India Housing Finance Sector Report 2014

Vinod Kothari Consultants P. Ltd.

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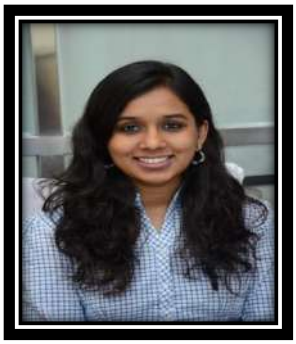

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The data noted in this Report is based on published annual reports of various companies', however certain assumptions have also been made during the data collation and analysis. In case of any inaccuracy in any of the data noted, the respective company can report the same at the following email ids:

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Introduction

Housing is a primary necessity in every economy and is a basic indicator of growth and social well-being. Development of housing is not just important to economic growth but is also one of the tools for economic development considering the accelerator impact it has on various industries including construction and infrastructure sector; it generates demand for supporting industries and leads to creation of job opportunities. Development of housing in a country is a sign of economic welfare.

For any emerging economy, development of the housing sector has its own challenges. The biggest of these challenges is access to finance. While investment in real estate is an easy candidate for borrowing, real estate lending is more opportunity-based. In India, access to finance for housing needs is largely concentric and focused at higher income groups, as that is the sector where there are formal evidences of income such as salary slips or income-tax returns. Since lenders tend to lend to sectors where lending is the easiest, the lower segments of the population pyramid will remain unserved or underserved, if the system was left entirely to itself. Therefore, there is a need, in every financial system, to enable access to finance by lower segments of the population pyramid.

While the upper middle-income segment is well-served by banks and mortgage lenders, the lower middle income segment has low or no access to banks for mortgage finance; creating a huge demand in this segment and lack of access of finance. The fact that the upper segments of the pyramid are well-served is evident from the highly competitive mortgage lending rates prevailing for the sector.
There is also a much longer way to travel in terms of ensuring the availability of housing finance to low income to middle income groups.

Rural Housing Shortage

According to India's Twelfth Five Year Plan[1] (2012-2017), the rural housing shortage in the country is estimated at 44 million units. Over 90 percent of this demand is from low-income households, especially Below Poverty Line (BPL) families. The same study identified access to finance as a critical and fundamental pre-requisite for habitat development. **Error! Reference ource not found.** shows an estimate of shortage in Rural Housing and the factors taken into consideration for assessing the same.

S. No	Factors taken into account for assessing Housing shortage	Calculation	Shortage (in million)
1	No. of Households not having houses in 2012	No. of Households Less No. of Housing Stock in 2012	4.15
2	No. of Temporary Houses in 2012	No. of Housing Stock Less No. of Permanent Houses (Pucca + Semi Pucca)	20.21

[1] http://planningcommission.gov.in/aboutus/committee/wrkgrp12/rd/wgrep_iay.pdf, page 9

3	Shortage due to Congestion in 2012	6.5%[2] x No. of Households	11.30
4	Shortage due to Congestion in 2012	4.3%[3] x No. of Household	7.47
5	Additional Housing Shortage arising between 2012 to 2017	No. of Households projected for 2017 over 2012 Less No. of excess Housing Stock projected for 2017 over 2012	0.55
Total Rural Housing Shortage 2012 – 2017			43.67

Table 1: Estimate of shortage in Rural Housing
Source: Working Group on Rural Housing for 12th Five Year Plan, Ministry of Rural Development[4]

The Government has taken numerous initiatives to overcome the housing shortage, out of which the Indira Awaas Yojana (IAY) is the premier scheme of the Ministry of Rural Development that concentrates on providing houses to below poverty line (BPL) families.

Urban Housing Shortage

Further, according to the estimates of MHUPA, the urban housing shortage in the country in 2013 was estimated to be 18.78 million which is likely to increase if the rate of urbanization increases; 96 percent of this shortage was estimated to be in EWS and LIG[5]. **Error! Reference ource not found.** shows an estimate of shortage in Urban Housing and the factors taken into consideration for assessing the same.

Factors taken into account	Congestion
Households living in non-serviceable temporary houses	0.99
Households living in obsolescent houses	2.27
Households living in congested houses requiring new houses	14.99
Households in homeless conditions	0.53
Total Urban Housing Shortage	**18.78**

[2] Congestion factor of 6.5% of Households was estimated based on 2001 census data of number of couples not having a room to themselves
[3] Obsolescence factor of 4.3% was based on data of 58th round of NSS. Houses that were more than 80 years old
and those with a life span of 40 to 80 years that were of bad quality were considered obsolete.
[4] http://planningcommission.gov.in/aboutus/committee/wrkgrp12/rd/wgrep_iay.pdf
[5]http://mhupa.gov.in/W_new/urban-housing-shortage.pdf

Table 2: Estimate of shortage in Urban Housing
Source: Report of the Technical Group on Urban Housing Shortage (2012-17)[6]

Access to Finance

Housing finance products are classified based on the borrower segment. Access to finance is concentric where the title is clear and the income stream is determinable. The housing finance product or mortgage lending is traditional, standardised and mostly vanilla to the so called upper segment of the pyramid. Lending to the bottom of the pyramid, where clear title of ownership of property is unavailable or absent and the income streams are low and inconsistent, is mostly progressive or of small tickets. Such finance is called affordable housing finance or housing microfinance. The collaterals here are pseudo collaterals mostly and the credit underwriting is largely qualitative than relying on stream of estimated cashflows. Between the traditional mortgage lending products and affordable housing loans is micro-mortgages where the tenure and the ticket size is lower than that of traditional mortgages. As the name suggests, micro-mortgage is a smaller mortgage loan.

Housing finance generally and affordable housing finance in particular, is clearly a policy priority for India. The government is dedicated to the cause of bringing financial inclusion and there are several schemes floated for the borrowers, housing finance companies and developers facilitating lending to what are commonly referred to as the 'bottom of the pyramid.' It is unarguable that for housing finance to grow, housing finance companies have to be effectively able to borrow at costs which can allow them to lend at affordable rates to the eventual borrowers.

This report intends to provide an insight on the state of housing finance market, opportunities and undercurrents and the outlook for forthcoming period.

[6] http://mhupa.gov.in/W_new/urban-housing-shortage.pdf

Segments of Housing Finance Sector

1. **Retail Home Loans**

   In the current scenario, both banks and HFCs have been thriving on retail lending. Retail lending of banks includes various types of retail residential mortgages, consumer credit cards, automobile and personal loans, loans against securities, and small business loans. However home loans constitute the largest percentage of retail loans in India.

2. **Developer Funding**

   Developer Funding / Construction Finance / Project Finance is a unique offering under which funding is directly made to real estate developers for projects they are developing. Few banks have come up with innovative Housing Loan Schemes in association with developers / builders. These schemes are popularly known as the 80:20, 75:25 Schemes. Our article on the same can be viewed here.

3. **Loan-Against-Property**

   A loan against property (LAP) is exactly what the name implies -- a loan given or disbursed against the mortgage of property. Loan against property belongs to the secured loan category where the borrower gives a guarantee by using his property as security. Normally a loan is taken against self-occupied or rented residential property. This could be a house or even a piece of land. Our article on LAP can be viewed here .

4. **Rural and Affordable Housing finance**

   Affordable housing is mainly composed of two elements affordable cost of the house and affordable means of financing such cost. The collaterals here are pseudo collaterals, mostly having deterrent value for borrowers to not default. These loans are low ticket size loans and the tenure is shorter than traditional mortgage.

5. **Housing Microfinance**

   These loans have features of traditional housing loans and microfinance. Largely loans are unsecured and are incremental or progressive in nature. The loans are directed towards repair of houses, change in amenities, adding a floor to the existing house etc. In India, this is a newly introduced product class.

Pace of Growth

The housing loan portfolio of both banks and HFCs has grown considerably over the period of four years and this was possible due to supportive guidelines introduced by Government of India (GoI) and Reserve Bank of India (RBI). GoI provides for fiscal concessions under sections 80 C and 24 of the Income Tax Act' 1961 and now housing loans upto Rs. 25 lakhs given by banks were brought under Priority Sector Lending. Recently, RBI has carved out residential project loans out of the purview of Commercial Real Estate arena to boost financing of project loans for increasing the supply of housing stock. Financial institutions are providing housing loans at competitively affordable and relatively lower rates because NPAs have reduced considerably and banks and some HFCs also get supported by SARFAESI Act.

According to ICRA's[7] estimate the total housing credit outstanding in India as on March 31, 2014 was over Rs. 9.0 trillion, as against Rs. 7.5 trillion as on March 31, 2013, indicating a 20% growth in 2013-14, as against the 19% growth reported in the previous fiscal year. Growth in housing credit by housing finance companies (HFCs) and non-banking finance companies (NBFCs) moderated from 28% in 2012-13 to 23% in 2013-14. With banks sharpening their focus on retail home loans, this segment reported a higher growth of 18% in 2013-14 versus the 15% growth reported in 2012-13; this in turn led to the overall growth of 20% in housing credit in 2013-14 Figure 1 shows growth in housing credit over a period of 4 years.

