949)

AMENDMENTS

1. In section 5, after clause (ffc), the following clause shall be inserted, namely:—

'(ffd) "National Housing Bank" means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987;'.

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2. In sub-section (*1*) of section 18, in the *Explanation*, in sub-clause (*ii*) of clause (*a*), after the words "or from the Reconstruction Bank", the words "or from the National Housing Bank" shall be inserted.

3. In section 34A, in sub-section (*3*), after the words "the Reconstruction Bank", the words "the National Housing Bank" shall be inserted.

4. In section 36AD, in sub-section (*3*), after the words "the Reconstruction Bank", the words "the National Housing Bank" shall be inserted.

5. In section 56, under clause (*j*), in the *Explanation*, in sub-clause (*ii*) of clause (*a*), after the words "the Reconstruction Bank", the words "the National Housing Bank" shall be inserted.

PART III

AMENDMENT TO THE INDUSTRIAL DISPUTES ACT, 1947

(14 OF 1947)

AMENDMENT

In section 2, in clause (*a*), in sub-clause (*i*), after the words "the Industrial Reconstruction Bank of India", the words and figures "the National Housing Bank established under section 3 of the National Housing Bank Act, 1987" shall be inserted.

PART IV

AMENDMENT TO THE PAYMENT OF BONUS ACT, 1965

(21 OF 1965)

AMENDMENT

In section 32, after sub-clause (*f*) of clause (*ix*), the following sub-clause shall be inserted, namely:—

"(*ff*) the National Housing Bank;".

C. RAMAN MENON,
Additional Secy. to the Govt. of India.

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ANNEX 5

DEVELOPMENT OF A SECONDARY MORTGAGE MARKET

1. Background and Summary

A great deal of interest in both the private and public sectors has recently centered around the development of a secondary mortgage market in India. In the private sector, HDFC, as the largest commercial generator of primary mortgages, has understandably taken the lead. HDFC thinks that there is an excellent match between their needs for liquidity and the existence of "investible, long term" surpluses in institutions that wish to diversify their portfolios but have no interest in specializing in direct mortgage lending. Such institutions include the Life Insurance Corporation, General Insurance Corporation, Unit Trust of India or the employee provident funds. In addition, Citibank, American Express Bank and Bank of America have expressed interest in the secondary market.

There seems to be a consensus on at least one point regarding the reasons for considering a secondary market in India: liquidity in the primary mortgage market could be enhanced by (1) linking the primary with the capital markets by packaging and selling mortgages and (2) developing a market for some form of mortgage-backed securities. There is little agreement, however, on (1) whether any secondary market facilities are really feasible in India, due to the immaturity of the primary market; (2) if so, what timing of their development should be, and (3) what form the institutional and regulatory aspects of the market might take. Furthermore, the role of the United States secondary market as a model is limited. Although study of the U.S. secondary market experience is in some ways instructive, for the most part the factors involved in its origins and development do not exist in India, and the current U.S. institutions and instruments are far more numerous and complex than need be replicated in India.

The major issue is perhaps whether India should pursue development of any secondary facilities when the primary market is as yet so small, immature, and saddled with serious constraints. Major problems inhibit the development of the primary market, including the need for increased flow of funds to primary lenders; reform of laws regarding foreclosure, rent control and land tenure; development of mortgage insurance; and standardization of underwriting and lending practices.

Some observers feel it is premature to consider a secondary market until these issues have been addressed. A more prudent alternative, however, is to begin development of at least some aspects of a secondary facility (for example, the packaging and sale of mortgages to outside investors) in parallel with fostering the growth of the primary market. This would at least allow the institutional and regulatory groundwork to precede and give direction to procedures ultimately to be established by the National Housing Bank (NHB). In addition, regulatory structures that would inhibit the eventual development of a secondary market can be avoided.

2. Formulation of Secondary Facilities

Establishment of a separate secondary mortgage market structure is not a precondition to having secondary market activities proceed. HDFC (or potentially any other housing finance agency with an acceptable record) can package and sell mortgage-backed securities (MBS) to an investor, such as LIC. The sale of these securities would provide additional lending capital to the primary mortgage system.

However, although primary market institutions can employ some manner of collateralized obligation to access the capital market, in the long run an efficient secondary market requires an institutional structure of its own. In theory, HDFC could be a net purchaser and net seller of mortgages and MBSs, but since its loan demand is likely to be greater than its deposit resources, it would tend to be a net seller. A true secondary market could help match buyers and sellers.

In general, governments can support the secondary market by enacting legislation to bring an organizational structure into being; by permitting mortgages or MBSs to serve as eligible reserves; or in the most extreme case, to establish a public sector secondary mortgage market institution that would purchase mortgages from the primary market and issue its own obligations (possibly backed by GOI). While the latter course of action is not being suggested on the eve of the formation of the NHB, one should be looking forward to designing the best, most modern financial system possible. Planning ahead would provide guidance for NHB and the Reserve Bank of India to design a regulatory system conducive to evolution of a secondary market, including standarization of terms and amelioration of the foreclosure problem.

In the first instance, NHB could consider the eventual development of a secondary mortgage market structure by (1) creating an organizational framework, (2) setting standards for mortgage origination, (3) setting standards for the secondary market procedures, and (4) enforcing standards. In addition, NHB could establish a discount window and purchase mortgages or obligations from HDFC and other housing finance organizations. One problem is that except for HDFC, little is known yet about the performance of housing finance company portfolios; thus, NHB might begin by tracking performance.

3. Technical Assistance

AID has continued to offer technical assistance in India on secondary market and related issues. AID has used technical assistance to address the mortgage insurance and foreclosure problems, assist HDFC in considering development of mortgage-backed securities, and conduct preliminary missions regarding market feasibility and purpose. In addition, a seminar on secondary markets is being planned for winter 1988-89 which will bring together all the potential private and public sector participants.

There has not, however, been a comprehensive study assessing the options for establishing a regulatory and institutional structure, discount facilities, and the potential for the growth of primary and secondary markets. AID's winter seminar will be both useful for facililating communication and opportune as a forum for helping design the framework of a broader study. In summary, the study should pull together the related studies already done, examine the secondary market experiences and plans of other developing countries, develop alternative suggestions for secondary market organization and regulation, examine the behaviour of present mortgage portfolios and develop projections of future market size.

Two other options for AID assistance might also be considered: HG capitalization of a guarantee fund at NHB and/or advances to an intermediary which is purchasing and packaging mortgages for resale. Actual implementation of these options would be premature at this time; they can, however, be considered for future funding along with the technical assistance and research discussed above.

ANNEX 6

DOCUMENTS DESCRIBING HOUSING FINANCE COMPANIES

1. Ownership of Surveyed HFCs
2. Deposit Rates
3. Summary of Loan Terms
4. Demand for Funds
5. IHFD Publicity Material
6. CanFin Brochure
7. Residency Brochure
8. Dewan Balance Sheet, Profit and Loss Account

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Table 6.?

Ownership of Surveyed HFCs

			Equity capital, Rs. Crores
Private sector			
Dewan	Public subscription		2.5
IHFD	Public subscription		0.8
Residency	Public subscription		0.5
Joint Sector			
CanFin	Canara Bank	40%	
	HDFC	11%	
	UTI	15%	
	Others	40%	
	Total		5.0
GRUH	HFC	12.5%	
	HDFC	12.5%	
	AKFED	12.5%	
	ICICI	7.5%	
	UTI	5.0%	
	Public Banks	25.0%	
	Other Institutions	25.0%	
	Total		2.0

Table 6.2

Summary of Deposit Rates, March 1988

Period, months	Interest rates, % per annum						
	Commercial Banks	Post Office	HDFC	Dewan	IHFD	GRUH	CanFin
1 - 2	3.0-4.0	5.5	NA	NA	NA	NA	NA
3	8.0	5.5	9.0	NA	NA	NA	NA
6	8.0	5.5	9.5	10.0	11.0	9.5	9.0
12	9.0	9.5	10.5	11.0	11.5	'''	11.0
24	10.0	10.0	11.0	12.0	12.5	'''	NA
36	10.0	10.5	11.5	12.5	13.5	'''	12.0
60	10.0	11.0	12.0	13.5	14.0	12.0	12.0
Contract	NA	NA	6.0-9.0	10.0	12.0	NA	9.0-10.0

Note: HDFC and Dewan HDF offer an additional 0.5% p.a. to certain categories of investors. Interest received from commercial banks is normally taxable; interest from the Post Office Savings Bank, Post Office Recurring Deposit Accounts and from housing finance companies is tax free within specified limits. GRUH savings schemes are planned, not operational.

NA: Not available

Table 6.3 Summary of Loan Terms for Surveyed HFCs

	Private: Dewan	RHF	IHFD	Joint GRUH	CanFin	HDFC
1. Interest Rates	<Rs.20,000 13.5% Rs.20-35,000 15% Rs.35-80,000 16% >Rs.80,000 16.5%	<Rs.20,000 12.5% Rs.20-50,000 13.5% Rs.50-100,000 14.5% Rs.100-150,000 15.5% >Rs.150,000 16.5%	Large shareholders 14% Large depositors 14.5% General public 15%	<Rs.25,000 12% >Rs.25,000 13%	<Rs.20,000 12.5% Rs.20-50,000 13.5% Rs.50-100,000 14% >Rs.100,000 14.5%	<Rs.20,000 12.5% Rs.20-50,000 13.5% Rs.50-100,000 14% >Rs.100,000 14.5%
2. Maturities	7-12 years	7-15 years	5-15 years	5-20 years	15-20 years	5-15 years
3. Maximum Loan/Value Ratio	70%	70%	70%	80%	75% 70% for savers	70%
4. Payment	33% of net	30% of net	40% of gross	25% of gross	30% of gross or 50% of net	30% of net
5. Average Loan Size Sanctioned	Rs.44,000	Rs.100,000	Rs.97,000	Rs.37,000	Rs.55,000	Rs.52,000
6. "Normal" Loan size	Rs.7,500 -165,000	Rs.20,000 - 200,000	Rs.10,000 -100,000	-Rs.75,000	Rs.10,000 -100,000	Rs. 7,000 -100,000

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4. Demand for HG funds

This section uses the information presented in the previous analyses to estimate the probable demand for Housing Guaranty program funds over four years. The factors considered were: the companies' own estimates of whaat they could lend to below-median income households, actual lending history, an estimate of how much growth could be reasonably expected to be accommodated by the companies over the life of the program, and an estimate of take-up of HG funds.

Tables 6.4 and 6.5 below summarize the findings in constant, 1988, prices. Figure 2, in Section III.B.12, describes the estimation process.

The first step in the analysis was to construct a base year lending amount for each company surveyed. Because of the varying circumstances of each company, the method used was different in each case: for a private company severely constrained by lack of lending capital but with a prior history of active lending to low income households, the year of highest volume was used on the grounds that the company had demonstrated the capacity to handle such an amount; for companies recently in business, the volume to date was expanded to a year's total; for other companies in business more than one year, the total activity was divided to reach a year's volume. These various methods all produced quite conservative results: for example, companies recently starting to lend could be expected to expand their activity over the course of the first year, not remain at the level of the first few months.

The next step was to arrive at an estimate of the proportion of the company portfolios that represents lending to households below the median income. This exercise involved a variety of estimaing techniques, due to the varying definitions of household income used by the companies. The team therefore took into account not only the companies' own estimates of the amount of lending they did to below median income households, but also data on actual loan sizes which would be affordable to lower income households. The estimate of low income lending was then applied to the base year figure to produce a base year estimate of low income lending shown in the first column of Table 6.4.

Then, expansion factors were applied to each company's base year lending for each of the four years of program life on the assumption of an unconstrained supply of funds for low income lending. The factor for the first year was the largest, ranging from a doubling of activity (for the more conservative companies) to a quadrupling, on the assumption that, with adequate lending capital, the greatest growth in loan volume would take place between the first and second years of the program. (HDFC's own history supports this assumption --

Table 6.6 reproduces the "operational highlights" of their first five years.) The larger expansion factors imply that the company will have lines of credit through corporations as an increasing proportion of their portfolio. After the first year, the same expansion factors were applied to all companies: 50% growth in years 2 and 3 and 20% growth in year 4. These factors are slightly lower than HDFC's actual performance over the same length of time. The analysis assumes that the joint companies will expand at the same rates as the private companies, a probably overly conservative assumption, but the base year lending is in all cases substantially higher for the joint sector companies, which tend to be better capitalized, better at mobilizing other resources for lending and with a more aggressive branching and outreach program. In the one case where these estimates exceed the companies' own estimates of lending, that company's own figures were used. The other four companies' estimates considerably exceeded those of the PP team.

The next step involved estimating demand for low income lending by other HFCs. It was - perhaps conservatively - assumed that no other private sector company would become eligible to participate in the program, whether by virtue of their inability to serve the lower income market, because they predominantly service a single construction company, or because they fail to meet NHB's criteria for sound management. Two other joint sector companies, however, are expected to start business shortly. The analysis assumed that jointly they would mirror CanFin's progress, but lagged by one year.

This calculation resulted in a total estimate of eligible mortgage lending of $83 million over four years: $22 million for the private sector companies, and $61 million for the joint sector companies.

