Strong Fundamentals Outweigh Turbulence in Housing Finance

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Overview

The growth for the housing finance segment gained momentum last year with the sector growing at 11% y-o-y backed by low-interest rates and improvement in the overall macroeconomic situation. While banks continued to dominate the housing finance space, the housing finance companies (HFCs) were able to regain some of their lost share in FY22. Growth in the large prime was supported by both retail as well as the wholesale segment. However, the loan against property (LAP) segment dominated the disbursements for the affordable. Going forward, we expect growth momentum to continue and the HFC portfolio to grow at around 12% y-o-y in FY23 driven by the steady growth in disbursements and improving macro-economic environment.

In terms of profitability, high credit costs primarily on account of builder book continued to be a drag for the prime segment. However, the profitability profile of the affordable HFCs improved due to relatively higher net interest margins (NIMs) and controlled credit costs. Affordable HFCs were relatively slow in passing on the interest rate benefit to the customers which boosted their NIMs. Going forward, return on average assets for the overall HFC sector is expected to remain around 1.9%-2.0%, supported by controlled credit costs and largely stable NIMs.

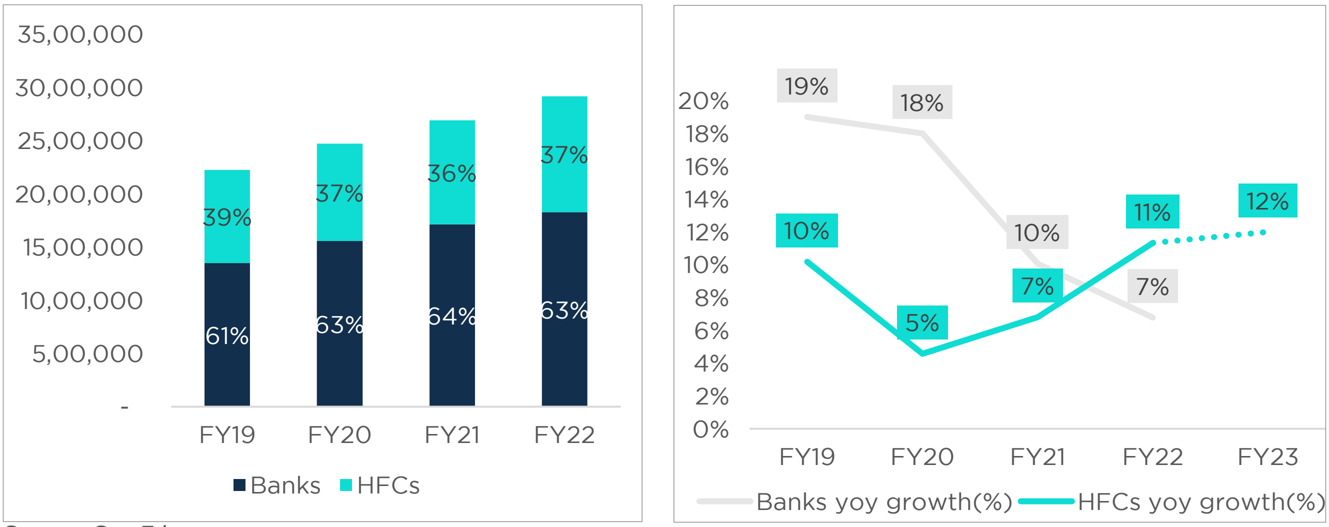
Asset quality, although improving for the retail segment, on an overall basis is still facing headwinds on account of wholesale exposure. Going forward, though the sharp rise in inflation may affect disposable income, the recovery trend is expected to continue. GNPA is expected to decline to around 3.1% for the sector in FY23.

The capital structure for the sector continues to be modest, with the affordable segment operating at relatively low gearing as the risk appetite for the lenders was low and the market remained cautious.

Banks Continue to Dominate; HFCs Regain Some Lost Share

Although the banks continued to dominate and accounted for 63% of the overall housing finance portfolio, HFCs outshined in FY22. After reporting modest growth for two consecutive years, HFC reported a double-digit growth rate in FY22 at 11% y-o-y surpassing the 7% growth rate reported by the banks. Consequently, the share of HFCs, which has been contracting for the past two consecutive years, improved in FY22 from 36% to 37%. Improvement in the macroeconomic environment, low-interest rate regime, and initial signs of recovery witnessed in the real estate sector were the key catalysts for the high growth.

