PN-ABU-013

PN 94913

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Capital Market Instruments for the National Housing Bank: Design, Development, Pricing and Marketing Strategies

UTI Institute of Capital Markets
Vashi, New Bombay

May 1994

Prepared for
Indo-US Housing Finance Expansion Program

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USAID Project No. 386-0526-00-C-2295-00

C O N T E N T S

PREFACE

The National Housing Bank has been playing a very vital role in providing finance to the housing industry in India. Since inception, the National Housing Bank has been getting funds from different sources. These include the Reserve Bank of India, Life Insurance Corportation of India and other concessional sources of finance. Since 1991 there has been a decline in the availability of concessional finance. Added to this ,there has been a shift in the policy of the Government of India. The Government has been slowly and steadily asking various institutions to raise other resources at market related rates. All the above factors have put some constraints on the sources of finance of the National Housing Bank. This has forced the National Housing Bank to look for alternative sources of finance.

As part of the Indo-US Housing Guarantee Expansion Programme, a study was required to be commissioned for designing an appropriate instrument that would be used by the NHB to raise market rate funds. Abt. Associates Inc., awarded the project to the UTI Institute of Capital Markets ,requiring them to study various possible sources of finance for the National Housing Bank. The institute has been asked to mainly explore possibilities of debt market instruments for National Housing Bank. Therefore, throughout the study our main focus has been on the debt market for National Housing Bank.

This study has been divided into six chapters. Chapter 1 deals with introduction and methodology. Chapter 2 discusses the results of various studies and finally analyses and interprets them. Chapter 3 narrates various financial products that are available in the Indian capital market. Chapter 4 deals with design, development and pricing of financial products suitable to National Housing Bank. Chapter 5 explains credit rating and Chapter 6 provides an overview of marketing strategies for National Housing Bank.

This study derived substantial benefits from interviews and discussions held with the officials of housing finance companies and financial institutions. We are particularly grateful to the officials of National Housing Bank, Housing Development Finance Corporation, LIC Home Finance Ltd, Dewan Housing Development Finance Corporation Ltd, Gujarat Rural Housing Finance Corporation Ltd., Can Fin Homes Ltd, SBI Home Finance Ltd, Vysya Bank Home Finance Ltd, Weismann Industries Ltd, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India, and Small Industries Development Bank of India.

This study could not have been completed without interaction with various experts and academicians from various research institutions . We would like to place on record our appreciation of ,the review of the research methodology for the project by Dr.B.G. Shah, Member, Governing Council, UTI-ICM. We are also thankful to Dr.J.S. Saini, Dr.D.D. Sharma, Mr.Bansal and Mr.Venugopal for their valuable help extended to us during the project.

We are thankful to the officials of the branches of the Unit Trust of India who helped our team members during their visit to various parts of the country in connection with the survey.

We also thank scores of investors all over the country, who co-operated with us and provided their responses to the questionnaire administered to them.

We are grateful to M/s. Abt. Associates Inc., USA, for having reposed their confidence in the UTI Institute of Capital Markets and awarded this consultancy assignment under Indo-US Housing Finance Expansion Programme to us.

K.G. Vassal
Director
May 26, 1994

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EXECUTIVE SUMMARY

The demand for housing in a developing economy like India is quite high, and there is tremendous scope for expansion of mortgage lending by formal financial institutions. The National Housing Bank (NHB) was created in 1988, to operate as the apex institution for housing finance, and act as a regulatory authority, that oversees the working of the specialised housing finance companies (HFCs). As an apex institution, the NHB also provides a secondary mortgage facility to the HFCs by refinancing certain types of loans disbursed by them to the primary borrowers.

The liberalisation process initiated for the financial sector in 1991, envisages the discontinuation of the system of directed credit to financial institutions, and has injected an element of market orientation in the functioning of most institutions, the NHB being no exception. Since its incorporation, the NHB had benefitted from one or the other concessional source of funding. It had also provided refinance to identified beneficiaries through a system of cross subsidisation. The almost abrupt withdrawal of directed sources of credit, has led to a review of the funding and deployment strategies for the NHB. This study explores the alternatives available to the NHB, through appropriate instrument design, to tap market rate funds for its operations.

The study assesses the preferences of the investors with a view to ascertaining the features of an instrument, that would be able to compete with the others on offer to the same target group. The retail market for funds has been tapped by few financial institutions in the recent past. Their experiences and the strategies deployed by them have also been studied with a view to finding out if the NHB can replicate their approach. The Indian capital market has recently been freed from the system of administered pricing of financial products. Instruments that have been popular with the investors in the developed countries can be tailored to attract the investors in India, by appropriate structuring and pricing. This report examines these aspects with reference to the requirement of the NHB to access market rate funds.

Investor Preferences

Individual Investors spread across ten major cities were administered a structured questionnaire that sought to ascertain their preferences for yield and packaging features. The system of administered pricing as was till recently prevalent in the capital market, almost invariably underpriced the IPOs of issuers. Investors had understood the benefits of subscribing to the IPOs, rather than acquire a security from the secondary markets through the brokers. Even after the advent of free pricing of issues, investors exhibit a preference to subscribe to IPOs. Recent issues have not lived up to the expectation of the investors in this context, and caution may substitute enthusiasm, sooner than later.

The benefit of capital gain inherent in the hitherto prevalent administered system, has resulted in an increased preference for equity, and quasi -equity instruments, over debt instruments. However, institutions have, in the recent past, packaged debt instruments attractively and sold them successfully, indicating the importance of product packaging in tapping the retail market for funds. Innovative structures combined with a good marketing strategy, could help place a debt instrument in the market. A certain structure , Deep Discount Bond, holds particular appeal to the investor. New products are able to appeal by virtue of their novelty value, as indicated by the response to the floating rate notes that were recently issued by few financial institutions.

The holding period, or the time horizon of the investor, has reduced markedly in the recent past. The investor perception is that the market is in a state of flux, and that funds should not be committed for long periods in such a scenario.

Experiences Of Financial Institutions

Financial institutions such as the ICICI,IDBI,SIDBI, and the SBI have accessed market rate funds with a remarkable degree of success. Their experiences were studied in detail.Most of them have introduced innovative product structures that were also aggressively marketed to the investors. Since these institutions were accessing the market for the first time, the pricing was quite competitive and in few cases more attractive than the competing options available to the investor. In the case of some institutions, the amounts on offer were kept small compared to their total funds base, with the clear objective of testing the market, while keeping the weighted average cost of funds at a manageably low level.

The features of the product were matched more to the requirements of the target investor, rather than the requirements of the issuing institution. Among the reasons for the success of the issues of these institutions were : Attractive yield structure, Innovative product design, and aggressive marketing.

Notably, these institutions have altered the design of their instruments in their second issue, and have not repeated the strategies that worked so well for them in their maiden issue. They have shifted from fixed rate instruments to floating rate instruments (all the three institutions that made the second offer) and have reduced the term to maturity to 7 years or less. These instruments were also able to garner more funds than that targeted by the issuers. The experiences of these institutions, and the general state of the primary markets in the post-liberalisation period, are indicative of eagerness on the part of investors to take part in innovative issues, albeit those with medium term maturity.

PRODUCT DESIGN FOR THE NHB

The demand for NHB refinance from the eligible institutions and the flexibility available to the NHB to profitably price it are the major determinants of its funding strategy. The NHB should be able to augment resources at a price that is attractive to the investor, while at the same time be able to disburse the funds to the primary lenders within the policy framework that has been set for it as the apex institution.

However, the ability of the NHB to attract retail investors who would demand competitive yields on their investments is limited. Instead, the NHB can attract market rate funds from institutions, which would be willing to place them at lesser rates that would be affordable from the NHB's point of view. Some amount of directed credit for housing is existent and is being made available by provident funds, insurance companies and commercial banks. There is a case for tapping these resources, as long as they are available at concessional rates, by the NHB.

The NHB should however prepare itself for accessing retail funds in a large scale in the near future, and has to tap the retail markets for small amounts, in a phased manner.

ABBREVIATIONS

AB Home	:	Andhra Bank Home Finance Limited Finance Ltd.
BOI FL	:	Bank of India Finance Limited
BRs	:	Bankers Receipts
CBDT	:	Central Board for Direct Taxes
CCPS	:	Cumulative Convertible Preference Shares
CRISIL	:	Credit Rating and Information Services of India Limited
DDB	:	Deep Discount Bond
Fairgrowth FSL	:	Fairgrowth Financial Services Limited
FCD	:	Fully Convertible Debentures
FIIs	:	Foreign Institutional Investors
FRB	:	Floating Rate Bonds
FRN	:	Floating Rate Notes
GICGV	:	General Insurance Corporation Grih Vitta (Now GIC Housing Ltd.)
GOI	:	Government of India
GRUH	:	Gujarat Rural Housing Finance Corporation
HDFC	:	Housing Development Finance Corporation
HFC	:	Housing Finance Company
HLA	:	Home Loan account
HUDCO	:	Housing and Urban Development Corporation
ICICI	:	Industrial Credit and Investment Corporation of India
IDBI	:	Industrial Development Bank of India
IIs	:	Institutional Investors
IPO	:	Initial Public Offering
LDSP	:	Land Development and Shelter Project Scheme
LIBOR	:	London Inter Bank Offered Rate
LIC HFL	:	Life Insurance Corporation Home Finance Limited
LTO	:	Long Term Operations
MFs	:	Mutual Funds
NBFIs	:	Non-banking Financial Institutions
NHB	:	National Housing Bank
NHP	:	National Housing Policy
NRI	:	Non-resident Indians

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OECF	:	Overseas Economic Co-operation Fund
OTCEI	:	Over The Counter Exchange of India
PF	:	Provident Fund
PFT	:	Provident Fund Trusts
PPF	:	Public Provident Fund
p.a.	:	Per Annum
RBI	:	Reserve Bank of India
ROC	:	Registrar of Companies
SBI	:	State Bank of India
SBI Homes	:	State Bank of India Homes
SCICI	:	Shipping Credit and Investment Corporation of India
SGL	:	Subsidiary General Ledger
SIDBI	:	Small Industries Development Bank of India
SLR	:	Statutory Liquidity Ratio
SPN	:	Secured Premium Notes
Sr. Nos.	:	Serial Numbers
Stanchart	:	Standard Chartered Bank
TISCO	:	Tata Iron and Steel Company
USAID	:	United States Agency for International Development
UTI -I CM	:	Unit Trust of India - Institute of Capital Markets
VBHFL	:	Vysya Bank Housing Finance Limited

CHAPTER 1

INTRODUCTION AND METHODOLOGY

The resource mobilisation strategy for the NHB involves tailoring a financial product, that would suit the preferences of the investor on one hand, and place least strain on the over-all cost of funds of the NHB on the other. The product design exercise therefore requires inputs on investor expectations with regard to risk and return, packaging and distribution. Equally important would be inputs on the housing industry and NHB's fund deployment opportunities and cost.

The experiences of other financial institutions which had to market their issues with respect to the above trade-off, can be expected to help crystalise an appropriate strategy for NHB. This chapter delienates the scope and methodology adopted to serve the aforesaid objectives.

This chapter has been divided into three sections. The first section delineates the objectives, scope and methodology adopted for finding out the following :

(a) the preferences of individual investors
(b) the strategies and methods used by financial institutions which have tapped the capital market
(c) the policies and performance of NHB
(d) performance of the housing finance industry.

The second section discusses the performance of the NHB with specific reference to its fund mobilisation and utilisation. The refinance programme of the NHB is discussed in this section.

The third section provides an overview of the housing finance industry and analyses the sources of funds for the housing finance companies. The implications of the cost of funds of housing finance companies for NHB have been analysed.

SECTION - I

OBJECTIVE AND METHODOLOGY OF SURVEY

Individual Investors

A survey was conducted in ten major cities of India and 938 investors were interviewed to get their responses to a detailed structured questionnaire given in the Annexure - I

Objectives of Questionnaire

The objectives of questionnaire were to find out :

i The investing habits of investors in the primary , as well as in the secondary market, in the immediate past.

ii Investors' preferences among various instruments (which have influenced their investment decisions in the past).

iii Investors' objectives and preferences in the future

iv The relative attractiveness of unsecured bonds vis-a-vis other marketable instruments.

v Investors' minimum level of expected return and their ability to bear risk.

vi The various marketing techniques adopted by financial institutions in the past and their relative appeal to investors.

vii Extent of investor awareness of National Housing Bank and its image among them, etc.

The questionnaire had 34 questions. These were predominantly objective type questions. Only two of 34 questions were open-ended questions.

Methodology

The process adopted to logically fulfill the above-mentioned objectives is enunciated below under various sub-heads.

Constraints

The National Housing Bank indicated to us that RBI would not like to dilute its share-holding and hence it was looking at a debt market instrument having a long term maturity period, for raising resources to meet its refinance needs.

Sample

The Deep Discount Bond was chosen from an array of fixed income instruments mainly because of its long term maturity period and wide acceptance by the investors inspite of it being a new instrument. Since IDBI and SIDBI were the institutions which had already successfully marked Deep Discount Bonds (DDBs), the sample was chosen from the respondents of DDBs.

Therefore, a select sample of SIDBI investors was chosen from 10 major cities in India. The addresses were obtained from the Registrars to the issue.

In addition to the four metropolitan cities of India, six other cities were chosen on the basis of a few factors like, response to previous issues like Reliance Petroleum, geographic distribution (covering a few regions of the country) and in consultation with the officers of National Housing Bank. The cities chosen for the purpose of survey are mentioned below in Table 1.1 alongwith the number of investors interviewed in those cities.

Table - 1.1

Geographic Profile Of The Sample

S.No.	City	No.of Responses
1.	Bombay	60
2.	Delhi	141
3.	Calcutta	66
4.	Madras	97
5.	Bangalore	102
6.	Hyderabad	81
7.	Cochin	101
8.	Ahmedabad	85
9.	Jaipur	105
10.	Chandigarh	100
	Total	938

PROCEDURE FOLLOWED TO COLLECT DATA

A team of twelve members comprising of faculty and officers of UTI-ICM was constituted. They personally administered the questionnaire door-to-door to the decision maker in the households. At times repeated visits had to be made to the same household, due to the non-availability of the decision maker.

While administering the questionnaire, care was taken to clarify the technical questions.

DATA PROCESSING

The analysis of the Survey responses was done by using computers. The questionnaire filled by the investors were segregated on the basis of City and fed to the computer. The analysis was done on the basis of the following parameters:

- City
- Age
- Annual Household Income
- Educational qualifications
- Profession

Some of the questions were analyzed on the basis of combination of more than one parameter also, to highlight group-wise preferences on certain key issues like Marketing, Investment patterns and Perceptions of investors.

The processing of questions was done by using two different methods as outlined below :

i. For the questions type-A (multiple alternatives) the responses were accumulated for each alternative of that question to arrive at the best alternative of these questions as preferred by majority of the investors. This summation figure when compared with the total sample size gave the Percentage Preference figure for each alternative. The alternative having highest Preference Percentage Figure was the most preferred alternative of that question. As few of the investors did not respond to some of the questions, the summation of percentage figures for a question sometimes does not add up to 100 percent. The difference indicates number of investors who had not responded to that question.

ii. For the questions type-B, (where rankings were to be given) the relevant options were ranked by the investors in order of their preference for that option. The relative significance of each option was arrived at by assigning equi-diminishing weightages to different ranks and then adding up the product of rank and weightage over all ranks for that option.

For example :

If a question had five options, then each option could be ranked in the range of 1-5 by the investors. Following weightages were assigned for each rank :-

Rank - 1	=	10	(100%)
Rank - 2	=	8	(80%)
Rank - 3	=	6	(60%)
Rank - 4	=	4	(40%)
Rank - 5	=	2	(20%)

Hence, if an option had been ranked as 1st by 300 people, 2nd by 200 people, 3rd by 150 people, 4th by 100 people and 5th by 200 people, then the Significance Number arrived at for that option would work out to 6300 (10 x 300 + 8 x 200 + 6 x 150 + 4 x 100 + 2 x 200). The option getting the highest Significance Score was the best preferred option.

All the results were expressed in terms of percentages to maintain the uniformity across both types of questions. These computations are represented graphically in the form of bar and pie charts for easier understanding and analysis of findings of the Survey. The charts for all questions are enclosed in Annexure IV.

FINANCIAL INSTITUTIONS, HOUSING FINANCING COMPANIES AND NATIONAL HOUSING BANK.