The final step of the exercise involved estimating the proportion of this demand that could be met from long-term borrowings at an interest rate of 12.5%. At this stage, it was still assumed that there are no constraints on long-term borrowing (e.g., a 50% cap of borrowings by joint sector companies, or a $25 million a year ceiling on HG borrowings). Two assumptions were made : (1) that loans to individual HFCs must be at least Rs.1 crore per year; and (2) that GRUH, having a present maximum lending rate of 13.0%, would be unwilling to borrow at 12.5%; but that, by year 2 of the program, three of the four joint sector companies would be willing to borrow at that rate.

The conclusion is that, under the conditions of the HG program described in this paper, and on the assumption of a 12.5% on-lending rate by NHB, the estimate of demand will support a level of funding of $50 million. It is clear, however, that the joint sector companies could utilise a considerably larger volume of funds than the $25 million available under this program.

Table 6.4
Projected Demand for Low Income Lending, Rs. crores

	Base Year	Year 1	Year 2	Year 3	Year 4	Total Years 1-4
Private Sector	1.7	4.2	6.2	9.2	11.2	31.0
Joint Sector	3.7	9.8	17.0	25.4	32.9	85.1
Total	5.4	14.0	23.2	34.8	44.1	116.1
($million)		10.0	16.6	24.9	31.5	82.9

Table 6.5
Unconstrained Take Up of HG Funds*, Rs. crores

	Year 1	Year 2	Year 3	Year 4	Total Years 1-4	($million)
Private Sector	4.1	6.1	9.2	11.0	30.4	21.7
Joint Sector	5.1	17.0	25.4	32.9	80.4	57.4
Total	9.2	23.1	34.6	43.9	110.8	
($million)	6.6	16.5	24.7	31.4		79.1

* Supply of funds assumed unconstrained; demand constrained by on-lending rate of 12.5%.

HIGHLIGHTS

OPERATIONAL HIGHLIGHTS

	1982-83	1981-82	1980-81	1979-80	1978-79
Total Loan Approvals (Rupees in crores)	72.59	44.01	31.44	22.75	7.08
Total Loan Disbursements (Rupees in crores)	47.84	29.79	20.99	9.06	1.31
Total Number of Units (In Terms of Approvals)	17,250	11,761	9,185	7,255	6,665
Repayments (Rupees in crores)	5.71	3.43	1.33	0.19	0.01
Average Loan per Unit (Rupees)	42,000	30,000	26,000	21,000	11,000
Average Age of Borrowers (Years)	37	38	36	36	38

1 crore = 10 million

1 lac = 100,000

FINANCIAL HIGHLIGHTS

(Rs in crores)

	1982-83	1981-82	1980-81	1979-80	1978-79
Profit before Tax	4.33	2.72	1.68	0.93	0.10
Profit after Tax	2.89	1.82	1.15	0.62	0.06
Shareholders' Funds (Net Worth)	14.24	12.35	11.28	10.62	9.93
Loans	39.98	16.83	13.27	1.06	0.25
Deposits	67.07	39.87	17.81	3.88	
Funds Employed	121.29	69.05	42.36	15.56	10.17
Housing Loans Outstanding	98.53	56.39	29.82	10.11	1.29
Net Worth per Share	Rs 142.40	Rs 123.51	Rs 112.80	Rs 106.25	Rs 99.28
Earnings per Share	Rs 28.87	Rs 18.18	Rs 11.49	Rs 6.21	Rs 0.64
Profit after Tax to Average Net Worth	21.71%	15.39%	10.49%	6.07%	0.94%
Dividend	10%	7½%	5%	-	

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" TIMES OF INDIA " NEW DELHI 14.[illegible].87

to make extra money in your spare time

IHFD SHOWS YOU THE WAY

IHFD India Housing Finance & Development Ltd., has been established as a public limited company under the Indian Companies Act with the object of providing finance to those who need it for constructing their own flats, houses and also developing housing sites, colonies, flats and houses for sale to the public on hire purchase and on easy repayment terms at reasonable rates of interest.

To popularise the schemes of the Company and to canvas Fixed and Recurring Deposits, IHFD has vacancies for Propagandists-cum-Canvassers in each town in India. Now you can make extra money in your spare time by joining the Company as its Authorised Propagandist-cum-Canvasser. All you need is spare time, the will to work and make that extra money.

For details of the schemes and terms, please correspond with the Company or call personally.

IHFD

SERVICE ABOVE PROFITS

INDIA HOUSING FINANCE & DEVELOPMENT LTD.

Regd. & Head Office:
Ullas Building,
29 Whites Road,
Madras - 600 014.
Tel: 87125.

Branches at

- Handloom House Annexe, 38 Police Court Lane, Bombay - 400 001. Tel: 261713/268563
- Plot No.6, Journalist Colony, Banjara Hills, Hyderabad - 500 034
- First Floor, Sringeri Mutt Complex, K.V. Temple Road, Sultanpet, Bangalore - 560 053. Tel: 77417

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AN OPPORTUNITY TO OWN YOUR HOUSE

START SAVINGS TODAY TO OWN YOUR HOUSE

India Housing Finance & Development Limited

29, Whites Road, Madras – 600 014.

IHFD, with the specific object of helping you to achieve your dream of owning a house, have formulated a number of innovative schemes to suit your convenience.

FIXED/CUMULATIVE DEPOSIT SCHEMES

FIXED DEPOSITS OF Rs.1000/- & above			CUMULATIVE DEPOSITS			
			With Preferential treatment in housing loan		Without Preferential treatment in housing loan	
Period	With Preferential Treatment in housing loan	Without Preferential Treatment in housing loan	Maturity Amount	Effective rate of interest.	Maturity Amount	Effective rate of interest.
6 Months	11.0%	11.5%	—	—	—	—
1 year	11.5%	12.0%	—	—	—	—
2 years	12.5%	13.0%	1265.60	13.28%	1276.90	13.85%
3 years	13.5%	14.0%	1462.13	15.40%	1481.54	16.05%
4 years	13.5%	14.0%	1659.52	16.48%	1688.96	17.22%
5 years	14.0%	14.5%	1925.41	18.50%	1968.00	19.36%

Interest payable/compounded annually on 1st January.

All branches of Allahabad Bank will accept the deposits on our behalf at par all over India.

1. Interest up to Rs.7,000/- is exempted U/s: 80L of the Income Tax Act.*
2. Deposits up to Rs.5 Lakhs exempted from Wealth Tax.*
3. Deposits of Rs.10,000/- or more for five years will get ½% reduction in the interest charged for the housing loan.
4. Preferential treatment in sanction of housing loan if deposit is made under that scheme
5. Single deposit of Rs.10 Lakhs or more will be eligible for one half of one percent additional interest.
6. Priority allotment of houses/flats developed by IHFD under long term hire purchase scheme.

* The company has made an application to the Central Government in this regard whose consent is awaited.

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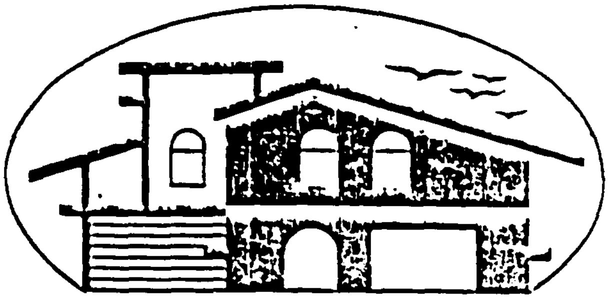

HAVE A HOME
A CAN FIN HOME

'Innovation' is the key word behind the phenomenal success of Canara Bank. Innovation is a way of life at Canara Bank. And forms an integral part of all planning and policy decisions. Side by side with the traditional schemes used by most banks, Canara Bank has the unique distinction of having introduced a variety of innovative schemes — all with the customer in mind.

CAN FIN HOMES LIMITED

Yet another innovative scheme sponsored by Canara Bank in the International Year of Shelter for the Homeless, the CAN FIN HOMES LIMITED in association with the Unit Trust of India (UTI), the Housing Development Finance Corporation (HDFC), Industrial Credit and Investment Corporation of India Limited (ICICI) and Canbank Financial Services Limited (A wholly owned subsidiary of Canara Bank).

MORE ABOUT CAN FIN HOMES LTD.

CAN FIN HOMES LTD is a housing finance company incorporated under the Companies Act 1956. CAN FIN HOMES lends money to individuals, co-operative societies and corporate bodies for acquisition/construction of residential housing.

The Registered Office of the Company is situated in Bangalore and to begin with the area of operation of CAN FIN HOMES is in the Southern region of India. A branch at No. 404, 22nd Cross, 3rd Block, Jayanagar, Bangalore 560011 has already commenced operation. Branches will be opened shortly in Madras, Trivandrum and Hyderabad.

ELIGIBILITY

CAN FIN HOMES lends mainly for construction of new residential houses to individuals, association of individuals, groups of individuals and individual members of co-operative societies. Normally, CAN FIN HOMES will lend to families who do not own any house. The property proposed to be purchased/constructed has to be in the name of the applicant. In case joint loan application is made, property also should be in joint names, except in the case of husband and wife. Retired people, who are on pension and/or above the age of 60 are not eligible to apply for a loan.

PURPOSE OF THE LOAN

Loans may be granted for purchase of ready houses, construction of new houses or for purchase of flats in existing or proposed co-operative societies or in Apartment Owners Association. Loans are not granted for ... dwelling houses or by way of reimbursement of existing loans.

Repayment could commence one month immediately after the final disbursement of the loan. Pending the disbursement, the applicant is required to pay interest on the portion of the loan disbursed. This interest, known as pre EMI interest, is to be paid every month. Normally, the applicant is expected to complete the construction of the house in 14 months and in case of purchase, complete the transaction in three months.

SPECIAL REPAYMENT SCHEMES

Life Insurance Linked Repayment

CAN FIN HOMES offers a unique scheme for individuals who wish to keep their instalment commitment low. Under this scheme, an individual can avail the benefit of repaying only 50% of the loan by EMI. Balance 50% only interest need be paid. The individual has to offer by way of collateral security the life policy in his name for this portion.

This unique facility is offered to help individuals who have already commitment towards life insurance policies and who wish to avail higher quantum of housing loan, having in view their repayment capacity.

A table showing EMI for Rs. 1,00,000/- for varying periods is given below. Alongside, EMI for 50% of the loan is given in column 3. Since for the balance 50% only interest need be paid, the interest commitment per month is shown in column 4.

Period (Years)	EMI	EMI for 50% of loan	Monthly interest for balance 50%	Total commitment
(1)	(2)	(3)	(4)	(5)
5	2430	1215	585	1800
10	1600	800	505	1305
15	1360	680	585	1265
20	1260	630	585	1215

Thus, it can be seen that the total commitment of 50% EMI and monthly interest will be less compared to the EMI on the total amount.

Telescopic Repayment Facility

A special telescopic repayment facility is offered to persons who have good prospects in service/career and expect the income to increase over a period.

Instead of equal instalments for the entire repayment period, repayment is fixed in such a way that the initial instalment is kept low and increased every five years. For instance, for a loan of Rs. 10,000/- repayable over 20 years, the EMI will be Rs. 116/-. Under telescopic repayment, it will be Rs. 98/- per month for the first five years and for every block of five years thereafter it will be revised to Rs. 117/-, Rs. 138/- and Rs. 168/- respectively. A chart giving the possible telescopic repayment for Rs. 10,000/- for different blocks is given below.

For a 15 year term

Rate of interest	First 5 years	Next 5 years	Final 5 years
12.5%	116	132	146
13.5%	122	139	157
14.0%	125	142	164
14.5%	128	146	169

For a 20 year term

Rate of interest	First 5 years	Next 5 years	Next 5 years	Final 5 years
12.5%	[illegible]	117	[illegible]	[illegible]

[illegible] ... payable at the place where the offices are located.

The application can be made by an individual when he decides to acquire/construct a dwelling unit. The application can also be made even before the property is identified.

On receipt of the application CAN FIN HOMES will make necessary enquiries as it deems fit and process the application. The loan will be conveyed to the applicant by way of a letter of offer.

CHARGES PAYABLE TO CAN FIN HOMES

While applying for the loan, the applicant should pay processing fee which is non-refundable at the rate of 0.8% of the loan amount applied, that is Rs. 8/- per every Rs. 1,000/- applied for. Applications unaccompanied by the processing fee will not be considered.

Once the letter of sanction of loan is accepted by the applicant, he is liable to pay administrative fee of 1% of the loan amount sanctioned subject to a maximum of Rs. 250/-. The administrative fee is waived in case of persons belonging to low income group, when the loan requirement does not exceed Rs. 50,000/-.

SECURITY

Normally security for the loan will be first mortgage of the property to be financed. Equitable mortgage by way of deposit of title deeds is acceptable to CAN FIN HOMES. In respect of properties under construction, the applicant may have to furnish interim security by way of bank guarantee and/or securities like life policies equivalent of surrender value of the loan amount if the disbursement will have to be made before mortgage. Pledge of shares are also acceptable to CAN FIN HOMES. Property without clear title or encumbered to any other individual/organisation will not be acceptable. Loans are not granted on second mortgage of the property.

In certain cases CAN FIN HOMES will insist for suitable guarantors.

