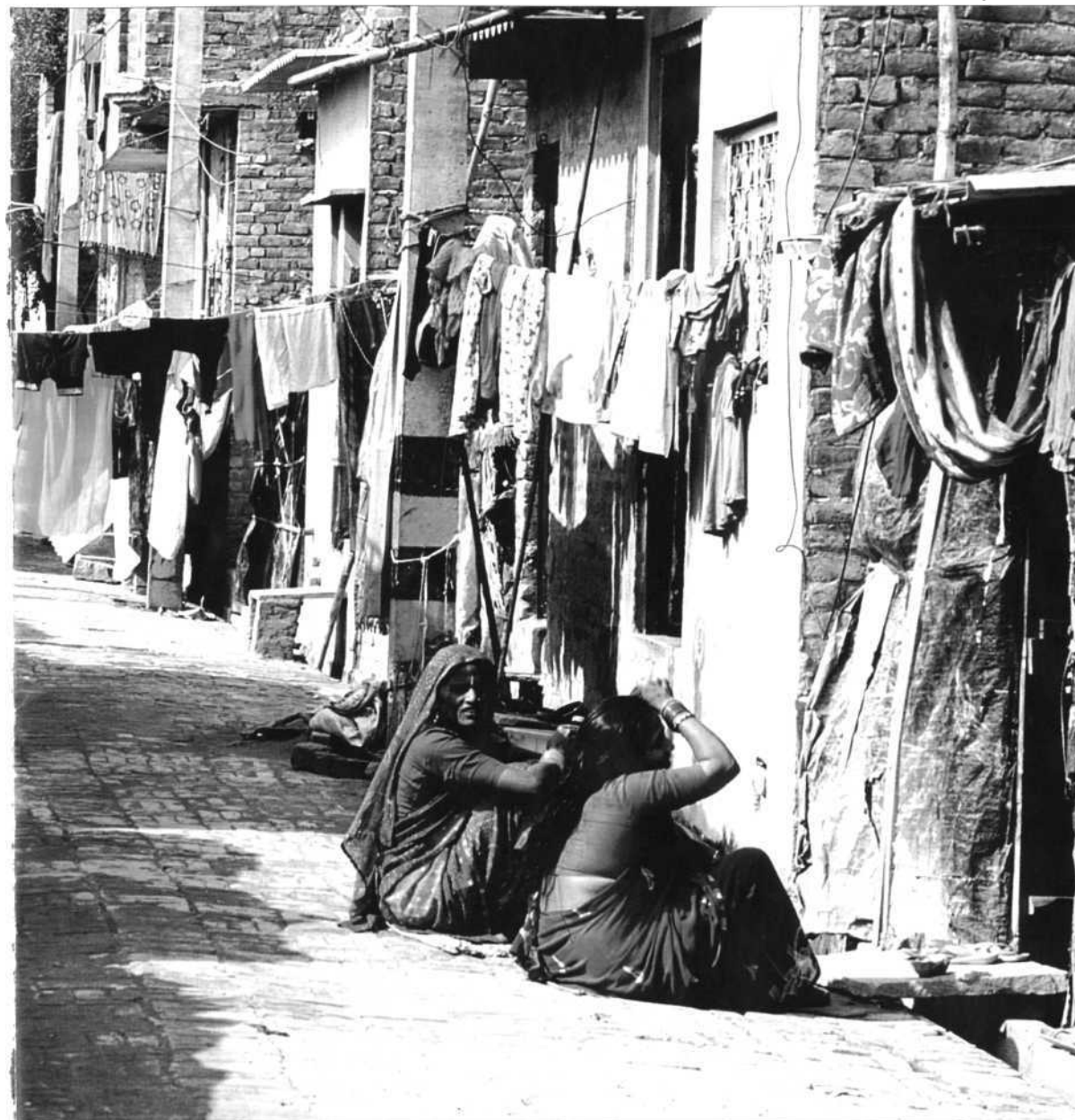


IF STRATEGY IS RIGHT



LAKSHMAN ANAND

Many people with low income are interested in moving to the suburbs if facilities are provided

