Growth Momentum for Affordable Housing to Continue in FY23

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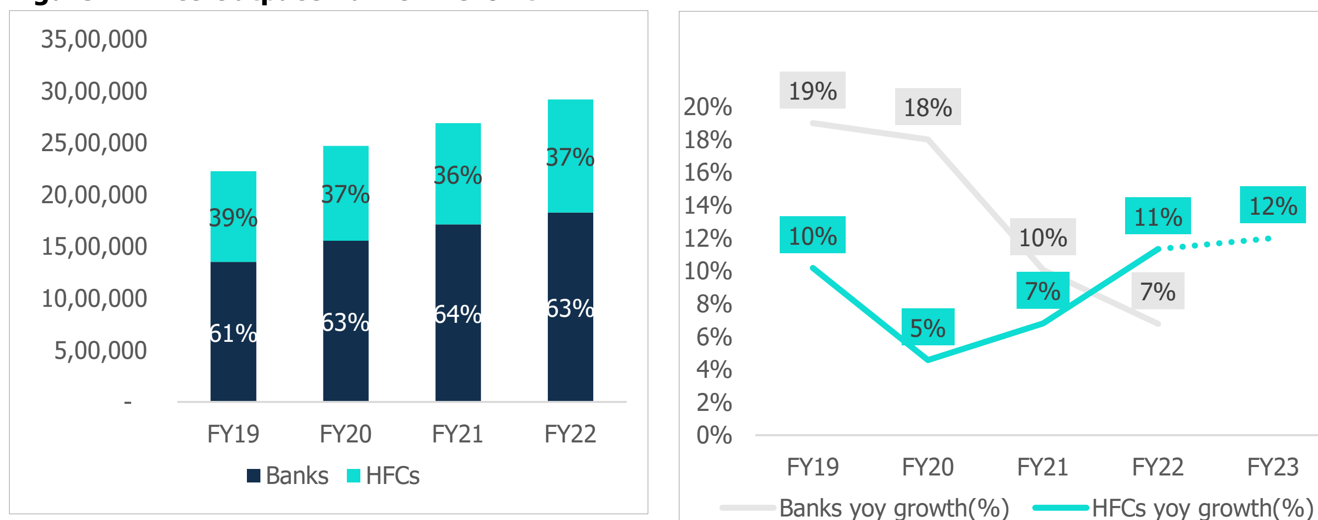
Overview

- The affordable housing finance segment grew 20% y-o-y in FY22 after a muted show in FY21, with rising share of LAP in the overall loan book. Going forward, CareEdge expects affordable segment to continue to outpace the industry with an expected growth rate of around 18% in FY23
- As affordable HFCs were relatively slow in passing on the interest rate benefit to the customers, profitability for HFCs improved with relatively higher net interest margins (NIMs) and controlled credit costs.
- The asset quality improved on the back of rising recoveries. CareEdge expects affordable HFCs to continue to report healthy profitability metrics with RoTA of around 3%.
- With HFCs operating at a relatively low gearing due to the lower risk appetite of lenders and a cautious market, the capital structure remained modest. Bank loans continued to dominate the funding profile of the affordable segment, with Nation Housing Bank (NHB) forming a major share.

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, HFCs 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 Growth

