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# **The proposal/recommendation of the Ministry of Housing and Urban Poverty Alleviation, Government of India for inclusion of “Affordable Housing” into the harmonized Master List of infrastructure sub-sectors**

## **1.1 Background and Magnitude of the problem**

The Indian cities are centres of economic growth as they contribute to over a third of the Gross Domestic Product (GDP) of the nation<sup>1</sup>. This growing importance of urban areas in the economic sphere and the opportunities it presents has led to migration and increase in rate of urbanization. However, the state of planning and preparedness of urban centres in India to cater to the current or future trends needs much to be desired.

The Planning Commission in its 12<sup>th</sup> Five Year Plan Approach Paper “Faster, Sustainable and More Inclusive Growth” has stated that *“the pace of urbanisation is expected to accelerate over the next two decades. The 2011 Census also shows an increase in the urban population from 27.8 per cent in 2001 to 31.2 per cent in 2011, and it is likely to exceed 40.0 per cent by 2030. This would generate a heavy demand for better quality infrastructure in urban areas, especially water, sewerage, public transport and low cost housing”*.

Further the report states that *“the infrastructure of India’s present towns is very poor. Sewage, water, sanitation, roads and housing are woefully inadequate for their inhabitants. The worst affected are the poor in the towns. As more urban conglomerations form and grow without adequate infrastructure, the problems will only become worse. Therefore, India’s urban agenda must get much more attention.”*

The lack of housing and basic services at the required pace to meet the challenges of urbanisation has resulted in the development of slums and squatter settlements with wider ramifications on the health, safety and well being of the citizens. The gap between the supply and demand of the housing has been widening-making housing an unaffordable proposition. As per the report of the Technical Group on Urban Housing Shortage (2012-17) constituted by the Ministry of Housing and Urban Poverty Alleviation under Prof. Amitabh Kundu, there is a shortage of 18.78 million dwelling units out of which nearly 96% belongs to the Economically Weaker Sections (EWS) and Lower Income Group (LIG) Households. The mammoth investments needed for creation of the housing infrastructure is

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<sup>1</sup>Report on Urban Infrastructure and Services by High Powered Expert Committee chaired by Dr. Isher Judge Ahluwalia set up by Ministry of Urban Development (MoUD), Government of India

beyond the limited public resources available with the governments of the day. Incentivising and facilitating private sector led growth is the only viable option. Keeping this in mind the Technical Group(*ibid*) has suggested that *“Housing should be made a part of infrastructure sector or declared to be an industry, so that it is possible to incentivise the construction activities to deliver an appropriate mix of dwelling units to meet the needs of the people in housing poverty.”*

## **1.2 Potential of the segment**

Construction sector has been growing at a Compounded Annual Growth Rate (CAGR) of about 11.1 per cent over the last eight years. The Construction sector accounts for around 9.0 per cent of GDP (Planning Commission 12<sup>th</sup> Plan Approach Paper). However, the potential of this sector to contribute to the growth of economy has not been completely tapped. Both from the perspective of increasing the employment & income generation and augmenting the housing stock in the country, the affordable house construction industry can impart the necessary fillip to the economy.

Given the magnitude of housing shortage and budgetary constraints of both Central and State Governments, it is apparent that public sector efforts alone cannot suffice. Reflecting this, the National Urban Housing and Habitat Policy (NUHHP) 2007, seeks active participation of multiple stakeholders viz. the private sector, the cooperative sector and the industrial sector for employee housing etc. In order to encourage these sectors to come up with affordable housing projects and also to attract investment in these projects, we need to create an enabling environment and offer fiscal and financial incentives.

At present affordable housing projects do not have the status of infrastructure and therefore promoters of such projects can't avail any tax and non-tax benefits which are available to other infrastructure projects. Hence, inclusion of affordable housing projects in the Harmonized Master List of Infrastructure Sub-Sectors is necessary.

**Housing has already been accorded infrastructure status by the following entities:**

- Housing was part of infrastructure till 1.4.2000 for availing concessions under Section 80 IA of the Income Tax Act, on a plot of land with minimum area of one acre where the residential units with built up area of less than 1000 sq. ft. were built.