plot of land, get his clearances and start constructing. Unlike the top end of the market where the developer could 'pre-sell' some of his flats even before construction had started - thereby providing some finance for starting construction - customers were hesitant to book these flats in advance as such developers have a reputation for being less reliable. Also, typically, the developer would not be able to get construction finance (as there were concerns about delays) and so the developer would use his own finances to quickly put up a building and complete a sample flat to attract customers. Customers in the Rs 12,000 and above income group would see the sample flat and if they liked it, would try to get a loan. Due to the concerns of banks and housing finance companies described above, typically only customers working in larger organisations (formal sector employees) would get a loan and hence by default this market was focused on the formal sector in this

income group. The funds from these early customers would provide the developer with finance to continue construction and he would continue selling flats (at higher and higher prices, in keeping with land appreciation) to fund ongoing construction. At times the flow of new customers would not keep up with the construction and there would be delays while the developer arranged for financing (or just waited to get more customers). Also, given the unorganised nature of the developers, the quality of the finished product could vary significantly. In other words, a market fraught with delays and poor quality - the consequence of which was borne by the customer.

An innovative business model to serve formal sector customers: We developed a set of new business models to address the concerns of different stakeholders. The first model is aimed at organised sector employees and uses the employer as a nodal point to aggregate customers and facilitate processing including

payroll deduction. Employers have shown a strong interest in doing this as it helps with retention and performance improvement. Financial institutions like banks and housing finance companies are very interested in such groups of customers because (a) they feel these customers are inherently low risk and (b) it lowers their cost to serve as the employer is facilitating the loan application process and providing payroll deduction. Developers are very keen on providing housing to these agglomerated pre-financed customers as it reduces their marketing cost, and selling risk. In fact, due to the pre-financed customers, it also enables them to get construction finance. This access to funds in turn enables the developer to keep to schedules and reduces the chances of delays. In fact, the aggregated buying power can also be used to negotiate better terms with the developer including good quality construction. In other words, it's a business model that addresses the key issues of the different stakeholders and is a win-win for all concerned.

An alternate set of innovative business models to serve informal sector customers: The second model is analogous, except that it targets the informal sector and uses an MFI to do the aggregation, qualification and collection, thereby achieving the required lower cost. The actual loan is provided by the bank as it has the appropriate funds (magnitude and tenure) and the bank is also responsible for repossession of the house in case of default - a task most MFIs are not interested in performing. The second model also uses an external credit guarantee to reduce risk and make the customers attractive to the financial institution. Quite a few banks / traditional housing finance companies (HFCs) we spoke to were interested in participating in such a model but they wanted to align the MFI's incentives with theirs (i.e., ensure the MFI did not bring in customers who were poor credit risk). All the urban MFIs we interacted with could understand the FI's perspective and agreed to align incentives - they said that if any customer defaulted, for that customer they would payback all the fees and a bit more!

The third model is for financial institutions that have customers in this target segment (or which specifically focus on new customers in this segment), and again uses an external guarantee to reduce risk for the lender. This model has inherent potential as it combines the advantages of the bank / traditional housing finance company and the MFI in one entity. This 'targeted' lender, typically set up legally as a housing finance company, can get appropriate funds - both in magnitude and tenure - obviating the need for the bank / traditional HFC, and can adopt (with modification) approaches used by MFIs to lower cost. A number of smaller financial institutions / entrepreneurs have recognised the potential opportunity in this space and have or are in the process of starting companies that will focus on this segment.

Pilots: To prove the feasibility of these models, we are facilitating a series of pilots having 300 to 800

flats each in Ahmedabad, Mumbai and Hyderabad. In each case. Monitor is identifying a developer interested in this opportunity and supporting him through the actual process - getting him customers, getting the customers financed, helping the developer secure construction finance, facilitating development of cost- efficient unit designs and overall complex layouts, etc. One of the developers has constructed a 229 square foot mock flat and the general reaction to the unit has been that (a) "this is much bigger than 229 square feet" and (b) "this is too good to be low income housing". The reason for these reactions is that the unit has been carefully designed (e.g., effective utilisation of space, visually attractive proportions, high ceilings, good ventilation) with a few key amenities leading to a feeling of space and quality while managing costs.

