ICRA

INDIAN MORTGAGE FINANCE MARKET

JANUARY 2020

Asset quality continues to weaken amid slowing growth

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Executive Summary

HIGHLIGHTS

- Overall market size of Rs. 20.2 lakh crore as on September 30, 2019; YoY growth slows down to 10% primarily due to muted growth of HFCs
- Asset quality deteriorates in construction finance segment; could weaken further
- Fixed deposits, securitisation and NCDs form majority of incremental funding mix for HFCs in H2 FY2019 and H1 FY2020
- Spread between cost of funds for HFCs and 5-year G-sec yield has widened over the last four quarters

OVERVIEW

Credit Growth: In line with estimates, the overall on-book housing loan portfolio growth of housing finance companies (HFCs) and non-banking financial companies (NBFCs) reduced significantly to 4% YoY for the period ended September 2019 owing to lower disbursements due to continued funding constraints for the sector. The pace of growth of banks continued to be higher than HFCs, partly supported by portfolio buyouts, leading to their overall market growth of 19% (16% for the same period last year).

Portfolio Mix: Owing to the higher securitisation of retail loan portfolios, mostly seasoned home loans, the share of on-book home loans for HFCs declined to 62% as on September 30, 2019 ended September 30, 2019 from 65% as on March 31, 2018.

Asset Quality: The overall gross non-performing assets (GNPAs; stage 3 assets as per revised Ind-AS June 2018 onwards) increased to 1.9% as on September 30, 2019 (1.6% as on March 31, 2019), led by a deterioration across HFCs in the non-housing loan segment, namely the loan against property (LAP) and construction finance segments. A higher deterioration was seen in the construction finance segment, given the tight liquidity faced by some developers with delayed projects and the reduced fund availability for the developers. The tough operating environment impacted the cash flows of LAP borrowers, who are mostly self-employed in the unorganised sector. Consequently, the reduced refinancing of these loans impacted the asset quality to some extent. While the lifetime losses on secured LAP and small and medium enterprise (SME) loans are partly limited by the underlying collateral and a moderate loan-to-value (LTV), a downward movement in property prices could expose lenders to higher levels of credit risk. Some entities also witnessed an increase in the NPAs in the home loan segment.

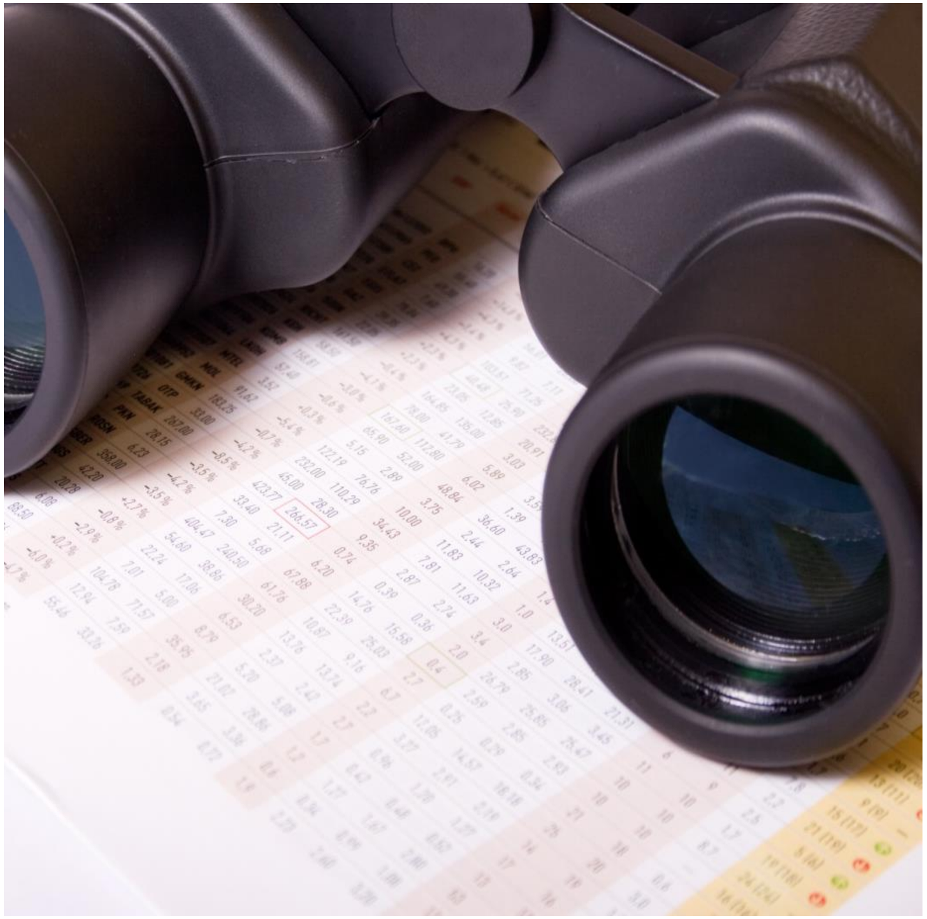
Funding Mix: The share of commercial paper (CP) borrowings reduced to 6% of the overall borrowings of HFCs as on September 30, 2019 (12% as on September 30, 2018).