In order to enable NHB to raise resources for its long, medium and short term uses, the following tasks were identified and information was analysed from the management angle:

1) To find out the pricing and marketing strategies adopted by institutions and companies which made public issues. with a view to finding out if NHB can replicate the same model or modify the model to suit its requirements.

c) Information that remained to be sought was listed, and a distinctive questionnaire was framed for each targeted company/Organisation, and administered in a personal interview with the concerned executives of the target organisation. (See Annexure III for sample questionnaires)

The following are the companies/Institutions that were analysed as detailed above:

1. National Housing Bank

Housing Finance Companies

1) AB Home Finance Limited.
2) GIC Housing Ltd.
3) LIC Home Finance Ltd.
4) Housing Development Finance Corporation.
5) Dewan Housing Finance Ltd.
6) Gujarat Rural Housing Finance Corporation.
7) Can Fin Homes Ltd.
8) SBI Home Finance Ltd., and
9) Vysya Bank Home Finance Ltd.

Institutions

1) Industrial Development Bank of India.
2) Industrial Credit and Investment Corporation of India and
3) Small Industries Development Bank of India.

Scope

1) Housing finance companies were not expected to exhibit uniformity in capital structure, asset structure and future plans and prospects. They may not be turning to the NHB for all their financial requirements but may either be availing loans from the parent organisation or tapping institutional sources of finance. Housing finance companies may be looking for niche segments within the industry in which they would choose to specialise, thereby balancing their financing costs and spread. It was therefore imperative that the characteristics of the organisations be thoroughly understood, and available secondary sources of data be analysed, and the inputs so derived supplemented by interviewing the managements.

2) The NHB had to be studied in detail before suggesting a financial instrument for their long term financial requirements. The refinance function of the NHB had to be evaluated and the demand analysed. It was also necessary to look into the cost which NHB can bear and the volumes of business that it can sustain. The impact of becoming a market oriented organisation on the housing industry also had to be understood. The likely credit rating that NHB can get and its implication for the structure of the proposed instrument had to be projected.

3) Various financial institutions such as ICICI, IDBI and SIDBI had tapped the capital market in the past. They had come out with different instruments and with different marketing strategies. While a few features were expected to be common across these issues, those features which differentiated the response to these issues will also have to be examined.

Methodology

The methodology adopted to serve the above objectives was as under:

a) A master questionnaire that enlisted all types of information that was required for the project was first prepared. (See Annexure II)

b) Secondary sources of information pertaining to each of the targeted company / institution was to be collected and analysed and was related to the information required as detailed in the master questionnaire.

SECTION-II

NHB : FUND MOBILISATION AND UTILIZATION - KEY ISSUES

The primary financial activity of the NHB is its refinance program, and the resource mobilisation strategy has to be tied with the ability of NHB to profitably deploy funds. This section evaluates the refinance activity of the NHB.

Refinance Program Of NHB : An Evaluation

The refinance facility of NHB is an open ended commitment of NHB which it had promised to honour at the time of its formation. NHB also sets the rates at which refinance would be made available and the rates at which HFCs can in turn lend to the primary borrower. The refinance scheme was designed to encourage HFCs to lend to the "small man " without having to plan for funds to do so and bother about the spread that can be earned on such loans. Housing finance companies have been the largest borrowers from the NHB, utilizing about 80% of the total refinance made available by the NHB.

The rates at which the refinance is provided by NHB have been altering from time to time and have been increasing. The number of slabs and the number of rates have been reduced and there are now 2 slabs where refinance is offered at 10% for loans up to Rs. 25,000, and at 14.25% for loans above Rs. 25,000 up to Rs. 2,00,000 . As at end January 1994, the total refinance provided by NHB was Rs.1810 crores. The incremental refinance provided by the NHB over the years has reduced from Rs. 675 crores in 1991-92 to Rs. 485.92 crores in 1992 - 93 and the total refinance for the current year is expected to be less than Rs. 200 crores. Among the reasons for the fall in refinance activity of NHB are the lack of adequate resources with NHB.

The critical factor that would influence the demand for refinance from the NHB would be the comparative cost at which NHB is making the funds available and the speed with which the demand is met. The rate at which NHB has been providing refinance has been steadily increasing, and this has happened at a time when the rates of interest in the economy have actually fallen. This has led to a situation where the NHB refinance has become costlier source of funds to the HFCs.

Whether the demand for funds by HFCs translates into demand for refinance, is dependent on the availability of funds with NHB and its ability to offer the funds at rates that are comparable with the rates at which other sources of finance are available. The NHB had obtained funds for its activity from various sources, many of them concessional, in the past. But the situation at present is that the NHB has to increasingly source market rate funds, since the below-market rate funds are slowly drying up. Since the housing industry is growing at comfortable rates, it can be expected that should NHB manage to garner competitively priced resources, there would be demand for funds from the eligible organizations.

The HFCs that were interviewed have indicated that they would be willing to avail refinance despite the small spread as long as amounts are available soon enough and the rate is competitive. The experience of HFCs with the speed of service at NHB has been mixed.

The report of Arthur Anderson on the administration of NHB refinance points out that there is tremendous scope for improvement in the procedural aspects. There is scope to speed up the disbursal of refinance. Many HFCs which were earlier enjoying back to back refinance now find that it is necessary to provide for some kind of float before the funds are released by the NHB. The efficiency of the NHB in disbursing in refinance could be an important factor influencing the demand for refinance.

The fund mobilisation exercise of the NHB has to be done bearing the above factors in mind. Any increase in the cost of funds for NHB would get translated into increase in the cost of funds to the ultimate borrower who would have to pay for the two layers of intermediation that are involved. If the cost of funds and hence the cost of refinance from NHB, are higher than the costs at which HFCs can mobilize resources, those HFCs that have access to low cost funds would move away from NHB. Those HFCs which cannot mobilize funds from the other sources would depend on NHB. If the refinance rates are comparable with the cost of funds of the HFCs, those HFCs which have access to other low cost funds would avail refinance and deploy the low cost funds at the premium end of the market and make higher profits.

More importantly, the sources that are tapped by the NHB should either be not available to the beneficiaries of refinance or they should face some constraints in directly accessing such sources. In only in these two cases will the NHB be able to raise funds and make it available to refinance beneficiaries and also justify the cost involved in intermediation.

Funds For Housing : Policy Issues

The thinking of the Government and the policy makers on the sources of finance for housing are embodied in the National Housing Policy. The major points relevant to the NHB's fund mobilisation exercise are the following:

1. The policy recognizes that household savings will have to be tapped through an "elastic and wide spread resource mobilisation strategy". One common observation that underlies all studies on housing finance is that the household sector being the identified beneficiary of housing finance, and also the largest saving sector in the economy, funds have to be mobilized from and ploughed back into this sector, through a well designed mechanism.

2. The policy directs that resources from insurance Cos., UTI and the banks should increasingly be diverted to housing. These institutions, except the UTI, are statutorily required to invest a proportion of their incremental resources in housing. The policy envisages not only the continuation, but also an increase in these allocations. The point to be noted however, is that these institutions are not required to lend these resources at a concessional rate but at a rate that "reflects the average yields of these resources". Presently, these institutions, except the UTI, are lending for housing finance, at below market rates.

3. The policy envisages the introduction of innovative capital market instruments, so that housing finance companies can access capital markets on a competitive basis. Such instruments are to be issued through mutual funds for housing, created by the NHB and HUDCO.

4. It is planned to introduce a secondary mortgage system , through the securitisation of mortgage receivables. This option was rendered quite unattractive due to the lack of adequate foreclosure rights under the law, and the inhibiting stamp duties that are payable on transfer of instruments. The recent budgetary proposal of the Maharashtra Government, reducing the stamp duties from 3% to 0.1% would make this option feasible. Securitisation can be expected to emerge as an important alternative for the fund mobilisation efforts of the housing industry.

5. The policy assures continued institutional support to co-operative movements especially for lower and middle income groups, which might come as explicit subsidy rather than perspecting the present system of cross-subsidisation.

6. Resources for housing finance are expected to come from the following hitherto untapped sources :

   a. Housing linked saving schemes for P.F.subscribers, wherein P.F. accumulations may be directed to housing. It may also be feasible to include the self employed through the formation of appropriate pension fund schemes.

   b. Mobilisation of funds from the capital market through specialized housing mutual funds.

   c. Securitisation of mortgage receivables.

The strategy for NHB should therefore be

(i) to augment existing institutional resource bases, albeit at market rates.

(ii) to increase focus on the household savings, through an appropriate instrument.

The options available to the NHB and the strategies relevant for raising resources are discussed in the subsequent section.

SECTION - III

HOUSING FINANCE INDUSTRY: AN OVERVIEW

The housing finance industry is characterised by huge demand and a limited supply. The demand for housing however does not always come from sectors that are capable of affording borrowed funds for the same. Tapping this segment calls for specific efforts in product design and receivables management. Housing Finance Companies (HFCs) are instead primarily servicing that segment of borrowers, who are able to service a housing loan from their incomes.

HFCs in India so far exist as plain vanilla housing finance organisations. Their primary activity continues to be providing long-term loans against mortgage of property. Most of them lend to individuals, though the trend towards increased lending to and through corporations, for providing loans to their employees for housing is on the increase.

Many HFCs recognise that utilisation of 25 % of funds (as permitted for availing tax concession under Section 36 (i) (viii) of Income Tax Act) in other activities can boost profits and the range of activities have increased to the extent to which funds are available. The recent trend has been that housing companies are looking at newer activities for deploying 25 % of their funds. Some of them are already into financing builders and developers on a short-term basis ; some are planning to enter into leasing of construction machinery ; some are expanding into consumer finance ; bill discounting and factoring are also opportunities envisaged by some housing companies.

To the extent that the hard core housing finance activity is not perceived to be profitable, the housing finance industry would not attract new entrants. It does not augur well for the industry if its profitability hinges on the other income factor. From another point of view, the very flexibility to earn other income can attract new entrants, who would consider the industry profitable because of the existence of this very factor. From the long-term point of view, there is a necessity to have a policy decision as to what are the activities that a housing finance company can do and also be profitable. It might not be advisable to allow HFCs to earn losses on their main activity and make it up from other activities. A review of the administered spread allowed by the NHB has to be done in this context. Scope for better product design, to tap new markets, also exists for HFCs.

Sources of Finance of HFCs

HDFC, the first housing finance company in the private sector, had the benefits of being the pioneer , since all the types of sources of finance that were availablc to HFCs were tapped and utilised by HDFC. The company, in the initial years of formation benefited from the financial support provided by the promoters, and owing to its excellent operating performance was able to source funds both equity and debt from the capital markets, and benefited from the support of international funding agencies when there was no other company in the industry that could compete for these funds. HDFC is now a RS.4000 crore company and is larger than all the recognised HFCs put together. The problems of HFCs in raising money, that we propose to discuss in this section would not apply to HDFC.

The major sources of finance for housing finance companies directly relate to the manner in which they had been formed. In the case of 8 HFCs which were formed by scheduled commercial banks , they had recourse to term loans from the banks. Banks are required to deploy 1.5% of their incremental deposits in housing and the housing finance subsidiaries of banks had a preferential recourse to these funds. In the case of HFCs such as SBI Homes and VBHFL funds were available through a cash credit account and the effective cost of funds was lower since the interest was payable only on amounts actually drawn. 2 HFCs were formed as subsidiaries of insurance companies, and term loans were available to both of them from the parent insurance company. In case of the other HFCs, there was no such advantage arising out of their formation. Some of them had sourced funds from the government at the time of formation.

The HFCs that did not have a tie-up for funds with their promoter companies, grew to become more dependent on NHB for funds and represent companies that are most affected by the drying up of refinance and the increase in the rate of refinance from NHB. The largest beneficiaries of refinance are ironically those HFCs that have lower weighted average cost of capital. We have already seen that the refinance policy requires review, and the impact the policy has had on the cost of capital of HFCs, requires further examination.

The other sources of funds to HFCs were deposits from the public and owned funds. HFCs abroad were typically dependent on the deposits from the public for their financing requirements, till the emergence of an active secondary market for mortgages. In India there are certain legal and procedural changes that are required to make the securitisation option feasible.

Deposits have been recognised as an important source of finance and HFCs are increasingly looking at the retail deposits as an important source of finance. As on 31st March 1993, deposits were 10.74 % of the total funds of the HFCs, and according to the inputs received from the interviews, the figure is expected to be 15% of the total funds for the year 1993-1994.

Table 1.2 provides an overview of the sources of finance of the HFCs as on 31st March 1993. Term loans, which were mostly sourced at soft terms from the government, banks and financial institutions form the largest source of funding for HFCs , accounting for 35% of the total funds.

Changes In Sources Of Finance : Implications For The NHB

One of the major providers of the concessional long term funds to HFCs have been commercial banks. Apart from being the largest lenders to their subsidiary housing finance companies, these organisations have also being providing funds to other HFCs. Their ability to provide concessional funds is threatened by the pressure under which their profitability have recently come. Banks have to raise risk capital from the markets to satisfy the new capital adequacy norms. There has to be an increase in the focus on profitability and all types of concessional lending would come under close scrutiny. This means that 1.5% of incremental deposits which are now being made available to the housing industry might dry up. Alternatively banks may desire a market rate of return on these funds.

Insurance companies which are similarly providing a part of their funds at concessional rates, could be constrained to restrict or completely stop such funding for profitability considerations. The acceptance of Malhotra committee report would result in increased competition in the insurance business.

The threats to the traditional sources of funds to which HFCs had been used to for sometime now, has compelled them to look at public deposits for their funding requirements. HFCs plan to sooner than later, replace about 50% of their funding with deposits, and do so at rates that do not impact on their profitability and viability.

Bank sponsored HFCs have been the first to venture into collecting deposits from the public using their branch networks to advantage. HDFC was the first housing financial company to successfully exploit this source of finance. It has collected more than Rs. 1000 crores as public deposits . It should be noted that HDFC offers a rate of interest that is one percent below the maximum rate of interest stipulated by the NHB. The success of HDFC has encouraged many housing finance companies to go to the public for deposits.

Most HFCs have initiated mobilising deposits from the public. Even HFCs such as Dewan Housing, Gruh, which were not collecting any public deposit earlier have initiated efforts in the current year and are confident of raising deposits enough to meet their requirements atleast upto 25%. HFCs that have been dependent on the parent companies such as LICHFL, and GICGV, plan to collect public deposits in the next year.

The demand for refinance from NHB will directly depend upon the comparative cost and convenience involved in mobilising public deposits. At present, about 60% of the deposits raised by HFCs is at the highest permissible rate of interest. The weighted average cost of capital remains lesser, due to availability of preferred sources of finance to most HFCs. To the extent that incremental requirements are financed by deposits, the cost is bound to increase.

The HFCs in India have a limitation compared to their counter parts elsewhere in the world, since housing loans in the U.S for instance, are provided by saving and loan institutions that discharge both the functions of mobilising savings as well as deploying them. HFCs in India on the other hand, have not emerged as major saving institutions. They may have to therefore continue to offer higher rates to attract deposits. The positioning of refinance as an alternate source of finance has to consider these aspects.

The primary factor that would determine the type of funding source that would be preferred by the HFCs is the effective cost. If the cost of funds for NHB plus the spread that NHB builds on it, is lower than the cost at which deposits are mobilised, HFCs would prefer NHB. The effective cost of raising deposits would increase by the extent of agent commission and brokerage paid, and the cost of administration. If NHB can mobilise bulk funds and economise on the costs, it could provide funds at a competitive rate.

The government has recently permitted provident funds to advance loans at concessional rates to subscribers. Banks have also been permitted to make housing loans up to Rs. 2 lakhs to individuals, as a priority sector advance. This move has resulted in low cost funds being available to the primary borrower, or the HFC that can tap such funds.

The system of preferred access for few HFCs to concessional sources of finance should be done away with, and replaced by a system where an intermediary mobilises concessional rate funds available for housing and redistributes it to the HFCs equitably. The NHB can ideally play this role.

The NHB has been deprived of the below market rate funds to which it had access, and has to provide refinance at competitive rates. In a system where some funds are still available at below market rates, such funds should be ideally tapped by the NHB. Instead of NHB tapping high cost funds, and diverting it to HFCs at still higher costs, the cheaper sources of funds should directly be tapped by the NHB. All directed credit for housing with provident funds, banks, and insurance companies should be routed to the NHB, which in turn can make funds available to the HFCs through its refinance program. This would also ensure that the phased withdrawal of directed credit system does not create shocks in the industry.

The proposed shifts in the funding pattern of HFCs with increased reliance on deposits, can cause problems of asset-liability mismatch. Since HFCs primarily engage in lending for housing, the term structure of their asset portfolio is typically 15 - 20 years. In an ideal situation, HFCs should be able to match the repayment schedule of their liabilities to this portfolio. Recourse to refinance would provide a better match and reduce interest rate risk for HFCs, while deposits would expose HFCs to such risks.

The problem of asset-liability mismatch was not very serious when the interest rates were administered and organisations did not have the necessity or the flexibility to hedge against interest rate risk. Financial liberalisation is changing all this. The methods of management of interest rate risks as well known in developed countries is yet to be applied in India. At a simplistic stage, spreads are worked out annually and used to modify fund mobilisation and lending strategies. It is noted that no HFC did any type of sophisticated interest risk analysis. Only one of the managements of the HFCs interviewed understood the presence of interest rate risk and indicated that some work on the management of the same is being done.

