



A STUDY OF BEHAVIOURAL FINANCE WITH RESPECT TO INVESTORS IN THE CONTEXT OF HOUSING FINANCE

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Abstract:

The Field of Behavioural finance investigates the cognitive factors that impact the decision making process of Investors of housing finance. This paper highlights general aspects of behavioural finance in the context of housing finance. There has been considerable debates on the role played by Behavioural finance in the Housing Market. Housing assumes significant importance. In terms of income multiplier, housing sector ranks fourth and is ahead of other sectors like transport and agriculture. 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 study the financial behaviour of investors in the context of housing finance

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 5 Major Public sector Financial Institutions and the Sample size was 300 Investors 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 was applied.

It is found that housing investors do not always adhere to rationality and are influenced by emotions. The paper concludes with the recommendations like loss aversion behaviour in terms of competitive pricing in terms of lower interest rates and improving credit delivery mechanism which will enable the housing financial institutions to withstand competition. This paper will form the basis of more advanced research in the field of behavioural finance with reference to Housing finance

Key Words: Behavioural Finance, Housing Finance & Investor Behaviour

Introduction:

Housing Boom is to a certain extent considered speculative, because of the high prices created largely by investors enthusiasm. There is a certain element of herd mentality especially with reference to fear of increasing interest rates. Since 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 decade 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.

Justification of the Study:

In the past few years, the housing finance industry has been experiencing, in some measure, the process of integration with the capital market through the securitization route. This integration has established functional links between savers, home loan Investors, financiers and capital market investors in different regions and different components of the population. With growing number of players and increased competition, the housing sector has become increasingly market-driven. The present study aims to conduct an empirical investigation on the impact of Behavioural finance on investors with specific reference to its impact on interest rates on availing of Housing finance and on the various Housing finance Parameters in the context of Behavioural Finance

Objectives of the Study:

Primary Objectives:

- To study the impact of behavioural finance on availing of Housing finance

Secondary Objectives:

- To Study the Association between various Housing finance Parameters among the Investors of select Housing Financial Institutions.

Hypothesis:

The following hypotheses are tested using several statistical tests (Chi-Square, ANOVA, t test, etc.) to test if there is any significant difference in the different categories of Investors in their perception of Housing Finance.

- There is no Association between impact of behavioural finance on the Perception regarding Housing Loan and Application of Housing loan Funds.

- There is no Association between the impact of Behavioural finance on the Perception regarding Interest rate and its Reasonability

The study area covers 5 Major Public sector Housing Financial Institutions in city of Chennai.

Literature Review:

Evidences from Real Estate Market:

Researches focused on judgment and decisions in the property and Real estate markets from perspective of human behaviours (Gallimore, 2004). Identifying biases in the property buying behaviour, differences in information processing, which is suggested as one the potential reasons for valuation inaccuracies (Brown, 1992). According to Black (1997) when sales were concluded, sales price anchoring bias evident. Galimore and Gary (2002) examined the investors sentiments in Housing decision making

Some authors have argued Psychology rather than fundamentals play a key role in explaining how expectations are set for future price appreciations: Case and Shiller (2004). Shiller cites the survey evidence that supports his conclusion that "A psychological theory, that represents the boom as taking place because of a feedback mechanism or social epidemic that encourages a view of housing as an important investment opportunity, fits the evidence better." (than "...fundamentals such as rents or constructions costs)

Brunnermeier and Julliard (200&0 argue when inflation falls, home owners take advance of low nominal interest rates without recognizing that future appreciation rates of prices and rents to fall commensurately.

Genesove and Mayer (2001) the most direct evidence on the importance of Psychology in the housing markets more caused on loss aversion in downturns,

Human Behavioural Theories:

To explain an irrational investor, major Human Behaviour theories include:

- Prospect Theory-Tversky and Kanheman (1979) describes how people manage risk and uncertainty. Emphasis is on the framing effect;
- Judgment under uncertainty – it summarizes how beliefs are formed under uncertainty. Overconfidence-Alpert and Raiffe (1982) –it describes how people overestimate their precision of the knowledge and the ability to do well. Fear of Regret: Linked with this is the fear of cognitive dissonance, based on the idea that their beliefs have been wrong (shiller 1995
- Anchoring and Adjustment: people make judgments under uncertainty use this heuristic by starting with an anchor or (reference point and then adjust in to reach a conclusion.

