International Journal of Computational Research and Development (IJCRD)
Impact Factor: 5.015, ISSN (Online): 2456 - 3137
(www.dvpublication.com) Volume 3, Issue 2, 2018

AN ANALYSIS OF THE MORTGAGE INTEREST RATES AND BORROWERS PREFERENCE WITH RESPECT TO SELECT HOUSING FINANCIAL INSTITUTIONS

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Cite This Article: Dr. Regis Arunodayam, Dominic Savio & K. Senthil Velan, "An Analysis of the Mortgage Interest Rates and Borrowers Preference with Respect to Select Housing Financial Institutions", International Journal of Computational Research and Development, Volume 3, Issue 2, Page Number 31-36, 2018.

Abstract:

Housing assumes significant importance. In terms of income multiplier, housing sector ranks fourth and is ahead of other sectors like transport and agriculture. The rapid growth in housing loan market has been supported by the growth in the middle class population, favourable demographic structure, rising job opportunities. The phenomena being witnessed in the stock market have led to time tested avenues of investment like real estate with significant appreciation over the years as a safer bet and a hedge against inflation. The present study aims to analyse the Mortgage Interest rates and Borrowers Preference with respect to select Housing Financial institutions. The Research design adopted is Descriptive research. Cross sectional research design was used in the descriptive research. Non Probability sampling procedure is adopted in the study. In total only 5 Major Public sector Financial Institutions and the Sample size was 300 borrowers have been chosen for the study. A Schedule was administered to 80 executives of Public Sector Housing Financial Institutions. The Choice criteria were based on the number of persons taking loans from the major financial Institutions which varied considerably. Secondary Data was collected from various Reports; Manuals, Journals and Reports of Public sector Bank and Public limited Housing companies. Statistical tools like Chi square tests were applied. It is found that Mortgage Interest rate was the deciding factor followed by the service charges which includes Processing fees. The paper concludes with the recommendations like competitive pricing in terms of lower interest rates and improving credit delivery mechanism which will enable the housing financial institutions to withstand competition.

Key Words: Mortgage Interest Rate, Borrowers Preference & Credit Delivery

Introduction:

Housing is a significant engine for growth and development of the Economy. The importance of housing sector as the 'engine of growth' has been historically acknowledged in most of the developed nations of the world. In India, the housing finance business has assumed significance during the last 5-7 years, spearheaded by the keen interest evinced by the commercial banks in this sector. The growth potential further gathered momentum through continued fiscal and monetary fillips and budgetary provisions. The burgeoning middle class, increasing purchasing power, changing demographics and increasing number of nuclear families, scaling down of the real estate prices and a softer interest rate regime and traditionally low default rate resulting in low nonperforming assets as compared with the other sectors also enabled the housing finance sector to grow at a phenomenal rate of around 39% on the average during the last 3 years.

It is quite indicative of the potential that exists if the proportion of investment in housing in other developed and emerging economies is considered. The proportion of investment in housing to the Gross Domestic Product (GDP) is 54 per cent in USA, 57 per cent in UK, 40 per cent in the European Union, 14 per cent in Thailand, 34 per cent in Malaysia and 4 per cent in China and 2.5% only in India depicted in Figure 1.1. Although there was no major incremental fiscal or budgetary incentives for housing in the Union Budgets, the Government appreciated the prominence of housing as one of the 'life time concerns' of the citizens

Justification of the Study:

With growing number of players and increased competition, the housing sector has become increasingly market-driven. The sector has offered good business opportunities for the lending agencies and attractive terms for the borrowers. Housing finance as a major business in the country, an increasingly large number of Prospects for home loans. Interest rate plays a prominent factor for borrowers in choosing the financial Institution. The present study aims to conduct and empirical investigations of the Mortgage Interest rates and Borrowers Preference with respect to select Housing Financial institutions

Mortgage Interest Rates:

Throughout the decade of the 1980s, Mortgage interest rates were stable, predominantly as a result of a closed economy. The ushering in of economic liberalisation in 1991 resulted in volatility in interest rates. The periods between 1994 and 1996 were characterised with an acute liquidity crunch in the economy with interest rates on housing loans peaking at 14 to 18 percent per annum. Till 1999, interest rates on home loans were at fixed rate. The year 2018 interest rates were around 8.70% to 9.00% on an average

Objectives of the Study:

Primary Objectives:

To analyse the Mortgage Interest rates and Borrowers Preference with respect to select Housing Financial institutions

