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Industry Outlook and Performance Review of Housing Finance Companies and the Indian Mortgage Finance Market for 2010-11

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The Indian mortgage finance market, which accounts for around 7% (cumulative) of GDP, has been able to maintain a steady growth rate while keeping asset quality under control despite some headwinds in the operating environment. However, going forward, the changing attitude of borrowers towards debt, relatively high property prices, tight liquidity position of builders, rising interest rates, increasing competitive intensity, and regulatory tightening pose new challenges for the sector. The intensity of competition in the housing finance industry has been particularly high post Q32008-09 —a period that has seen various players introducing teaser home loans as well as loans with higher loan-to-value (LTV) ratios in a bid to revive the market. Such schemes have increased the vulnerability of the loan book, although their impact on asset quality has been limited so far. Also, the tighter regulations brought in subsequently (Maximum LTV at 80-90%, higher risk weights for larger ticket/higher LTV loans, and additional provisioning for teaser loans) could protect the lenders from the higher risks involved. As for the interest rate risk residing in the portfolios of lenders, while the same is currently low, given that the lenders' credit book consists predominantly of floating rate loans, a further increase in interest rates (which would lead to a rise in equated monthly instalments, or EMIs) could pose asset quality challenges, which in turn could limit the capacity of lenders to raise interest rates, thereby diminishing their interest spreads. As for growth, although a rise in interest rates could reduce the demand for fresh loans and push up prepayments, higher ticket sizes (because of higher property prices) and increased income levels could support a 15-18% growth of the Indian mortgage market in 2011-12.

This note attempts to capture the emerging trends in the Indian mortgage market, besides presenting an update on the performance of housing finance companies (HFCs) during 2010-11.

An Overview of the Mortgage Finance Market

Growth moderate in 2010-11, likely to remain muted in 2011-12

The rate of credit growth in the Indian mortgage finance market was around 18% in 2010-11 (as against 11% in the previous fiscal), with the enabling factors including a stable operating environment, buoyant property prices, and the continuance of attractive interest rate schemes (with teaser rates) offered by both banks and HFCs for sometime in 2010-11 (till the Reserve Bank of India, or RBI, increased the provisioning requirement on these loans in November 2010 from 0.4% to 2%). Although most players discontinued the teaser rate scheme by December 2010, State Bank of India (SBI) withdrew the scheme later, in April 2011. Going forward, two of the main factors that could lead to lower portfolio growth in 2011-12 as compared with the previous two financial years are high property prices and increasing interest rates, both of which affect borrowers' affordability adversely.

Chart 1: Trend in Domestic Housing Credit

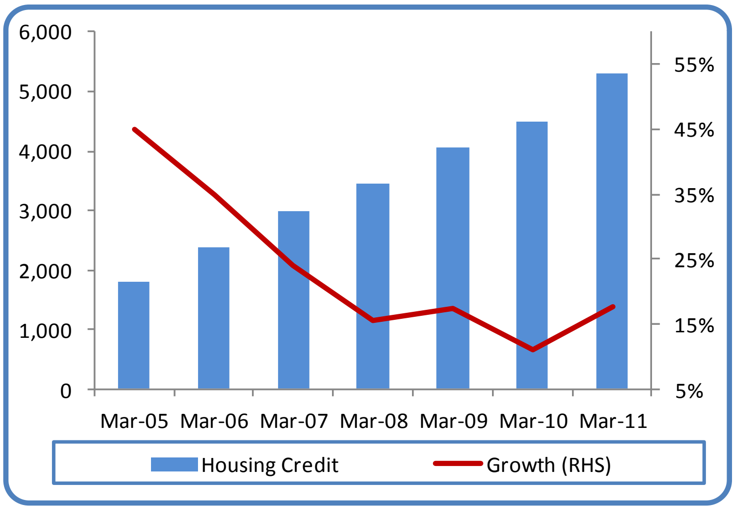
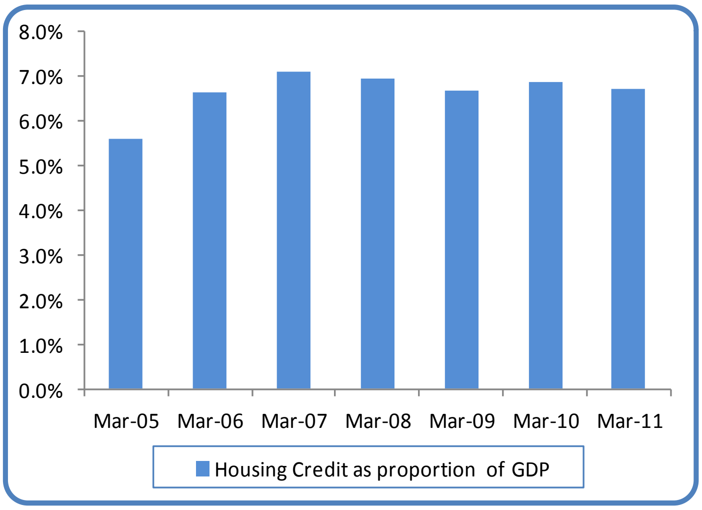


Chart 2: Housing Credit as a Percentage of GDP



Source: RBI, Annual Reports of mortgage lenders, and ICRA's estimates

Mortgage penetration levels (mortgage loans [1]as a percentage of GDP) in India, which had risen from around 2% as in March 2002 to a little over 7% (cumulative) as in March 2007, have remained at the 7% levels till date. This figure is however significantly lower than the penetration rates in developed countries, and being so it appears to point to a significant scope for further growth in future. Some factors that could be driving such future growth in mortgage penetration in the domestic market over the long term are:

- Viewing of property as a savings or investment vehicle
- Tax incentives on home loans for both principal and interest repayment
- Favourable demographics, with India having a large proportion of its population below the age of 30 years
- Changing social scenario (increasing rate of urbanisation and number of nuclear families)
- Increase in supply of affordable homes and expectations of price increase in the residential real estate market
- Large inventory of unleveraged homes (which could be pledged by borrowers to raise loans against property)

[1] This category includes only individual home loans (as per Annual Reports of various HFCs); it does not include loans given to builders, refinance loans, and loans against property.

