AFFORDABLE HOMES ALTERING MORTGAGE MARKET DYNAMICS

SMALLER ONES ARE SCALING UP, NEW PLAYERS ARE ALSO CLAWING IN

Report by

CRISIL

An S&P Global Company

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AFFORDABLE HOUSING COMMITTEE PRESENTS

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Affordable homes altering mortgage market dynamics

Smaller ones are scaling up, new players are also clawing in

The market dynamics of housing finance, one of India's more resilient sectors, has seen significant changes of late, with smaller players chipping away at the spoils. And if the buzz around affordable housing is any indication, the next few years would see even more changes.

The overall sector remains concentrated, with the top four housing finance companies or HFCs (with loan book greater than Rs 50,000 crore) having a share of around 79%. But their share was down around 600 bps in the two years to fiscal 2016, and is expected to have declined further by at least 500 bps in fiscal 2017.

This, even as mid-sized HFCs (with loan book between Rs 5,000-50,000 crore) have increased their market share – up 600 bps to 17% at the end of fiscal 2016 – and smaller HFCs (with loan book below Rs 5,000 crore) have been able to hold on to their share.

The past couple of years have seen a large influx of new players, taking the number of HFCs from 55 in fiscal 2014 to 70 in fiscal 2016, with around 80 licences pending with the National Housing Bank (NHB). Interestingly, many of these new entrants are focussed on the affordable housing segment (CRISIL Ratings defines affordable housing loans as those with a ticket size less than Rs 15 lakh), where there is a lot of buzz today, thanks to regulatory and policy changes.

Altering landscape

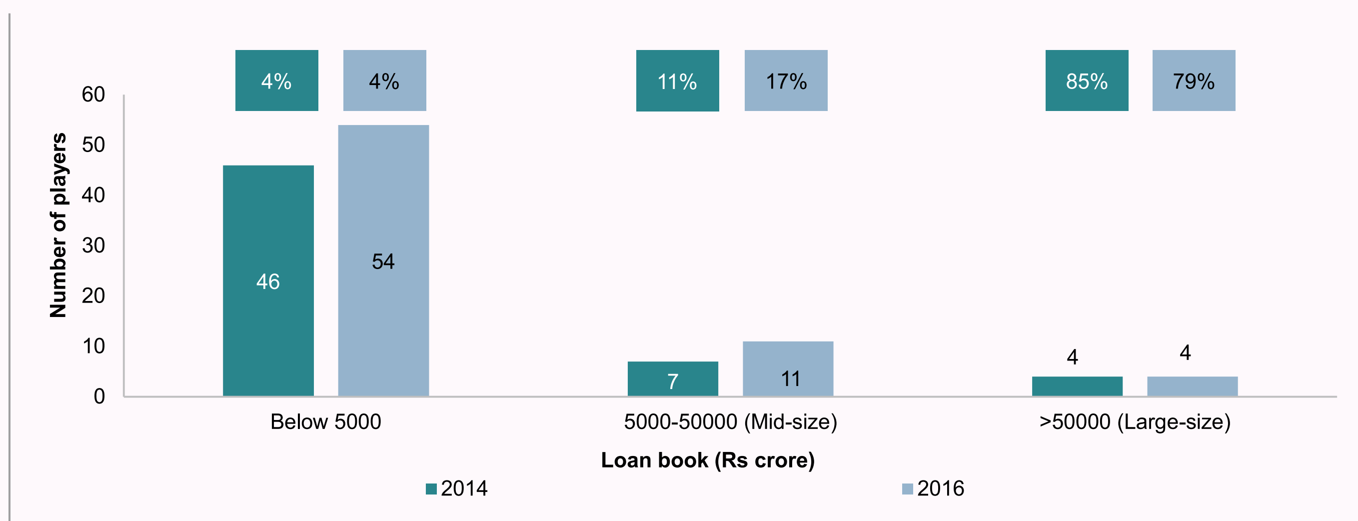


Figure in box indicate % market share
HUDCO is treated as a financial institution

