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Abstract

This note raise many policy issues related to real estate and the urban sector. Urban issues and the very high cost of real estate in India have deep rooted problems that have their origin in the policy, law and working of government. The potential of high growth to deliver benefits to people but especially the poor have to a large extent been negated by the large perversities that underlie the real estate sector in India. These have been compounded by structural problems in governance. Without correction it is unlikely that India would be able to face to the challenges in rapid urbanisation that lies ahead.

¹ This paper is largely intended to allow discussion in the classroom on the issues of policy and governance that bear on the real estate sector and urban management. The author acknowledges the help provided by Mr. Sajan Joseph, Coordinator, Centre for Infrastructure Policy and Regulation, Indian Institute of Management Ahmedabad

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Issues in Real Estate and Urban Management – A Note

The Real Estate Sector in India

The Real Estate sector has become a very important growth sector after the liberalisation of the economy, and is the second largest employer in India, next only to agriculture, and its size is close to US \$ 12 billion and grows at about 30% p.a. and it accounts for about 5% of the country's GDP. This sector has significant linkages with several other sectors of the economy and over 250 associated industries. It has large spending multiplier effects on the rest of the economy. The sector is dominated by local players. National level players are emerging rapidly, and local reputation is still very important to success. The sector is unregulated on dimensions of quality, terms of delivery, information provided to potential buyers, etc. On other dimensions such as land use, building norms there is more of dysfunctional regulation. With high growth and the emergence of larger players there is a need for manpower formally trained for the sector.

The Tenth Five Year Plan estimated a shortage of 22.4 m dwelling units. Over the next 10 to 15 years, it is estimated that 80 to 90 million housing dwelling units will have to be constructed with a majority of them catering to the middle and lower income groups. Recovery mechanisms for loans granted are only now witnessing some improvement. Real estate has not yet emerged as a significant (market) asset class, owing to both legal restrictions and lack of transparency among those companies operating in the sector. Only 5 – 7 per cent of the loans go to builders and institutional developers.³

Limited land being made available in the periphery of cities, low Floor Space Indices (FSIs) which planners use, restrict the rate of expansion of supply so that real estate booms very quickly translate into high price increases in comparison to similar booms elsewhere for instance in East Asia. Additionally in many cities supply of urban land is largely controlled by state-owned development bodies (like the Delhi Development

³ Chapter 7.6, "Tenth Five Year Plan", GOI, Planning Commission. This section draws much from the chapter.

Authority (DDA) in Delhi) and Housing Boards leaving very limited developed space free, which is controlled by a few major players in each city. Restricted supplies of from these agencies keep prices high. Similarly the neglect of the 'planned economy' to invest sufficiently in roads has put pressure on land in cities adding to the burden of land prices. Vast cantonment lands often in the very centre of cities with no agreed development trajectory in cities such as Kanpur and Pune compound the problem. Land prices are very high even in the distant periphery of cities since it is only here that some land would be made available.

Real Estate Mutual Funds or availability of funds from pension or insurance companies are yet not the norm in India and similarly real estate assets are kept outside the financial market and not leveraged for investment purposes. Mortgage backed securities, which are crucial for the development of secondary market, are also not popular in India, despite their larger potential in the country.

This industry is constrained by archaic laws as well as government policies both at the central and state levels. There are more than 100 laws governing different aspects of this sector and most of these are dating back to the 19th century. E.g. the Land Acquisition Act 1894, Indian Contract Act 1872, Transfer of Property Act 1882, Registration Act 1908, The Indian Evidence Act 1872, etc. The states still exercise control through a variety of laws such as Rent Control Act and Urban Land Ceiling and Regulation Act. In 1992 the Central Government proposed a model rent control legislation but only a few states have introduced the model act. Some reforms have started happening in these acts due to the JNNURM projects since the Central Government had made it a condition for release of funds under the JNNURM. However in some states Stamp Duties is as high as 14 – 15% and in some these cases it is applicable in subsequent transactions triggering large scale tax evasions and benami transactions and money laundering. Processes for obtaining approvals to start construction are very cumbersome which includes obtaining the Environmental Impact Assessment Notification from the offices of the Ministry of

Environment and Forests (MoEF). This has led to huge corruptions and almost no transparency.

The State does not certify a title to housing or land property and the revenue records are not documents of title and ownership is established only by the sequence of earlier transfers thus often leading to enormous litigations. Most of the sale transactions are done through the Power of Attorney route to evade high transaction costs like registration, stamp duties, property tax, etc. Therefore the onus of verifying the validity of the title lies with the purchaser in part and/or the mortgager. The title risk is so large that a title insurance market cannot exist at this juncture in the country. 'Title Arbitrage' renders a large premium to properties sold by governments since here the title risk is absent.

Few local developers have the financial strength to invest in large-scale development projects. Over regulation of existing built-up areas and land use which is more inflexible than elsewhere in the world has made urban renewal and growth problematic. As a result housing development is increasingly poised to take the form of 'new township' development, even if the linkage aspects of these with existing towns are problematic. The development of new towns and cities would require massive investment and technical expertise that domestic players alone cannot provide. Foreign investments until now could be only through NRIs and PIOs. However, the Government has now decided to liberalise the FDI norms in the construction sector through the Press Note 2 (2005). FDI is possible in townships, housing, built-up infrastructure and construction-development projects but in Greenfield projects only. Similarly there is a need to encourage participation of the private sector in bringing technical and managerial expertise in formulating and delivery of basic amenities like water, sanitation, sewerage, transport and electricity through Public Private Partnerships in the real estate sector.

