Update

RBI warns Stakeholders over 80:20 Housing Loan Schemes

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"Buy 1 get 1 free", "20% Extra Free", "Pay for 2, take away 3"….

A typical Indian scenario when it comes to marketing strategy, isn't it? But have you ever thought of Home Loans being offered in such an attractive package?

Yes, lately it has been noticed that few banks have come up with innovative Housing Loan Schemes in association with developers/builders. These schemes are popularly known as the 80:20, 75:25 Schemes.

Mechanism of 80:20/75:25 Schemes

Banks have started providing housing loan by upfront disbursal of the sanctioned individual loans to the builders. This is quite contradicting to the earlier situation where loan amount used to be disbursed at various stages of construction in a proportionate ratio. Moreover to facilitate the individual borrowers, the builders are serving the EMI payment, which ideally is the duty of the borrower.

Under this scheme, the borrower pays 20% or 25% of the loan amount upfront. The other half i.e. 80 % or 75 % is given as a loan by the bank. Here, the builders get the option to receive full price of the flat i.e. 100% (20% upfront from the individual borrower and 80% from the bank). Because of full realization of the flat price at one go, this helps the builder to deploy his fund in other sectors. Having done this, the builder wouldn't be at a loss if he pays the EMI cum Interest to the bank on behalf of the borrower. Hence the builder in such a scheme offers the borrower to pay the EMI.

From a borrower's point of view this might be an ideal transaction to get into as prima facie it appears that re-payment and payment of EMI are solely the responsibilities of the builder's. However this is so untrue and it's here where the whole concept of ***"Please read the offer documents carefully before signing"*** comes into picture.

Risk involved in such Schemes

As we see that there are 3 parties involved in this transaction viz. the bank, the builder and the borrower; the complication starts as soon as the tripartite agreement is executed. Likewise, all the 3 are exposed to the risks of such transactions.

<u>From the Bank's point of view</u>

When we talk about funding, banks always have the option to recover the loan from the borrower, in the event of default by builder. The chances of default by the builder will always persist, as there are other factors also that affect the construction. Hence it is always recommended to link disbursements of loan amount to stages of construction, rather than upfront disbursal as provided in the 80:20 schemes.

<u>From the Borrower's point of view</u>

Investing in under-construction premises has always been a trouble for homebuyers due to soaring estate prices. Happiness of getting your loan sanctioned by the bank doesn't last long, if the builder does not complete the construction timely. It is ultimately the borrower who is at the risk of not being able to get his/her dream home. Also, in case of default by the builder in payment of EMI/Interest, the bank shall catch hold of the borrower if the tripartite agreement reads so.

Thus, it is always advisable to the homebuyer to weigh the risks diligently before getting into the tripartite agreement and keep himself updated with the market situation.

However, on the other hand there are chances, that the investors with the help of such schemes increase the platform of speculative transaction. For e.g;

Assume an investor buys a 1,000 sq. ft. flat at Rs. 2,000 per square foot. Instead of Rs. 20 lakh, he pays only Rs. 4 lakh, with bank funding the rest and the builder paying the interest during construction. In a few months, if he sells at Rs. 2,200 per square foot, he makes a profit of Rs. 200,000 (200 rupees per sq. ft) on an investment of Rs. 4 lakhs – an outright 50% return on investment."

<u>From the Builder's point of view</u>

Everything seems to have fallen in place for the builders with the upfront disbursal of loan amount. Apart from nominal risks, there is no other risk that the builder might have to face or is subjected to.

The new 10:80:10 Scheme

To add to the borrowers' misery from the 80:20/75:25 schemes realtors have recently come up with a 10:80:10 Scheme. While the scheme may seem more lucrative than the 80:20 or 75:25 scheme, it is on the contrary more vicious for the borrowers. Under this scheme the home buyer has to pay up only 10 per cent upfront for booking his flat, 80 per cent via bank loan during the period of construction and the final 10 per cent after getting possession of the flat. So over a 10% upfront invest the borrowers can now dream of owning a flat over a period of time. The fallacy in the 10:80:10 scheme is as grim as that of the existing schemes..

RBI's warning

RBI vide its Circular ***RBI/2013-14/247***[1] dated 11th September, 2013, warned it stakeholders not to get carried away by such loan offers, as there are possibilities of higher risks associated with such lump-sum disbursal of sanctioned housing loans.

It further emphasized that though the urban banks might be in a position to bear the risk involved however the RRBs while introducing any kind of product should take into account the customer suitability and appropriateness issues and also ensure that the borrowers/customers are made fully aware of the risks and liabilities under such products.

Effect of RBI's warning to the Realtors

In the recent past, with the ardent increase in land values, it has become extremely difficult to buy properties without a loan from the bank. Due to this, the builders also had to go through tough time. The 80:20 schemes seemed to have brought in a ray of hope to the realtors by indirectly provided funding options to the builders.

But with RBI's warning to the stakeholder of not getting into such agreements, this might again create a lull in the real estate market.

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- **Other articles on Housing Finance can be viewed at: http://vinodkothari.com/affordable_housing.htm**

[1] http://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=8402