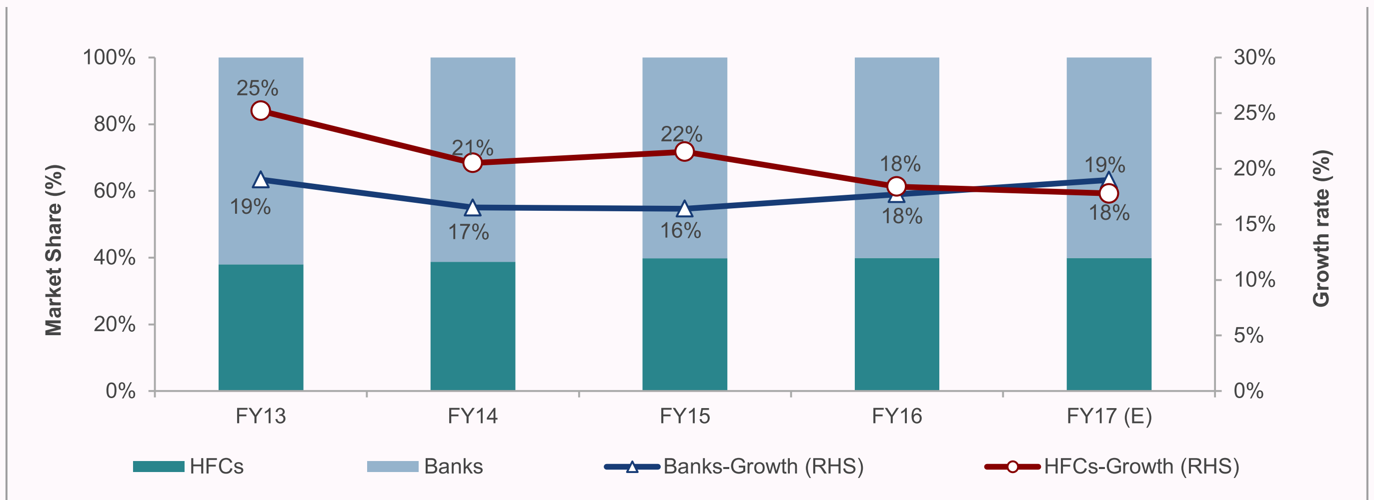
Advances to remain strong, but competition will bite

Overall advances growth of the sector is expected to remain healthy at 17% CAGR over the next three years. Advances are expected to almost double to Rs 12.7 lakh crore by fiscal 2020 from Rs 6.7 lakh crore as on March 31, 2016.

However, the competition has intensified in the traditional home loans space, particularly from banks, which are being compelled by subdued demand and asset quality pressures in the corporate sector to focus on retail lending.

We expect banks’ home loan growth to outpace that of the HFCs for the first time in five years, though this competition could reduce as corporate credit demand picks up gradually.

Growth in housing portfolio of HFCs vs banks

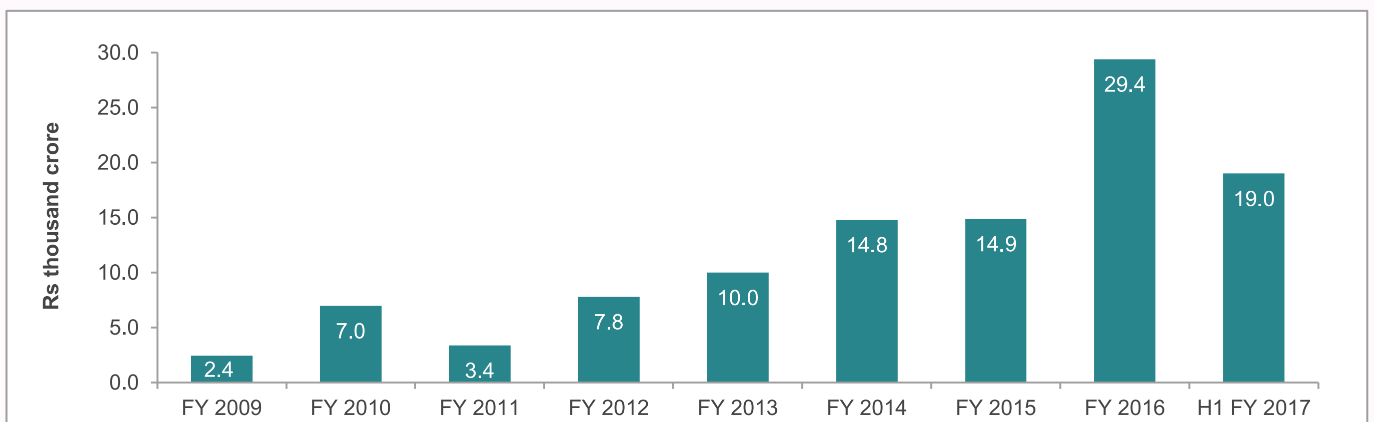


The increased focus of banks is also reflected in portfolio buyouts. Volumes of mortgage backed securities (MBS) and their contribution to overall securitisation volumes have been increasing over the past five years.