The long-term drivers notwithstanding, there are a few factors that could also slow down the rate of increase in mortgage penetration in the near term, including:

- Increasing interest rates
- Political uncertainties and/or uncertainties relating to land-acquisition policy
- Difficult operating environment may lead to lower income growth vis-a-vis expenses impacting affordability for the borrowers

Bank's share of the housing loan market remains large while HFCs continue to grow

According to ICRA's estimates, the total housing credit outstanding in India as on March 31, 2011 was over Rs. 5,292 billion as against Rs. 4,499 billion as on March 31, 2010, indicating growth of 18%. The housing loan portfolios of HFCs as a whole reported a growth of 24% during 2010-11—higher than the 15% growth reported by scheduled commercial banks (SCBs). The share of HFCs in the mortgage market has been growing. Going forward, HFCs may be able to maintain their market share on the strength of their focused approach, targeting of special customer segments, relatively superior customer service, and significant growth plans (in the case of some of the new HFCs). However, banks are also likely to be able to maintain a sizeable share of the market, considering their extensive network and broad customer base, access to stable low-cost funds, and their mandatory compulsion to meet priority sector lending targets.

Table 1: Break-up of Home Loan Portfolio among HFCs and Banks[2]

	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Jun-11[3]
HFC	468	598	734	912	1,105	1,332	1,649	1,730
Bank	1,343	1,791	2,245	2,529	2,941	3,168	3,643	3,766
Housing Credit	1,811	2,389	2,979	3,441	4,046	4,499	5,292	5,496
Credit Growth—HFCs	32%	28%	23%	24%	21%	21%	24%	5%
Credit growth—SCBs	50%	33%	25%	13%	16%	8%	15%	3%
Growth	45%	35%	24%	16%	18%	11%	18%	4%
Share								
HFC	26%	25%	25%	27%	27%	30%	31%	31%
Bank	74%	75%	75%	73%	73%	70%	69%	69%
Total	100%	100%	100%	100%	100%	100%	100%	100%

Note: Amounts in Rs. billion
SCB: Scheduled Commercial Banks
Source: RBI, financial results of mortgage lenders, and ICRA's estimates

[2] *For the years 2005-2008, the data for SCBs has been taken, after suitable adjustments, from the RBI-published "Trends and Progress of Banking in India", and for the balance years from "Sectoral Deployment of Bank Credit", also an RBI publication, after suitable adjustments.(as this data is published on a monthly basis by RBI). In the note published by ICRA earlier in June-10, the figures for banks' housing portfolio were taken from Trends and Progress of India/Macroeconomic and Monetary Developments published by RBI*

[3] *Growth over March 31, 2011 levels*

Portfolio of banks still concentrated largely in metros and Tier I cities, but contribution from smaller cities gradually also rising

The housing loan market remains concentrated, with the Top 5 centres (Mumbai, including Thane; National Capital Region; Bengaluru; Hyderabad; and Chennai) accounting for 38% of the overall SCB housing credit (as on March 31, 2010). However, the share of these Top 5 centres has been declining over the last few years and most of the portfolio growth has been coming from the smaller centres (mainly Tier 2 and Tier 3 cities).

Table 2: Share of Banks' Housing Credit Outstanding in Top Centres

	Mar-07	Mar-08	Mar-09	Mar-10
Share				
Top 5 Centres	46%	42%	42%	38%
Top 10 Centres	56%	53%	53%	49%
Top 20 Centres	63%	62%	60%	57%
Others	37%	38%	40%	43%
Growth				
Top 5		4%	16%	-2%
Top 10		6%	17%	0%
Top 20		12%	12%	2%
Others		13%	24%	17%

Source: Basic Statistical Returns of Scheduled Commercial Banks in India, RBI

SCBs report moderation in growth in number of home loan accounts

Portfolio growth in the housing finance market is a function of two factors: growth in number of accounts, and growth in loan outstanding per borrower. Compared with the 2005-07 levels, there has been an overall slowdown in growth both in the number of home loan accounts (taken as a proxy for home buyers), and in the loan outstanding per borrower. The slowdown is attributable mainly to rising property prices (leading to increase in ticket size) and high interest rates. Over the last five years, the average ticket tickets sizes are estimated to have grown threefold to around Rs. 2 million.

Table 3: Trend in Number of Accounts and Ticket Sizes for SCB Home Loans

	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10
Growth in housing portfolio of SCBs[4]	49%	44%	26%	9%	15%	8%
Growth in number of accounts	21%	23%	11%	4%	10%	6%
Loan outstanding per borrower	23%	16%	13%	4%	5%	2%

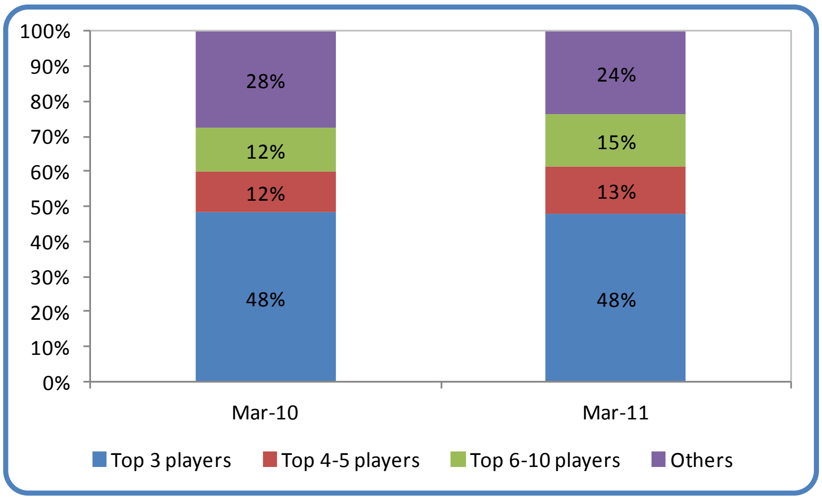
Source: Basic Statistical Returns of Scheduled Commercial Banks in India, RBI

[4] *The growth in SCB home loan portfolio in this data pertains to data from RBI publication Basic Statistical Returns of Scheduled Commercial Banks in India*

Housing loan market continues to be dominated by a few large players, but share of newer players rising

The housing market is quite concentrated, with the top three players (SBI along with Associates, HDFC Group, and ICICI Group) clearly dominating the domestic mortgage market and cumulatively accounting for 48% of the total housing credit in India (as of March 31, 2011). However, the players ranked 4 to 10 in terms of housing loan size players are catching up, and were able to increase their share from 24% as on March 31, 2010 to 28% as on March 31, 2011. Apart from these big players, there are some HFCs with relatively smaller credit portfolios operating in their respective geographies or serving niche customers. Besides, some new HFCs are also focusing on the relatively underpenetrated low ticket home loan segment and/or affordable housing segment. While small HFCs have been expanding their portfolio over the last few years, ICRA expects the currently dominant players to continue maintaining their market standing over the medium term.

