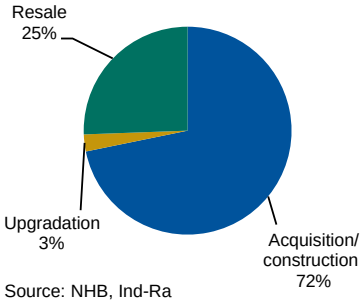
Large Ticket Housing Loans: 'Smaller Room' for Growth

Housing Finance Economics to Face Roadblocks Due to Falling Bank Interest Rates

Special Report

Figure 1

HFC Market Loan Book Breakdown



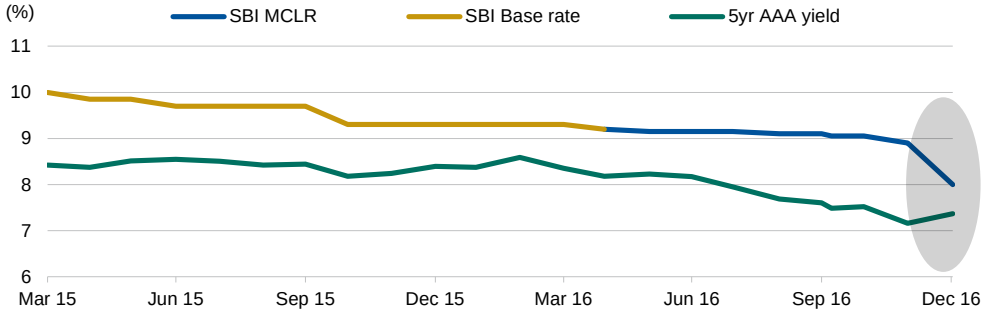
Source: NHB, Ind-Ra

The spread between the SBI benchmark rate and the AAA five-year borrowing rate shrunk to 63bp in January 2017 from 158bp in early 2016.

Thin Spreads, Evolving Market Dynamics to Force Rethink on Business Strategy: The large-ticket housing loan segment (primarily ticket size above INR5 million) is likely to face disruption, as housing finance companies (HFCs) would be forced to realign their strategies in view of a sharp reduction in lending rates by banks, says India Ratings and Research (Ind-Ra). The rate competition will not only impact the incremental loan growth in the high-ticket price-sensitive borrower segment but will possibly have implications for the existing portfolio in the segment, as some existing borrowers may shift their portfolios to banks to take advantage of widened differential. This situation will increase pressure on HFCs, which have been facing a slowdown in core housing loan portfolio growth. About 20% of the housing portfolio of large HFCs could be higher than INR5 million ticket size.

Figure 2

Tracking Yield Difference Between HFCs vs Banks



Source: Bloomberg, Ind-Ra

Limited Manoeuvrability to Increase Leverage to Counter Spreads: The majority of large HFCs are operating at a fairly elevated leverage (8x-10x median leverage). Any further significant increase in their leverage or a rise in their high-yield non-core book (developer and loan against property) portfolio to counter the impact on return on equity may affect their credit strength, increasing funding costs and offsetting benefits. Moreover, playing on the yield curve (short-term borrowing to save on tenor premium while lending largely remains long-term) would expose HFCs to liquidity and refining risks.

Balance Transfer/Takeout Financing to Put Pressure on Portfolio Growth: As borrowers take advantage of reduced interest rates, balance transfer from HFCs (no prepayment charges on loan transfer, if borrowing is undertaken on a floating rate) to banks would put additional pressure on the loan portfolio of HFCs. The migration would be tempered for fixed-rate borrowers. Assuming a 50bp reduction in borrowing costs, a borrower with a 15-year INR5 million loan could be looking at a monthly EMI reduction of about INR1,500, translating into a 5-6-month reduction in the loan tenure.

Loan Transfer to Benefit Private Banks More: Private banks are likely to benefit more from balance transfer, given their aggressiveness in the housing segment and faster turnaround time. Having said that, public sector unit (PSU) banks are increasingly becoming aggressive in the housing loan segment due to a lower risk weight, thereby leading to a low capital consumption, and the granular nature of this portfolio.

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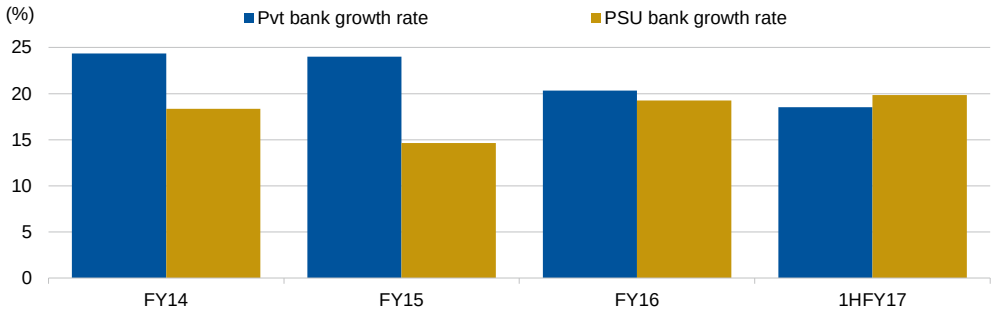
Figure 3

Loan Growth, Private Banks vs PSU Banks (YoY)



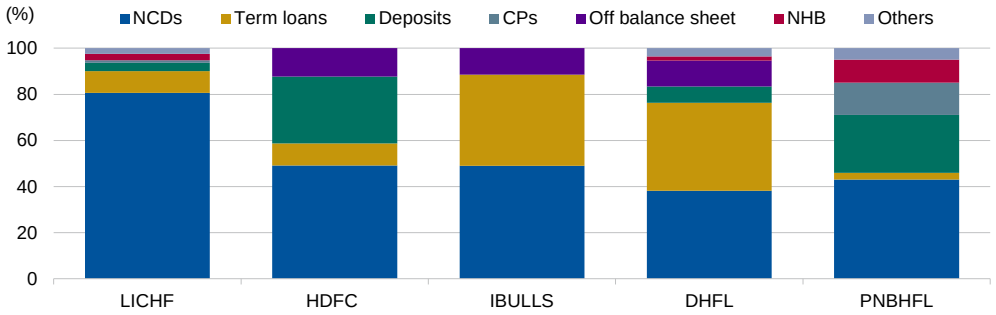
Source: RBI, Ind-Ra

Small-Ticket Loans to Largely Remain Unaffected: India Ratings and Research (Ind-Ra) believes that the impact of the recent lending yield correction on players offering small-ticket loans is unlikely to be significant, as borrowers are generally less price-sensitive. Furthermore, HFCs in this segment have a superior pricing power due to limited competition from banks.

Limited Funding Cost Benefits for Large HFCs: HFCs with a large proportion of high-ticket urban portfolio are mostly funded through capital market funding (fixed-rate). Hence, the benefit of a fall in the marginal cost of funds-based lending rate (MCLR) of banks in the overall funding cost is likely to be modest, as capital market yields have not significantly declined. On average, capital markets accounted for 60%-80% of the borrowings of the top five HFCs in India by portfolio size in FY16. On the other hand, regional HFCs focused on this segment could witness a decline in costs, as they borrow largely from banks.

Figure 4

Funding Breakdown of HFCs



Source: Company, Ind-Ra

Meanwhile, funding costs for banks have been declining since April 2016 due to a downtrend in deposit rates and a fall in loan growth. Thus, lower loan growth has led to banks shedding high-cost institutional bulk deposits. Moreover, a recent increase in low-cost current account saving account (CASA), due to demonetisation, led to a fall in marginal cost of funds.

Large Proportion of Under-Construction/Quasi-Housing Loans Could Increase Credit Costs

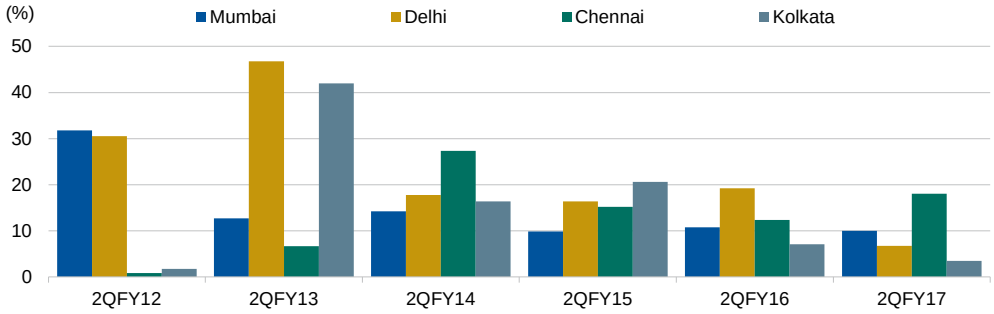
The housing finance portfolio has arguably been the best performing asset class in the last 15 years, with the delinquency ratio across the majority of lenders at less than 100bp and their credit costs at less than 30bp. However, the period was marked by a sustained increase in property prices, except for a temporary blip during the global financial crisis in FY09.

If property prices come under pressure, as expected by Ind-Ra, large-ticket housing loans may witness higher-than-historical delinquencies. Especially vulnerable will be the portfolio where borrowers' equity is modest and remains low or shrinks on account of price correction. This reduces incentive to liquidate or refinance such loans by the borrowers. Under-construction projects funded through aggressive financing schemes, where borrowers pay little amount upfront and/or do not need to pay anything until possession (10:80:10 and no EMI until the completion of construction) are likely to be especially at risk.

The risk of equity dilution increases, if there is a significant delay in project completion without a simultaneous rise in property prices, as interest keeps building up. Moreover, these special scheme loans camouflage real loan to value ratios (LTVs). Although such loans are recorded as housing loans, the underlying risk largely remains on builder, though the interest rate charged is much lower than what would be charged to builder. Anecdotally, disbursements for under-construction projects could be upward of 50% for HFCs, while the proportions of such projects in the high-ticket loan segment under so-called special schemes vary.

Figure 5

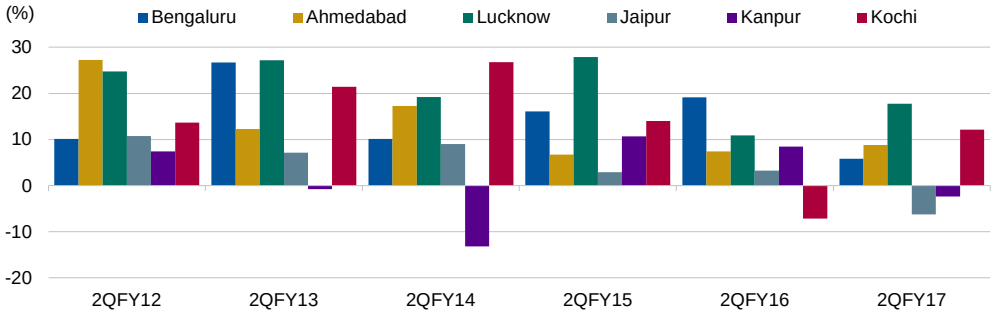
Property Price Trends Across Metros (YoY)



Source: RBI, Ind-Ra

Figure 6

Property Price Trends Across Key Cities (YoY)



Source: RBI, Ind-Ra

Current Pricing Offers Limited Buffers to Absorb Unexpected Credit Shocks

Most players with a high-ticket housing finance portfolio are operating on thin margins, with equity returns being managed through modest credit costs and higher leverage. Any unexpected shock in credit costs could have an adverse impact on the profitability of such HFCs.

Figure 7

Sensitivity of RoA to Change in Credit Costs and Pre-Provision Operating Profit (%)

ROA	Incremental housing loan	Pre-provision operating profit				
	1.08	1.25	1.50	1.75	2.00	2.25
	0.15	0.7	0.9	1.1	1.2	1.4
	0.25	0.7	0.8	**1.0**	1.2	1.3
Credit cost	0.35	0.6	0.8	0.9	1.1	1.3
	0.45	0.5	0.7	0.9	1.0	1.2
	0.55	0.5	0.6	0.8	1.0	1.1
	0.75	0.3	0.5	0.7	0.8	1.0

source: Ind-Ra

For a 1.75% PPOP and a 0.25% credit cost, RoA would stand at just 1%. Assumptions: Cost of funds on total assets: 6.8%; Yields on loans: 8.7%; Other income: 0.25%; Opex: 0.25%

Shift in Focus to Low-Ticket, Less Price-Sensitive Housing Loans

Incrementally, HFCs are likely to target low-ticket, less price-sensitive customers to counter the slowdown in the high-ticket loan segment and compressed profitability. However, the low-ticket loan segment has different dynamics than the large-ticket loan segment and requires the establishment of infrastructure and people skills to carry out such lending. Most HFCs have been incrementally focusing on balancing their portfolio by increasing low-ticket, less price-sensitive customers; this activity needs to be scaled up and strengthened.