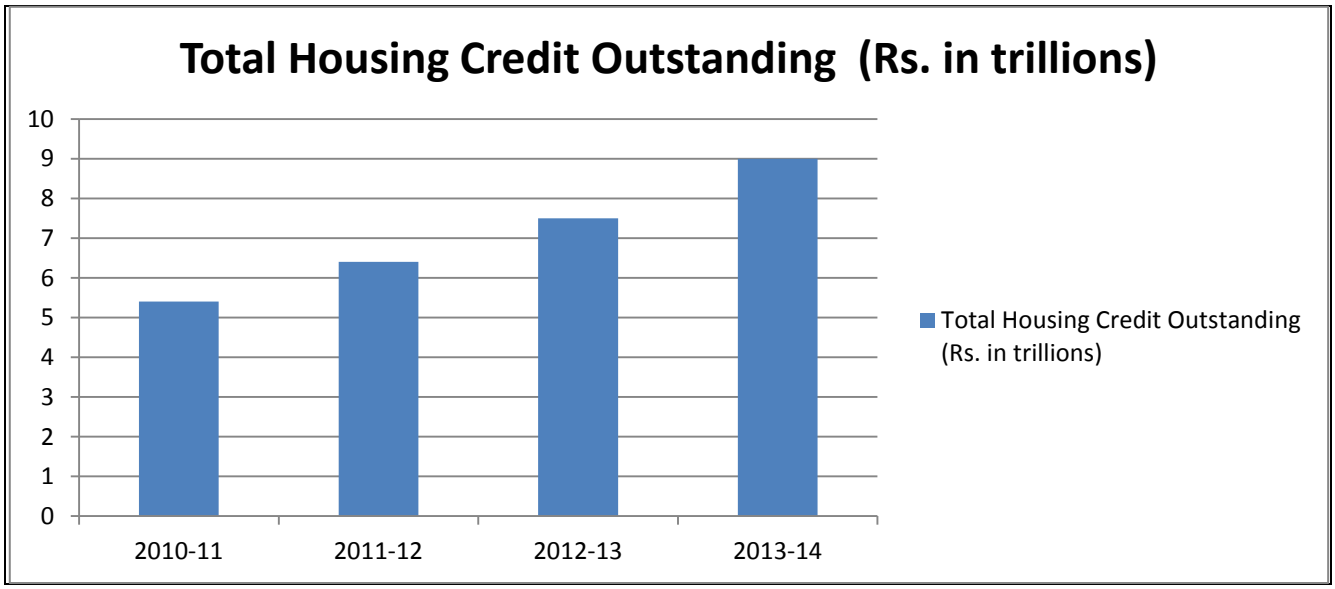

Figure 1: Housing Credit Growth (absolute nos.)
Source: ICRA estimates

Housing Credit as a Percentage of GDP

If we speak of the Indian mortgage lending market, mortgage lending is a sizeable business in absolute numbers, but in terms of penetration levels, that is, outstanding mortgage debt as a percent of the GDP has touched 9% in March 2014 following a 20% growth in the portfolio of banks and HFCs. Despite being lower than most developed economies, the uptrend in penetration reflects positively on the outlook for the sector.

[7] http://icra.in/Files/ticker/SH-2014-Q3-1-ICRA-Housing%20Finance.pdf

shows the housing credit as percentage of GDP and the percentage of growth in housing credit.

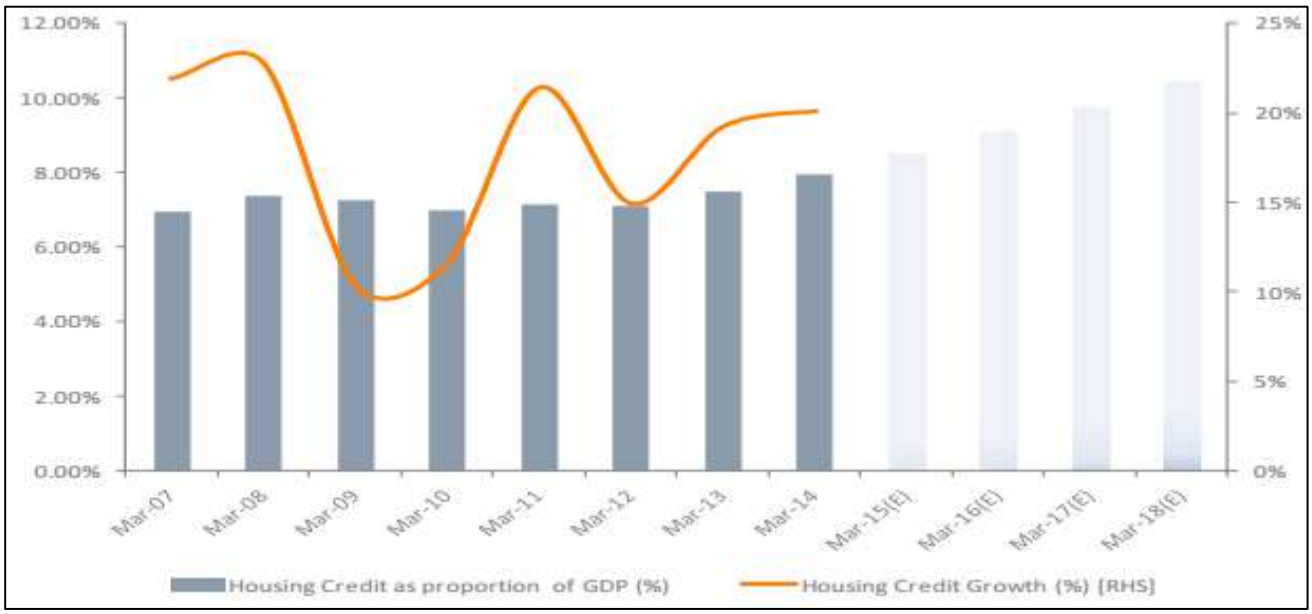

Figure 2: Housing Credit as a Percentage of GDP & Housing Credit Growth (%)
Source: ICRA estimates

Housing Finance Players

In India, mostly, mortgage lending is dominated by banks though the share of HFCs is growing consistently. The major reason for larger share of banks in housing finance business is that HFCs are not able to compete with banks on cost of funding. While the Banks have access to the CASA funds, the HFCs mostly borrow their funds from banks; thus, the cost of funds of the HFCs is higher compared to that of the Banks.

Figure 3 shows the trend in market share of HFCs and banks (in terms of Outstanding Housing Loans) over the last eight years.

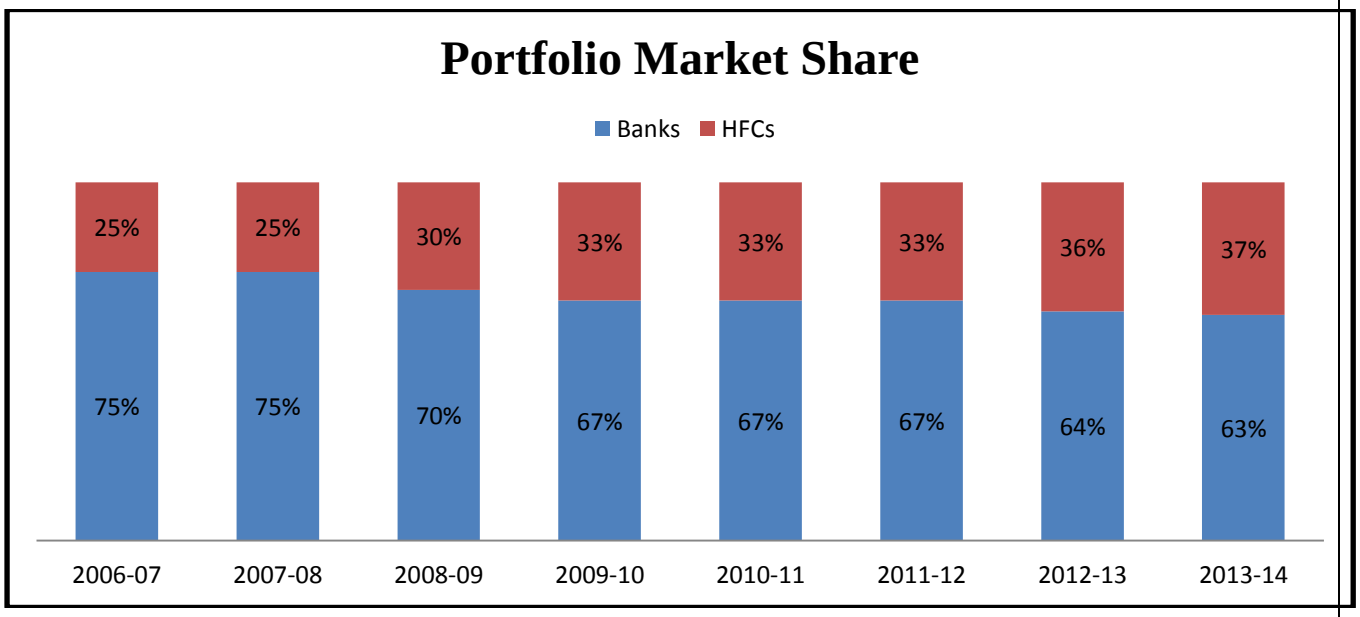

Figure 3: Portfolio Market Share
Source: NHB, RBI, ICRA, IFMR, Author's Compiled Data

Performance of Banks

Housing finance is a small proportion of the total assets of the banking system; however as a proportion of retail lending done by banks, housing finance is clearly the largest asset class. The banks in India are governed by the RBI. Thus, all the instructions and guidelines are issued by it through circulars and notifications, in respect of housing finance.

There are several reasons why banks find housing finance attractive. First of all, housing finance is among the safest in retail assets, with delinquency rates in housing finance business being quite low. Secondly, investments in the low income housing segment qualify as a priority sector loan, which is mandatory in case of banks. Over the years the disbursements of funds made by the banks towards low income and affordable housing finance segment has

been increasing, clearly an indication of growing interest in the space. **Table 3** shows slab-wise disbursement of housing loans by banks in India.

