HOUSING LOAN DISBURSEMENT IN INDIA: SUGGESTIVE METRICS TO PREVENT BAD DEBTS

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I. Abstract

One of the most important factors in credit processing is to understand the need of the customer before actually processing of the loan. This is true for every kind of loan. Since the point of discussion of this paper is only of housing loan, we would adopt a perspective towards this type of loan only. The sub prime crisis in the United States has shown the entire world the fallout, which the mortgage market can create when the lending goes wrong. It has thus become imperative for each and every country to review their policies towards the same. Taking a leaf further, each and every company, be it a Non-Banking Financial corporation (NBFC) or a bank in each of the countries involved in the business of lending mortgage loans also took stock of their policies and terms & conditions. Critics and some experts might argue that given the technologically advanced systems in place to do credit scoring, it is enough to have certain set of quantitative parameters to do a check. The parameters, which are discussed in the credit scoring software, are primarily quantitative parameters and some qualitative features whose measurements are also quantified. However certain subjective parameters also are required to gauge the complete credentials of the individual (or the set of individuals) applying the said loan. Given the fallout that the world just saw, it is imperative that these qualitative points should also be taken into consideration while doing the analysis. Needless to say, the subjective parameters can surely be used to strengthen the objective parameters.

Key Words: Housing loans, credit appraisal, case study, mortgage, title deeds

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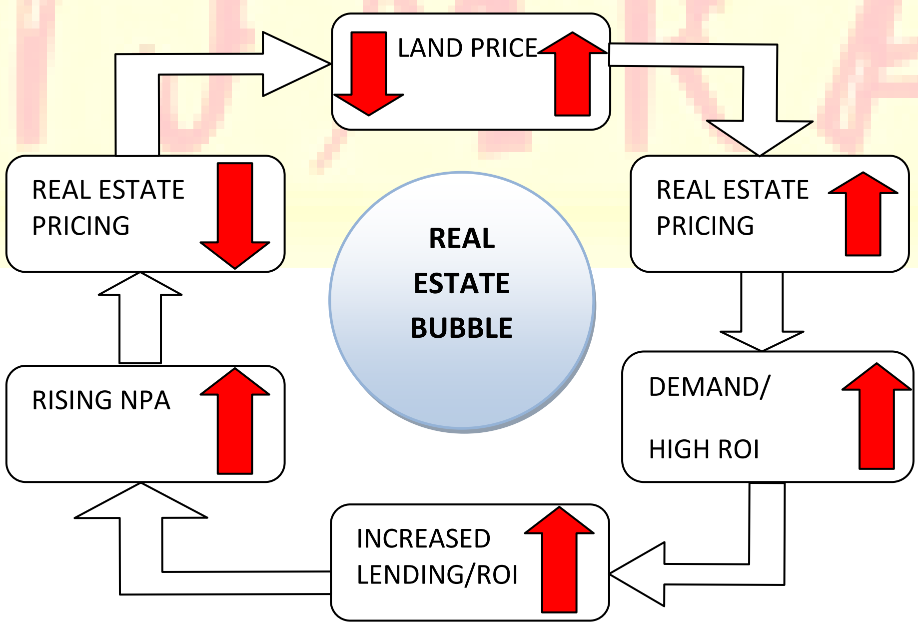
II. Introduction

Mortgages have been differently priced and are marked as priority sector lending in most developing countries. Priority sector constitutes those sectors that impact large segments of population & the weaker sections, and which are employment-intensive, as part of the priority sector. In India, agriculture, small scale industries, small road and water transportation, education, housing, consumption loans and investment by banks in venture capital constitute priority sector. Housing loan comes under the priority sector lending wherein any financial institution has to have a portfolio of 40% in priority sector lending.

The dual pricing method is to a certain extent creating a shift in focus from quality lending to quantity lending. Majority of the mortgage financing companies focus on high priced mortgages with an objective of gaining more returns. Hard sales and focused objective credit approach is one of the major factors which drive mortgage market today. The easy accessibility of mortgage loans has created the real estate bubble which is also a bad signal for the economy. The rising real estate prices are a major concern with no regulatory body controlling the real estate market. There has been major price rise in the urban cities with land prices soaring very high. This has a chain reaction on the lending volume also.