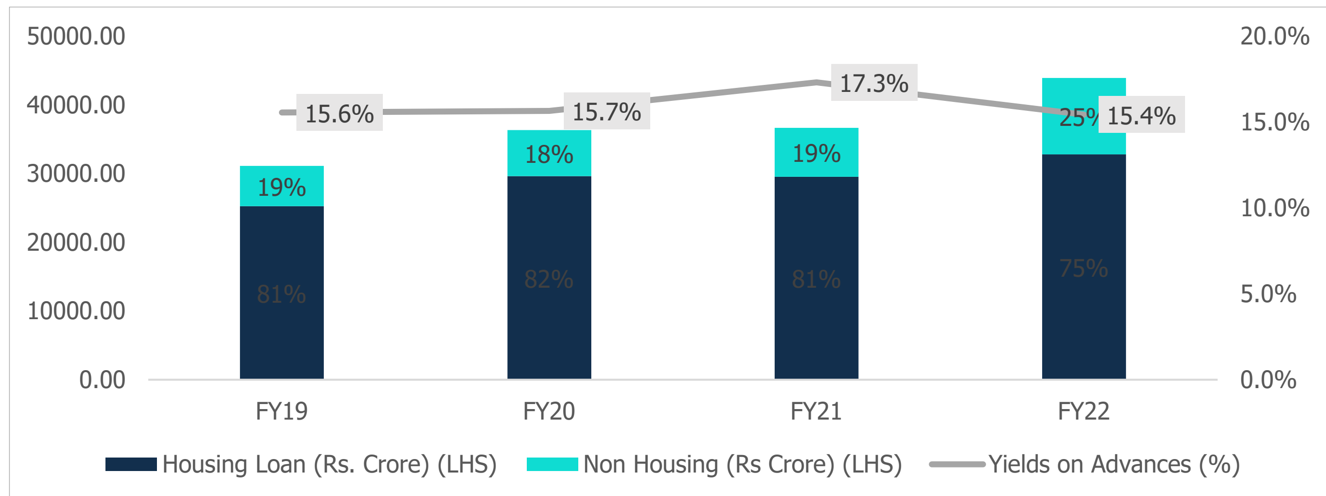


Source: CareEdge

LAP Leads Growth for Affordable HFCs

The affordable HFCs, 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 unorganised segments and strong appraisal skills to underwrite below-prime customers remained the key strengths for the affordable.

Figure 2: LAP on the Rise



Source: CareEdge

In terms of loan products, growth in affordable HFCs was mainly driven by the relatively higher-yielding LAP segment. Accordingly, the share of the LAP segment increased from 19% to 25% in the overall loan portfolio of affordable HFCs.

With respect to yields, 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.

Going forward, the segment may face some headwinds from the rising interest rates, increasing construction costs and decline in disposable income amidst high inflation. However, CareEdge expects affordable HFCs to continue to outpace the industry growth with an expected growth rate of around 18% projected for FY23.

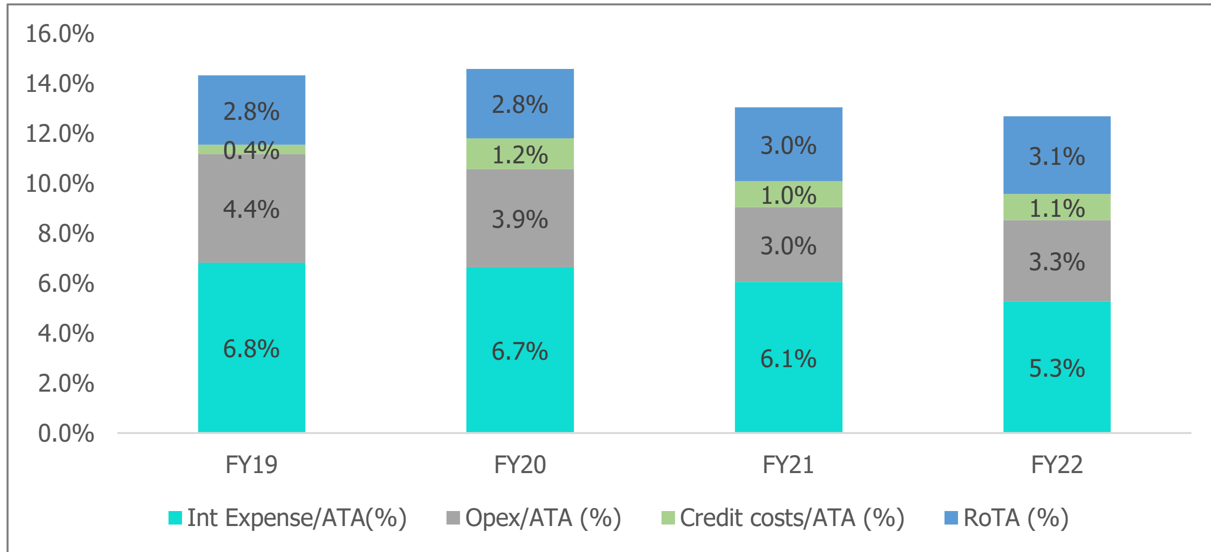
Profitability Indicators Remain below pre-Covid Levels

Affordable HFCs 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 higher due to the cautious stance taken by most of the HFCs). Funding costs for affordable HFCs, 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 RoTA at 3.1%, which is higher than the pre-Covid level.

