



# **AFFORDABLE HOUSING IN INDIA: BUDDING, EXPANDING, COMPELLING**



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## EXECUTIVE SUMMARY

Over the last few years, India has emerged as one of the global investment hotspots. This trend has gained further momentum in the post-crisis environment, with the ongoing rebalancing of global economic activity from the West to the East. The new economic identity of India is possibly best demonstrated by the Rupee symbol launched recently, as India joined an elite group of nations that can boast of a symbolic identity for their national currencies.

While most sectors in India hold promising potential, infrastructure is particularly compelling. The potential for infrastructure is essentially because of the massive need for infrastructural development in the country, as India continues to march ahead on the road of fast-paced economic growth. When these high levels of economic activity are combined with other factors like rapid urbanisation, rising disposable incomes, and an enormous population base eager to improve their lifestyle, the need for housing becomes obvious.

Notwithstanding the tremendous opportunity available for housing development in India, one must take cognizance of the changed dynamics in the real estate sector post the crisis. At the time of the crisis, real estate developers in India, like everywhere else, faced liquidity problems. The weaknesses of their business model, where construction activities are financed primarily by collections from advance bookings came to the fore, as real estate sales volumes dipped. Forced by this challenging business environment, homebuilders in India turned towards a product of better mass appeal --affordable housing.

Today, the economic environment in India has strengthened from that in 2009, and housing sales volumes have picked up. Logically, one would expect developers' interest to shift back to premium housing, at the cost of affordable housing. However, such is not the case, as the appeal for affordable housing not only remains, but is actually gaining momentum. Much of the vigour being witnessed in this market can be ascribed to the inherent characteristics of affordable housing that make it well-suited for the Indian context.

This report analyses the Indian affordable housing market, and attempts to identify and underscore opportunities in this segment.

## 1. INDIAN REAL ESTATE: FYING HIGH

The Indian real estate sector has rebounded strongly in the post crisis environment, supported by an innate, robust appetite for housing, and other favourable economic and sector drivers. The main economic drivers are sustained high levels of output growth and rising disposable incomes, which are fuelling an era of consumerism. Within the real estate sector, an expanding middle-class population and rapid urbanisation rates, coupled with supportive policy measures, are the key factors driving growth.

Consequently, a significant level of demand is estimated to exist across segments in the Indian real estate market, waiting to be tapped and monetized.

High economic growth, an expanding middle class, rapid urbanisation, and supportive policies are driving Indian real estate

Exhibit 1 Demand projections across top 7 cities	
Real estate market segment	Estimated demand (2010-14)
Residential	4.25 million units
Office	240 million sq.ft
Retail	161 million sq.ft
Hospitality	78 million room nights

Source: Cushman & Wakefield, Aranca Research

### 1.1 Residential market: Demand far outweighs supply

The residential segment of the Indian real estate market looks particularly attractive, with a significant demand-supply gap in place. The demand-supply gap is highest in the low- and mid-income segments, where, in certain cities, demand exceeds supply three- to four-fold.

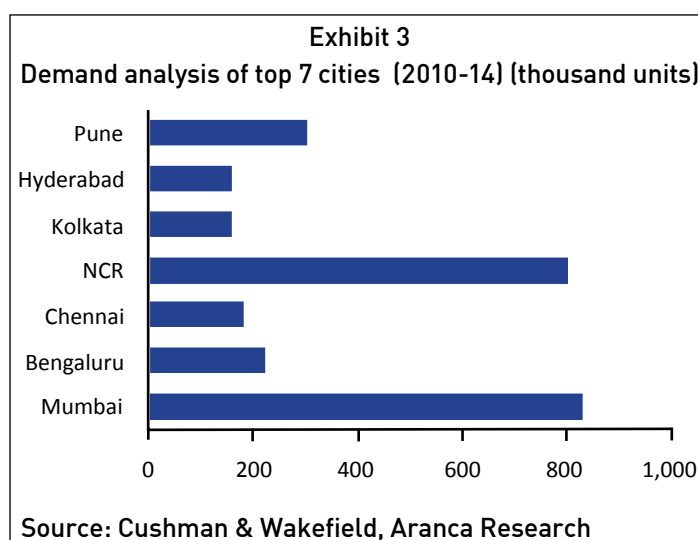
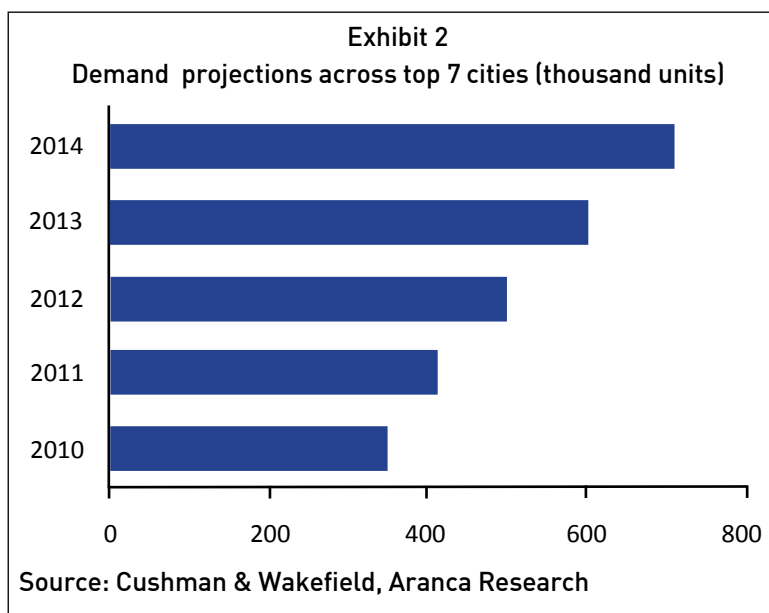
Going forward, this gap is expected to widen even further; demand is forecasted to grow at a compounded annual rate of 15%<sup>1</sup> between 2010 and 2014, so that the pan-India cumulative residential demand stands at 4.25 million units. Tier I cities like Mumbai and the National Capital Region (NCR) are expected to account for 40% of this additional demand. Mumbai is forecasted to register the highest cumulative demand growth of 23%, with the NCR ranking second at 20%<sup>2</sup>.

