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Housing Finance Post Subprime

International Conference on Housing
National Housing Bank, India

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Presentation Outline

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- Subprime Crisis
- Performance of Indian Mortgage Market
- Challenges to assess a bubble in Indian Context and to increase resilience of the system
- Role of securitization market
- Healthy & Sustainable Balance Between ‘Inclusive Housing and Prudent Lending’

Subprime Lending:
Creation & the Burst of Housing Bubble

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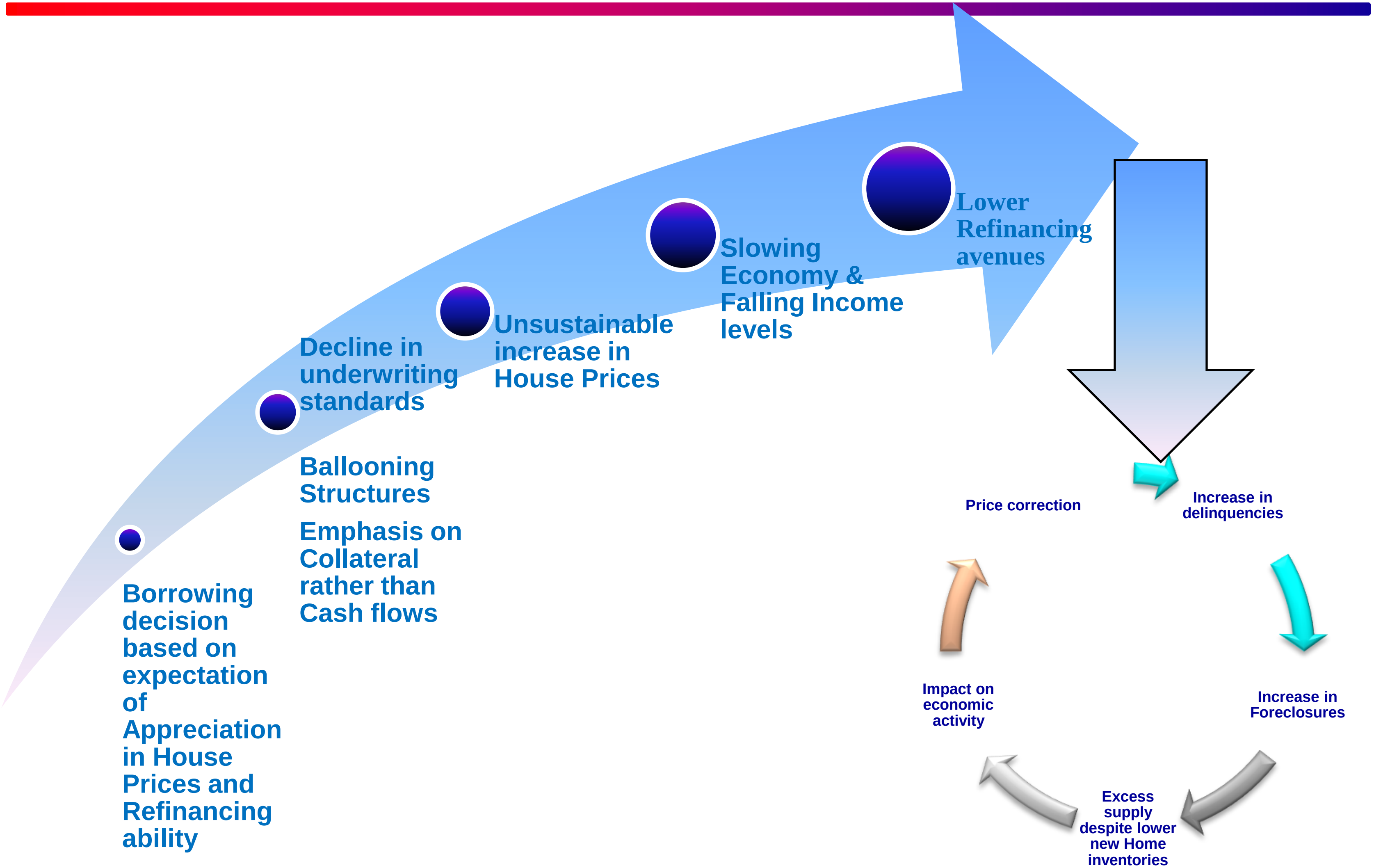

Indian Mortgage market

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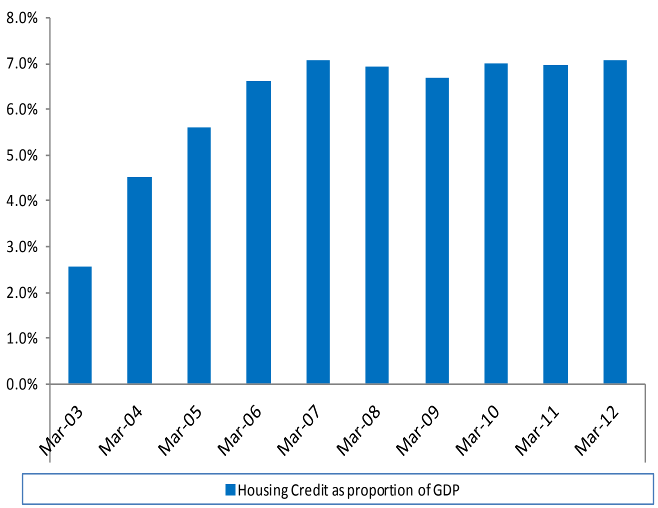
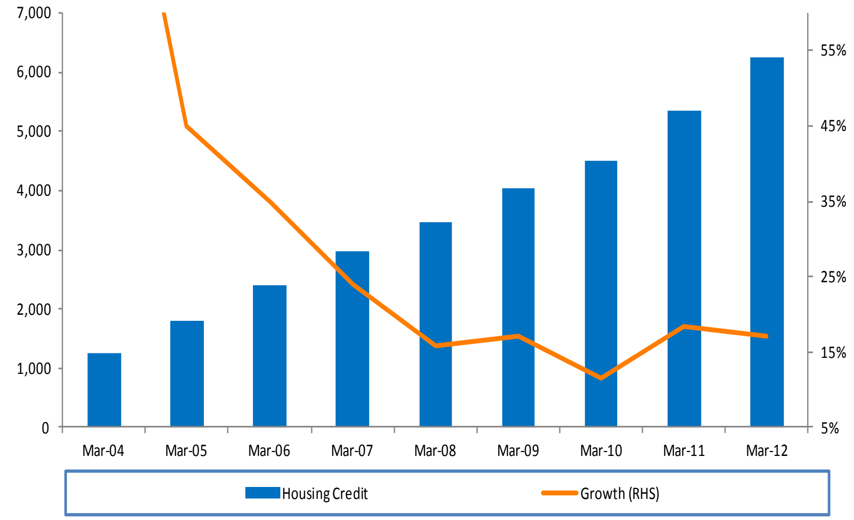
Housing Credit as a Percentage of GDP



Trend in Domestic Housing Credit



Source: RBI, Annual Reports of mortgage lenders, and ICRA's estimates; Amounts in Rs. billion

- Mortgage penetration levels rose from around 2% as in March 2002 to a little over 7% (cumulative) as in March 2007
- Mortgage Penetration unchanged at the 7% levels since 2007

Mapping the Indian Market

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Credit Information Bureau	Improving coverage, used extensively by mortgage lenders
LTV caps	90% for upto Rs. 2 million loan, 80% for > Rs. 2 million loan
Risk weights	50%-125%, linked to the size and LTV of the loan as against 35% under Basel II
Capital Requirement	Tier 1: 6% under Basel II, 9.5% under Basel III
Standard Asset Provisions	0.4%
Mortgage Penetration	Low at 7%
Securitization	Low
Risk retention requirement to address 'Originate to Distribute model'	Yes, Minimum Retention Requirement 10%
Legal Framework	In place, pace of recovery through legal route varies across states
Countercyclical measures	Introduced in the past by tweaking risk weights and standard asset provisioning, Countercyclical buffers and dynamic provisioning - WIP
Economic Outlook	GDP growth to remain moderate at ~6%%, no significant job losses / salary cuts expected

Mapping the Indian Market

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Near Prime / Sub Prime lending	Limited but increasing, Significant space to expand because of large underreported income as well as property prices in self employed segment, lucrative segment for lenders from ROE perspective
Property as an investment avenue	Increasing
Annual Appreciation in property Prices in last five years	15% - 25% in major markets
ALM mismatches	Yes
Availability of Long Term Funding Sources	Limited
Data on new home sales / inventories	Not Available

Trends in Asset Quality Indicators

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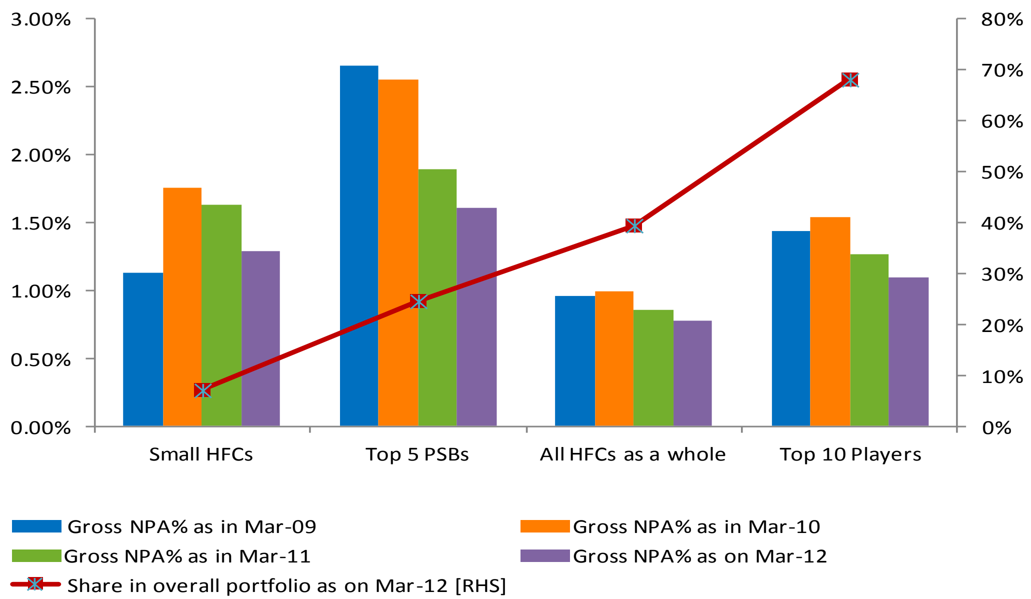

- Sound asset quality despite significant rise in interest rates
- Underwriting by and large characterized by moderate levels of LTVs (cash component provide significant additional cushion), self use properties, lending based on reported income levels
- Asset Quality has also benefited with limited correction in property prices

Challenges to assess a bubble in Indian Context

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Cluster	Time Period	% Increase in Home Prices	Areas
Cluster 1	2007-12	>200%	Chennai, Gurgaon, Mumbai (Mahim,Matunga, Lower Parel)
Cluster 2	2007-12	100%-200%	Faridabad, Pune, Bhopal, Kolkata, Mumbai(Bandra, Cuffe Parade, Andheri, Goregaon) , Indore
Cluster 3	2007-12	<100%	Ahmedabad, Pune, Ludhiana, Vijayawada, Lucknow, Surat, Patna

•Wide Regional variations in prices

•A comprehensive data capturing and reporting mechanism is evolving, although coverage under residex is increasing

•Actual property rise could be different than reported property price rise

Suggestions to strengthen prudential Regulations

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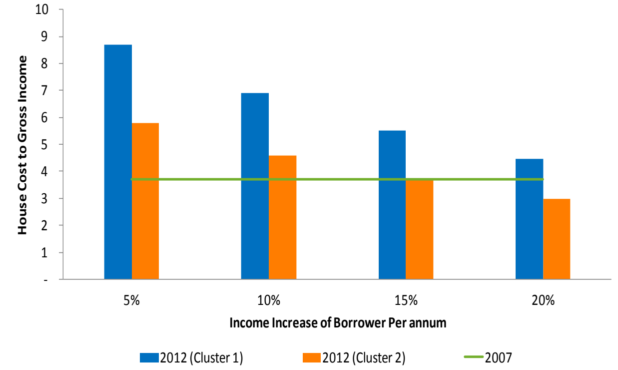
➢**Current Approach:** Tweak risk weights and provisions

➢Macro prudential Norms do not address:

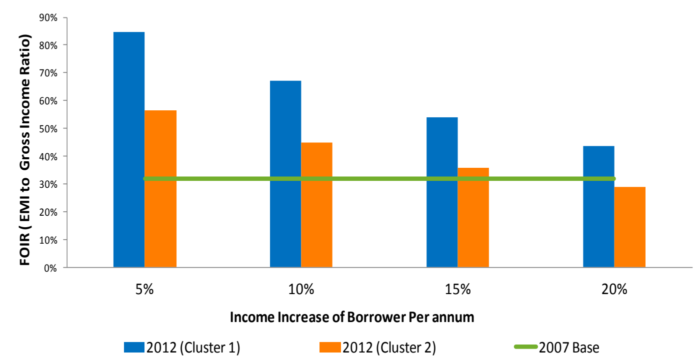
- Unsustainable price rise in certain markets
- Risks associated with lending based on assessed income or to the borrowers with volatile income profile (salaried vs. self employed)

➢Risk weights based on Affordability or debt servicing indicator (such as Fixed Obligation to reported income) and LTV could address part of these concerns?

Property prices (in relation to annual income) in cluster 1 and cluster 2 in 2012 vs. 2007



FOIR (Net Loan Obligations as a percentage of Gross Income in cluster 1 and cluster 2 in 2012 vs. 2007



Cluster 1 (property appreciation by around 200 % in 2007-2012 period), Cluster 2 by 100%

Securitization: Addressing the moral Hazard Issues

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MRR Requirement = 10% book Value

First-loss credit enhancements > 10% of book value	First-loss credit enhancements < 10% of book value	First-loss credit enhancements = 0% of book value
MRR=First Loss Credit Enhancement	MRR = First Loss Credit Enhancement + pari passu investment in senior tranches	MRR = 10% of the securities issued

- Minimum Holding Period (MHP) and Minimum Retention Requirement (MRR) address the moral hazard issues associated 'Originate to distribute'
- MHP requirement: 12 months for loans with Original Maturity of more than 5 years
- No distinction in MRR levels based quality of MRR

Role of securitization market

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- Securitization is an effective risk management tool
  - Exposure management – geographical and borrower profile diversification
  - Liquidity management through better ALM and Diversification of funding sources
- Securitization helps lower rated entities in accessing funds at competitive rates
- Scope to increase efficiency of capital by
  - Making MRR levels aligned to the quality of MRR
    for instance lower levels for First loss piece
  - Allowing reset of credit enhancements

‘Inclusive Housing and Prudent Lending’

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- Current Approach on Prudential norms: Lower risk weights for small loans

	< Rs 3 million	Rs. 3-7.5 million	> 7.5 million
LTV <= 75%	50%	75%	125%
LTV>75%	100%	100%	125%

- Alternate Approach
  - Align Risk weights to the underlying risk
  - Improve flow and reduce cost of funds for enders for on-lending to affordable housing segment
  - Encourage fixed rate lending products for low income group as their capacity to absorb higher EMIs is limited

Thank you !