



Policy Lab 3:
Private Sector Investment in Rental Housing:
Challenges and Opportunities

Understanding the Formal Urban Rental Market in India

Includes findings from Draft Report by Claude Taffin and Anindita Mukherjee for the World Bank in Tamil Nadu, 2018

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1 out of 3 urban dwellers in India resides in a rented accommodation

Proportion of renters does not vary much between slum and non-slum population (about 27%)

(Census 2011)

Policies skewed towards home ownership

Homeownership steadily growing: at around 64% in 2019

Renting among lower consumption quintiles steadily increasing over 2008-2019

Ambiguity of tenurial status reduces among higher consumption categories

(NSS 65th, 69th and 72nd Rounds)

	Urban Housing Stock	Owned Housing Stock	Rental Housing Stock
India Total	78.8 Million	54.5 Million (69.15%)	21.7 Million (27.54%)
India Slums	13.7 Million	9.6 Million (70.23%)	3.6 Million (26.26%)

Remaining stock: Other tenurial arrangements

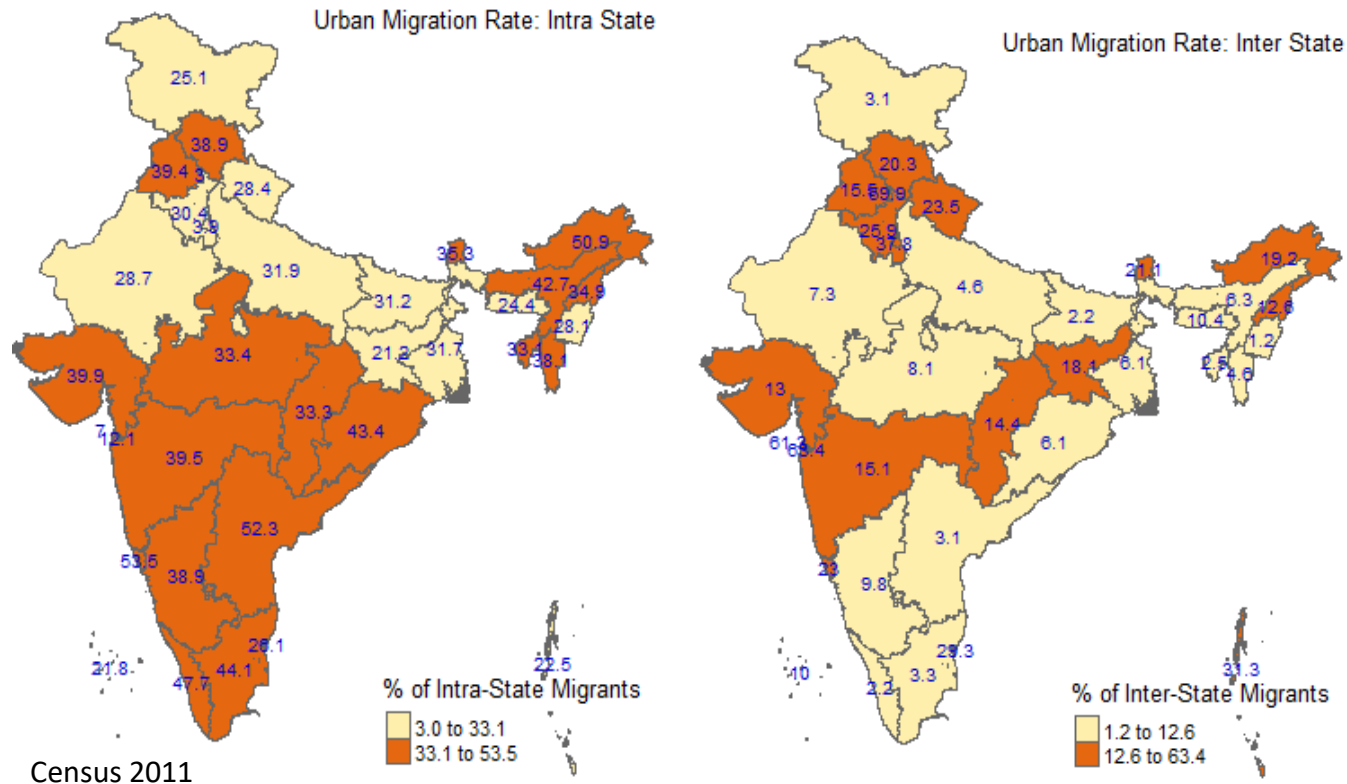
MPCE Quintile	Owned			Hired		
	2008-09	2012-13	2018-19	2008-09	2012-13	2018-19
1	18%	17%	24%	9%	11%	10%
2	19%	18%	22%	13%	15%	17%
3	19%	20%	20%	20%	19%	21%
4	20%	21%	18%	24%	23%	24%
5	24%	24%	17%	34%	32%	28%
Total	100%	100%	100%	100%	100%	100%