Rapid demand growth in the top metropolitan areas likely to outpace planned supply, creating significant development opportunities

<sup>1</sup>Cushman & Wakefield

<sup>2</sup>Cushman & Wakefield

A number of factors are contributing to this exponential growth of housing demand in India. Chief among them are rapid urbanisation rates, a decreasing average household size, and easier availability of home loans. The effect of urbanisation rates on housing demand is most profound in the Tier 1 cities, where a large influx of migrants is causing housing demand to surge. Moreover, rising income levels are empowering an increasing number of persons to live independently, and break away from the traditional large/joint-family structure. This socio-cultural shift is providing an additional fillip to housing demand in India. The improved home affordability in India, and the ensuing higher demand for homes, can also be ascribed to easier availability of home loans, especially in the low- and mid-income segments.

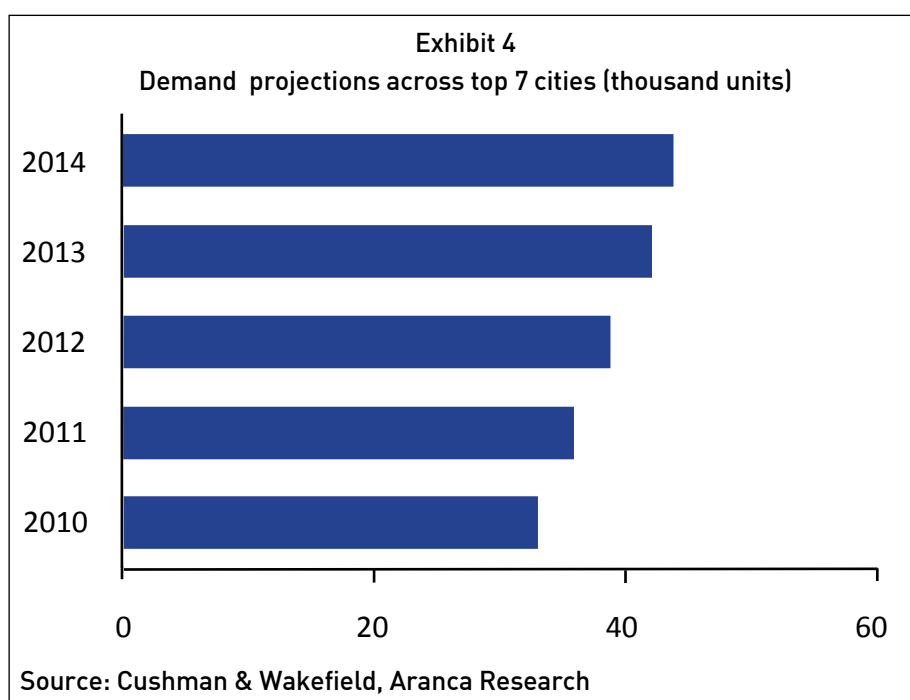


1.2 Office market: Tier II cities appear most opportune

Like most emerging economies, demand for office space in India is concentrated in the country's chief metropolitan regions. The top three cities -- Mumbai, the NCR and Bengaluru -- account for 46% of total demand for office space in India<sup>3</sup>.

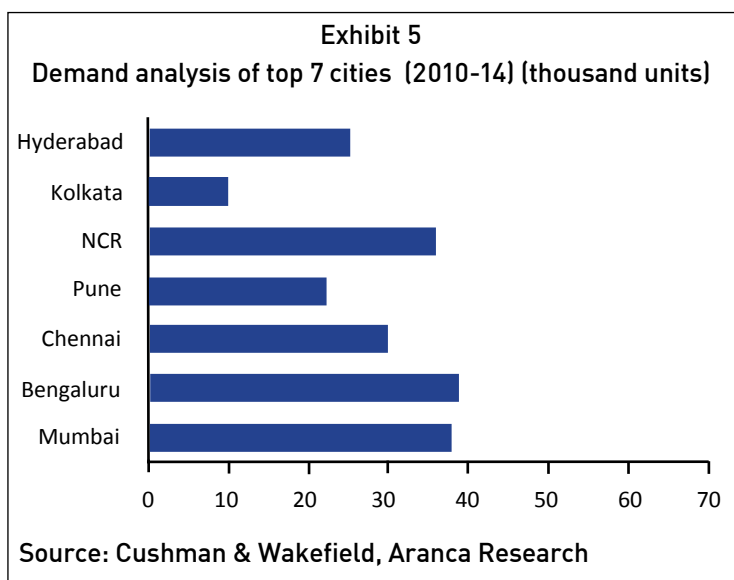
However, the office markets in India's Tier II and Tier III cities are growing rapidly, as these cities account for an increasing proportion of the national business activity. Notably, between 2010 and 2014, demand growth for office space is projected to be the highest in Kolkata and Chennai<sup>4</sup>. Rapid growth of the services sectors --IT/ITeS, BFSI and Telecom--in these cities is expected to trigger the increase in demand for office space.