- Housing projects which are integral components of road projects continue to qualify for infrastructure status under Income Tax regulations.
- The recent notification by Ministry of Finance under Sec 35 AD<sup>2</sup> of the Income Tax also recognizes the need to promote affordable housing and defines what categories of housing are entitled to be categorized under this head.
- SEBI has included *Housing* as facilities or services included in the term “Infrastructure Sector”. Under sub clause (8) in its Schedule X of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, it defines Housing, including the following:
  - Urban and rural housing including public / mass housing, slum rehabilitation etc.
  - Other allied activities such as drainage, lighting, laying of roads, sanitation facilities etc.
- The World Bank treats housing, and urban services amongst other sectors as infrastructure.

In this context, the Ministry of Housing and Urban Poverty Alleviation, Government of India urges the Hon'ble Finance Minister through its Institutional Mechanism (IM) to accord infrastructure status to “*affordable housing*” as the sub-sector satisfies three parameters viz., (i) Importance to the scheme of economic development; (ii) ability to contribute to the human capital and (iii) specific circumstances under which it has developed in India. Further the affordable housing largely meets the six qualifying criteria viz. (i) Natural monopoly; (ii) High-sunk costs or asset specificity; (iii) Non-tradability of output; (iv) Non-rivalness in consumption; (v) Possibility of price exclusion; and (vi) Bestowing externalities on society. Detailed justifications are given in the succeeding paragraphs.

With this impetus the Ministry envisages that this sub-sector (once included in the Master List) will facilitate in realising vision of providing ‘Affordable Housing for All’ along with the prospect of revitalising the economy with renewed vigour. Once included into the Master List, same may be reviewed for by the end of 14<sup>th</sup> plan period<sup>3</sup>.

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<sup>2</sup>Guidelines for notification of affordable housing project as specified business under section 35AD of Income-tax Rules, 1962, in Part II, in sub-part F

<sup>3</sup> Principles for updating the harmonized master list of infrastructure sub-sectors as contained in the CCI Note of Framework for using the harmonized Master List of infrastructure sub-sectors. para 22 (ii) (b) c & d.

### **1.3 Definition of the sub-sector: 'Affordable Housing':**

Individual dwelling units with a carpet area of not more than 60 sq. mt. and preferably within the price range of 5 times the annual income of the household as notified, either as a single unit or part of a building complex with multiple dwelling units.

#### **Definition of "Affordable Housing Project":**

Housing projects wherein at least 60% of the FAR/FSI consists of dwelling units with a carpet area of not more than 60 square meters and 15% of the total project FAR/FSI or 35% of the total number of dwelling units, whichever is higher, is reserved for EWS category.

The definition has also been accepted by the Ministry of Finance and RBI with respect to the formulation of External Commercial Borrowings. Apart from this the entire investment on creation of dwelling units for rental purposes must be treated as infrastructure.

### **1.4 Assessment of the three parameters and link with the objective**

#### **1.4.1 Importance to the scheme of economic development**

As the world enters the era of urbanisation, many urban centres are seeing rapid and largely uncontrolled population growth, creating situation where in the very urban areas that are growing fastest are also those that are least equipped to deal with the threat of socio-economic challenges as well as the danger of environmental degradation and climate change. These areas often have profound deficits in governance, infrastructure, economic and social equity. People arriving in already overstressed urban centres are forced to live in dangerous areas that are unsuitable for human settlements like the nallah beds, dump yards, floodplains, swamp areas and unstable hillsides. The residents of these informal squatter settlements are not to be blamed for their pathetic condition, instead they are to be considered as the fundamental workforce and supported in every possible fashion. It is these poor urban dwellers who sustain the cities with their cheap labour, be it as a carpenter, mason, cobbler, electrician, plumber, drivers, sweeper, domestic help or an industrial labour. Thus alongside the threats posed by the ill effects of unabated urbanisation there

are an equally compelling set of opportunities for socio-economic-cultural development of the nation. Creation of a healthy habitat in urban centres involves a garland of 7 entitlements/ services viz., security of tenure, affordable housing, water, sanitation, health, education and social security with an intention to provide safe environment for the every citizen to grow into his/her full potential.

