Housing Market Mayhem*

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Late in February 2019, the GST Council, prodded by the Centre, decided to modify Goods and Services Tax rates applicable to the housing sector. The declared intention was to reduce prices that home buyers would have to pay for their property. The modification, which takes effect as of 1 April 2019, involves doing away with input tax credit for residential property construction for sale and significantly reducing the GST rate applicable at the final stage of sale of housing. At present the GST rates stand at 12 per cent for normal residential housing and at 8 per cent for "affordable housing", with sellers eligible for input tax credit, or the set-off of taxes paid on goods and services bought. As is the case in other markets as well, final buyers have complained that the benefit of input tax credit does not get reflected in the price they pay, being absorbed by sellers into their profits. Claiming that it seeks to address this complaint, the Council has decided to do away with the input tax credit for housing and bring down the GST rates to 5 per cent for normal housing and 1 per cent for affordable housing.

The Council has also changed the definition of "affordable" housing, raising the bar on the kind of houses that would be eligible for the lower rate of taxation. As of now there is a project-wise ceiling on carpet area, with no ceiling on the value, used for identifying affordable housing. But as of April, apartments costing up to Rs 45 lakh and with carpet area of up to 60 square metres in metros and 90 square metres in non-metros would be treated as affordable. This is expected to considerably enhance the size of the houses that would fall in the "affordable" category, and therefore be eligible for the low rate of GST.

Interestingly, though these changes are supposed to benefit the buyers, it is real estate developers who have hailed the move, going as far as describing the step as 'revolutionary'. Their reasoning is clear. This would help bring down house prices and resolve a crisis they are staring at, which is a significant shortfall of demand for houses relative to supply, reflected in large inventories of unsold housing. Estimates of unsold inventories vary. Property analytics firm Liases Foras places the unsold inventory at around 15 lakh units across the country, with the area involved estimated at close to 2 billion square feet. About 13 per cent of completed residential property and 9 per cent of properties near completion are lying unsold, tying up capital, it is argued, and forcing builders to hold back on construction and cut back on new launches.

While the problem of excess inventories is blamed on sluggish demand, the actual causes are more complex. One is that high profit expectations and easy access to credit in the recent past drove developers to acquire land and launch new projects at a pace not warranted by the potential demand. Even in the first half of 2018, when residential real estate sales were flagging or flat according to some analysts, new launches across seven cities went up by 10 per cent, going by estimates from 'property consultants' Anarock. Two factors explained this euphoria. First, the large gap between prevailing prices in major markets and the costs to be incurred in constructing houses and placing them on the market. The property business looked profitable, even though demand was turning sluggish. Second, the easy availability of credit to finance new construction, which fuelled a race among competing firms to enhance supply and grab as much of the market as possible.

But the situation now is changing rapidly. Underlying both of these tendencies was the liquidity surge that had occurred in the Indian money market over the last decade. Attractive spreads between capital to be mobilised by borrowing short term or issuing short maturity commercial paper and the interest that can be charged to house buyers or returns to be earned from housing projects resulted in two significant changes in the housing finance market. The first was that banks that had been expanding their housing loans in their retail lending portfolio were joined by non-bank finance companies (NBFCs), believing that, given easy access to credit, diverting short term capital to financing long term lending in the real estate area was not a problem. In the event of a liquidity crunch, it was believed, loans could be rolled over by borrowing anew to pay off maturing debt. Soon, the NBFCs were racing ahead in this market, even while banks were turning cautious because of fears of overexposure. The second change was that the share of lending from the NBFCs going to property developers, as opposed to aspiring home owners, rose sharply. If lending had to grow rapidly, both buyers and sellers had to be financed.

Looking to win new clients in an increasingly competitive market for developer loans, non-bank housing finance companies offered credit at lower rates with a grace period for repayment of principal and even a moratorium on interest payments in the initial years, often for an upfront fee. With euphoric developers only too willing to take the bait, this triggered an acceleration in the pace of new launches of housing projects. Initially, this was not a problem as the demand generated by rising credit to homeowners had also triggered a surge in demand and a rise in prices. But as prices rose, the growth in the number of new buyers with the requisite income to match these high prices slowed. Soon, the rate of growth of housing in the pipeline exceeded the rate of growth of demand.

But competition among developers, the fear of losing out on a potential opportunity, and the continued access to credit because of competition among lenders riding on the easy liquidity situation had two consequences. First, new launches continued to rise. And prices remained high, despite rising unsold inventory, since access to credit gave the developers (convinced that the market would turn) staying power.

Matters began to change when factors such as rising non-performing assets in the banking system began to slow credit growth. As liquidity tightened, developers spread their capital thin, delaying projects and leaving homeowners, who had paid up much of their dues, high and dry. Some realised the need to clear inventory by reining in prices. The Reserve Bank of India’s House Price Index, which rose by 20 per cent in Mumbai and 36 per cent in Delhi in 2011-12, registered gains of a lower, though significantly positive, 11 and 19 per cent by 2013-14. But that rate declined in Delhi starting 2014-15, while holding in Mumbai. By 2017, the two rates had fallen to 3.5 per cent and 2.0 per cent.

It was while this slow and inadequate “correction” was underway that the IL&FS default made lenders to and investors in NBFC paper wary. Liquidity froze and a second round of defaults were feared. The combination of an alleged scandal and evidence of stress in Dewan Housing Finance Limited (DHFL) only made matters worse. The market it appeared was sitting on an industry wide crisis with ramifications for the solvency of NBFCs, the performance of already stressed banks, the health of mutual funds that had attracted money from savers looking for better returns, the survival of a host of real estate developers, and the delivery of houses to already-harassed home buyers who were paying both interest on home loans and rent on leased premises.

The markets response is as expected pro-cyclical. Rating agencies began downgrading NBFC paper. For that and other reasons, not only are the NBFCs finding it difficult to mobilise new capital, but when they do manage, the interest burden is significantly higher than in the recent past. The difference between the rate on NBFC and government bonds is widening sharply. That increases the burden on this set of stressed borrowers, who have been borrowing short-term to lend long-term, further weakening them. It is this fragility that has pushed the government into finding ways of clearing the excess inventory by boosting demand. The decision to reduce GST is an initiative in that direction. However, since the reduction in rates is accompanied by the removal of input tax credit, the net benefit many claim may not be all too high in cases where the benefits of that credit were indeed being passed on to the buyers. Further, the Rs. 45 lakh ceiling for categorisation as “affordable housing” may mean that much property, in the metros at least, would not benefit from the differential in rates.

Financialisation creates the hope that the dream of home ownership cherished by the poor and middle classes alike seems realisable in a relatively short period of time. Till the edifice on which such dreams are built comes crashing down. That seems to be the future that India is moving to, unless the government can once again come up with measures that help socialise the losses that the process of financialisation has generated.

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