Growth of the services sector in Tier II cities expected to fuel robust demand for office space



<sup>3</sup>Cushman & Wakefield

<sup>4</sup>Cushman & Wakefield



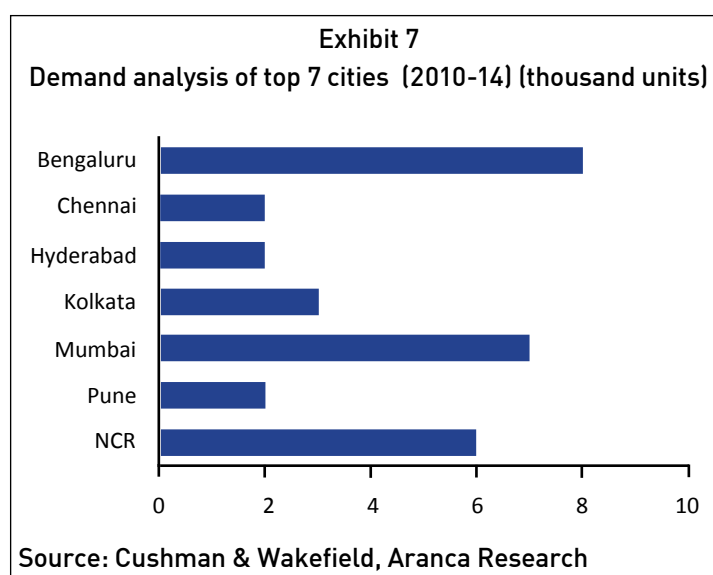
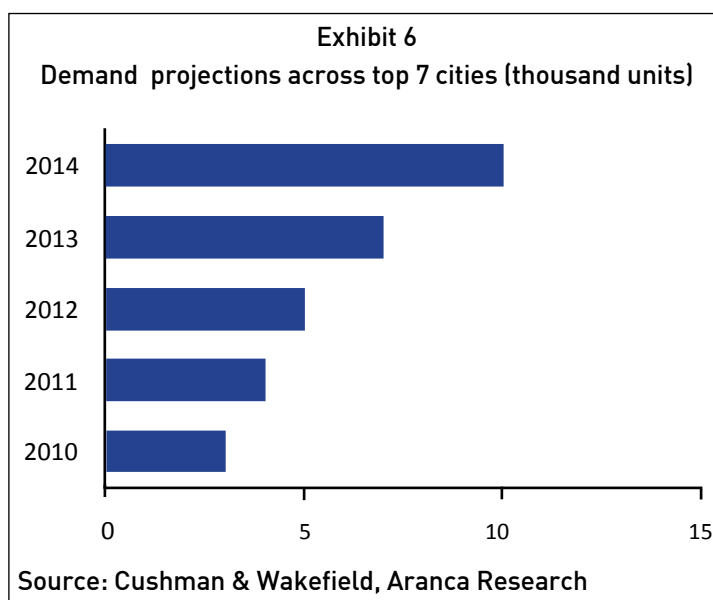
### 1.3 Retail market: Riding the wave of burgeoning consumerism

Although retail currently accounts for a small portion of the Indian real estate market, the significance of this segment is expected to grow exponentially over the next few years. Fuelled by a buoyant economy that is backed by strong domestic consumption, the organised retail sector in India is growing at 20-30% annually. This growth is being further catalysed by the entry of international retailers, who are collaborating with local partners to benefit from India's fundamental strengths.

Consequently, by 2014, demand for mall space in India is forecasted to be about 55 million sq ft, doubling from the existing mall space of approximately 56 million sq ft<sup>5</sup>. While the NCR is expected to continue to lead the country in terms of total mall space (it accounts for about 30% of the total mall supply in India), the additional demand is likely to be the highest in Bengaluru.

The NCR is expected to continue to lead in terms of absolute mall space, although additional demand is likely to be the most in Bengaluru