As stated in the introductory paragraphs, on one hand there is an enormous housing shortage in the country caused by influx and in-situ population growth resulting into massive demand for low cost housing to the poor and on the other hand the real estate industry is competent to supply the necessary housing stock. Important factors that are largely responsible for preventing the emergence of a near total saturation are: From the buyer's perspective -high cost of houses in cities and towns making it affordable and lack of paying ability of the informal sector employees who find it hard to prove their credit worthiness. Lack of purchasing power flows from the fact that cost of housing is every increasing and the urban poor cannot sustain families while paying both rent as well as EMI till they get the property. From the Suppliers perspective - non-availability of sufficient 'business interest' in constructing the low cost houses and non-availability of sufficient market for these products (for the reasons explained above).

There is also a crying need to address the issue of non-availability of rental housing be it for industrial sector employees or the informal sector employees/ migrants who cannot own a house. Corporate management of the rental housing stock is a viable proposition when compared to the government involvement in this sphere. The private sector can be incentivised to construct and maintain these facilities if the return on their investment is acceptable. Considering the investment on creation of rental housing as infrastructure can induce boom in this desirable economic activity. Even the industrial enterprises would then take up development of rental housing stock which is neither mandatory nor remunerative at present.

Thus governmental intervention on both these counts becomes inevitable. Providing 'infrastructure status' to affordable housing including rental housing is bound to provide the necessary impetus to augment housing stock, resulting in competitive and affordable housing for all.

The importance of the housing and construction industry can be gauged from the fact that it supports more than 250 ancillary industries and contributes nearly 9% to the GDP. Further, a Study by the IIM, Ahmadabad has brought out that for every rupee invested in housing an additional Rs. 0.78 gets added to the National GDP. The Segment provides 4.71 income multiplier and 7.76 employment multiplier effects and most importantly, the Construction Sector ranks 4<sup>th</sup> in terms of

additional income generated (Agriculture – 6<sup>th</sup>). Thus, the affordable housing segment which is a sub set of the construction sector has a lot of externalities, the benefits of which are generally not remunerated. Housing sector ranks third among the fourteen major sectors in terms of total linkage effect with other sectors of the national economy. Thus the government policies on the housing front have a direct impact on the health of the economy and go a long way in rejuvenating the sluggish economy by leaps and bounds.

#### **1.4.2 Ability to contribute to human capital**

A large number of workers engaged in the urban economy are self-employed or are in the informal sector and are low wage/salaried workers or casual workers like carpenters, masons, electricians, plumbers, mechanics, sweepers, drivers, gardeners, cobblers, street vendors of errand goods, domestic helpers, construction workers etc. It is these people who provide the secondary level support to the cities by working round the clock. They play a vital role in wealth creation, development of infrastructure, and providing a quality of life to the urbanites. However, they have themselves been denied shelter, basic urban amenities, healthy urban environment, and a dignified life. The gap between the urban rich and poor has widened considerably.

Though urban centres contribute over 60% of national GDP, Indian cities have faced several structural constraints and thus have negated the benefits of agglomeration economies by distorting land and housing markets, rendering cities non-creditworthy, and leaving them with expensive yet poorly functioning urban services. In this scenario, if urban poor are provided affordable housing either on ownership basis or on rental basis (for those who can't afford ownership housing), the march of Indian economy towards becoming a super power would be more grounded and meaningful.

#### **1.4.3 Specific circumstances under which affordable housing has developed in India**

1. Since independence it has been a national endeavour to achieve the mission of 'housing for all'. Up to the 6th Five Year Plan (1952 to 1985) Government gave various fiscal incentives to individuals to build a house and to employers to build houses for their employees. Social housing was the main emphasis and was solely