On the assets side, the HFCs feel that newer loans can be disbursed at higher rates of interests to identified target groups, which are not exactly interest rate sensitive. The borrowing capacity of this group, comprising mostly of salaried urban middle class, is determined more by their ability to regularly part with a certain sum of money, than by the exact rate of interest on the loan. It is felt that higher rates can be charged to this interest insensitive segment, as the cost of borrowings increases.

It should be noted that HFCs have not exercised the option to increase the rate of interest on existing loans though the option to do so is available to them. It is feared that such increases could spur defaults. Changes in interest rates after disbursal of loans has however been attempted to a limited extent in case of institutional borrowers. HFCs are however apprehensive about their ability to alter interest rates on loans to individual borrowers.

It appears that the HFCs are quite unprepared to the situation of becoming completely market-oriented in operations and many of them had apprehensions about their future profitability, if falling interest rates spurred prepayments. NHB refinance can be positioned as a convenient alternative in such a scenario of lack of skills in interest risk management.

Concluding Remarks

1) The HFCs seem to at best exhibit indifference between other sources of finance and NHB refinance. The preference for any source would depend on its relative cost.

2) There is a case for diversion of directed credit for housing made available to HFCs and primary borrowers by banks, provident funds and insurance companies to the NHB.

3) The profitability of NHB is dependent on its spread and any reduction in volumes will directly affect its viability. The funding exercise for NHB should arrest shifts in HFC's sources of funds away from the NHB.

TABLE 1.2

SOURCES OF FINANCE OF HOUSING FINANCE COMPANIES : 31st MARCH, 1993

(Rs. in Crores)

	Domestic Term Loans	Term Loans From Abroad	Bonds Deben	Deposits Capital	Equity Accruals	Internal Refinance	NHB	Total
AB Home Finance Limited	0.13	-	-	13.77	9.0	0.95	17.97	41.821
Akshay Awas Nigam Ltd.	2.57	-	-	-	7.6	1.76	2.76	14.69
Canfin Homes	171.62	7.0	10.5	53.43	20.45	15.55	76.79	355.34
Central Bank HFL	-	-	-	0.21	5.0	0.383	2.0377	7.63
Dewan HDFL	8.9	-	-	38.3923	9.036	1.915	95.795	154.036
Fairgrowth HFL	5.87	-	-	1.9326	5.896	0.6436	2.465	16.80
GIC Grih Vitta Limited	0.5	-	-	-	5.0	1.4	-	6.9
GRUH	15.5	-	-	1.8494	5.15	1.4591	22.99	46.9485
HDFC	1062.25	741.98	192.40	636.6126	68.6175	256.9668	403.1811	3131.0
Ind Bank Hsg Ltd	20.81	-	-	11.43	10.0	1.305	8.9786	52.52
India Housing Ltd.	0.6703	-	-	8.0257	6.045	0.7440	31.587	47.072
LIC HFL	746.89	-	-	-	25	6.27	14 2.18	920.34
Parshwanath HFCL	-	-	-	-	-	-	-	-
PNB HFL	35.299	-	-	26.1977	10.0	3.1775	32.3302	107.00
Saya SFL	0.1484	-	-	0.0111	1.0	0.0496	0.6928	1.90
SBI HFL	47.88	-	-	17.8842	15.0	3.369	20.9834	105.1166
Vysya Bank HFL	3.00	-	-	3.1951	3.0	0.4531	0.0415	9.6897
HUDCO	664.37	-	1351.76	34.34	242	260.97	314.89	2868.33
TOTAL	2786.41	748.98	1554.66	847.2806	447.79	556.4157	1175.6	7887.1338
% Composition	35%	9.5%	19.7%	10.74%	5.67%	7.05%	14.9%	15%

CHAPTER 2

ANALYSIS AND INTERPRETATION

This chapter focuses on analysis and interpretation of the results obtained from the survey of investors and institutions which have tapped the capital market, organised into two sections. Section one concentrates on individual investors and Section two on the financial institutions.

SECTION - I
ANALYSIS OF RESULTS -INVESTORS SURVEY

As has been stated earlier, a survey was conducted in ten cities all over India to determine the investing habits of individual investors. The results obtained were processed and analysed on the computer.Graphs were printed out for further analysis. A look at the graphs in Annexure IV would give a fair idea of the investor preferences. The main findings of the survey are summarised below :

Primary and Secondary Markets

The survey results clearly indicate that individual investors prefer investing in the Primary Market as compared to Secondary Market. Around 85% of the investors have invested in the Primary markets in the last 3 years.

Another significant finding has been that growth oriented instruments viz. ,Equity, Fully Convertible Debentures (FCD) and Growth Oriented Mutual Funds are preferred (See Annexure - IV).

Fixed Income Instruments

The study also highlights that fixed income instruments are less fancied by individual investors, which is evident from the fact that about 70% of the investors hold fewer than six bonds/debentures.

The preferred rate of interest was in the range of 14% to 20% p.a. with 15% and 18% being the most popular choices of the investors. (Annexure IV).

The maturity period desired by the investors is in the current economic scenario of changing interest rate was about 2-5 years. This was a surprising finding considering the fact that our sample of investors was predominately drawn from Deep Discount Bond holders and the bond being of a maturity period of 25 years.

Another fact reflected was that about 60% of people are willing to invest upto Rs.10,000 next one year in the primary issues of bonds / debentures. As many as another 14% are willing to invest between Rs.10000 and Rs.25000 in the same period.

The study reveals that the investors prefer both call and put options built in the instrument schemes but they are ready to stay with the scheme for full duration if they get an attractive redemption premium at the end of the scheme. Growth oriented schemes have an edge over the other schemes.

Preferred Instrument and Incentives

The equity has emerged as the most preferred investment in the capital market today. The investors also prefer the mutual fund schemes. The floating rate bonds being a new entrant has managed to attract the investors to a certain extent.

This conformity of the future perception of the investors with their past preference indicates that there is no substantial shift in the investment pattern of the people. The equity remains as the most preferred instrument.

The study reveals that the additional benefits like Concessional Housing Loans, Tax Concessions, Medical and Insurance benefits and Buy Back facility are the most preferred by the investors today. But at the same time these don't play an important role in the investment decisions of individual investors.

Investment Objective

One of the main investment objectives of investors has been faster growth followed by security and steady income. This emphasis on faster growth and steady income objectives has been further reinforced by the fact that investors prefer steady income and capital appreciation as the desired mode of return from fixed income instruments.

National Housing Bank

The survey shows that almost 65% of the interviewed investors have heard of NHB and they feel that it is a good Institution to invest in. Most of the investors prefer a guarantee for the NHB instrument by the Government or RBI.

The concept of NHB instrument to be considered as a collateral security against a housing loan with accident risk cover was very appealing to the investors.

General Issues

The survey findings show that investors do attach importance to credit rating and the minimum rating they would look for is **AA**. The investors also attach importance to the private placement by an issuer to reputed financial institutions.

They perceive the company which has privately placed portion of its equity as more sound and safe for investment.

Marketing

Investors are generally influenced in their investment decisions by write ups and ads in newspapers while advice of friends and relatives also plays an equally important role in their decision making.

Investors generally like to get the application forms of any issue from Bank branches. They also prefer the forms to be distributed through agents or directly door to door.

SECTION -II

ANALYSIS OF FINANCIAL INSTITUTIONS

FINANCIAL INSTITUTIONS : NEW DEVELOPMENTS AND OPPORTUNITIES

The liberalisation of the financial sector, among other things, has reduced the budgetary support to public financial institutions, and has made the interest rate systems market oriented. Financial sector reforms have led to the following important developments, which underlie the efforts of most of the institution to access market rate funds:

a. Concessional lines of credit available to financial institutions at below market rates are to be done away with in a phased manner. This would mean that the applications of funds or the asset portfolio of these institutions would have to be realigned, to ensure that spread is protected after an increase in the cost of funds.

b. The withdrawal of concessional lines of credit has put profitability of these institutions in sharp focus. These institutions were all set up with a view to enabling the development of a certain sector through the channelisation of concessional credit. The drying up of such credit would realign the activities of these institutions, such that they would allocate credit more efficiently than they had done earlier. These institutions would have to shed some or all of their "specialised " nature, and pursue profitable opportunities wherever they exist.

c. The adjustments enlisted above would ultimately result in a situation where market rate funds would be put to market rate uses, thus reducing the scope for too many layers of financial intermediation.

d. Funds from the households which were mobilised by banks at below market rates are now not available with ease due to the emergence of competing organisations such as the mutual funds. The factors that determine the risk premia investors are willing to pay are yet to be analysed. Investors willing to make a term deposit at 8% are not necessarily settling for a lower return for the lower risk involved, because the same investors are not willing to park funds with bank sponsored mutual funds or the UTI at rates that are equal or even marginally higher than the term deposit rates. At the moment, it appears that the interest rate structure is not well defined in terms of the risk - return characteristics of the various options. As the competition for household savings increases, it can be expected that newer products and finer risk - return structures would emerge.

The switching over from the directed credit system of funding for both banks and the public financial institutions, has led to a series of important developments. The most important of them is, emergence of the rates at which public limited companies are tapping the market for funds as the bench mark rates. Institutions that have so far been availing concessional direct lines of credit at below market rates, would find it difficult to compete at the market place at these high rates.

The adjustment process is bound to be difficult for institutions since the liability side and the asset side of their balance sheets are not changing simultaneously but are changing with a lag. While the compulsions to pay higher rates for funds has already arrived, the opportunity to earn a higher margin on assets is not available yet. The reasons are not difficult to find. Most institutions have an asset portfolio whose term structure is essentially 8-10 years. These assets are locked with interest rates that are low and not amenable to change, since the borrowers would find it convenient not to retire the debt in advance.

Where the funds are deployed at market rates, the risk of the borrower opting for a prepayment in a falling interest rate regime is high. The institutions would therefore, find their portfolios going through tremendous changes, calling for assiduous management. The management of interest rate risk would be at the core of any capital structuring plan.

Financial Institutions That Have Already Tapped The Market : Findings

Financial institutions have adopted two major strategic changes in their operations. The first one is to tap the capital market for funds ,even as the indications of the stoppage of directed credit completely , has been there, though some below market funds are still available. Some of them have commenced the exercise before the others, and enjoy the advantage of experience and first hand knowledge of the capital market.

The second one is the complete realignment of activities, the primary features being diversification into other financial services and increased resort to Off Balance Sheet activities that require no financing, but can bring in profits. The range of activities for most institutions is increasing and many of them are emerging as financial super markets. There is a marked shift from specialised activity to a range of activities in the financial sector. Some institutions, realising the intermediation costs involved in their activity, have resorted to directly servicing the user entities, rather than providing refinance to another institution for directing funds to the ultimate user. It is expected that the changes in the activity profile would augment the profitability of the institutions and increase their capability to pay higher costs on their funds.

Some of the institutions which have gone to the capital market for funds, are the Industrial Development Bank of India (IDBI) the Industrial Credit and Investment Corporation of India (ICICI), the Small Industries Development Bank of India (SIDBI) and the State Bank of India (SBI). A study of the public issues made by these institutions brings about certain major common factors that would become important to any such institution that would tap the markets.

1) Some of these institutions were tapping the capital market for the first time. These institutions were essentially involved in refinance activity and term lending.

2) The major factor that influenced the design of the instrument was the rate of interest offered by banks and mutual funds on investment by households. It was perceived that the instrument had to be attractive in comparison with these investment avenues available to the investor.

3) Neither the rate nor the period was completely influenced by the asset portfolio of these institutions. They prefer to have some kind of flexibility in this regard. IDBI for instance offered an instrument with a term structure of 25 years. At the time of offering IDBI thought that it could roll over its asset portfolio whose term structure is 10 years, about 2 1/2 times. It however retained the flexibility to retire the debt earlier. The plan is now to pay off the investor in a 10 year period. The instrument has the flexibility for such prepayment. SIDBI for instance is still open on servicing the debt for the complete term. Surprisingly the management does not want to retire the high cost debt early and switch to a low cost debt. ICICI on the other hand preferred to have a medium term instrument of 5 years, and has matched the maturity to its asset portfolio. It has not kept for itself the call option since it felt that investors might not feel secure with such a feature. The institutions have therefore, locked themselves with a higher rate of interest .They have the option of issuing subsequent instruments at lower costs should the interest rates fall or at floating rates, so that the over all costs of funds somewhat reduces. Given that the amounts they have raised are quite small compared to their total resource base, the cost is considered to be manageably small.

4) Since the markets were tapped for the first time, the institutions had to launch a corporate advertisement campaign to familiarize the investors with the organisation's functions.

5) There has been a change in the term structure of the instruments that were offered by the institutions for the second time.The instruments issued in the year 1992, were mainly long-term debt instruments. Those issued in the following year however, were of medium term length of 5-7 years duration. This lowering of the term lengths is a conscious decision to protect against interest rate risk .

6) The first public financial institution to tap the market was the IDBI. IDBI wanted to offer different instruments to appeal to the investor fancy and to wean them atleast partially, from other competing avenues such as mutual funds, fixed deposits and bank deposits. Hence they had kept multiple bond types, so as to attract all kinds of investors. It emerged after the issue, that the Deep Discount bond was highly preferred by the investors, and SIDBI which made a public issue shortly thereafter emulated the IDBI model.

7) The pricing of the instrument in the case of both the deep discount bonds was done on the basis of perceived preference of investors.The Deep Discount Bonds (DDBs) of 25 years duration were issued at Rs. 2700/- by IDBI; SIDBI issued DDBs at Rs. 2500/- ; The deeply discounted issue amount was arrived at by working backward from a targeted maturity value of Rs. 100000. The intention was to play up the possibility of being a "lakhpati" on maturity of the bond, and was expected to appeal to the ordinary investor, to whom owning a lakh of rupees would at best be a dream.

This 'Lakhpati' concept caught on and subscription for DDBs was overwhelming in the IDBI issue. The issue price was kept low for DDBs in both the above issues to attract small investors. DDB was meant for public at large, and there was more of an emotional play. Investment was done for their children or for retirement benefits by individuals. The ICICI issue was targeted at fixed deposit holders, hence the face value of these bonds was kept low at Rs. 1000/-.

8) The IDBI issue of March 1993 and the ICICI issue of April 1993 both offered the prevailing market rate of 16% p.a to the public. Though IDBI offered three options , the maximum response was for the Regular Return Bonds (RRBs) in this issue. The ICICI bond which too was of the Regular Returns type received overwhelming response. In both these issues, particularly the ICICI issue,Provident Funds and Charitable Institutions were major investors. The amendment of the prudential norms for investment of provident funds, facilitating investment upto 15% of accretions in bonds of public financial institutions, helped both these issues significantly.

9) The offer amounts of the issues were not based on the funding requirements of the respective institution. The target amount was therefore , not kept too high . It was important to ensure that the issue was not undersubscribed.

10) All these institutions perceive an unstable interest rate scenario in the near future, hence they have consciously moved away from committing themselves to a fixed rate, for even the medium term.There have been floating rate issues from both IDBI and ICICI and the rates have been pegged to the treasury bill rates, with a certain percentage mark-up. The ICICI issue also has a cap and a collar.

11) While the earlier issues were characterised by long term instruments, the preference now seems to be for the medium term, and institutions are retaining the call option in order to protect themselves from being locked into a high -rate instrument for long.

12) Preference has also shifted from public issue to private placement. Banks and other institutions are presently flush with funds, and there is a tendency to avoid a public issue, with its accompanying costs and marketing requirements. The competition for household savings is increasing with more and more issuers crowding the market, and institutional placement is expected to be easier, and rates that can be negotiated are expected to be finer.

13) There is a strong case for institutional placement, given the background of most institutions. They have been by nature of their functions, organisations that have not liaised with individuals, and therefore do not have the necessary service orientation most required for handling individuals. Operations in the large scale markets for funds has precluded them from knowing the cost, effort and time inputs required for servicing the retail investors.IDBI and SIDBI found servicing the public difficult as well as expensive, especially when the number of investors were large. It is possible that IDBI targeted its second issue at high net worth individuals, and kept the entry level at Rs. 5000/- only to keep down the number of investors.

14) Another advantage of private placement with institutions and Banks is the scope provided by institutional placing, for an active secondary market for the instrument. With the impending commencement of trading at the National Stock Exchange, the instruments would be traded in the market, and provide the issuer the necessary continuous valuation inputs that can be useful for subsequent public issues.