<sup>5</sup>Cushman & Wakefield



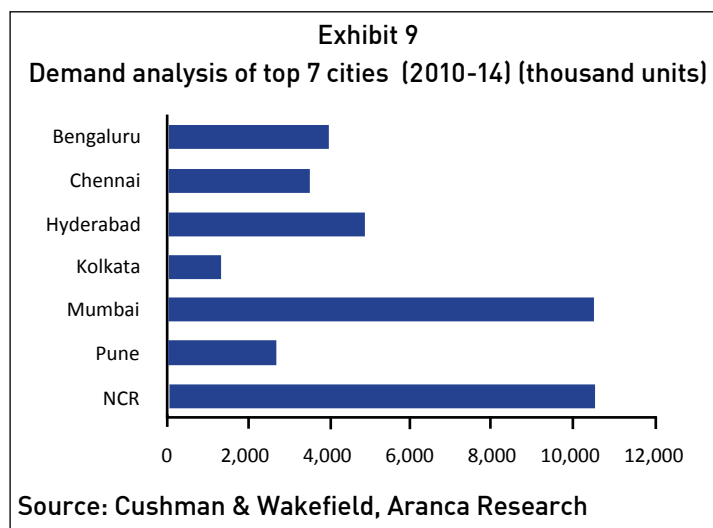
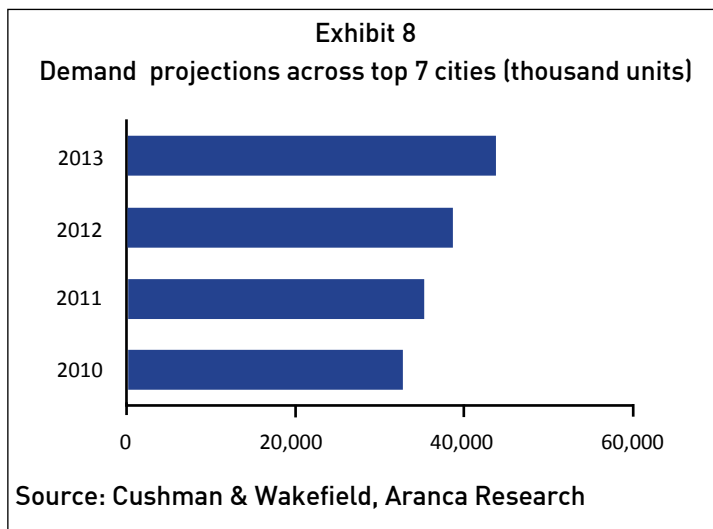
#### 1.4 Hospitality market: Offering pockets of opportunities

The metropolitan regions of Mumbai and the NCR are by far the biggest hospitality markets in India, a status quo that is likely to be maintained in the foreseeable future. The increasingly global nature of Indian businesses, which is boosting business travel, is the key factor driving the hospitality markets of these top Indian business destinations. In particular, the niche luxurious serviced apartments market in these cities offers attractive opportunities.



Besides these top-tier cities, opportunities in the hospitality market can also be found in the smaller Tier II and Tier III cities. In particular, government initiatives to promote tourism are generating significant demand for hotels in these cities, especially for budget hotels. These initiatives include tax incentives and additional floor space index (FSI) for hotels.

Attractive opportunities present in the niche serviced apartments markets of Mumbai and the NCR, along with budget hotels in Tier II and III cities



## 2. AFFORDABLE HOUSING: BUDDING, EXPANDING, COMPELLING

Within the attractive real estate sector of India, affordable housing appears as a particularly bright opportunity. The potential of affordable housing is bolstered, to a great extent, by the very nature of its business model, which is in sync with India's shifting socioeconomic landscape--the rise of the middle class. Moreover, due to its wider target market, affordable housing is less susceptible to the vagaries of the macroeconomic environment.

In the sections that follow, the report first defines the scope of affordable housing in the Indian context, then goes on to trace its emergence in the wake of the global economic downturn, before identifying the enormous potential this segment holds in India's robust growth story, and the ways to capitalise on that potential.

### 2.1 Defining affordable housing

'Affordability', per se, is a nonspecific term, the meaning of which changes with the context being considered. As a result, there is no fixed definition of affordable housing that can be applied uniformly across the world. The definition and scope of affordable housing is greatly contingent on a country/region's level of economic development and income levels.

In India, KPMG and The Confederation of Real Estate Developers' Associations of India (CREDAI) have jointly developed definitions of affordable housing for Tier I, II and III cities, based on three key parameters--income level, size of the dwelling unit, and affordability.

Affordable housing has emerged as one of the brightest spots in the Indian real estate story, primarily due to the essential nature of its business model

**Exhibit 10**  
**Definitions of affordable housing in India (as developed by KPMG and CREDAI)**

Income categories	Income level	Size of unit	Affordability
Economically weaker section (EWS)	<INR 150,000 per annum	Up to 300 sq ft	EMI to monthly income - 30 to 40%
Lower income group (LIG)	INR 150,000 to 300,000 per annum	Up to 300 sq ft	EMI to monthly income - 30 to 40%
Middle income group (MIG)	INR 300,000 to 1 million per annum	600 to 1200 sq ft	House price to annual income - less than 5.1x

**Source: KPMG**

## 2.2 Emergence of affordable housing

The economic slowdown of 2009 changed the business climate, forcing real estate developers to focus on affordable housing.

