HOME LOANS

NEEDED: A BENCHMARK FOR FLOATING RATES

The NHB is set to begin work towards evolving an index that can be used as a benchmark to determine floating interest rates for home loans. The move could bring in transparency in the housing finance market

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THE Reserve Bank of India's decision to hold the interest rates in its first bi-monthly policy must have brought cheers to home owners who have been struggling to pay off the equated monthly instalments (EMIs) of their home loans for a few months now due to prevailing high interest rates. On April 1, while announcing its monetary policy, the central bank left key lending rate, i.e. the repo rate, unchanged at 8 per cent. It also indicated that the lending costs would not go up if inflation continued to moderate. RBI has raised interest rates thrice between September 2013 and January 2014 due to high headline inflation.

This is good news for those paying EMIs based on floating interest rates. Floating interest rate is linked to lending rate of banks or housing finance companies and moves with the market conditions. It is linked to base rate system in the case of banks or prime lending rate (PLR) system in the case of housing finance companies (HFCs). As and when there is a change in the lending rate, your EMI changes too.

However, this situation is likely to change. The National Housing Bank (NHB) is contemplating bringing in some predictability for floating interest rates by way of introducing a benchmark index for such rates.

The suggestion has come from RBI central board member Nachiket Mor. Last month, Mor suggested that the NHB should work on a benchmark index for floating interest rates in housing loans to bring in transparency, uniformity and standardisation in the rates. This, he argued, would to lead to more clarity for customers who, at times, are faced with an opaque system where they may not get to know about the prime lending rate to which their floating rates are linked. Currently, banks and HFCs have their own internal benchmarks, leading to huge variations in the floating rate.

Essentially, what it would mean is that instead of individual PLRs (in case of housing finance companies), or base rates (in case of banks), there would be a benchmark index, probably linked to the movement of the housing industry, and all the HFCs and banks would be required to follow the index for pegging their floating rates.

This, experts say, would bring in huge predictability for a large population of borrowers, most of whom take housing loans on floating and not fixed interest rates. As per NHB estimates, that proportion of borrowers is as high as 90 per cent.

Over the last 25 years, the housing finance landscape has changed massively in India. The outstanding housing loans of the HFCs were Rs 25,326 crore as on March 31, 2000 while that of scheduled commercial banks was Rs 18,524.88 crore. This has grown to Rs 2,85,711 crore for HFCs and Rs 4,62,200 crore for banks in March 2013, totalling Rs 7,47,911 crore. This is growth of 1605.58 per cent. Given the huge market, it only becomes imperative to look at the vagaries of a floating rate and attempt to make it more transparent.

"The proposal will certainly facilitate a more transparent pricing mechanism. It will give a window of opportunity to all borrowers. Today, a large number of borrowers take housing loan on floating interest rate. However the behaviour of such rates is volatile and borrowers at time end up paying huge interest. By having a benchmark index, you bring some transparency and predictability," RV Verma, chairman and managing director, NHB, told *The Indian Express*.

He added that essentially the proposal is creation of benchmark index by working around normal floating rate and standard deviation so as to get data for a particular period.

"By developing this, you get some degree of predictability about the floating interest rate. The movement of floating rate in relation with benchmark index will give a curve for a particular period, say 15 years, and once you understand the data for the period of your home loan, you know the risks which lie ahead," Verma said.

Essentially, setting up of a benchmark index would present the future liabilities to the borrowers who can then take an informed decision based on the data. After knowing the pattern of floating interest rate for a certain period, borrowers would also be able to decide on opting for a fixed rate or floating rate regime for their home loan.

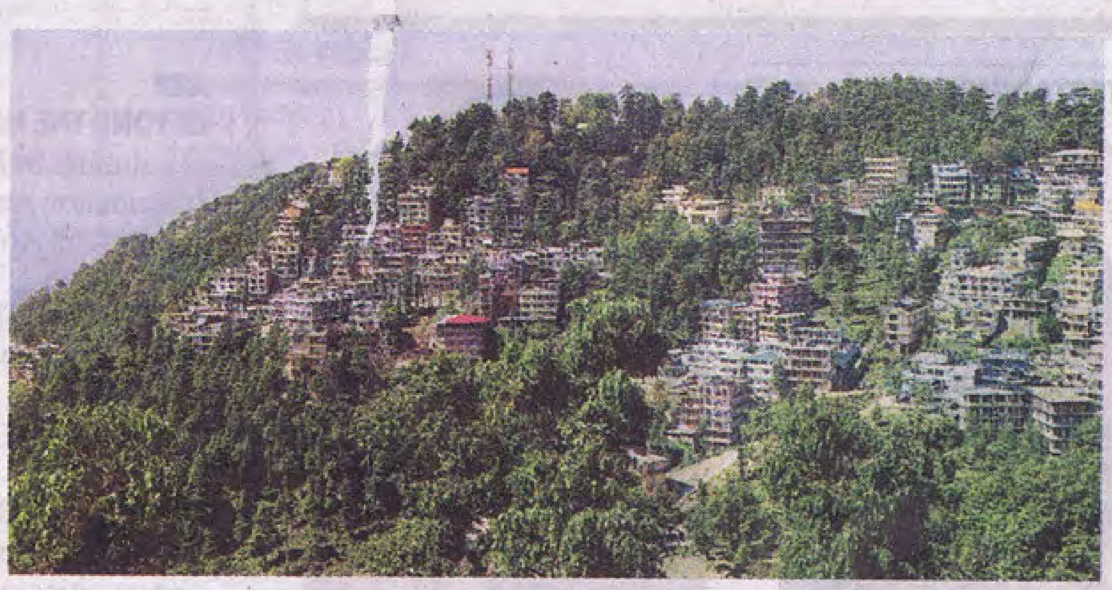
"While for lenders, the benchmark index helps them advise their clients better, borrowers can study their future liability and decide accordingly. They will benefit from the transparency of the system," Verma added.