Remaining stock: Other tenurial arrangements

The pandemic has exacerbated the housing vulnerabilities, especially among migrant workers

High migration rate across the country:

- Increased mobility: 1.5x increase in absolute number of people moving for better employment opportunities to urban areas in 2001-2011 (Working Group on Migration, 2017)
- Highly urbanised states like southern states, Maharashtra, Gujarat, Tamil Nadu account for high intra-state and inter-state urban migration



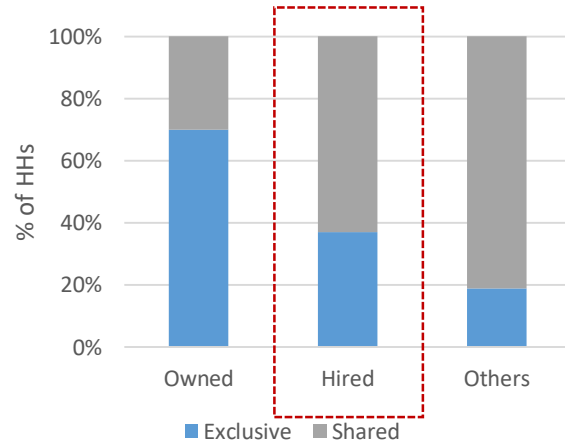
Migrants resort to renting to ensure mobility, flexibility, and ability to save

- 8/10 households reported **inability to pay the following month's rent** owing to lockdown ([Centre for Sustainable Employment, 2020](#))*
- Central government **advisory** for rent waivers and full payment for employees during lockdown: implementation ambiguous
- Average **rental unit size is smaller for the urban poor**, making it difficult to practice social distancing and maintaining adequate hygiene

Congestion, higher cost and poor quality of services for renters

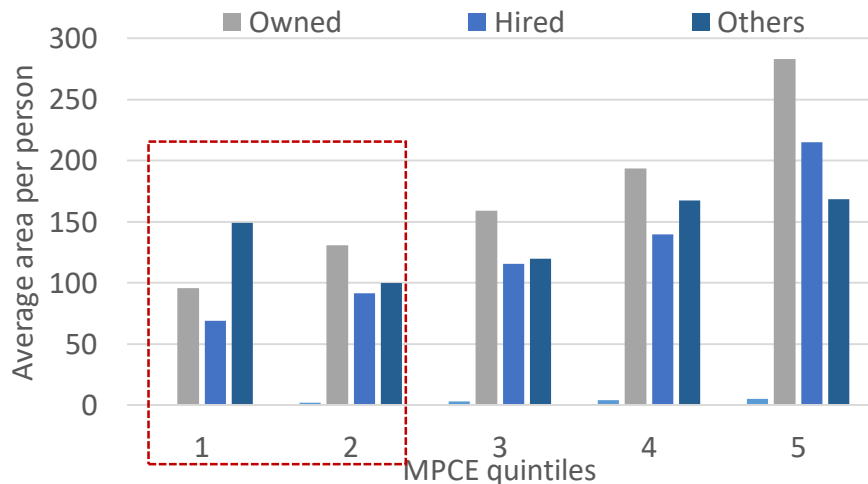
Higher reliance on shared services among rental HHs:

Access to water through shared source more common among renters



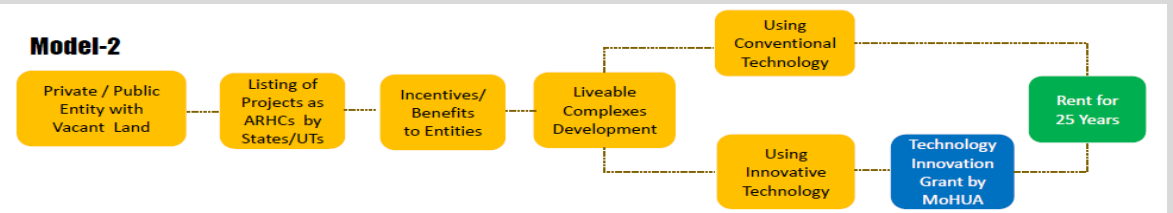
Higher density of people living in lower quantiles:

Overcrowding common for renters: most tenants live in a single room (49% across India)



Source: NSS 2019

Model 2 of the newly launched Affordable Rental Housing Complexes (ARHCs) vertical of PMAY:



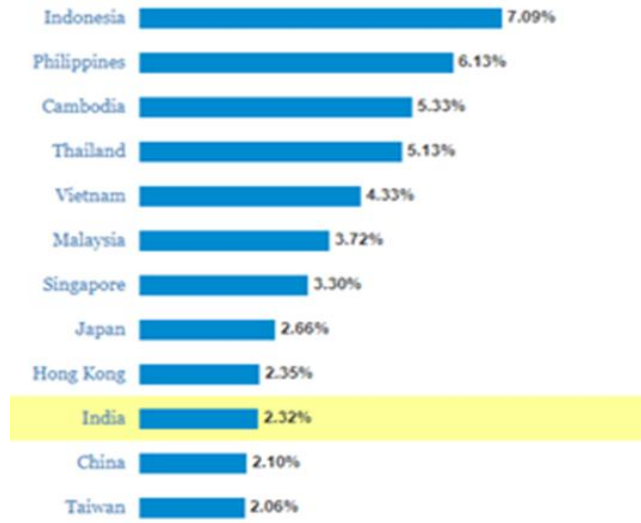
40,000 DUs & 1,80,000 Dormitory Beds to be constructed in initial phase by private entities

- Rent fixed by Entity as per local market benchmarking; increase allowed biennially at 8%; maximum of 20% in aggregate, over a period of 5 years
- Incentives:
 - Exemption of income tax and GST on profits
 - Promotes use of innovate technology for leveraging Technical Innovation Grant (TIG)
 - Provision of allied infrastructure and municipal services by the ULBs/State to increase liveability
 - Land use change flexibility for vacant land
 - Provision of 50% additional FAR/FSI free of cost

Obstacles and perceived risks in renting

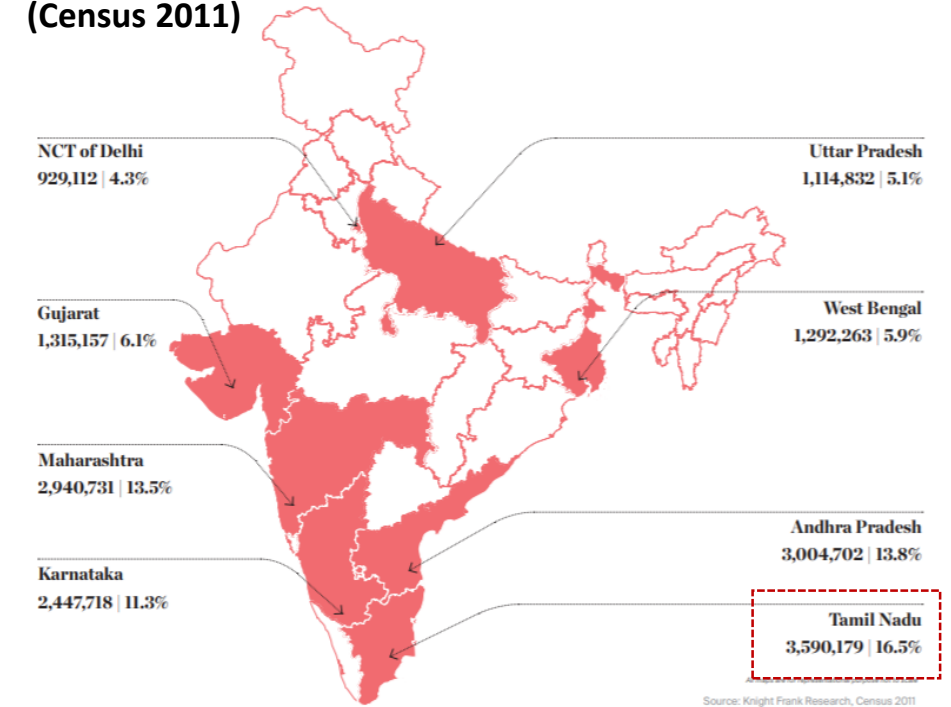
- Cultural bias
- Perceived/real bias of legal framework that makes eviction highly complex
- Low estimated gross rate of return: 2-4%
- Lack of adequate finance for residential rental investments
- Lack of financial incentives
- Lack of formal property management
- **As a result landlords prefer to keep properties vacant (11 million¹ vacant houses)**

Low rental housing gross yield, 2018



- **Unorganised, fragmented and informal** rental market
- **Preference for no contracts** or short L&L agreements → **Limited investments** from large players

States/UTs with highest % share of rental market (Census 2011)



Source: [Khaitan & Co and Knight Frank Study, 2019](#)

16.5% Tamil Nadu with the highest % share of rented households in India

→ **Study of Tamil Nadu** to understand how to develop urban rental housing markets

Landlord-Tenant Relationship: Tamil Nadu Tenancy Law, 2019 (highlights)