Even though Real Estate came under the purview of the Consumer Protection Act 1986 in 1993 after an amendment to the definition of 'service' to include the term 'housing construction' there are still several lacunae relating to consumer protection. E.g. Housing

is considered as a service and not as 'goods' due to which replacement of defective housing unit or damages cannot be claimed. Similarly pricing of housing units are not covered in this law. Further the seller is protected from giving a warranty and the final responsibility lies with the customer. More importantly there are perverse processes that have evolved that allow the builder to shirk responsibility – such as dealing formally through societies and not directly with the builder. Standards vary widely, as also the measure of area- carpet area super built up area, inclusion of balconies etc. Similarly on larger colonies builders retain the overriding right to add to floor spaces even though ex-ante sales are made on the basis of claimed lower built up areas. There is almost no – recourse to the problem of poor construction quality. Therefore the premium that reputable builders can enjoy can be as high as 30 % or more.

The Urban Sector in India

The urban sector more broadly considered has its own problems emerging out of problems in the real estate sector. But far more importantly the problems in urban governance, regulation (of land use and building bye laws as already mentioned) have had constraining effect of the development of real estate. These may be briefly stated as follows:

- There is little responsibility embedding in the municipalities and urban local bodies despite the 74th Amendment to the Constitution. Since the power of decision making are dysfunctionally split between the elected and the career civil servants, and neither can be held accountable in a task/functional sense, so that urban citizens have little recourse when urban services are inadequate or poorly provided. Most problems arise out of this basic institutional/organisational problem.
- Poor planning, either in the form of over ambitious land use restrictions or very little planning at all, result in sprawls with inadequate usage of public services/spaces.

- Indian cities are woefully short on drinking water provision, public toilets, sanitation and sewage services, and other public health measures. These failures have resulted in urban India having very high morbidity rates.
- There is almost no linkage between area/land use planning and transport planning so that movement within cities is problematic and provision of roads and communication links ex-post development becomes difficult or very expensive, and remain unprovided. Sprawls and highly spread out cities result rather than compact cities which are known to be functional and the objective of regulation in the first place. Public transport and especially rapid transport like Metros and bus systems then become problematic since the cities then have too low a density to support public transport especially metros or rapid bus.
- Operational management of cities is without any scientific basis. Thus there is little scientific regulation of parking, hawking, road use, allocation between public and private transport use, etc so that overall capacity for movement measured in terms of person trips is adversely affected. Road and street geometrics, kerb and pedestrian ways overbridges and cross overs are so poorly and unscientifically designed and executed that Indian roads especially city roads are a major safety hazard. The movement of traffic in cities is so unsafe that on that count alone, for all who can afford, there would be attempts to minimize their exposure as pedestrians on the road. This is an added factor that has pushed up four wheeler use among those who can afford and led to a decline in non-motorised modes like bicycles even when distances involved are small.
- Locational policies, since they have typically ignored locational economics, and movement types in cities increase the movements required for the same number of trips.
- There is a vicious circle of high cost of public transport arising out of low densities, lack of mixed land use models, poor provision of public transport which makes private transport the only option for many. That in turn creates biases against the use of public transport.

- There is almost a complete absence of multi-modal transport, and the lack of any institutional basis to bring about the coordination required across the many departments and functions of government. This creates further biases against public transport, adds to congestion and slows down movement to levels far lower than they need be given the actual road spaces in Indian cities.
- The quality of manpower available at all levels in ULBs but especially at the top is either poor or not rooted in the organisation, given the administrative structure of the country.
- Urban governments in India face the challenge of creating the right frameworks for PPPs that include models for PPP backed by appropriate law in such sectors as water, sanitation, roads and bridges, parks, parking, sewage systems, bus services, etc. Indian ULBs would need much hand holding from higher levels of government and from policy advisory groups, and institutions to be able to use PPPs effectively.
- The weaknesses of the urban governance mechanism is structural and deep rooted. This has been revealed by the response and working of the ULBs when fairly large funds were made available by the central government under the JNNURM. In most cities the sudden flush of funds has led to wasteful and inappropriate expenditure. And the rules for construction applied on contractors being devoid of any regulatory reference to the nuisance and disturbance that construction can cause, the pain imposed on citizens by the construction in the wake of the JNNURM has been very high and almost entirely avoidable with rational governance and contracting.
- Methods of land acquisition for urbanisation, changing use, and town planning models are prone to rent generation on a scale unmatched in either the developed west or even in South East Asia. Better examples such as the Ahmedabad TP Scheme or transfer of development rights which have been used widely despite their proven success are not being actively considered by other cities, since either the vested interests spawned by rents are quite strong or as is most likely there is little awareness among the few who could have made the decisions.
- Indian urbanisation would increase by leaps and bounds. Until the eighties it had been constrained by slow growth of the economy when compared to East Asia. With

growth now exceeding 8%, urbanisation would happen at an accelerated pace, and Indian ULBs and governance structures are ill equipped to handle the challenge that lies ahead.

- The issues raised above and in the discussion on real estate are obviously related, and any proper understanding with a view to act to correct them would require an integrated approach that spans knowledge of management, economics, geography, sociology, public administration, transport economics and engineering.

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