Housing loans disbursed across various slab (Rs. in Billions)									
Slab-wise Housing Loans	**F.Y. 2010 – 2011**			**F.Y. 2011 – 12**			**F.Y. 2012 – 2013**		
	Disbursement	**Outstanding**	**NPA (%)**	**Disbursement**	**Outstanding**	**NPA (%)**	**Disbursement**	**Outstanding**	**NPA (%)**
< 0.2 million INR	57.62	94.42	6.07	52.54	67.86	11.54	29.57	61.65	11.25
0.2 – 0.5 million INR	113.34	483.07	4.09	55.71	384.91	4.82	40.28	366.59	4.48
0.5 – 1 million INR	135.10	587.71	3.74	117.60	643.21	3.37	112.81	694.36	3.01
1 – 2.5 millions INR	202.37	683.98	2.57	266.41	1011.89	1.67	299.12	1193.62	1.41
> 2.5 millions INR	243.28	541.62	1.55	246.32	622.34	1.09	236.78	803.59	1.01
Total	**751.71**	**2390.79**	**3.23**	**738.31**	**2730.12**	**2.63**	**718.57**	**3119.82**	**2.35**

Table 3: Slab-wise disbursement of housing loans by Banks in India
Source: Report on Trends and Progress of Housing in India, 2013

According to ICRA's[8] estimate banks' retail loan portfolio grew by 15.5% during 2013-14 (14.7% during 2012-13). Within retail, housing loans, which account for over 50% of banks' retail loan book, gained the most reporting 18.4% growth during 2013-14.

Sources of funding for Banks

Public deposits are a major source of funding for banks and the costs of deposits may be around 9.8% or so. Apart from the public deposits, they rely on other sources of on-balance sheet funding. CASA funds are available at rates as low as 4% p.a. In the Budget 2014, a new instrument, called *Long Term Infrastructure Bonds*, was introduced whereby banks could raise funds through long term bonds issued against their exposure in infrastructure sector; the same has been discussed in details later in this Report.

Cost of financing for banks

There are primarily two ways banks may refinance their investment in mortgage lending – deposits, and dedicated bond issuance, permitted by a recent RBI guideline. Obviously, most banks have traditionally relied upon public deposits as a source of financing their balance sheets. The second of the on-balance-sheet options, a dedicated bond, was opened only by Budget 2014, and has quickly gained in popularity.

[8]http://icra.in/Files/ticker/SH-2014-Q2-1-ICRA-Performance%20Review%20&%20Outlook.pdf

Long-term infrastructure bonds (LTIB):

Budget 2014 introduced a new instrument whereby banks have been allowed to issue long term bonds[9], against investments in infrastructure. While the definition of "infrastructure" is, generally speaking, narrow, for the purpose of issue of LTIB, bank portfolios in "affordable housing" are also included. The term "affordable housing" has been given a new definition for this purpose. Affordable housing includes the following:

- All that is included for priority sector lending purposes, that is to say, loans to individuals up to Rs.2.5millions in metropolitan centres with population above 1 million and Rs.1.5 millions in other centres for purchase/construction of a dwelling unit per family, besides certain other lending facilities, including, subject to conditions, loans to HFCs.

- Housing loans to individuals upto Rs. 5 millions for houses of values upto Rs. 6.5 millions located in the six metropolitan centres viz. Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad and Rs. 4 millions for houses of values upto Rs. 5 millions in other centres for purchase/construction of dwelling unit per family.

The unique feature of LTIB is that the banks do not have to create SLR, CRR and PSL against such lending[10]. The bonds have to have tenure of at least 7 years.

As is clear, this new dispensation creates a new class of home loans for the banking sector. Since banks can issue LTIB without having to suffer cost increments in form of SLR, CRR and PSL, the impact on cost of borrowing as discussed above is not applicable in case of these instruments. So, if a bank manages to issue LTIB at a coupon of 9%, the cost of financing to the banks is 8% only.

The definition of 'affordable housing', for the above purpose, includes loans within a limit of Rs. 5 millions in metros and Rs. 4 millions in other locations. Not only is the loan size relevant for this purpose, the cost of the house is also relevant – limits being Rs. 6.5 millions in metros and Rs. 5 millions in other locations.

To the extent banks have or acquire incremental affordable housing portfolios, it will surely make sense for banks to issue LTIB.

Current scenario points to a substantial rush by the banks to issue LTIB. In early september 2014, ICICI Bank was reported to have issued bonds of Rs 39000 million, with a maturity of 10 years, at a cost of 9.25%[11]. This report also indicated that lots of other banks are also in the fray for issuing LTIB.

Conclusion

The usual cost of deposit liabilities for banks may be around 9.9% and as discussed above the cost of LTIB, taking ICICI as a case in point, may be around 9.25%, or 9.50% (adding a bit for the sourcing costs).

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[9] http://www.rbi.org.in/SCRIPTs/NotificationUser.aspx?Id=9103&Mode=0

[10] For a discussion on long-term bonds for infrastructure, see Vinod Kothari's write up here: http://www.india-financing.com/images/Articles/Guidelines_for_Long_Term_Infrastructure_Bonds.pdf

[11] http://www.livemint.com/Home-Page/5zexdkBQWf63GpnISQUlbM/ICICI-Bank-raises-close-to-Rs3900-crore-via-10year-bonds.html

Mortgage lending rates in case of banks ranges in between 10% to 12%, as indicated by the **Table 4: Mortgage lending rate of Banks in India** . This provides a net interest margin of approx 1-2%.

Mortgage Lending rates of Banks in India		
Name of Bank	**Amount of Loan**	**Rate of Interest**
State Bank of India	For Women Borrowers – 10 bps above the Base Rate	10.10%
	For other Borrowers – 15 bps above the Base Rate	10.15%
Canara Bank	UptoRs. 7.5 millions	10.20%
	Above Rs. 7.5 millions	10.45%
Indian Bank	UptoRs. 7.5 millions	10.25%
	Above Rs. 7.5 millions	10.50%
Bank of Baroda	UptoRs. 3millions	10.25%
	Rs. 3 millions - Rs. 7.5 millions	10.25%
	Above Rs. 7.5 millions	10.25%
Central Bank of India	UptoRs. 7.5 millions	10.25%
	Above Rs. 7.5 millions	10.50%

Dena Bank	UptoRs. 7.5 millions	10.25%
	Above Rs. 7.5 millions	10.50%
Axis Bank	**For Salaried –** UptoRs. 7.5 millions Above Rs. 7.5 millions	 10.15% 10.40%
	For Self Employed – UptoRs. 2.5 millions Above Rs. 2.5 millions	 10.40% 10.90%
Corporation Bank	Upto Rs. 5 millions	10.25%
	Above Rs. 5 millions	10.50%
IDBI Bank	-	10.25%
Bank of India	UptoRs. 7.5 millions	10.20%
	Above Rs. 7.5 millions	10.45%
State Bank of Hyderabad	UptoRs. 3 millions	10.50%
	Above Rs. 3 millions	10.75%
Union Bank of India	UptoRs. 2.5 millions	10.50%
	Rs. 2.5 millions - Rs. 7.5 millions	10.55%

	Above Rs. 7.5 millions	10.80%
Punjab & Sindh Bank	UptoRs. 2.5 millions	10.50%
	Rs. 2.5 millions - Rs. 7.5 millions	10.75%
	Above Rs. 7.5 millions	11.00%
Allahabad Bank	Rs. 3 millions – Rs. 7.5 millions	10.25%
	Rs. 7.5 millions – Rs. 30 millions	10.25%
	Rs. 30 millions – Rs. 50 millions	10.50%

Table 4: Mortgage lending rate of Banks in India
Source: Author's Compiled Data

Performance of HFCs

In India, currently there are 63 HFCs registered with the NHB[12] to carry out housing finance business. HFCs have been catering to the needs of housing finance since the early nineties. HDFC was registered as the first HFC and at present it is the largest HFC. Over the years the HFCs grew from almost a negligible number in the early nineties to a total of 63 HFCs as on end-October, 2014. Between 1st April, 2013 to 31st August, 2014, 6 new HFCs have entered the market. Of these 63, 12 HFCs can accept public deposits, 6 HFCs are required to obtain prior permission of NHB before accepting public deposits and the rest 45 HFCs are not permitted to accept deposits from public. In India, the top three names in the housing finance market are HDFC, LIC Housing Finance, and Dewan Housing Finance (in terms of the volume of transactions done)

Table 5 shows the volume of disbursement by some of the leading Housing Finance Companies in India during the last three financial years:

[12] http://www.nhb.org.in/Regulation/list_of_housing_finance.php, last visited 6th November, 2014. Housing **finance companies mandatorily need registration with the NHB. A housing finance company is defined as one** which lends against residential house property; the income and assets from housing finance business must form majority of the income/assets of the company in question.

Volume of Disbursements by the HFCs			
	Rs. in Billions		
Name of the Housing finance Company	**2013-14**	**2013-12**	**2012-11**
Housing Development Finance Corporation Limited	924.55	824.52	71,1.13
Housing Urban Development Corporation	74.38	61.00	
LIC Housing Finance Limited	1,40,5.76	1,16,4.33	92,9.84
ICICI Home Finance Company Limited	66.48	35.69	37.86
PNB Housing Finance Limited	55.00	36.82	15.08
Dewan Housing Finance Corporation Limited	16,6.47	13,3.57	90.65
GIC Housing Finance Limited	16.65	13.54	9.92
Can Fin Homes Limited	25.48	18.14	8.59
GRUH Finance Limited	25.71	21.74	14.87
Tata capital Housing Finance Limited	31.59	25.91	16.53
Sundaram BNP Paribas Home Finance Limited	24.93	25.72	19.48
Mahindra Rural Housing Finance Ltd	6.30	4.33	2.67

Table 5: Volume of Disbursements
Source: Companies' Annual Reports

Performance of small & medium HFCs

All these years the market has been highly concentric, the graph indicates that the smaller HFCs are growing faster. While the concentricity remains the smaller HFCs growth has been remarkable. Smaller HFCs picked up pace of growth in 2013-14 as it grew by 29% in their home loans book surpassing the growth registered by their larger counterparts in that fiscal year. The growth momentum has been sustained despite the difficult operating environment, notwithstanding the smaller base effect for such companies. Further, the affordable housing space is quite large and untapped giving access to significant unmet demands from self-employed customers in the affordable segment for such companies, which offers higher

growth potential. Figure 4 shows that **Error! Reference source not found.**small[13] and mid-sized[14] Housing Finance Companies have shown good growth over the last 5 years.