Treats commercial and residential rentals equally

Rent and tenancy period to be mutually agreed

Existing tenancies continues to be governed under RCAs for 12 months before subsuming under the new law

Mandates registration of ongoing/new agreements with the rent authority (RA)

Enables the landlords and tenants to approach the RA independently if unable register through mutual agreement

Provides for assigning a unique number to all registered properties

Inheritability of Tenancy allowed within the agreed period

Allows a maximum of 3 months security deposit of rent equivalent

In case of dispute, rent can be deposited to RA; gets forfeited upon 5 years of non-withdrawal

However,

- **Registration is problematic:**
 - No penalty for non-registration
 - Dual registration continues; no automatic registration
 - Registration avoided through 11 month contracts
- **Unregistered** agreements with the RA remains **outside the purview**
- **RA not empowered to evict**, and in case of dispute, repossession done by Rent Court; therefore:
- **Repossession is not expedited** as new law does not seem to significantly reduce the 5-10 years it typically takes to repossess

Low rental yield: Case of Tamil Nadu

Applicable taxes and levies on rental properties

- The landlord and the tenant pay jointly:
 - 1.5% of the lease value as stamp duty,
 - 1% of the lease value as registration fee (subject to a maximum of INR 20,000)
 - 100 INR registration fee with Rent Authority (new law).
- Property Tax: ≈6% to 12% of the property value. Due by landlord and deductible from rental income for income tax purposes.
- Rental Income:
 - Individuals: added to other incomes after limited deductions (30% of annual rental value)- no incentive to invest in large maintenance
 - Firms: net profit from rental treated as other profits (30%-45%)

Need for better financing mechanisms

- When using finance, the **net rate of return should be modified** (replacing the total value by: equity + mortgage take-out + registration fees + withdrawing loan repayment from the rental income).
 - **Using leverage increases the rate of return** if the cost of capital is below the rate of return needed for equity.
- For the model to work-out, the mortgage interest rate should be less than 7%.
 - Current mortgage interest rates: 9.5% to 10% for a 15-year term loan.
- The impact on the **rental return can reach 2% for the first year** (decreasing thereafter if the loan is not interest-only) and for a borrower able to get a loan with a 70% LTV.

Rental returns gets directly affected

- Net **rate of return from renting a residential property lags** far behind the net return from a savings account
- No risk in savings account and more liquid liquidity
- With returns in the range of **1.5% - 2%**, **the risk-adjusted rate of return will often be negative** (estimates based on scarce data)
- High instances of exclusive renting to kith and kin or leaving unit vacant due to **inability to evaluate risks accurately** and frequent **over-estimation**
- Majority of **small/informal landlords**
- 80% of rental contracts are **non-written**
- Through this, they can cash the capital gain when in event of selling the house, whereas **occupancy by a tenant jeopardizes the possibility of repossessing** it in a timely manner

Recommendations

•Minimize the obstacles that reduce efficiency of the rental market, such as:

- Imbalanced legal framework in favor of tenants
- High cost of contract registration
- Lack of adequate finance/subsidies for investors or tenants

Diversity of tenants:

- Take into account diversity of potential tenants (young migrant workers, students, low-income HHs, etc)

Standardised leases:

- Establish a **standard lease** to be available **online** to reduce legal fees

Tax incentives:

- Provide **tax incentives to investors** in newly-built or renovated units (with a maximum size, price or rent), eg. income tax exemption

Grants for renovation of vacant houses:

- For vacant/locked properties: **grants for renovation, taxation of vacant units**

Recommendations

Financial incentives:

- Provide **long-term finance** (loans or bonds)
- Set **cost-based rents and provide various incentives**, financial and regulatory, to help to keep them affordable.

•Policy to account for market segmentation:

- **Focus on social renting for urban poor migrants** (34 million migrants in bottom 2 quintiles to urban areas)
- **Creation of registered social landlords**

•Need for building dependable data through further research:

- Limited data available on rental housing: **suppliers as well as demand generators; market segments**, size, typical duration of renting, etc

•IT based interventions for greater impact:

- Build **additional data bases** to account for the current data gap (availability of data on rental housing is limited compared to ownership);
- Encourage **IT based solutions** for better accessibility.

THANK YOU

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The Scaling City Institutions for India (SCI-FI) programme aims to better understand 'governance scale' in Indian cities in tandem with 'sector specific socio-economic scales'. Through research, the programme aims to inform stakeholders, including the three tiers of the government, to develop better informed policies and programmes enabling improved governance and service delivery. It has two key thematic focus in areas of Land, Housing and Planning, and Water and Sanitation. The SCI-FI programme is nested at the Centre for Policy Research (CPR) since 2013.