QUANTUM OF LOAN

CAN FIN HOMES will consider loans ranging from a minimum of Rs. 10,000/- to a maximum of Rs. 1,00,000/- for individual housing units. Loans above Rs. 1,00,000/- and upto a maximum of Rs. 3,00,000/- will also be considered in special cases. Loans will not exceed 75% of the total cost excluding the cost of land. Loans also will not be granted exclusively for purchase of land.

The rate of interest will depend upon the quantum of loan and will be subject to change in the monetary policy and money market conditions and any other levy or tax that the Government may impose on the interest collected.

Loan amount	Interest rate per annum
Rs. 20,000/- and below	12.5%
Rs. 20,001/- to Rs. 50,000/-	13.5%
Rs. 50,001/- to Rs. 1,00,000/-	14.0%
Rs. 1,00,001/- and above	14.5%

The quantum of loan that will be sanctioned to individuals will be determined by CAN FIN HOMES having regard to the repayment capacity of the borrower. Among others, the Company will consider the age, income, qualification of the applicant, number of dependants, income of the spouse, assets, liabilities and prospects of the individuals and the savings record of the individual.

REPAYMENT

Loans are repayable in Equated Monthly Instalments (EMI) comprising principle and interest depending upon the quantum of loans, the interest rate applicable and the period of the loan. A sample of various EMIs corresponding to different periods is given in the table below.

Term of loan (Years)	EMI for a loan of Rs. 10,000/- @ 12.5%	13.5%	14.0%	14.5%
5	235	240	243	246
10	151	157	160	163
15	126	133	136	140
20	116	123	126	130

OTHER TERMS

The property should be insured properly by the owner for fire and other hazards, as required by CAN FIN HOMES during the currency of the loan and in the insurance policy CAN FIN HOMES should be noted as a beneficiary. Property taxes etc. are to be paid by the applicant from time to time and copies of relevant proof are to be furnished regularly.

DEPOSIT FACILITIES

CAN FIN HOMES offers attractive deposit schemes for individuals under the fixed deposit scheme and cumulative deposit scheme. The rate of interest payable and maturity value are at present as under.

Fixed deposit

6 months	9%
1 year	11%
3 years to 5 years	12%

Cumulative deposit

Initial Deposit	Amount payable on maturity — Period: 6 months	1 year	2 years	3 years	4 years	5 years
Rs. 2,000.00	2090.00	2226.00	2477.00	2837.00	3187.70	3581.70
Yield	9.00%	11.30%	11.9[illegible]	13.9[illegible]	14.85%	15.82%

Deposits under FD and CD will be accepted in multiples of Rs. 1,000/- with a minimum of Rs. 2,000/-.

CAN FIN HOMES also offers special Loan Linked Deposit (LLD) scheme for periods ranging from 15 months to 60 months. LLD accounts which offer 9% interest per annum with interest compounded half yearly, can be opened with an initial deposit of just Rs. 200/-. There is no fixed instalment.

Govt. approval awaited for exemption under Section 80L of Income Tax Act for interest earned on deposits with CAN FIN HOMES.

SPECIAL BENEFITS TO DEPOSITORS

CAN FIN HOMES processes loan applications from depositors on a preferential basis.

SPECIAL BENEFITS TO SHARE HOLDERS

The following special benefits are offered to initial share holders of CAN FIN HOMES who may subscribe to public issue.

i) Preference in sanction of loan

ii) A concession in the interest to the extent of 0.5% per annum on a portion of loan equivalent to 10 times the face value of shares held by the share holders.

The share holders acquiring shares by transfer will receive preferential treatment in sanction of the loan. However, on transfer of shares in all cases of share holders, various concessions granted will cease to operate from the beginning of the year of transfer of the shares.

For any further information, please contact the Branch/Registered Office.

The above policies of CAN FIN HOMES are subject to revision and change periodically.

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RHF

The need for Housing Finance is continuously growing and the demand is rapidly outstripping the availability of funds. Although the banks and other corporations meet a part of the requirement, a large percentage of the population is still left untapped.

To augment the Government's efforts in this direction, RESIDENCY HOUSING FINANCE LIMITED (RHFL) has been promoted to meet a part of the people's needs. The Company has been promoted by the Rankas, who have already established a name for themselves in the construction of Residential Apartments in Bangalore, Coimbatore and Pune.

Some of their completed projects include Chandraloka Apartments, Queens Corner Apartments, Ranka Park and Ranka Plaza in Bangalore, Jewel Apartments in Poona and Shanti Apartments in Coimbatore. The total value of projects already completed amounts to Rs.24 crores, with many more projects in the stage of execution.

INFORMATION ON HOUSING LOAN

Objectives of RHFL:-

RHFL grants loan for the construction/purchase of mainly, new houses/apartments. However, in special cases, RHFL may finance the acquisition of old houses/apartments.

To what extent does RHFL finance:

The quantum of loan will normally depend on the repayment capacity of the borrower as assessed by RHFL. Loans would not normally exceed 75% of the value of the property, including the cost of land. However, the minimum loan amount will be Rs 20,000/- per unit.

Who is entitled to borrow:

RHFL will consider applications from Individuals, Group of Individuals, Companies/Corporations planning to construct Residential Quarters for their Employees, Professionals and Businessmen.

RHFL reserves the right to vary the rate of interest prospectively at any time, in response to the change in money market condition or if a levy tax on interest, or any other charge/burden is imposed or levied by any Government or authority.

The borrower shall ensure that the property is duly and properly insured against fire and other appropriate hazards, for the period of the Loan as required by RHFL, and shall produce such evidence to RHFL. RHFL should be a beneficiary of such policy.

Procedure for loan application

All loan applications shall be made on the Company's standard form, which is available on payment of a fee of Rs 15/- by cash or money order or demand draft.

Processing Fee

Processing Fee as given below is payable along with filled in application form.

Loan applied for (Rs.)	Non-refundable fee Amount (Rs.)
20,000/-	500
20,001/- to 50,000/-	500
50,001/- to 1,00,000/-	500
1,00,001/- to 1,50,000/-	750
1,50,001/- to 2,00,000/-	1000
2,00,001/- to 2,50,000/-	1250

Legal and Technical fees

After completing the scrutiny of the application form, RHFL will send a letter of in-principle approval.

On acceptance of this offer, the borrower shall remit to RHFL the legal and technical fees of 1% of the amount sanctioned, subject to a minimum of Rs. 500/-, which is not refundable.

Disbursement of Loan

Disbursement will take place after the property has been technically assessed, all legal documentation has been completed, and the borrower has fully invested his part of the contribution.

The loan will be distributed in full or in suitable instalments based on RHFL's assessment of the progress of construction.

Commitment charges

From the expiry of the sixth month from the date of in-principle approval of the loan, a commitment charge equal to 1% of the undrawn amount will be levied.

Pre-payment of Loan

RHFL will consider pre-payment of loan ahead of schedule on such terms and conditions as it may prescribe from time to time. In cases of pre-payment of the loan in part or in full, a pre-payment charge will be recovered.

Transfer of Loan

Loans are transferable in exceptional cases at

Rates of Interest:

Loan amount	% per annum
Rs. 20,000/-	12.5
Rs. 20,001/- to Rs. 50,000/-	13.5
Rs. 50,001/- to Rs. 1,00,000/-	14.5
Rs. 1,00,001/- to Rs. 1,50,000/-	15.5
Rs. 1,50,001 to Rs. 2,00,000/-	16.5
~~Above Rs. 2,00,000/-~~	~~17.5~~

1/2% rebate will be allowed for prompt repayments.

Period of Repayment

Company offers four schemes with repayment periods of 7 years, 10 years, 12 years and 15 years respectively.

In the case of 12 year and 15 years loans, the total loan repayments are less compared to other prevailing schemes by 18%–25%.

Schedule of repayment for the four Schemes is given below :-

Schedule of Repayments

7 Year Loan Scheme — Loan Amount: Rs.10,000/-

EMI/No. of years	12.5	13.5	14.5	15.5	16.5	17.5
Year 1 to Year 7	185.48	191.39	197.31	203.32	209.38	215.54

10 Year Loan Scheme — Loan Amount: Rs.10,000/-

EMI/No. of years	12.5	13.5	14.5	15.5	16.5	17.5
Year 1 to Year 10	150.52	156.65	162.89	169.23	175.64	182.15

12 Year Loan Scheme — Loan Amount: Rs.10,000/-

EMI/No. of years	12.5	13.5	14.5	15.5	16.5	17.5
Year 1 to Year 6	178.42	184.42	190.55	196.71	202.98	209.30
Year 7 to Year 12	55.06	57.61	60.19	62.81	65.48	68.18

15 Year Loan Scheme — Loan Amount: Rs. 10,000/-

EMI/No of years	12.5	13.5	14.5	15.5	16.5	17.5
Year 1 to Year 8	152.66	158.90	164.90	171.65	178.17	184.76
Year9 to Year 15	50.25	52.92	55.30	58.39	61.19	61.03

transferee being found eligible as per terms and conditions laid down by RHFL. In this case, the transferee will have to go through the normal credit evaluation procedure of RHFL.

Special Incentives for Shareholders:

Original shareholders of RHFL, who have acquired shares at the time of RHFL's Public Issue, will receive special benefits comprising the following:

- Preferential treatment in obtaining loans.
- Interest concession of ½% on the normal lending rates of RHFL on a portion of loan equivalent to 20 times, the nominal value of shares held by the concerned shareholders.

However, on transfer of shares by shareholders eligible for interest concession, the interest concession will cease from the beginning of the financial year of RHFL during which such transfer is effected.

Other Activities of RHFL

1. For the corporate Sector RHFL will identify and also help in building residential quarters, apart from financing the same.
2. RHFL will finance not only the acquisition of residential premises but also the required furniture and fixtures and other household appliances like refrigerators, televisions, etc.
3. RHFL will lend its expertise to develop and administer housing loan schemes for the corporate sector and its employees.
4. RHFL will also undertake turn-key construction jobs on borrowers site.

The above policies will be reviewed from time to time and are subject to change.

Bangalore Office:
202-B, 'A' Wing, II floor Queen's Corner
3, Queen's Road Bangalore-560 001.
Phone: 70406

Coimbatore Office:
28/35, Ponnurangam Road West
Coimbatore-641 002.
Phone: 22901.

RHF
RESIDENCY HOUSING

Security for the Loan

Security for the loan will be the first mortgage of the property to be financed by deposit of title deeds and such other collateral as may be necessary. In respect of property under construction, an interim security may be called for, such as bank guarantee or such other security acceptable to RHFL.

RHFL will not finance any property where there exists already, a mortgage, loan or litigation.

Pending final disbursement, interest alone, will be charged on the amount drawn, which will be payable every month. Payments shall be made by "A/C Payee" Cheques/drafts drawn on "RESIDENCY HOUSING FINANCE LIMITED" and made payable at Bangalore or such other places where RHFL has a branch office.

The cheques shall be sent along with a challan which shall be supplied by RHFL.

Annual Statement of Account

RHFL will not issue separate receipts for the payments, however, at the end of every financial year, a statement of account will be sent to borrowers on specific request.

TOTAL ANSWER TO HOUSING FINANCE

RHF

RESIDENCY HOUSING FINANCE LIMITED

- Total loan Repayments less by 18% to 25% in certain special Schemes compared to others.
- Loans considered upto Rs. 2.5 lakhs
- Interest rate compares favourably with other popular schemes in the country
- Special Incentives for shareholders
- Deposit linked loan schemes in the offing
- Incentives for prompt repayments
- Package of Services designed to meet

BALANCE SHEET AS AT 31ST DECEMBER, 1986

	Schedule	As at 31-12-1986		As at 31-12-1985	
SOURCES OF FUNDS:		Rs.	Rs.	Rs.	Rs.
SHAREHOLDERS' FUNDS					
Share Capital	A		2,41,05,250		1,91,86,250
Reserves & Surplus	B		4,07,438		1,09,980
LOAN FUNDS					
Secured Loans	C		83,18,430		20,00,000
Unsecured Loans	D		21,05,400		—
TOTAL:			3,49,36,518		2,12,96,230
APPLICATION OF FUNDS:					
Fixed Assets:	E				
Gross Block		4,48,814		4,11,609	
Less: Depreciation		46,272	4,02,542	25,481	3,86,128
Housing loans			3,29,71,516		1,97,97,387
Current Assets, Loans & Advances:	F	11,93,821		8,59,864	
Less: Current Liabilities	G	11,14,283		15,60,056	
Net Current Assets			79,538		(7,00,192)
Miscellaneous Expenditure (to the extent not written off or adjusted)	H		14,82,922		18,12,907
TOTAL:			3,49,36,518		2,12,96,230
NOTES TO ACCOUNTS	L				

In terms of our Report of even date
For A. N. CHATURVEDI & CO.
Chartered Accountants

M. M. CHATURVEDI
Partner

Bombay: 27th March, 1987.