With the change in the interest rate scenario, the lending spreads may come under pressure. Affordable HFCs, have also started to pass on the rate hike to their customers, though at a relatively slower rate. ll impact of the repricing will be visible in FY24 as a lot of resets may happen during the current year. However, the spreads charged by lenders on these companies over benchmarks are generally getting compressed with improvement in the balance sheets of the companies.

Overall, CareEdge expects affordable HFCs to continue to report healthy profitability metrics with RoTA of around 3%. Any impact of a decline in NIMs is expected to get largely offset by improved operating efficiency and controlled credit costs.

Figure 3: Higher NIMs Boost Profitability for Affordable HFCs



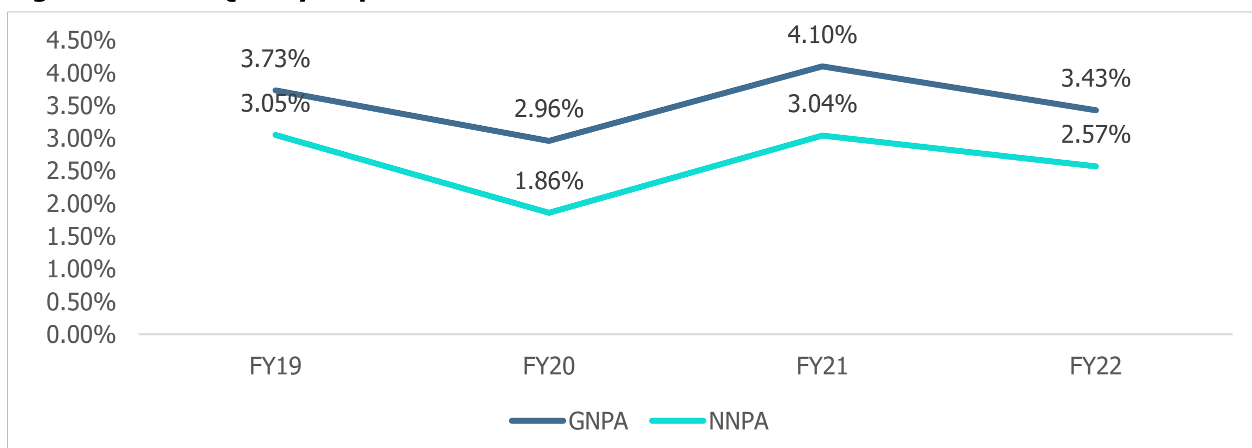
Source: CareEdge

Improving Economy Helps

Affordable HFCs reported improvement in their asset quality metrics with the 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 unorganised sector flourished.

Headline asset quality metrics also got impacted by the implementation of IRAC norms. The impact of IRAC norms was relatively higher on the affordable segment as compared to prime due to their target borrower profile. Affordable HFC borrowers generally have limited financial flexibility and are highly susceptible to the impact of an economic downturn. This makes it difficult for them to clear the entire due amount resulting in relatively sticky GNPAs.