The CP borrowings were largely refinanced by fixed deposits, which witnessed an increase in their share to 15% from 13%, and by securitisation, where the share increased to 13% from 9% during the same period.

Incremental Funding Mix: As per ICRA, estimates, debt raised by HFCs increased by 13% to around Rs 5.07 lakh crore of debt between October 2018 to Sep 2019 vis-a-vis 4.5 lakh crore during the period October 2017 to September 2018. While the share of incremental bank term loan funding reduced to 23% from 27% a year ago, incremental share of funds raised from securitisation/assignments increased from 11% to 19% and from fixed deposits increased from 12% to 16%. While the overall bond issuance volumes for HFCs were up 40% during the period of Oct-18-Sept-19 vis-a-vis 12 months prior to that, leading to increase in incremental share from 18% to 23%, however 80% of HFC domestic debt issuances were limited to two large issuers vis-a-vis 33% for the prior period.

Liquidity Profile: With the increased share of long-term funds, the liquidity profile of the HFCs in the short-term buckets improved from Q3 FY2019 with gaps in the up to 1-year bucket reducing to around 2% as on September 30, 2019 (4% as on March 31, 2019) from around 6% as on September 30, 2018. Further, most of the HFCs continued to maintain on-balance sheet liquidity buffers for meeting near-term debt obligations and for overcoming any sudden market disruptions.

Profitability: The overall profitability indicators for HFCs remained stable with Return on Equity (ROE) at 16% in H1FY2020 (14% in FY2019). However, excluding one large player with high non-interest income, a slight compression in the interest spreads led to some moderation in the ROE indicators to 11.8% in H1 FY2020 from 13.7% for FY2019.



OUTLOOK

Given the tough operating environment, ICRA expects housing credit growth to be 12-14% in FY2020 (lower than the last three years' CAGR of 17%). Banks are expected to grow at a faster pace than HFCs. The affordable segment is expected to grow at around 20-25%, almost double the industry growth. As some HFCs aim to go slow on construction finance to conserve liquidity, given the lumpy nature of these loans, the growth in non-housing loans is expected to be significantly lower. However, given the low mortgage penetration levels in the country, the long-term growth outlook for the sector remains good and ICRA expects housing credit growth to recover as the operating environment improves.

The asset quality could be under some pressure due to the challenging operating environment and the risk factors. Further, under-construction properties sold by builders under subvention or buyback/assured return schemes could be more vulnerable as some of the builders are facing a liquidity crunch and their ability to honour these obligations may be limited. In ICRA's opinion, GNPAs in the HFC home loan segment are likely to increase to be around 1.2-1.5% over the medium term from the current level of 1.2%. Moreover, given the tight liquidity faced by some developers with delayed projects, reduced fund availability to the developers could lead to some stress in the construction finance portfolio of the HFCs, leading to an increase in the overall GNPAs for HFCs to around 2-2.2% over the medium term from 1.9% as of September 2019. As per ICRA's estimates, the overall stressed assets could be higher by 20-40 bps if one were to include write-offs and repossessed assets (not included in NPAs) as well as written-off NPAs.

While the profitability indicators for FY2020 are likely to remain rangebound with ROEs estimated at 13-15%, (partly supported by the upfront income booking on assignments), a prolonged slowdown in growth could impact the operating expense ratios and the quality of some asset classes, which could lead to a moderation in the profitability indicators over the medium term

ICRA

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