15) Though the timing of the issue is very important, the experience of the Institutions has been that it is difficult to adhere to the planned timing, since various procedural and legal formalities have to be completed. It is essential to have an activity chart drawn up and realistic estimates of time required for completion of each level of activity estimated and planned. SIDBI had planned to open its issue in the months of September - October , when the salaried class would be highly liquid, but could not complete the necessary formalities in time.

16) Significance of credit rating for the issue was acknowledged and highlighted while marketing the issue. IDBI and ICICI felt that the investors were well aware of these ratings, but SIDBI was not too sure about investor awareness.

17) Among the problems in initially servicing the issue , the IDBI issue had an early bird incentive, which was found to be cumbersome to service. SIDBI experienced problems in servicing of the issue due to delay in bank collections and postal services.

While designing appropriate financial instruments for NHB, the experiences of these institutions have been taken into account and strategies have been appropriately modified to suit the specific requirements and constraints of NHB.

CHAPTER 3

EXISTING FINANCIAL INSTRUMENTS IN INDIA

This chapter deals with various financial products that are available already in the Indian financial system. This review will help in identifying, analysing and choosing if need be an appropriate financial instruments among the existing ones. Basically the financial instruments are divided into two broad segments.

1. Money Market Instruments and
2. Capital Market Instruments.

Although the distinction has got a very thin line of difference, indeed they are part of the continuum on the scale.

Money market instruments may not be suitable to the National Housing Bank to raise the resources, as these are short dated instruments. Taking the asset-liability time - frame of National Housing Bank, we feel the money market instruments are not appropriate to garner the resources for National Housing Bank. Hence, the detailed analysis of them is not very much required. A mention of them is made in the following lines :

A. Treasury Bills

   1. 91-day Treasury Bills
   2. 180-day Treasury Bills
   3. 364-day Treasury Bills

B. Term Deposits (3 months)

C. Money-at -Notice

D. Call Money

E. Commercial Bills

F. Commercial Paper

G. Certificates of Deposit

We have large variety of capital market instruments in the Indian Financial System. Capital Market instruments have more flexible and sophisticated features. These instruments can be broadly divided into four sub-categories.

A. Variable Income Instruments or Equity Instruments,
B. Fixed Income Securities or Fixed Income Instruments
C. Add-on Instruments and
D. Derivative Instruments

A. VARIABLE INCOME INSTRUMENTS OR EQUITY INSTRUMENTS :

i. Under this category, the most important instrument is **common stock / equity shares / ordinary shares.** This is one of the instruments which is very widely used by the Indian Corporate Sector. Equity is preferred by Indian investors due to various attractive reasons. A number of them include

a. Dividend Income
b. High Capital Appreciation
c. Voting Rights
d. Liquidity
e. Marketability

Common stock is a perpetual source of finance to the company. Issuers do not have any fixed obligation towards the holders of this instrument. Cost of raising and servicing equity capital is highly flexible. In the sense it is costlier as well as cheaper. It is costlier if one takes into consideration post tax dividend payment and it is cheaper if one takes into consideration no fixed obligation reason.

The primary market as well as the secondary market for equity shares is very active. Since there is a very active secondary market, investors prefer to invest in equity shares of a company. Investors find ready marketability and liquidity. The returns on equity shares have been on rise and they out-perform other securities in the Indian Financial System. Therefore, it has been comparatively easier to sale equity shares than other instruments to the public.

ii. **Preference Shares** : Indian Companies have been issuing preference shares to the public as well as to the other selected groups. Preference shares have various sub-categories within itself. Due to the following unattractive features, the market that is Primary as well as Secondary for the preference shares has been defunct. The features include :

1. Fixed Rate of Dividend
2. Dividend is paid from the post tax profits
3. No tax advantage to the issuer.

From the Investors point of view, the limitations include :

1. Lack of secondary market
2. Lack of liquidity
3. Owing to fixed rate of dividend, there is an erosion in the principal value of the investment.

iii. **Cumulative Convertible Preference Shares (CCPS) :** Cumulative Convertible Preference Shares are popularly known as CCPS. CCPS is of a recent origin to the Indian capital market. This instrument also could not get necessary support from the investors and enthusiasm from the issuers that could be due to the following reasons :

1. As the name itself indicates CCPS is a convertible instrument which means CCPS converted into equity shares. CCPS has also got some preference over ordinary shares. CCPS has got a feature of cumulative nature that means if the dividend is not paid in the initial years then that dividend gets accumulated and becomes payable at the time of conversion. The dividend rate fixed for CCPS is 10% which is paid from the post tax profits. Many companies whose gestation period is substantially long, will not have profit to share initially in the form of dividends. Therefore, the issuers do not prefer going for CCPS. This instrument works out costlier than ordinary shares to the companies. Therefore, companies do not prefer to issue CCPS.

B. Fixed Income Securities or Instruments :

Fixed Income Securities can be sub-classified on the basis of :

a. Convertibility
b. Coupon Payment
c. Tax Structure

On the basis of Convertibility or Non-convertibility the instrument can be classified as under :

i. Non-cumulative Debentures

Under the present guidelines, the companies can issue non-cumulative debentures for any period. Also there is no ceiling on interest rate. Depending on credit rating and market conditions, companies are free to fix the period and interest rates that may suit them. If the period is less than 18 months, then bonds need not be secured. If the period is more than 18 months, then they need to be in addition secured, to be credit rated and listing is compulsory. Guidelines related to issuance of debentures are issued by the Securities & Exchange Board of India.

ii. Cumulative Debentures

Cumulative Debentures almost akin to non-cumulative debentures except the interest in this case gets accumulated and paid at the time of maturity of the instrument. In all other respects this is similar to non-cumulative debentures.

iii. **Tax Free Bonds**

Tax free bonds are issued by Government of India Undertakings / Public Sector Undertakings. Government has become very selective and restrictive in permitting issuance of tax free bonds. Very few high priority companies and industries are permitted to issue tax free bonds. In the recent past, Government of India permitted HUDCO, Konkan Railway Finance Corporation and Indian Railway Finance Corporation to issue tax free bonds. The Investor in Tax Free Bond is not liable to pay income tax / corporate tax on the interest income received without any limit. Depending on the tax bracket applicable to various entities, this instrument works out to be very attractive. Prior permission from the Government is required to issue Tax-free bonds.

iv. **Floating Rate Bonds**

Floating Rate Bonds have become very attractive for certain categories of issuers. Interest on this instrument is pegged to short term instrument while the underlying asset may be long term one. The interest / yield in the international market generally pegged to LIBOR or US Treasury yield. Since in India, we do not have any good reference inter bank rate, it has become very difficult to quote and maintain one important reference rate. This instrument will have a premium over and above the reference rate. The reference rate could be 91 day treasury bill yield or 182 day treasury bill yield or 364 treasury bill yield or term deposit interest rate. Over and above the reference rate each issuer pays certain premium depending on the following conditions :

1. Ability to raise resources
2. Market Conditions
3. Credit Rating of the Company
4. Rates offered by other issuers

To take care of various uncertainties in this instrument, the issuer can have floor and cap on the instrument. In addition, the issuer may also build in put and call option. By virtue of these features, the issuer as well as investor are protected against unforeseen possibilities in the interest rate structure changes.

v. Secured Premium Notes (SPNs)

Secured Premium Notes are not quite different from Zero Coupon Bonds or Deep Discount Bonds, discussed next . So far 2 Companies issued secured Premium Notes, they are 1) Tata Iron & Steel and 2) Bombay Dyeing & Manufacturing Co. The difference between principal amount and the redemption amount is expected to be divided into 2 parts :

1) Interest Component and
2) Premium Component

The investor may able to treat the premium as long term source of income, provided Central Board for Direct Taxes allows to do so. In such an event, the investor benefits. The issuer would be able to pay premium from general reserves and surpluses.

Currently, the tax status on premium component is not very clear. We were given to understand that CBDT has not clarified yet how premium is going to be treated in the hands of the receiver. Both the companies are issued secured premium notes with warrants attached to it. In the case of TISCO, Rs.300/- invested becomes Rs.600/- and the Investor gets Rs.150/- each year for 4 years starting from 4th year. In other respects, the instrument is similar to debenture.

vi. Deep Discount Bonds or Zero Coupon Bonds

As the name suggests the redemption value is deeply discounted and the instrument is issued at present value which is considerably lower than face value. Zero-coupon Bonds and Deep Discount Bonds are used interchangeably.

Investors do not get regular interest payments. The issuer has number of advantages. The issuer does not pay interest while he debits it to his Profit & Loss A/c. Therefore, there is a net higher cash in-flow. The cash in-flow could be reinvested to get higher internal rate of return. In a rising interest rate milieu, it is disadvantageous to the investors. Generally, Deep Discount Bonds are issued for very long period ranging from 20 years to 100 years. In India, Deep Discount Bonds are issued typically for 25 years. We were given to understand that all the issues were successful. So far during our interviews with Investors in different places, we also found that investors prefer to have 2 or 3 Deep Discount Bonds . They facilitate their cash flow planning and planning for their children. To great extent, it also facilitates planning for those who are retiring in future.

vii. Convertible Debentures/ Bonds

Under Convertible Bonds, we have following sub-categories :

a. Partly Convertible Debentures
b. Fully Convertible Debentures
c. Zero-Coupon Convertible Bonds

a. **Partly Convertible Debentures :**

As the name suggests , a part of the face value of the debenture is converted into equity shares of the respective companies. The conversion can take place upon allotment or after some time.

If the conversion takes place before end of 18 months from the date of allotment then the premium can be fixed up - front. If the conversion is proposed to take place after 18 months but before end of 36 months, then the investor will have put option. If the conversion is going to take place after 36 months, then, the investor will have put option and the issuer will have call option. The conversion can take place either at par or at premium.

If the debentures have maturity period of 18 months or more then debentures have to be secured and the issuer has to get credit rated compulsorily,for debentures offered to public. This requirement is as per the guidelines issued by Securities & Exchange Board of India .

b. **Fully Convertible Debentures :**

100% of the face value is converted into Equity shares. The conversion could be either at par or at premium. When 100% converted into equity, generally, the conversion takes place after some time from the time of allotment. If the conversion is going to be after 18 months then credit rating becomes compulsory and the debentures are to be secured. If the conversion is after 18 months but before 36 months then the investor will have put option. If the conversion is after 36 months then the issuer will have call option and the investor will have put option

c. Zero-Coupon Convertible Bonds :

Zero-Coupon Convertible Bonds do not carry any Coupon rate. In India, this instrument has been marketed very successfully by the Companies. This instrument is suited well to certain categories of issuers depending on cash flow requirement and tax structure. The instrument also suits few categories of investors. In India, so far a large number of companies have issued fully convertible Zero-Coupon Bonds. However, there is no bar on issuing partly convertible Zero-Convertible Bonds. This type of instrument may suit certain categoty of investors.

C. Add-on-Instruments

viii. Warrants

Warrants is a quasi-equity instrument. It is also a derivative instrument, that is why many a time warrant is referred as a call option. Warrant confers on the holder the right but not the obligation to purchase or sell a fixed amount of underlying security at fixed price and fixed future day. We have variety of warrants that include :

a) Detachable Warrants
b) Attachable Warrants
c) Putable Warrants
d) Wedding Warrants
e) Naked Warrants

In the international market, we have many more variety of warrants. In India, companies mostly explores detachable warrants. This is one area which is highly fertile .

D. Derivative Instruments :

We have variety of derivative instruments including futures and options, swaps, securitisation etc. Owing to legal constraints, some of the derivate Instruments have not been introduced in the Indian capital market. Swaps being over the counter product ,many institutions have used but still a long way to go for a matured market in the swaps. The securitisation has been tried by some institutions not quite successfully. Here also, there have been some legal and administrative constraints.

CHAPTER 4

FINANCIAL PRODUCT DESIGN - DEVELOPMENT AND PRICING

This chapter mainly deals with various possible financial products with the help of which National Housing Bank would be able to raise resources for different terms. Basis for each recommendation stems from varied sources. The sources are:

Firstly, our research and questionnaire administration to investors in 10 different cities of the country. The findings of this research helped us to a great extent, to design and develop various instruments.

Secondly, we also interviewed managements of various housing finance companies and their views were also taken into consideration while recommending the instruments or group of instruments. Inputs derived from them on the housing finance industry was used in designing an appropriate instrument for the NHB.

Some of the financial institutions which have tapped the capital market recently with innovative financial products such as Deep Discount Bonds and Regular Return Bonds were also approached to find out their strategies and the manner in which the instruments were structured to suit their purposes. These institutions are IDBI, SIDBI and ICICI.

We also held discussions with the executives of National Housing Bank at Bombay as well as at Delhi. Their views are also taken into consideration to ensure that the instrument suits the cost and term period requirements of the NHB.

With the fast changing economic secenario, the financial services industry is undergoing tremendous changes. These changes have impact on various macro and micro parameters that influence the ability of an organisation to effectively structure and market an issue. Therefore, it would be appropriate to analyse various possible ways of raising resources for National Housing Bank.

Our recommendations are analysed and presented, taking time as one of the most important dimensions. The time is divided into three useful periods namely Short Term, Medium Term and Long Term. For the purpose of this study, the short term is defined as one year or less than one year, medium term is defined ranging from one year to three years and finally long term is defined as more than three years.

SHORT TERM

Various strategies for National Housing Bank in the short term, are explained in the following paragraphs. In the short term uncertainties are less and predictability will be more. Important factors such as interest rate, inflation, liquidity, preferences of investors, capital market environment can be reasonably, accurately forecasted.

In the short term, NHB should focus more on institutional sources of finance. Currently, many institutions are flush with funds and they are looking for attractive investment opportunities. The institutions include Mutual Funds, Investment Institutions, Provident Fund Trusts, Limited Companies, Banks and Charitable Trust

Under the prevailing capital market environment, we recommend the following instruments which are suitable for raising resources. In the order of importance, we recommend :

a) Floating Rate Bonds
b) Securitisation of Mortgage Receivables
c) Deep Discount Bonds
d) Tax Free Bonds
e) Pension Funds
f) Incremental Interest Rate Bonds

a) **FLOATING RATE BONDS / NOTES**

Floating Rate Bonds will have flexible interest rates. The interest rate should be linked to Treasury Bill Rate/ yield. In India, we have three versions of Treasury Bills:

i) 91 - Day Treasury Bills
ii) 182 - Day Treasury Bills
iii) 364 - Day Treasury Bills

The more popular among these three are 91 day and 364 day treasury bills. Recently, a few institutions mobilised resources by way of issuing floating rate bonds. Some institutions used 91 day treasury bill yield as a reference rate / bench mark and some others used 364 day treasury bills rate. We recommend 364 day treasury bills rate as a suitable reference rate for NHB. In the case of 364 day treasury bills, fluctuations are less and calculations are simpler. In addition to the cut off yield rate for 364 day treasury bills, NHB may offer 2.5 percentage points more which may work to 12 to 12.5 % yield. The maturity period for the Floating rate bonds may be kept at 5 years. We also recommend a cap and collar on foating rate bond. If the floating rate notes is going to be of five years duration, then NHB may give put option after three years. Alternatively, longer the period of floating rate notes, NHB may introduce put as well as call option. The above additional features will help market the instrument successfully.

b) **SECURITISATION OF MORTGAGE RECEIVABLES**

HFCs are increasingly finding it difficult to match yield expectations of the investors, from whom funds are to be raised either through deposits or bonds. One alternative funding technique, that has been successfully exploited in the developed markets, is securitisation of mortgage receivables.

Securitisation essentially converts a financial claim into a transaction, by creating a security that packages the receivables of an entity, such that the instrument can be issued, and traded, like any other liquid and marketable instrument. Securitisation thus releases capital that is locked in receivables for further asset creation.

A securitised product can be created out of a selected pool of receivables, such that the credit quality, maturity, and risk element are homogeneous. This possibility, in many cases, results in a higher credit rating for the pool of assets, than what the originating HFC can get for itself, if it were to tap the market, for say, bonds or deposits. A securitised pool of receivables thus provides the opportunity to raise funds at lesser cost, than that payable on lower credit rated instruments.

The selected receivable pool is transferred to a special purpose vehicle (SPV), which holds the receivables in trust, on behalf of the originating HFC. The SPV then issues to investors, instruments that pass the beneficial interest in the pool of receivables to them, at a certain rate, which is the basic cost of securitisation to the originating HFC. The instrument thus issued may take any of these forms:

a) Participation certificates (pass through a pay through)
b) Collateralised mortgage obligation
c) Mortgage backed loans.

Mortgage back securities would engage investor interest only if they are liquid and marketable. To serve this end, there should be large a number of investors who would create a continuous market for trading in these securities. The first step however, should be issue of mortgage based securities to investors, who would nold them until maturity. Alacrity Housing and DLF Universal which have securitised their receivables, have been able to place their issues thus.

