ICRA

A MOODY'S INVESTORS SERVICE COMPANY

AFFORDABLE HOUSING FINANCE COMPANIES

Resilient earnings in FY2021; Covid 2.0 impacts asset quality in Q1 FY2022

SEPTEMBER 2021

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Manushree Saggar
+91 124 4545316
manushrees@craindia.com

Table of Contents

Table of EXHIBIT

LIST OF ENTITIES USED FOR AGGREGATION IN THIS NOTE

Classification	HFCs used for consolidation of financials
Affordable Housing Finance Companies – AHFCs	Aavas Financiers, Aadhar Housing Finance Limited , Aptus Value Housing Finance India Ltd, Home First Finance Company, Motilal Oswal Home Finance Limited, India Shelter Finance Corporation Limited, Mahindra Rural Housing Finance Ltd, Poonawalla Housing Finance, MAS Rural Housing and Mortgage Finance Limited, Muthoot HomeFin (India) Limited, Shriram Housing Finance Limited, Shubham Housing Development Finance Company Limited, Vastu Housing, Fullerton Home, DMI Housing, Aviom Housing and IndoStar Home

Note: *AHFCs – Affordable housing finance companies; HFCs – Housing finance companies*

LIST OF ABBREVIATIONS USED IN THIS NOTE

Abbreviation	
HFC	Housing finance company
AHFC	Affordable housing finance company
NHB	National Housing Bank
NPA	Non-performing asset
YoY	Year-on-year

WHAT DO WE DEFINE AS AFFORDABLE HOUSING FINANCE COMPANY

Track Record of Operations

Largely business growth in last 10 years

Target Segment

EWS/middle-to-low-income groups, cash salary, informal income, higher share of self-employed customers

Geographical Presence

Outskirts of cities, Tier II/III cities/towns, rural areas

Average Ticket Size & Interest Rate Charged

Typically below Rs. 10 lakh and interest rate can range from 11% to 20%

Note: *Traditional HFCs also have affordable housing portfolios but these have not been included for the analysis in this note as the share of such loans in the overall performance for such HFCs is still small; EWS – Economically weaker section*

OUTLOOK/CREDIT OUTLOOK

Long-term growth prospects remain positive

The AHFCs, which had been growing at significantly higher rates than the industry in the past, witnessed a moderation in growth in FY2021 following the Covid-19 pandemic-induced challenges in the operating environment. Nevertheless, the largely underpenetrated market, favourable demographic profile, Government thrust on housing, and the favourable regulatory/tax regime support the long-term growth outlook for the sector.

Growth to pick up and remain higher than overall HFC industry, driven by good demand and low base

- **Growth could pick up in FY2022:** The growth in the loan book moderated to 11% (YoY) in FY2021 and further to 10% (YoY) in Q1 FY2022 due to the lockdowns following the second wave of Covid-19 infections (Covid 2.0) while the portfolio remained flat as on June 30, 2021 compared with March 31, 2021. However, with some improvement in the operating environment, demand is expected to pick up in subsequent quarters and the loan growth of AHFCs could increase to 12-15% in FY2022.

Asset quality indicators to remain at March 2021 levels by end of March 2022; some increase also expected on account of portfolio seasoning

- **Collections impacted in Q1 FY2022:** With stricter lockdowns across various states in Q1 FY2022, the collections for these AHFCs were impacted. Further, unlike the moratorium and restrictions on bucket movement which were available in Q1 FY2021, there were no such dispensations this time. Hence, these entities witnessed some weakening of asset quality with reported gross NPA (GNPA)/Stage 3% of 4.1% as on June 30, 2021 (3.3% as on March 31, 2021). With steady improvement in collection efficiencies since June 2021, forward bucket movement is likely to be contained for most players, though resolution/rollbacks could take longer as it would be difficult for the borrowers of these AHFCs to clear multiple instalments at the same time. Thus, ICRA expects GNPA/Stage 3% to be 3.6-3.9% by the end of March 2022 compared to 3.3% as on March 31, 2021.