- government's responsibility. For others the fund requirements were largely met though borrowings from the employer or from friends and relatives. Requirement of private sector participation was hardly recognised.
2. 7th Five Year Plan onwards there was a paradigm shift in the approach and emphasis was gradually shifted to encourage private sector participation in financing the affordable housing projects, as it dawned that governmental resources alone do not suffice for achieving this mammoth task. Private sector participation was recognised as essential;
  3. Housing has remained a priority for the union governments and substantial allocations in various plans were made apart from several fiscal and monetary incentives provided to boost the housing activity. The strategy for providing fiscal incentives to give a push to the housing sector are two pronged viz., (i) On demand side, making housing loan accessible to the middle class, (for example: deduction on interest paid on home loans etc.) and (ii) on the supply side, making more home loans available by deploying resources of the banks and HFCs.
  4. A major macro-economic policy initiative by the Reserve Bank of India in this regard was the **inclusion of housing in priority sector lending** (PSL) by commercial banks since 2000; even though no separate earmarking for housing has been provided within the PSL limits. The measure was to encourage commercial banks to channelize flow of funds into the sector.
  5. Government of India announced an over-arching policy in 2007 called the "**National Urban Housing and Habitat Policy**" (NUHHP), which focused on creation of a supportive environment for housing, and undertaking reforms for enabling accelerated flow of resources to the housing and related infrastructure sector in the country.
  6. In the recent past Govt has implemented Jawaharlal Nehru Urban Renewal Mission (JNNURM), with its two components viz., Basic Services to the Urban Poor (BSUP) and Integrated Housing and Slum Development Programme (IHSDP), Rajiv Awas Yojana (RAY), The Affordable Housing in Partnership (AHP) scheme, **1% interest subvention scheme**<sup>4</sup> and the Interest Subsidy Scheme for the Urban Poor (or ISHUP) which provides for 5% interest subsidy.

In order to make the shift from a purely government led initiative to a private sector led growth; creation of right policy environment is the necessary first step. This can only be achieved by bestowing 'infrastructure status' to the affordable housing sub-sector.

## **1.5 Analysis of the six characteristics of infrastructure:**

Housing as an infrastructure meets the parameters laid down by Shri. Rangarajan Committee to a large extent as analyzed in the following sub-sections:

### **1.5.1 Natural monopoly:**

Affordable Housing sector was conceived as a sole responsibility of governments until the 1970s when housing finance corporations (HUDCO and HDFC) were formed to facilitate credit to promote housing. Post the 1980s finance regulator viz the National Housing Board (NHB) was formed and commercial banks and other financing agencies began funding this segment. This was further enhanced by liberalization of economy where in a number of tax concessions (direct and indirect) were given for housing sector. Even though the housing sector was opened up for FDI, all these efforts mainly cater to richer sections of the society who are tax payers (MIG and HIG) and non-tax payers of the informal marketplace/poor (LIG/EWS) have been excluded as they could not afford house or did not have adequate income and/or documentation to enter the formal housing markets. In this context, only State players (Government of India and State Governments) have been involved in provision of (affordable) housing to these EWS and LIG segments. The private builders do not see this segment as a viable business model and hesitate to venture into a not so profitable arena. Hence, **affordable housing** has been a **natural monopoly** as only government has been taking up the construction and provision of EWS/LIG housing post-independence. Also, housing needs to be supported by adequate allied physical and social infrastructure such as roads, water supply, liquid and solid waste management which are also natural monopolies.

The economies of scale where in the cost decreases with increasing output throughout the range of the possible demand is clearly in existence in the housing industry. The economies of scale experienced by the private builders are bound to result in decreased unit costs offered for sale, thus making the housing a more affordable proposition.

As in the case of housing for the MIG/HIG, The Ministry envisages that the natural monopoly of affordable housing also will cease once the required impetus to the sector is given by according infrastructure status to the affordable house construction industry, though it might take couple of decades for the same.

### **1.5.1 High-sunk costs or asset specificity:**

Sunk costs are investments costs which cannot be immediately recovered by the possible sale of the assets that were invested in. Though the sale of assets in affordable housing is plausible, there is no ready market for such sector as the dwelling units are typically small in size (25-60 sq. mts.) and only the EWS/LIG segments prefer to live in such settlements. Also due to the fact that the paying capacity of EWS/LIG home buyers limits their aspirations, there is no ready market for such products. The argument can be substantiated by the fact that due to limited purchasing power, the EWS/LIG find it difficult to pay the down payment, further the payment capacity of EMI along with the rent in the initial stages cause severe financial constraint. Finally to add insult to the injury, the urban poor are denied loans by formal financial institutions due to non-availability of the documentary evidences of their creditworthiness.

Moreover the gestation period from the stage of project conception to final sale and taking over of possession, may take several years as the necessary approvals for land conversion and actual construction of the project is a lengthy process. The investments needed for affordable mass housing projects are huge and are thus locked up for several years in the project. Further, there is no assured market for these goods and recovery of sunk costs can take several years.

