Affordable Housing Finance Set to Grow 30% in FY24-25

February 16, 2024 | Ratings

Synopsis

- **Growth Projections for AHFCs:** Following a period of subdued growth in FY20 through FY22, Affordable Housing Finance Companies (AHFCs) experienced a resurgence in growth during FY23, expanding by 27% year-over-year. This growth trajectory is expected to continue, with CareEdge Ratings forecasting a 29% growth in FY24 and a further 30% in FY25 for AHFCs.
- **Increase in Non-Housing Portfolio Share:** Amidst intense competition and the imperative to maintain margins, the share of the non-housing portfolio among AHFCs has risen from 17% as of March 31, 2019, to 26% as of March 31, 2023. This trend is anticipated to persist, with the non-housing portfolio share projected to reach 27% by March 31, 2024.
- **Trend in Priority Sector Lending (PSL):** The proportion of PSL-compliant home loans within the overall banking sector portfolio has been declining over the past two years, creating opportunities for AHFCs to expand their portfolios through co-lending or direct assignment transactions.
- **Moderation in Profitability:** With the impact of increased cost of funds getting visible in FY24, net interest margin (NIM) are expected to come under pressure in FY24 and FY25, alongside an increase in operating expenses attributed to the expansion phases of AHFCs. Consequently, the Return on Total Assets (RoTA) is projected to moderate to 3.23% in FY24 and further to 3.04% in FY25, down from 3.8% in FY23.
- **Stable Asset Quality:** The improvement in collection efficiency and strategic write-offs have contributed to enhanced asset quality metrics in FY23. These metrics are expected to remain robust in FY24, with the Gross Non-Performing Assets (GNPA) ratio anticipated to be around 1.2% as of March 31, 2024.
- **Exposure to Vulnerable Borrower Segments:** AHFCs predominantly serve self-employed customers who may be more susceptible to income volatility due to economic downturns, thereby posing a higher credit risk.
- **Robust Capital Structure:** The sector's capital structure is anticipated to remain robust, supported by healthy internal accruals, with a gearing ratio of approximately 2.9x expected as of March 31, 2024. Banks are likely to continue being a primary funding source for AHFCs.

Growth Reached pre-Covid Level for AHFCs

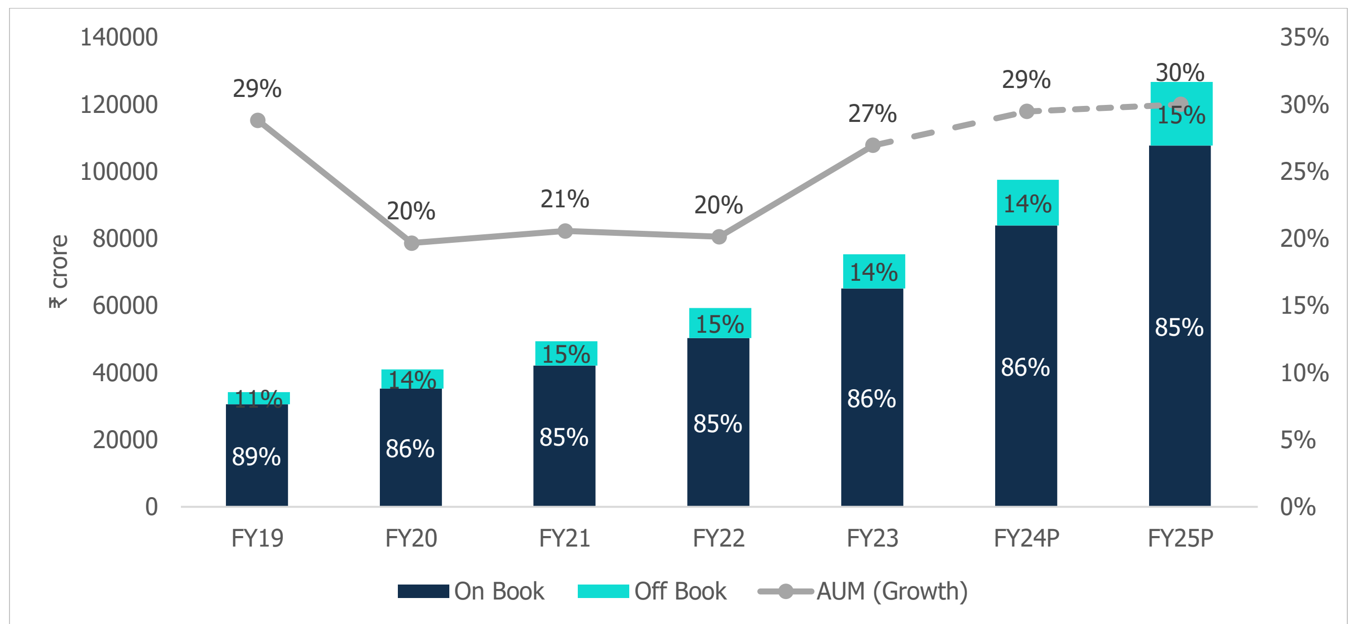
Affordable Housing Finance Companies (AHFC) represent a niche yet swiftly expanding sector within the broader housing finance market, accounting for approximately 6% of the total market share. Despite encountering funding challenges in the past, AHFCs have consistently emerged as the most rapidly growing segment in the housing finance domain.