Liquidity profile expected to remain comfortable

- **Liquidity expected to remain comfortable:** The liquidity profile of these entities is expected to remain comfortable supported by the sizeable on-balance sheet liquidity being maintained by these players. At the same time, the availability of funding lines would be imperative for growth. The banking channel and NHB will remain key sources of incremental funding. Given the low gearing levels, the need for growth capital is likely to remain low.

Profitability expected to remain stable in FY2022 compared to FY2021 levels

- **Profitability to remain stable in FY2022:** Given the likelihood of elevated credit costs, the return on assets (RoA) is likely to remain at 2.2-2.4% in FY2022 compared to the range of 1.8-2.4% during FY2017-FY2021, despite improved scale of operations. Over the long term, the ability to improve the operating efficiencies further and control the credit costs would be imperative for improving the return indicators.

EXECUTIVE SUMMARY

Over the last decade, several new players have emerged in the housing finance space, focusing primarily on the affordable housing segment. The property cost in this segment is usually below Rs. 20 lakh and borrowers have relatively low income and sometimes do not have any formal income proof. Earlier, most large players did not cater to this segment. However, over the last couple of years, even large HFCs have set up dedicated verticals focused on the affordable housing segment.

While banks are also present in the smaller-ticket home loan market, their lending to the economically weaker section (EWS) and low-income group (LIG) segments and borrowers without any formal income proof is limited. These specialised HFCs are trying to tap this underserved market segment. They have been growing at much higher rates than the industry, albeit on a small base, and are estimated to have accounted for 5% of the overall HFC market as on March 31, 2021.

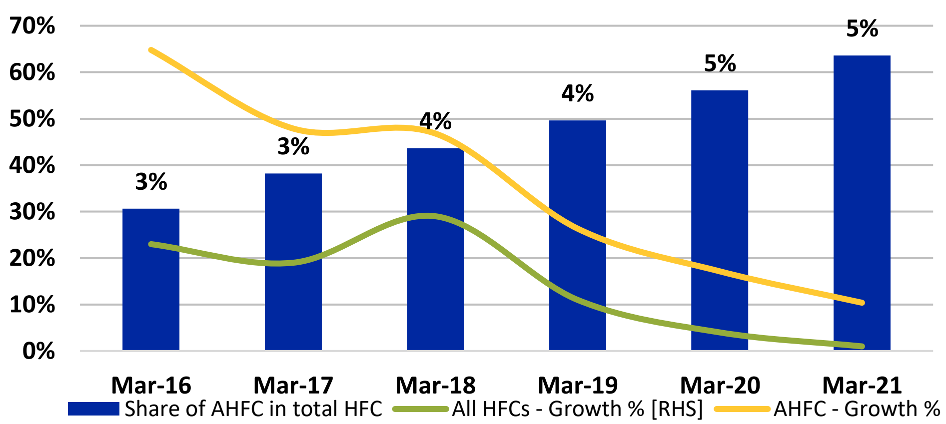
As per ICRA's estimates, the total portfolio of the new AHFCs in the affordable housing space stood at Rs. 60,468 crore as on June 30, 2021, registering a YoY growth of 10%, much lower than the last five-year average of 24%. The HFC industry was largely flat in Q1 FY2022. In terms of the portfolio mix, individual housing loans continue to dominate the mix at 78% with the balance largely comprising loans against property (LAP) with very limited project loans/construction finance loans.

While the long-term growth outlook remains positive, supported by the favourable demographic profile, under-penetrated market, tax sops and Government thrust on 'Housing for All', access to adequate funding would be critical for these AHFCs to scale up.

As highlighted in earlier ICRA publications, the portfolio vulnerability for these AHFCs remains high due to multiple factors such as larger share of self-employed borrowers and borrowers with cash salaries, borrowers with relatively lower income buffers making them vulnerable and hence more susceptible to economic shocks, high level of assessed income-based lending, and challenges related to the collateral (both documentation and repossession). In this backdrop, the pandemic has impacted the target borrower profile of these AHFCs, and they witnessed some moderation in the asset quality over the last two fiscals with reported GNPA/Stage 3% of 4.1% as on June 30, 2021 as compared with 3.7% as on March 31, 2020. The reported numbers were also supported by significant write-offs by some players.

Covid 2.0 has exerted further pressure on the asset quality indicators for these players, especially in the softer buckets where delinquencies have shot up significantly. To put this in perspective, the 30+ days past due (dpd) for some select AHFCs[1] increased to 7.2% as on June 30, 2021 from an estimated 5.1% as on March 31, 2021, though the 90+ dpd was under control at 1.6% as on June 30, 2021 (1.3% as on March 31, 2021 and 0.9% as on March 31, 2020). Nevertheless, there has been a steady improvement in collection efficiencies since June 2021. Hence, forward bucket movement is likely to be contained for most players, though resolution/rollbacks

EXHIBIT 1: Share of AHFCs in overall HFC industry



***Source:** ICRA Research*

[1] *The delinquency data is for a smaller set of entities [9 entities, aggregating 65% of the total loan book of AHFCs] compared to those used for aggregate NPA/Stage 3 numbers [21 entities]*

could take longer since it would be difficult for the borrowers of these AHFCs to clear multiple instalments at the same time. Over the long term, however, the ultimate losses to the lenders could be limited, given the secured nature of the loans though the recovery time could get extended further. These lenders have strengthened their balance sheets through additional Covid-19-related provisions and higher expected credit loss (ECL) provisions in FY2020 and FY2021.

These AHFCs have been relying on the banking system and larger non-banking financial companies (NBFCs) for meeting their funding requirements with these channels accounting for ~60% of their outstanding debt. Some increase was seen in the share of market instruments (largely non-convertible debentures; NCDs) in FY2021, possibly because of the targeted long-term repo operations (TLTROs). At the same time, given the various kinds of liquidity support offered by NHB, the share of NHB refinance in the overall mix almost doubled in FY2021. Continuing with the trend in the past, the share of commercial paper (CP) in the overall mix remains negligible for these entities, given their credit profile and hence their relatively lower credit ratings. Also, as a significant part of the portfolio qualifies for priority sector lending, sell-down has been a source of funding for these entities. The cost of funds for these entities also moderated in FY2021, in line with the softening of interest rates, though the extent of reduction was lower given the higher risk premium attached with the NBFC/HFC sector.

As for liquidity, given the inherent nature of the business, these entities are exposed to asset-liability mismatches as the assets have much longer tenures compared to the liabilities. However, adjusted for the sizeable on-balance sheet cash and cash equivalents, these entities have positive gaps across buckets unlike their traditional peers. As per ICRA's estimates, cash and cash equivalents constituted 14% of the balance sheet of the AHFCs as on March 31, 2021. This, coupled with sanctioned but undrawn bank lines, supports the overall liquidity profile of these entities.

While the net interest margins (NIMs) of the AHFCs moderated in FY2020 and further in FY2021 owing to negative carry on the sizeable on-balance sheet cash, the impact was offset by a commensurate decline in the operating expenses in relation to the average assets with the increased scale of operations. This, coupled with stable credit costs compared with FY2020 and higher upfront income from direct assignment (DA) transactions, led to a stable performance in FY2021and the reported RoA of 2.4% for FY2021 was in line with ICRA's projections. ICRA expects the profitability indicators for these HFCs to remain at similar levels in FY2022 as the credit costs could remain elevated compared to the pre-Covid levels.

Corrigendum:

The 30+ dpd mentioned on page 8 was inadvertently mentioned as 3.2% as on March 31, 2021 instead of 5.1%. The same as been corrected.

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: Jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: Communications@icraindia.com
Tel: +91 124 4545 860

Registered Office

B-710, Statesman House 148,
Barakhamba Road
New Delhi-110001
Tel: +91 11 23357940-45

Corporate Office

Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon - 122 002
Tel: +91-124-4545300

Ahmedabad

1809-1811, Shapath V,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

Bengaluru 1

'The Millenia', Tower B Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

4th Floor, 'Shoban'
6-3-927/A&B. Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

No. 7-1-58, 301, 3rd Floor, 'Concourse',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 1194

Email: Info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.Icraresearch.in