Thus the investment into affordable housing represents both barriers to entry into the sector (as the investment is irreversible) as well as exit from the sector (to investors in these assets as these assets have no ready market). The magnitude and scale of investments for housing and allied infrastructure (Rs. 5 lakh \* 18.78 million housing shortage) also makes it a proposition with high sunk costs. Affordable housing is capital intensive and immobile and hence a firm cannot exit market without substantially losing its investments.

### **1.5.2 Non-tradability of output:**

As brought out above, the capital investment can be recovered over long period of time as the products are not easily saleable commodities. Unlike MIG/HIG apartments/houses secondary and subsequent sale is even more difficult in this category. Affordable housing is not a tradable good or service that can be sold in another location distant from where it was produced as it is capital intensive and immobile. As explained earlier, though housing per se is a tradable commodity,

there is no ready market for such sector. The supply of affordable housing cannot be augmented through imports.

### **1.5.3 Non-rivalness in consumption:**

Affordable housing is both non-rival (provision of affordable housing to an individual does not preclude its availability to others, unless it reaches capacity or congestion limit) and non-excludable (no poor segments can be effectively excluded from seeking the affordable housing).

### **1.5.4 Possibility of price exclusion:**

Unlike supply of water and electricity, full charges are not recoverable in case of affordable housing as the poor don't have the paying capacity. To supplement this lack of purchasing power, support in the form of tax and capital subsidies etc., both to the suppliers and buyers are essential to contain the costs. Since price of affordable house cannot be a simple arithmetical summation of costs plus profit that can be easily recovered, it needs extensive governmental support and handholding. To that extent the affordable housing acquires the characteristic of a public good like water supply and electricity.

### **1.5.5 Bestowing externalities on society:**

As per NSSO, *A slum is a compact settlement with a collection of poorly built tenements, mostly of temporary nature, crowded together usually withinadequate sanitary and drinking water facilities in unhygienic conditions*<sup>5</sup>. Most of the slums/squatter settlements (predominantly housing the urban poor) are characterized<sup>6</sup> by overcrowding and unsanitary conditions. These do not have access to safe and secure shelter and basic infrastructure and services. The poor (who are mostly migrants from other places) are forced to live in illegal and informal settlements as they can't afford formal shelter".

UNCHS introduced the concept of *'housing poverty'* which includes *individuals and households who lack safe, secure and healthy shelter, with basic infrastructure such as piped water and adequate provision for sanitation, drainage*

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<sup>5</sup> NSS Report No 486: Condition of Urban Slums, 2002: Salient Features

<sup>6</sup> Research Study on Slum Typology and Grading for Improvement Inputs, National Resource Centre on Urban Poverty, SPA, New Delhi .

*and the removal of household waste.’ The term ‘slum’, thus has wider connotations implying a wide range of low-income settlements with poor living conditions<sup>7</sup>.*

Squatter settlements also have negative impact on the surrounding areas and adversely impact the quality of life and the prices of real estate properties due to the absence of basic supplies and services. Any effort towards affordable housing for the urban poor (EWS/LIG segments) is bound to improve the living conditions and provide better quality of life. Upliftment of the social milieu will result into positive externalities. The natural results of overcrowded settlements like health hazards, impoverishment and social unrest leading to disgruntled youth taking recourse to extremism/ terrorism etc., could be avoided through provision of decent living to the poor.

Naturally, if private players do not reap all the benefits of a good which they have produced, their incentive to produce it voluntarily might be insufficient and market may fail to produce efficient results.

## **1.6 Conclusion:**

Thus it is clear that for the unabated growth of the economy and development of the human capital in terms of employment generation and creation of healthy and sustainable cities and towns, development of affordable housing segment becomes fundamental. In order to provide for the paradigm shift from government led initiatives to the private sector spurred development, creation of congenial policy environment emerges as an inevitable proposition and an undisputable agenda. This is in sync with the two-pronged strategy suggested by the Planning Commission to bridge the gap in resources viz., to create a policy environment for fostering cost-saving innovations and mobilisation of resources through innovative methods of financing to address the basic infrastructure needs of the urban poor who are largely employed in the informal sector and suffer from multiple deprivations and vulnerabilities that include lack of access to the basic amenities including decent housing among other things.

According the status of Infrastructure to the ‘Affordable Housing’ construction projects is therefore recommended for the inclusion in the Harmonized Master List of Infrastructure sub-sectors.



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<sup>7</sup> UN-HABITAT, 2003