Chart 3: Market Shares of Key Players



Source: Annual Reports of various Mortgage Lenders

Risk-based pricing yet to pick up; mortgage market still lacks transparent benchmark rate for variable rate loans

As for the benchmark rate, unlike in the developed markets where borrowers opting for floating rate loans can choose an external benchmark rate (such as the London interbank offer rate [LIBOR] or a Government securities [G-Sec] rate), Indian borrowers are forced to go by the lender's base rate or prime lending rate (PLR), which could be quite inflexible in a scenario of declining interest rates. Typically, lenders take in new borrowers at thin interest spreads but subsequently raise these rates significantly so as to improve their interest spreads. The extent of such increase could be substantial, and it is very often the case that an existing borrower with a substantial equity build-up and a clean track record ends up paying a higher rate of interest than a new borrower. Thus, practically most new variable rate mortgage loans in the Indian market do have some characteristics of "teaser loans". The NHB circular "Uniformity in charging interest for old and new customers" dated October 19, 2011, if implemented in spirit, may bring in greater discipline in this regard. Since, the requirement of uniform pricing is applicable to HFCs at present, their competitive positioning vis-à-vis banks could weaken.

Performance of Housing Finance Companies

According to ICRA's estimates, HFCs were able to achieve an overall 22% growth in their total loan portfolio outstanding in 2010-11 over the previous fiscal, with the year-end figure at Rs. 2,212 billion, of which Rs. 1,649 billion was towards housing loans and the balance towards other loans.

Although the larger HFCs have a geographically diversified portfolio mix, most of the small HFCs have a geographically concentrated credit book, which makes them sensitive to adverse movements in property prices in specific regions because of factors such as local oversupply or slowdown in demand.

Non-home loans account for a sizeable portion of HFCs' loan book

Although housing loans remain the main source of revenues for small HFCs[5], the proportion of other loans accounted for 20% of their loan book as on March 31, 2011. Other loans consist mostly of LAP, lease rental discounting, and builder loans. One of the primary reasons for the HFCs to have a sizeable non-home loan portfolio is the relatively higher yields that they earn from these loans, although the risks inherent in these segments are higher than those in traditional housing loans. Nevertheless, the stricter lending norms being followed by the HFCs (like maintaining LTVs of up to 65% on LAP) do provide some protection against events like decline in property prices and loss on distress sale of non-performing assets. Also, close monitoring of the portfolio helps mitigate risks to an extent.

Apart from HFCs, non-banking finance companies (NBFCs) also have a sizeable share in the home equity book and have been growing at a fast pace. According to ICRA's estimates, the size of NBFCs' home equity portfolio stood at around Rs. 240 billion as on March 31, 2011, having grown by over 100% in 2010-11.

Chart 4: Portfolio Mix—All HFCs

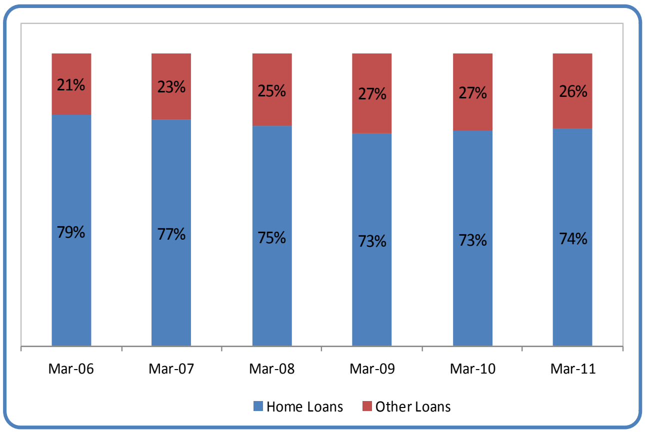
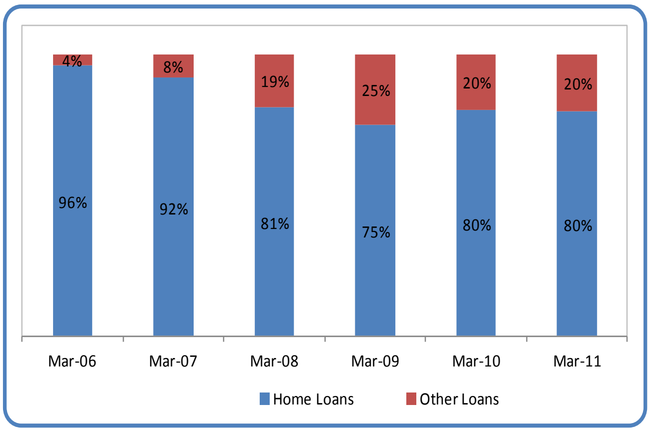


Chart 5: Portfolio Mix—Small HFCs



Source: Financial Results of various mortgage lenders and ICRA's estimates

[5] *For the purpose of this note, the numbers for Small HFCs have been calculated after excluding the numbers for HDFC Limited, LIC Housing Finance Limited and Dewan Housing Finance Limited.*

Key Regulatory Changes

Removal of prepayment penalty

In October 2010, National Housing Bank (NHB), the regulator for HFCs, advised all HFCs not to levy any prepayment charge or penalty on pre-closure of housing loans by borrowers if the borrowers were pre-closing loans with funds from their own sources. Further in NHB's circular dated October 19, 2011, NHB directed the following.