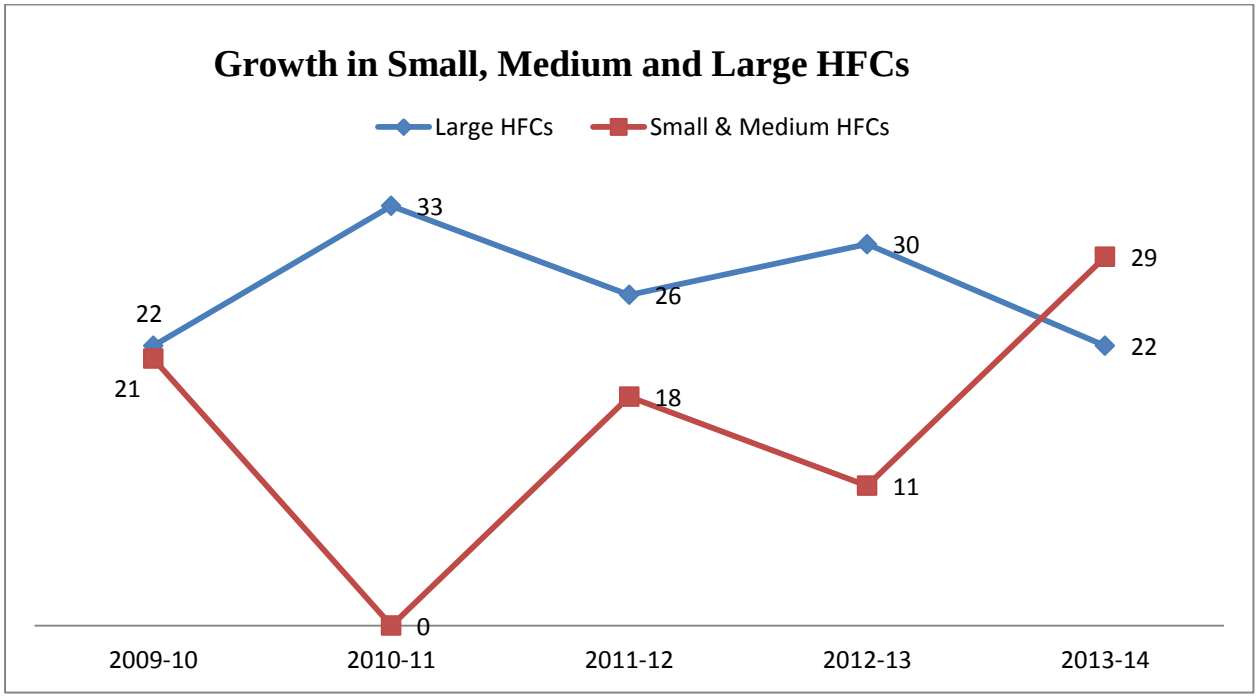

Figure 4: Growth in Small, Medium and Large HFC
Source: ICRA, CRISIL, IFMR Investments Research

With regard to HFC's performance in 2014, we have done a year-on-year comparison of top 4 HFCs and are as below:

For the year ended 31st March,	2014	2013
Income /Total assets (%)	11.29	10.98
Expenditure /Total assets (%)	8.47	8.25
Operating Exp[15]/Total Assets (%)	0.72	0.77
Gross NPA (%)[16]	0.71	0.69
Return on Business Assets[17](%)	12.28	11.82

[13] ICRA defines Large HFCs to include HDFC Limited, LIC Housing Finance Limited, Dewan Housing Finance Limited and Indiabulls Housing Finance Limited Small HFCs exclude the above mentioned Large HFCs
[14] CRISIL defines mid-sized HFCs as companies with a portfolio between Rs. 50-250 billion

[15] Total Expenses- Interest Expenses –Finance cost
[16] Weighted average of NPAs have been computed, AUM have been taken as weights.
[17]= PBIT/Business Assets; Business assets = loans and advances (asset on finance) +Debtors + Investments

Return on Net Worth[18](%)	19.91	17.55
Net worth (A) (Rs. billion)	111.17	98.43
On Balance Sheet Liability[19] (B) (Rs. billion)	848.44	726.77
Debt/ Equity Ratio (B/A)	8.68	8.34
Off Balance Sheet liability[20] (Rs. billion) (C)	48.11	27.93
Total Liability (D) = (B +C)	894.55	754.7
Effective Leverage Ratio (D/A)	9.34	8.72

[18] PAT/Net Worth

[19] Long term borrowings + Current Maturity of Long term borrowings + Short term borrowing

[20]. The funding raised by way of securitisation and/or assignment reflects a cosmetic (off balance sheet) liability which the entity would have raised otherwise, had it not opted for securitisation and/or assignment. The figure represents amounts disclosed in Notes to Accounts in terms of securitisation of assets and/or assignment of receivables.

In this section we have tried to put together the performance of some of the major HFCs operating in this sector for the year 2013-14 and have also compared the same with the performance of these companies in 2012-13.

Particulars	HDFC		LIC HFL		DHFL		Indiabulls	
								(Rs. in billions)
For the year ended 31st March,	2014	2013	2014	2013	2014	2013	2014	2013
Income /Total assets (%)	10.72	10.82	9.75	9.51	11.33	11.39	13.36	12.21
Expenditure /Total assets (%)	7.42	7.46	7.84	7.80	9.65	9.69	8.95	8.05
Operating Exp[21]./Total Assets (%)	0.06	0.35	0.35	0.45	1.03	0.97	1.45	1.29
Gross NPA (%)	0.69	0.7	0.67	0.61	0.78	0.71	0.83	0.79
Return on Business Assets[22](%)	12.69	12.38	9.82	9.35	10.95	10.89	15.66	14.65
Return on Net Worth[23](%)	19.46	19.52	17.48	15.78	14.80	9.45	27.91	25.45
Net worth (A) (Rs. billion)	279.55	248.3	75.33	64.81	35.74	32.37	54.07	48.25
On Balance Sheet Liability[24] (B) (Rs. billion)	1842.97	1588.27	820.35	687.64	394.56	320.33	335.88	310.85

[21] Total Expenses- Interest Expenses –Finance cost
[22]= PBIT/Business Assets; Business assets = loans and advances (asset on finance) +Debtors + Investments
[23] PAT/Net Worth
[24] Long term borrowings + Current Maturity of Long term borrowings + Short term borrowing

Debt/ Equity Ratio (B/A)	**6.59**	**6.40**	**10.89**	**10.61**	**11.04**	**9.90**	**6.21**	**6.44**
Off Balance Sheet liability[25] (Rs. billion) (C)	**69.44**	**51.75**	**0.00**	**0.00**	**26.15**	**6.86**	**88.83**	**53.10**
Total Liability (D) = (B +C)	**1912.41**	**1640.02**	**820.35**	**687.64**	**420.71**	**327.19**	**424.71**	**363.95**
Effective Leverage Ratio (D/A)	**6.84**	**6.60**	**10.89**	**10.61**	**11.77**	**10.11**	**7.85**	**7.54**
AUM (Rs. bn)	**1824.12**	**1751.26**	**927.96**	**785.86**	**448.22**	**361.16**	**411.69**	**344.25**

[25]. The funding raised by way of securitisation and/or assignment reflects a cosmetic (off balance sheet) liability which the entity would have raised otherwise, had it not opted for securitisation and/or assignment. The figure represents amounts disclosed in Notes to Accounts in terms of securitisation of assets and/or assignment of receivables.

Sources of funding for HFCs

A Housing Finance Company (HFC) in India can raise funds in the following ways:

(a) Owned funds

(b) Bank Financing

(c) Accepting public deposits, this is however, limited to only those HFCs which are allowed to accept the deposits from public.

(d) ECB

ECBs are not allowed to HFCs under the automatic route; however based on specific approval of FIPB, HFCs may raise ECBs.

(e) NHB Refinancing

(f) Capital Market Instruments

(g) Securitisation

Bank loans to HFCs may, on satisfaction of certain conditions, qualify as priority sector loans, thus motivating banks to lend to HFCs[26]. HFCs can raise money directly from the capital market by issuing bonds/debentures. It seems bond issuance is a significant source of funding by HFCs particularly for well-rated HFCs. Therefore, larger HFCs prefer raising funding on their own by issuing capital market instruments; low ratings of smaller HFCs acts as a hurdle for them to raise funds through bond issuances.

Proportion of capital market funding, primarily by issue of bonds/debentures, has gone up from about 49% to about 51%. Leading HFCs are able to place their bonds on insurance companies, banks, foreign portfolio investors, and other institutional investors. The reason for the cost bonds being cheaper than bank finance is not difficult to understand: Banks operate at higher cost of capital than many of the capital market intermediaries, due to substantial blocking of resources in SLR, CRR and directed priority sector lending (See discussion on the real cost of deposits in case of banks).

Figure shows the funding profile for HFCs.