Secondary Objectives:

- To Assess the Perception regarding the impact of mortgage interest rates of Housing Loan and Application of Housing loan Funds.
- To examine whether there is Association between the Borrowers Perception regarding Mortgage Interest rate and its Reasonability
- To Find the Preferences of Mortgage loan interest rate among the Borrowers belonging to different categories of Income

Hypothesis:

The following hypotheses are tested using several statistical tests

- There is association between perception regarding the impact of mortgage interest rates of housing loan and application of housing loan funds.
- There is association between mortgage interest rate reasonability and the different purposes for which housing loan is availed.
- There is association between preference for mortgage interest rate and educational qualification.

The study area covers 5 Major Public sector Housing Financial Institutions in Chennai City and the respective Borrowers of these Financial Institutions. The Institutions have been closer to make a comparative analysis of the performance of housing finance in a major mega city like Chennai dividing in areas and zones geographically. Major suppliers of housing finance in Public sector are involved in the study

Literature Review:

Supply of Housing:

Housing supply is produced using land, labour and various inputs such as electricity and building materials. The quantity of new supply is determined by the cost of these inputs, the price of the existing stock of houses, and the technology of production. For a typical single family dwelling, approximate percentage costs can be broken down as: acquisition costs 10%, site improvement costs 11%, labour costs 26%, materials costs 31%, finance costs 3%, administrative costs 15%, marketing costs. A production function such as Q = f(L, M, N) can be constructed in which Q is the quantity of houses produced, N is the amount of labour employed, L is the amount of land used, and M is the amount of other materials.

The long run price elasticity of supply is quite high. George Fallis estimates it as 8.2 (Fallis, G.1985), but in short run supply tends to be very price inelastic. Supply price elasticity depends on the elasticity of substitutions and supply restrictions. Other studies on Housing finance and lending to Borrowers asserts that Commercial banks which do not find low-income families viable or "bankable" [Remenyi, 2000: x-xvi]. Various approaches have been attempted - from the promulgation by banks of special and targeted credit programmes to active legislation which has attempted to curb the functioning of ICM suppliers [ADB 2000: 193-201, Germidis, 2000: 50-54, Vincent, 1995: 34-43 and Ghate 2000 69-41].

Considering the current state of affairs, there is a need for a supportive role on the part of the government and commercial banks and a streamlining developmental role on the part of the Financial Institutions [Germidis, 2000: 214-239]. Studies takes the approach of minimalistic credit' as opposed to credit plus' [Adams, 2000: 8-10]. The problems being faced in housing, infrastructure, credit, land and other sectors in urban areas of India are a result of shortcomings inherent in both the government and its various agencies, as well as the urban middle income groups themselves, who are the focus of this Research [Germidis, 2000:23-46, Remenyi, 2001: 8-13, ADB, 2000: 30-

Methodology of the Study:

The Research Methodology is summarized below. There are about 84 Financial Institutions of varying size in Chennai city offering loans for the purchase of houses/Flats Etc. Many of these financial Institutions are enjoying the support extended by the Government of India (GOI), RBI, NHB. In this context few Public sector Housing Financial institutions are identified and selected based on their Merit and performances. In total only 5 Major Financial Institutions and the borrowers have been chosen for the study. The Choice criteria were based on the number of persons taking loans from the major financial Institutions which varied considerably. The study area covers 5 Major Public sector Housing Financial Institutions in Chennai City and the respective Borrowers of these Financial Institutions. Borrowers belonging to various areas and zones geographically. The study covers period from 2014- to 2018 with 2014 as a base year.

Research Design:

Descriptive Research design is used in the study. The methods of data collection predominantly here is the observation method and through the interviews or questionnaires. Which is aptly used in the research.

Sampling Technique:

Non Probability sampling is adopted in this research.

Sampling Size:

The sample size (n) is determined using the following procedure which was suggested by Paul. E. Green, Donald S. Tull and Gerald Album (2000): The sample size is 300 Borrowers and 80 Borrowers from Executives of Housing Financial Institutions.

Sampling Unit:

In the present study the Housing loan borrowers (380) and the Lenders of Housing finance Public sector Housing Financial Institutions) are the units of study. The five Public sector Housing Financial Institutions are:

- HUDCO-Housing &Urban Development Corporation Ltd.
- LICHF-Life Insurance Corporation Housing Finance.
- BOBHF-Bank of Baroda Home Finance.
- SBIHF-State Bank of India Home Finance.
- IBHF-Indian Bank Housing Finance

Sampling Frame:

The sampling frame of the Public sector Housing Financial Institutions and the sample frame of beneficiaries for each of the financial Institutions are the fundamental units of the study, which form the primary data in addition to the Government documents, published materials in Journals from secondary data.

