

High home prices: The problem and the solution



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Housing in cities like Mumbai is very expensive. Some other cities like Gurugram are also becoming expensive. These cities are more expensive compared to other cities. But even if we take housing on average in an Indian city with reasonable livelihood opportunities, the prices are high; this is particularly true, given the size and quality of homes, and the surroundings, facilities and amenities available.

Why are home prices high in urban India? And, what can be done to

reduce these prices? Does a solution exist at all? Yes, it does but let us first diagnose the problem. The complete story is long but a shorter and simplified version is presented here. This article is based on Singh (2024); see also the references therein.

Diagnosing the problem

It will help to abstract from taxes here, which is not to say that these are not important. Then the price of a home consists of, broadly speaking, the price of construction and the price of land in the city. The price of construction at least in low-rise buildings does not increase too much on a regular basis over time compared to the general inflation in the economy. It is the price of land that has been rising faster than the general inflation in the economy. This is the main reason for high and rising home prices.

It is true that the cost of construction has been going up with the rising number of floors in buildings in some cities. However, the rise in the number of floors is itself usually due to the high price of land. So, we are back to the high price of land.

The price of land is, like any other price, a matter of both demand and supply. It is true that the demand for land in cities has been rising due to various factors like rising population, demand backed by black money, and so on. But note that many of these demand-side factors apply to just about all goods and services. For example, the demand for mobile phones or clothing is also rising for similar reasons. And, yet their prices, after adjusting for general inflation, are not rising much, if at all. In fact, some inflation-adjusted prices are even falling. This is because supply of most goods and services rises to meet the demand. But this is not the case with the supply of land for the urban economy.

There is actually no shortage of *physical* land in India for the purpose of urbanisation, and real estate development! Why then? Consider land use in the country. Suppose that there is some optimal quantity of land for urban India,

which is actually not very much. But only a fraction of even this rather small requirement is actually met. This can be due to reasons like outdated planning of land use, some laws, vested interests, and issues of mindset. In any case, the policy on land use has serious implications.

If the supply of land for the urban economy is mainly determined by government policies, then we do not have true market prices for land. Such prices of land can be very high in cities relative to the intrinsic worth of land in alternative uses such as agriculture in rural India; there is a massive gap.

Closely related, there is another important fault in policies. Though the government is spending heavily on infrastructure, this is mainly on highways, etc. To some extent, it is spent on improving and extending the infrastructure in the existing big cities. But expanding the existing big cities is very messy and very costly. On the other hand, there is hardly any public spending on developing new cities or extending existing small cities meaningfully. We can treat such extensions of small cities as new cities.

It is true that the government is spending on the *Smart Cities Mission* but this mission is mainly targeted at improving quality; it is hardly about increasing the quantity. There is a need to build new cities, and increase supply of homes (and workplaces).

Not only is the government itself not spending much on developing new cities and providing infrastructure, there is hardly any clear and explicit policy that enables the real estate developers or other such companies to provide such infrastructure. Of course, a precondition is that the government, in consultation with experts and stakeholders, identifies a new area, and creates a master plan for each new city. The companies can provide the infrastructure and charge the buyers of properties in the new area; the cost per buyer is not very much. This can be an alternative way to expand the infrastructure for the new cities but this is also not happening.

To some extent now and then the government takes the initiative to develop some cities but the success is limited. Not many people move and stay there. Why? The real estate companies are often not enabled to participate meaningfully in the development of the new cities and so the marketing is a serious issue, even if the layout, engineering and financial sides are handled well. Though marketing is important in any business, it has a special role in the development of new cities.

To see this, consider a simplified picture. One family would like to shift, if another family is willing to shift. Similarly, a family would like to shift if a business sets up "shop" there, and a business will provide goods and services if people actually live there. There is a need for "coordination" between one home buyer and another home buyer and between home buyers and businesses, which is what the real estate developers (not builders) do.

Will people shift to new cities? Yes, many will. This is because in such places the property prices are low and affordable, homes are more spacious, and there are

prospects of higher appreciation rate than in the existing cities, which are anyway not affordable. Also, many people in the existing big cities do not have good fulltime occupations, and decent incomes. As a new city develops and is sustained, there are opportunities. These too can attract many people. But hardly any new cities are, in practice, coming up meaningfully.