RAJESH KUMAR WADHAWAN *Chairman & Managing Director*
BIPAN K. WADHAWAN *Director*
Y. M. DESAI *Director*
Q. F. ADENWALA *Secretary*

PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST DEC., 1986

	Schedule	For the year ended 1986	For the year ended 1985
INCOME:		Rs.	Rs.
Interest	I	42,58,988	15,11,093
Fees and other income		8,28,644	9,81,398
TOTAL:		50,87,632	24,92,491
EXPENDITURE:			
Payment to and provision for staff	J	8,82,748	4,68,672
Operational and other expenses	K	32,22,364	12,86,223
Depreciation		20,791	19,524
Preliminary and share issue expenses written off		3,67,818	3,886
TOTAL:		44,93,721	17,78,305
Profit for the year		5,93,911	7,14,186
Less: Prior year's adjustments		11,453	—
		5,82,458	7,14,186
Less: Provision for taxation		2,85,000	—
		2,97,458	7,14,186
Add/(Less): Balance of Profit (Loss) of earlier year brought forward		1,09,980	(6,04,206)
		4,07,438	1,09,980
APPROPRIATIONS:			
Special Reserve under Section 36 (i) (viii) of Income-tax Act, 1961		3,85,000	—
Balance carried to Balance Sheet		22,438	1,09,980
TOTAL:		4,07,438	1,09,980

In terms of our report of even date
For A.N. CHATURVEDI & CO.
Chartered Accountants

M. M. CHATURVEDI
Partner

Bombay: 27th March, 1987.

RAJESH KUMAR WADHAWAN *Chairman & Managing Director*
BIPAN K. WADHAWAN *Director*
Y. M. DESAI *Director*
Q. F. ADENWALA *Secretary*

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1/2.

ANNEX 7.1

MEDIAN INCOMES

There has been no comprehensive survey of urban household income more recent than the National Council of Applied Economic Research (NCAER) 1975-76 survey of Household Income and its Disposition. There have been a few subsequent surveys of income in individual towns, and two expenditure surveys, but none of these have sufficient authority to be used as a unique source of data on all-India household incomes.

The World Bank, in its Appraisal Report for the loan to HDFC, has used an urban median of Rs.1,700 for 1986-87. Using the indices quoted in Table 7.1, the World Bank estimate is equivalent to Rs.2,000 in mid-1988. Since this latter figure is broadly consistent with other estimates, it has been taken as the base urban median for the purposes of the HG program.

The following paragraphs review the alternative estimates. Sources are described at the end of this note; and references in Annex 7.6.

Alternative Estimates of Urban Household Income

The World Bank statistic is based on the NCAER estimate for 1976, "updated by growth rate of all India household income". The Appraisal Report does not quote a source for the inflation factor used.

The Project Paper for HG-002 calculated the urban median income to be Rs.1,403 per household per month in December 1983. This was derived from a 1978 World Bank estimate of Bombay incomes, adjusted to account for an expectation of higher incomes in Bombay than in other urban areas of India, and adjusted for inflation. The 1983 estimate made no allowance for any real increase in incomes. Using an identical methodology, the median in June 1988 would be Rs.2,150. (See Table 7.1.) If the median had increased pari passu with the growth of per capita consumption since 1983, it would be Rs.2,400 in mid-1988. (This last assumption is equivalent to saying that the urban income distribution has remained unchanged: an assumption that can be challenged but not disproved. Mills and Becker devote considerable space to an analysis of changes in income distribution, and conclude that "India's income distribution appears to fluctuate widely and does not display distinctive time trends" (page 167).)

The National Sample Survey Organisation found that the median urban consumption expenditure was Rs.715 per household in 1983 (as reported in Sarvekshana, April 1986). Using

(1) an estimate of consumption expenditure:total income of 1.20 (derived from the estimate by the Central Statistical Organisation that net domestic savings were 16.4% of personal disposable income in that year);
(2) price and income inflators quoted in Table 7.1; and
(3) assuming a relationship between median consumption and median incomes;

then, the urban median would be Rs.1,300 in mid-1988. However, a summation of urban and rural household incomes derived from this survey is approximately 25% lower than the national estimate of personal disposable income given by the National Accounts statistics. This suggests that the present day urban median might be around Rs.1,700 per household per month.

Lall (1985) conducted a survey in six towns of Maharashtra (excluding Bombay), finding that the average household had an income of Rs.1,200 in 1984. The survey report does not quote the working definition of "income", nor does it reproduce the survey form used; but the text strongly implies that the Rs.1,200 is earned income. Using a multiplier supplied elsewhere by the same author (Lall, 1984), the equivalent total household income from all sources would then have been Rs.1,600. The adjusted equivalent mid-1988 figures are Rs.1,800 and Rs.2,400 per household per month.

Mehta and Mehta surveyed sample households in the city of Ahmedabad, finding a median income of Rs.1,040 in 1986. They acknowledge, however, that "one expects under-reporting of household income"; and that the economic charateristics of Ahmedabad make it likely that city-wide incomes are below average for India. An arbitary adjustment of 20% for underreporting and a further 20% to inflate incomes to the national average give a median income of Rs.1,500 in 1986 and Rs.1,950 in mid-1988.

For purposes of comparison, the offical GOI income classifications are as follows:

Economically Weaker Section	Rs.750 per month and below
Lower Income Group	Rs.750 - 1,500 per month
Middle Income Group	Rs.1,500 - 2,500 per montn
Upper Income Group	Rs.2,500 per month and above.

These categories were determined in December 1985. Inflating by the CPI, the division between Lower and Middle Income Groups would fall as Rs.1,850 in June 1988.

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Table 7.1

Inflation Factors for Urban Incomes

	Index of Consumer Prices for Industrial Workers (Note 1)	Index of Per Capita Consumption (Note 2)	Median Urban Income, Rs/hhld/month (Note 3)
1981-82	91.0	98.0	1,249
1982-83	100.0	100.0	1,400
1983-84	111.2	102.0	1,588
1984-85	116.7	104.0	1,699
1985-86	127.1	106.1	1,888
1986-87	136.7	108.2	2,071
1987-88	150.0	110.4	2,318
June 1988	153.8 est.	111.0	2,390

Notes

(1) Source: Economic Survey 1987-88, GOI, 1988 for 1981-82 to 1987-88; Economic Indicators, Centre for Monitoring the Indian Economy for June 1988.
(2) Per capita consumption assumed to grow at the average rate for 1980-81 to 1984-85 (2.0% per annum); Source, CMIE.
(3) Estimates calculated from 1982-83 base; Source: Project Paper, HG-002, May 1985.

ANNEX 7.2

AFFORDABILITY ANALYSIS

Typical loan terms offered by the housing finance companies surveyed by the PP team are as follows:

- interest rate: 13.5% - 16.5%
- maturity: 7-15 years
- maximum loan/value: .70 to .80
- payment/income: .25 to .40 of gross income, .30 to .50 of net
- loan amount: Rs.35,000 to Rs.150,000

There are several potential problems stemming from lending to below median income households within this framework. First, borrowers need access to substantial sources of other funds in order to meet down-payment requirements. Table 7.2 shows sources of housing finance for HDFC-assisted households. (However, note that HDFC's average loan/value ratio is only about 40%, less than the range being considered here.) Also, as discussed below, limited evidence suggests that India may have a high propensity to consume housing compared to other developing countries. The difficulties arise, however, when sudden reductions in income (due to drought, for example), affect a sizeable proportion of the beneficiaries. When current income is thinly stretched and the household's asset cushion has already been utilized in the downpayment, the likelihood of delinquencies arising from income fluctuations is bound to increase. Furthermore, under the loan terms currently available, a fairly circumscribed range of loan amounts, and therefore house prices, is affordable to median and below median income households. Thus, effective expansion of the program depends on an adequate supply of low cost dwellings.

Table 7.2

Sources of Housing Finance for HDFC-Assisted Owners, 1982

	% of total capital cost
Loans	
HDFC	41.5
LIC	0.1
Banks	0.1
Employers	0.9
Relatives	6.9
Others	5.5
(Total Loans)	(55.0)
Own Wealth	45.0
Total Capital Employed	100.0

Source: Lall, 1982

Tables 7.3 and 7.4 present an assessment of affordability under alternative loan conditions and purchase prices of houses generally affordable to low income households. Table 7.3 indicates what loan amounts (under alternative assumptions regarding rate, maturity, and payment-to-income ratio) are affordable by what segment of the income distribution. The table entries are the ratio of the income required to make the loan payments to median income. Thus, if the ratio of required to median income is 1.0, the loan payment can just be afforded by a median income household; if the ratio is .80, a household at 80% of median can make the payments. Similarly, larger loans are affordable only by households over median income; at 125% of median, for example, the ratio in the table would be 1.25.

Table 7.3 suggests that program beneficiaries can generally afford loans ranging from Rs.35,000 to Rs.50,000, depending on terms and payment ratio. At typical terms of 14% and 15 years, for example, median income households paying 25% of their income can afford a loan of approximately Rs.37,000, while households paying 33% of income can finance a loan of Rs.48,000. When the maturity is extended to 20 years, the achievable loan amounts increase to Rs.40,000 and Rs.52,000 respectively. Similarly as interest rates increase from 12% to 16% the size of an affordable loan falls from about Rs.40,000 to Rs.33,500 for households spending 25% of gross income on payments, and from

Rs.54,000 to Rs.44,300 for households spending at the higher rate. Beyond these fairly narrow bounds, loans become quickly unaffordable; an Rs.80,000 loan (at 14%, 15 years) requires a household income of more than twice median, for example. In contrast, households at 60% to 80% of median income can afford a loan of only about Rs.30,000.

Increasing maturities or introducing alternative mortgage instruments (such as CanFin's "telescopic" loan) are the only commercially viable means to increase affordability, assuming that housing prices and interest rates are now at "correct" market levels. Increasing maturity from 15 to 30 years (at 14%) for example, increases the loan size affordable at median income from Rs.37,000 to Rs.42,000 (or from Rs.48,000 to Rs.55,000, depending on the payment-to-income ratio).

Table 7.4 lists "supportable" purchase prices. Loans ranging from Rs.30,000 to Rs.60,000, at loan-to-value ratios of .60 and .45 (chosen as "typical" parameters), support purchase prices of between Rs.50,000 to Rs.133,333. In addition, employers' assistance may in some cases effectively extend this range. Although few data are available, there seems to be general consensus that units are available at these prices from private developers in secondary urban centres but not in metropolitan cities. Houses are currently available in Ahmedabad for Rs.25,000, but formal housing priced at this low level in other cities is probably exceptional. GRUH states that about one-third of the housing they finance costs less than Rs.50,000; and about 20% costs Rs.100,000 or more.

Finally, mention should be made of the assumptions regarding payment-to-income ratios. It may be the case that India does indeed have a high propensity to consume housing compared with other developing nations. Studies by Malpezzi and Mayo have shown that the fraction of income spent on housing depends on both household income and the level of economic development. Comparisons across countries indicate that as city income increases, average payment-to-income ratios increase. Comparisons within cities indicate that as household income increases, payment-to-income ratios decrease.

Table 7.5 sets forth comparisons among five Third World cities at different levels of development. Data for India are for Bangalore, 1975. The average propensity to pay, .25 at median income, is nearly as high as in Manila, where per capita income is over five times that in Bangalore. A similar comparison is then made at a "constant" income level of $150. Again, the average rent-to-income ratio is .18, almost as high as in Cali where income is over 3 times the level in Bangalore. (It should be noted, however, that other Indian studies show that propensity to pay is considerably lower in other cities than in Bangalore.)

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Table 7.3

Ratio of Required Income to Median Income
for Servicing Alternative Loans *

Terms	13%		14%		15%		16%	
Loan amount	.25	.33	.25	.33	.25	.33	.25	.33
				15 years				
Rs.								
20,000	.52	.39	.54	.41	.57	.43	.60	.45
30,000	.77	.59	.81	.62	.86	.65	.89	.68
40,000	1.03	.78	1.08	.82	1.14	.87	1.19	.90
50,000	1.29	.98	1.36	1.03	1.3	1.08	1.49	1.13
60,000	1.55	1.17	1.17	1.63	1.24	1.72	1.79	1.36
70,000	1.81	1.37	1.90	1.44	2.00	1.51	2.09	1.58
				20 years				
Rs.								
20,000	.48	.36	.50	.38	.53	.40	.56	.43
30,000	.71	.54	.76	.57	.80	.61	.85	.64
40,000	.95	.72	1.01	.76	1.06	.81	1.13	.86
50,000	1.19	.90	1.26	.95	1.33	1.08	1.41	1.07
60,000	1.43	1.08	1.51	1.15	1.60	1.21	1.69	1.28
70,000	1.67	1.26	1.76	1.34	1.86	1.41	1.79	1.50

* Lines indicate the point at which affordable loan ceilings are reached by median income households. Note that under current conditions, the top right and bottom left corners of each table are not generally available; interest rates increase with size of loan for four of the five HFCs surveyed.

Table 7.4

Illustrative Affordability and Purchase Price
for Medjan Income Households
(Ratio of Required to Median Income)

Purchase Price (Rs.)		15 Year Mortgage 14% interest rate		20 Year Mortgage 14% interest rate	
Loan/ Value=.60	Loan/ Value=.45	Payment/ Income=.25	Payment/ Income=.33	Payment/ Income=.25	Payment Income=.33
50,000	67,000	.81	.62	.76	.57
67,000	88,889	1.08	.82	1.01	.76
83,000	111,111	1.36	1.03	1.26	.95
100,000	133,333	1.63	1.24	1.51	1.15

Note: Not all companies offer all these loan amounts on the above terms.

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Table 7.5

Estimated Payment-to-Income Ratios for Owners in Selected Cities

City	City Median Income * $	Payment-to-Income at Median Income	Payment-to-Income at $150
Bangalore	81	.25	.18
Cairo	104	.10	.08
Cali	259	.17	.20
Manila	432	.27	.42
Seoul	469	.40	.76

* Converted to 1981 U.S. dollars using local price indices and official 1981 exchange rates.

Source: Malpezzi and Mayo, 1987.

In summary, analysis of the current portfolios and future plans of both HDFC and the smaller housing finance companies suggest that the affordability targets of the program are feasible. Extending maturities or increasing loan-to-value ratios could make mortgages affordable to somewhat lower incomes or reduce loan-to-income ratios. Clearly, however, significant decreases in income would increase default rates for low income borrowers and, if a large enough proportion of their portfolios were affected, could threaten the viability of the HFCs.

ANNEX 7.3

PRESS ARTICLES

"Housing policy : a sellout?" (Hindu, May 1988)

"New accent on housing needs" (Hindu, February 1988)

"Acute housing shortage in major cities" (Financial Express, May 1988)

"Govt. not indifferent to housing" (Hindu, February 1988)

"Fiscal reliefs for housing needed" (Times of India, January 1988)

"Oriental Finance : smooth scan" (India Today, May 1987)

Housing policy: a sellout?

"HINDU", New Delhi, 28/5/88

SO sharp and widespread has been the criticism of the National Housing Policy (NHP), presented to Parliament during the closing stages of the budget session, that its authors would appear to be in a chilling minority. The policy, which had been in the making since January 1987 and went through as many as three drafts, satisfies no one — least of all those whom it is intended to benefit: the homeless. Only the private builders, in whose favour it is clearly tilted, have reason to be happy.

The main criticism is that the policy is too vague and couched in a sort of rhetoric that would not be easy to translate into action. Even in its vagueness, it is much too ambitious to be realistic. One of its "main broad goals" is to "eradicate houselessness" by the turn of the century which, given the present backlog, appears almost impossible to achieve. The policy document itself gives some idea of the magnitude of the problem when it says that as far back as 1981, the shortfall was 23.3 million dwelling units. "As per the 1981 census, the total number of houseless households was six lakhs — four lakhs in the rural areas, and two lakhs in urban areas" the document says.

Herculean task

Considering the present rate of population growth (three to four per cent a year in the urban areas alone), the number of shelterless households would rise sharply by the turn of the century, and population projections indicate that by 2001, over 63 million new households would need shelter (THE HINDU, May 16). Such then is the scale of "houselessness" which the policy promises to "eradicate" in the next 12 years or so.

This is not all. The policy goes a step further and seeks to "upgrade" all kutcha houses in the rural and urban areas, reduce overcrowding, and provide "a minimum level of basic services", especially in areas where the poor live. It is not that the authors of the policy are not aware of the magnitude of the operation, for the document clearly states that the rate of house construction will have to be stepped up by 33 per cent over the existing rate. The investment will also have to be raised by 30 to 35 per cent. Yet, the document does not suggest a plan of action and the section on "strategies" reads more like another set of objectives than a framework for concrete action.

In what is seen as a major concession to the private builders, they are to be involved more actively in house building with the role of the Government agencies being restricted to providing financial support and land, etc. To facilitate the entry of the private sector into housing, presumably in a big way, certain laws are to be amended. "This is an indication that the Urban Land Ceiling Act will be liberalised, which is something that the private builders' lobby has been demanding for a long time", says a town planner, pointing out that the NHP is along the lines of a blueprint prepared by a U.S. agency for Third World countries.

Deceptive document

The Calcutta-based National Committee for Housing Rights (NCHR), which has been leading a campaign for a more "rational" housing policy, has said that the policy amounts to "handing over housing activities to landowners, builders and developers." A pamphlet circulated by the NCHR says that with house building passing into the hands of real estate owners and developers — "supported and legitimised by the state" — the price of land, building materials and other inputs is bound to rise "rapidly." It also fears that because of the increase in the cost of house building, "unauthorised settlements" will multiply, whereas one of the ostensible aims of the policy is to curb such settlements. "It is a sophisticated document, and it is easy to be misled by its apparent liberal intentions", says a spokesman of the NCHR.

It is stated that various professional organisations such as the Indian Institute of Architects have been ignored by the Government while formulating the policy and this despite their appeal that there should be a public debate on the issue. "No public discussion has been invited and yet the Government has claimed at international conferences during the International Year of Shelter for the Homeless that the draft policy was widely discussed," points out an NCHR document.

Earlier drafts

The final policy is not significantly different from the earlier drafts, and it is virtually a carbon copy of a draft prepared in December 1987, a draft whose existence has been repeatedly denied by senior Government officials, even though its copies are in circulation. This correspondent has a copy of the "nonexistent" December draft, and it corresponds to the final document to the last word except that in places certain expressions have been substituted. Both run into 22 pages, and both begin with a preamble stating that "shelter is a basic human need..." and end with the formulation that "housing policy has to be dynamic ... (and) ... be periodically reviewed." Why then the secrecy about the existence of this particular draft?

Even an earlier draft, prepared in January 1987 and circulated in a limited way, is more or less along the same lines as the final document except for some changes. One major change in the final document relates to the role of the private sector. The January 1987 draft said that "immediate administrative and legal measures shall be taken for declaring housing as an industry so that institutional finance and other facilities may become available to developers both in the public and private sector." In the final document, there is no direct reference to developers either in the private or public sector, and the terminology is couched in more sophisticated terms. Stating that the "organised private sector housing has been small", it says that "there is obviously a need to recognise and rely on multiplicity of actors (and for this) the Government will need to devise and implement ... shelter strategies which will enable all the various actors to complement one another..."

Element of secrecy

According to NHCR sources, there is yet another draft which has not been made public. This draft was said to have been prepared in March 1987 and it closely followed the January 1987 document. "It had only four or five radical changes (aside from dozens of minor editing changes), but nowhere does it either acknowledge the existence of a previous version, or explain why the changes were made," according to these sources. What is more intriguing — these sources say — is that while the March draft was distributed at the United Nations' Tenth Commission on Human Settlements in Kenya in April 1987, it was the first draft that was presented to the State Housing Ministers' conference in Srinagar in May 1987.

The question that is being raised is, why go through the motions of preparing different sets of drafts when the essential spirit of the policy remains unchanged? The official response is that the changes made in successive drafts reflect public opinion as articulated at various conferences and seminars, but this is not accepted by those who have closely followed the whole process. What makes them sceptical about the Government's claim is the element of secrecy that has surrounded at least two drafts, especially the December 1987 draft.

However, even the critics of the policy and of the manner in which it has been evolved concede that there is need for a National Housing Policy. And despite its urban bias, and all too visible tilt towards the private sector, it is not without merits. The most significant positive aspect of the policy is the proposal to set up a National Housing Bank (NHB) to mobilise resources for the housing sector, promote housing finance institutions, and regulate the functioning of the existing institutions, among other things.

Housing finance

The policy recognises that the housing finance system needs to have "an elastic and widespread resource mobilisation strategy" and this would require institutional mechanisms to provide access to "affordable credit on individual, group and cooperative basis." In this context, it envisages the strengthening of the Housing and Urban Development Corporation (HUDCO) to enable it to play a more active role in low-income housing programmes both in urban and rural areas. Another area that is proposed to be encouraged is cooperative housing through easy access to land and credit.

"Luxury housing" is to be discouraged by placing "appropriate" monetary ceilings on institutional finance. But "luxury housing" has not been defined, nor has it been specified what the "appropriate" ceiling would be. The policy also lays emphasis on improving the environment and encouraging the use of locally available materials but again no clear line of action has been suggested. Merits or demerits of the policy apart, the main thing is its implementation. And housing being a State subject, this is likely to create problems. A "national" housing policy in real terms could well end up as a notional concept.

Hasan Suroor

Special Correspondent in New Delhi.

New accent on housing needs

Shelter is one of the basic needs of life and living in any society. A certain minimum standard of housing is essential for healthy and civilised existence. Housing activity is intricately related to several fundamental human needs like shelter, health, sanitation and education. Apart from providing dwelling units to the citizens which infuses a sense of security in them, housing activity has a tremendous impact on the overall economic development. It mobilises resources, promotes income generating activities and provides employment opportunities on a large scale. Housing activity is thus an activity of great socio-economic importance.

GOVERNMENT'S PRIORITIES

The importance of the Housing sector has been recognised by the Government. Our Prime Minister in his Budget Speech (1987) observed that Housing is high on our list of priorities. It is a basic need. It also generates employment. We propose to launch a comprehensive programme for housing development particularly housing for economically weaker sections. The provision of shelter particularly to the weaker sections of our society has all along been an integral part of the 20-Point Programme. Points 14 and 15 specifically focus on measures required for improving the housing conditions.

The Government is now seized of the need to formulate a comprehensive National Housing Policy laying down clearly the objectives and priorities in the housing sector and the methodology and strategy of achieving them. This policy directional document will concretise the multifold measures that need to be initiated to meet the shelter requirements of our people. It is only in the fitness of things that our National Housing Policy is being given the final shape during the current year which is being observed all over the world as the International Year of Shelter for the Homeless.

NATIONAL HOUSING POLICY

The draft National Housing Policy document prepared by the Ministry of Urban Development was circulated to the State Government/Union Territories Administrations for their views and comments. It has also been discussed at various forums like the Parliamentary Consultative Committee, Housing Ministers' Conference, various meetings and seminars in which persons from all walks of life including experts in the field took part. The draft National Housing Policy is now being finalised keeping in view the deliberations and the discussions that took place in the various forums and the feedback received.

The proposed objectives of the National Housing Policy are four fold. The most important objective is to encourage investment in housing and thereby achieve a sustained growth of the nation's housing stock. This also includes proper conservation, renovation and upgradation of the existing housing stock. Second objective is to motivate and help the homeless to acquire for itself affordable shelter by providing access to land, materials, technology and finance. The other objectives are to improve the environment of human settlements with a view to raise the quality of life through the provisions of drinking water, sanitation and other basic services and to promote vernacular architecture.

HOUSING — A PEOPLE'S ACTIVITY

It has now been widely recognised that if a major thrust in the field of housing is to be made, construction of houses has primarily to be a people's activity. The role of Government and its agencies should not be so much that of a builder of houses as of a promoter and facilitator of housing. It is the Government alone which can create a climate which is congenial for investment in housing, provide the necessary legal framework which encourages housing activity and give fiscal and other incentives for savings and their channelisation to the housing sector. Besides this Government ought to take necessary steps to facilitate access to various inputs for housing at an affordable price such as developed land, credit and building materials. While continuing its core programmes to provide affordable housing to the socially disadvantaged sections such as the Scheduled Castes, Scheduled Tribes and the landless in the rural areas and the economically weaker sections in the urban areas.

Innovative shelter strategies which can ensure provision of shelter within affordable limits need to be developed. The policy document outlines the steps needed to promote the production and use of locally available building materials, standardised good quality construction materials and components and application of appropriate building technology and energy saving methods.

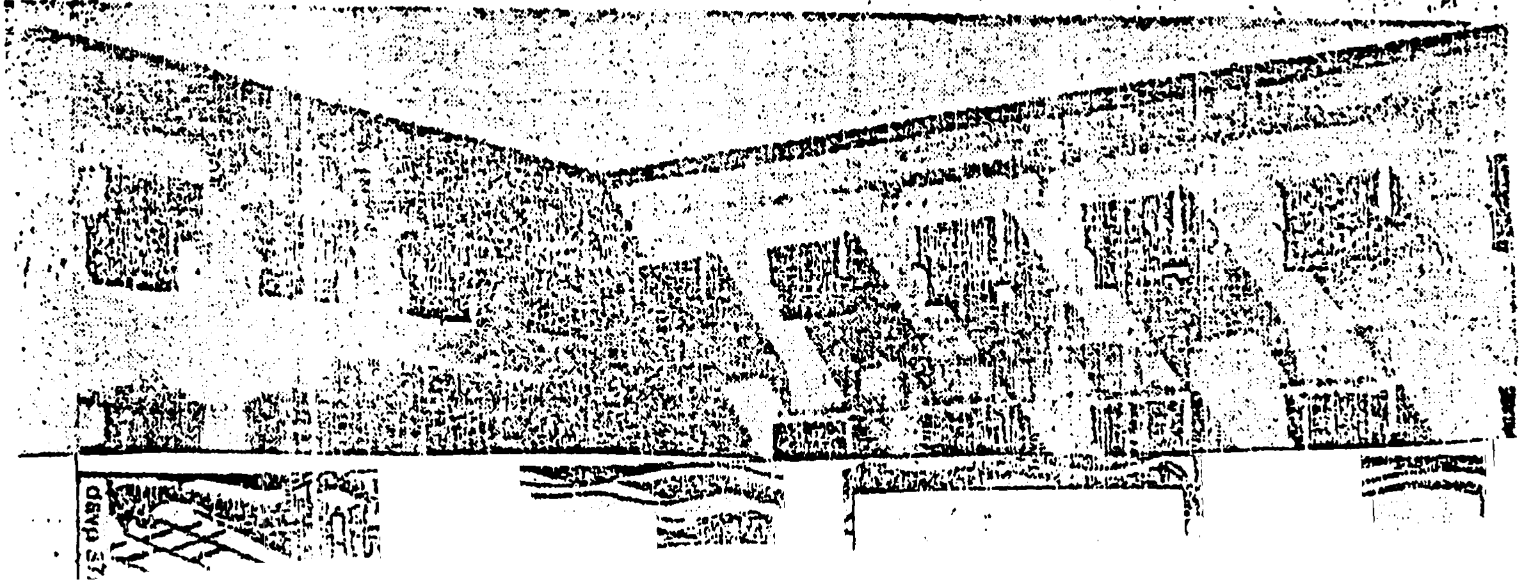
—by Smt. Mohsina Kidwai

(UNION MINISTER FOR URBAN DEVELOPMENT)

EASING CONSTRAINTS

Easy access to credit is another important area identified for action to give a fillip to individual, cooperative and corporate housing efforts. A National Housing Bank is being set up at the apex level to promote a widespread housing finance network. Along with this appropriate fiscal incentives to promote savings and their channelisation for housing, development of a secondary mortgage market and mortgage insurance are also on the anvil.

The existing constraints and irritants that inhibit housing activity need to be speedily removed. The Urban Land Ceiling Act is already under critical review. States have been requested to review their existing Rent Control laws. Local authorities too ought to review their Development Control Rules, Building byelaws/codes and planning standards to facilitate appropriate and affordable housing for the poor.



Financial Express, New Delhi, Monday, May 9, 1988 Page 11

Acute housing shortage in major cities

NEW DELHI, May 8 (UNI)— Between one-fourth and a half of the urban population in India's largest cities lives in makeshift shelters and slums.

The figure is a pointer to the growing problem of housing, next only to the problem of food and clothing that India and other third world countries face today.

The estimated shortage of houses at the beginning of the Seventh Plan was 24.7 million units—18.8 million in rural and 5.9—million in urban areas.

With the process of migration from urban to rural areas assuming gigantic proportions, the housing shortage is expected to grow to 40.9 million units—31.2 million units in rural and 9.7 million units in urban areas by 1990.

The situation, in fact, has become so grave that the National Buildings Organisation has estimated the current shortage of rural dwellings in Bihar alone at 4.99 million units, 22 per cent of the all-India figure.

In Delhi alone, which has seen a population increase from two-to-eight million between 1957 and 1987, there is an addition of 60,000 persons each year who need to be provided new housing.

Almost 70 per cent of Delhi's population lives in sub-standard conditions. Jahangirpuri, the country's largest resettlement colony, which has 12 blocks of 2,000 houses each, does not have a single sewer line. The community lavatory its residents are forced to use, does not even have running water.

With the country's slum population at present standing at nearly 30 million, slum dwellers from 32 per cent of the population in Delhi, 38 per cent in Bombay and 42 per cent in Calcutta.

The situation is no better in Bangalore, Hyderabad, Ahmedabad, Kanpur, Pune, Nagpur, Lucknow and Jaipur.

The slum population, governmental efforts notwithstanding, is expected to show a sizeable increase by the next decade, adding to the housing problem.

Squatter settlements in the country continue to mushroom despite various strategies and initiatives. When initial efforts to resolve the housing problems of the poor through provision of houses built for the economically weaker sections failed the strategy shifted to the sites and services programme.

It was felt that the poor could build houses more suited to them and at tion were provided to them.

The programme met with mixed success as the poor found services sites on the periphery of the town expensive. The weaker sections also could not cope with long repayment schedules for the land as they also had to invest in construction.

Of late, the Housing and Urban Development Corporation has been laying stress on sites and services backed by cash loans.

But these strategies only provide a limited solution to those sections who have acquired some social and economic stability and not to poverty-stricken new migrants.

The order of development in squatter settlements is people, sites, shelter and services. The people first select a site which meets their social and economic needs, build shelters and then wait for the services to move in over a period of time.

Although the settlements fulfil the needs of the people's logical sequence, they violate city planning regulations.

The cost of regularising these settlements without getting any value for the land and services is also substantial. The next best order of development would then be land, people, shelter and services.

Until now government housing programmes have been hit by lack of adequate finance with the high cost of formal construction programmes. Brick, cement and concrete technologies necessitate high consumption of energy, another scarce item in developing countries.

With nearly 80 per cent of the rural and 30 per cent of the urban population living in mud houses, the importance of the material, they use should be recognised instead of being regarded as a remainder of primitive cultures.

Apart from encouraging the poor to go in for low-cost non-formal housing technologies, the budget for 1988-89 contains fresh concessions and schemes to promote better housing.

There is a cut in excise duty on cement, structural intermediates and components of prefabricated housing.

A separate social security fund with a corpus of Rs 100 crores will be set up a national scheduled caste and scheduled tribe finance and development corporation created and a contribution of Rs 100 crores made to the national housing bank which will become operational shortly.

It is also proposed to extend the function of the land development banks to cover the field of housing finance for farmers.

A new rural housing programme is being launched by HUDCO, which in the course of 17 years of its existence, has helped nearly three million households mainly belonging to the weaker sections. The village abadi environmental improvement scheme to improve rural settlement infrastructure is also planned.

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Govt. not 'indifferent' to housing

From Our Staff Reporter

NEW DELHI, Feb. 10.

The top Government functionaries today claimed "path-breaking" achievements in the housing sector during the International Year of Shelter for the Homeless (IYSH-1987).

Reviewing the IYSH programme in India at an international seminar on "Low cost housing and alternative building materials" here today, the Union Urban Development Minister, Mrs. Mohsina Kidwai and the Urban Development Secretary, Mr. D M Sukhtankar, referred to the yet to be finalised National Housing Policy (NHP) and said "once it is finalised in the near future, it will be an important landmark and a major and significant effort mounted during the IYSH."

'Outlining the broad features of the proposed policy, Mr. Sukhtankar said it would promote the basic inputs to housing such as land, finance, building materials and technology, human resources, legal environment and institutional framework.

"Taking a cue from the Seventh Plan document that the major responsibility for house construction would have to be left to the private sector through self-help efforts, it is envisaged that the Government will provide the package of supporting inputs in the role of an enabler, facilitator and promotor, rathar than the builder of houses," the Secretary said.

The Minister said that unless home-owners themselves took up construction the varying needs and preferences of different households would not be catered to. Voluntary organisations would get encouragement and support.

Organised by the Central Building Research Institute (CBRI), Roorkee the two-day seminar is co-sponsored by the Union Urban Development Ministry, the Department of Science and Technology, the Housing and Urban Development Corporation, the Delhi Development Authority and the National Buildings Organisation. The excercise is one of the major efforts aimed at a global review of IYSH. Experts from all over the world are attending.

Mr. Sukhtankar said it was a distortion to say that the Government had been indifferent to the housing scenario and recounted programmes taken up over the successive Plan periods. These included the Indira Awas Yojana, schemes for house sites to rural landless, grant of construction assistance and environmental improvement of slums.

At the instance of his Ministry, the National Buildings Organisation took up in 1987 a number of special activities to transfer research findings to the field to provide better, livable homes at low cost to the economically weaker sections.

National Housing Bank: Mr. Sukhtankar said the Reserve Bank had agreed to provide an initial equity contribution of Rs. 100 crores to the National Housing Bank (NHB). It would be an apex housing finance institution to promote, at the State, regional and local levels a series of housing finance institutions and lay the foundation of lower level organisations to meet the individual credit needs of potential owners. It would also channel savings into housing finance intermediaries.

The NHB would give technical and administrative guidance to housing and finance institutions at the local and regional levels and advise on savings mobilisation, credit appraisal and disbursement.

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TIMES OF INDIA " NEW DELHI 31/1/88

Fiscal reliefs for housing needed

By D. G. GUPTE

The Times of India News Service

BOMBAY, January 30: With the setting up of the National Housing Bank, the housing finance system is expected to be built up in an effective manner. NHB has been thought of as an apex institution in the field of housing finance, similar to the IDBI and NABARD in the fields of industrial and agricultural finance, respectively. The main functions of the NHB will be to promote regional and local level housing finance institutions, grant refinance facilities to the eligible housing finance institutions and to control the entire gamut of housing finance sector.

At present, HUDCO, HDFC in the corporate sector, about 20 companies in the cooperative field and about the same number of apex cooperative housing finance societies are the main housing finance institutions. Since the demand for credit for housing is expected to grow fast in the wake of the overall shortage of housing in the country, new regional and local level institutions are proposed to be set up by the NHB.

Since the financial institutions in the cooperative field come under the purview of the state governments, the NHB will be able to regulate initially only institutions like HUDCO, HDFC and about a dozen smaller companies set up in the corporate sector.

In urban areas and metropolitan centres, builders could be encouraged to increase the supply of housing. The state housing boards have proved unsuccessful in increasing the supply of housing in urban areas and metropolitan centres to meet the ever rising demand. Delhi Development Authority (DDA) is reported to have taken a decision to create infrastructure and leave it to the builders to construct houses and apartments. This example could be followed in other centres.

In big cities, urban land ceiling act has acted as a drag on development of housing on a big scale. This needs to be amended speedily.

Financial incentives

Direct financial incentives for home ownership will go a long way in encouraging people in investing in housing, it is felt. With appropriate fiscal reliefs to mobilise household savings and channalising the same to residential housing finance in the different segments of society will lead to a viable and self reliance housing finance system.

At present, two fiscal incentives are available under the income tax act for house ownership. A deduction of Rs. 5,000 is available under section 24(1)(VI) in respect of interest payable on money borrowed for purchase of houses. The Finance Act 1987 introduced a new clause (H) under section 80C(2) whereby a deduction of Rs. 10,000 is available to individuals and Hindu undivided families (HUFs) for investment in houses where the construction is completed after March 31, 1987. Investment for this purpose includes the repayment of principal of housing loans taken from the government, LIC and approved housing finance institutions.

The monetary limits prescribed for these two deductions are not adequate taking into consideration, the increasing prices of houses especially in metropolitan cities like Bombay, Delhi, Calcutta and Madras and individuals who purchase a house generally do so out of borrowed funds and is, therefore, burdened with a heavy repayment commitment. Further, local taxes connected with house ownership adds to his burden. Some observers suggest that a tax benefit should be granted to savings made by an individual in the form of a deposit or bond of a minimum period of three to five years of an approved housing finance institution. Such a tax benefit could be on the lines of section 80 C(2)(H) of the Income Tax Act. A new section similar to Section 80 CC could be introduced for the purpose.

Money review

Efforts are being made to set up regional level housing finance institutions. The HDFC has sponsored Gujarat Rural Housing Finance Corporation Ltd., whose activities will be confined to the rural areas in Gujarat. Housing Promotion Finance Corporation Pvt. Ltd. is being set up with an initial capital of Rs. 5 crores, basically to cater to the requirements of eastern and north eastern regions of the country. SBI Capital Markets will subscribe 20 per cent of the capital of this company, HDFC another 20 per cent and 35 per cent by the financial institutions like the UTI, GIC and LIC. The balance 25 per cent will be privately placed with public and private sector companies operating in eastern India.

Can Fin Homes Ltd. has been promoted by Canara Bank in association with U.T.I., H.D.F.C. and ICICI. The company will lent money to individuals, cooperative societies and corporate bodies for acquisition and construction of residential housing. It will lend money normally to families who do not own a house. The initial equity capital is Rs. 5 crores, to be subscribed by Canara Bank (26 per cent), Canbank Financial Services Ltd. (4 per cent), UTI (12.5 per cent), HDFC (12.5 per cent) and ICICI (5 per cent. The Asian Development Bank (ADB) has also agreed to subscribe to the company's capital to the extent of five per cent. The balance 35 per cent will be offered to the public for subscription.

In the northern sector, Punjab National Bank together with HDFC is planning to set up a new housing finance company. Whether the new company will follow the route of SBI Capital Markets or Canara Bank remains to be seen.

The National Housing Bank will have to pay greater attention to rural housing. Observers feel that housing finance companies on the pattern of Gujarat Rural Housing Finance Corporation, promoted by HDFC, could be pattern for this sector. Such companies could be quasi government and quasi private.

In respect of rural housing finance, mortgage of properties could loose a serious problem. Systematic procedures will have to be formulated, since the general attitude of the people in many rural parts of the country is not to return the loans taken by them.

ORIENTAL FINANCE

Smooth Scam

CAN Kerala's once-booming non-banking finance companies be depended on? Last fortnight, there were no prizes for answering that question after Sajan Varghese of the high-profile Oriental Finance and Exchange Company sought anticipatory bail, fearing arrest by the Madras police for cheating his depositors. When the sessions court at Madras rejected the bail application, Sajan simply disappeared.

The sensational bursting of the deposit bubble shocked countless depositors of Kerala's "blade companies"—so called because of the cut-throat interest rates they charge. The closure of all 20 branches of Oriental was not all. Five other companies in the business also closed shop last fortnight. Among them was Samarias Financiers, once a leading name, which shut down all its 11 branches located within the state and outside.

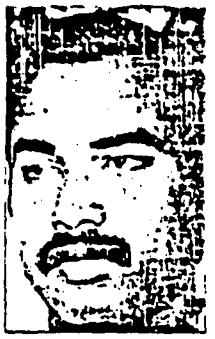
When the Reserve Bank of India (RBI) had asked for financial statements of all the companies in the business towards the end of 1985, Oriental had claimed that up to August 1985 it had only 1,830 depositors with accounts worth Rs 63.31 lakh. But senior RBI officials feel that Sajan collected over Rs 15 crore from 40,000 depositors, big and small, in the last four years.

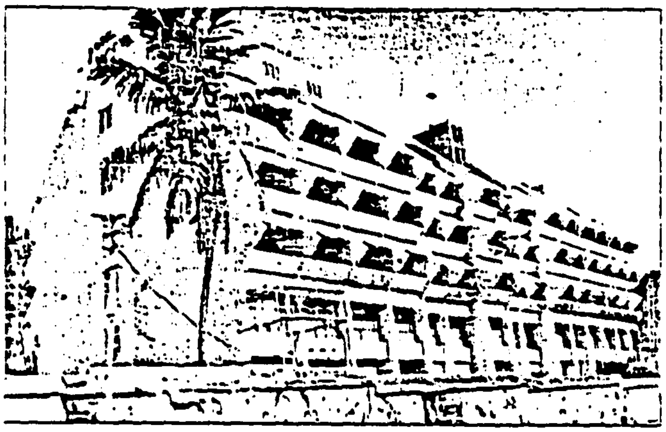
Sajan's success story in the early '80s is the stuff of which best sellers are made. Rising from relative obscurity as manager of one of the early "blade" companies, Sajan started his own company and soon grew into one of the most well-established names in the business.

His life-style was the envy of even film stars in Kerala. At one time, he had three Mercedes Benz, two Toyotas and a Honda. He built an air-conditioned mansion in Kottayam at an estimated cost of Rs 35 lakh and bought a Trivandrum hotel. According to Muthoot Pappachan, a leading private financier, "Sajan's life-style fooled everybody. His depositors were so awed by his style that they forgot to ask how he managed to give them a 33 per cent interest on deposits."

Pappachan and other financiers allege that Sajan did not loan out his deposits at all. His modus operandi in the last four years was simple—he issued full-page and half-page advertisements in leading newspapers promising to give 33 per cent on deposits, and this lured greedy investors in droves. Argued Pappachan: "If Sajan was paying 33 per cent when we were giving 18 per cent to 20 per cent, he should have made loans at 46 to 48 per cent to make a profit." Bankers in the state feel that no businessman could have afforded these rates. The theory, therefore, is that Sajan was paying his depositors from the principal itself, and diverting the rest of the money into film production, real estate and lavish living.

The closure of the Oriental Finance and Exchange Company, following Varghese's disappearance, has shocked Kerala's depositors.





Sajan Varghese's hotel: high profile

Flush with funds, Sajan started making films in 1983. He produced or distributed as many as 13 Malayalam films and five Tamil films, but most of them bombed at the box-office. The only real success was *Avanazhi*, the I.V. Sasi-directed thriller.

The proverbial last straw was Sajan's latest production, *Kadathanadan Ambadi*, an action-packed Malayalam fantasy. The film overshot its Rs 50-lakh budget to reach the Rs 1-crore mark. To raise money to complete the film, Sajan planned another deposit mobilisation scheme.

But early this year, the Monopolies and Restrictive Trade Practices Commission (MRTPC) took notice of his methods and restrained Oriental from issuing any more advertisements. Sajan tried to use posters instead, but the commission came to know about it and directed the Madras police to stop him.

In desperation, Sajan started borrowing from Marwari financiers in Madras to keep himself afloat. The inflow of deposits was reduced to a trickle and, amid rumours of an impending crash, some large depositors withdrew their balances. Sajan's cheques began bouncing and finally, on a complaint by J.M. Ranjithan, a retired additional superintendent of police who was one of his depositors, the Madras police registered a case of cheating against Sajan and his partners, his brother and father.

Several of Sajan's depositors in Kerala have formed associations, but it is unlikely that they will get their money back. Samarias' depositors too have formed an action council and demanded a probe into the activities of private financing firms. Said a senior RBI official: "The crash of Oriental and others in the last month has made the people aware of the risk involved in blade companies. A run has started on the remaining ones and very few are likely to survive."

The Government too has sat up and taken notice. Said Viswanatha Menon, the new Marxist finance minister: "We will be amending the laws to counter the 'blade' menace though, at present, there is no legal provision to deal with them effectively."

Meanwhile, a massive manhunt has been launched by the Madras police to track Sajan down. An enterprising producer has announced a film based on the life and times of Sajan Varghese. Mammooty, Kerala's top star, will play the title role. Film or not, Kerala is unlikely to forget the man for a very long time.

—SREEDHAR PILLAI

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ANNEX 7.4

AID-SPONSORED RESEARCH IN HOUSING FINANCE IN INDIA, 1986-88

- Analysis of the Roles of the General Insurance Corporation and the Life Insurance Corporation in Housing Finance in India (Robert van Order, for The Urban Institute) (draft: May 1987).
- Housing Finance for Corporate Employees (Michael Lee) (September 1987).
- Informal Housing Finance in India (Michael Lee) (October 1987).
- Description of RBI Regulation of Commercial Banks (A.F. Ferguson & Co., for The Urban Institute) (December 1987).
- The National Housing Bank: Regulatory Options and Assessment Factors (Karen J. Wilson, for The Urban Institute (January 1988).
- The Impact of a Housing-Linked Contract Savings Scheme on Households' Holdings of Financial Assets (The Urban Institute) (September 1988).
- Implications of Mortgage Loan Prepayment (The Urban Institute and HDFC) (in progress).
- Study of Housing Finance Systems in Metropolitan Areas (Ahmedabad School of Planning) (in progress).

ANNEX 7.5

TRAINING FOR HOUSING FINANCE

1. Focus of Training for HG-003

The purpose of this Housing Finance Sector Program is to promote the development of a financially-sound, market-oriented housing finance system, by supporting selected market-oriented HFCs. A housing finance system, by definition, consists of a number of interlinked and interdependent components. Focusing attention merely on the primary lenders - and, at that, only on one group of lenders - is therefore a necessary but not a sufficient condition to ensure development of a system of market-oriented mortgage lending. The training and technical assistance component is designed to assist with the development of the whole of that segment of the system which will provide market-oriented housing finance. The private and joint sector HFCs are the core of that segment. They interrelate with other components of the system, notably the regulators and financial intermediaries. The training and technical assistance program is directed, therefore, not exclusively at the HFCs, but also at those related institutions of regulation and control.

In order to focus the program and keep it to a manageable size, the training and TA program will be related primarily to those institutions which directly participate in the HG program (HFCs and NHB itself), and GOI line ministries, unless AID and GOI specifically agree otherwise. This limitation would exclude from the program, for instance, other HFCs which may be eligible to borrow from NHB's Housing Finance Companies Loan Fund, training institutions and state governments.

This note goes on to discuss existing training opportunities in housing finance in India; the training needs generated by and related to this program; and describes the program framework for providing those needs. It concludes with a note on development assistance and research for the program.

2. Training Opportunities

Only one training organization currently offers courses in housing finance. This is the Human Settlements Management Institute (HSMI), affiliated to HUDCO. HSMI's courses on Housing Project Finance are run as residential workshops. They are of three weeks duration and are held annually. They are typically attended by 15 to 20 participants, predominantly from state and municipal housing authorities, and are designed for "middle level professionals such as engineers, architects/planners, social workers and finance executives". HSMI says that the courses would be increased in frequency if there were greater demand.

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There is little doubt but that the present courses are relevant to the needs of public sector agencies engaged in project development. HSMI also runs other courses on housing policy, which would be of some interest to finance executives. Although the various courses are occasionally attended by fee-paying representatives of the private sector, however, the courses have relatively little bearing on their own specific needs. They have no direct relevance to the HG program and would be of no more than marginal relevance to any of the participating companies.

HSMI is mandated to offer other courses and is understood to be interested in expanding the scope of its training activities when the physical improvements to its premises currently in hand have been completed. It is, however, understood that its training will continue to be primarily directed to the needs of its immediate clients. These, it may be assumed, will continue to be public sector organizations, although possibly with an increasing interest in direct housing finance. Nevertheless, HSMI currently has no expertise in training in mortgage lending and related subjects; nor is there any real likelihood that it would be able to acquire such expertise in the foreseeable future. If this is correct, two conclusions follow. The first is that HSMI does not offer, nor does it have any reasonable expectation of offering, any training courses relevant to the present HG program. Secondly, that since training in this field is so weak, it would behove the forthcoming India Training Plan to explore the possibility of offering assistance to HSMI to build up its abilities in this field.

So far as is known to USAID, housing finance does not feature in Indian degree courses in planning and urban management, except in the context of public sector project financing.

The National Institute of Public Finance and Policy (NIPFP), in New Delhi, is host to the HDFC Professor of Urban and Housing Finance, and a research assistant. The Institute does not offer training courses, but it does mount occasional seminars. In this role, NIPFP has informally requested USAID to co-host a seminar on Secondary Mortgage Markets in India, in winter 1988/89.

Similarly, the Society for Development Studies, a non-profit consulting organization based in Delhi, has a continuing interest in housing finance in India and a demonstrated ability to organize seminars. As with the NIPFP, however, the number of professionals with any housing finance expertise is extremely small.

Many of the HFCs offer some form of in-house training. HDFC is, of course, the acknowledged leader, and its training programs are substantially more advanced than those of its competitors and siblings. HDFC has its own Training Department, offering induction courses for new professional employees, and specialized training programs for specific requirements. The Division is involved in the production of training manuals and of video-cassette programs for internal use. Recently, it has started the systematic training of in-house trainers. As part of their training program, HDFC staff are also encouraged to attend conferences in India and abroad.

Under the terms of the 1988 World Bank loan, HDFC is to spend a little over Rs.1 million ($80,000) "to develop training curricula and organization and train new and existing staff in technical and human relations skills needed for branch expansion, systems development, and computerization".

HDFC now itself offers technical assistance to managements of its sibling organizations - GRUH, CanFin and the Housing Promotion and Finance Corporation (HPFC) of Calcutta, as well as to new institutions in other countries of the region. The agreement with the World Bank specifies that HDFC will provide technical assistance to new housing finance institutions to a value of Rs.2 million ($160,000) over 1988-91, for:

- development of operating systems and procedures;
- operational assistance during start-up; and
- staff training (about 36 man-months).

With USAID's help, HDFC is also planning to establish a Housing Finance Policy Institute in the foreseeable future. One of the principal functions of the Institute would be to provide training, for its own staff and for staff of other HFCs, siblings and competitors. Details remain to be worked out, including a schedule of start up. It is, however, clear that this Institute will offer the most obvious medium for system-wide training for housing finance, subject to it (a) becoming operational sufficiently quickly to meet demand, (b) providing appropriate courses, and (c) being seen to be independent of HDFC.

There are a number of institutions throughout the country that offer training in financial management, but without specific reference to housing finance. IDBI, for instance, has a newly established training college at Hyderabad, which is to offer programs both for its own staff and for professionals from its client organizations. The programs are residential and non-residential, taking in aspects of development banking and management.

3. Training Needs

HDFC itself has, of course, grown to occupy its present position of eminence having made good use of technical assistance, and of formal and informal training. This included classroom teaching, overseas study tours, attendance at local and international seminars

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and conferences, and advisory visits by distinguished specialists in the field of housing finance. Much of this was achieved by HDFC's own efforts (and using internally-generated resources): some was financed and facilitated by USAID; and some, again, was made available by other donors to HDFC as India's sole and successful representative of a market-oriented HFC.

One major activity, undertaken by HDFC and funded by USAID in 1983, was of a "management audit", conducted by the Chicago Institute for Financial Education. As noted in the April 1985 Evaluation of USAID's project HG-001, the audit provided a "brief, lucid decription of the HDFC personnel function and general management practices". As a result of its findings, six two-day workshops were conducted, for all of HDFC's professional staff, focusing on "personal skill development and team building using a problems solving framework". This activity was the precursor of HDFC's own formal management training program.

This much history is repeated to emphasize that training, in one form or another, is indispensable to the development of sound enterprises, especially in a field as new (to India) as housing finance. Correspondingly, it would be irresponsible to expect that a housing finance system could develop in a vacuum and without the benefit of training. It may not be fanciful to suggest that the present stagnation of the housing finance system, with the obvious exception of HDFC itself, is due to a lack of understanding by its proponents of its special features. (This is, of course, not to deny the financial and entrepreneurial acumen of the principals of the surveyed HFCs; merely to point out certain gaps in their expertise with respect to the specialized field of housing finance.)

The analysis of HFCs described in this Project Paper finds a number of areas in which their operations would benefit from improvement and, implicitly, therefore from training. These include an understanding of the following issues, skills and techniques:

- the components of a housing finance system, including the existing role of central institutions and their potential; regulation of the industry; mortgage insurance; secondary mortgage markets;

- policy issues, from the importance of housing in the national economy, through the implications of subsidies on the housing finance industry, to issues of rent control;

- types and uses of alternative mortgage loan instruments;

- outreach to special target groups; this implies a number of subsidiary questions, including (a) definition of target groups: the primary group being below-median income households; others that may be targetted include the self-employed and households in smaller towns and rural areas; (b) the nature of special mortgage instruments that are appropriate to such groups, and the implications of using them; (c) appropriate credit appraisal techniques, lending criteria and recovery mechanisms; and (d) techniques for outreach;

- resource mobilization techniques, including alternative mechanisms for attracting savings into the housing market;

- introduction to computerized systems for financial analysis and in financial management information systems:

- management problems in housing finance, in particular portfolio management; the control of defaults and delinquencies; customer contact skills;

- personnel and non-financial management issues, including management effectiveness and control, strategic planning, communications within a firm, goal-setting and performance evaluation.

