Indian Mortgage Finance Market Update for Q1 FY2019

Worsening Liquidity Position Could Impact Growth and Asset Quality

Performance Review of Housing Finance Companies and Industry Outlook

ICRA

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Financial Sector Ratings

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Executive Summary

HFC long-term growth prospects look good; tight liquidity situation to affect near-term growth prospects: ICRA estimates that the total housing credit outstanding was around Rs. 17.2 lakh crore as on June 30, 2018 (Rs. 16.7 lakh crore as on March 31, 2018) leading to overall YoY growth of 18% (vis-à-vis 15% YoY growth for the period ended June 30, 2017). While the home loan portfolio of housing finance companies (HFCs) continued to grow at a faster pace of 21%, the pace of growth for banks also increased 16% YoY growth for the period ended June 2018 (11% YoY growth for the period ended June 2017) supported by a lower base effect.

In its earlier report dated June 2018, ICRA had expected overall housing credit growth to pick up to 17-19% in FY2019 on the back of an improvement in primary sales, along with support from the Government of India (GoI) for the affordable housing segment, which is likely to expand the market. However, owing to the tight liquidity situation, ICRA expects growth to slow down by around 200-300 bps to 14-17% in FY2019. Growth trends are likely to reverse as the pace of growth for banks is expected to go up, also supported by the increase in direct assignment transaction activity seen in early Q3 FY2019 to raise funds. A marginal shift in market share across HFCs and banks is also expected. Nevertheless, ICRA expects the long-term growth prospects for the segment to remain good. Additionally, the pace of growth in the non-housing loan segment is expected to come down as HFCs would prefer to conserve liquidity given the lumpy nature of these loans. However, owing to increased retail portfolio sales by various HFCs, the share of home loans in the overall on-book portfolio could come down for the HFCs.

Incremental Funding Requirement High at Rs. 1.7-1.9 Lakh Crore for Achieving Growth of 15%

As per ICRA's estimates, HFCs would require Rs. 1.7-1.9 lakh crore to grow at about 15% (about Rs. 2-2.3 lakh crore of fresh debt funding during H2 FY2019 to support growth of about 20%). Of this, the refinancing requirement alone is around Rs. 90,000 crore as about 90% of Rs. 1 lakh crore of commercial paper (CP) exposure outstanding, as on September 30, 2018, from mutual funds would mature by December 31, 2018. Given that mutual funds are being selective in rolling over/taking incremental exposures, some of the HFCs will have to mobilise other sources of funding.

Systemic measures to promote incremental lending and ease liquidity: To ease liquidity and promote incremental lending to non-banking financial companies (NBFCs) and HFCs, the Reserve Bank of India (RBI), on October 20, 2018, permitted banks to include an additional 0.5% of Government securities held by them under mandatory statutory liquidity ratio (SLR) investments, up to an amount equal to their incremental outstanding credit to NBFCs and HFCs (over and above the amount of credit to NBFCs and HFCs outstanding on their books as on October 19, 2018) as Level 1 High Quality Liquid Assets for the purpose of computing their liquidity coverage ratios (LCRs). This is in addition to the carve out of 2% from the mandatory SLR allowed via the RBI circular dated September 27, 2018. Hence, the total carve out from the SLR available to banks has increased to 13.5% from 11% till mid-September 2018. The RBI's measure is likely to create additional headroom for banks to lend to HFCs that are looking for refinancing. Further, while many HFCs have an adequate cushion of unutilised bank limits, from a near-term liquidity perspective, it would be crucial for banks to allow the timely drawdown of these facilities. The said measure could also help mutual funds generate liquidity by selling market instruments of HFCs to banks. While this is a positive measure at a systemic level, lenders may adopt a cautious or an entity-specific approach towards lending to the sector.

It would be crucial for banks to continue lending to HFCs, allow the drawing of already-sanctioned facilities and take incremental exposures (either through direct lending or portfolio buyouts) to support the liquidity profile of HFCs. While the overall liquidity would remain adequate if banks were to honour the sanctioned lines, some HFCs may face repayment challenges in the near term in case there are delays in tie-up of alternate funding sources or if the collection efficiencies deteriorate. However, measures such as an increase in refinance limits by National Housing Bank (NHB) and the HFCs' prospects of increasing the direct assignment of their retail portfolios to banks, are expected to support their immediate liquidity requirements.

Funds being raised through direct assignment route: Some HFCs are actively raising funds through the direct assignment route via the sale of retail portfolios to banks. Owing to this, a marginal shift in the market share in favour of banks is also expected. Further, while the growth in the non-housing loan segment is expected to decline as HFCs would prefer to conserve liquidity given the higher ticket size of these loans, the share of home loans in the overall on-book portfolio could also decline owing to increased retail portfolio sales by various HFCs.

Increase in overall GNPAs: Overall GNPAs (stage 3 assets as per revised Ind-AS for June 2018) increased by around 20 bps from March 2018 levels to 1.3% as of June 2018 (1.1% as on March 31, 2018) largely owing to a deterioration in the asset quality in the non-housing loan segment of some large HFCs and some deterioration in the affordable housing segment owing to the seasoning of the portfolio as well as some entity-specific factors. While the slippage seen in Q1 FY2019 is seasonal in nature, the impact of the tightening liquidity and slowdown in growth could impact the asset quality in segments like construction finance and LAP. Further, owing to increased portfolio sales by some HFCs, the overall on-book portfolio mix could change further with increased share of newer vintage and non-housing loans in the portfolio. The ability of HFCs to sell the repossessed assets in a timely manner will also be a key monitorable. In ICRA's opinion, gross NPAs in the HFC home loan segment are likely to increase to around 0.8-1% over the medium term from the current level of 0.6%. While it is difficult to estimate the expected trends for asset quality in construction finance, given the lumpy nature of the portfolio, assuming gross NPAs of 2.5-3.5% in the non-housing loan portfolio of HFCs, overall gross NPAs could go up to around 1.3-1.8% over the medium term.

Moderation expected in profitability ratios and RoE in FY2019: The overall profitability indicators for HFCs remained healthy in Q1 FY2019 as most of the listed and larger players migrated to Ind-AS from IGAAP earlier. Earnings for Q1 FY2019 remained good with overall return on equity (RoE) of 17% in Q1 FY2019. Going forward, a mix of factors could impact the earnings of HFCs. Given that around 25% of the borrowings would be refinanced at higher rates, the overall cost of funds for HFCs is likely to go up by around 40-50 bps in FY2019. While most of the HFCs have increased their lending rates also by 20-30 bps, the overall impact on net interest margins (NIMs) could be lower at around 25-35 bps. Further, a slowdown in growth is likely to impact the operating expense ratios. Prolonged slowdown in growth could impact the asset quality of some asset classes, which could lead to increased credit costs. Therefore, there could be moderation in profitability ratios by around 30-40 bps and in RoE by around 250-350 bps to around 13-15% by FY2019. However upfront income booking on assignment transactions is likely to support the profitability indicators positively.

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