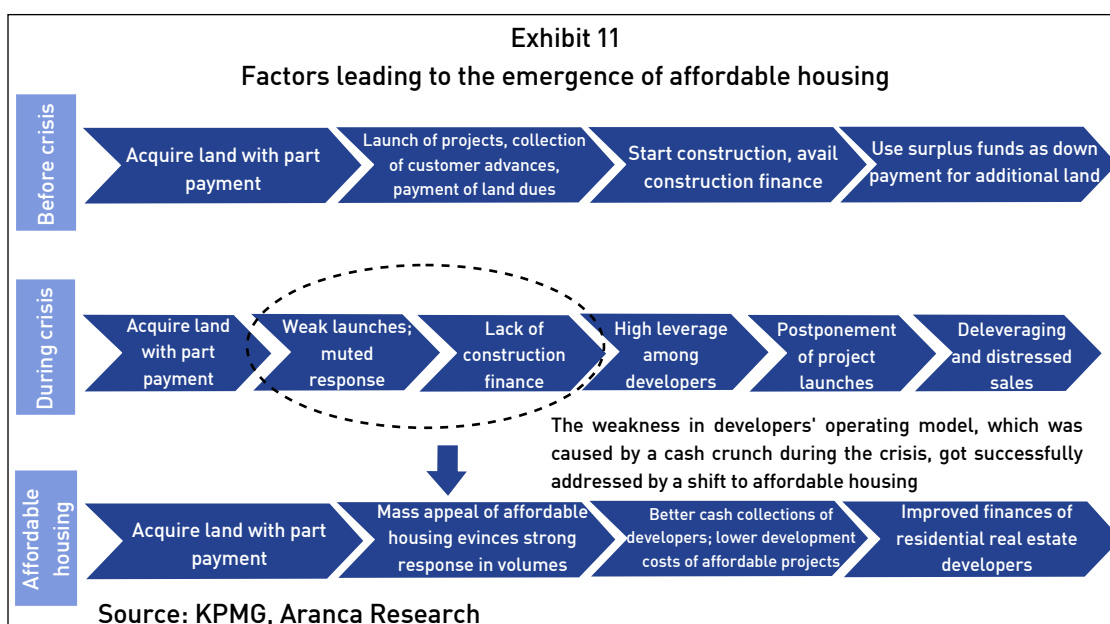
In the operating model that Indian homebuilders followed prior to the crisis, much of the construction activity was financed with customer advances collected through pre-construction bookings. Thus, construction activity was largely dependent on advance bookings by customers. This model worked fine during times of economic boom, when there was a huge demand for residential real estate.

However, muted real estate demand with the outbreak of the economic slowdown highlighted the weaknesses of this model. With demand falling, collections from advanced bookings also decreased, and homebuilders were pinned on the mat by a funding crunch. As a result, construction activities suffered, projects were postponed, and occasionally, developers had to resort to distressed sales at deep discounts.

The crisis saw the concept of affordable housing emerge in India. The mass appeal of affordable housing led to volumes outpacing that for premium housing and boosting collections from advance bookings. Moreover, lower development costs of affordable projects helped to further improve developers' finances.

Thus, in affordable housing, developers saw a solution to their liquidity problem, thereby leading to the creation of a new market segment.

Liquidity crunch faced by homebuilders in the wake of the economic downturn gave birth to the concept of affordable housing in India



### 2.3 Promising potential due to robust drivers and favourable market dynamics

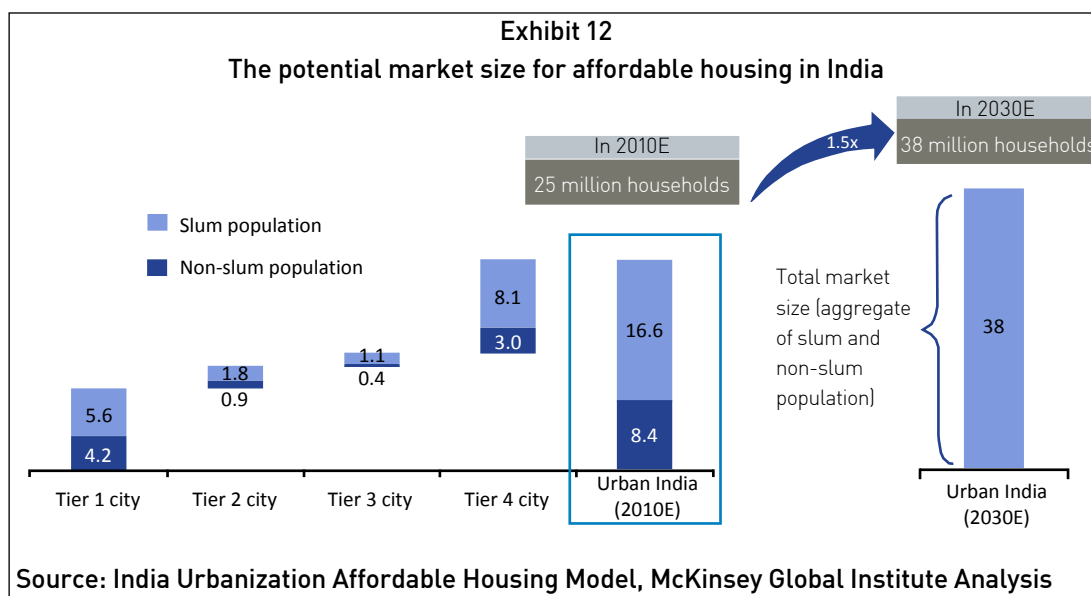
The challenges brought by the global economic slowdown have mostly abated in India, and the economy appears to be back on the growth path. Nonetheless, the inherent strengths of the affordable housing model, coupled with its strategic fit in the current Indian landscape, have ensured that this segment continues to generate interest among homebuilders.

#### The potential for affordable housing is compelling...

The present status of infrastructure in urban Indian leaves much to be desired. Availability of housing, in particular, is a key stress point--about 80 million households in India are estimated to be living in slums<sup>6</sup>, for want of affordable housing. As the Indian middle class expands, the demand for affordable housing is likely to increase even further.