III. Understanding the present chain:

Land price- property prices – urgency of owning a home/ higher return on investment - loan amount – higher risk



When the land price starts going up, the prices of property starts to move upwards proportionately thus creating an urgency to own or acquire a home at particular price considered to be low at that point of time. People also buy properties as an investment expecting higher returns in the short term. This creates an artificial demand in the market and thus results in prices of properties moving upwards. To meet this urgent need to buy property borrowers start to avail loans of higher amounts as compared to what they can repay with their present income. They start factoring in future property price movements and future income growth when availing these loans. **The increase in the demand also spurs the increase in the lending rates at a future date which measures the increasing liquidity in the market. With the lending rates going up the repayment becomes difficult for borrowers as 90% of the lending happens on adjustable rate which is linked to the money market. Thus there is a rise in the NPA's of banks and financial institutions. The demand for real estate starts to fall drastically and the bubble bursts.**

The mortgage market in India has grown rapidly in the last decade. The pricing has become narrower with stiff cut throat competition. National Housing Board (NHB) RESIDEX a pilot project launched by the NHB for measuring the contribution of housing and real estate sector to the overall national wealth. The NHB RESIDEX has benchmarked year 2007 as the base year.

CITY	2007 Index	Jan- June 2008 Index	July- Dec 2008 Index	Jan-Jun 2009 Index	July-Dec 2009 Index	Jan-Mar 2010 Index
Delhi	100	124	130	121	113	104
Bengaluru	100	73	76	58	59	65
Mumbai	100	112	117	124	126	134
Kolkata	100	114	140	159	185	157
Bhopal	100	139	151	139	162	151
Hyderabad	100	96	92	65	81	75
Faridabad	100	100	121	136	145	147
Patna	100	103	100	107	119	102
Ahmedabad	100	106	100	127	128	113
Chennai	100	104	95	120	143	158

Jaipur	100	119	115	71	63	66
Lucknow	100	103	102	104	119	109
Pune	100	101	97	103	117	133
Surat	100	101	98	111	123	104
Kochi	100	106	95	90	83	76