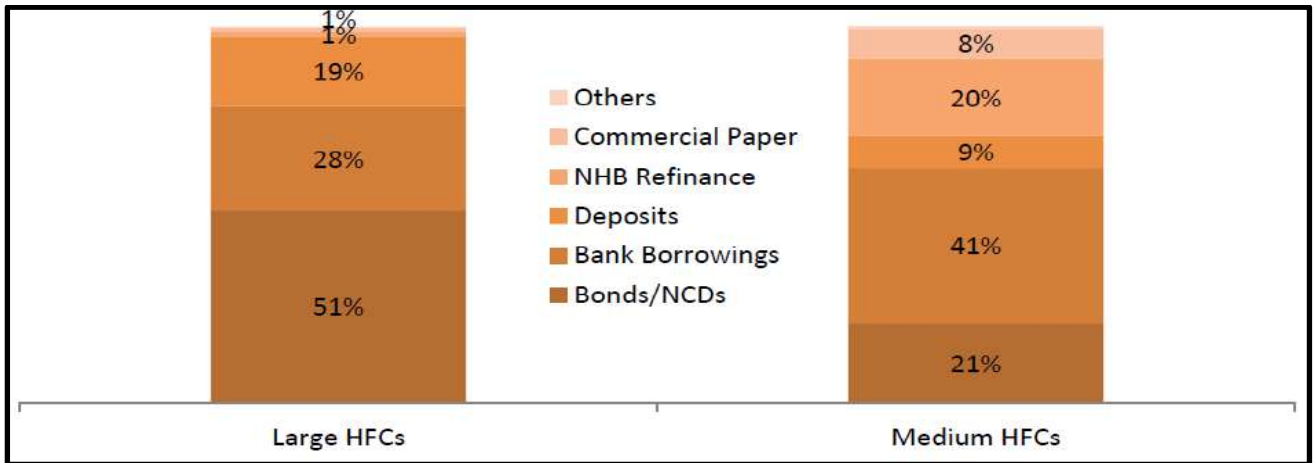

Figure 5: Funding Profile for HFCs

[26]Master Circular on Priority Sector Lending issued by RBI on July 1, 2014 provides for broad categories of sectors, the loans to which will qualify as "Priority Sector Lending (PSL)" which includes financing of HFCs by banks, in regulatory parlance, it is referred to as "indirect housing finance".

Source: CRISIL HFC Sector Overview, 2014

Therefore, evidently, HFCs have been opting for bond issuance. Most of the bond issuance happens on private placement basis. There are several such issuances by each issuer – mostly based on opportunity of placing the same on selected investor(s). For instance, in year 2014, upto 12th May 2014, there were nearly 180 debt issuances by 13 HFCs.

Table 6 shows the data pertaining to debt issuance by HFCs, during 2012, 2013 and part of 2014 (upto 12th May 2014). Our observation of the coupon rates is as follows:

HFCs		
Year	**Particulars**	**Rate**
2012	Average Interest Rate	11.51%
	Minimum Rate	9.85%
	Maximum Rate	13.05%
2013	Average Interest Rate	11.84%
	Minimum Rate	8.82%
	Maximum Rate	42.75%
2014	Average Interest Rate	10.63%
	Minimum Rate	9.40%
	Maximum Rate	28.00%

Table 6: Terms of debt issuance of HFCs

The maximum rate is the highest coupon offered on issuance and the minimum rate is the lowest coupon offered for debt issuance in the year. The average interest rate is the average of all such debt issuances in the particular year.

Alternative financing instruments for the housing finance sector

Primarily, the alternative sources may include the following:

- Secondary mortgage markets, in form of selling down a mortgage portfolio, either in form of mortgage backed securities (MBS) or as whole loan sell-offs,
- Covered bonds
- Credit-enhanced bonds.

While covered bonds and credit-enhanced bonds have not been used in India, but alternative sources of funding are important to be able to bring down the costs of financing for the HFCs, expand the sources of funding, provide means for capital relief etc.

Cost of financing in case of HFCs:

HFCs have primarily relied on bank borrowing, public deposits and others including debentures for raising their funds. While banks have access to deposits, most HFCs do not have access to deposits. Even where they have an access to deposits, most HFCs have not used public deposits to any large extent, due to high cost of deposits. In any case, banks have much stronger access to deposit market than HFCs. Banking deposits also have the protection of depositor insurance, not applicable so far to HFC deposits. The proportion of deposits as a way of financing liabilities of HFCs is only about 12.47%, and the proportion is gradually coming down. **Error! Reference source not found.** shows that he cost of borrowings by HFCs is in the region of 9% - 12%.

Name of the company	Finance Cost	Opening Borrowings	Closing Borrowings	Average of Op and Closing Borrowings	Cost of Debt

					Rs. in Billions
HDFC	160.29	1,58,8.27	1842.97	1715.62	9.34%
DHFL	37.83	274.39	482.42	378.40	10.00%
LIC HFL	71.74	663.26	782.97	723.11	9.92%
GIC HFL	4.20	33.96	40.98	37.47	11.21%
Indiabulls Housing Finance	32.32	246.15	283.51	264.83	12.20%
Repco Home Finance	3.24	25.71	33.07	29.39	11.02%
CanFin Home	4.22	30.73	46.93	38.83	10.87%

Table 7: Cost of Borrowings by HFCs
Source: Companies' Annual Reports,

Notes: the average cost of borrowing has been computed by us by averaging the opening and closing balances as shown by respective annual reports.

On the contrary, if one compares the cost of borrowing as above with the portfolio rates of return, computed from the annual reports of selected HFCs (as given in**Table 8: Portfolio rates of return of HFCs**), it is clear that the Net Interest Margin(NIM) works out to about 2% to 3%. It is notable that the data above may include interest from construction loans, Loans Against Properties (LAP) or other higher yielding loans that HFCs may be giving. Therefore, the NIM reflected by the annual reports may not be a good indicator of NIMs for prime residential mortgage loans, but there is no doubt that the NIM for prime mortgage lending in India is very low and this number is alarming in comparison with other low interest regimes. For example, even in the USA, mortgage spreads in 2013 were estimated to be about 100 bps, whereas risk free rates were quite low.[27] .

It is also notable that the data above is of highly rated HFCs. There is a large part of the HFCs population that either does not enjoy AA or AAA ratings, or may not have any formal rating at all. In such cases, the cost of borrowing of the HFC in question is substantially higher. As the market for prime residential loans is obviously competitive, this leaves only limited geographical territories, or limited customer segments, for the low-rated HFCs.

Name of the company	Mortgage Interest received	Opening Loan Pool	Closing Loan Pool	Average of Opening and Closing Pool	Weighted average rate of return
					Rs. in Billions
HDFC	226.92	1,695.69	1,965.53	1,830.61	12.40%
DHFL	46.13	339.01	405.95	372.48	12.38%
LIC HFL	93.34	777.94	913.18	845.56	11.04%
GIC HFL	6.24	45.39	53.12	49.25	12.67%

[27] See here:: http://www.economist.com/news/finance-and-economics/21572796-feds-frustration-mortgage-profits-have-been-soaring-spread-besting

Indiabulls Housing Finance	54.19	308.80	355.79	332.29	16.31%
Repco Home Finance	5.35	36.18	45.85	41.01	13.04%
CanFin Home	5.77	40.30	58.75	49.53	11.65%

Table 8: Portfolio rates of return of HFCs
Source: Companies' Annual Reports
Note: The interest information is picked from the annual reports of the respective companies, and may include interest income from sources other than mortgage lending In India, HFCs have several other products apart from home mortgage loans. One such product is Loan Against Property.

Key Regulatory Changes

1. National Housing Bank

1.1 Housing Finance Companies Directions, 2010

1.1.1 Housing Finance Companies (NHB) Directions, 2010 (As modified up to 1st July, 2013)[28]

Modified up to 1st July 2013, NHB had issued directions for HFCs in respect of matters relating to acceptance of deposits by housing finance companies, prudential norms for income recognition, accounting standards, asset classification, provision for bad and doubtful assets, capital adequacy and concentration of credit/ investments to be observed by the housing finance companies and matters to be included in the Auditors Report by the auditors of such housing finance companies and matters ancillary and incidental thereto and amended the said Directions from time to time.

1.1.2 Amendments to the Housing Finance Companies Directions, 2010 (Para 12)[29]

NHB has directed that the Housing Finance Companies (NHB) Directions, 2010, para number 12 to be amended for following aspects –

Interest payable on deposits pre-closed after 3 months but within 6 months fixed at 4% p.a. for individuals, and no interest for other depositors.

Penal rate of interest for deposits pre-closed after 6 months reduced by 1% to 1% & 2% as may be applicable, from 2% & 3%, respectively.

1.1.3 Amendments to HFC (NHB) Directions, 2010[30]

NHB directs that the Housing Finance Companies (NHB) Directions, 2010 be amended for following aspects –

[28] http://www.nhb.org.in/Regulation/HFC(NHB)-Directions-(As-modified-upto-1st-July-2013).pdf
[29] http://nhb.org.in/Regulation/Notification-No-NHB-HFC-DIR-12-CMD-2014.pdf
[30] http://www.nhb.org.in/Regulation/Notification-NHB-HFC-DIR9-CMD-2013.pdf

Para Numbers	Amendments
Para 2	With effect from September 30, 2013, the definition of "non-performing asset" has been amended to mean assets overdue for "more than ninety days" instead of "ninety days or more"
Para 4	HFCs allowed to accept deposits only for a tenure between 12 to 120 months
Para 11 (3)	Procedure provided in case of payment of interest on deposits seized by government authorities
Para 12	It is obligatory on the part of an HFC to intimate the details of maturity of the deposit to the depositor at least 14 days before the date of maturity of the deposit.
Para 27A	Ceiling on Loan to Value Ratios amended: (a) Upto 90% for loans upto Rs. 2 million (b) Upto 80% for loans between Rs. 2 million and Rs. 7.5 million (c) Upto 75% for loans exceeding Rs. 7.5 million
Para 28	Changes in provisioning requirements for Commercial Real Estate (CRE) exposures: (a) Standard Assets for CRE Residential Housing – 0.75% (b) Standard Assets for other CRE exposures – 1%
Para 29	Additional disclosures in Balance Sheet
Para 30	Changes in Risk weightages: (a) Individual Housing Loans upto Rs. 2 million and LTV<= 90%: 50% (b) Individual Housing Loans between Rs. 2 million and Rs. 7.5 million and LTV<= 80%: 50% (c) Individual Housing Loans more than Rs. 7.5 million and LTV<= 75%: 75% (d) Loans given for insurance of financed property: Same as corresponding Housing Loan (e) Exposures to CRE (Residential): 75% (f) Exposures to CRE (Commercial): 100% (g) Restructured Housing Loans: Risk Weight as applicable above + 25%
Para 32A	HFCs are disallowed from being partners in Limited Liability Partnerships and in Association of Persons
Para 38	HFCs are disallowed from lending against gold including bullion, jewellery etc.
Others	Changes in disclosures in balance sheet