Raymond Struyk, who studied the feasibility of the secondary mortgage market in India (1989) identifies the following five areas that need to be addressed for evaluating the secondary mortgage market:

a) Quality of assets

The lack of foreclosure laws, and mortgage underwriting are impediments to quality assurance for assets.

b) ASSESSMENT OF MARKET POTENTIAL

Liquidity and marketability of mortgage backed assets cannot be ensured unless adequate volumes of mortgages are securitised.

c) INSTRUMENT DESIGN AND PRICING

Flexibility to alter lending rates to match cost of a securitised instruments is prerequisite to effective structuring of the instrument.

d) SECONDARY MARKET FACILITY

A secondary market facility that would purchase the mortgages and base the securities issued on such mortgage pools is required. NHB could play this role and realign its refinance program for the purpose.

e) OPERATIONAL DETAILS

Specific planning and implementation tasks are part of the exercise to create a secondary markets for mortgages.

It appears to us that the NHB can act as an SPV that would issue the mortgage pools of HFCs, to institutional investors such as mutual funds, through issue of participation certificates. A pass through structure would be attractive to mutual funds which offer monthly income schemes to investors. An yield of 12.5% to 13% should be attractive to these investors. Initially, bulk placing of PCs to institutions could be attempted, and after familiarity with the instrument and its features, a secondary market can be expected to emerge.

c) **DEEP DISCOUNT BONDS**

Another favourable instrument and more suitable instrument to NHB is the deep discount bonds. In the last two years, a few institutions very successfully marketed deep discount bonds. Our survey also reveals that investors prefer to have deep discount bonds in their portfolio.

d) **Tax Free Bonds**

Tax Free Bonds are quite popular with the investor in the higher tax bracket. In the immediate past, a few companies very successfully mobilised resources by way of tax free bonds. At this crucial juncture of NHB's life, we strongly feel that tax free bonds would be more useful and suitable to NHB. Therefore, the NHB should persuade Government of India to issue tax free bonds. The survey conducted by our Institute also substantiates the fact that tax benefit is one of the most attractive add -on benefits. The maturity of the bonds could be more than ten years. The interest rates payable by NHB may be fixed at 10.5% to 11%. Interest income should be totally exempt from income tax. In addition, there should be no gift tax and capital gains tax. Tax Free Bonds are presently strategical alternative for NHB. These instruments may be listed on the National Stock Exchange to create marketability and liquidity. Bonds may also be listed on Over-the-Counter Exchange of India.

e) **Pension Funds**

With increased emphasis on economic liberalisation, there will be considerable demand for Pension Funds. There will be more and more private sector organisations and self-employed people. Since they are not likely to have their own pension schemes NHB should be able to offer pension scheme to various segments of investors. The pension scheme can have two or three variation. The pension scheme will have the following features :

i) There will be a one time contribution and no further contributions. After completing 60 years of age, the subscriber would be eligible to receive monthly pension amount. Entry of the individual may be restricted say for example 40 years of age which means the funds are available to NHB for next 20 years. This gives reasonable stability and flexibility. NHB would be able to offer anything between 12 to 12.5% per annum rate of return and 10 to 10.5% return as pension. Anything that is surplus on the account of each may be distributed to the beneficiaries at the end of the scheme period so that the subscriber will not suffer. This also ensures no transfer of surplus from one group of subscribers to another group. The second variation would be that there can be an open ended pension scheme where subscriber will contribute monthly or annually for a number of years and they would start receiving pension amount after completing 60 years of age.

f) Incremental Interest Rate Bonds

Incremental Interest Rate Bonds may be more suitable to Mutual Funds and to Investment Institutions. Mutual Funds that have income schemes would be interested in subscribing to Incremental Interest Rate Bonds. Investment Institutions also would be interested provided the yield is attractive enough. The NHB should be able to offer the rates between 13.5% to 14%. The maturity period of this instrument may co-terminate with the maturity period of the mutual fund schemes. The Incremental Interest Rate Bonds will have a less interest rate in the initial years and interest rate goes up during the later period. The average effective rate would be 13.5 tc 14%.

Marketing Strategies

In the Short Term, the National Housing Bank has been advised to tap the Institutional Market i.e. wholesale market. The marketing strategies that are more appropriate to tap these Institutional resources are described in the following lines:

Institutional Investors are knowledgeable and are also sophisticated. Therefore, contacting each individual institute and negotiating with them directly would be more helpful and useful. This also can be achieved by way of private placement of securities with them. This can be achieved either by direct marketing or by taking services of investment bankers. We propose that availing of investment bankers' services would be more fruitful.

Medium Term

In the medium term, NHB has to diversify its portfolio of investors and have in its portfolio, the institutions as well as the public. Dependance on institutions for medium term purpose may not be highly suitable. Therefore, NHB needs to develop retail market also. Since institutional Investors are sophisticated investors and wholesale investors, they are likely to disinvest or may not invest depending on their alternative opportunities and market conditions. Therefore, dependance on institutions in the medium term is not advisable. Our recommendation is to increase and enlarge dependance on public resources (Household savers).

The sources of finance in the medium term would include institutions as well as public investors. Among institutions, Mutual Funds, Banks, Investment Institutions, Provident Fund Trusts, Charitable Trust and Limited Companies are very important segments. Retail investors are also important segment (Household investors).

For medium term, we recommend the following Instruments :

i) Floating Rate Bonds
ii) Debt with profit sharing in the form of interest
iii) Pension Funds
iv) Deep Discount Bonds

i) **Floating Rate Bonds**

The details of Floating Rate Bonds are discussed elsewhere in the report.

ii) **Debt with Profit Sharing in the form of Interest**

Debt with profit sharing in the form of interest will be very attractive instrument to the Public. This instrument will have fixed rate of interest. Over and above certain percentage of the post tax profits may be distributed in the form of interest to the holders of this debt instrument. The percentage of profits to be shared in the form of interest should be linked to the quantum of funds to be raised by way of issuing debt with profit sharing instrument and also over all interest rate that is going to prevail at the time of issue of this instrument. The profit sharing component is going to be a flexible one.

Therefore, investors will be interested in investing in this type of instrument. The marketing becomes easier. Since NHB is going to the public for the first time, it is very important to design the instrument which is readily acceptable to the investors.

Marketing Strategies

Marketing strategies for the National Housing Bank to avail resources from the Institutions as well as household sector are : As far as institutions are concerned, NHB can go for direct marketing or through investment bankers. Whereas, mobilising resources from the household sector would be more difficult one. Here, the NHB needs to build up their corporate image, issue image and sectoral image. NHB should well in advance start advertising on various media about the industry and its importance. This is followed by corporate image of NHB. Finally, the advertising should highlight on marketing of issue. This may be achieved by advertising in the newspapers, putting up hoardings, conducting road shows, using the electronic media, conducting conferences and public seminars.

Long Term

In the long term, NHB should depend more on public funds. Public funds are likely to stay with NHB for longer period than institutional funds. Once NHB develops good relationship with Investors, they are likely to attract large number of investors and huge amount.

In the long run, NHB should depend more on public sources of finance and less on institutional finance. The Instrument that are suitable in the long run are :

i) Pension Fund
ii) Fixed Deposit
iii) Deep Discount Bonds

Pension Funds and Deep Discount Bonds are explained in the earlier paras. One of the most beneficial instrument in the long run would be Fixed Deposits. It has been found out that many institutions in the housing industry are able to raise large amount of money by way of Fixed Deposits. The interest rate on Fixed Deposits is decided by the Reserve Bank of India and also the maturity period is prescribed by the Reserve Bank of India. There are various other parameters which are also from time to time given by RBI.

As far as fixed deposits are concerned, servicing the client is very important. Servicing includes prompt despatch of fixed deposits, sending of interest warrants, repayment of principals, etc. These need good amount of experience and net worth. At the present juncture, NHB has nither. Since we are recommending this instrument for the long term, NHB should be able to develop to mobilise the resources by way of fixed deposits. If NHB is not able to develop its own agents network, it will have to develop alternative ways of servicing the client.

MARKETING STRATEGIES

In the long term, as we suggested that NHB should depend more on Household sector. This is a retail market. In the long run, NHB needs to develop a very strong and effective marketing network. This can be achieved by recruiting, training agents throughout the country. Alternatively, NHB can also avail of services of some of the companies who are specialising in providing services such as the marketing of issues, maintaining records, servicing investors etc.Here, the NHB needs to build up their corporate image, Issue image and Sectoral image. NHB should well in advance start advertising on various media about the housing industry and its importance, followed by Corporate image of advertising of NHB. Finally, the advertising should highlight on marketing of issue. This may be achieved by advertising in the Newspapers, putting up hoardings, conducting road shows, using the electronic media, conducting conferences and public seminars.

CHAPTER 5

CREDIT RATINC

We have a few agencies which have been carrying credit rating of debt instruments in India. Various parameters are taken into consideration while rating instruments. Some of the parameters that are taken into account are :

a. Governmental Policies and Attitudes towards the Industry
b. Regulatory environment governing the Industry
c. Competition in the Industry
d. International Competition Technology
e. Composition of market players in the industry
f. Financial aspects of the industry
g. Prospects of the industry
h. Structure of the company
i. Competence of the Management
j. Professional Expertise of the Management
k. Cost Structure in the company
l. Profit Margin
m. Scope for the business growth
n. Financial parameters etc.

Housing Industry

Housing is one of the basic needs of the people in India. There is a large gap between demand for houses and supply of houses. Many people in the country cannot afford to have reasonably good houses due to lower levels of per capita income. At present, the approximate housing gap in India is 31 million units and the National Buildings Organisation has estimated that by the year 2000, housing gap would touch 41 million units.

With more than 232 lakh people being homeless, over 572 lakh people living in slums and 50% of the urban households staying in over-crowded one room tenaments, the urgent need to provide houses, is evident .

However, beginning has been made by establishing NHB and formulating a comprehensive national housing policy setting out strategies proposed to be adopted to tackle housing problem in the years to come. An estimate of the total investment in housing for the 8th Plan is Rs. 73,496 crores.

In India, flow of formal sector housing finance as a proportionate of total housing investment is 20%. The working group of finance for housing sector in the 8th plan (92-97) as estimated that the housing finance system in the country will have to be provided Rs. 25,000 crores during the plan period. In the light of the above factor, it is possible that housing industry will have a favourable credit rating and more weightage to the industry factor.

The likely credit rating for NHB may be presented under different situations.

Situation - I

NHB is reported to have been involved in securities purchases and sales. As on June 22, 1992, NHB had 32 outstanding contracts for purchase of securities for aggregate value of Rs. 1458.73 crores for which it did not seem to hold securities, SGL transfer forms or BRs.

Subsequently, an amount of Rs. 187.53 crores was received from outstanding contracts. An amount of Rs. 1214.30 crores was still due. One bank later paid an aggregate amount of Rs. 707.56 crores to NHB under protest. Another sum of Rs. 506.54 crores has been received from a bank subject to dispute being referred to arbitration. If this sum amount of Rs. 506.54 crores comes in favour of NHB, then NHB would have recovered all the money. This would improve its Balance Sheet position and financial strength. Under this situation, it would be possible for NHB to get **AA** rating.

Situation - II

If the arbitration ruling goes against NHB, then the financial position and the Balance Sheet strength of NHB would be very poor. Therefore, NHB will be likely to get **BBB**.

SITUATION - III

If the arbitration ruling is favourable to the NHB to the extent of 50%, then NHB instrument will get **A.**

All the above ratings are linked to the size of the issue and the interest rate that it offers. Higher the size, lesser will be the credit rating ceteris paribus. If the interest rates are lower then the debt servicing capacity will improve. Therefore NHB would likely to get a better rating.

MANAGEMENT

Management is one of the crucial factors while credit rating is done. Currently, NHB does not have a full time Chairman. If NHB gets its full time chairman and organises itself, it would be getting better credit rating. Under situation, it may get **AAA** rating . Even in other situations rating with further improve.

CREDIT RATING AND COUPON RATES / YIELDS

In the following lines we are trying to suggest an approach with the help of which NHB may be able to fix its coupon rate or yield. We are keeping this very flexible since the market may undergo changes from time to time. We are comparing NHB's future credit rating with public sector organisations' credit rating and suggesting likely coupon rates. If public sector company gets **AAA** and offers X percentage interest rate, then NHB should also offer same rate. We feel that there is no need to offer more premium. If public sector bond at that time gets **AA** and offers Y percentage, NHB can also offer the same percentage. This is true for other types of credit rating such as **A, BBB** etc. The X percentage, Y percentage ets., may be converted into absolute figures if need be, say X = 13%, Y = 13.5% and so on.

CHAPTER 6

MARKETING STRATEGIES

There has been significant transformation in the capital market flows in the nineties. An important element of change, is the shift from the system of allocated credits to a system where all sectors of the economy are competing for the same pie. The ability to raise capital, enlarge it, and to service it is a challenge for most institutions in a competitive environment, more so, for those who do not have an experience in raising resources on commercial terms, on a competitive basis.

The search for resources has crossed domestic borders with corporates and financial institutions raising low cost funds by launching Euro issues. In a financial market scenario which is fluid, with fall in interest rates and shifts in yield curves, institutions are wary of being locked into high cost funds. There has been a perceptible shift in the instrument design to floating interest rates with financial institutions taking the lead.

Capital market transformation has spurred product innovation. A good product, that can exploit the gaps in the market and carve a niche for itself, would never have to look back. Traditionally, good product management, with an emphasis on creating first class products, which would eventually build up brand image was the key to successful selling. Today, the market segmentation approach is a significant departure from the traditional view, that only high quality products can sell. Products can be customer tailored for different segments of the market. By proper positioning and sending out the right signals, a perception can be created that a firm can deliver quality service and honour its commitment. Creating this perception is a difficult but crucial task which can pave the way for successful marketing.

National Housing Bank

The National Housing Bank has the special advantage of being created for a target segment - housing. It can carve a niche for itself, as it has been identified as the principal agency to promote housing finance in the country. However, it has not realised the full potential of its promotional role. The gradual dimunition in the quantum of below market funding has driven it to a tight corner. The immediate task of NHB is to rebuild its image and reposition itself as a sound financial institution in the market. Then it would be in a position to augment its resources from the market.

In designing a placement strategy, the considerations involved are :

i) nature and feature of the instrument to be placed.
ii) the relative appeal of the instrument to individual and institutional investors.
iii) the needs of individual and institutional investors in different interest rate and money market scenario and the ability of the instrument to match the needs.
iv) the quantum of funds to be raised with individual and institutional investors
v) the rate at which it can be placed
vi) the total cost to NHB, including selling commissions / front-end fees, advertising and marketing expenses, for placing with individuals and institutions
vii) institutional investors and their objectives and constraints in investment decisions
viii) the kind of placement strategy that NHB should have in place which can successfully raise the targeted amount in the least cost manner possible.

INVESTOR PREFERENCES : RELEVANCE TO MARKETING STRATEGY

The findings of the Investors' survey conducted by UTI-ICM in ten major cities of India has shown some interesting findings. The important findings that are relevant to marketing the NHB bond / any other type of instrument are as under:

1. NHB is a familiar institution to the majority of the households.
2. NHB is considered a good institution to invest by a sizeable number of respondents.
3. Minimum credit rating below which households will not be inclined to invest is AA/A.
4. Majority of the households prefer to have Government / RBI guarantee if provided for.
5. Equity is the preferred instrument for the households followed by Mutual Fund Schemes (during interactions with NHB, it was made clear to us that NHB does not intend to issue shares).

6. Minimum return expectation of households is 15% p.a.
7. Safety is the primary consideration in investment. The risk-prone would look for growth primarily, with a minimum return expectation of 18% p.a.
8. Investors prefer to buy debt instruments through bank branches in most cities, followed by agents.
9. Investments are made by households, largely on the advise of friends and relatives and based on write-ups in newspapers.
10. Additional benefits thrown in would facilitate easy marketing. Here, tax-benefits would rank first, followed by housing loans at concessional rates of interest.

Potential For Placing With Individuals

The findings of the survey of investors in IDBI and SIDBI bonds highlight that any instrument offering less than 15% p.a. can be marketed among households only with sweetners like substantial tax benefits and concessional loan facilities,apart from an assurance of buy-back from the institution floating the instrument.

We need to look at other segments of the investing population. One segment which State Bank of India has tapped successfully through the medium of Floating Rate Bonds is the investors in fixed deposit of SBI. As SBI has the infrastructure of its branch network, it could have a wider reach. NHB may find it difficult to place a sizeable amount with individual investors for the following reasons :

i) to design an instrument to match the return-risk expectations of individuals is a complicated exercise.

ii) to design an instrument for a short to medium period of 1 - 4 years as desired by a majority of investors which would also fetch an attractive return of 15% p.a. to 18% p.a. would be an ardous task.

Potential For Placement With Institutions

Institutional investors can be grouped into :

i) Commercial Banks
ii) Mutual Funds & Investment Institutions, Foreign Institutional Investors
iii) Provident, Gratuity & Superannuation Funds
iv) Religious, Charitable and Public Trusts

Commercial Banks

Commercial bank's liabilities are short to medium term in nature. The current and saving bank accounts are of a floating nature, while fixed deposits of 3 - 5 years tenure are of a permanent nature. They are looking for primarily short to medium term instruments with low interest rate risk and market risk. At the long end, they are able to obtain 12 per cent by investing in a 5- year government security. At the short-end, call money yields only 5 per cent and Commercial Paper, Certificates of Deposit around 12-12.5% per cent. Since Indian Banks Association specified a floor of 12.5 per cent for placing commercial paper with banks, companies have chosen a lower cost route of mutual funds, where they can place at around 10 per cent. Thus the opportunities for investment at the short end ,or even for 3 years, are limited for commercial banks. Hence, they would welcome floating fate bonds, as it gives the flexibility to align interest rate to prevailing market rates.

At the long-end, when demand for industrial activity picks up, the quantum of investible funds with commercial banks would decline. A recent policy statement has included even housing loans upto Rs.2 lakhs by commercial banks under priority sector lending. This policy would encourage more housing loan disbursal. But until demand for credit from the commercial and priority sector increases, there would be a situation of excess liquidity with the banks, which would have to be suitably deployed.

Mutual Funds

The income funds, the growing income funds and the new private sector funds are looking for lucrative investment opportunities for (i) temporary placement of funds pending investments and (ii) fixed return instruments which can given regular income with some appreciation. A stepped up interest rate bond may appeal to them as well as a floating rate bond for short-term placements.

Provident Funds, Gratuity And Superannuation Funds

The Government of India, effective April, 1993, has permitted Provident Funds, Superannuation Funds and Gratuity Funds to invest upto 15 per cent of their annual investible funds in the bonds and securities of public sector financial institutions, including Banks. IDBI and ICICI are public sector financial institution and SCICI Limited is a notified public financial institution under Section 4A of the Companies Act, 1956. Hence PFs can place their investible funds in their FRBs. NHB could also target such funds. Even a medium term instrument of a flexible nature, yielding 12.5 % to 13 % would appeal to them.

Religious, Charitable And Public Trusts

The instrument to be placed by NHB is to be declared as a public security under the State Acts and trustee security under the Indian Trusts Act for it be considered for investment by religious, charitable and Public Trusts. They would look for a safe medium to long term instrument yielding 12.5 to 13% p.a.

Institutional Placement Possibilities For NHB

Placement with institutions appears to be a more attractive and feasible option to NHB. Recent experience indicates that Floating Rate Notes (FRNs) are highly preferred by institutional investors. Issuers have been able to place their FRNs with institutions at fine rates, and managed a good over-subscription of their issues.

While SBI could use to advantage, its wide branch network by tapping its fixed deposit clientele, the other institutions have chosen the private placement route, and substantially reduced the cost of placement. Among the privately placed bonds, SCICI has borrowed at the lowest cost, its FRN is linked to 91 - day treasury bill, with the total cost working out to 11.77% p.a., while IDBI's FRB is linked to 364 day treasury bill, which is less volatile and will pay 12.65% p.a. SCICI's bond has a 5 year tenor with a put and call option at the end of 3 years, IDBI has a 3 year tenor.

SCICI, IDBI and ICICI have got a AAA rating for their FRN issues. NHB may not be able to get a such rating, and therefore might have to make additional effort to package and market its product. Since NHB is rating might be lower than AAA, it might have to offer a higher spread over the treasury bill rate, with an appropriate reference rate such as the yield on a 364 day treasury bill.

If the market timing is delayed beyond 6 months, the reference rate may increase and consequently increase the overall cost of borrowing. The reference rate can be re-set annually and interest paid on a half-yearly basis. The treasury bill is a market driven instrument and carries market risk and liquidity risk.

The immediate task of NHB is to re-organise its house and build-up an image. It has to work towards name recognition and re-positioning itse lf in the market. NHB has to analyse the expectations of each market segment and look at geographic locations and their peculiarities while framing marketing strategies. UTI-ICM survey of a cross-section of investors has that the factor influencing i nvestment decision varies from city t o city (Table 6.1). While planning the product and advertisement compaign, the preferences have to be studied and exploited. In some cities agents and brokers have made no dent in promoting a product.

Planning a marketing strategy for individual placement is more elaborate, expensive and risky than for institutional placement, where skills of negotiation would carry more weightage. The ability to custom tailor products to suit institutional investor needs would also be valued. When a good suitable product is in place it is not difficult to put together a marketing strategy for different segments of the potential institutional investors.

TABLE 6.1

INVESTOR RESPONSE - GUIDING FACTOR IN INVESTMENT DECISION

City	Friends & Relatives	Write-Ups	Ad-NP	Brokers
		RANK		
Ahmedabad	4	1	2	3
Bangalore	1	3	2	5
Bombay	1	2	4	3
Calcutta	1	2	3	5
Chandigarh	2	1	3	5
Cochin	1	3	2	4
Delhi	3	1	2	5
Hyderabad	3	2	1	4
Jaipur	1	2	3	4
Madras	3	1	2	4
ALL CITIES	1	1	2	3

TABLE 6.2

INVESTOR RESPONSE - SELLING STRATEGIES

City	Banks	Agents	Door-to-Door
	RANK		
Ahmedabad	1	1	2
Bangalore	2	3	1
Bombay	2	1	4
Calcutta	1	2	3
Chandigarh	1	2	3
Cochin	1	2	3
Delhi	1	2	3
Hyderabad	1	3	2
Jaipur	1	2	3
Madras	1	3	2
ALL CITIES	1	2	3

PUBLIC ISSUE / PRIVATE PLACEMENT EXPENSES (ONLY DEBT ISSUE)

MINIMUM ISSUE SIZE Rs. 100 CRORES

		Public Issue		Private Placement (%)
		Lower (%)	Maximum (%)	
1.	Underwriting Commission	1.75	1.50	1.50
2.	Brokerage	1.00	1.50	1.50
3.	Printing (Application and Prospectus)	1.18	2.30	0.10
4.	Advertising	2.24	4.00	0.05
5.	Registrars Charges	0.79	1.10	0.15
6.	Managers Fees	0.25-0.5	0.50	1.00
7.	Bankers Incentives	0.36	0.50	0.00
8.	Mailing	0.58	0.75	0.05
	TOTAL	8.15	13.15	4.35

NOTE : If the issue size is larger, then the percentage of expenses to issue size will come down.

ACTIVITY SCHEDULE - SECURITY ISSUE PROCESS

		Public Issue	Private Placement
1.	Design of an Instrument	X + 10	x + 10
2.	Plan of the Issue	X + P=0	X + 15
3.	Application to SEBI/RBI/GOI	X + 15 (P)	X + 15
4.	Application to Registrar of Companies	X + 25	X + 25
5.	Appointment of Agencies a) Printers b) Ad. Agency c) Registrars d) Underwriting Agencies e) Brokers f) Bankers to the Issue	X + 40	X + 35
6.	Prepare Prospectus and Application form	X + 50	X + 35
7.	Draw up Advertisement/Marketing Strategy	X + 55	X + 35
8.	Finalise Underwritng Tie-Up	X + 60	X + 35
9.	File Prospectus with ROC	X + 60	-----
10.	Clearance of Prospectus by a) Underwriters b) Auditor c) Legal Advisors d) Stock Exchange(If it is to be listed) e) Merchant Bankers f) Application for Listing of Shares g) Material Document File/Consents h) RBI Consent (NRI Issue)	X + 70	X + 40
11.	Receive acknowledgements	X + 75	X + 40
12.	Release Mass Printing Order of Stationery with distribution schedule	X + 76	-----
13.	Complete printing and distribution	X + 82	-----

14.	Release advertisement	X + 85	------
15.	Open Issues	X + 95	X + 45
16.	Earliest Closing	X + 97	------
17.	Latest Closing	X + 105	------
18.	Collect bank collection figures	X + 115	X + 50
19.	Draw - up allotment pattern	X + 120	X + 52
20	Cut allotment pattern approved by Stock Exchange	X + 122	X + 52
21.	Make allotment	X + 124	X + 55
22.	Send refund orders / allotment advice	X + 130	X + 56
23.	List securities to start trading	X + 132	------
	TOTAL DAYS	**132**	**56**

NOTE :-

a) P Stands for Parallal activity
b) Some activities are simultaneous. It is not required to have additonal days.
c) X Stands for Starting days.

ANNEXURES

7. **Which of the following have you invested in ?**

(a) Deep Discount Bonds / Debentures

(b) Tax Free Bonds / Debentures

(c) Floating Rate Bonds / Debentures

i) SBI

(d) Unsecured Institutional Bonds/Debentures of :

i) Industrial Development Bank of India ii) ICICI

iii) Small Industries Development Bank of India iv) Others (Specify)

(e) Secured Premium Notes

8. **In how many companies do you or your household members hold bonds /debentures ?**

a) NIL b) 1-5 c) 6-10 d) 11-20

e) 21-30 f) 30-50 g) >50

9. **What are your investment objectives in order of preference ? (Please rank your choice in order of preference)**

a) Steady Return (Income) b) Faster Growth

c) Security d) Liquidity

e) Any other (Please specify)

10. **What is the minimum rate of interest which you expect from fixed income instruments ?**

a) 12% b) 13% c) 14% d) 15% e) 16%

f) 17% g) 18% h) 18-20% i) 20-22% j) 22-24%

ANNEXURE I

SAMPLE QUESTIONNAIRE ADMINISTERED TO INVESTORS

1. **NAME & ADDRESS:**

2. **AGE & SEX** : a) Minor b) 18-30 c) 30-40 d) 40-50 e) 50-60 f) 60-70 g) 70 & above

   Male / Female

3. **MONTHLY INCOME** (Gross) : a) Below Rs. 2500 b) Rs.2500-5000 c) Rs.5000-10000 d) Over Rs.10000

4. **EDUCATION** :
   a) Non-Graduate
   b) Graduate
   c) Post Graduate / Professional Degree

5. **EMPLOYMENT**

   a) *Self Employed*

      i) Agriculture (ii) Industry (iii) Service

   b) *Salaried Class*

      i) Financial Sector (ii) Non-financial Sector (Specify)

   c) *Retired*

6. **Have you Invested in the last three years in the following**
   (please tick the appropriate column)

	Primary Market	Secondary Market
a. Equity		
b. Debentures i) Fully Convertible Debentures		
ii) Partly Convertible Debentures		
iii) Non-convertible Debentures		
c. Mutual Funds i) Income Oriented		
ii) Growth Oriented		

16. **Which one of the two options would you prefer more ?**

(a) The Issuer retaining the option to call in installments with premium

(b) The Investor being given an early withdrawal facility with no premium

17. **If you are given an attractive redemption premium, would you stay with the scheme for the full duration ?**

a) Yes b) No

18. **What additional features of the following would be preferred ? (Please rank your choice in order of preference)**

a) Housing Loans at concessional rate of interest

b) Insurance & medical benefits

c) Tax Benefits

i) Capital gain exemption
ii) Income exemption

d) Buy-back facility

e) Attached Warrants

f) F rly bird incentive commission

g) Interest warrants to be despatched for the entire year in advance

h) Floating interest rates

19. **Did additional benefits given in unsecured bonds/Debentures influence your decision to invest in them in past ? If yes, what ?**

a) Yes b) No

'0. **Do you attach any importance to credit rating in your investment decision making ?**

a) Yes b) No

11. What is the desired mode of return (Please rank your choice in order of preference)

(a) Cumulative Return

(b) Periodical Return
- i) Monthly
- ii) Quarterly
- iii) Half Yearly
- iv) Annually

(c) Capital Appreciation

12. What is the maturity period of the fixed income instrument that you would prefer to invest in ?

a) 1 year b) 1-3 years c) 3-5 years d) 5-10 years

e) 10-25 years f) Any other (Please specify)

13. Where would you prefer to invest your surplus funds ? (please rank your choice in order of preference)

(a) Equity

(b) Debentures
- i) Fully Convertible Debentures
- ii) Partly Convertible Debentures
- iii) Non-convertible Debentures

(c) Company Deposits

(d) Deep Discount Bonds/Debentures

(e) Floating Rate Bonds/Debentures

(f) Mutual Fund Schemes

(g) PPF, Bank Deposits (etc.)

(h) Others (Specify)

14. What percentage of your total investment do you expect to invest in the primary market (New Issues)?

a) 10% b) 20% c) 50% d) 75%

e) 100%

15. Can you indicate probable amount you would invest in primary issues of bonds / debentures ?

(a) Nil (b) Upto 5,000 (c) 5,000-10,000

(d) 10,000-25,000 (e) 25,000-50,000 (f) 50,000-1,00,000

(g) Over 1,00,000

26. **How would you like future National Housing Bank instruments to b marketed?(Rank in order of preference)**

a) Agents b) Door - to - Door c) Bank Branches

d) Petrol Pumps e) Any Other (Specify)

27. **If the National Housing Bank instrument is considered as a collatera security against your Housing Loan by Housing Finance companies, woulc it influence your decision to invest in National Housing Bank ?**

a) Yes b) No

28. **If a housing loan taken against NHB instrument as a collateral is accompanied by the housing insurance cover then would that be seen as a major influencing factor for subscription to the NHB instrument ?**

a) Yes b) No

29. **If National Housing Bank launches different instruments in the next year as indicated below, what would your preference be ? (Please rank your choice)**

a. Equity Issue at Par

b. Equity Issue at Premium

c. Convertible Debentures/Bonds

d. Non-Convertible Debenture with Warrants

e. Unsecured Fixed Interest Bonds/Debentures

f. Unsecured Floating Rate Bonds/Debentures

g. Unsecured Deep Discount Taxable Bonds/Debentures

h. Income Oriented Mutual Fund Scheme

i. Growth Oriented Mutual Fund Scheme

j. Tax Saving Scheme of Mutual Fund

1. **What is the minimum rating below which you would not be inclined to invest ?**

   a) AAA   b) AA   c) A

   d) BBB   e) BB

2. **Do you buy capital markets instruments on the advice of (Rank in order of importance)**

   a) Ads in Newspapers/Magazines   b) Writeups in Newspaper / Magazines

   c) Friends & Relatives   d) Agents

   e) Brokers   f) Merchant Bankers

   g) Ad on TV   h) Ad on Radio

   i) Others (Specify)

3. **Have you heard of National Housing Bank ?**

   a) Yes   b) No

4. **Do you consider National Housing Bank a good company to invest your savings in ?**

   a) Yes   b) No

5. **Which of the following would make investment in National Housing Bank more attractive to you ? (Rank in order of preference)**

   a) RBI / Govt. gives a guarantee for the instrument floated by NHB

   b) If any international agency is funding it

   c) If buy back facilities are guaranteed

30. **If a major portion of an issue is privately placed with investment institutions including foreign institutional investors, would you subscribe to the issue more confidently ?**

    a) Yes   b) No

31. **How would you prefer the mode of registration of instrument ?**

    a) By endorsement and delivery.

    b) By registration of certificates with organisation.

    c) By lodging securities with a custodian and transfer through book entries.

32. **Would you prefer scripless trading ?**

    a) Yes   b) No

33. **Are there any suggestions regarding the Housing loan approval / disbursement by Housing Finance Companies in India ?**

34. **What are your suggestions for future capital market instruments ?**

ANNEXURE II

Master Questionnaire For Housing Finance Companies And Institutions

Housing Finance Companies

1) FORMATION

Whether the company was incorporated

a) Through Legislation. If Yes, what are the major provisions of the relevant legislation that directly impact on the functioning of the company.

b) As subsidiary of an existing company. If Yes, what are the functions of the holding company and what is the extent of inter-relationship in functioning. The availability of the holding company to support the activities of the subsidiary company is to be noted.

c) As a diversification move of an existing company / institution which already has experience in the housing industry. If Yes, what are the advantages the company enjoys by having access to the expertise of the parent company in the industry.

d) As a diversification move of a scheduled bank. If Yes, what are the specific advantages and dis-advantages.

e) Others, which includes formation of the housing finance companies through any other mode other than those listed above.

The information on formation of the company is expected to be linked with information obtained on the activities of the company with a view to finding out inter-relationships and ascertaining whether a certain type of housing finance company exhibits certain advantages/ dis-advantages.