Type of Loans	Action on prepayment penalty proposed by NHB
Floating Rate Loans	No penalty when preclosed through any source
Fixed Rate Loans	No penalty when preclosed through own source (any source other than borrowing from bank/HFC/NBFC/FI)

Waiver of prepayment charges could impact HFCs profitability negatively as there may be prepayment penalties on their liability side. However, most of the HFCs have floating rate home loan book and run Asset liability mismatches, therefore excess funds can be absorbed and the interest costs can be passed on to the new borrower.

Though, the NHB initiative is a positive for borrowers of HFC and given that there is no such regulation for banks, borrowers from banks would remain at a disadvantage in case they were prepaying housing loans with funds from their own sources. However, at the September 2011 Banking Ombudsman Conference on improving customer services for banks, the RBI advised banks not to recover pre-payment charges in the case of floating rate loans and some banks have started offering the same.

Restriction on LTV ratio

While earlier, there were no restrictions on the LTV ratios for HFCs, since December 2010, the LTV ratio has been restricted to a maximum of 80% for all housing loans larger than Rs. 2 million to individuals and to a maximum of 90% for all housing loans up to Rs. 2 million to individuals. Although the average LTV ratios for HFCs is lower at around 70% and is expected to remain at similar levels, this restriction on LTV ratios could impact the competitive position of some players who were extending loans at higher LTV ratios to garner fresh business.

Provisioning on teaser rate loans and standard assets

The provisioning requirements introduced by NHB since December 2010 for loans extended by HFCs are discussed in the following bullet list.

- In December 2010, NHB introduced provisioning on standard non-housing loans (loans to builders, corporate entities, and agencies for housing and other purposes, LAP) in two stages: 0.2% by March 31, 2011, and 0.4% by September 30, 2011.

- In December 2010, NHB further stated that HFCs would have to maintain a 2% provisioning cover on the total amount outstanding against housing loans (standard assets) offered at teaser/special rates, that is, housing loans at comparatively lower rates of interest in the first few years after which rates are re-set at higher rates of such loans. The provisioning of these loans would have to be reset after one year at the applicable rates from the reset date, if the accounts remain "standard".

- In August 2011, NHB mandated a 0.4% provisioning cover for standard housing loans (other than teaser rate loans) from the 0.0% earlier to 0.4%.

With NHB mandating the additional provisioning requirements for standard assets and teaser rate loans, the credit costs of HFCs increased by 15 bps in 2010-11 and are likely to increase further in 2011-12.[6]

- **Risk weights linked to LTV and Size**

Earlier, in 2009, NHB had linked the risk weights on the loan books of HFCs to the LTV ratios and to ticket size. In December 2010, NHB made some changes in the risk weights, as *Table 4* shows.

Table 4: Revised Risk Weights according to NHB Guidelines

Criteria	Risk Weight
Housing loans sanctioned to individuals above Rs. 3 million but below Rs. 7.5 million secured by mortgage of immoveable property classified as standard asset with LTV ratio equal to less than 75%	75%
Housing loans sanctioned to individuals up to Rs. 7.5 million secured by mortgage of immoveable property classified as standard assets with LTV ratio higher than 75%	100%
Housing loans of Rs. 7.5 million and above sanctioned to individuals irrespective of LTV ratio and secured by mortgage of immoveable property classified as standard asset	125%

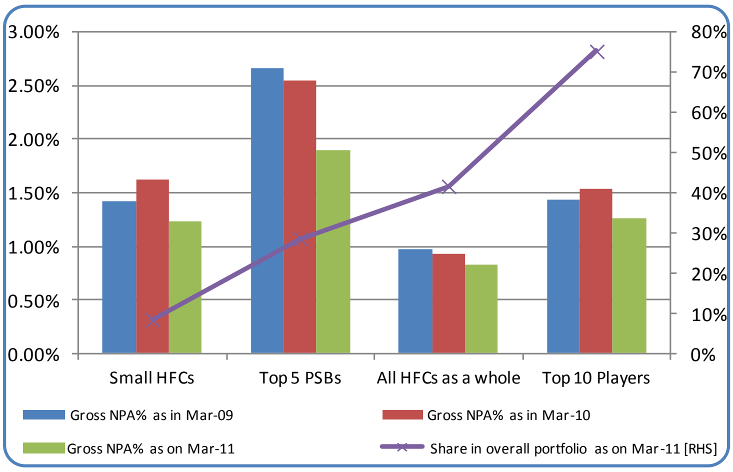
Despite the higher risk weights and the 22% growth in credit portfolio during 2010-11, the impact of the higher risk weights on the capital adequacy ratio of HFCs has been low, with the HFCs reporting a decline of just 76 basis points in Capital Adequacy Ratio CRAR from 16.00% as in March 2010 to 15.24% as in Mar 2011 (on a weighted average basis), being aided by adequate internal capital generation and equity infusions.

- **Uniformity in charging interest (floating rate basis) for old and new customers**

To improve transparency in the systems on October 19, 2011, NHB also directed that HFCs should ensure uniformity in rates, on floating rate basis, charged to their old and new customers, with the same risk profile, irrespective of the time of entry in the market.

Asset quality indicators of HFCs remain comfortable and are superior to that of PSBs

Chart 6: Trend in Asset Quality Indicators of HFCs versus Banks



Source: Annual Reports of HFCs and ICRA's estimates

During 2010-11, while the Gross Non-Performing Assets (Gross NPAs) of HFCs increased by 16%, their Gross NPA percentage declined, with the growth in the loan portfolio having been higher at 24%. The asset quality indicators of the HFCs continue to remain superior to that of the top five public sector banks (PSBs) in the housing loan segment. While the Gross NPA percentage for the HFCs stood at 0.82% as on March 31, 2011 (0.93% as on March 31, 2010), the consolidated Gross NPA percentage of the top five PSBs in the housing finance market was at 1.89% as on the same date (2.55% as on March 31, 2010).