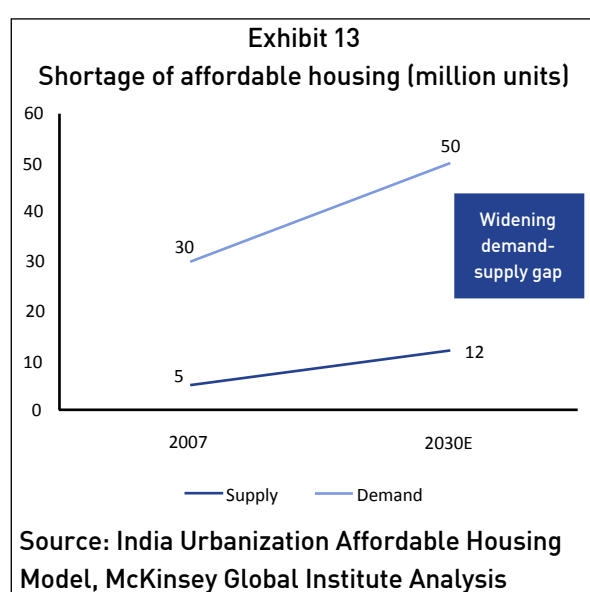
Consequently, the potential market size for affordable housing in urban India is forecasted to grow about 1.5 times from an estimated 25 million households in 2010 to 38 million in 2030. Maximum potential is believed to be in the rich Tier 1 cities that have a considerable mass of urban poor, and in lower-income Tier 4 cities.

The demand potential of affordable housing in India is forecasted to grow 1.5 times over the next 20 years



...supported by strong demand-supply dynamics...

The growth potential is further fortified with the favourable demand-supply dynamics that are playing out in the market. While demand is strong, and slated to grow, supply has historically been low, creating substantial opportunities to bridge the gap.



Key factors bolstering growth in demand for affordable housing include:

- **Rapid urbanisation:** India's urban population is forecasted to grow to 590 million by 2030, at a compounded annual growth rate (CAGR) of 2.4% between 2010 and 2030. The percentage of urban-to-total population is forecasted to increase from 30% in 2010 to 40% by 2030<sup>7</sup>.
- **Rising demand for affordable homes:** With home prices far outpacing general inflation and wage growth, premium homes in Tier 1 cities have become largely unaffordable, increasing demand for affordable homes.
- **A culture of home ownership:** The local Indian culture has an inclination for home ownership. Even people in lower income groups are determined to purchase a home, rather than rent one.

On the other hand, supply of affordable housing has hitherto remained inadequate, primarily owing to the following causes:

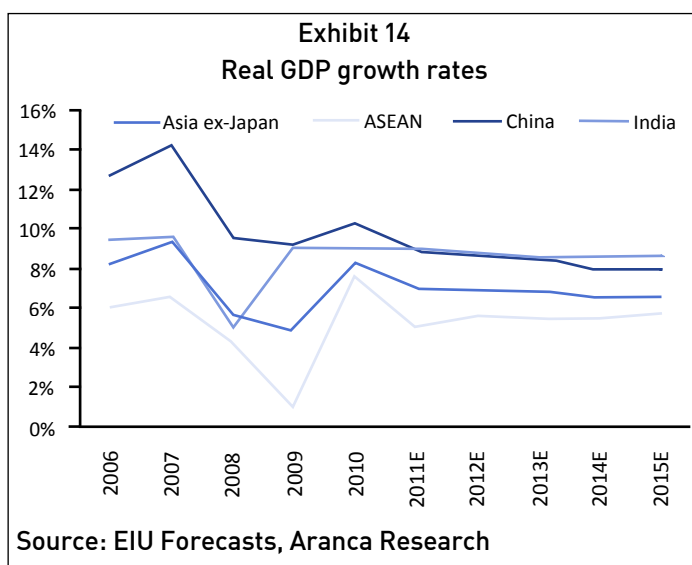
Robust demand, coupled with inadequate supply, is shaping an environment full of opportunities

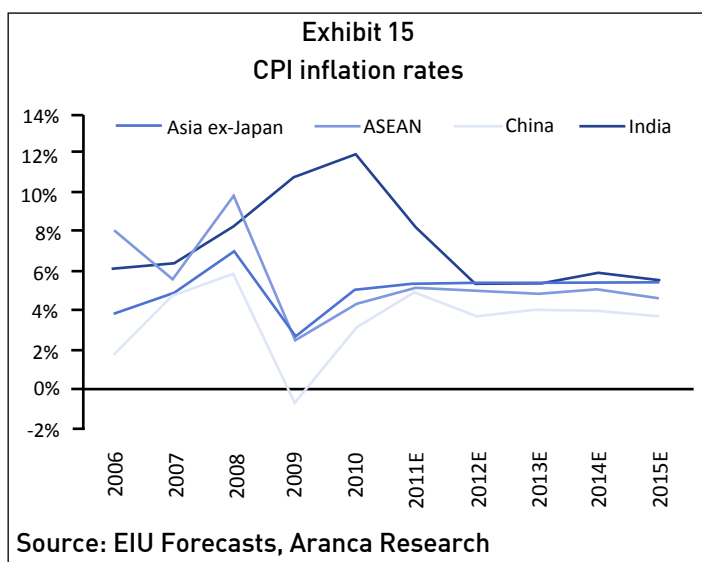
- **Availability of land at reasonable costs:** The availability of land at reasonable costs is an important determinant of affordable home supply. Currently, there is a shortage of affordable homes, as policy measures in the past have failed to address the concern of affordable housing.
- **Lack of financial support:** Commercial banks and other home financing organisations have traditionally been averse to financing low-income housing due to the perceived higher risk.

