Credit Quality remains strong for HFCs despite increase in NPAs

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The second wave of the pandemic, which started in March 2021, has tapered in most parts of the country currently. Although it was far more devastating in terms of its spread, casualties, and impact on health of people than the first wave, the economic impact of the second wave has been lower as the lockdowns were more region specific, and not as strict as those during the first wave. Also, the economy and people were better prepared as they had the experience of the first wave to go by.

However, as more data and information emerge with respect to the incomes, repayments and debt servicing at retail level, it seems that the actual situation on ground is worse than what was earlier estimated. Some indicative data points include persistence of high bounce rates, fall in savings rate, increase in stressed assets in the loan portfolios of financiers of retail loans, etc.

Housing Finance Companies

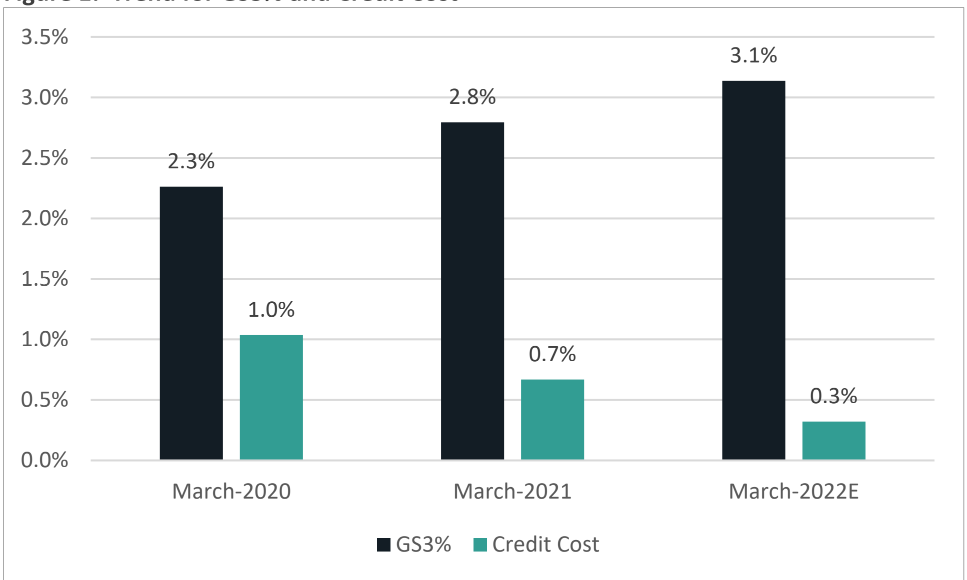
Housing Finance Companies (HFCs) have been an important part of the economy and have helped customers to buy a home at a reasonable interest rate, for their own consumption and for building wealth over a period of time. Business growth for HFCs has remained good with many large HFCs showing strong disbursements even during FY21. Early indications from the current financial year suggest that growth for FY22 would also be robust for the Housing Financiers. HFCs are looking at a growth of around 8%-12% in housing finance portfolios.

Deterioration in asset quality of HFCs

HFCs have seen weakening of asset quality with Gross Stage 3 (GS3) ratio as at end of FY21 at 2.8% for HFCs, which was around 50 bps higher than GS3 ratio at the end of FY20. CARE expects that the second wave of Covid-19 would cause the NPAs in the near term to increase further. The deterioration would be higher in H1 of FY22; however, we expect that collections and asset quality for HFCs would improve in the second half as the economy improves. While a large portion of deterioration would come from developer loan book, we expect that retail prime loans would also witness stress as retail borrowers have also been impacted economically during the pandemic.

According to our estimate earlier in the year, the GS3 assets for HFCs as at the end of FY22 would increase by 20 bps to 2.9% from an estimated 2.7% at the end of FY21. We now estimate that GS3 ratio as on the end of FY22 would be 3.1% which would be around 30 bps higher that what was observed, i.e., 2.8%, as at the end of FY21. We have considered top six large HFCs rated by CARE for our analysis.

Figure 1: Trend for GS3% and Credit Cost



Note: We have considered top six large HFCs rated by CARE for our analysis, which would cover around 65-70% of HFC sector.
Source: CARE Ratings, Company data.

Credit costs are expected to be lower in FY22 compared with FY21 as a large part of credit cost has already been provided till in FY21. There is also an additional buffer of higher provisioning over and above Stage 3 provisions to the extent of around 1.03% of AUM for top HFCs rated by CARE. Provisioning would be front loaded with higher provision during the first half of FY22 due to the second wave of Covid-19; however, it is expected to reduce in second half of FY22 as the economy is expected to perform better during second half.