Tools Construction:

The Questionnaire is used an important tool to elicit borrowers perceptions of Mortgage finance with reference to Mortgage interest rates. There are two types of Questionnaires a structured questionnaire and a non structured Questionnaire. The present study utilizes structured questionnaire and a Schedule It contains definite, concrete and pre-ordained questions. Questionnaire administered to the borrowers is divided into 4 sections. A total of 28 questions are patterned and grouped

Secondary Data:

Secondary Data was collected from various Reports, Manuals, Journals, Training Materials published by International Organisations and central and state Governments. Annual Reports published by LICHF, HUDCO, SBIHF, BOBHF, IBHF and other institutions were also consulted and used. Establishing Reliability of the tool. Cronbach's Alpha (Cronbach, 1951). An alpha value of 0.7 or above is estimated.

Content Validity:

For the present study content validity was established through a panel of individuals. Consisting of -2 Academicians, 4 Mangers of Housing Finance lender, 10 Borrowers of Housing finance.

Data Analysis:

Distribution of Borrowers Perception on the impact of interest and Application of Housing Loans. There is no difference in the Perception regarding the impact of interest rates of Housing Loan and Application of Housing loan Funds among the Borrowers. The following Table analysis reveals Borrowers opinion on changing interest rates.

Table 1: Perception on changing Mortgage interest rates and availing of housing loans

Opinion on Changing Interest Rates	Positive	Neutral	Negative	Total
N of Borrowers	86	179	392	380 (100)

Source: Primary Data (Figures in Parenthesis represent percentages)

Table 1 indicates the Perception of the Borrowers regarding the changing interest rates and availing of loans. 179 Borrowers have a neutral opinion while 392 express that effect would be negative. 86 of the Borrowers feel that the effect would be positive and will not alter their decisions in availing Home loans. Chi square is done in order to check whether there is difference in the housing financial institution sanctioning loan to borrowers based on Annual income.

H0 : There is No difference in the Perception regarding the impact of Mortgage interest rates of Housing Loan among the Borrowers with different Application of Housing loan Funds.

H1: There is difference in the Perception regarding the impact of Mortgage interest rates of Housing Loan among the Borrowers with different Application of Housing Loan funds.

Table 2: Chi –Square Analysis of Borrowers perception regarding the impact of Interest rates of Housing Loan and Application of Housing Loan funds

Mean	2.54	2.32	2.91	2.1	2.01
Chi	14.45				
DOF	8(3-1)(5-1)				
Table Value	12.65				
Significance	S				

Source: Primary Data

Inference:

The calculated Chi-square value is greater than the table value 12.56. It is in favour of Alternate Hypothesis. It is concluded that there is difference in opinion of the borrowers of Housing finance, regarding the impact of changing interest rates.

Distribution of Interest Rate Charged and it's Reasonability:

Based on the analysis it is found that majority of the respondents feel that the interest rate is reasonable, while the rest is not reasonable and can be less. The following table illustrates the opinion of the Borrowers regarding interest rate and its reasonability. Chi square analysis is done in order to check whether there is significant difference in the reasonability of interest rates among the Borrowers based on different purposes for which Housing loan is availed.

H 0: There is no association between borrowers perception regarding mortgage interest rate and its reasonability and the different purposes for which housing loan is used.

H 1: There is association between borrowers perception regarding mortgage interest rate and its reasonability and the different purposes for which housing loan is used.

Table 3: Chi square analysis of the borrowers opinion regarding mortgage interest rates and its reasonability based on different purposes for which housing loan is availed

Chi	8.45
DOF	4
Table value	7.2
Significance	S

Source: Primary Data

Inference:

It is concluded that there is difference in opinion in the borrowers application of funds and reasonability of mortgage interest rates. When asked for the suggestions, a number of borrowers have expressed that rate of interest of 5% -6% can be reasonable.

Distribution of Parameters Like Restriction of the Loan Amount Versus Higher Interest Rates:

Based on the study it was found that one of the reason for restricting the borrowed loan amount even though the required amount to the respondent was more. The choice in the study was high rate of interest for higher loan." The table 4 below gives details.