2) LEGAL FRAMEWORK GOVERNING THE OPERATIONS

The legislative framework that governs the functioning of housing finance companies has to be examined from the point of view of ascertaining the extent to which they impact on the functions, the capital structure and the asset portfolio. The efficacy of the legislative framework in allowing flexibility while at the same time providing adequate controls and monitoring mechanism has to be studied.

a) Activities

What are the activities that a housing finance company can carry out ? Would it be housing finance only ? or can it include allied activities such as setting up building material units etc. Can the housing finance company carry out any other activity other than the above two ? The scope of activities prescribed by the legal framework and the actual range of activities of housing companies can be compared for analysis.

b) Methods of raising finance

What are the legally acceptable sources of finance available to housing companies ? Are there any guidelines as to the ceiling amounts that can be raised from various sources ? What are the procedural formalities involved ? What are the various guidelines applicable to housing companies that seek to raise finance from the various available sources?

c) Deployment of funds

What is the legal framework for the asset structure of housing finance companies ? Are they obliged to invest a proportion of their funds compulsorily in any asset ? Are there guidelines which determine the maturity structure of assets ? Are the housing finance companies obliged to provide for non performing assets ? If Yes, to what extent.

3) ACTIVITIES

a) Brief History of Activities

What are the activities the housing finance companies have been traditionally carrying out ? If they have been only concentrating on plain vanilla housing finance, do they see scope for continuing to carry out the same activity in the future ? If they plan to diversify, what are the reasons and what are the compulsions ?

If there has been a shift in the activity profile of the housing finance companies, what has caused the shift ? Is the shift temporary or otherwise ? What is the outlook for the future?

Do the housing finance companies project a shift in the activity profile in the near future ? If Yes, what is the nature of the shift and what are the reasons that would necessitate the shift ? What is the outlook for the industry in terms of the above trends in the activity profile ?

What is the profitability trend for the various activities of housing finance companies ? How is the profitability expected to change in the future ? What are the strategies if any, to protect the margins in the future ?

4) SOURCES OF FINANCE

What are the sources from which finance has been obtained by the housing finance companies ? How do the sources relate to their formation and the legislative framework ? What are the chances that the sources of finance would be available in the near future ? Is there any indication of shift in the sources of finance in the immediate past ? If Yes, what has caused such a shift?

What are the plans of the housing finance companies for their capital structure ? Do they see the need to re-align the same ? More specifically, are they planning to tap any new source of finance in the near future ? If Yes, what are the alternatives they are considering ? What is their view on the various alternatives such as institutional finance, raising money from capital market etc.

If they plan to tap capital market, what has specifically made them look at this alternative of financing ? How do they plan to price and structure their instrument ? Would it be an equity instrument or a debt instrument ? If it is a debt instrument what would its features be ? What is the marketing and pricing strategy for the instrument ? How have the features of the instrument been crystallised ? Have they drawn from the experiences of the other issuers ? If Yes, what are the features on which they have deviated from the issues of other institutions ? Are they considering any innovative instrument such as the floating rate note ? What are the specific features that have to be included in an instrument issued by a housing finance company, if any such product differentiation is required ?

What is their feel for households as a source of finance ? Have they experimented with the deposits route of finance earlier ? If Yes, what has been their experience ? Do they plan to structure a product for the households ? If Yes, what are the features of the product ?

From the above questions it is expected that an evaluation of the universe of sources of finance for the housing finance companies can be made in the following terms:

a) Traditional sources and their merits / de-merits.
b) Shifts within the traditional sources and reasons there for.
c) New sources and the reasons for considering them.
d) The understanding of finance companies about product structuring and packaging.
e) Financing plans of finance companies and their impact on the NHB.
f) The overall industry scenario for the sources of finance.

5) COST OF FUNDS

The cost of funds for the housing finance companies can be worked out from their capital structures. The asset liability structures can be studied to ascertain the constraints in managing and matching the same. The following questions regarding the cost of funds have to answered.

a) How has the cost of funds for housing finance companies been ? Has it stagnated over years ? If not, why has it changed and what is the outlook for the future ?

b) What are the major factors that affect the cost of funds ? What is the cost of each source of funds and how has it changed ? What is the effective cost of funds ?

c) Are there any strategies employed by housing finance companies to control the cost of funds ? What is their perception of the controllable and non-controllable components of the cost of capital ? What is the scope to further reduce the cost ? What are the impediments to this exercise ?

The focus of the questions on the cost of funds would be to find out the following.

a) An estimate of the cost of funds for the industry
b) A forecast of the future trends in cost of funds
c) The effectiveness in the management of the cost of funds

6) MANAGEMENT OF ASSETS AND LIABILITIES

Since housing finance companies function as financial intermediaries, the management of assets and liabilities directly impinges on their profitability, which derives from the spread between the cost of funds and the rate at which they are deployed. The asset and liability structure will have to be analysed to find out the following :

(a) What is term structure of the asset portfolio ? How well does it match with the term structure of the liabilities ? If there is a mismatch what is the reason ? How does the company tackle the mismatch ? If there is no mismatch, is there a chance of it occurring in the future ? If Yes, what would cause the mismatch ? What is the strategy to manage the same?

(b) What is the trend in the spread ? What is the outlook for the spread in the future ? What are the factors that have historically affected the spread ? What is the chance that these factors would alter in the future ? What are the strategies to protect or improve upon the spread ?

(c) What has been the role of NHB as a re-financing organisation in the asset liability management of financing companies ? Has the presence of NHB help or hindered ? How ?

7) INDUSTRY INFORMATION

It is expected that the scenario for the industry can be culled out by aggregating the information obtained from individual companies. The following industry information is expected to be available after studying the housing finance companies.

a) Future scenario for the housing finance industry in terms of activities, sources of finance, application of finance and profitability.
b) Problems and prospects of the industry.
c) Impact of liberalisation on the functioning of the housing finance companies.
d) The level of competition and the future scenario.
e) The scope for the improvement in the functioning of the companies.
f) The strategies of companies to gear up for changes in the future scenario particularly the expected drop in the interest rates and a expected increase in access to capital markets.

FINANCIAL INSTITUTIONS THAT HAVE TAPPED THE CAPITAL MARKET

The objective of studying the issues made by Financial Institutions is to ascertain whether NHB can adapt their strategies for its use and to suggest modifications that have to be made in the process.

It is intended to study the issues in terms of the following :

a) The Instrument
b) The Investor
c) The Marketing Strategy

The Instrument

The features of the instrument issued by these institutions are to be studied for the following details :

What was the type of the instrument? Was it Equity or Debt? If it was Debt was it a guaranteed bond ? Or was it a debenture?

If it was a debenture how was it structured? Was it a convertible (Fully or Partly) debenture? What were the features in terms of interest payment and repayment of principal ? Was there any specific incentive for subscribing to the instrument ? Was the incentive a tax saving feature ? If yes, what was the nature of the provision of tax law ? What were the other incentives offered ? How was the set of incentives determined ? What are the factors which finally influenced the choice of incentives? Were there any warrants attached to the instrument?

Were there any constraints in the structuring of the instruments? Do these constraints exist now? Have there been any new constraints to product design since?

What was the term structure of the instrument? What are the factors which influenced the term structure? Was the instrument designed to suit the holding period preference of prospective investors? Alternatively was the term structure purely determined by the asset portfolio of the Institution ? If there was a trade off between the above two considerations, how was it arrived at?

How was the pricing of the instrument done? How was the return expectation of prospective investors estimated ? Was the instrument purely priced on the rate the issuing institution could bear? How was it established that such a rate would also be attractive to the investors?

How has the experience in servicing the instrument been ? Is there a necessity to think of some restructuring if the option of doing so is now available ? What have been the specific advantages the chosen structure provided? What are the major disadvantages arising out of the chosen structure? How are they being tackled?

In the light of the changing environment how would the instrument be structured if it were to be issued now or in the near future?

Investors

It is necessary to find out who were the aspiring and actual investors to the products of these institutions and their profile could be studied to understand the investor preferences. This would however be out of the scope of this group's task.

Marketing Strategies

Most financial institutions that have tapped the capital market were doing it for the first time. It is therefore necessary to find out the strategies adopted to ensure success of the issue. The following are important questions that have to be asked to get a feel for the marketing strategies of these institutions:-

What was the basis for the issuers confidence in marketing the issue? Did they do a survey of investors to know their preferences? If not what was the source of information on investor preference? Was a pilot study done on a small sample?

What was the strategy for timing the issue? Did the institution benefit from timing? What in its opinion are factors that help determine appropriate timing for the issue? Would they have done better if the timing was different? What is their analysis of the importance of timing in the marketing of issue?

How was the information dissemination handled? How was the media of advertisement and publicity chosen? Who handled the account? What is the feedback on the reach achieved by advertisement and publicity? Do you think you could have done better? If yes, then in what respect?

How was the distribution and collection of forms handled ? Were there any specific strategies to ensure wide distribution of application forms? Was the distribution of forms done through agents and investment counsellors? What is the feedback ?

What was the expense involved in issue management? Could it have been managed better? If yes, what are the specific areas requiring control?

What were the major factors that aided the subscription to your issue? What would you attribute the success of your issue to? What were your expectations about the response and how did it compare with the actuals? How much of the actual response was foreseen by you? What was the basis of such forecasts? Would you be able to replicate such response if you offered a similar instrument and marketed it similarly now or in the near future? If yes, what specifically makes you think so? If you can better your performance , what do you think would primarily cause it? If you are apprehensive what are the reasons?

What is your feel for the market now? Have things changed since your issue? If yes, how ? Do you see further changes in market perceptions? If yes, what are they and what are the factors that are altering market perception?

Annexure III

Sample Questionnaire Administered To Institutions And HFCs.

Questionnaire For SBI Home Finance Limited

1) Formation

SBI Home Finance Ltd. (SBHF) was formed in 1988 subsequent upon the Governments decision to set up housing finance companies in all the four major regions in the year 1987, declared as the year for shelter.

SBHF was promoted by the State Bank of India and was to cater to the east and north eastern regions.

a) Who are the co-promoters of SBHF? What are their stakes in the equity capital of the company?

b) Is SBHF a subsidiary of SBI or is SBI only one of the promoters?

c) Does SBHF enjoy any special advantage and disadvantage by virtue of its formation?

d) What is the extent of inter relationship between SBI and SBHF?

2) Legal framework governing operations

SBHF is a recognised housing finance company which enjoys tax concessions under section 36 (1)(viii) of the Income Tax Act. This concession requires that SBHF deploy 75% of the funds in housing finance for individuals, and also create special reserve from the profits.

a) Does SBHF consider the regulation above useful? Does it require further tax concessions? Elaborate.

b) Does SBHF perceive the restriction on deployment of funds detrimental to its growth? Elaborate.

c) What is the view of SBHF on the regulations governing the housing finance companies?

d) SBHF did not get its recognition under section 36 (1)(viii) until 1991. Why?

3) Activities

The company had to concentrate on the east and northern region because of the regulation governing its formation until 1992. The company did not expand activities substantially in the initial years.

a) How did the geographical location impact upon the performance of the company? It looks like the region allotted to the company was a difficult one to work with. What were the reasons for slow development of business in the designated regions and what were the efforts made by the company? What are the major constraints to housing in the eastern region?

b) In the opinion of the company what are the steps required for handling the concentration of housing finance companies in the south and west?

c) Given the relaxation in the geographical area of operation, can it be expected that the company would shift its focus to the western and the southern regions? Alternatively does the company view its presence in the east as a strength?

d) The company has been utilising the branch network of SBI for its activities. Does this provide specific cost advantages? Are there problems in marketing and reconciliation of accounts? What has been SBHFs experience in this regard?

e) Does SBHF concentrate on any niche segment in housing finance? Elaborate.

f) Does SBHF offer any fee based services ? What are the nature of these services and since when are they being offered? What is the scope for further increase in such activities?

g) Does the company plan to diversify (within the scope of 36 (1) (viii)) into newer activities? Does it perceive any compulsion to do so? Does it see any opportunity to do so? What are the plans and strategies in this regard?

h) Does the company plan to add value to its activities in any manner? Elaborate.

4) Sources of Finance

SBHF was completely dependent upon SBI upto the year 1989-90 when the capital and cash credit from SBI were the only sources of finance. After the establishment of NHB and availability of refinance the company resorted to this source albeit in a small way. Only in 1991-92 did the company tap the deposits route to finance. It has been tremendously successful in mobilising deposits that there has been a shift from SBI funding to funding through the deposit route. Within the deposits, deposits from others (which we guess are from institutions including trusts) have emerged as single largest source of finance for the company. In the year 1992-93 the company has also reduced its dependence on cash credit from SBI. The cash credit availed from SBI has reduced from 23 crores to 11 crores. This may not represent a major shift in sources in finance since, the monies collected through the public issue available for use in the year 1992-93.

a) Loans from SBI are available through a cash credit account which would entail savings in interest costs since the interest is on the amounts drawn. What is the cost of funds available from SBI?

b) Loa... ...n State Bank are available at a rate of 12% or is it lesser? Since State Bank has to deploy a statutorily fixed proportion of incremental deposits in housing finance. Given that bank profitabilities are under strain, it is expected that such statutory restriction on employment of funds would go. Even if they continue, the financial sector reforms is directing most interest rates to the market. Can it therefore be expected that funds may not be available from the banking sector to the housing finance companies in the future? Even if they are available, SBHF may have to pay market rates for these funds, and also compete with other avenues for investment available to State Bank. What is the view of SBHF on the above? What are the strategies given the probability of such scenarios?

c) While many housing finance companies were availing the deposit route even before the NHB guidelines on the matter, how has SBHF not resorted to other sources in the initial years?

d) To what can SBHF attribute the success of deposit mobilisation programmes? Has the utilisation of branch network of State Bank been of significant help?

e) The deposits from others represents the single largest source for SBHF. Explain the nature of these deposits. Who are the target market for these deposits? What is the future prospects of further growth in this source of finance? What is the present cost of this source (interest only)? What are the expectations for the future?

f) Some deposits have also been collected from banks. Does this represent the amounts available with these banks to be ear marked for housing finance? Which are these banks? Are these SBI's subsidiaries or are these banks which do not have a housing subsidiary? What is the costs of these funds? What is the scope for further augmenting this source?

g) What has been the SBHF experience in tapping the retail market for deposits? What has been the feedback on investor expectations? How willing are investors to consider parking their funds with housing finance companies? What is the cost of funds available through the deposit route from individual investors?

h) What are the strategies and plans of SBHF for deposit mobilisation? Is SBHF planning to increase its dependence on this source?

i) Is it expected that the sources of funds would be exploited to the maximum available extent assuming that demand for loans would be on the increase? Or is SBHF not tapping all available sources for want of profitable loan business? What is the present state of affairs at SBHF?

j) Does the SBHF operate the HLAS? What has been the experience in the regard?

k) SBHF has been increasing its dependence on refinance from NHB. What is SBHF experience in using this source of funds ? Specifically we need the following clarifications.

   i) What is the percentage of disbursals that on an average qualify for refinance? Does SHF plan to deliberately increase funding to such eligible loans?

   ii) The refinance stipulations of NHB are perceived to be restrictive by the industry. What is your view?

   iii) The industry also opines that NHB refinance is fraught with delays and procedural hassles. What has been your experience?

   iv) What is your view of the NHB's ability to increase its refinance activities?

l) SBHF had made a public issue in the year 1992-93 and was extremely successful. What is the opinion of the management on the response? Is there an increased preference to subscribe to the equity of housing companies or was the response largely because of SBIs brand equity with investors?

m) The borrowing capacity of SBHF has tremendously increased with the increase in equity capital. What are the strategies for augmenting the borrowings?

5) Cost of Funds

SBHF's cost of funds was very low as long as it was only dependent on SBI for resources. After it resorted to the deposit route there has been an increase in cost of funds. By rough estimates the company paid an average cost of about 6% net on its funds upto 1990-91. The cost has since increased to 9% in 1991-92 and 13% in 1992-93. The profit position in 1993 is comfortable because of the profitable utilisation of application money lying with SBHF.

a) Provide a sources wise break up of cost of funds and expected scenario for the future?

b) What are the major factors that affect the cost of funds for SBHF? What is the outlook for the future?

c) What are the deliberate strategies for the control of the cost of funds?

6) Management of Assets and Liabilities

SBHF's spread position is not very comfortable. The company has been paying more interest than what it is earning from its loans. The profits have been augmented either out of investments or from fees and other charges. In the current year particularly the company has made tremendous gains from investments made out of money collected in the public issue. In a scenario of increasing cost of funds (note the shift to costly sources of finance in 4 above) the company might not be able to protect its spread without deliberate strategies for the same.

a) Housing finance companies have not actually matched their asset liability portfolios but have depended on either the availability of funds on tap (cash credit) or the possibility of roll over of shorter term liabilities. What is SBHF strategy in this regard?

b) What is the average age of the loan portfolio. Please provide break up of the composition in terms of interest and terms structure.

c) What is the company's view of the small spread? What are its strategies to increase the spread? What are the constraints?

7) Industry Information

Let us have your view on the following aspects of the housing finance industry.

a) Future scenario for the housing finance industry in terms of activities, sources of finance, application of finance and profitability.

b) Problems and prospects of the industry.

c) Impact of liberalisation on the functioning of the housing finance companies.

d) The level of competition and the future scenario

e) The scope for the improvement in the functioning of the companies.

f) The strategies of companies to gear up for changes in the future scenario particularly the expected drop in the interest rates and a expected increase in access to capital markets.