1.1.4 Amendments to HFC (NHB) Directions, 2010 (Paragraphs 2 and 19)[31]

NHB directs that the Housing Finance Companies (NHB) Directions, 2010 be amended for following aspects –

[31] http://www.nhb.org.in/Regulation/Notification-No-NHB-HFC-DIR-11-CMD-2014.pdf

Para Numbers	Amendments
Para 2	In clause (e), for the words "SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997", the words "SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011", shall be substituted
Para 19	"Requirement to obtain prior approval of National Housing Bank for acquisition or transfer of control of housing finance companies

1.1.5 Amendments to HFC (NHB) Directions, 2010 (Para 2, 12 and 17)[32]

NHB directs that the Housing Finance Companies (NHB) Directions, 2010 be amended for following aspects –

Para Numbers	Amendments
Para 2	Definition of public deposits amended to include unsecured portion of optionally convertible debt instruments as the words "with an option to convert into shares" has been replaced with "compulsorily convertible into equity" in said clause. Further, any hybrid or subordinated debt would also be included in public deposits if the instrument carries a call option within 60 months
Para 12	Amendment to General provisions regarding repayment of deposits
Para 17	Addition to Advertisements and statement in lieu of advertisement

1.2 Guidelines for Accounting and Taxation

1.2.1 Creation of Deferred Tax Liability(DTL) on Special Reserve maintained by Housing Finance Companies[33]

In May 2014 (amended vide Circular No. NHB(ND)/DRS/Policy Circular 65/2014-15August 22, 2014), NHB has advised all HFCs to make a DTL provision on Special Reserves created under Section 36(1)(viii) of the Income Tax Act, 1961. If the expenditure due to the creation of DTL on Special Reserves as at March 31, 2014 has not been fully charged to the statement of Profit and Loss, HFCs may adjust the same directly from Reserves and the amount so adjusted may be appropriately disclosed in the financial statements for the year 2014-15. DTL for amounts transferred to Special Reserves for the year ended March 31, 2015 onwards should be charged to the Statement of Profit and Loss of that year. This NHB advisory is likely to push up the tax expenses of HFCs from 26% as of 2013-14 to close to 33% 2014-15 onwards, thereby affecting profitability. Further, owing to the adjustment against Reserves and normal business growth, the reported gearing of HFCs is likely to increase to 8-8.4 times by March 31, 2014.

1.2.2 Reserve Fund under Section 29C of the NHB Act, 1987[34]

NHB vide its policy circular no. 61 proposes the format for presentation of Reserve Fund in the Annual Accounts, under the heading 'Notes forming part of the financial statements' from the financial year 2013-14.

1.3 Capital and Funding

[32] http://www.nhb.org.in/Regulation/Notification-Dir-10_Amendment-14.pdf

[33] http://www.nhb.org.in/Regulation/NHB-ND-DRS-Policy-Circular-No-65-14.pdf

[34] http://nhb.org.in/Regulation/Policy-Circular-No.-61.pdf

1.3.1 **Secured Debenture: Regulations under Companies Act, 2013 &** Housing Finance Companies (NHB) Directions, 2010

Debentures issued by an HFC may be secured or unsecured. Section 71 of the Act read with Rule 18 (1) of the Companies (Share Capital and Debentures) Rules, 2014 and the NHB Directions lay down the provisions concerning the same. Where the Act and its allied rules talk about secured debentures in general, the NHB Directions provide for security cover specifically for issue of NCDs. Below, we shall cover the main provisions of issue of NCDs, dealing with provisions of both the Act and the NHB Directions:

(i) **Security Cover or Asset Coverage Ratio –** The NHB Directions provide that HFCs cannot raise NCDs unless the NCDs are fully secured at all points of time. However the NHB Directions are silent as to the category of assets over which security cover to be created. To fill up this gap, the Act read with the rules provide that an issue of debentures shall be secured by the creation of a charge or mortgage, on the properties or assets of the company, *having a value which is sufficient for the due repayment of the amount of debentures and interest thereon*.

Further the security for the debentures shall be created in favour of the debenture trustee on –

(a) any *specific movable property* of the company (not being in the nature of pledge); or

(b) any *specific immovable property* wherever situate, or any interest therein.

As can be seen from above, the Rules to the Act provide that security charge is to be created both on the principal value of the NCDs and also on the interest portion. This may be interpreted to mean that the entire interest for the term of debentures should also be covered by the assets. However, it is opined that if the assets are interest-bearing loans, it is sufficient if the principal from the assets covers the principal payable on the bonds, and the interest payable thereon covers the interest.

Additionally, the Rule 18 (1) (d) provides that the charge has to be over 'specific' movable and immovable property of the company *i.e.* a fixed charge. This has created a difficulty with NBFCs/HFCs because they have to create charges on specific and static loan portfolios, which, given the nature of loans, is not practical. Representations have been made that this rule is impractical, and it is expected that the rule may be relaxed soon.

(ii) **Debenture Redemption Reserve (DRR) Requirement** –Section 71 (4) of the Act read with the rules provides that:

(a) a company issuing debentures is required to create a DRR out of the profits of the company available for payment of dividend. An interpretation of the above would mean that an HFC would be required to create a DRR only if it has profits which would otherwise be available to payment of dividend. In case the HFC does not have distributable profits, it is not required to create a DRR.

(b) HFCs registered with NHB are required to maintain DRR of 25% of the value of debentures issued through public issue. However for privately placed debentures, no DRR is required[35].

[35] Exemption for HFCs has been inserted by way of an amendment to the Companies (Share Capital and Debentures)Amendment Rules,2014 *vide* MCA circular dated 18th June, 2014

(c) The amount so credited to the DRR shall not be utilised by the company except for the redemption of debentures.

(iii) Liquidity creation before redemption (or Debenture Redemption Fund requirement):

(a) Where an HFC is required to create a DRR, is also required to invest or deposit from the amounts so deposited in a DRR, before 30th April each year, an amount not less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of the next year. Deposit to be made with any scheduled bank; investment to be made in unencumbered securities of the Government or unencumbered security / bonds under section 20 of the Indian Trusts Act, 1882.

(b) The amounts so invested or deposited not be used for any purpose other than for redemption of debentures maturing during the year referred above;

(c) Further, the amount remaining invested or deposited shall not at any time fall below 15% of the amount of the debentures maturing during the year ending on the 31st day of March of that year.

(iv) **Debenture Trustee Requirement –** Section 71 of the Act exempts a company offering NCDs to the public or its members amounting to less than 500 from appointing debenture trustees. However, pursuant to Rule 11 of Housing Finance Companies issuance of Non-Convertible Debentures on private placement basis (NHB Directions), 2014 requires an HFC to appoint a debenture trustee even in case of private placement of NCDs. In case of issue of secured debentures, debenture trustees shall be appointed before the issue of prospectus or letter of offer for subscription and not later than 60 days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders. The Rule further goes on to lay down the terms and conditions of appointment, qualifications and duties of debenture trustees.

(v) **Repayment and powers of the NCLT/CLB to force repayment** – A company shall redeem the NCDs and pay interest thereon in accordance with the terms and conditions of their issue.

Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the National Company Law Tribunal (or until it is duly instituted, the Company Law Board) may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(vi) **Consequences for default**

(a) Criminal liability for non-compliance with the NCLT/CLB order – If any default is made in complying with the order of the NCLT/CLB under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than Rs. 2 Lakh but which may extend to Rs. 5 Lakh, or with both

(b) Disqualification of directors –Section 164 (2) of the Act prohibits a person from being eligible to be appointed as a director of any company for a period of five years, if the company in which he is a director at present defaults to redeem any debentures on the due date or pay interest due thereon.

1.3.2 Applicability of Deposit Rules under Companies Act, 2013 & Housing Finance Companies (NHB) Directions, 2010 on issue of NCDs by HFCs

Section 73 of the Act read with the Rule 2 (c) (ix) of the Companies (Acceptance of Deposits) Rules, 2014 provides that the money raised by a company through the issue of non-convertible debentures would be considered as a deposit unless the same are secured or are issued by a company to another company.

However, Rule 1 (3) of the Companies (Acceptance of Deposits) Rules, 2014 clearly exempts HFC registered with the NHB from the applicability of the rules.

Since the Companies (Acceptance of Deposits) Rules, 2014 exempts HFCs from its purview we need to look at the 'The Housing Finance Companies (NHB) Directions, 2010' in this regard. Direction 2 (1) (y) of 'The Housing Finance Companies (NHB) Directions, 2010' defines the term 'public deposit' and exempts any amount raised by the issue of bonds or debentures secured by the mortgage of any immovable property of the HFC or by any other asset from the purview of public deposit.

Hence if the NCDs being issued by the HFC are secured by mortgage of any asset of the HFC, the amount received from the NCD issuance would not be considered as a deposit. In case the above is not fulfilled or the NCDs are not issued to any company, it will be considered as a deposit and the provisions of Chapter II of 'The Housing Finance Companies (NHB) Directions, 2010' need to be complied in this regard.

1.3.3 HFCs issuance of Non-Convertible Debentures (NCDs) on private placement basis Regulations under Companies Act, 2013 & (NHB) Directions, 2014[36]

For private placement of NCDs by an HFC, Section 42 of the Act read with Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 needs to be viewed. In this regard, Rule 14 (5) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 **exempts** HFCs registered with the NHB from the applicability of the following private placement provisions:

(i) Private placement offer cannot be made to more than 200 persons in the aggregate in a financial year; and

(ii) Investment size per person under private placement cannot be less Rs. 20,000/- of face value of securities.