Retail home loans as an asset class segment have remained very resilient throughout the pandemic. We expect that this asset class will show a minor uptick in GS3 assets by around 15-20 bps on an average by end of FY22. A large portion of these loans are for houses which are used by the borrower for his/her own residence, and there is improvement in Loan to Value (LTV) ratio over a period of time due to amortisation of loans. Hence, this asset class has remained one of the better performing asset classes historically.

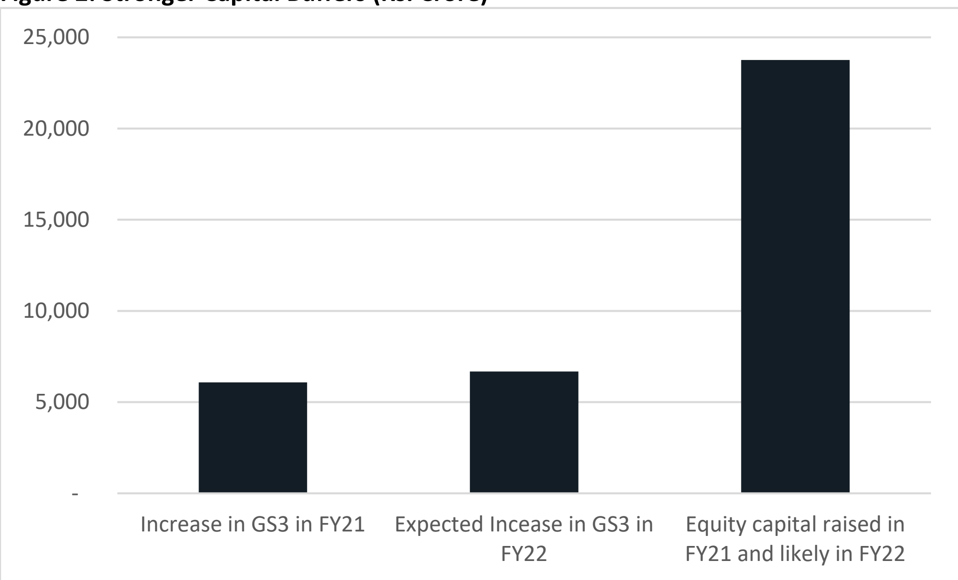
Construction Finance portfolio has seen a sharp deterioration over past few quarters as construction activity had seen big disruption during the first wave of pandemic. This impacted the cashflows for the developer segment adversely during that period. However, there was good rebound in construction and sales activities in second half of FY21. Still, this segment remains weaker, and we expect GS3 numbers for this segment to show an uptick of around 150-200 bps on an average by the end of FY22.

Stronger capital buffers

Taking advantage of the buoyant equity markets, many large HFCs have raised equity capital during FY21 and some are in the process of raising equity capital in this financial year. This has improved the strength of their balance sheets and augmented their loss-absorption capacity. It has also helped improve the market perception for HFCs and has provided comfort to investors in the current times where credit costs and Stage 3 assets are expected to rise.

According to our estimate, the total equity capital likely to be raised during FY22 along with actual equity raised in FY21 would be more than sufficient for the total increase in GS3 assets during FY21 and FY22.

Figure 2: Stronger Capital Buffers (Rs. Crore)

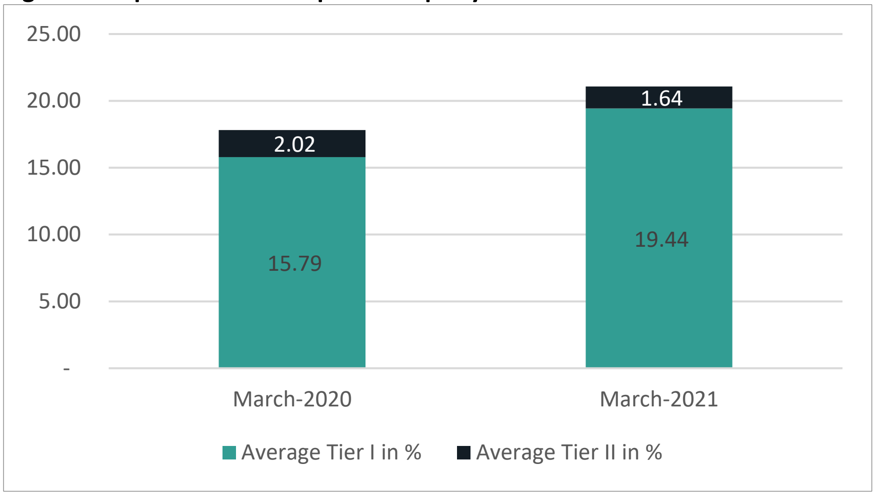


Source: CARE Ratings, Company data

We estimate that the total equity capital raised by HFCs during FY21 and the equity capital likely to be raised during FY22 would provide loss-absorption capacity to the extent of around 2.4% of AUM as on end of FY21.