Figure 4: Asset Quality Improves for Affordable HFCs



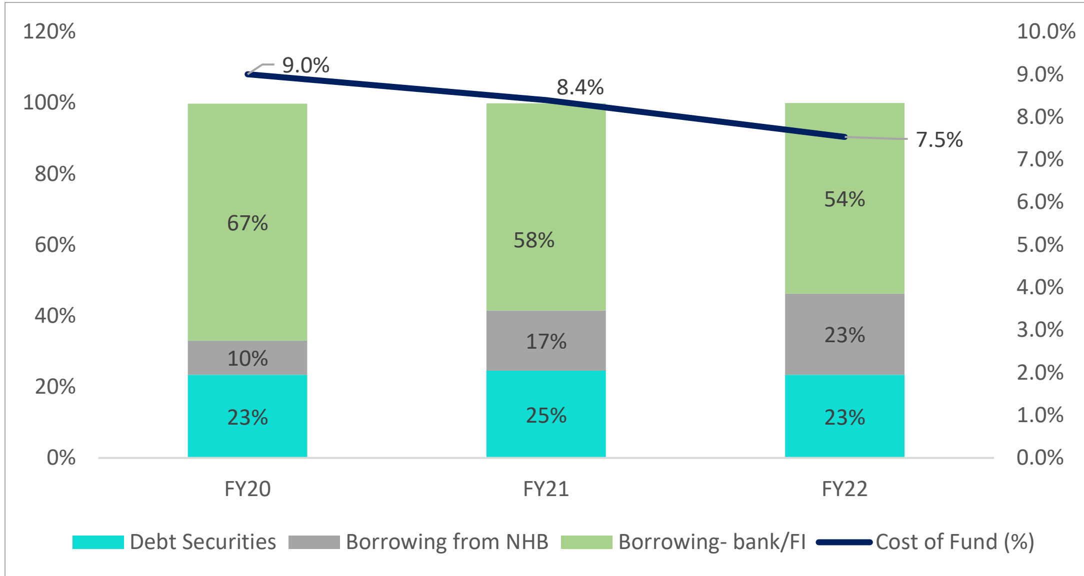
Source: CareEdge

In terms of provision coverage, affordable HFCs provided lesser as compared to prime HFCs with a provision coverage ratio of around 25% provisioning in the affordable segment, mainly since affordable HFCs do not have builder loans in their portfolio.

Banks Continue to Dominate Borrowing Profile of Affordable HFCs

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.

Figure 5: Rising Share of NHB-supported Funding Cost for Affordable

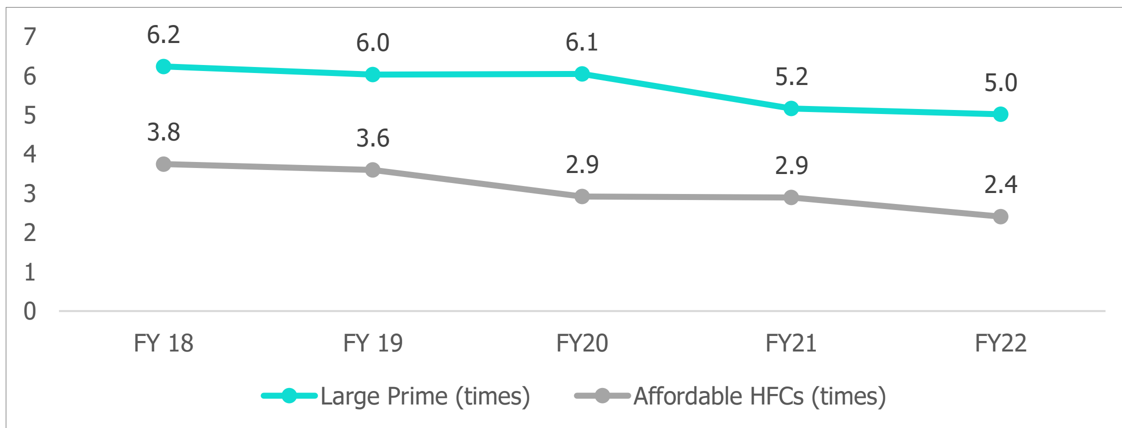


Source: CareEdge

Comfortable Capital Structure

Capital structure, for the sector, continues to be comfortable with gearing remaining lower than pre-Covid times for affordable HFCs. HFCs have been maintaining healthy on-balance sheet liquidity for the last few quarters given the challenging operating environment. The gearing for the affordable HFCs 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.

Figure 6: HFCs Continue to Operate at Lower Gearing than pre-Covid



Source: CareEdge

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