However, there is scepticism that such a move may not be a wise one given the complex nature of such products. Amitava Mehra, CEO, India Mortgage Guarantee Corporation (IMGC), said that though it would be ideal to have such a benchmark index, customers may find it complex to understand. "Pegging the floating rates against the benchmark is a great idea but how will it get implemented is a big issue. How many customers understand such complex product is also to be seen. It has to be extremely simple for being useful to them."

Instead of an absolute figure, there should be a standard methodology for calculating such interest rates. "The market is diverse and each lending institution has its own method for calculating the rate. You can't have an absolute figure. The more attractive the idea appears in background, the more difficult it is to be implemented. Risk-based pricing is the best answer to the lack of transparency," Mehra added.

Currently, the housing finance market is highly skewed with players ranging from giants with huge balance sheets to small and marginal players. This brings in variation in the products offered because companies have products based on their cost of funds.

Verma agrees. "To accommodate all of them in the same index will not be possible immediately. It is a long-term vision due to asymmetry of information and financial profile of banks and housing finance companies. We will commission a study on the subject and will engage professionals. The industry has to be developed to a certain level where there are many players of more or less the same size, following which such an index can be developed."



AREA WATCH

Himachal: Hotspot for second homes

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BUYING a holiday or second home in the lap of nature remains an attractive real estate investment proposition. Himachal Pradesh is one such destination that is gaining prominence and emerging as a sought after location for investment because of its proximity to the national capital and to Chandigarh. There is an increased interest among high net worth individuals and professionals with high incomes for property in the state.

Until recently, there was a lot of confusion on the legality of buying property in this state. The Himachal Pradesh Apartment and Property Regulation Act, 2005, permits non-domiciles to buy a plot of land or apartment from a licensed builder without seeking any approvals from the government. However, there is a restriction on non-agriculturist buying land used for agriculture purposes. Any person who does not own agricultural land in Himachal Pradesh is a non-agriculturist.

According to Rule 38 A (3) of the Himachal Pradesh Tenancy and Land Reforms Rules 1975, there are permissible limits on different purposes for acquiring land. For example, the limit building a residential house is 500 square metres.

Famous tourist destinations like Shimla, Solan and Kasauli offer a variety of villas, bungalows and apartments. The prices for mid-range apartments range between Rs 2,500-5,000 per sq ft. Studio apartments and 1 BHK apartments are the favourite investment type in these locations as they are fully furnished.

Generally, these apartments also provide management services; this is an option that is available by paying extra. Areas of these apartments vary between 600 and 1,100 sq ft. However, premium options are also available for those who want to invest in luxury projects.

Shimla, the capital, was the first to witness real estate development. Various projects are developed by the local government authority, Himachal Pradesh Urban Development Authority (HIMUDA) and local developers. Prominent developers such as DLF, have also launched luxury housing projects in Shimla. However, Shimla is now getting congested and there are limited options available near the city centre. Projects located farther away are not preferred as these locations lack basic amenities and infrastructure.

Recently, Solan, the second most populous city in the state, has also emerging as a favoured investment destination because of its strategic location on the Kalka-Shimla National Highway 22. The town is situated between Chandigarh and Shimla and is equidistant from other tourist spots like Kasauli, Kullu, Manali, and Chail. Unlike Shimla, Solan provides a variety of options in the lap of nature with many basic amenities available.

Tata Housing, DLF and Woodside Developments are the prominent national developers who have launched luxury projects in Kasauli, Solan district. Myst by Tata Housing is a luxurious duplex villa project, priced in the range of Rs 3.7-8 crore. DLF Samavana, is an "invitation only" project consisting of plots, villas and apartments priced anywhere between Rs 1.7-8.5 crore. Woodside Developments is close to completing a project in Kasauli with 35 villas of 2,800 - 5,000 sq ft. Private equity fund, Fire Capital, has also entered the sector with a luxury apartment project called Clouds' End in Kufri, where apartment sizes have been deliberately kept small to bring the ticket size down to Rs 60 lakh-Rs 1.5 crore.

One should be sure of the title of the property, security and maintenance to enjoy a hassle-free ownership experience. The location should be one that is easily accessible with basic amenities available within a periphery of 0.5-1 km. So long as these conditions are satisfied, one can expect decent returns by investing in these areas over the long term.

— The author is Associate Director, Colliers International