An HFC registered with NHB is exempted from the private placement rules under the Act only to the extent of the abovementioned two provisions. The other provisions with regard to private placement of securities would be applicable to the issue of NCDs by the HFC.

In this regard, NHB on 19th March, 2014 came out with the NHB Directions[37], made effective from 1st April, 2014, to regulate the issue of NCDs by HFCs. The RBI directions on issue of NCDs on private placement issued on 27thJune, 2013 were applicable only to NBFCs registered with the RBI and not to HFCs, which though being NBFCs, are registered with NHB. Hence, the gap created by the RBI directions, was bridged by the NHB by issuing the NHB Directions, which are specifically applicable to HFCs.

Highlights of the NHB Directions are:

Eligibility Criteria – Only HFCs having net owned funds of Rs. 1 billion as per the last audited balance sheet are allowed to issue NCDs on private placement. This is consistent with the fact that HFCs are mandatorily required to have a minimum net owned fund of Rs. 1 billion.

[36] http://www.nhb.org.in/Regulation/Notification-NCD-Dir.1_New-Directions-2014.pdf

[37] http://www.nhb.org.in/Regulation/Notification-NCD-Dir.1_New-Directions-2014.pdf

Subscription criteria –The maximum number of investors to whom the NCDs can be issued has been restricted to 49, with the minimum subscription amount being Rs. 25 lakhs for a single investor and in multiples of Rs. 5 lakhs thereafter.

Note: These are the two provisions under the Act which have been exempted for NCDs issued by registered HFCs.

Rating requirement –The NCDs issued by an HFC need to be rated from a list of credit rating agencies, as provided in the NHB Directions and should have minimum credit rating of adequate degree of safety regarding timely servicing of financial obligations.

Maturity of the security – The maturity period of the NCDs shall not be less than 12 months, but it should not exceed the validity period of the credit rating, if any. In case of put/call option, the exercise date shall not be within 1 year from the date of issuance.

Note: The NCDs having tenure of less than 1 year are anyways covered by the Non-Convertible Debentures (Reserve Bank) Directions, 2010 , which regulates the issuance of NCDs having maturity of less than 1 year but more than 90 days. These directions are applicable to all the participants of capital market; hence the HFCs coming out with private placement of NCDs of maturity of less than 1 (one) year are also covered by these directions.

***Quantum of issuance by the HFC* –** The maximum amount of NCDs that an HFC can issue should be is the lower of the following –

i. Amount as decided by the Board of Directors; or

ii. Amount prescribed by the Credit Rating Agencies, if any.

Security – The NCDs will have to be fully secured at all points of time. If at the time of the issuance, the security cover is insufficient/ not created, the issue proceeds shall be placed under escrow until creation of security, however such security creation shall be completed within 1 month from the date of issue. This shall not be applicable in case the HFC is issuing sub-ordinate debt instruments or hybrid debt instruments. However, the directions are silent with respect to the type of security to be created.

Note: Since the NHB Directions provide that the NCDs issued by HFCs are required to be fully secured, the provisions of Rule 18 (1) of the Companies (Share Capital and Debentures) Rules, 2014 need to be complied in this regard. Further, since the directions are silent as to the type of security cover, the same needs to be as per the provisions of Rule 18 (1), as mentioned above.

Other highlights –

i. A debenture trustee has to be appointed for the issuance of NCDs through private placement.

ii. Lending against own debentures has been barred for the HFCs.

Further, compliance with the other provisions laid down under the Act *(except to the extent exempted)*, SEBI (Issue and Listing of Debt Securities) Regulations, 2008, or any other law that may be applicable, needs to be ensured

1.4 Guidelines on 'Know Your Customer (KYC)'

1.4.1 Revised Guidelines on 'Know Your Customer (KYC)' & 'Anti Money Laundering (AML) Measures' for HFCs[38]

NHB vide its policy circular no.60 provides revised guidelines on KYC requirements and AML measures. This circular also states that the letter issued by the Unique Identification. Authority of India containing details of name, address and Aadhaar number is an officially valid document within the meaning of Rule 2(1)(d) of the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 and, therefore, can be relied upon by an HFC for the purposes of Rule 9 of the said Rules.

1.4.2 Central Know Your Customer Registry (CKYCR)[39]

The Ministry of Finance, Department of Financial Services (DFS) advised that there be Common KYC Templates for central depository for CKYCR. Common KYC templates (Individual and Non-Individual) were designed for HFCs. HFCs were requested to furnish their comments/ suggestions, if any, on the Common KYC Templates by 10-02-2014. The final Common KYC Templates and other modalities of availing the services of CKYCR will be intimated to HFCs in due course.

1.5 Lending - Loan Products and Features

1.5.1 Disbursement of housing loan to individual linked to the stages of construction[40]

NHB vide policy circular no.58 advises HFCs that disbursal of housing loans sanctioned to individuals should be closely linked to the stages of construction of the housing project/houses and upfront disbursal should not be made in cases of incomplete/ under construction/ green field housing project/ houses.

1.5.2 Most Important Terms and Conditions[41]

NHB vide its policy circular no. 54 provides guidelines for HFCs to obtain a document containing the most important terms and conditions of such loans in all cases, as per the suggested format.

1.5.3 Levy of Foreclosure charges / Pre-payment penalty on floating rate home loans

NHB vide its policy circular no. 63[42] prohibits HFCs from charging any prepayment penalty / foreclosure charges in case of floating rate home loans to individuals, whether the prepayment is in part or in full.

Further NHB vide its policy circular no.66[43] has also clarified that the circular will be applicable in all cases irrespective of the date of sanction of the home loans. Further, this circular is not applicable in case the borrower or co-borrower is a company, firm etc

1.6 Investments

1.6.1 Ready Forward Transaction in Government Securities and Accounting thereof

NHB vide its policy circular no.57 clarifies that HFCs can enter into ready forward contracts on government securities subject to the terms and conditions contained in the concerned RBI circular.

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[38] http://nhb.org.in/Regulation/Circular-No.-60-English-14.pdf
[39] http://nhb.org.in/Regulation/Policy-No.59-English-14.pdf
[40] http://www.nhb.org.in/Regulation/Policy-No.58-English.pdf
[41] http://www.nhb.org.in/Regulation/English-54-policycircular.pdf
[42] http://nhb.org.in/Regulation/NHB-ND-DRS-Policy-Circular-No-63-14.pdf
[43] http://nhb.org.in/Regulation/NHB(ND)-DRS-Policy-Circular-66-2014-15.pdf

1.7 Refinance Schemes

NHB's refinance assistance can be availed for a variety of purposes and is available at competitive rates for varying tenures, with fixed and floating interest rate options. The Bank has also launched a few new schemes such as the Urban Housing Fund, Refinance scheme for Women, etc. catering to the emerging requirements of the sector. A list of all refinance schemes by NHB can be viewed here.

1.7.1 Loans under Rural Housing Funds Scheme/Urban Housing Fund Scheme – Clarification[44]

NHB has clarified that it is clarified that such loans are not to be regarded as loans given at teaser / special rates within the meaning of item (iv) of sub-paragraph (I) of paragraph 28 of the Housing Finance Companies (NHB) Directions, 2010

1.7.2 Urban Housing Fund & Rural Housing Fund – Interest Rates

The revised rates and loan size, which shall be applicable on all refinance disbursements made under the Urban Housing Fund[45] & the Rural Housing Fund[46] on or after the date of this circular, are as under:

Loan Size	Interest Rate on Refinance	On Lending Cap
Upto Rs. 1 million	7.10% p.a.	9.6% p.a.

2. Reserve Bank of India

2.1 RBI Master Circular[47] for Housing Finance

The Reserve Bank of India has consolidated all the instructions/guidelines issued to banks till June 30, 2014 relating to Housing Finance

2.2 RBI Master Circular[48] – Priority Sector Lending – Target and Classification

This Master Circular consolidates the current instructions of all the circulars/mail box clarifications to banks on Priority Sector Lending, issued by Reserve Bank on the subject up to June 30, 2014. The eligibility under priority sector loans to HFCs is restricted to five percent of the individual bank's total priority sector lending, on an on-going basis.

2.3 'CRE-RH' – New Sub-sector in commercial real estate sector

RBI vide a notification[49] dated 28th January, 2014 had created a sub-sector called Commercial Real Estate – Residential Housing (CRE-RH). Loans to residential housing projects under the Commercial Real Estate would come under this sub-sector and shall include loans to builders/

[44] http://www.nhb.org.in/Regulation/NHB(ND)-DRS-Misc-Circular-NO-14-2014-15-05-2014.pdf
[45] http://www.nhb.org.in/Financial/housing-finance-circular/Circular-12-UHF-Interest-Rates.pdf
[46] http://www.nhb.org.in/Financial/housing-finance-circular/Circular-11-RHF-Interest-Rates.pdf
[47] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/68MH01072014F.pdf
[48] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/95PSLT010714FL.pdf

[49] http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=8713&Mode=0

developers for residential housing projects (except for captive consumption) under CRE segment. Typically an exposure in CRE sector would attract a risk weight of 100% and would require provisioning of 1% for standard assets. RBI in the recent notification, while carving out the sub-sector also stated that owing to lesser risk and volatility in CRE-RH sector the risk weights on CRE-RH exposure would be 75%. Also the standard asset provisioning for CRE-RH would be 0.75% as against 1% in CRE segment exposure. Also in the present economic scenario we have full fledged REITs regulation along with tax pass through, this CRE-RH mechanism will definitely expand the scope of borrowings for REITS. Articles relating to REITs can be viewed here.