Table 4: Distribution of respondents on preference for low rate of mortgage interest on high loans sanctioned

Opinion on Rate of interest to be lowered on Higher loans availed

	Opinion on Rate of interest to be lowered on Higher loans availed	
Institution	Yes	No
	Borrowers in Nos	Borrowers in Nos
LICHFL	156	4
HUDCO	72	4
SBIHF	14	5
BOBHF	99	3
IBHF	22	1
	363	17

Source: Primary Data

The above table reveals the feelings of the Borrowers. Higher amounts of loan would have been procured if Interest rate was less. But they have restricted this due to the increasing rate of interest on the increasing loan amount, which is practiced with all Housing Finance Institutions. Borrowers feel that this is direct proportion could affect their repayment of loan amount. They prefer the Housing Finance Institutions to adopt the indirect proportion of interest rates ie when the loan is high the rate of interest should be less. Nearly majority of Borrowers of LICHF, feel that interest rate has to be reduced for higher loan amount. This is policy matter. In other countries mostly developing countries such indirect proportions are followed. To develop housing and to meet the housing shortages indirect proportion will be a more suitable solution.

Distribution of Interest Rates Vis - A Vis Loan Amount:

A Question on the preferences for more loan amount if the lower rate of interest is offered was placed before the Borrowers. Many interesting replies were given. Table given below explains the parameter.

Table 5: Distribution of mortgage interest rates vis- a vis loan amount

Options	Borrowers (in nos)
Yes	274
No	106
Total	380

Source: Primary Data

The above table 5indicates the options of the Borrowers for more loan amount if the rate of interest is low. It is found that majority of the beneficiaries demand to reduce the rate of interest further. The past experience shows that there has been a gradual decline in the interest rate of all the Housing Finance Institutions.

Findings of the Study:

- An interesting finding of the study is that mostly the middle and high income group of people seek loan from housing finance institutions for construction Purchase of house.
- Of the total individual loans, for low and lower middle income group of borrowers rate of Mortgage interest was the most dominant and highest determinant of their choice of housing finance company whereas for upper middle and high income groups, ease of securing loan which ranked first, was the most important determinant of their choice of housing finance company
- It is concluded that there is significant difference in opinion of the borrowers of Housing finance, regarding the impact of changing interest rates. A considerable proportion of the Borrowers feel that it has a negative impact.
- Majority of Borrowers are satisfied with the interest rates charged by Housing Finance Institutions. When asked for the suggestions, a sizable number of Borrowers have expressed that rate of interest of 5% -6% can be reasonable . There is no significant difference in the Application of the housing loan and Reasonability of Interest rates.
- The feelings of the Borrowers. They could have taken more loans if Mortgage Interest rate was less. But they have restricted this due to the increasing rate of interest on the increasing loan amount, which is practiced with all Housing Finance companies

  The opinion of the Borrowers for more loan amount if the rate of interest is low. It is found that90% of the beneficiaries demand to reduce the rate of Mortgage interest further. Past experience shows that there has been a gradual decline in the interest rate of all the Housing Finance Institutions.

Recommendations:

- The Interest rate of Housing Finance is the most important factor in deciding the level of finance required especially in cities like Chennai. The concept of “Less is More” needs to be adopted. Though the Mortgage interest rate on Housing Finance is dropping day by day, it is suggested that the policy makers should consider the Global scenario with respect to the interest of housing loan and to fix the rate of interest as low as 5%. All other hidden administrative costs should be absorbed as part of the Interest. So that the borrower is not duped by the arithmetical gimmics of the financial Institutions. The interest should also reflect the risk levels involved.
- Willingness to pay is directly linked to the levels of income and hence the repayment method needs a scrutiny. Both the Fixed Rate and the Floating rate has to be encouraged.. The Floating rate is a better choice as this would help the borrowers to adopt better options.

Conclusion:

The Public sector Housing Financial Institutions have played a major role since a decade and have been responsible to access mortgage finance over the years. Due to changing policy of the state on housing and housing finance the interest rates have dropped ever since the trend seems to follow to encourage housing activity in general but there is lag in operations by Public sector Housing financial institutions, when compared to the private Housing financial Institutions. From the analysis, the researcher comes to the conclusion that all home loan borrowers have more or less the same perception about the Public sector housing finance Institutions and the loan provided by them. The impact of mortgage interest rates in availing housing loan has a significant effect on the borrowers

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