**...and healthy economic fundamentals**

The Indian economy is forecasted to register robust growth rates over the next few years, on a sustained basis. Higher levels of economic activity will likely translate into higher personal disposable incomes. Moreover, well-timed monetary policy measures, coupled with an anticipated softening of international commodity prices, could lower India's inflation rates significantly between 2010 and 2015. Consequently, the real purchasing power of an average Indian is likely to get a boost, in an environment of high economic activity and low inflation. This, in turn, could trigger a growth in the demand for affordable housing, especially from an expanding urban middle class. Additionally, lower inflation expectations are likely to check interest rate hikes, thereby accelerating the demand for real estate.

Sustained high economic growth rates and moderating inflation create a favourable macroeconomic environment





## 2.4 Recent initiatives stimulating interest among developers

In addition to the inherent growth fundamentals of India's affordable housing market, certain measures taken recently have created greater interest in this segment among developers. These measures include fiscal policies, such as interest rate subsidies and tax allowances, and better institutionalisation of the real estate financing practice.

**Exhibit 16**  
**Recent initiatives for affordable housing**

Initiative	Description
Interest rate subsidy	A 1% subsidy on loans up to INR1.5 million for home purchases of less than INR2.5 million, as per the Union Budget of 2011-12.
Tax allowance	100% deduction in capital expenditure incurred for development of affordable housing.
Funding through microfinance institutions	The Micro Housing Finance Corporation has been set up to focus exclusively on housing finance.

Source: KPMG, Aranca Research

Encouraged by these initiatives, an increasing number of developers are now exploring the affordable housing segment.

- In 2010, Tata Housing formed a 100% subsidiary --Smart Value Homes-- to focus on the affordable housing segment; the company plans to invest INR25 billion by 2011 in affordable home projects across Tier 1 and Tier 2 cities.

- Provident Housing plans to invest around INR30 billion by 2012 to set up four affordable housing projects in Karnataka and Tamil Nadu.
- Unitech plans to invest INR20 billion in affordable housing in 2011-12.
- Soham Group plans to launch affordable housing projects worth INR10 billion over the next two to three years, primarily in the Mumbai region.
- Ansal Properties has launched a programme worth INR5 billion to build 10,000 affordable housing units in Uttar Pradesh and Rajasthan.

A number of real estate developers in India are foraying into the affordable housing segment

### 3. THE PPP MODEL: AN ATTRACTIVE PROSPECT

The public-private-partnership (PPP) model can be effectively used to tap this compelling opportunity in the Indian affordable housing market. Collaboration between the public and private sectors not only creates a huge pool of resources, but also carries inherent benefits that help to address stakeholder concerns.

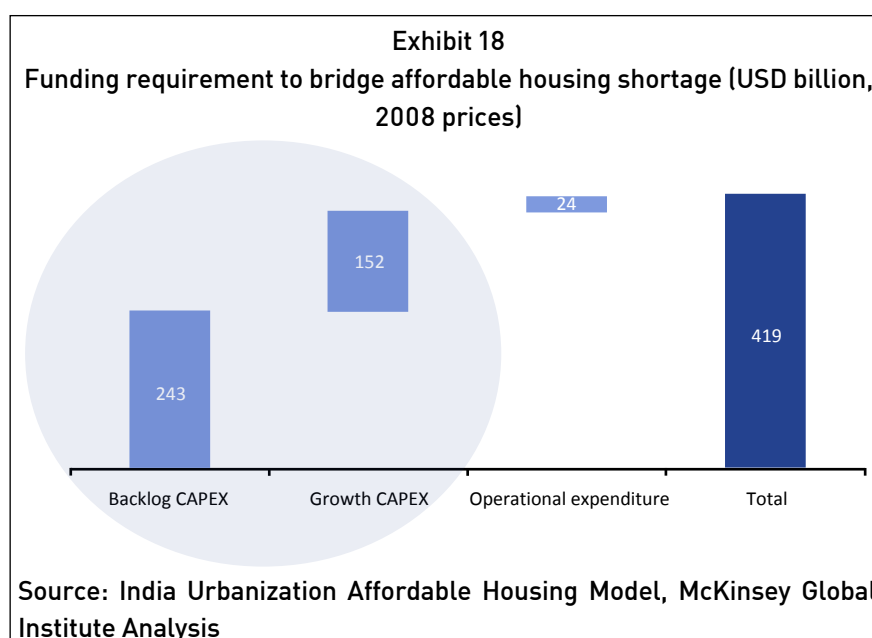
<b>Exhibit 17</b>	
<b>Benefits of PPP model in affordable housing development</b>	
Categories	Benefits
Land availability	<ul style="list-style-type: none"> <li>• The government owns vast land banks that can be distributed to private developers through a transparent bidding process. This can, to an extent, mitigate woes related to the unavailability of land at reasonable costs.</li> <li>• The government can relax FSI norms as a means to provide cashless subsidy to developers, bringing down development costs.</li> </ul>
Improved financing	<ul style="list-style-type: none"> <li>• A joint pool of public and private funds is likely to be more effective and efficient in financing development projects.</li> <li>• The government can form development consortiums with private developers and guarantee bank loans borrowed by such consortiums, thereby reducing borrowing costs.</li> </ul>
Lower costs	<ul style="list-style-type: none"> <li>• Development companies formed through PPPs can obtain project approvals more easily, thereby reducing project cost and time overruns.</li> <li>• The government can indirectly lower costs by giving tax relief and reducing stamp duties.</li> </ul>
Economies of scope	<ul style="list-style-type: none"> <li>• A PPP model should be more beneficial in developing integrated affordable townships, where the infrastructure and utilities development activity can be taken care by the government, while private developers with expertise in residential development can build affordable homes.</li> </ul>