Given that the approved land with physical infrastructure and a livable eco-system for new cities is limited, it is not surprising that the price of land in the existing cities is high. Also, note at this stage that the development of new cities itself can be an engine of higher economic growth and employment. But this is also not happening. And, given that new cities are not coming up, this itself limits the livelihood opportunities, and cheaper and decent housing in the cities. This brings us to a very important part of the whole story.

Farmers in the rural economy are reluctant to sell their land and make it available for urbanisation and real estate development. This is because they are worried about alternative occupation, livelihood, social circle, and affordable housing. And so, they and their representatives insist that the Land Acquisition Act, 2013 should not get diluted. This adds to the difficulties in setting up the new cities. What to do about this, and the other several difficulties considered above?

The policy solution

A long-term problem requires a long-term solution. The housing problem at present is serious enough that the government needs to make housing a priority, just as, say, the Green Revolution once became a priority for the nation. And, it is important that we do not begin by amending the Land Acquisition Act, 2013 which is anyway very difficult, if not impossible. Also, it is important not to build new cities with public money and state capacity, both of which are limited. We need instead enabling public policy.

Enabling public policy means that the government takes the initiative, it consults, plans, identifies an area for a new city, and provides a policy framework under which real estate developers, and companies in the business of providing infrastructure can build, carry out the “marketing”, and charge the buyers each of whom will need to pay a small amount for the general infrastructure because the costs get spread out. This is not to say that the government does not need to spend at all. But this spending can be minimal, given the enabling policy.

Developing new cities is relatively easier at present than it was some years ago. This is for two reasons. First, the Real Estate Regulation and Development Act (RERA), 2016 has come in. This keeps some check on real estate developers. Second, given that many good highways have come up already, it is relatively easier to develop new cities “on the way”. Good highway connectivity is already in place on many long routes.

Let us consider finance now. At present, there are, in some ways, restrictions on or difficulties in lending by banks and other financial institutions for the purpose of basic real estate development. There is a need to revisit such regulations. Banks should be allowed to, *but not forced to*, lend more liberally for various real estate and infrastructure projects. This can pave the way for the co-existence of the two models - ‘sell and build’ and ‘build and sell’. At present, basic real estate development is often relying on the ‘sell and build’ model under which the risk (and the expected returns) are higher for the buyers. This limits real estate development to some extent. This needs to change.

The government, departmental undertakings like the railways, and the public sector companies hold a large quantity of land that they do not really land. They should sell this gradually. Given the vision to build new cities, the plans, the policy framework, and the initiation, the public authorities can move to some relaxation in the Land Acquisition Act, 2013. The farmers and their representatives have, *in this context*, an assurance that there is some possible, even if preliminary and imperfect, answer to the questions of farmers like, “where will we go? What will we do?” There is relatively more realism in terms of decent and affordable housing, livelihood, etc. in the new cities. This is over and above the decent compensation for farmers for the sale of land.

Much of the discussion above is about developing new cities. This is indeed the main focus but there is also a need to liberalise and make it easier for builders and landowners to build what is anyway supposed to be permissible within the existing cities.

Once the supply expands on a large scale, home prices, adjusted for general inflation, will stop rising significantly except for some locations; they may even fall. There is then much less of an incentive to have vacant properties. This too adds to the effective supply of homes in the market.

The conditions in slums and even in unauthorised constructions in the existing cities are bad. It is not just housing that is difficult, the incomes and the quality of employment and occupations too are low. As the new cities develop, there can be improvements in two ways in this context. Housing can improve, and occupations and incomes can be better as the new cities need labour, and managers. There can be a voluntary movement out of the slums, and unauthorised constructions, in the existing cities.

Of course, all this will happen in a phased manner and with possible hiccups.

In conclusion, the home prices are high in urban India mainly for policy reasons. We need to think out of the box. More specifically, we need to think beyond the existing big cities. There is a need for new cities. And, a major change in policy can make this possible.

Reference

- ¹ Singh, Gurbachan, 2024, The high price of land: The problem and the solution, Working Paper, presented at NIPFP (Delhi), CSEP (Delhi) and King's India Institute, King's College (London), p. 1-40.