Prashant Choksey exemplifies a forward thinking modern developer, An engineering graduate from the University of Southern California, his entry into the construction business was driven by a combination of economic opportunity and a need for better quality construction, especially in the middle income market. "We have a chemical's business and we know the improvement in quality with just marginal more cost through materials like waterproofing and good site supervision, but this is woefully inadequate today" he says. Choksey Construction is currently building high quality middle income housing and is actively expanding into low income housing.

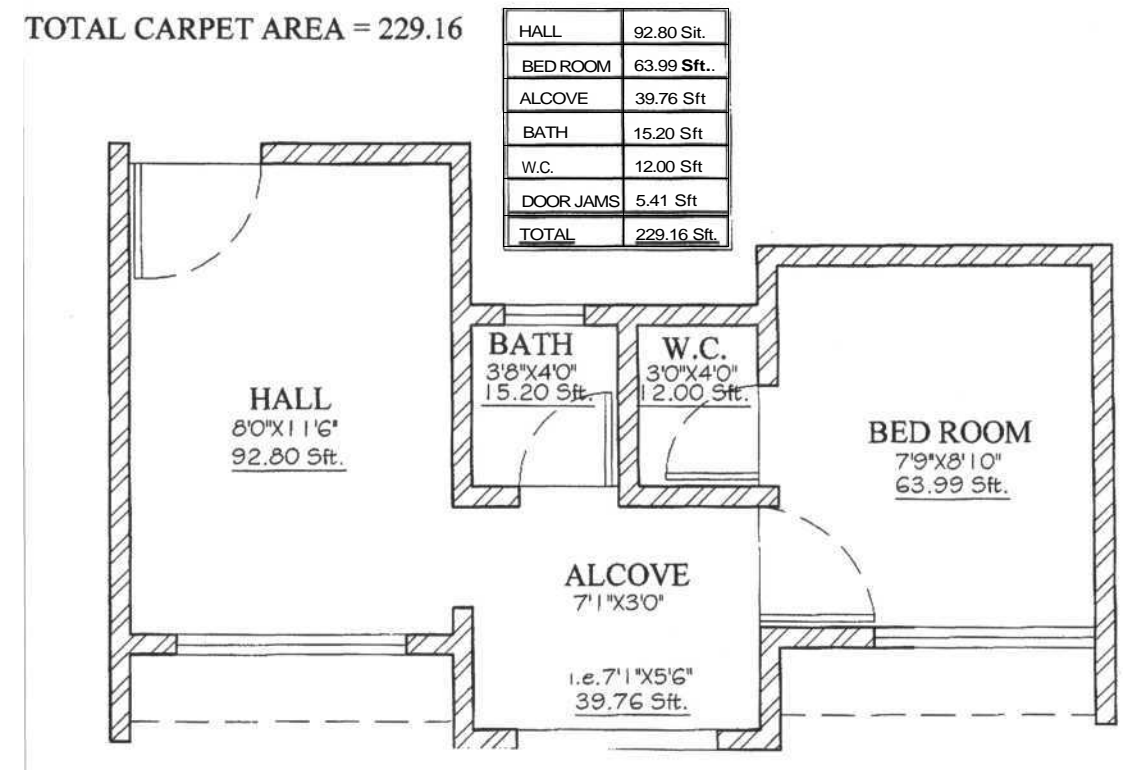
Taral Bakeri exemplifies a developer who can identify market potential. Hailing from a family that has been synonymous with good quality construction for over 40 years in Ahmedabad, Taral has been running his own unit over the last 12 years. He has been one of the few developers across India who has built and sold close to 2,000 flats of varied sizes with carpet areas as small as 320 sq ft. "Families in the lower income segments in India live in rented houses and see marginal increase in their household incomes, This segment is always looking to own houses that are affordable and there are very few developers who serve this segment," he says. Taral Bakeri is currently executing a project of - 800 flats as small as 210 sq ft carpet area in Ahmedabad and has plans to build - 5,000 flats for the lower income segment over the next three years in and around Ahmedabad.