**Source: KPMG, Aranca Research**

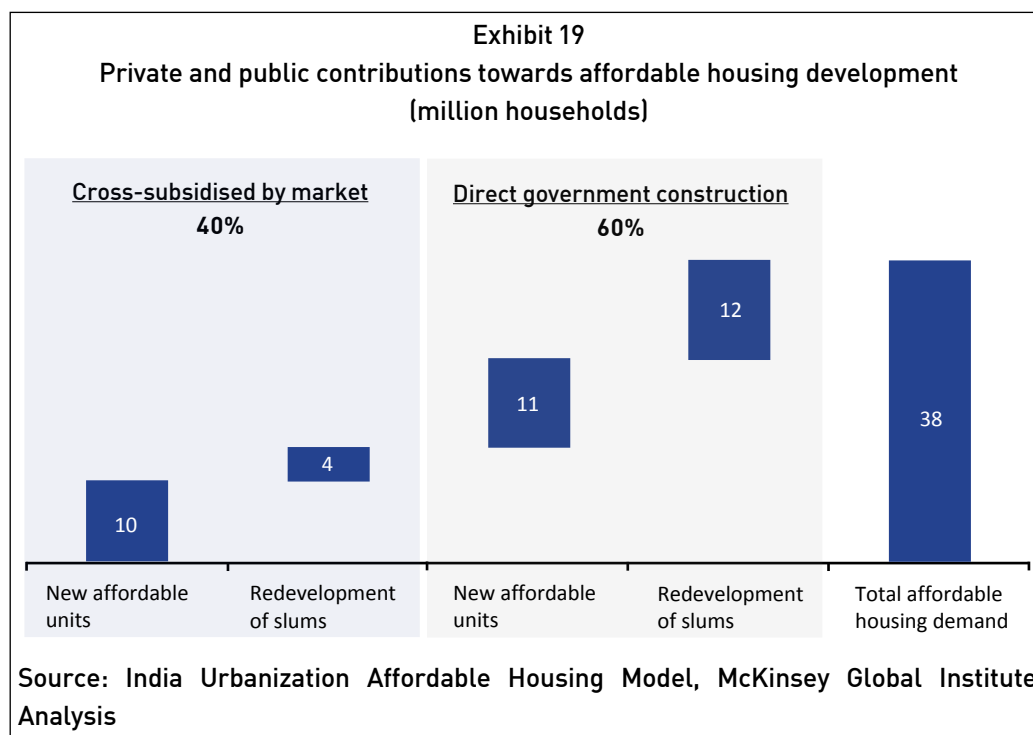


Among all the benefits listed in Exhibit 17, the greatest of all is the combined pool of funds that can be optimally utilised to meet the market demand for affordable homes. The India Urbanization Affordable Housing Model developed by the McKinsey Global Institute (MGI) estimates the need for USD395 billion in gross fixed capital formation (GFCF) to bridge the gap between demand and supply in the Indian affordable housing market. Of this, USD243 billion would serve as backlog capital expenditure to meet the current supply deficit. The balance USD152 billion would go towards growth capital expenditure to cater to future demand. Separately, an additional USD24 billion would be required to fund the operating costs of rental stock.

The enormous need for affordable housing in India necessitates a joint effort by the private and public sectors



This huge GFCF requirement can be optimally met only through the active participation of the private sector. According to the MGI model, the government can directly contribute about 60% of the funds required for the development of affordable housing, including redevelopment of slums and building new affordable homes. The balance 40% can come from concerted partnership between the public and private sectors, wherein the private sector focuses on the development of homes, while the government provides the ancillary infrastructure and interest and tax subsidies.

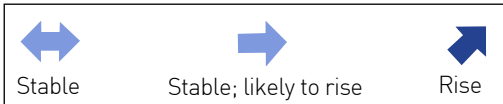


#### 4. CONCLUSION

A multitude of strengths and opportunities support the cause of affordable housing in India. Significantly, not only are the buyers and suppliers interested in promoting this market, but policymakers too have emphasised the need for affordable housing, if India has to address its urban infrastructure problems. A number of initiatives have been introduced with respect to affordable housing. The PPP model can be leveraged for the development of this segment, given the model's advantages. Opportunities are plenty, and the market is underdeveloped, giving sufficient room for players to grow.

**Exhibit 20**  
**Opportunities in the smaller Indian cities**

City	Office	Retail	Residential	Hospitality	Investment opportunities
Chandigarh	↔	→	↔	↔	High segment residential, hospitality
Lucknow	↔	↔	→	↔	<b>Affordable housing</b>
Nagpur	↔	→	↔	→	Shopping centres, budget hotels
Jaipur	↔	→	↗	↗	High segment residential, hospitality
Kochi	↗	↔	↗	↔	High segment residential, office space
Indore	↔	↔	↗	→	<b>Affordable housing</b> , budget hotels
Coimbatore	↔	↔	↗	↗	<b>Affordable housing</b>
Mysore	↔	↗	↗	↔	Shopping centres
Vizag	↔	↗	↗	↗	Shopping centres, high segment residential



↔ Stable      → Stable; likely to rise      ↗ Rise

**Source: Cushman & Wakefield, Aranca Research**

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