Figure 1: HFCs Outpace Banks in terms of Growth

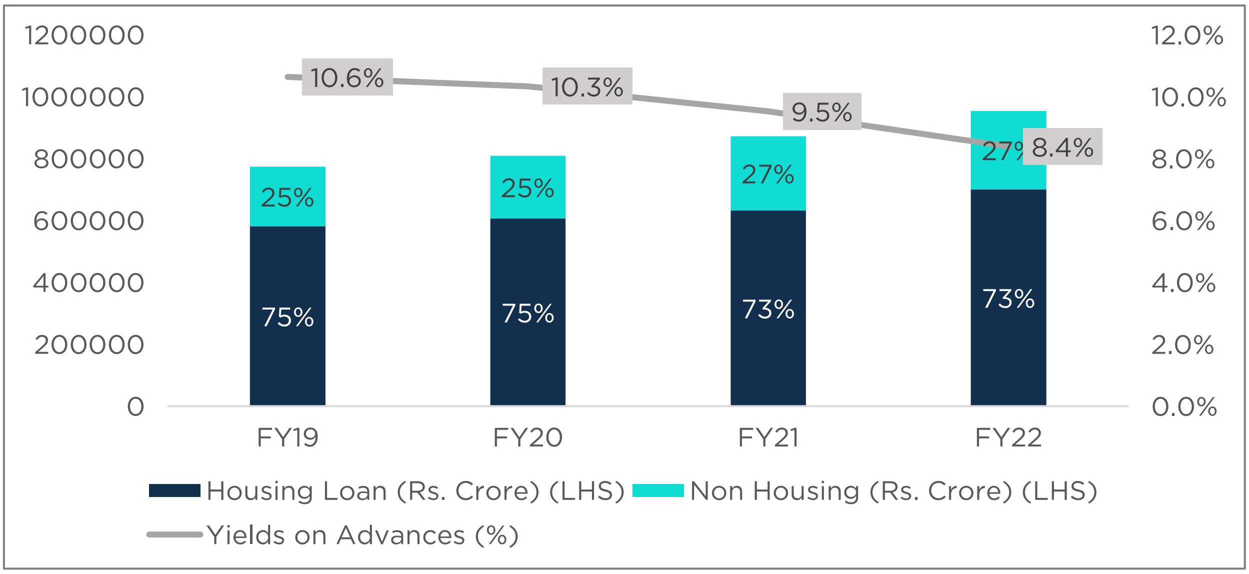


Source: CareEdge

Double-digit growth in AUM for Prime HFCs; LAP lead Growth for Affordable

The HFC sector growth continued to be driven largely by the prime segment, which constitutes around 90% of the overall housing portfolio. Growth in the prime segment continued to rise with the sector growing at 9% y-o-y in FY22 as compared with 8% y-o-y in FY21 and 5% y-o-y in FY20. The share of housing and non-housing remained largely stable in the prime segment at 73:27 as of March 31, 2022.

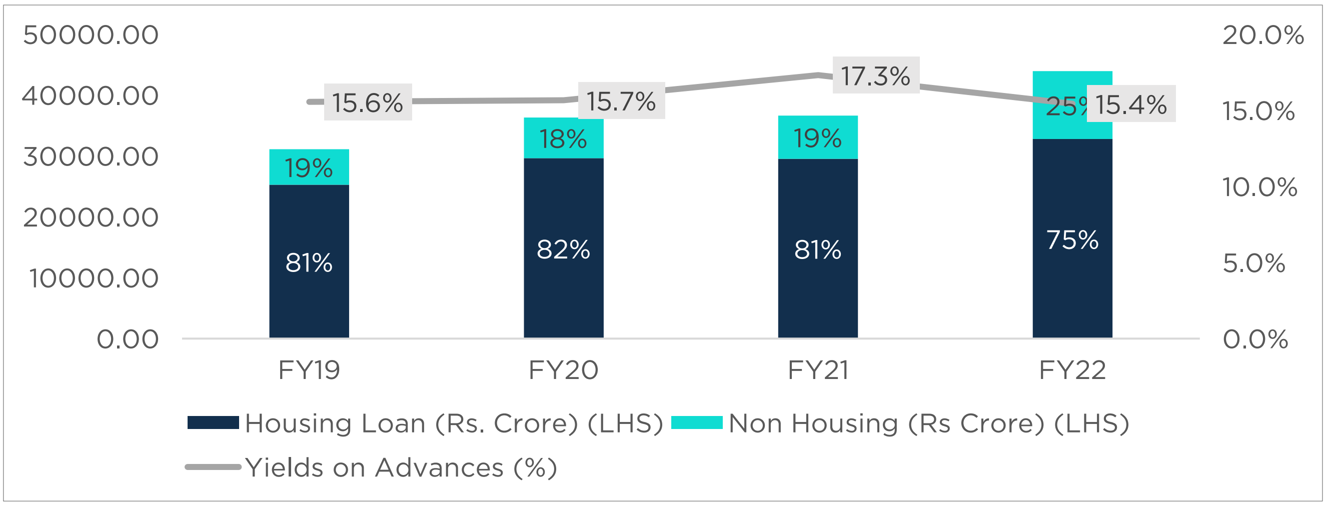
Figure 2: AUM Grows by double-digit for Prime HFCs