2.4 **Affordable Housing: Re-defined by RBI**

The Reserve Bank of India, in its circular dated July 15, 2014, has extended the definition of affordable housing. Earlier, loans to individuals up to Rs.25 lakhs in metropolitan centres with population above ten lakhs and Rs.15 lakhs in other centres for purchase /construction of a dwelling unit per family were considered as affordable housing loans and the same were eligible for priority sector lending. But, post this circular, loans to individuals up to Rs. 50 lakhs for houses of values upto Rs. 65 lakhs located in metropolitan areas and loans up to Rs. 40 lakhs for houses of value Rs. 50 lakhs located in areas other than the six metropolitan centres would also be considered as affordable housing loans in addition to the earlier limits set for priority sector lending. However, the above definition is applicable only for the purpose of this circular, this means that, for all other purposes of RBI, the earlier definition would prevail.

2.5 **Government eases norms of FDI Policy in Construction Sector**

The extant FDI policy was revised vide Press Note 10 (2014 Series)[50] to relax some of the conditions on FDI in construction. A quick comparative of the amendment and its impact is as below:

Particulars	Revised FDI Policy	Existing FDI Policy	Comments
Investment limit	100% equity investment under automatic route in Construction-development projects	100% equity investment under automatic route in Construction-development	Same as existing provision
Minimum area to develop	Minimum area to be developed: ➢ In case of development of serviced plots, no minimum land area requirement. ➢ In case of construction-development projects, a minimum floor area of 20,000 sq. meter. ➢ Conditions above would not apply in case investee/ joint venture companies commit at	Minimum area to be developed: ➢ In case of development of serviced housing plots, a minimum land area of 10 hectares. ➢ In case of construction-development projects, a minimum built-up area of 50,000	No minimum floor area requirement for development of serviced plots The reduction in the minimum floor area requirement will allow more construction development projects to attract

[50] http://pib.nic.in/newsite/erelease.aspx?relid=112475

	least 30 percent of the total project cost for **low cost affordable housing**.	sq.mts.	FDI. Affordable housing segment would get boost since there is no restrictions in area and minimum capitalization norms.
Minimum capital	Investee company will be required to bring minimum FDI of US$ 5 million within six months of commencement of the project. The commencement of the project will be date of approval of the building plan/lay out plan by the relevant statutory authority. Subsequent tranches of FDI can be brought till the period of ten years from the commencement of the project or before the completion of project, whichever expires earlier. Minimum capitalization norms not applicable in case investee/joint venture companies commits at least 30 percent of the total project cost for low cost affordable housing	Minimum capitalization of $10 million for wholly owned subsidiaries and US $ 5 million for joint ventures with Indian partners. The funds would have to be brought in within six months of commencement of business of the Company	Now Minimum Capital investment by any investee company has been halved to US$ 5 million as against earlier it was $10 million for wholly owned subsidiaries and US $ 5 million for Joint venture partners. Commencement date of the project will be date of approval of building plan by statutory authority is specifically mentioned. Further, the avenue for bringing additional FDI over period of time has been explicitly provided for.
Repatriation of FDI	FIPB may permit repatriation of FDI or transfer of stake by one non-resident investor to another non-resident investor, before the completion of project.	Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. However, the investor may be permitted to	First, the lock-in period requirement has been done away with completely and investors can exit after the development of trunk infrastructure.

		exit earlier with prior approval of the Government through the FIPB.	Further, the transfer of stake by one Non-Resident investor to another Non- Resident investor can happen before completion of project with approval of FIPB. The provision for transfer of stakes has been newly inserted and allows flexibility of liquidating investments. This should certainly find favor with overseas investors.
Approvals	The Indian investee company shall be responsible for obtaining all necessary approvals, and complying with all other requirements of laws.	The investor/investee company shall be responsible for obtaining all necessary approvals and complying with other requirements of laws.	Now Indian investee company has responsibility to take approvals and comply with laws. Rightly there should have been no obligation on the investor to be able to obtain necessary approvals and undertake compliances. The fine tuning of the regulation to this effect is much welcomed.
Sale of Developed plots	Indian investee company will be permitted to sell only developed plots. "developed plots" will mean plots where trunk infrastructure i.e.roads, water supply, street lighting, drainage and	The investor/investee company would not be permitted to sell undeveloped plots. "undeveloped plots" will mean where roads, water supply, street lighting, drainage,	Now once the trunk infrastructure is made available the plots can be sold. Condition of developing at least

	sewerage, have been made available.	sewerage, and other conveniences, as applicable under prescribed regulations, have not been made available. At least 50% of each such project must be developed within a period of five years from the date of obtaining all statutory clearances.	50% of project within 5 years of obtaining clearances has been dropped in the revised regulations.
Definition of Affordable housing project	Project using at least 40% of the FAR/FSI for dwelling unit of floor area of not more than 140 square meter will be considered as Affordable Housing Project for the purpose of FDI policy in Construction Development Sector. Out of the total FAR/FSI reserved for Affordable Housing, at least one-fourth should be for houses of floor area of not more than 60 square meter.	NA	Now for the purposes of FDI it has been clarified as to what will constitute an affordable housing project. While there are several definitions of affordable housing already in existence, the specific definition for FDI purpose brings clarity for foreign investors as to what may constitute as affordable.
100% FDI under automatic route in completed projects	100% FDI is permitted under automatic route for operation and management of townships, malls/ shopping complexes and business centres	NA	This seemingly is quite interesting insertion. The revised regulations indicate that the maintenance of these projects can also invite FDI.

Liberalization in the existing FDI policy was the need of the hour. Key amendments of exempting developers from area restrictions and minimum capitalization would also help in fulfilling the shortage of affordable houses in the country. In essence the revised regulations are much welcomed

for increasing the flow of FDI into the sector and for providing the much needed impetus to the sector.

Future Outlook

ICRA in its report states [51] *"With the latest Parliamentary elections delivering a strong verdict, business sentiments have improved significantly on expectations of faster decisions and more investor friendly reforms. However, concerns over the real estate sector in general and the tight liquidity positions of developers in particular are likely to get addressed only in the medium term. Given this backdrop, ICRA expects housing credit to grow at a similar pace in 2014-15 as in 2013-14, and pick up thereafter. Overall, housing credit is expected to report a 19-21% growth in 2014-15 (20% in 2013-14). Over the medium term, ICRA expects mortgage penetration to increase to double digits; this should happen by March 2018"*

Given the present scenario, it is necessary to bring down the cost of funding for both banks and HFCs. Banks have found a partial solution in form of the long-term infrastructure bonds; however, HFCs have limited access to capital market instruments; so there is an urgent need to introduce capital market instruments.

Net interest margin for HFCs is quite narrow and is not appropriate; therefore there is a need to introduce low cost instruments.

There is possibility of a huge spurt in the affordable housing segment. The government has ambitious plans for affordable housing. Surely enough, housing cannot be affordable unless housing finance is affordable. NHB is conscious of the need and will most likely take steps that may help to bring down the cost of funding for HFCs.

Domestic cost of borrowing with AAA bonds is close to 10 %. Off-shore cost of bonds, after taking into consideration, the cost of hedging, works out to nearly the same as the domestic cost of borrowing. At present some of the larger HFCs have raised or are in the process of raising funds through ECB-funding. This happened primarily because there is no significant cost advance after taking into consideration the hedging cost. However, there has been some recent issuance of rupee-denominated bonds outside India, where the cost of funding has been a good 150 bps lower than the sovereign rate. Of course, one will need to add to this the cost of the third party enhancement, but the cost may still be much lesser than domestically available options. Given the policy prerogatives of the government, these instruments may be explored. These instruments may be much better than an interest subsidy[52].

In the year 2013-14 India Mortgage Guarantee Corporation (IMGC) performed its first mortgage guarantee (MG) contract in the Indian mortgage market. With this performance it is expected that the primary mortgage and securitization market will expand since MG products are celebrated to contribute towards the growth, expansion and stability of the mortgage market.

Government of India has also implemented Interest Subvention Schemes like 1% Interest Subsidy Scheme, Interest Subsidy Scheme for Housing the Urban Poor (ISHUP) and Rajiv Awas Yojana (RAY), etc., in order to make housing loans affordable for the targeted segments. These implementations have and will further improve the demand for housing loans.

Recognising the importance of housing and real estate sectors, the Union Budget for 2014-15 included several announcements[53] such as –

a. 8000 crores allocated to the Rural Housing Fund run by NHB.
b. 7,060 crores allocated for development of 100 new smart cities in the country.
c. Relaxation of FDI norms in the real estate sector.

[51] file:///C:/Users/Vinod%20Kothari/Downloads/SH-2014-Q3-1-ICRA-Housing%20Finance%20(1).pdf
[52] An ambitious plan has been formulated by the Government, under the banner Sardar Patel Urban Housing Mission, which aims at providing housing to all urban poor by 2022. One of the measures being considered under the scheme is interest subsidy. See some details here: http://pib.nic.in/newsite/PrintRelease.aspx?relid=110393
[53] http://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=910

d. 4,000 crores allocated for low-cost housing and ` 50,000 crores for urban housing.
e. Slum development to be treated as Corporate Social Responsibility (CSR) activity.
f. Real estate investment trusts (REITs) introduced. SEBI has since issued guidelines in this regard.
g. Increase in deduction limit on interest paid on home loans.

Housing is integral for individual, community and society on the whole. Good quality housing produces results which are beyond those that are financial or material. It is psychologically beneficial as it provides a sense of security in one's life. Even though the housing sector has made creditable progress over the years, yet, it can achieve greater heights. Availability of sufficient housing units in the affordable segment and better home ownership together with accessible formal housing finance for the lower income segments remains to be an important concern if significant overall economic growth is to be achieved.

Also see our other related write-ups: Articles on Housing Finance Sector can be viewed at: **http://www.india-financing.com/housing-finance.html**

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