Training in some or all of these issues would be beneficial to representatives of the HFCs at all organizational levels: members of the Boards of Directors, managers, heads of department and other corporate staff members. Training under the Housing Finance Sector Program will thus be aimed both at the policy level and at the technical level: directed at long-term growth and institutional strengthening. At the most senior level of management, training will focus on policy issues and aim to promote an understanding of the implications of these on both the shelter sector as a whole and, more narrowly, on the operations of their own enterprises. At the technical level, training will attempt to upgrade the skills of middle and lower level professional staff, as well as assisting them to develop a broader understanding of the context of housing finance.

Although the most obvious needs for training are of the HFCs, yet the NHB and the GOI (Ministries of Finance and of Urban Development) may feel that they would also benefit from some upgrading of their knowledge of some of the more arcane issues of housing finance. The proper nature of such support will be determined in conjunction with the National Housing Bank.

4. Program Proposals

The purpose of the training and technical assistance component of this program is three-fold: (1) to identify training and technical assistance needs of participating HFCs and related institutions; (2) to finance training for specific needs generated by this program; (3) to finance training for related institutions. The program thus does not take in the upgrading of housing finance training capabilities of Indian institutions; and, except in certain small areas, does not include any direct training by AID itself.

Although it is possible to map out the broad training needs of the sector, there are several key imponderables which make it impossible to be more precise about the definition of a future strategy at the present time. Most importantly, these include the fact that the participating HFCs have not yet been selected, hence specific needs cannot be known; and, since different companies will take different routes to expand their low income lending program, whether by increasing their individual lending programs on conventional lines, by seeking new markets for individual loans or by opening new markets for loans through corporations, they will consequently have different training requirements. A second factor is that the needs of the National Housing Bank cannot be ascertained until its scope of work has been determined (nor until the experience of its staff members is known). A third factor is that HDFC has not yet decided on the curriculum or on the timing of inception of its Housing Finance Policy Institute; hence the supply of training facilities is indeterminate.

In the light of these uncertainties, it will be necessary to have a rolling assessment of training needs. As discussed above, these will include matters relating directly to housing finance, those which are common to other financial undertakings, and those of a more general nature, including personnel and non-financial management issues. Since NHB will be in frequent contact with participating HFCs, the program proposes that NHB itself should have the responsibility of defining the training program for HFCs and for itself.

A variety of methods will be used to deliver the training, according to specific needs. Training events will range from formal lectures and on-the-job technical assistance missions, through seminars and workshops, to study tours and distribution of literature. It is proposed to use in-country training so far as possible, but in many cases it will be more effective for participants to travel to courses in the U.S. or third countries.

As noted, USAID will not be directly involved in the process of training except to a relatively minor degree (such as the delivery of occasional lectures). Its role will be restricted to (a) facilitating the identification and accessing of appropriate training opportunities; and (b) providing funding.

It will be the responsibility of NHB, in consultation with AID, to prepare an outline training plan for HFCs. If NHB considers that a specialist training needs assessment is needed, it might recommend accordingly. The training plan would include a detailed appreciation of the needs of the HFCs, and a statement of sources of training, a budget and an implementation schedule. It is envisaged that the plan can be completed by September 1989, by which time NHB will have amassed sufficient experience of the HFC's needs. This plan will be supplemented by a separate assessment of a training strategy for the NHB itself and GOI, to be undertaken in conjunction with USAID.

Orientation training for NHB staff involved in the Housing Finance Companies Fund may need to be scheduled before the Implementation Agreement is drafted and before NHB initiates consultations with the HFCs. It may take the form either of a combined study tour/special training course in the U.S., or of U.S. specialist advisors visiting India to conduct a purpose-designed orientation course.

It is likely that all training associated with this program will be short-term (of no more than a few weeks duration), and in sharply-defined subject areas.

Funds for all components of the training program would be accessed from the Development & Management Training Project. This project will require agreement between USAID/New Delhi and GOI on specific training activities to be financed. Selection of training activities will be guided by the training plan after it has been completed, and, prior to that date, on ad hoc requests made by USAID, NHB or the GOI to a specially-constituted working group.

5. Technical Assistance

Development Assistance

There are a number of fields identified in the Project Paper as areas in which change could beneficially lead to systemic development, and in which the U.S. has a wealth of relevant knowledge and experience. These include, for instance, mortgage default insurance; secondary market operations; regulation of the housing finance industry; foreclosure legislation; and even the area of training, such as with assistance to training institutions. These are typical areas in which short-term technical assistance missions, from the U.S., could be useful to Indian institutions and are likely to be welcomed.

Technical assistance from the U.S. is available in these and similar fields. Financial support can be obtained under the existing contract with The Urban Institute and from the proposed Technical Assistance and Support Project (TASP).

Research

Research into issues of shelter, including housing finance, has seemingly been given very low priority in India's academic institutions. Much of the little that has already been undertaken is, by international standards, of low caliber. HSMI, together with the National Institute of Urban Affairs, has recently started to sponsor a few shelter research studies, but housing finance issues are not prominent. There is, nevertheless, a body of opinion in India which holds that all worthwhile research has already been done, and there is little practical value in undertaking any more.

The result is a woeful ignorance about housing finance and related issues in India; and a corresponding vacuum for making decisions which may affect the sector. In recent years, USAID has taken a lead in undertaking some specific studies - these are listed in Annex 7.6. More work is currently being undertaken by the NIPFP. The charter of the National Housing Bank - see Annex 4.1 - permits it, too, to undertake research. (However, the wording of the National Housing Bank Act leaves some question about the research priorities envisaged by the drafters of this piece of legislation: it says that the Bank may undertake "research and surveys on **construction techniques** and other studies relating to or connected with shelter, housing and human settlements" - emphasis added.) There is little doubt but that improved knowledge of how the system presently works would both make for easier and more effective decision making, and would serve to improve the image of the sector so, hopefully, allowing it to attract more first class professionals.

Among other subjects that can profitably be researched are the following: the operation of informal housing finance systems; patterns of repayment by households of differing socio-economic categories; public and private sector institutional investment practices; the flow of funds for housing finance; indexation of land and housing prices; corporate practices of financing construction; the impact on savings and investment of alternative taxation structures; the demand for construction finance; and the current and future demand for mortgage credit.

Many of these studies can be carried out by local institutions; others would need U.S. expertise. Funding is available from the same sources as for development assistance. Priorities would be determined in conjunction with NHB and in accordance with procedures agreed for the Technical Assistance and Support Project.

ANNEX 7.6

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ANNEX 8

Country Risk Assessment

Assessments of India's debt servicing capability over the past year by several U.S. based financial institutions and USAID have concluded that India continues to be an excellent credit risk over the medium term. The basic assumption underlying these assessments is that India will continue to be a prudent borrower in international capital markets.

Taking into account the impact of the serious drought of 1987, India's overall balance of payments situation remained difficult but manageable during the Indian fiscal year 1987-88 which ended on March 31, 1988, it is expected to continue to be so over the 1988-89 period but to begin to ease thereafter. The principal factors in this assessment are first, the peak in 1988-89 in repayment and service charges for the IMF structural adjustment loan of 1981 followed by the decline of these payments in the early 1990s and, second, the strong export performance in the past two years.

The late 1980s arrived not only with the peak in IMF repayments - $845 million in 1987-88 and $965 million in 1988-89 - but also with an added unanticipated drought-induced foreign exchange burden and other import increases in 1987-88, principally petroleum and edible oils which together accounted for over 80 percent of the total import increase of $1.47 billion. However, the increased net loan disbursements in 1987-88 resulting partially from accelerated disbursements of development funds and drought related assistance, the strong export growth of the past two years (about 21 percent in dollar terms in 1987-88 on top of over 10 percent growth in 1986-87), and World Bank and USAID projections of external account performance for the period 1988-89 to 1990-91 indicate that India will come through this period with some improvement rather than any deterioration in the overall balance of payments situation.

The debt service ratio - considered as the most acceptable indicator of the balance of payments situation - is projected to decline gradually and consistently from its peak at 27.0 percent in 1986-87 to 24 percent in 1988-89, 22 percent in 1989-90, and 20.7 percent in 1990-91. The current account deficit as a percentage of GDP - considered as the second most acceptable indicator - declined from its peak at 2.5 percent in 1985-86, to 1.7 percent in 1986-87, and is anticipated to decline further to a modest level of about 1.5 percent by 1990-91. The level of foreign exchange reserves will show a modest decline until 1988-89 - net decreases of $352 million in 1987-88 and $260 million in 1988-89, primarily due to IMF repayments, with net increases thereafter of about $1 billion each in 1989-90 and 1990-91.

As a result, India's credibility as prudent borrower and excellent credit risk has been maintained through what was anticipated to be a particularly difficult period. And in the early 1990s India should begin to see a distinct improvement in the balance of payments situation.

An important factor that has contributed to India's ability to manage through this difficult period without having to sacrifice economic growth or credibility as a prudent borrower has been the success of the two pronged structural adjustment program worked out with the IMF in 1980-81 - the one prong aimed at raising domestic production of crude and refined oil thereby holding down the oil import bill and the other, at increased capital goods imports in order to make Indian industry more efficient and energize the stagnant export sector.

The first part of the strategy has been more successful than the second until 1985-86 and thereafter the process reversed. Physical output of crude oil virtually tripled from 10.5 million MT in 1980-81 to 30.2 million MT in 1985-86 and the refining capacity increased by 66 percent from 25.8 Million MT in 1980-81 to about 43 million MT in 1985-86. Crude oil production has virtually stagnated in the 30.0 to 30.5 Million MT range since 1985-86 and is unlikely to exceed 33 Million MT in 1989-90. In the past few years, discoveries of oil reserves have been very slow. Unless large oil reserves are discovered, oil imports will increase substantially in the early 1990s. To help accelerate oil exploration, the GOI has recently involved foreign companies in the development of oil resources; five exploration/production contracts with such companies were signed in late 1987 and early 1988.

As regards the second part of the strategy, the imports of capital goods in dollar terms at current prices increased by about 90 percent from $2.4 billion in 1980-81 to an estimated $4.5 billion in 1987-88. Some part of the strong export performance in the past two years noted above, after a dismal stretch of virtually stagnant export growth in the first half of the 1980s, is attributable to this second part of the strategy. Other factors that contributed to the strong export growth include direct tax concessions to exporters - recently raised to 100 percent, and reduction in import duty on imports of capital goods for identified export "thrust" industries.

The above said, a constant in assessing risk throughout the 1980s has been the continued conviction that India's management of external accounts would be conservative whatever the circumstnces. For example, if concessional assistance to cope with the drought or the recent spurt in growth of exports had not materialized, the consensus is that India would have taken difficult short term measures with adverse consequences for its long term development strategy to maintain its credibility as prudent borrower and as a "self reliant" country. The perception is that the capacity and the will to pursue conservative management of external accounts remains very much in place.

With respect to the above it is worth noting that India in the past year or so has been walking very close to the line where, by the standards India has set for itself internationally and domestically, it would be forced to consider interventions to restrain the rise in borrowing. However, barring another unanticipated shock such as the severe drought of 1987, the GOI should be able to manage without intervening in ways that would adversely affect its medium and long term development strategy.

Another important factor in assessing the debt servicing capability is that, despite some not insignificant problem areas such as disappointing performance by public sector enterprises, levelling off of growth of oil production and an increasingly difficult budgetary situation, India appears to have moved over the past decade to a somewhat higher trend rate of growth - at least 0.5 of a percentage point and possibly as much as one percentage point above the longer term rate of 3.8 percent per annum. Based on the trend rate of growth of GNP over the past decade a medium term outlook of over 4.0 percent per annum growth should be reasonably assured.

Finally, while some points of nervousness such as the measurement of private non-guaranteed debt and accounting for Non-Resident Indian deposits have been expressed by the international financial community in India, their overall assessments have been that India continues to be an excellent credit risk over the medium term. In this regard most recently, the New York based Moody's Investors Service undertook a credit rating of the Government of India (GOI) in connection with a bid by the Oil and Natural Gas Comission (ONGC) to raise $315 million from the international bonds market. The bond issue will be guaranteed by the GOI. Moody's gave India an A2 rating, reportedly the highest any developing country has received. The rating, according to the report, derived from four broad factors : "(1) the manageable size and favourable structure of India's external debt, (2) strong external debt management policies and mechanisms, (3) a conservative attitude towards foreign borrowing and (4) recent improvements in its economic structure and performance and a fundamentally stable political system built on institutions such as free elections and a free press, which give considerable transparency to economic policies as well as political and social developments" (see Times of India, January 30, 1988). It is also understood that Standard and Poor have conducted a credit assessment for India and awarded it a satisfactory rating.