MBS volumes hit an all-time high of Rs 29,400 crore in fiscal 2016 – up a whopping 86% over the previous year – and are rising. In just the half-year ended September 30, 2016, volumes had surpassed 69% of the full-year fiscal 2016 volumes. Volumes in the third quarter were muted on account of demonetisation, but picked up again in the fourth quarter.

More than a third of overall MBS pool is non-priority sector lending (PSL) and demand for non-PSL MBS pools far outstrips the demand for non-PSL ABS pools.

Trend in MBS volumes



Overall performance steady, demonetisation a blip

The HFC sectors resilience has much to do with strong asset quality, with gross non-performing assets as low as 0.8%. This is supported by factors like the nature of the asset class, the customer profile (around 80% home loans are to salaried customer), practices like direct debit/ cheque being the primary mode of payment, and the fact that the average loan to value (LTV) is around 75%. This has enabled HFCs to maintain low credit costs and – coupled with low operating expenses – has helped keep profitability steady, with the return on assets (RoA) at 2.1%.

The so-far-steady mortgage segment witnessed some ripples due to demonetisation, with developer financing and loan against property (LAP) segments affected by a slowdown in growth over the near to medium term.

In the LAP segment, there could be a risk build-up due to a potential drop in property prices. CRISIL, however, believes the strength of business cash flows will determine the ability of the borrowers to service these loans. CRISIL sensitivity analysis indicates that a 30% fall in property price will lead to ~20% of the LAP portfolio having a stretched collateral cover. If this situation were to pan out, assuming a recovery rate of 80%, credit costs could rise 200-300 bps spread over 20-24 months. Nevertheless, if the cash flows are not impacted, the risk of default will be low, especially in cases where the collateral is residential property.

Price correction impact on collateral cushion

		Property prices decline		
		10%	20%	30%
Loan to value ratio	50%	1.8	1.6	1.4
	55%	1.6	1.4	1.3
	60%	1.5	1.3	1.2
	65%	1.4	1.2	1.1
	70%	1.3	1.1	1.0
	75%	1.2	1.1	0.9
	80%	1.1	1.0	0.9

High risk | Medium risk | Low risk

CRISIL believes the home loan segment is relatively insulated vis-à-vis the non-home loan segments. Overall, gross NPAs of HFCs is estimated to increase to 1%, up ~20 bps from 0.8% in fiscal 2016. Consequently, lower credit growth than earlier and increased credit costs is expected to cause a ~10 bps decline in profitability with RoA expected at 2.0% for the fiscal.

Affordable housing the new buzz in town

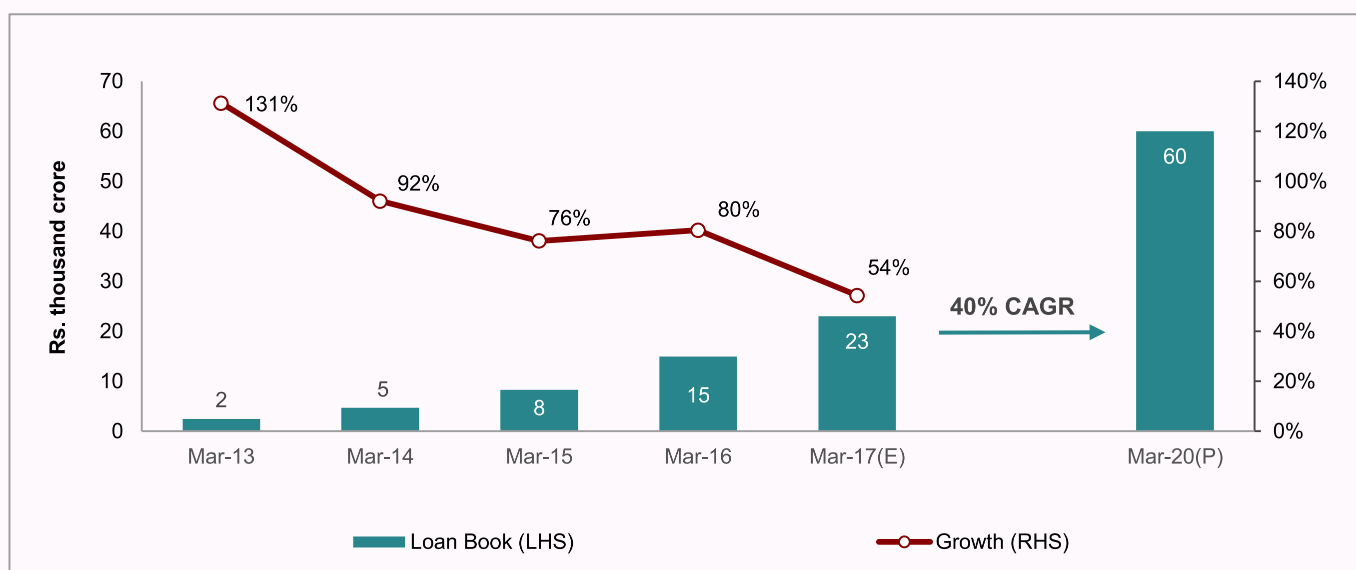
Increased competition and relative saturation of key metro markets has led to the affordable housing emerging as a new segment for a large number of the recent entrants. To top it up, government initiatives like „Housing for all by 2022 and regulatory impetus have provided much needed stimulus.

As per CRISIL estimates based on the top 30 HFCs, the affordable housing segment was worth around Rs 1.6 lakh crore, constituting more than 25% of all housing loans as on March 31, 2017.

The segment is largely catered to by HFCs, given the small ticket size and expertise required. Some of the HFCs have been around for a long time and have established themselves in this space, with affordable housing loans making up around 40% of their assets under management (AUM). These HFCs have understood the business segment and accordingly institutionalised the business models, and have logged stable performance in line with the overall HFC sector.

Lately, a lot of traction has come from new players solely focused on this sector. These HFCs command a share of around 15% of the overall affordable housing space, with an estimated AUM of ~Rs 23,000 crore as on March 31, 2017. The players have seen robust growth over the past couple of years and are expected to continue growing at a CAGR of 40% over the three fiscals through 2020, almost tripling the pie to ~Rs 60,000 crore by fiscal 2020.

Growth in loan book of recent entrants



Government and regulatory impetus spawns huge growth potential

The growth in the affordable housing segment has been supported by the government as well as the regulator. Under the Pradhan Mantri Awas Yojana (PMAY), around 7 lakh new housing units have been approved for construction. Also, the credit linked subsidy scheme (CLSS) has been rolled out to enhance affordability for the borrowers.

As per CRISIL estimates, under the CLSS scheme, for economically weaker section (EWS) and low income group (LIG) home buyers availing a 20-year loan of Rs 12 lakh and Rs 6 lakh & below, the reduction in EMI could be up to ~22% and ~45%, respectively. This is irrespective of the interest rate charged on the loan.

Coupled with tax incentives, the effective interest paid on a home loan could be significantly lower for some categories. CRISIL believes this substantially increases the incentive for home buyers.

Benefit in EMI because of CLSS

Loan amount	Rs 15 lakh	Rs 12 lakh	Rs 6 lakh	Rs 3 lakh
Tenure of the loan	20 yr			
Interest rate on loan	12.5%			
EMI without taking into account subsidy	Rs 17042	Rs 13634	Rs 6817	Rs 3408
Subsidy eligible under PMAY	Rs 2.67 lakh	Rs 2.67 lakh	Rs 2.67 lakh	Rs 1.34 lakh
Loan amount post adjustment for subsidy	Rs 12.33 lakh	Rs 9.33 lakh	Rs 3.33 lakh	Rs 1.66 lakh
Adjusted EMI	Rs 14005	Rs.10597	Rs 3780	Rs.1890
Benefit in EMI	18%	22%	45%	45%

The regulator has also provided impetus to this segment by reducing the risk weights for smaller-ticket housing loans, allowing high LTV for housing units costing below Rs 30 lakh and increasing the additional investment limit in HFCs to 15% (from 10%) for debt mutual funds, thereby increasing the overall sectoral cap for HFCs to 40%.

The recent budget provided further lift. The proposed infrastructure status to the affordable housing sector can lower the borrowing costs of developers, who could, in turn, pass on some of the savings to the buyers, thus spurring demand. This move is also expected to increase the willingness of banks to lend to projects in this space.

The budget also increased the allocation for the PMAY from Rs 15,000 crore to Rs 23,000 crore. Other budget proposals which are expected to provide a boost to the sector include tax exemptions for developers sitting on completed unsold inventory, amendment of section 80-IBA for relaxing the condition of period of completion of a project for claiming deduction to five years from three years now, etc. Also, instead of a built-up area of 30 and 60 square metre (sq m), a carpet area of 30 and 60 sq m is to be counted for affordable housing units in municipal limits of four metropolitan cities and the rest of the country, respectively.

All these initiatives are expected to further provide an impetus to the affordable housing segment.

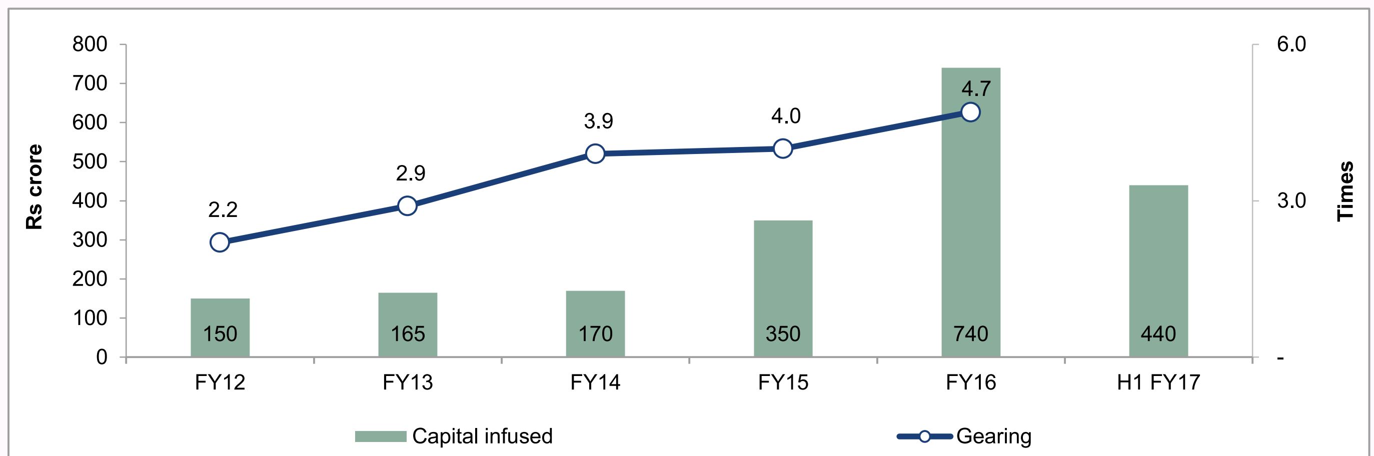
Growth supported by capital availability and increased PE interest

A growth enabler for recent entrants in the affordable housing space has been the large capital infusion seen of late – with as much as Rs 2,000 crore has infused in these HFCs over the past five years.

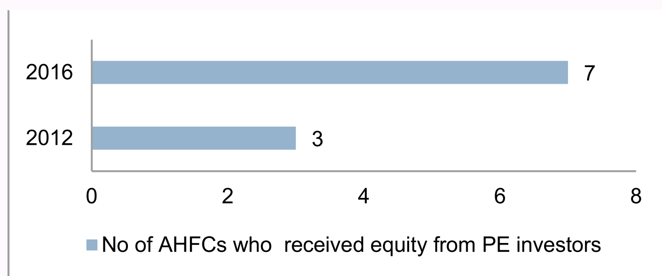
A number of these HFCs are backed by large NBFCs and private equity players (PEs). The number of PEs invested in this space has shot up from 4 to 18 in the past five years. CRISIL believes the sector will continue to attract capital from investors.

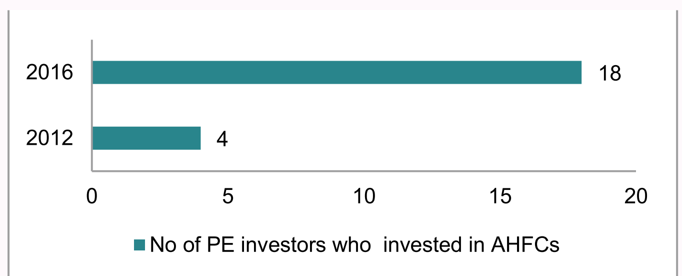
Incremental capital requirement to support growth till fiscal 2020 is estimated at ~ Rs 1,500 crore. At the same time, the leverage level is expected to gradually increase to 7-8 times from around 5 times now.

Capital infusion for recent entrants



Rising PE interest





Business metrics different from traditional home loans

The business metrics of HFCs in the affordable housing space are quite different from that witnessed over the years for traditional home loans.

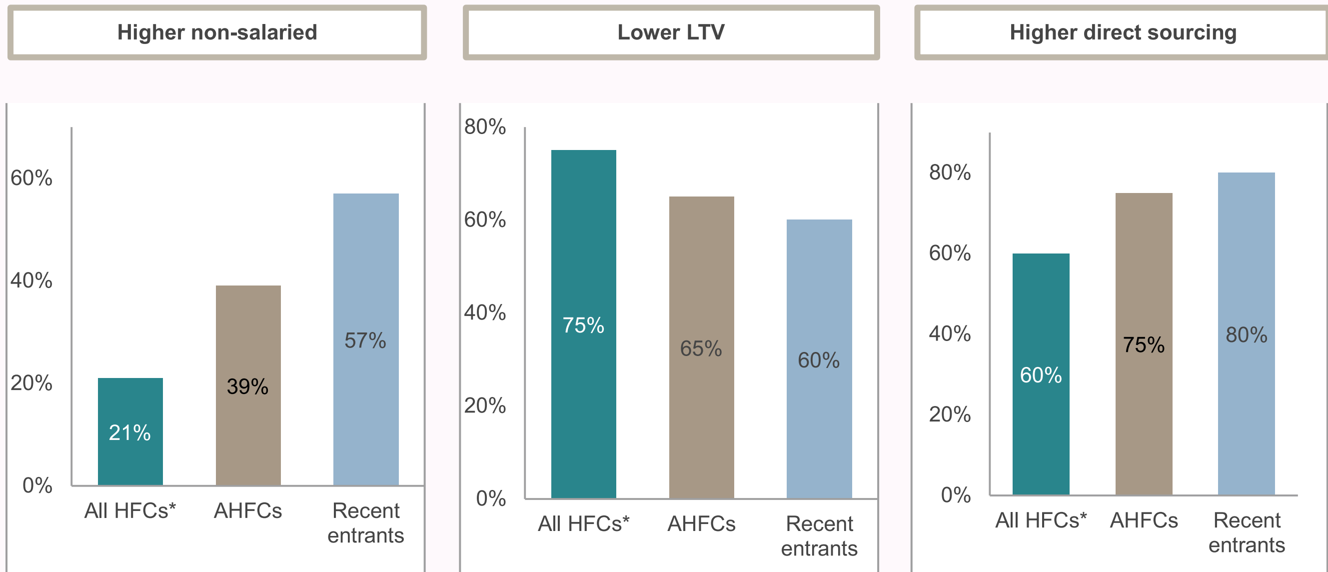
There are differences between the metrics of the recent entrants and established players in this space, too - while the established ones focus on customers with relatively better credit profile, the recent entrants cater to the next set of borrowers. To be sure, the target customer in the affordable housing segment has a very different credit profile vis-à-vis a traditional home loan customer.

Let's look at the key metrics. The average yield of the players who have been in the affordable housing space for a longer time is 11-13% and that of the recent entrants is over 13%. This is higher than the yield of overall housing finance companies at 10-11%. This is in accordance with the target customer profile and underlying credit worthiness of the borrower.

The proportion of self-employed/ informal salaried customers is the highest for recent entrants compared with established players and the traditional home loan segment. Also, given the higher volatility in the borrower's income in this space, the LTVs are lower for the recent entrants compared with the overall home loan segment.