If we look at AUM-weighted average capital adequacy for HFCs for last two years, there is improvement as on the end FY21 over the end FY20. We believe this would improve further by the end of FY22, despite strong growth being targeted in this segment. Also, Tier I capital adequacy remains quite strong and provides good buffer for these companies to raise Tier II capital in the short to medium term for their growth plans.

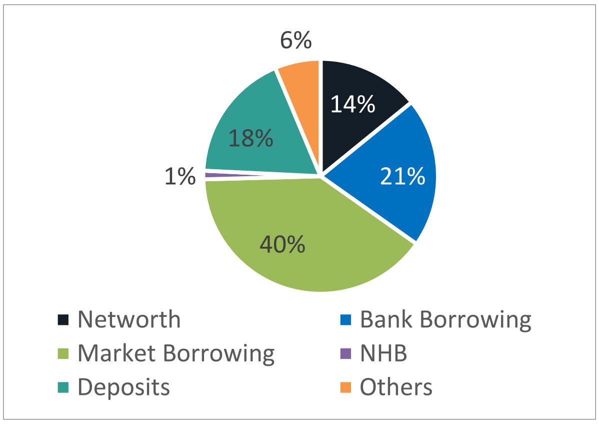
Figure 3: Improvement in Capital Adequacy for HFCs



Source: CARE Ratings, Company data

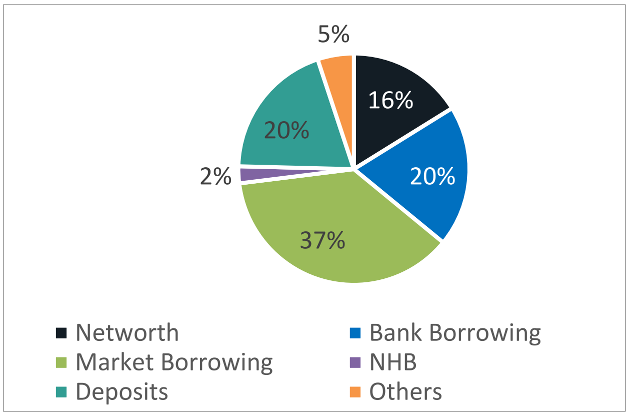
Funding profile for HFCs has seen improvement with some shift away from market borrowing as well as bank borrowing in last two years. We can see that the share of retail deposits, NHB refinancing, and Equity capital raising has increased for HFCs by the end of FY21 vis-à-vis the end of FY20.

Figure 4: Funding Profile as on March 2020



Source: CARE Ratings, Company data

Figure 5: Funding Profile as on March 2021



Source: CARE Ratings, Company data

Retail deposits from large HFCs provide a good alternative for retail investors, who are facing very low interest rates from Bank FDs, Mutual Funds, etc, as investment options. On a comparative basis, deposits from HFCs provide higher return than bank FDs for the investors, and on the other hand, HFCs get longer-term sticky funds, at rates lower than their market borrowings. This also helps the HFCs in diversifying their long-term resource-raising ability. We expect that large HFCs would continue to raise funds through deposit in the short to medium term as there are limited avenues for retail investors currently and this is likely to continue in the next few quarters.

Overall outlook

Overall view on HFCs remains stable as HFCs continue to remain one of the most resilient asset classes. While we expect that the impact of the pandemic on GS3 assets would be higher than what was earlier estimated, stronger balance sheets of large HFCs, and higher equity capital buffers provide good comfort. Also, improvement in fund-raising abilities of HFCs by tapping retail deposits augurs well for the longer-term credit outlook of HFCs.

Contact:

Sanjay Agarwal	Senior Director	sanjay.agarwal@careratings.com	+91-22- 6754 3582	+91-81080 07676
Himanshu Shethia	Director	himanshu.shethia@careratings.com	+91-22-6754 3468	+91-99872 61161
Mradul Mishra	Media Relations	mradul.mishra@careratings.com	+91-22-6754 3631	

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road
Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Tel. : +91-22-6754 3456 I CIN: L67190MH1993PLC071691

Connect: