Why affordable housing finance companies seem expensive to investors?

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Mid-size and small housing finance companies (HFC) that are focused on affordable housing have failed to inspire faith among investors despite staging a smart recovery from the pandemic and growing their balance sheets at a quick pace.

Shares of lenders such as Aavas Financiers Ltd, Aptus Value Housing Finance India Ltd and Repco Home Finance Ltd are down a massive 15-30 percent year-to-date. Larger peers such as LIC Housing Finance Ltd, PNB Housing Finance Ltd and Can Fin Homes Ltd have fared well.

Unsurprisingly, at the crux of investor worries is the rising interest rate cycle. Investors believe that as policy rates climb, these lenders would face the twin challenges of keeping their margins intact as also the quality of their loan book. The going so far has been good for them though.

Affordable housing has emerged as a key growth catalyst for HFCs in the aftermath of the pandemic. The largest non-bank home loan lender Housing Development Finance Corp. Ltd (HDFC) too has relied on this segment to fire up its loan growth now and in the past as well.

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Even during the pandemic year of FY20 and FY21, affordable housing financiers reported double-digit growth, unlike their larger peers, which reported either a contraction or slower growth. For instance, Aavas Financiers reported 28 percent growth in FY20 and 21 percent in FY21. Aptus Value Housing Finance, which listed last year on stock exchanges, reported loan growth of 36 percent and 27 percent for the two years.

Note that loan growth has decelerated for these lenders though that is not the primary reason for investors' worry.

Fast and furious

The affordable housing market is expected to grow by 17-18 percent during FY22-25 on a Compound Annual Growth Rate (CAGR) basis, according to Jefferies India Pvt Ltd. Better affordability, need for home ownership and lower penetration are some of the reasons the securities firm cites that would drive this growth. Aptus Value Housing Finance and Aavas Financiers are the best illustrators of the growth of their segment.

Aptus Value Housing Finance's loan growth has decelerated over the years, but stabilised near 30 percent in the past two years. Note that the breakneck growth of past years came on the back of a low base. Analysts at Edelweiss Securities believe the lender could continue to report strong loan growth. "We believe the company would chart high-growth trajectory in the near term (albeit on a small base)—loan CAGR of 25-30% over FY21-24," they wrote in a note dated August 8.

Aavas Financiers recorded average loan growth of 20 percent in the past three years despite the pandemic. True, growth has slowed slightly but is still far above others in the industry. "With a branch-intensive lending model, it has managed asset quality better than peers Asset quality pressures should ease further, supporting steady credit costs," said a Jefferies special report on affordable housing dated August 1.

That said, investors are yet to become comfortable with these firms. Analysts believe that the key concern remains the ability of the lenders to secure funding as they go after growth.

Getting expensive

HFCs depend heavily on bank funding and the bond market for growth capital. Affordable housing financiers have had to cough up a higher borrowing cost than their other peers in the past owing to their balance sheet vulnerabilities and small size. The policy rate hikes and progressive reduction in liquidity has made capital more expensive for these firms.
To be sure, HFCs have also hiked their lending rates in response to policy rate hikes. Even so, analysts foresee pressure on the net interest margin for these firms in the coming quarters.

While Aptus Value Housing Finance's spreads were stable for the June quarter at 9.17 percent from 9.15 percent a year ago, its margins came under slight pressure owing to an increase in delinquencies. Aavas Financiers too reported pressure on margins.

"Given the sharp turn in interest rate tables and Aptus's large fixed rate book (>75% of loans versus sub-40% of borrowing being fixed), we expect NIMs to be under pressure," the Edelweiss note said.

The very fact that affordable housing caters to a segment of the population that has a higher credit risk compared with other segments puts them in a vulnerable position. HFCs have hiked their lending rates in the past three months which has put additional pressure on borrowers in this category. The stress in this segment could increase and therefore credit costs would be a key monitorable.

With vulnerabilities in the cost of borrowing and asset quality, investors aren't wrong in discounting the growth story of these lenders. In the light of these, the valuation multiple of Aptus Value Housing Finance and Aavas Financiers look pricey compared with that of large peers. Jefferies analysts note that the stocks are priced to perfection with little room for deviation. Despite the sharp drop, shares of Aavas Financiers trade at more

than 4 times estimated book value for FY24 and those of Aptus Value Housing Finance trade at a steep multiple of 4.5 times FY24 estimated book value. This compares with HDFC's multiple of less than four times with a superior book.