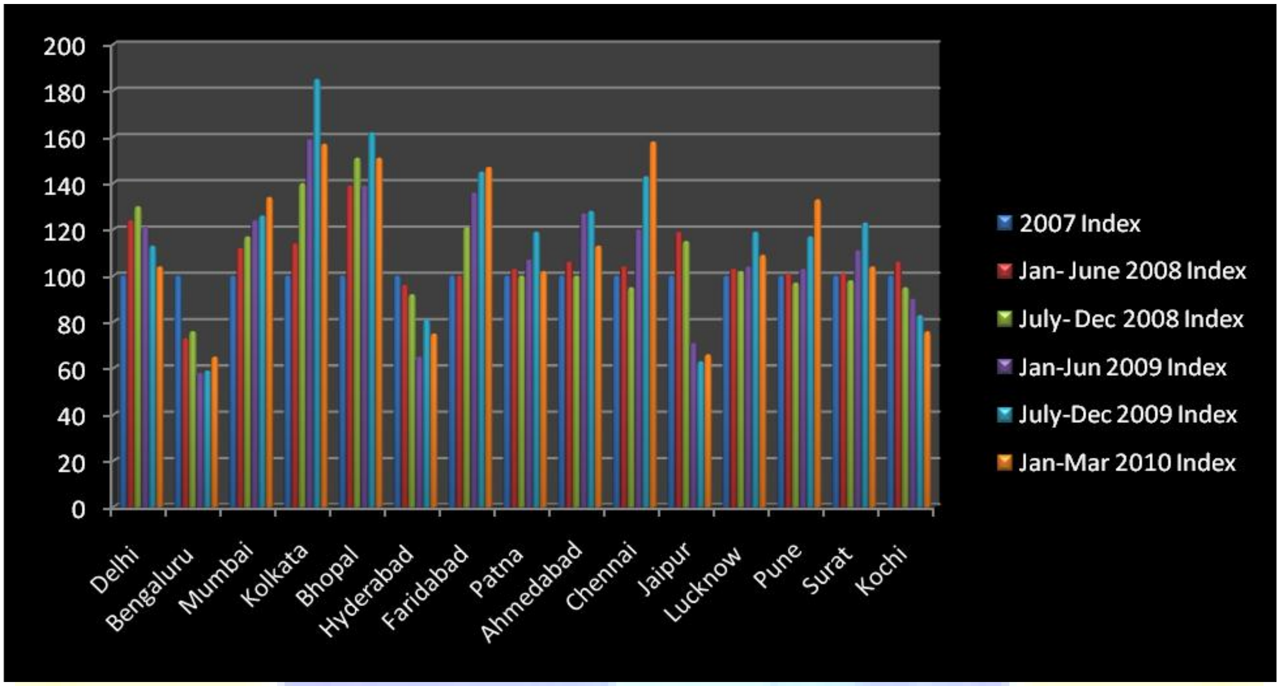


Table1 : A representation of the changes in the RESIDEX across cities from 2007-2010

It may be noted here that given the craze for the properties, which is duly described, finance companies are also making hay by offering loans at amazing rates and attractive term & conditions. We need to check out the unbalanced and unhealthy growth (if any) so that we are able to sustain the growth without allowing the bubble to burst as we have seen in other parts of the globe. India has been touted to have one of the best-managed financial systems across the globe because of which it has been able to withstand such pressures. We had a major hue and cry across the globe but this country was not affected so much. It is evident from the RESIDEX study above that except for few of the cities; there has been a growth in prices. The cities where we are seeing a de-growth in comparison to the base figures may be talked off as those having an already escalated price. So far the price rise is because of genuine demand for the same, it is all right. However when un-natural factors do crop in, it is a matter of concern.

Needless to say, the growth in the real estate is primarily because of the supply of money through the banking and the NBFC channel. Hence the cropping up of NPAs amongst them needs to be checked and pruned at the budding level itself. This checking is all the more required in India because of the sentimental aspect associated with houses in India.

We adopt the case study approach to suggest few checkpoints, which needs to be kept in mind of the disbursing authorities in order to do away with any bad payment in future. The cases mentioned are from the experience of the authors. These will not only elaborate the point individually and also warrant the necessary parameterization of the aspect. Each case has been diagnosed with a reason and the necessary checkpoint may be inferred from the reason mentioned thereof. These are suggestive measures for the lending organisations.

IV. Cases

a. Father and son aged 50 and 25 respectively avail a mortgage loan for construction of house on a property owned by the father. Loan is granted on the income eligibility of the son and the tenure of the loan is fixed basing the age of the son. Two years down the line the loan comes into delinquency. On enquiring the reason found is that the son who is now married is now not in good terms with his father. He is now staying away from his family. Father does not pay as his income is not sufficient for repayment. Son says that since he is not the owner of the property and does not enjoy the property anymore so he will not pay.

Reason: In the subjective approach of checking, we did not check with the background of the family and what kind of a relationship the father and son have. This could have been judged through a personal interview and probing questions, which could have highlighted the underlying factor basis, which the loan decision could have been taken, rather than basing it on objective facts.

b. Husband (X) and wife (Y) availed two housing loans in individual names for 2 properties. Due diligence was done by the financial institution on both the properties. The legality and technicality were also checked by independent empanelled associates. Other loans like personal loans and auto loans were also extended to the same borrower. One year down the line both all loans went bad. The case became a skip case with both husband and wife becoming untraceable.

After a thorough investigation it was found that both parties were chronic defaulters with other financial institutions and same kind of borrowing patterns and habits. On checking with the properties given as security, it was found that the documents indicating the mortgaged land and building did not exist. One of the properties was an orphanage and the other a vacant land which did not have an approach road. The said properties could not be booked under the SARFAESI Act as there was no security created. The title deed mortgaged with the financial institution was a forged one. The said cases had to be declared bad and written off.

Reason: The Title Deeds were not verified with the local SRO and Tehsil office. Before creating the mortgage the proper identification of the property (demarcation) was not done. Though CIBIL was checked yet no reference from other financial institution was collected.