The growth trajectory for AHFCs experienced a deceleration in fiscal year 2020 due to funding constraints and a cautious approach adopted by these companies. These challenges were further compounded in fiscal years 2021 and 2022 by the adverse impacts of the Covid-19 pandemic.

Buoyed by an improving macroeconomic landscape, AHFCs witnessed a significant rebound in growth during fiscal year 2023, with their portfolio expanding by 27% year-over-year.

This upward trend is anticipated to persist, with CareEdge Ratings forecasting a 29% year-over-year growth for AHFC portfolios in fiscal year 2024, followed by an estimated 30% year-over-year growth in fiscal year 2025. The optimistic outlook for AHFCs is supported by several factors, including their relatively smaller base compared to traditional banking institutions and prime housing finance entities, their capacity to penetrate unorganized market segments, and their adept appraisal skills. These competencies enable AHFCs to effectively serve customers who may not meet the prime credit criteria.

Exhibit 1: Growth Momentum to Continue

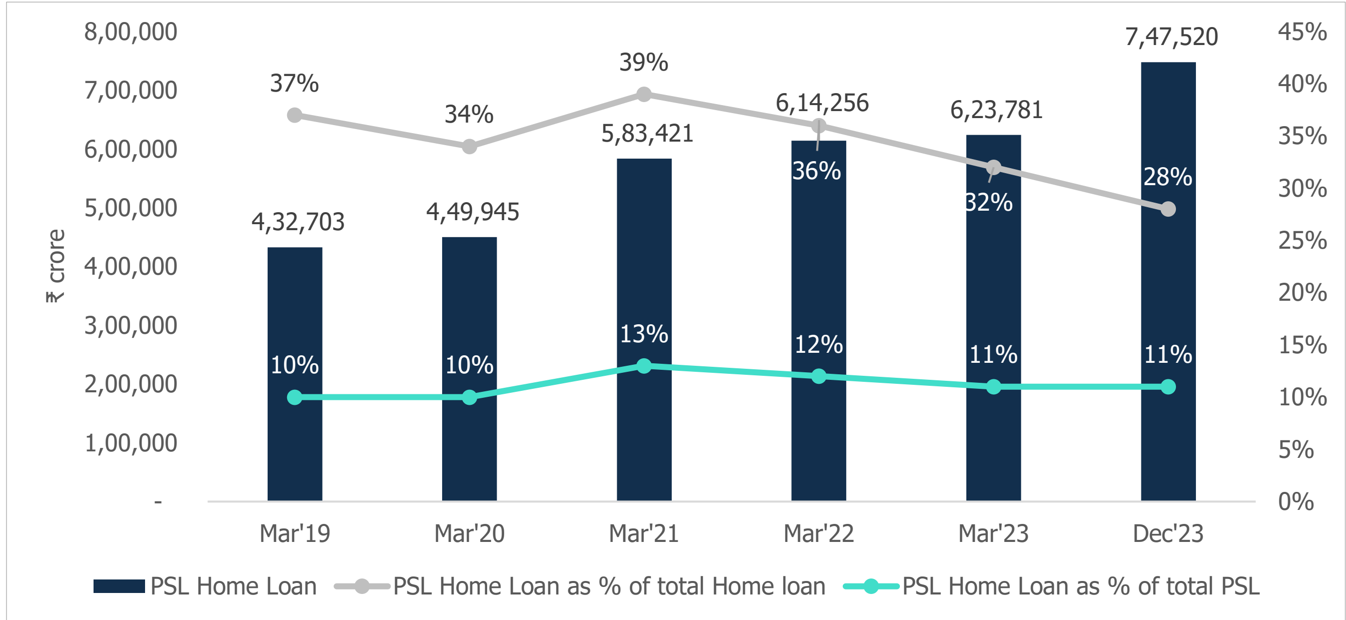


Source: CareEdge Ratings, Basis data set of 16 leading HFCs operating in affordable housing finance space

Declining Share of PSL-compliant Home Loans

The share of PSL loans in the home loans mix as well as in the overall PSL portfolio for banks is on a declining trend over the past two years. To some extent, it can be attributed to rising ticket sizes of home loans whereas PSL thresholds have remained fixed at up to ₹35 lakh in metropolitan cities and ₹25 lakh in other cities. This, in turn, acts as an opportunity for AHFCs who can further build their portfolio through co-lending or direct assignment transactions with banks. Any upward revision in the PSL thresholds could reduce the attractiveness of this niche sector.