Also, location-specific borrower profile leads to lower reliance on external sourcing channels for recent entrants. The credit and recovery process also differs in terms of requiring a lot more ground work and field investigation, assessing family income instead of just borrower income, deeper level of understanding about the business of the borrower so as to be able to assess income more accurately, informing the borrowers about the electronic modes of payments, etc.

The business metricsdifferential



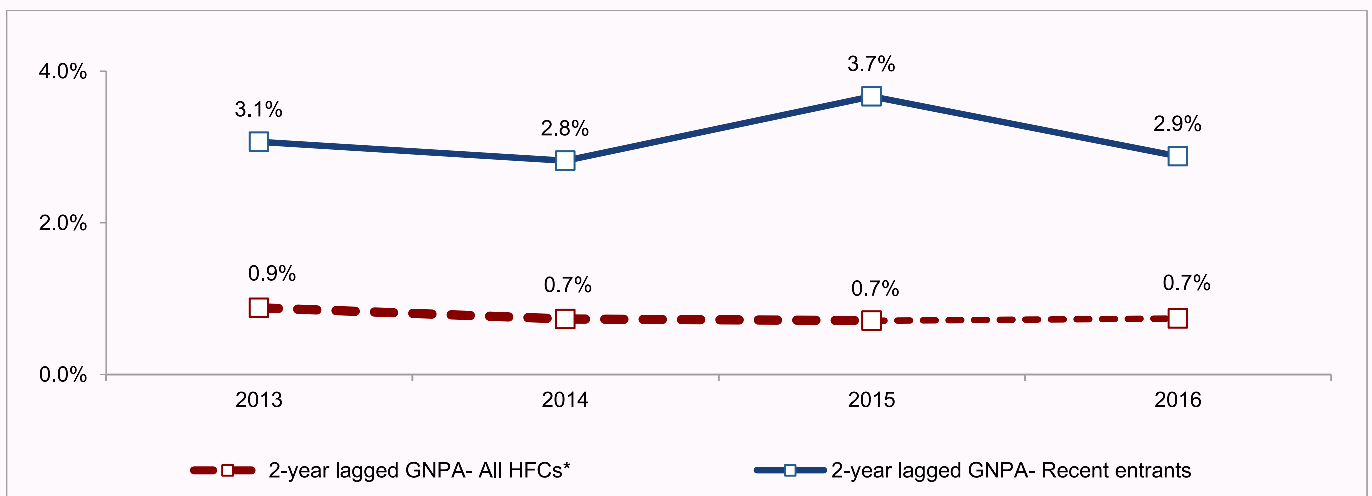
data pertaining only to home loans

Portfolio more susceptible to volatility

As mentioned above, the customer profile in the affordable housing segment is largely non-salaried/professions. Also, in case of exigencies, the limited financial flexibility leads to potentially higher volatility in cash flows, impacting the portfolio performance.

Further, the business models for the recent entrants is also evolving given the nature of underlying borrower. Once the business model is established and a greater understanding of the target customer segment is developed, volatility is expected to come off, as seen for players who have been catering to this segment for a long time. These established players have maintained healthy asset quality, although weaker than in the traditional home loans segment.