There is a lack of a central repository, which can be accessed by the financial institutions whereby the mortgaged properties can be checked. Though CIBIL is a credit scoring institution which only reflects the credit history of the borrower but the same cannot be explored further to collect substantial data on his other banking habits and relationship. Most of the financial institutions depend on empanelled associates to do the verification which is also a cause of such lapses.

c. A software engineer aged about 26 years with 3 years of working experience working in Bangalore applied for a home loan of Rs. 27 lakhs. His salary at the time of application was Rs 27000/-. The said application was processed by the financial institution and loan of Rs. 21 lakhs was granted to him. The case was considered after factoring a hike in salary in the coming 6 months. The EMI for a loan of Rs. 21 lakhs was Rs. 18900/-. The said person started defaulting after 6 months and could not pay the EMI's and his payment became irregular. The case was availed on a variable (floating) rate of interest.

Reason: The appraiser of the case did not take into account the living expenses of a person living in Bengaluru. He had also factored in a future hike in salary, which was being very optimistic. The appraiser had also not checked with the spending habits of the person.

There is a lack of a common platform, which will provide for his spending habits, banking habits and other relevant information, which can be factored in before considering the proposal. In all cases a personal interview should be conducted with such applicants.

d. An NRI (A) approached one of the financial institutions for a home loan to buy a property in the capital city of his home state. He was working in a oil company in London. His father (B) was a retired banker from a PSU bank. The loan was proposed by his cousin brother (C) who was an advocate by profession. C and the builder who was selling the property put the case in front of the loan appraisers. Till the time period of the loan A & B never met the bank officials. The loan was granted on the basis of documents of A submitted by C. The loan went into default after 6 months. After an year a legal case was initiated by the borrowers father (B). The legal suit was also filed against the developer on the basis that the possession of the property was not given as promised by the builder and the bank had not done its due diligence while disbursing the loan to the developer.

Reason: The case was just appraised on the basis of quantitative justifications. The basic intent of the loan was an investment. On further probing it was found that C who acted as a middleman for booking the property and sanctioning of the loan had used the opportunity to make money from the deal to the tune of Rs.4 lakhs from the developer. There was no direct interaction/personal discussion with the borrower or his father who was a co-applicant in the loan. The loan amount disbursed by the bank was also not properly utilized by the developer and was also not checked by the bank.

e. A businessman (X) wanted to avail a loan from financial institution (A) by mortgaging his existing property to the tune of Rs.8 lakh. The loan was declined for the reason of lack of strength in the financials. X then approached financial institution (B) for the same kind of loan for an amount of Rs. 20 lakh. The loan documents submitted were made as per the requirements of the bank. The loan was sanctioned on the basis of the given documents. The legal and technical due diligence was done by the external agencies appointed for the said purpose. The loanee defaulted from the 6 month onwards.

On further investigation it was found that the property mortgaged though existed was at a location and locality whose sale value was less than the valuation given by the technical agencies at the time of loan disbursal. The person was also a chronic defaulter in the market.

Reason: One of the major reasons for the default was lack a proper and thorough credit check by the appraiser. The same was also not captured in the personal discussion sheet. The present credit check is not a full proof check as many a times the information disclosed by the credit scoring agency is not accurate. There is also over dependence on the external agency for the legal and technical agencies. A proper system is not developed internally by the financials for checking of the legal and technical prices of the properties, as this is the primary security and base for a mortgage loan.

V. Conclusion

Immoral lending would bring about an unwarranted condition, which in India's case would do more damage than the benefit, which the industry (housing sector) has accrued over the years. In this country we have tax sops also in this sector because of the dependence of other heavy industries like steel, cement and electrical / household equipment manufacturing on the same. A plug in the loop would damage the prices and sentiments attached with the industry and in the long ruin the image of the country. Specific attention ought to be taken on this aspect of lending

Reference(s)

1. National Housing Bank website
2. Work experience of the authors

Important notables

a. *The cases mentioned above are real cases, due care has been taken not to mention the names. Any coincidence of the case with any individual / family is purely coincidental*
b. *The case language has been purposely made simple without any legal jargons for the readers / listeners to understand the actual root of the problem*