Source: CareEdge

The Affordable Housing Finance Companies, which had been growing at significantly higher rates than the industry in the past, witnessed a moderation in growth in FY21 following the Covid-19 pandemic-induced challenges. However, growth picked up in FY22, with the affordable segment growing at 20% y-o-y. Relatively smaller base, the ability to penetrate the unorganized segments and strong appraisal skills to underwrite below-prime customers remained the key strengths for the affordable. In terms of loan product, growth was mainly driven by the relatively higher-yielding loan against property (LAP) segment. Accordingly, the share of the LAP segment increased from 19% to 25% in the overall loan portfolio of affordable HFCs.

Figure 3: LAP Leads the Growth for Affordable Housing



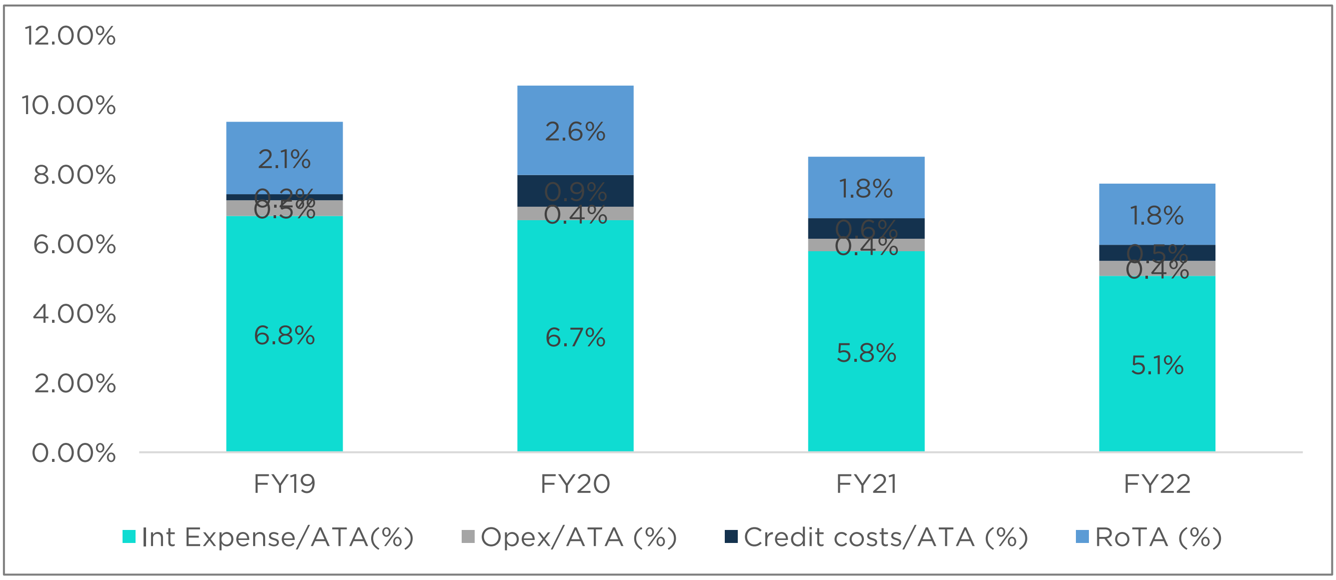
Source: CareEdge

With respect to yields, large prime HFCs largely passed on the interest rate benefit to their customers. The decline in lending rate along with a reduction in the high-yielding builder book resulted in a contraction in yields from around 10.3% in FY20 to 8.4% in FY22. On the other hand, most of the affordable HFCs were slow in passing on the interest rate benefit to borrowers, which along with the rising share of LAP in the portfolio, resulted in yields remaining largely in line with the pre-Covid levels.