6 However some HFCs may adjust the same against excess provisions or reserves in the Balance sheet

Chart 7: Trend in Gross NPA% of HFCs

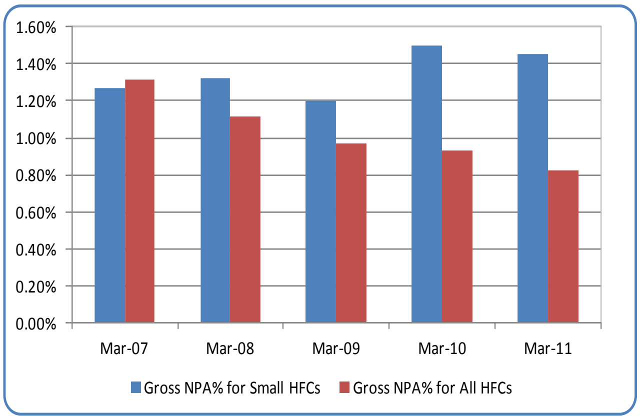


Chart 8: Trend in Net NPA% of HFCs

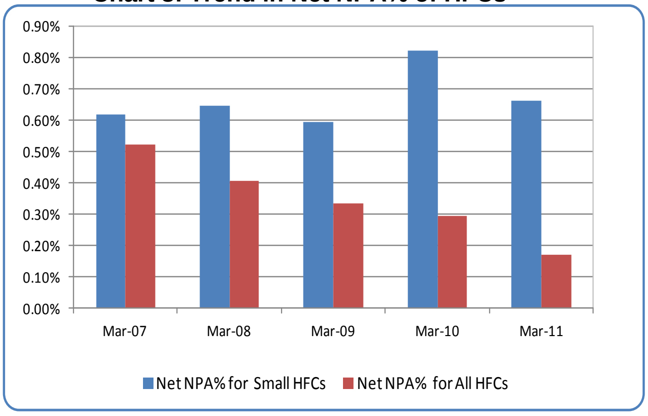
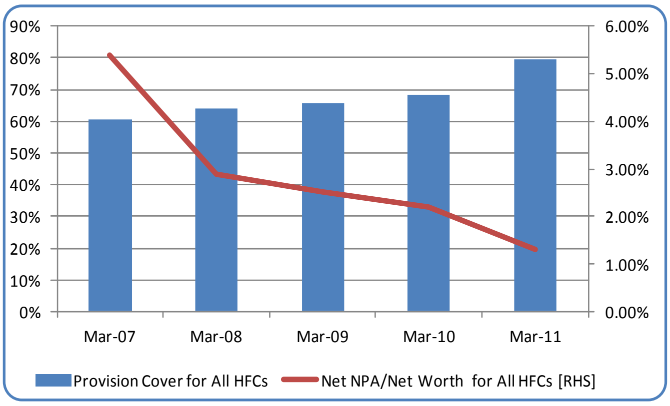


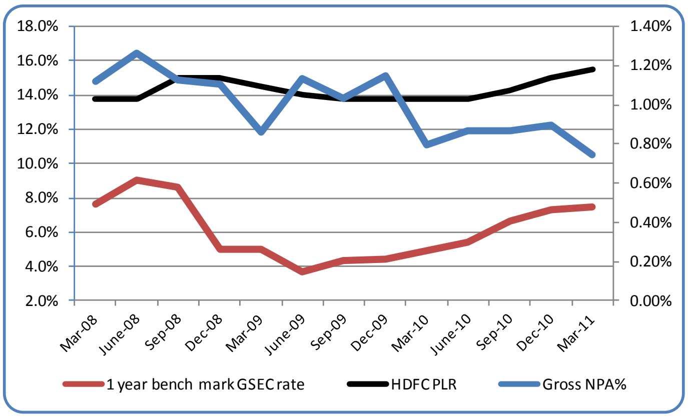
Chart 9: Provisioning and Solvency Indicators of HFCs



Source: Annual Reports of HFCs and ICRA's estimates

Although HFCs have been able to maintain their asset quality indicators on the strength of their focused approach, tight credit appraisal processes (benefited from extensive use of the Credit Information Bureau's database and its increased coverage of borrowers) and robust monitoring and recovery systems and processes, and have reported superior asset quality indicators vis-à-vis banks, within HFCs, the asset quality indicators of the smaller players have been inferior to the overall average (for all HFCs taken together). Further, in some States the effectiveness of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002, has reduced because of delays in getting permission from the District Magistrate/Chief Metropolitan Magistrate concerned for taking possession of the delinquent property; nevertheless, the Act remains a good deterrent and a large percentage of delinquent accounts are recovered/regularised before they can reach the repossession stage. The solvency indicators (Net NPA/Net Worth) of most HFCs are also comfortable as most of them follow more prudent provisioning policies than stipulated by NHB.

Chart 10: Trend in quarter wise Gross NPA% with Interest Rate Movements



Source: Annual Reports of HFCs and ICRA's estimates

The quarter-wise movement in the NPAs of HFCs vis-à-vis changes in interest rate over the last three years (refer *Chart 10*) reveals that HFCs have been able to maintain sound asset quality despite significant increases in interest rates, mainly on the strength of the following factors:

- As a practice, HFCs increase the tenure of loans rather than EMIs when interest rates rise. It is only if the residual tenure of the loan crosses the retirement age of the borrower or other eligibility criteria that the EMIs are increased. Therefore, the impact of interest rate changes on the borrower's cash flows is not very large.
- A large proportion of home loans are taken for end use.
- Lower LTVs lead to higher equity contribution from the borrower.

Going forward, the asset quality indicators of HFCs could deteriorate from the current levels, given their sizeable portfolio (20%) of relatively riskier products (such as LAP and builder loans), and the tilt in customer profile towards the self-employed segment (in which loans are sometimes offered on the basis of assessed income). Further, difficulties in the operating environment could lead to property prices stagnating or declining in certain areas even as rising interest rates could impact borrowers' affordability. Nevertheless, 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.

Dependence on wholesale funding sources remains high for HFCs

Most HFCs rely primarily on wholesale funding sources for onward lending. While the bigger HFCs have more diversified funding profiles, the smaller ones continue to depend largely on banks and NHB to meet their borrowing requirements. NHB is likely to remain an important source of long-term funds for the smaller HFCs, given that the institution mobilises funds at competitive rates and on-lends the same while maintaining thin interest spreads because of its developmental role in the mortgage finance market. Also, most HFCs have increased their emphasis on mobilising public deposits to diversify their funding profile, as they perceive deposits to be a more stable source of funding (especially after the liquidity crisis of October 2008). However, despite these initiatives, HFCs are likely to remain reliant on wholesale funding sources, and as a result, any prolonged tightness in liquidity at the systemic level could affect their cost of funds and hence their competitive position.