Exhibit 2: Declining Share of PSL-compliant Home Loans



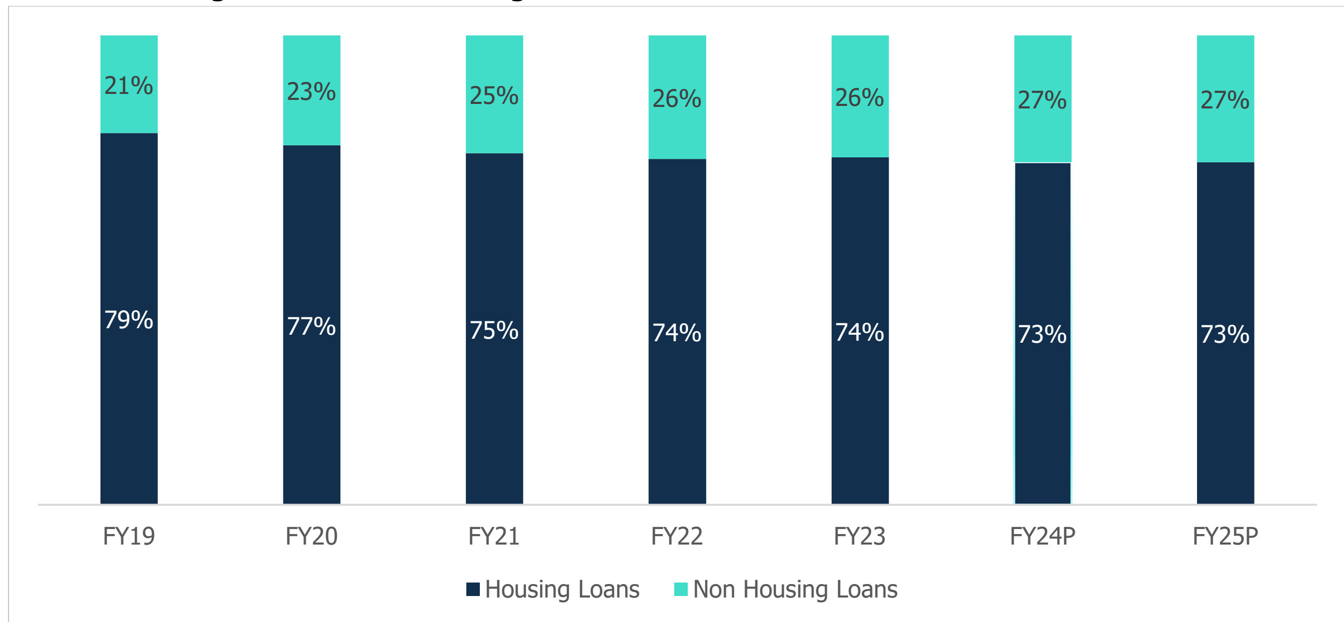
Source: RBI

Rising Share of Loans Against Property in AHFCs Portfolio

In terms of classification based on product type, AHFCs continue to have the majority of their loan book in the form of housing loans, owing to its mandate, which contributed to 74% of the total loan book share as on March 31, 2023. However, amidst the high competitive intensity, AHFCs are increasingly diversifying across non-housing segment to mitigate margin pressures. Non-housing portfolio is mainly in the form of 'loan against property' (LAP) in which micro, small and medium enterprises (MSMEs) and small businesses raise funds for their business and personal needs against collateral which is mainly in the form of property. Also, while the prime HFCs diversify their loan book through builder book/ construction finance, the AHFCs tend to lend towards LAP only under the non-housing segment. Consequently, the share of housing loans reduced from 79%, as on March 31, 2019 to 74%, as on March 31, 2023, in the AHFCs loan portfolio. The rise, however, is within the regulatory guidelines.

As per the RBI, HFCs need to have 60% of the portfolio towards housing finance by March 31, 2024. With non-housing portfolio of most of the AHFCs being well below the regulatory threshold, CareEdge Ratings expects the non-housing share to further increase to 27% in FY24 and FY25, in the pursuit of sustain the margins. For some of the AHFCs, where non-housing portfolio is near the threshold, the regulation could be a constraining factor for their growth in the near term.

Exhibit 3: Rising Share of Non-housing Portfolio



Source: CareEdge Ratings, Basis data set of 16 leading HFCs operating in affordable housing finance space

Margin Pressure May Impact Profitability

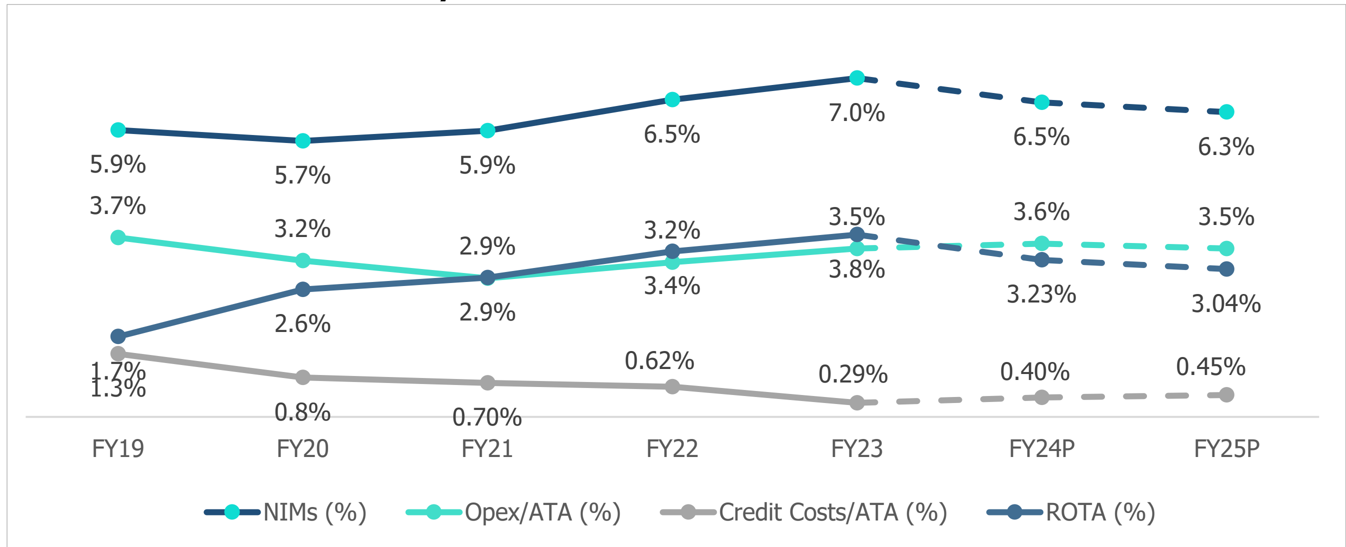
Net Interest Margins for AHFCs have seen improvement in FY23, primarily due to the rapid repricing of loans compared to liabilities. The growth in the proportion of the relatively higher-yielding non-housing portfolio, coupled with a reduced liquidity buffer, has further bolstered the spreads. However, the impact of earlier increase in cost of funds during the current fiscal being visible is anticipated to place pressure on net interest margins. AHFCs have exercised caution in transmitting interest rate hikes to their customers, balancing the dynamics of growth, asset quality, and margins. However, since the AHFC lending rates are relatively high, they face reasonably large balance transfers of existing borrowers moving towards banks and/or other larger HFCs.

The RBI, acknowledging the rapid growth in specific segments of consumer credit, issued guidance on November 16, 2023, directing banks and NBFCs to mitigate anticipated risks by augmenting the risk weights for NBFCs rated A and above on consumer credit exposures, excluding housing loans, education loans, vehicle loans, and loans secured by gold and gold jewellery. Although housing loans have been exempted by the RBI, reducing sectoral vulnerability, the tightened liquidity conditions in the market are expected to keep the cost of funds high in the short to medium term.

The expansion in disbursements and branch networks has resulted in the operating expenses to average total assets ratio reverting to pre-Covid levels. However, due to robust asset quality metrics, credit costs have remained well-managed. With interest rates expected to soften in the second half of fiscal year 2025, AHFCs might encounter an increased likelihood of balance transfers.

Considering the higher operating expenses ratio and the contraction of NIM, the RoTA is projected to moderate to 3.23% in FY24 and further to 3.04% in FY25, down from 3.8% in FY23.

Exhibit 5: Moderated Profitability Metrics



Source: CareEdge Ratings, Basis data set of 16 leading HFCs operating in affordable housing finance space

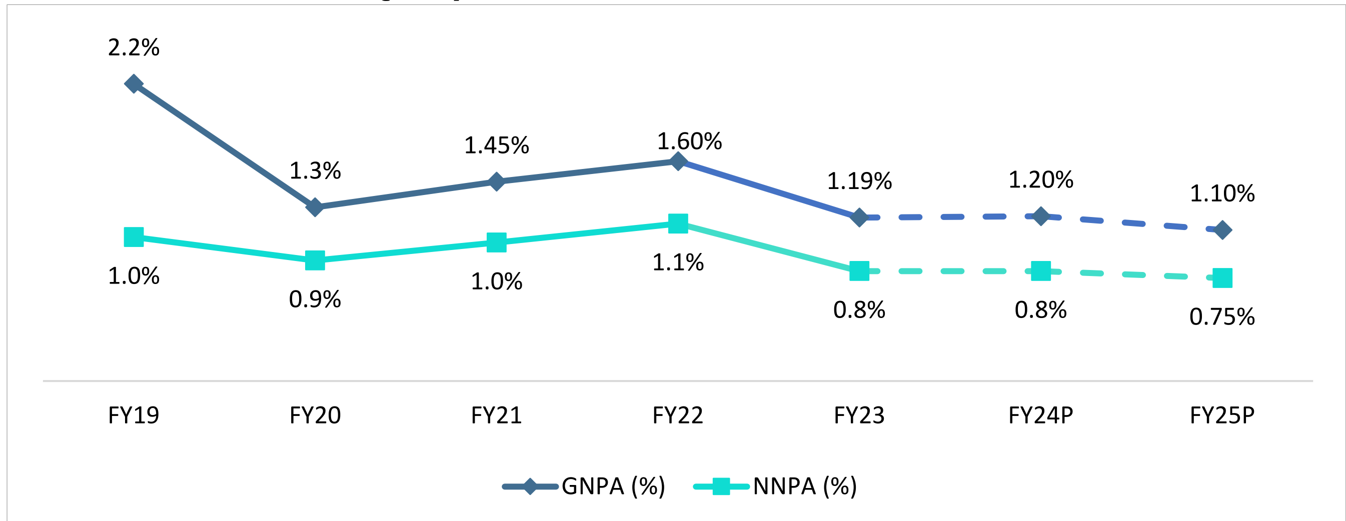
Improving Asset Quality

From FY20 to FY22, AHFCs experienced a gradual deterioration in their asset quality metrics. Nonetheless, these metrics largely remained within acceptable limits. Although early-stage delinquencies were elevated, with the 0 days dpd rate ranging between 5-10%, transitions to the 90-day delinquency category remained minimal, thanks to a strong collection framework.

The improvement in collection efficiency and strategic write-offs led to enhanced asset quality metrics in fiscal year 2023. This culminated in a reduction of the GNPA ratio to 1.19% as of March 31, 2023. This improvement occurred despite the implementation of revised IRAC norms, which slightly increased the overall asset quality metrics.

This positive trend in asset quality metrics is expected to continue into fiscal years 2024 and 2025, with the GNPA ratio projected to stabilize at approximately 1.2% and 1.1%, respectively.

Exhibit 4: Controlled Asset Quality



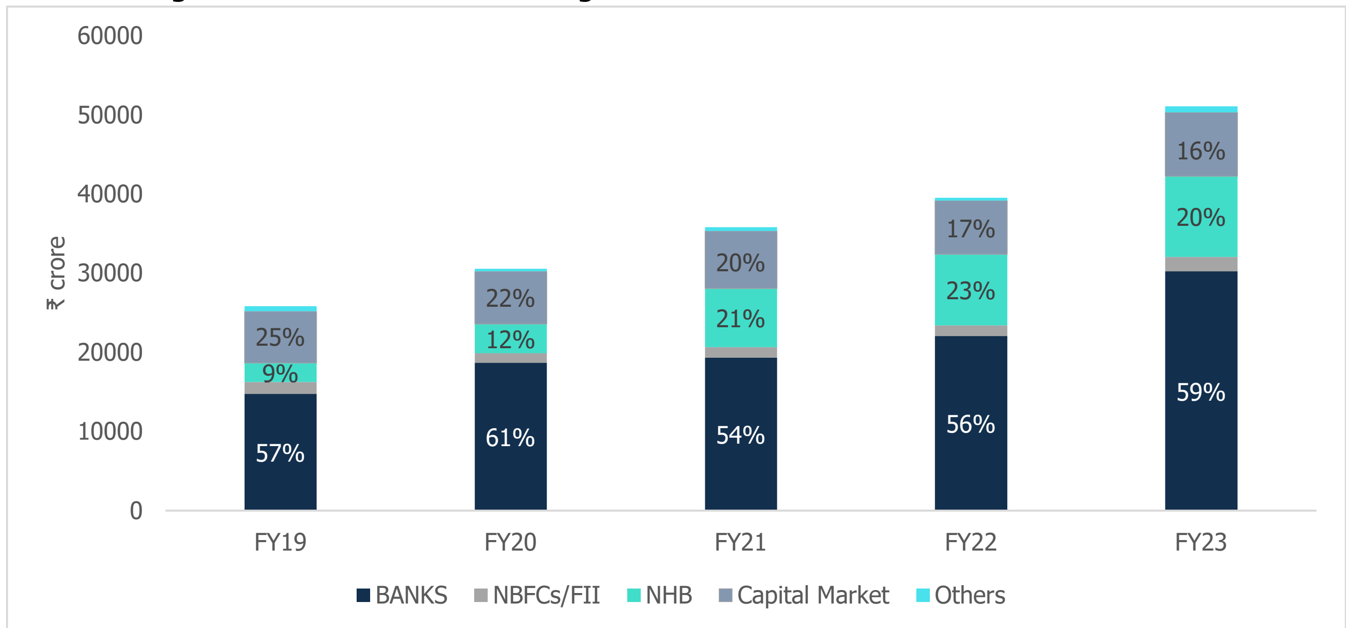
Source: CareEdge Ratings, Basis data set of 16 leading HFCs operating in affordable housing finance space

Banks Continue to Dominate the Debt Profile

The AHFCs borrow a major chunk of their borrowings from banks in the form of term loans, with a few large entities tapping the capital market. As on March 31, 2023, the borrowing mix of the AHFCs had 59% of the overall borrowings from banks, followed by the National Housing Bank (NHB) and capital markets.

During the Covid period, NHB offered liquidity and low-cost funding through its various special liquidity relief schemes. Accordingly, the share of NHB loans in the borrowing mix of AHFCs increased from 12%, as on March 31, 2020, to 20%, as on March 31, 2023. With NHB again moving back to its regular refinance schemes, there has been a gradual normalization in NHB share. Garnering low cost resources will continue to be significantly important agenda item of all HFCs including AHFCs.

Exhibit 6: High Share of Banks in Borrowing Profile of AHFCs

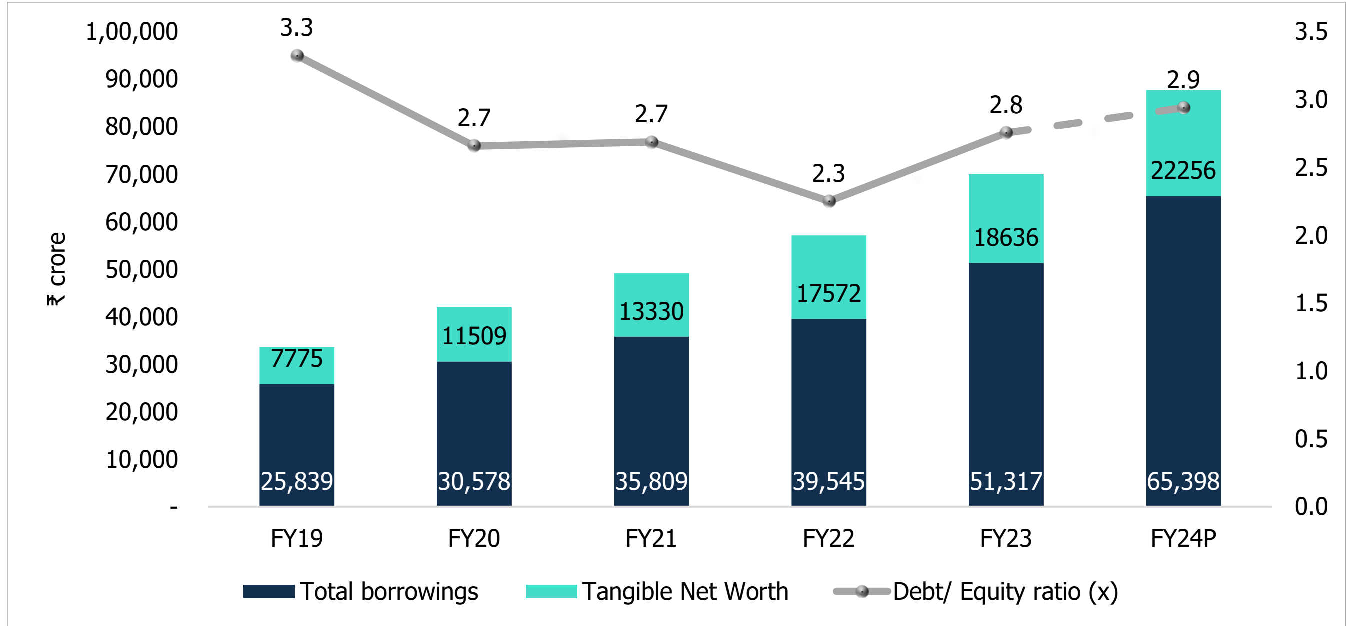


Source: CareEdge Ratings, Basis data set of 16 leading HFCs operating in affordable housing finance space

Comfortable Capital Structure

Capital structure, for the sector, continues to be comfortable with gearing at 2.8x as on March 31, 2023. Though loan book growth has picked up, healthy internal accruals supported the gearing profile. going forward, CareEdge Ratings expects gearing to slightly increase to 2.9x, as on March 31, 2024.

Exhibit 7: Comfortable Gearing Profile



Source: CareEdge Ratings, Basis data set of 16 leading HFCs operating in affordable housing finance space

CareEdge Ratings View

CareEdge Ratings expects the growth momentum for AHFCs in FY24 to continue at 29% with controlled asset quality with a GNPA ratio expected to be around 1.0%, as on March 31, 2024.

Share of the non-housing segment is expected to further increase to 27% by March 31, 2024, amidst the high competition, to mitigate margin pressures. With elevated cost of funds and higher operating expenses, profitability is expected to moderate with the RoTA expected to normalise at 3.2% in FY24. The capital structure for the AHFCs is expected to remain comfortable gearing of around 2.9x as on March 31, 2024.

With the AHFCs catering majorly to the self-employed customers, the AHFCs are vulnerable to higher credit risk.

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