Profitability Indicators Remain Below Pre-Covid Levels

While large prime HFCs benefitted from a decline in funding costs, a corresponding reduction in yields resulted in largely stable NIMs. The operating expenses to average assets ratio at around 0.4% remained stable and relatively small due to the business model and economies of scale which the prime segment enjoys due to its large size. However, continued pressure on the asset quality resulted in credit costs remaining higher than the pre-Covid levels. Consequently, the return on an average asset at 1.8% continued to remain lower than the pre-Covid levels for the prime segment.

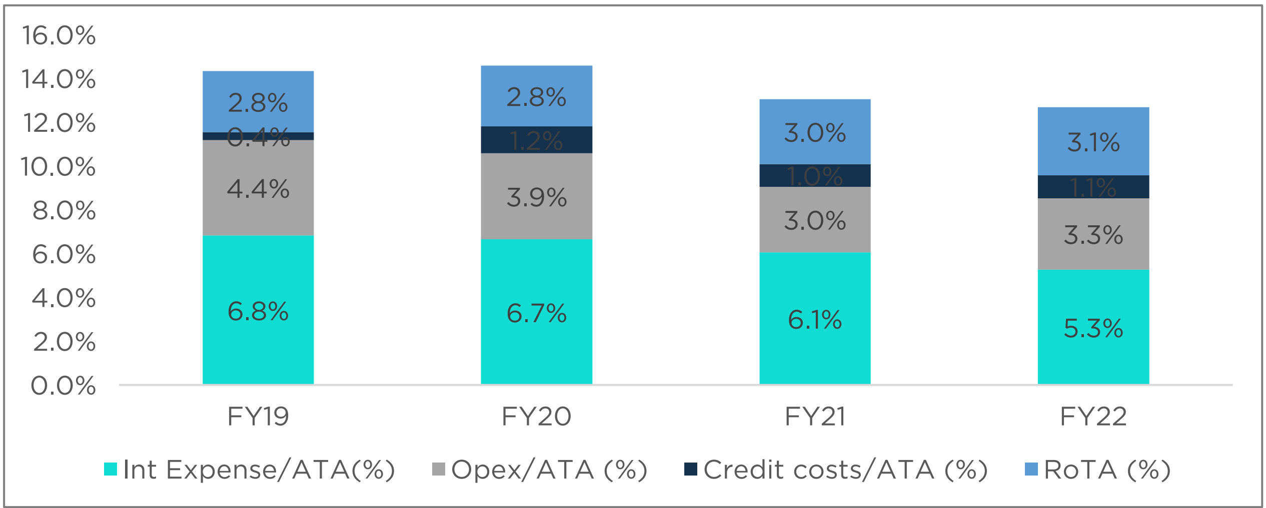
Figure 4: Higher credit costs and stable NIMs, resulted in subdued profitability for large prime



Source: CareEdge

Affordable HFCs, on the other hand, were relatively selective in passing on the interest rate benefit to their borrowers. Despite the declining interest rate environment, yields remained largely in line with the pre- Covid levels (Yields in FY21 were relatively higher due to the cautious stance taken by most of the HFCs). Funding costs, however, benefitted from the rising share of low-cost National Housing Bank (NHB) funding along with the low-interest rate regime. Consequently, NIMs improved to 7.4%. With the rise in disbursements, the operating expenses to the Average Total Assets (ATA) ratio increased; however, they remain lower than the pre-Covid level at 3.3%. Overall, higher NIMs along with controlled credit costs boosted the profitability profile of affordable HFCs, which reported a return on assets (RoA) at 3.1% higher than the pre- Covid level.

Figure 5: Higher NIMs boosted profitability for affordable

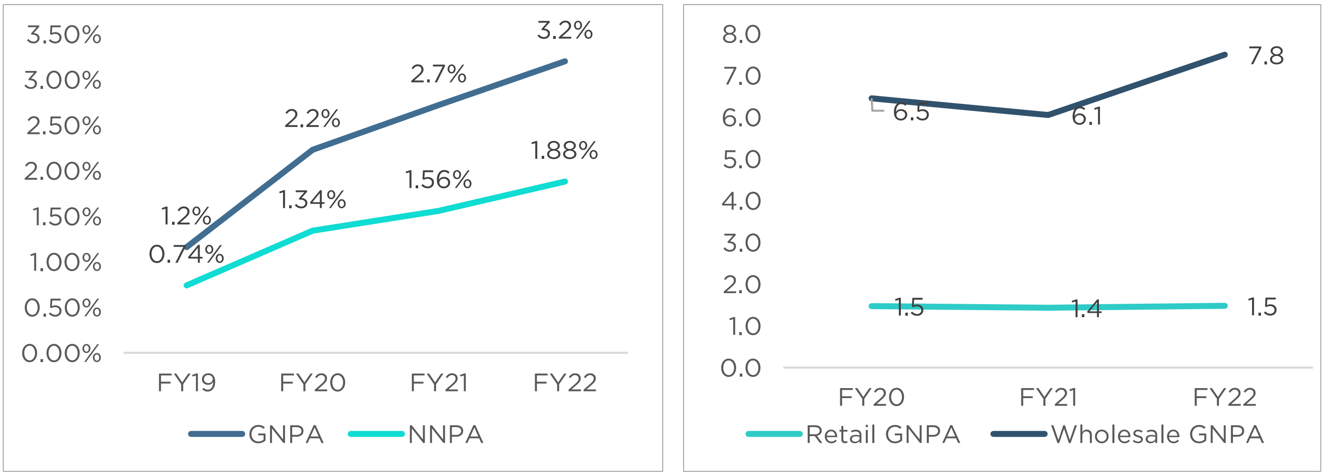


Source: CareEdge

With the change in the interest rate scenario, the lending spreads may come under pressure. The large HFCs have already started the process and the rates have gone up in line with the rise in REPO/ marginal cost of funds-based lending rate (MCLR) rates. Affordable HFCs, have also started to pass on the rate hike to their customers, though at a relatively slower rate. The full impact of the repricing will be visible in FY24 as a lot of resets may happen during the current year.

Asset Quality Remained Under Pressure for Prime Segment

Figure 6: Asset Quality Deteriorated for Large Prime Segment



Source: CareEdge

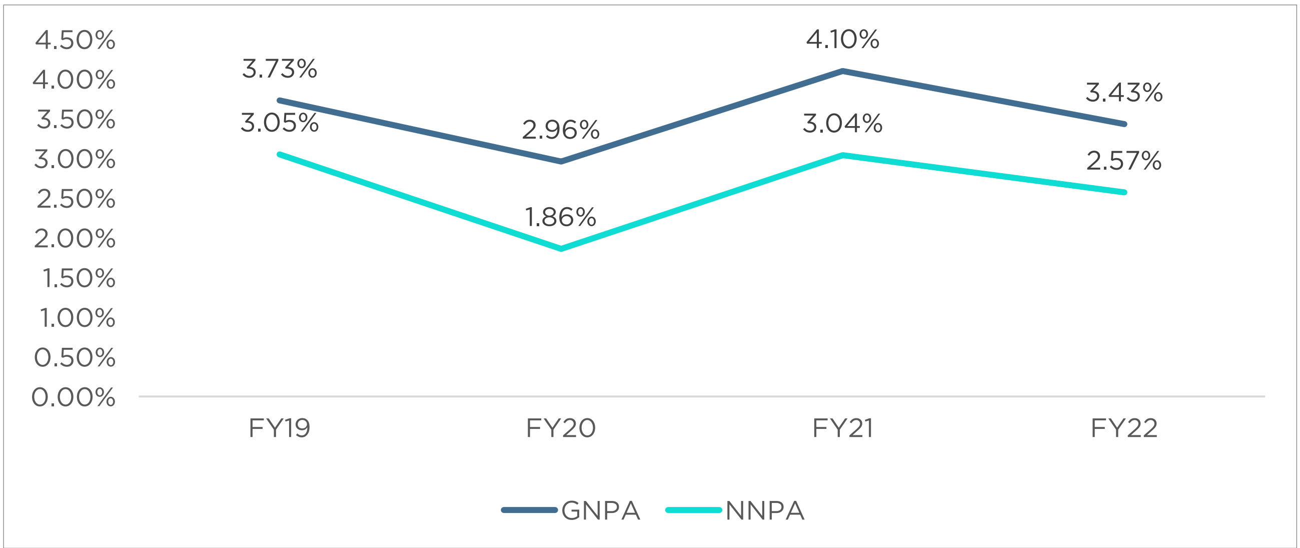
Asset quality continued to remain under pressure, with the gross non-performing assets (GNPA) ratio for the prime segment rising from 2.7% to 3.2% in FY22. The deterioration was mainly driven by the wholesale book, especially the builder segment. The GNPA ratio in the wholesale segment increased from 6.1% to 7.8% in FY22 due to a few large slippages, while for the retail segment it largely remained stable. With the improving macroeconomic environment, collection efficiency for the retail segment reported a steep recovery in Q2 and continued to improve in the subsequent quarters. Headline asset quality metrics, however, also got negatively impacted due to Income Recognition and Asset Classification (IRAC) norms implementation.

Despite the deterioration in the asset quality, large prime HFCs have been maintaining adequate provision coverage and healthy balance sheet liquidity which is likely to provide a cushion to absorb future losses.

Improving Economy Benefits Affordable

Affordable Housing Finance companies, on the other hand, reported improvement in their asset quality metrics with gross NPA ratio declining from 4.1% to 3.4% in FY22. The segment reported strong recovery performance in the second half of FY22 as the economic activity picked up and the unorganized sector flourished. However, going forward, a sharp rise in inflation may affect disposable income and pose some risk to recoveries.

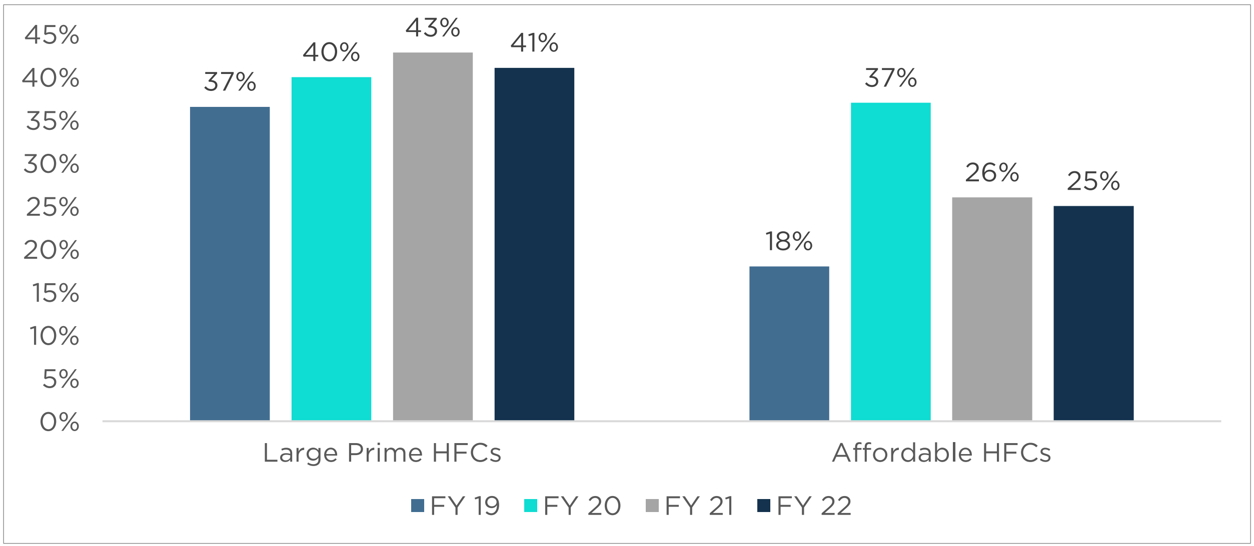
Figure 7: Asset Quality Improves for Affordable



Source: CareEdge

In terms of provision coverage, large prime HFCs are much better provided for with a provision coverage ratio of around 41% as compared with 25% provisioning in the affordable segment.

Figure 8: Provision Coverage Remains Lower than Prime

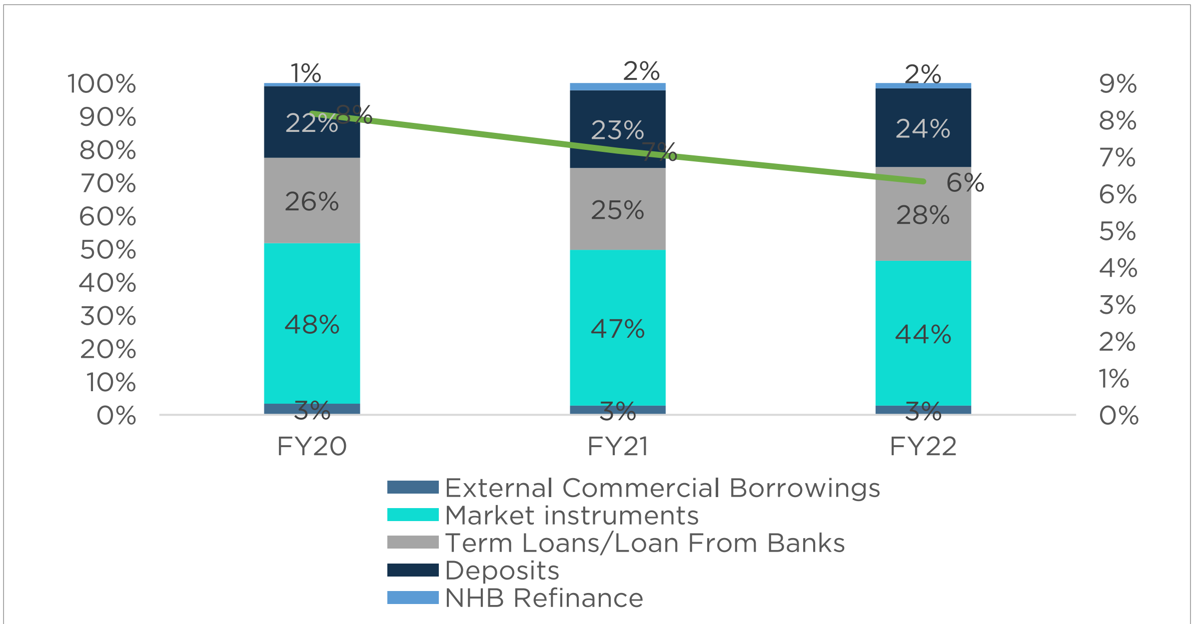


Source: CARE Edge

HFCs Benefit from Excess Liquidity

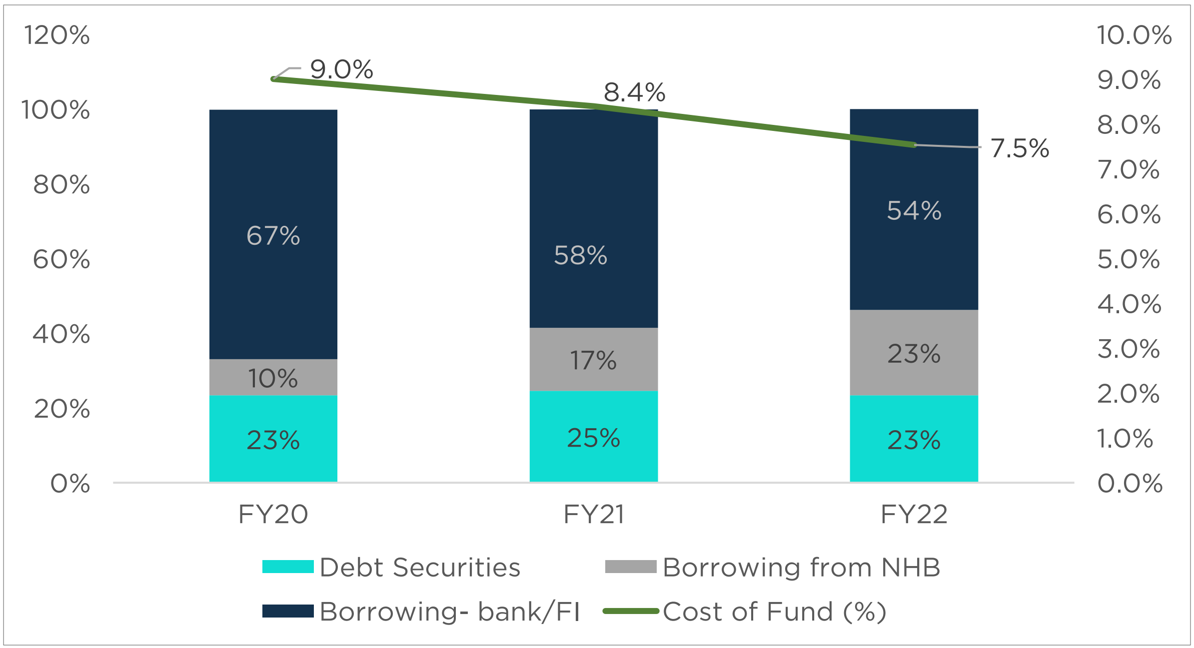
Market instruments continued to dominate the borrowing profile of the large prime HFCs, though the share of bank borrowings (mainly term loans) increased from 25% to 28% in FY22. Also, deposits of HFCs became more lucrative in the low-interest rate regime, and accordingly, their share has recorded a gradual improvement over the past two years.

Figure 9: Bank Loans Made a Comeback for Large Prime



Source: CareEdge

Figure 10: Rising Share of NHB-supported Funding Cost for Affordable

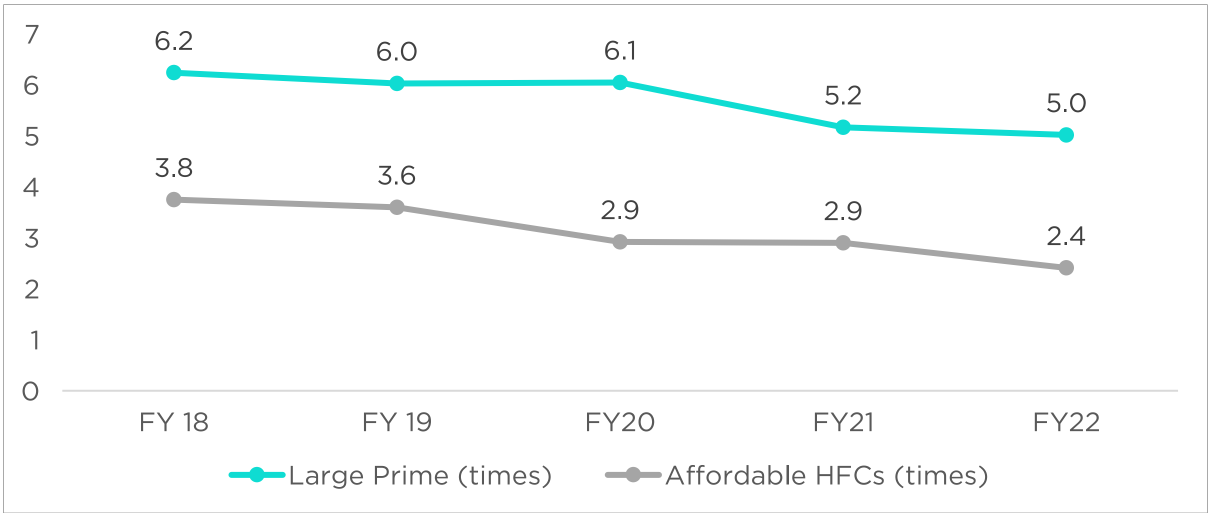


Source: CareEdge

For affordable entities, bank and NHB borrowings remained the major source of funding. The share of low-cost NHB borrowings improved from 17% to 23% of the borrowing mix, which further supported the decline in the cost of funds.

Comfortable Capital Structure

Figure 11: HFCs Continue to Operate at Lower Gearing than pre-Covid



Source: CareEdge

Capital structure, for the sector, continues to be comfortable with gearing remaining lower than pre-Covid times for both prime and affordable HFCs. HFCs have been maintaining healthy on-balance sheet liquidity for the last few quarters given the challenging operating environment. While gearing for the prime segment is reflected from the blue line hovered around 5x as compared with 6x in pre-Covid times, for affordable it stood at around 2.4x. The low-risk appetite of the lenders along with a cautious market stance led to a further decline in the gearing of the affordable segment.

CareEdge View

Going forward, we expect growth momentum to continue and the HFC portfolio to grow at around 12% y-o-y in FY23 driven by the steady growth in disbursements and improving macro-economic environment. Asset quality pressure is expected to ease up with GNPA declining to around 3.1% for the sector. Though the sharp rise in inflation may affect disposable income, the recovery trend is expected to continue.

Return on average assets is expected to remain around 1.9%-2.0%, supported by controlled credit costs and largely stable NIMs.

Contact

Sanjay Aggarwal	Senior Director	sanjay.agarwal@careedge.in	+91 - 22 - 6754 3582
Gaurav Dixit	Director	gaurav.dixit@careedge.in	+91 - 11- 4533 3235
Neha Kadiyan	Associate Director	neha.kadiyan@careedge.in	+91 - 8130340369
Mradul Mishra	Media Relations	mradul.mishra@careedge.in	+91 - 22 - 6754 3596

CARE Ratings Limited

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Phone : +91 - 22 - 6754 3456 l CIN: L67190MH1993PLC071691

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