Chart 11: Borrowing Profile of Small HFCs (March 2011)

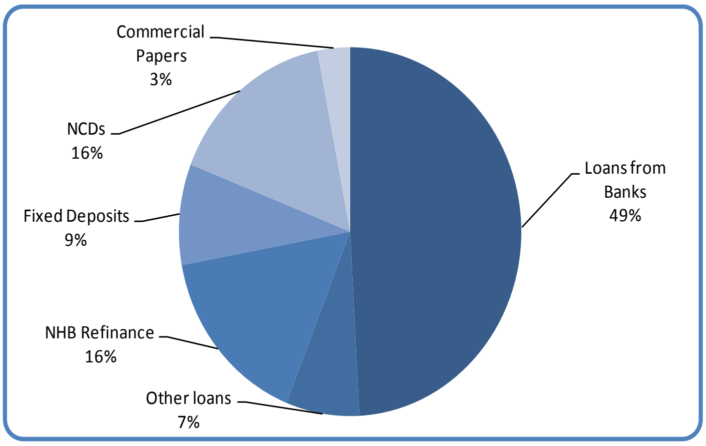
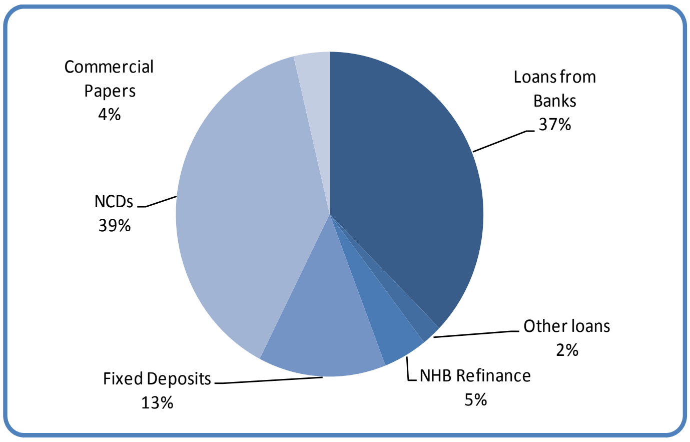


Chart 12: Borrowing Profile of All HFCs (March 2011)

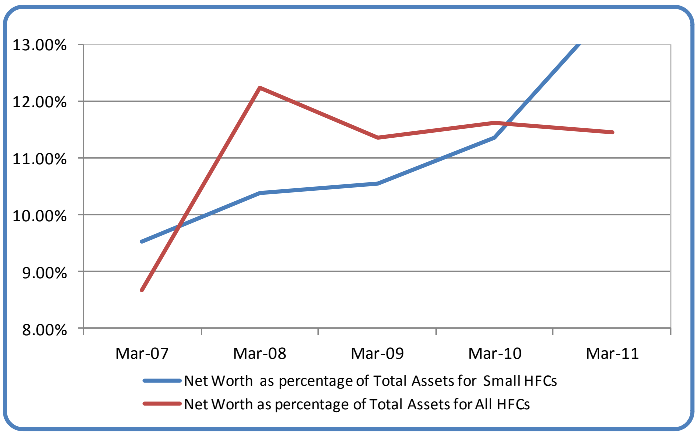


NCDs: Non-Convertible Debentures

Source: Annual Reports of HFCs and ICRA's estimates

Capitalisation levels of HFCs remain comfortable

Chart 13: Trend in the Capitalisation Indicators of HFCs



Source: Annual Reports of HFCs and ICRA's estimates

The capitalisation levels (Net Worth in relation to Assets) of HFCs remained comfortable at around 11.45% as on March 31, 2011 following good accretion to reserves and raising of capital by some players, although the total assets as a whole increased by over 21% in 2010-11. The regulatory capital adequacy of HFCs as on March 31, 2011 was higher (estimated at around 15.24 % on weighted average basis), with a large proportion of the home loans disbursed attracting lower risk weights (50% or 75%, depending on the size and LTV on the underlying loan). To assess the capitalisation levels of HFCs, ICRA also analyses their "net worth as a percentage of total assets" rather than the regulatory capitalisation indicators, as the latter are dependent on regulatory risk weights (which may vary, depending on economic cycles). Going forward, ICRA expects the HFCs to be able to maintain prudent levels of capitalisation on the strength of good internal capital generation (19% in 2010-11) and their strong ownership, which should ensure support from promoter entities. According to ICRA's estimates, HFCs would need additional Tier I capital of around Rs. 300 billion (that is, 100% of the estimated Tier I capital deployed by HFCs as on March 31, 2011), if the mortgage market were to grow at an annual rate of over 18% during the next five years.

Profitability indicators stable for all HFCs as a whole

Chart 14: Trends in Cost of Funds of HFCs

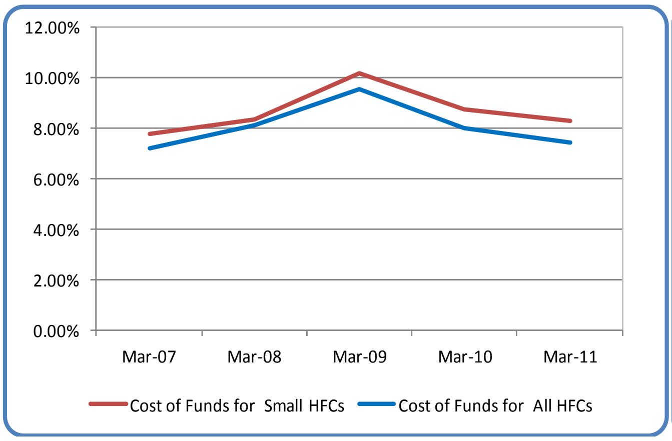
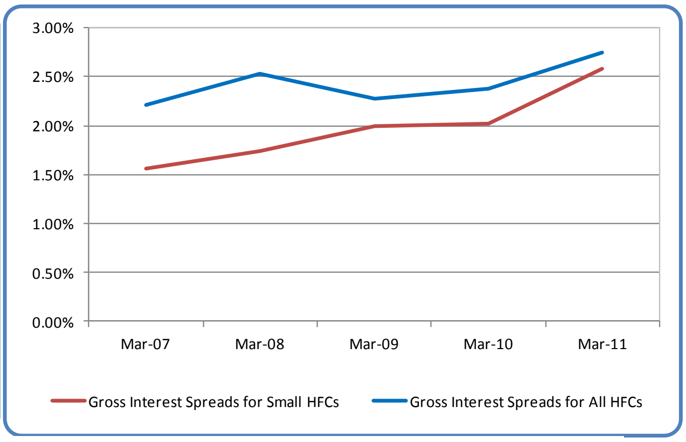