Economic returns for developers: In addition to demonstrating the overall feasibility of using market based solutions to meet the housing needs of low income households, the pilots are also highlighting the commercial value of the opportunity to developers, The return on investment is in the 50 per cent to 120 per cent range (pre-tax IRR) based on factors like time to get clearances, selling price escalations, etc. The reason the returns are so attractive is because (1) the land cost is low and hence the customers down payment covers all or a large part of it, (2) there is no other large outgo for the developer as construction finance has been arranged and (3) the timeframes are short (as the customers are arranged and financed before the project is even started).

Phased development of the overall business opportunity: About 40 per cent of households earning Rs 5,000 to Rs 11,000 per month work with large employers . It is estimated that 70 per cent to 90 per cent of these households live in rented housing or in multi-family units. Given the willingness of employers to facilitate housing and the financial institutions' comfort with this segment, these will

BEST USE OF SPACE

TOTAL CARPET AREA = 229.16



Taral Bakeri has been one of the few developers across India who has built and sold close to 2,000 flats of varied sizes with carpet areas as small as 320 sq ft.

be the easiest customers to start with. Even with a 20 per cent market share in the formal salaried segment of this income band, the business opportunity is Rs 60,000 crore. Serving this segment will lead to a significant supply of appropriately priced and located housing. It is expected that in parallel, given the fact that this is a collateralised loan, financial institutions will get more comfortable lending to the informal sector and this combined with increasing supply could lead to the market serving the entire space of households (organised and unorganised) earning Rs 5,000 to 11,000 per month - an opportunity of over Rs 720,000 crores.

Pure market based solutions may not be able to serve households earning less than Rs 5,000 per month, but it may be possible to facilitate delivery to these segments through a combination of market based solutions, policy initiatives and subsidies - a market of over Rs 320,000 crore.

Government can help facilitate market based housing for lower income households and many such interventions may not have a financial cost: 'Affordable housing for all' is a priority for the Government and market based solutions can help make this a reality. A key long term facilitator is increasing the supply of affordable land. The government may be able to institute policy changes that provide this without any subsidies or financial support (e.g., higher FSI for lower income housing). Financing is also critical and the Reserve Bank of

India (RBI) and government can introduce guidelines / incentives - which may be bereft of subsidies / financial support - to get financial institutions to serve this market and compensate for the related entry cost. In the longer term, given the depth of the market and using customised business models such as those tested by Monitor, the profitability of providing scores of small mortgages seems ensured

Opportunity to shape the market: The creation of a new market offers an interesting opportunity to introduce a new set of norms which become the de-facto standard as the market develops. Currently middle income housing in India often has poor quality construction, mediocre living spaces, high long term maintenance costs, etc. Our pilots can address these issues and since new entrants are likely to copy these designs in their entirety, we could influence the market as it develops. Therefore we at Monitor are working on architectural designs, sustainable elements, lowering maintenance costs, etc and are working with developers to include these "good housing" elements in the pilots. We are also working on a consumer education module and we will include all these aspects in our broader dissemination campaign.

Potential to create immense economic and social impact: The financial impact of such market based solutions can be enormous both at the aggregate level (as mentioned earlier, it is a Rs 600,000 crore opportunity for just households earning Rs 5,000 to Rs 11,000) and at the individual level. It will not only financially transform the lives of the customers but also have huge social implications - enhancing quality of life, emotional security of a home and a safety net, etc. It could also have a systemic impact on urban development by providing a potential benchmark for slum rehabilitation and options for housing that in the long term may help in slum prevention