Indian Mortgage Finance Market Update for 9M, 2014-15

Performance Review of Housing Finance Companies and Industry Outlook

ICRA RESEARCH SERVICES

Financial Sector Ratings

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Executive Summary

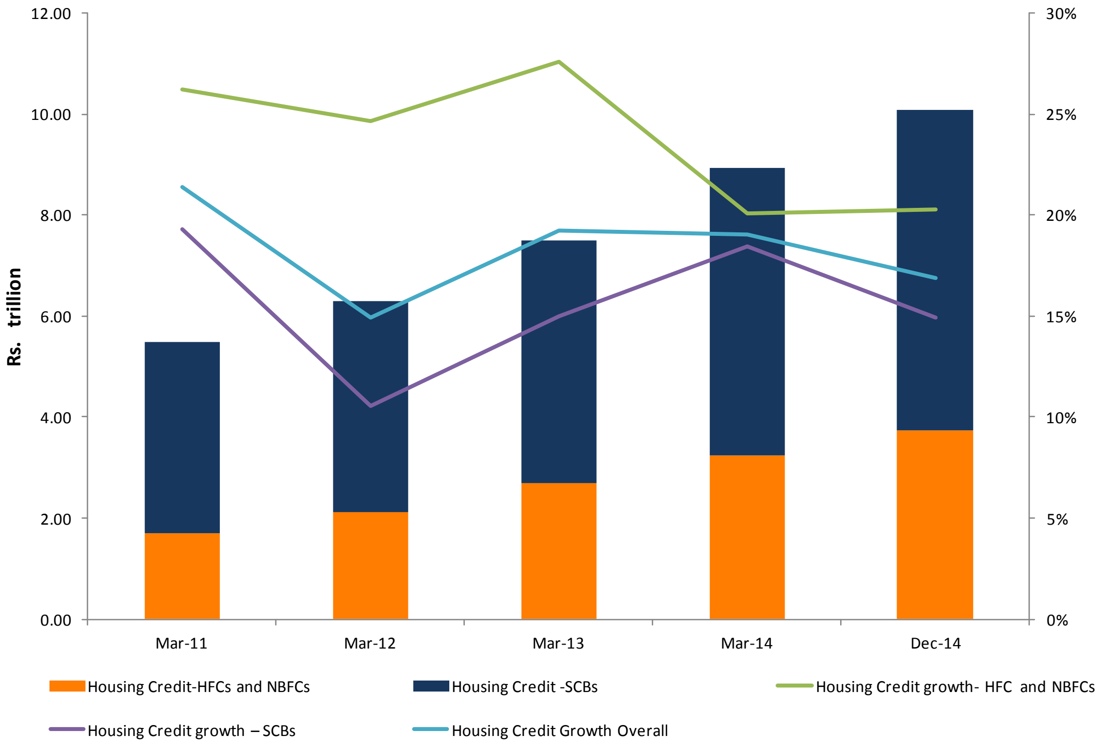
KEY HIGHLIGHTS

- The Indian housing finance market has crossed the Rs. 10 trillion mark as on December 31, 2014, indicating a steady growth of 17% (annualised) for 9MFY15
- While the market continues to be dominated by the five large groups accounting for 60% of the total housing credit in India as of December 31, 2014, emergence of a number of new HFCs in niche segments like affordable housing and self-employed customer segments, which have been growing at a faster pace(> 50% in 9MFY15)
- Governments focus on affordable housing , favourable regulations could push overall housing credit growth to 20-22% FY16 onwards , which could lead to improved mortgage penetration from current levels of 8.2%
- Investor sentiment for the housing sector has also improved as reflected by the recent capital infusions to the tune of Rs. 17.8 billion in various HFCs in FY15, and they are expected to report gearing levels of 7.5-8.0 times by March 31, 2015. In ICRA's estimates, HFCs will need external capital of around Rs. 180-280 billion to grow at 20-22% over the next 5 years, assuming an internal capital generation of 16% while maintaining the capitalisation levels at current levels
- HFCs have been able to maintain their asset quality (Gross NPA% of 0.74% as on December 31, 2014) Going forward ICRA expects Gross NPA% to remain range bound between 0.7-1.1 %
- Stable profitability indicators for the HFCs (ROA of 2.1% and ROE of 18.8% for Q3FY15). As per ICRA's estimates, HFCs would generate good returns (16-18% ROE) owing to reasonable growth expectations, stable/softening interest rate environment and stable asset quality

The Indian housing finance market has crossed the Rs. 10 trillion mark as on December 31, 2014, indicating a steady growth of 17% (annualised) for 9MFY15. Of this Rs. 10 trillion housing loan book, Rs. 6.3 trillion loans is with the banking sector and the balance Rs 3.7 trillion with HFCs/NBFCs. While the market continues to be dominated by the five large groups namely SBI Group, HDFC Group, LIC Housing Finance, ICICI Group and Axis Bank, accounting for 60% of the total housing credit in India as of December 31, 2014, there has been an emergence of a number of new HFCs in niche segments like affordable housing and self-employed customer segments, which have been growing at a faster pace (higher than 50% for the nine months slowly gaining market share.

Though mortgage finance penetration levels in India have been increasing consistently, (8.24% as on December 31, 2014) they still remain low vis-à-vis developed countries. Given that there is a large proportion of population which is still underserved by the traditional financial institutions, there is still untapped potential for growth especially in certain segments like affordable housing. To promote growth in the affordable housing segment, while on the supply side, various state governments have introduced initiatives to encourage builders/developers to launch projects in the affordable housing space, on the financing side, relaxation of regulations for the affordable housing sector such as higher LTVs(such as inclusion of stamp duty charges etc for calculation of LTV) , and lower interest rates (through RHF,UHF), long term bonds for affordable housing with relaxations on CRR/SLR requirements could improve the fund flow to the segment. Further, with GOIs new capital infusion criteria and the large capital requirements for banks, banks could be keen on growing the low risk weight home loan segment. Also, improvement in the operating environment could lead to an increase in new project launches and some improvement in the pace of under construction projects leading to higher pace of growth in the medium term which coupled with a favourable demographic profile, could lead to higher 20-22% credit growth for housing FY16 onwards vis-à-vis 17-19% growth witnessed over the last three years. Therefore higher growth in underserved segments as well as improved operating environment could push mortgage penetration to double digits over the next three years.

Chart- Housing Credit and Growth for various players



Source: Financials of Various HFCs, RBI and ICRA Analysis

Investor sentiment for the housing sector has also improved as reflected by the recent capital infusions to the tune of Rs. 17.8 billion in various HFCs in 2014-15, with some more capital infusions expected over the next quarter HFCs and they are expected to report gearing levels of 7.5-8.0 times by March 31, 2015. In ICRA estimates, HFCs will need external capital of around Rs. 180-280 billion to grow at 20-22% over the next 5 years, assuming an internal capital generation of 16% while maintaining the capitalisation levels at current levels. Part of this capital could also be in the form of mortgage guarantee.

As for the funding mix, the HFCs have a diversified funding base with the larger players being more active in the debt market and their smaller counterparts relying more on bank funding and NHB refinance. As per ICRA's estimates almost 40-45% of the HFC borrowings were at fixed rates of interest which could pose an interest rate risk for these players in a declining interest rate scenario. However, the risk is somewhat mitigated by the fact that these borrowings are not very long dated (average maturity of around 3-5 years) and/or have reset clauses, thus giving the HFC's some flexibility to reset the rates. At the same time, given the limited sources of long term funds to match the tenure of home loans (average maturity of 8-10 years including prepayments), asset liability management continues to remain a challenge for HFCs.

So far the HFCs have been able to maintain their asset quality (Gross NPA% of 0.74% as on December 31, 2014) despite the stress in the operating environment. However, given the increased focus of some of the players on products (like LAP and builder loans) and/or change in the borrower profile towards the self-employed and low-income segment (where income streams could be more volatile), the riskiness associated with HFC's loan book could increase leading to an increase in the gross NPA%. Nevertheless, the strong monitoring and control processes, borrowers' own equity in the property and the large proportion of borrowers staying in self-occupied property could reduce the impact of the above mentioned concerns on asset quality to an extent. Overall the Gross NPA% for HFCs is expected to remain range bound between 0.7% - 1.1% over the medium term.

As for the key performance indicators, the HFCs have seen a 9 bps moderation in cost of funds in Q3FY15, which has led to a marginal improvement in net interest margins. However, this has been partly offset by the increase in operating costs (including credit costs) and tax expenses resulting in stable profitability indicators for the HFCs (ROA of 2.1% and ROE of 18.8% for Q3FY15). Overall, as per ICRA's estimates, HFCs would generate good returns (ROE of 16-18%) for FY15 owing to reasonable growth expectations, stable/softening interest rate environment and superior asset quality.

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