Comparisonof gross NPAs of traditional home loans and recent entrants



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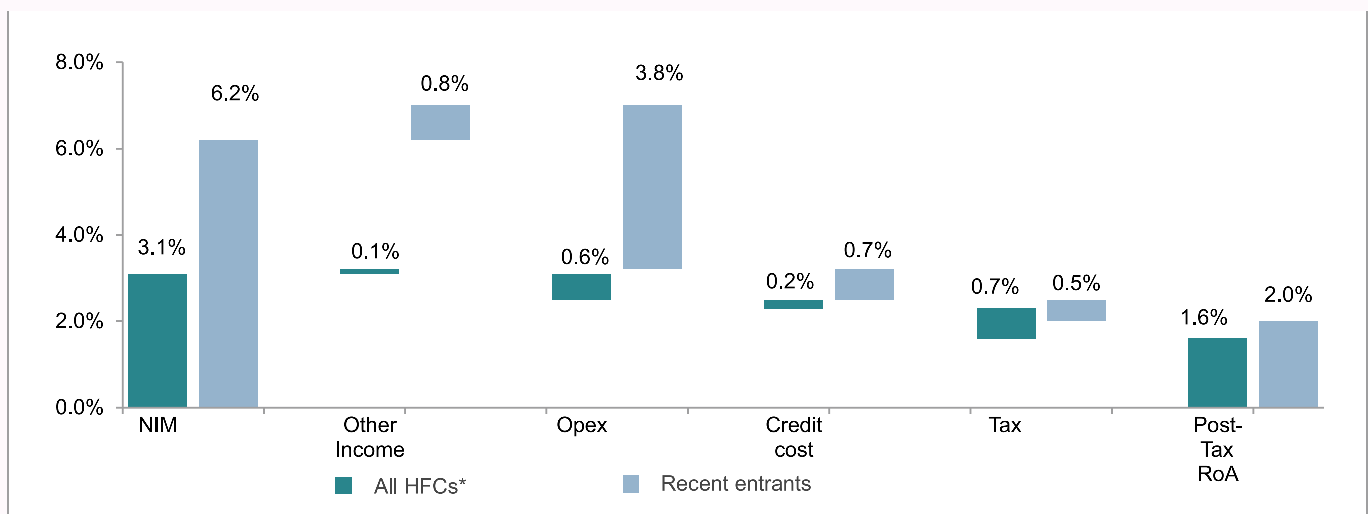
However, returns more than compensate for the risk

The volatility in the performance of the HFCs in affordable housing space is compensated for by the higher returns the players command, given that riskier profiles lead to higher yields for them. The segment also benefits from lower cost of borrowing due to the presence of strong parents or private equity players. This benefit is somewhat negated by the higher operational cost of recent entrants, though this is expected to stabilise as the business grows and the players leverage technology, and lower credit costs.

Comparison of profitability of traditional home loans and recent entrants



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Sound processes and practices will be key to long-term success

Although affordable housing has garnered a lot of interest and emerged as a key segment, and the overall growth and earnings potential remains high, the players ability to scale up while building an efficient business model is yet to be tested. The ability to manage asset quality, given low seasoning of the book, is a monitorable for the segment.

Credit assessment and underwriting practices are expected to play a critical role and will define the ability to build an efficient business model. Location-specific scouring, detailed field investigations and appropriate credit assessment of family cash flows would be critical here.

Further, intensifying competition, given the foray of a large number of recent entrants in this segment and hence multiple players targeting similar customer segments/ geographies, poses its own challenges, especially in terms of pressure on yield and quest for manpower. Overall, appropriate credit assessment and underwriting practices, as put in place by the established players, will be a determinant of growth in the long term.

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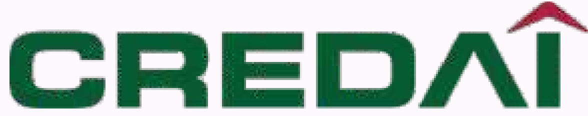

Mr.Shantilal Kataria
Chairman, Affordable Housing Committee
Credai National
President, Credai Maharashtra
Email- katariashantilal@gmail.com

Mr.Sachin Kulkarni
Convenor, Affordable Housing Committee
Credai National
Email:- sachin@vastushodh.co.in

Mr.Majid Kachhi
Convenor, Affordable Housing Committee
Credai Maharashtra
Email:- kachhigroup@gmail.com

Mr.Dilip Mittal
Convenor, Construction Cost Committee
Credai Maharashtra
Email:- dilip@mittalbrothers.com

Mr.Suhas Merchant
Chairman, RERA
(Legal Committee Credai National)
Email:- srmerchant@vsnl.com

Mr. Pankaj Kothari
Member Affordable Housing
Credai National
Email:- parkoakl@gmail.com

Mr.Mayank Modi
Credai NCR-Delhi

Mr. Suresh Patel
Credai Surat, Gujarat

Mr.Sanket Shah
Credai Ahmedabad , Gujarat

Mr. Sarvesh Javdekar
Credai Pune Metro

Supporting Partner

Contact Us:
CREDAI

5th Floor, PHD House, 4/2 Siri Institutional Area, August Kranti Marg, New Delhi-110 016

Tel: (011) 43126262/ 43126200 / Fax: +91 11 43126211 / Email: info@credai.org

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