Chart 15: Trends in Gross Interest Spreads of HFCs



Source: Annual Reports of HFCs and ICRA's estimates

Following the systemic decline in interest rates during the first half of 2010-11 and a corresponding decline in the PLRs of HFCs (by around 25-50 basis points), the yields on advances for all HFCs declined in 2010-11. However, with the cost of funds declining simultaneously following renegotiation of interest rates on loans contracted earlier (at higher rates) and mobilisation of fresh borrowings at lower rates of interest, HFCs were able to maintain and in some cases improve the interest spreads on an overall basis as compared with the previous year.

The the teaser rate home loan portfolio of most HFCs would start getting repriced the second half of 2011-12 onwards, and this should help improve the overall yields by 25-40 basis points (around 25% of the housing loan portfolio of HFCs was at teaser rates as on March 31, 2011).Nevertheless, given the sharp rise in interest rates in the current fiscal, there could be some compression in interest spreads in 2011-12. However, some of the cost increase has been passed on to borrowers via floating rates (most HFCs raised their PLR by 200-250 basis points March 2010 onwards).

Table 5: Profitability Indicators of HFCs

	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11
All HFCs					
Net Interest Margin/Average Total Assets	2.63%	3.25%	3.25%	3.05%	3.34%
Fee based income/Average Total Assets	0.53%	0.45%	0.54%	0.62%	0.50%
Operating Income/Average Total Assets	3.16%	3.70%	3.79%	3.67%	3.85%
Operating Expenses/Average Total Assets	0.69%	0.73%	0.78%	0.69%	0.58%
Operating Profit/Average Total Assets	2.47%	2.97%	3.01%	2.98%	3.27%
Provisions/Average Total Assets	0.09%	0.10%	0.08%	0.07%	0.22%
Profit on sale of investments and Assets/ Average Total Assets	0.34%	0.65%	0.03%	0.12%	0.22%
Profit before Tax (before extraordinary income)/Average Total Assets	2.72%	3.52%	2.96%	3.03%	3.27%
Profit After Tax/ Average Total Assets	2.16%	2.52%	2.10%	2.18%	2.36%
Profit after Tax/Average Net Worth	25.02%	23.61%	17.90%	18.95%	20.42%
Cost to Income Ratio	20%	17%	20%	18%	14%
Gearing(Total Debt/Net Worth)	10.09	6.86	7.44	7.27	7.30
Small HFCs					
Net Interest Margin/Average Total Assets	2.26%	2.57%	3.08%	2.91%	3.60%
Fee based income/Average Total Assets	0.93%	0.85%	0.89%	0.79%	0.91%
Operating Income/Average Total Assets	3.20%	3.43%	3.97%	3.70%	4.51%
Operating Expenses/Average Total Assets	1.28%	1.40%	1.79%	1.35%	1.35%
Operating Profit/Average Total Assets	1.92%	2.02%	2.18%	2.35%	3.16%
Provisions/Average Total Assets	0.23%	0.26%	0.19%	0.24%	0.38%
Profit on sale of investments and Assets/ Average Total Assets	0.07%	0.02%	0.03%	0.03%	0.23%
Profit before Tax (before extraordinary income)/Average Total Assets	1.76%	1.79%	2.03%	2.14%	3.01%
Profit After Tax/ Average Total Assets	1.37%	1.23%	1.47%	1.52%	2.14%
Profit after Tax/Average Net Worth	14.84%	12.28%	14.04%	13.84%	16.78%
Cost to Income Ratio	39%	41%	45%	36%	29%
Gearing(Total Debt/Net Worth)	9.17	8.27	8.21	7.53	6.03

Source: Annual Reports of HFCs and ICRA estimates

For HFCs, net interest income is the main contributor to their revenues, as their fee income remains low. Fee income consists primarily of processing fees and prepayment charges, which for the larger HFCs declined in 2010-11 on account of the new waiver granted by NHB regulations. However, overall processing fee for the smaller HFCs showed a reverse trend as their higher processing fee income (as a result of the over 25% growth in disbursements) compensated for the loss on prepayment charges).

Notwithstanding good asset quality, credit provisions of HFCs increased by 15 basis points owing to changes in NHB regulations (mainly higher provisioning requirement against teaser rate home loans). Going forward, credit provisions could increase further from the 2010-11 levels because of additional provisioning requirement on standard assets (home loans) by 15-25 basis points. Further, there could be some deterioration in asset quality because of difficulties in the operating environment and change in the risk profiles of some HFCs, which would adversely impact credit costs by another 10-15 basis points.

The improvement in interest spreads and decline in gearing (because of fresh equity infusion in several players) led to an improvement in Net Interest Margins (NIMs) for the small HFCs. Going forward, the NIM of HFCs could decline from the 2010-11 levels (by 20-30 basis points) because of rising interest rates. At the same time, a difficult operating environment and changes in regulations could lead to an increase in credit provisions by 15-25 basis points (some players are already making provisions in excess of the regulatory requirement). Higher cost of funds and credit provisions could reduce the Return on Equity(ROE)[7] of HFCs by 2-3%, profitability could further get impacted if lenders were to follow uniform pricing for same credit profile customer in spirit.

[7] Profit After Tax/ Average Networth

Summing Up

- Credit growth in the Indian mortgage finance market was at 18% in 2010-11 as against the overall banking credit growth of 21%.Credit growth for housing portfolio of Scheduled Commercial banks(SCBs) improved from the previous year's 8% to 15%, while that for Housing Finance Companies(HFCs) also increased from 21 to 24%. Though higher ticket sizes (as a result of higher property prices) and higher income levels could support the growth of mortgage credit going forward, rising interest rates could reduce the demand for fresh loans and increase prepayments as well, leading to lower 15-18% growth in the mortgage market in 2011-12.