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 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. 5 Major Financial Institutions and the Investors 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.

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.

Sampling Technique:

Non Probability sampling is adopted in this research.

Sampling Size:

The sample size is 300 Investors and 80 Investors from Executives of Housing Financial Institutions.

Sampling Unit:

Five Public sector Housing Financial Institutions were chosen:

Primary and Secondary Data:

For Primary data Questionnaire was used. Secondary Data was collected from various Reports, Manuals, Journals, Training Materials published by International Organizations and central and state Governments. Annual Reports published by housing finance.

Data Analysis:

Behavioural finance relating to the impact of interest and Application of Housing Loans. The following Table analysis reveals Investors opinion on changing interest rates.

Table 1: Impact of interest rates and availing of housing loans

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

Source: Primary Data (Figures in Parenthesis represent percentages)

179 Investors have a neutral opinion while 392 express that effect would be negative. 86 of the Investors 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 Investors based on Annual income.

H₀: There is No difference regarding the Impact of interest rates among different investors with respect to Application of Housing loan Funds.

H₁: There is difference regarding the Impact of interest rates among different investors with respect to Application of Housing loan Funds.

Table 2: Chi –Square Analysis Behaviour finance of Investors 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 Investors 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 Investors 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 Investors based on different purposes for which Housing loan is availed.

H₀: There is No Association between Investors Perception regarding Interest rate and its Reasonability and the different purposes for which Housing loan is used.

H₁: There is Association between Investors Perception regarding Interest rate and its Reasonability and the different purposes for which housing loan is used.

Table 3: Chi square analysis of the Investors opinion regarding Interest Rates and its Reasonability based on different Purposes for which Housing

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 Investors application of funds and reasonability of Interest rates. When asked for the suggestions, a number of Investors 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 Interest on High Loans sanctioned Opinion on Rate of interest to be lowered on higher loans availed

Institution	Opinion on Rate of Interest to be Lowered on Higher Loans Availed	
	Yes	No
	Investors in Nos	Investors in Nos
LICHFL	156	4
HUDCO	72	4
SBIHF	14	5

BOBHF	99	3
IBHF	22	1
	363	17

Source: Primary Data

Investors 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

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 Investors. Many interesting replies were given. Table given below explains the parameter.

Table 5: Distribution of Interest Rates Vis- A Vis Loan Amount

S.No	Options	Investors(in Nos)
1	Yes	274
2	No	106
	Total	380

Source: Primary Data

The above table 5 indicates the options of the Investors 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:

- Based on theories of Behavioural finance affecting the investor behavior it is concluded that there is significant difference in opinion of the Investors of Housing finance, regarding the impact of changing interest rates. A considerable proportion of the Investors feel that it has a negative impact.
- Behavioural finance also holds well on its impact on a Majority of Investors who is satisfied with the interest rates charged by Housing Finance Institutions. When asked for the suggestions, a sizable number of Investors have expressed that rate of interest of 5% -6% can be reasonable.
- Sales price anchoring was also evident, during the choice of financial Institution
- Cognitive Behavioural Bias was evident during the choice of Housing financial institutions.
- The feelings of the Investors. They could have taken more loan if Interest rate was less. Investors have restricted loan amounts due to the increasing rate of interest on the increasing loan amount, which is practiced with all Housing Finance companies

Recommendations:

- Investor sentiments play a significant impact in property investment decisions. 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 Investors to adopt better options.
- The Interest rate is the most important factor in deciding the level of finance. The concept of “Less is More” needs to be adopted. The findings indicate that the investors did not follow any systematic process in selecting the comparable properties based on interest rate. There was confirmation bias
- Investment decision making which had perceptions of the sentiments of the investors, were either rational or irrational.
- Loss aversion behaviour was evident with investors. Competitive pricing in terms of lower interest rates and improving credit delivery mechanism which will enable the housing financial institutions to withstand competition.

Conclusion:

The results presents the magnitude of rational and behavioral effects in explaining housing finance preferences of investors. The Public sector Housing Financial Institutions have played a major role since a decade and have been responsible for providing Housing s finance over the years. From the analysis, the researcher comes to the conclusion that the impact of Behavioural finance has an impact on the interest rates in availing housing loan and also on the various Housing Parameters, which has an effect on the investors.

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