- The share of HFCs in the mortgage market has increased to around 31% over the last three years. Going forward, HFCs may be able to maintain their market share on the strength of their focused approach, targeting of niche customer segments, relatively superior customer service, and significant growth plans (of some of the new HFCs). However, banks are also likely to be able to hold on to a sizeable share of the market, considering their extensive network, access to stable low-cost funds, and their priority sector lending mandate.

- The housing loan market remains fairly concentrated with the Top 10 players cumulatively holding a 76% market share (as on March 2011). There was some consolidation in the industry during 2010-11, with Dewan Housing Finance Corporation Limited taking over Deutsche Postbank Home Finance Limited, IDBI Home Finance Limited merged with IDBI Bank Limited.

- In terms of geographical spread, although the market remains concentrated primarily in the metros and Tier I cities the contribution from the smaller cities is increasing gradually. Annualised growth in the mortgage market in the Top 5 centres(Tier 1 centres) has been 7% during the three-year period ended March 2010 as against 15% in the Top 5-20 centres (Tier 2 centres).

- Typically, lenders take in new borrowers at thin interest spreads but subsequently raise these rates significantly so as to improve their interest spreads. The extent of such increase could be substantial, and it is very often the case that an existing borrower with a substantial equity build-up and a clean track record ends up paying a higher rate of interest than a new borrower. Thus, practically most new variable rate mortgage loans in the Indian market do have some characteristics of "teaser loans". The NHB circular "Uniformity in charging interest for old and new customers" dated October 19, 2011, if implemented in spirit, may bring in greater discipline in this regard. Since, the requirement of uniform pricing is applicable to HFCs at present, their competitive positioning vis-à-vis banks could weaken.

- HFCs continue to maintain superior asset quality vis-à-vis Public Sector Banks (PSBs). The Top Five PSBs[8] had a Gross NPA percentage of 1.89% in their housing finance book as on March 31, 2011, against which HFCs had 0.82%.

- While the total assets of HFCs increased by 21% in 2010-11, their capitalisation levels (Net Worth as a percentage of Average Total Assets) remained stable (at around 11.5%) owing to good internal generation (around 20%), and capital infusion by parents in several small HFCs.

- HFCs as a whole reported an improvement in interest spreads during 2010-11 because of a larger decline in their cost of funds vis-à-vis yields. Though the teaser rate home loan portfolio of most HFCs would start getting repriced the second half of 2011-12 onwards, and this should help improve the overall yields by 25-40 basis points. However, interest spreads may decline, given the sharp rise in the cost of funds in the current fiscal.

- Credit provisions of HFCs increased by 15 basis points in 2010-11 because of changes in NHB regulations (mainly higher provisioning requirement against teaser rate home loans). Going forward,

8 Which account for around 41% of the total housing credit extended by all banks taken together as on Mar-2011 credit provisions could increase from the 2010-11 levels by 15-25 basis points because of the additional provisioning requirement on standard assets (home loans). Further, there could be some deterioration in asset quality, given the difficulties in the operating environment and the change in the risk profile of some HFCs, which would adversely impact credit costs by another 10-15 basis points.

- Overall, the HFCs as a whole were able to improve their profitability indicators with ROE(Profit After Tax/Average Net Worth) at 20% in 2010-11 as against 19% in 2009-10. Higher cost of funds and credit provisions could reduce the ROE of HFCs by 2-3%, profitability could further get impacted if lenders were to follow uniform pricing for same credit profile ‘old and new’customer in line with NHB notification

Annexure I

List of ICRA-rated Housing Finance Companies

Company	Issuer Rating	Long Term	Medium Term	Short Term
Aptus Value Housing Finance India Limited		[ICRA]BBB- (Stable)		
Canfin Homes Limited			MAA+ (Stable)	
DHFL Vysya Housing Finance Limited		[ICRA]A+(Stable)		
First Blue Home Finance Limited		[ICRA]AA (Stable)	MAA (Stable)	
GIC Housing Finance Limited		[ICRA]AA+		[ICRA]A1+
GRUH Finance Limited		[ICRA]AA+ (Stable)	MAA+(Stable)	
Housing Development Finance Corporation Limited	IrAAA (Stable)	[ICRA]AAA (Stable)	MAAA (Stable)	[ICRA]A1+
ICICI Home Finance Company Limited		[ICRA]AAA(Stable)	MAAA(stable)	[ICRA]A1+
India Infoline Housing Finance Limited		[ICRA]AA- (SO)		
Indo Pacific Housing Finance Limited		[ICRA]BBB (Stable)		[ICRA]A3+
Reliance Home Finance Private Limited				[ICRA]A1+
Religare Housing Development Finance Corporation				[ICRA]A1+
Repco Home Finance Limited		[ICRA]A+ (Stable)		
Sundaram BNP Paribas Home Finance Limited		[ICRA]AA (Positive outlook)	MAA+(Stable)	[ICRA]A1+
Tata Capital Housing Finance Limited		[ICRA]AA+ (Stable)		[ICRA]A1+
Vishwakriya Housing Finance Limited		[ICRA]BB+(Stable)		

Annexure II

List of Housing Finance Companies compiled used for Consolidation of Financials

Name of the HFC
Aptus Value Housing Finance India Limited
Can Fin Homes Limited
First Blue Home Finance Limited
Dewan Housing Finance Limited
DHFL Vysya Home Finance Limited
First Blue Home Finance Limited
GE Money Housing Finance Limited
GIC Housing Finance Limited
Gruh Finance Limited
Housing Development Finance Corporation Limited
ICICI Home Finance Company Limited
India Infoline Housing Finance Limited
Indo Pacific Housing Finance Limited
IDBI Home Finance Limited[9]
Indiabulls Housing Finance Limited
LIC Housing Finance Limited
PNB Housing Finance Limited
Reliance Home Finance Limited
Religare Housing Development Finance Corporation
Repco Home Finance Limited
Sundaram BNP Paribas Home Finance Limited
Tata Capital Housing Finance Limited
Vishwakriya Housing Finance Limited

9 Till FY2010, as the company merged with IDBI Bank in FY2011.

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