Questionnaire For IDBI

Questions on the IDBI Bond Issues of January 1992 & March 1993

INSTRUMENT

1) Why did IDBI choose to come out with public issues ? Why not institutional placement ?

2) In both the issues why were 3 different options given ? What was the expected response under each option ?

3) How was the decision made to offer these bond types ? i.e., Why Deep Discount Bonds or Double Option Bonds ?

4) How was the expected amounts of 300 crore in the first issue and 200 crore in the second issue estimated ?

5) How much of the issue amount was expected to be collected under each option ?

6) The face value of 1 lac at deep discounted price of Rs.2,700/- implies a rate of return around 15 %. How was this rate arrived at ?

7) While pricing the bonds, how was the return expectation of prospective investors estimated ? Was this taken into consideration on fixing the price, or was it priced purely on the rate the issuing institution could bear ?

8) The maturity period was fixed at 25 years from the date of issue for Deep Discount Bonds. On what basis was this term length fixed ? Was this determined by the asset portfolio of the Institution or were there any other factors that influenced the term structure ?

9) How were the withdrawal/redemption options and the deemed face value at that time decided ? Were these given to suit the holding period preference of prospective investors?

10) It was felt that many investors had bought Deep Discount Bonds for a 5 year period. Do you feel that due to falling interest rates the investors will prefer to hold these bonds for a longer period ? Give your estimated expectations.

11) Are you planning to go in for early redemption as the interest rates are falling ? What arrangements, cash and procedural will be made to repay in case of early withdrawal or redemption ? Will you be going public for this ?

12) Why was the term length of the bonds in the second issue kept low as compared to the first issue ?

13) Were there any constraints in the structuring of the instrument ? Have there been any changes in these constraints since ? (Constraints like ceiling on interest rates or limits on public/private/institutional/NRI placements or an advertising and publicity.)

14) In light of the changing economic environment how would the instrument be structured if it were issued now or in the near future ? (In terms of Interest Rates, Competition from other Institutions, Availability of Foreign Funds, etc.)

15) The 1992 issue was underwritten whereas the 1993 issue was not? Why ?

MARKETING

16) What were the Marketing Strategies adopted in both the issues ? How were these planned, administered and executed ?

17) What was the basis for the issuers confidence in marketing the issue ?

18) Was any survey carried out to find out investor preferences ? If so, give details. If not, what was the source of information on investor preference ?

19) What was the strategy for timing this issue ?

20) Was the timing beneficial, or would the response have been better if the issue was brought out at some other time ?

21) How much importance is given to the timing of the issue ?

22) How was the advertisement and publicity of the issue done ? Who handled the account ?

23) What is the feedback on the reach achieved by advertisement and publicity ? Could this have been bettered and how ?

24) How was the distribution and collection of forms handled ? Were there any specific strategies to ensure wide distribution of application forms ? Was the distribution of forms done through agents and investment counsellors ? What is the feedback ?

25) CRISIL had rated the issue as Triple AAA ? Was the estimated internal rating the same?

26) How much importance was given to the ratings while marketing the issue ?

27) Do investors attach importance to these ratings ?

RESPONSE

28) The amount collected by IDBI was 480 crores in the first issue and 395 crores in the second. Why in your opinion was the response so good for the first issue?

29) Were there any deviation from the expected response in both the issues ? If yes, what in your opinion caused this deviation ?

30) What are the number of bonds and amounts collected under each option in the first issue?

31) What are the number of bonds and amounts collected from non-individuals in this issue?

32) What are the number of bonds and amounts collected under each option in the second issue?

33) Previously, you could borrow from the Government at low interest rates whereas now you are borrowing from the public at high interest rates. How have your activities changed to service this?

34) In the current market scenario where interest rates are falling, how will you service borrowings at higher rates ?

35) How has the experience in servicing both the instruments been ? Is there a necessity of some restructuring if the option of doing so is now available ?

36) What have been the specific advantages and disadvantages of the chosen structure ?

37) How are the disadvantages being tackled ?

38) What was the expense involved in issue management ?

39) Could it have been managed better ? If yes, what are the specific areas requiring control?

ANNEXURE - IV

GRAPHICAL

REPRESENTATION

OF

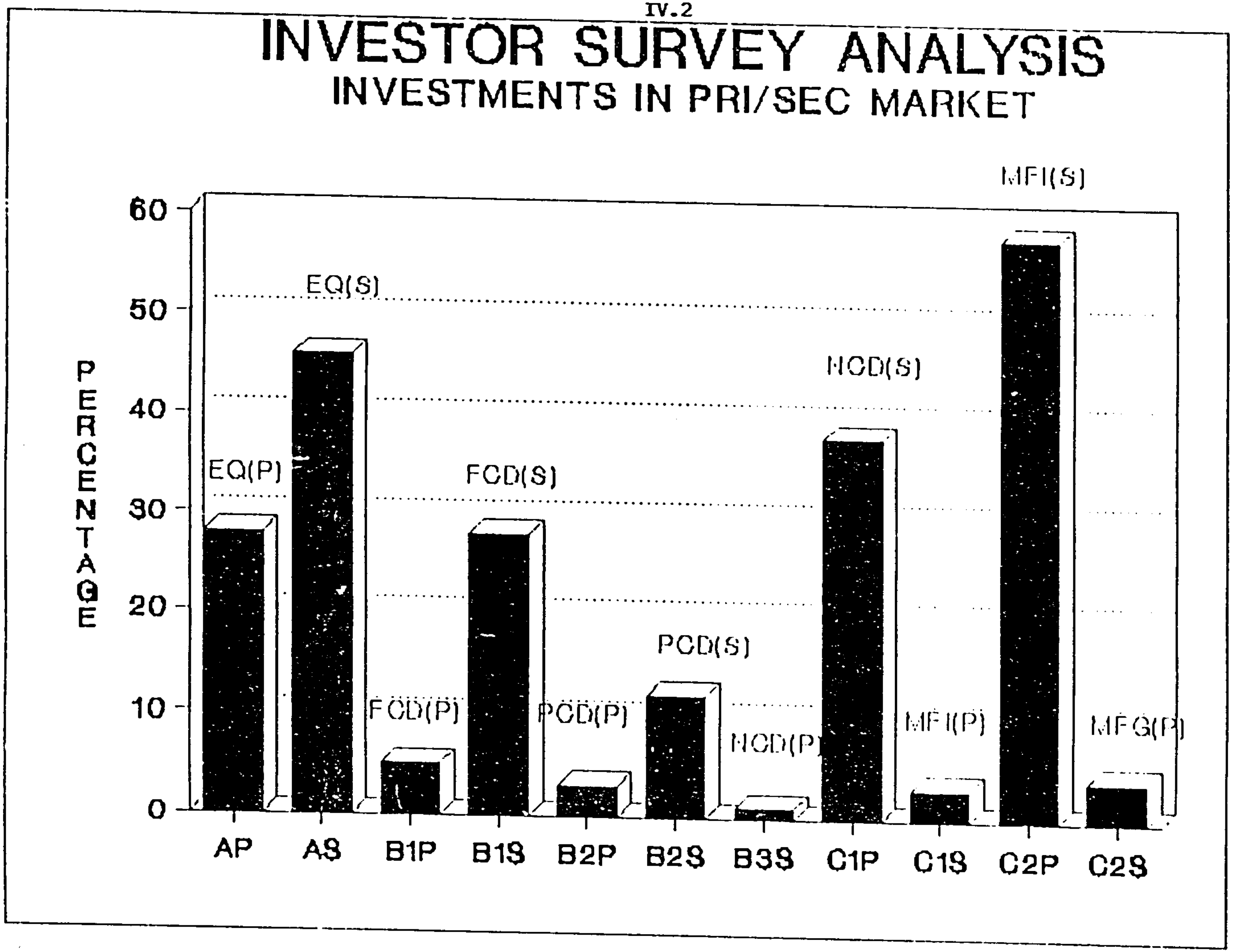
SURVEY

RESULTS

THE INSTITUTE OF CAPITAL MARKETS

Have you Invested in the last three years in the following ?
(please tick the appropriate column)

	Primary Market	Secondary Market
a. Equity		
b. Debentures		
i) Fully Convertible Debentures		
ii) Partly Convertible Debentures		
iii) Non-convertible Debentures		
c. Mutual Funds		
i) Income Oriented		
ii) Growth Oriented		


INVESTOR SURVEY ANALYSIS
INVESTMENTS IN PRI/SEC MARKET
PERCENTAGE
0
10
20
30
40
50
60
EQ(P)
EQ(S)
FCD(P)
FCD(S)
PCD(P)
PCD(S)
NCD(P)
NCD(S)
MFI(P)
MFI(S)
MFG(P)
AP
AS
B1P
B1S
B2P
B2S
B3S
C1P
C1S
C2P
C2S

93

Which of the following have you invested in ?

(a) Deep Discount Bonds / Debentures

(b) Tax Free Bonds / Debentures

(c) Floating Rate Bonds / Debentures

i) SBI

(d) Unsecured Institutional Bonds/Debentures of :

i) Industrial Development Bank of India

ii) ICICI

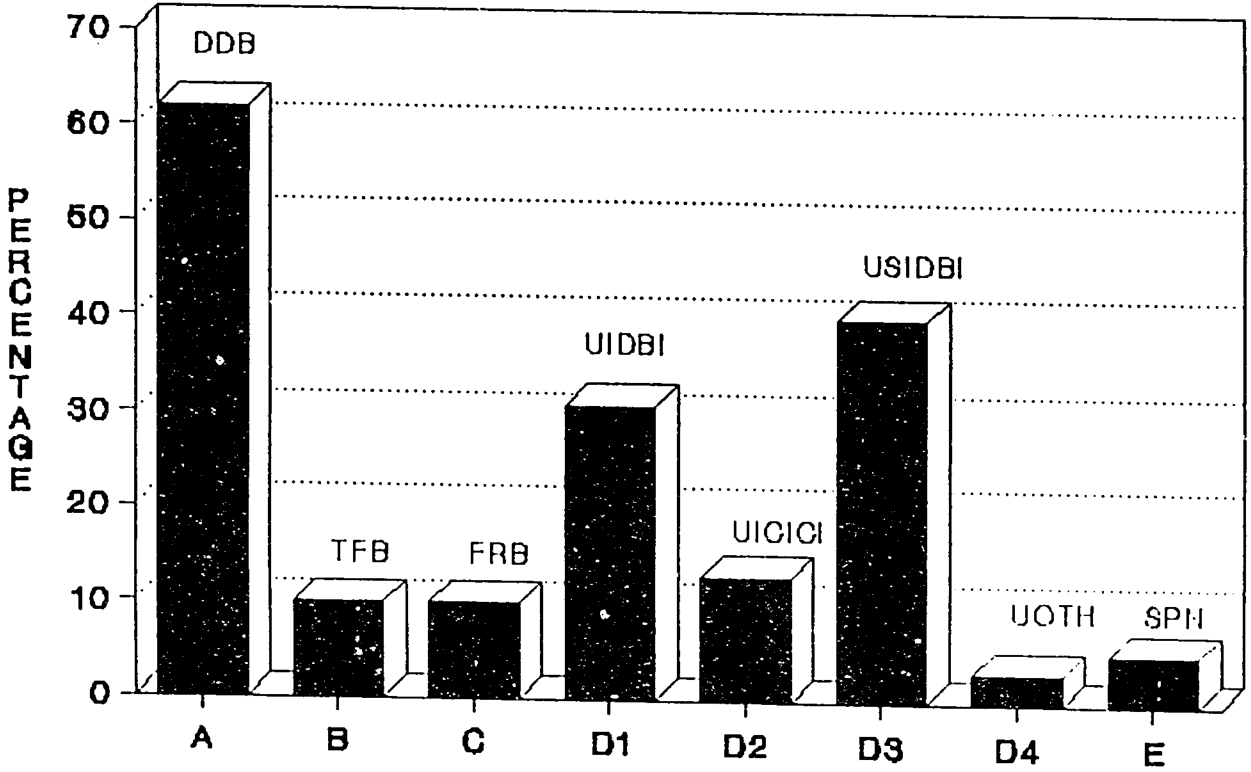
iii) Small Industries Development Bank of India

iv) Others (Specify)

(e) Secured Premium Notes

IV.4

INVESTOR SURVEY ANALYSIS
INVESTMENT PROFILE



In how many companies do you or your household members hold bonds/ debentures ?

a) NIL b) 1-5 c) 6-10 d) 11-20

e) 21-30 f) 30-50 g) >50

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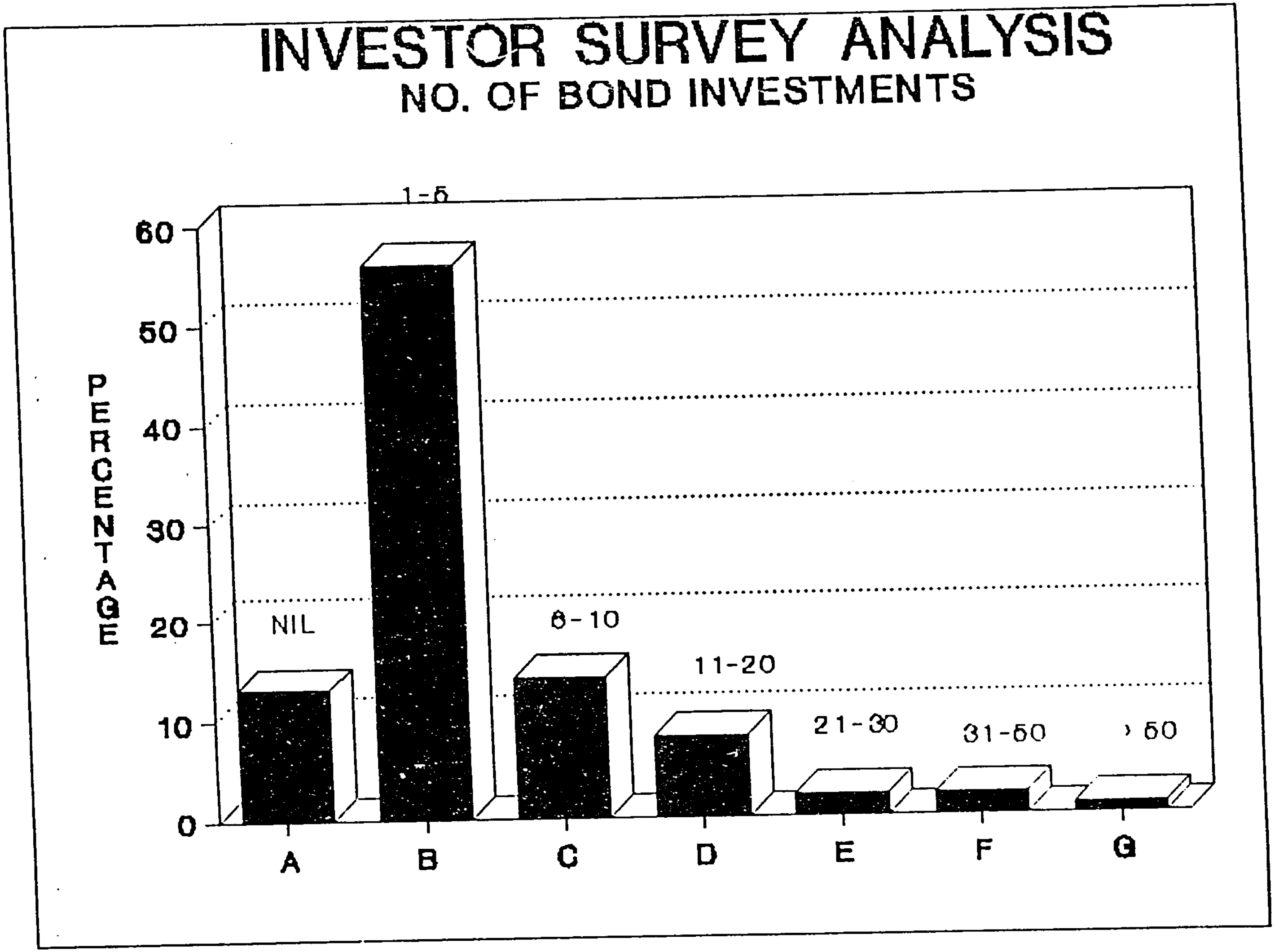

INVESTOR SURVEY ANALYSIS
NO. OF BOND INVESTMENTS
PERCENTAGE
0
10
20
30
40
50
60
NIL
1-5
6-10
11-20
21-30
31-50
› 50
A
B
C
D
E
F
G

96

What are your investment objectives in order of preference ?
(Please rank your choice in order of preference)

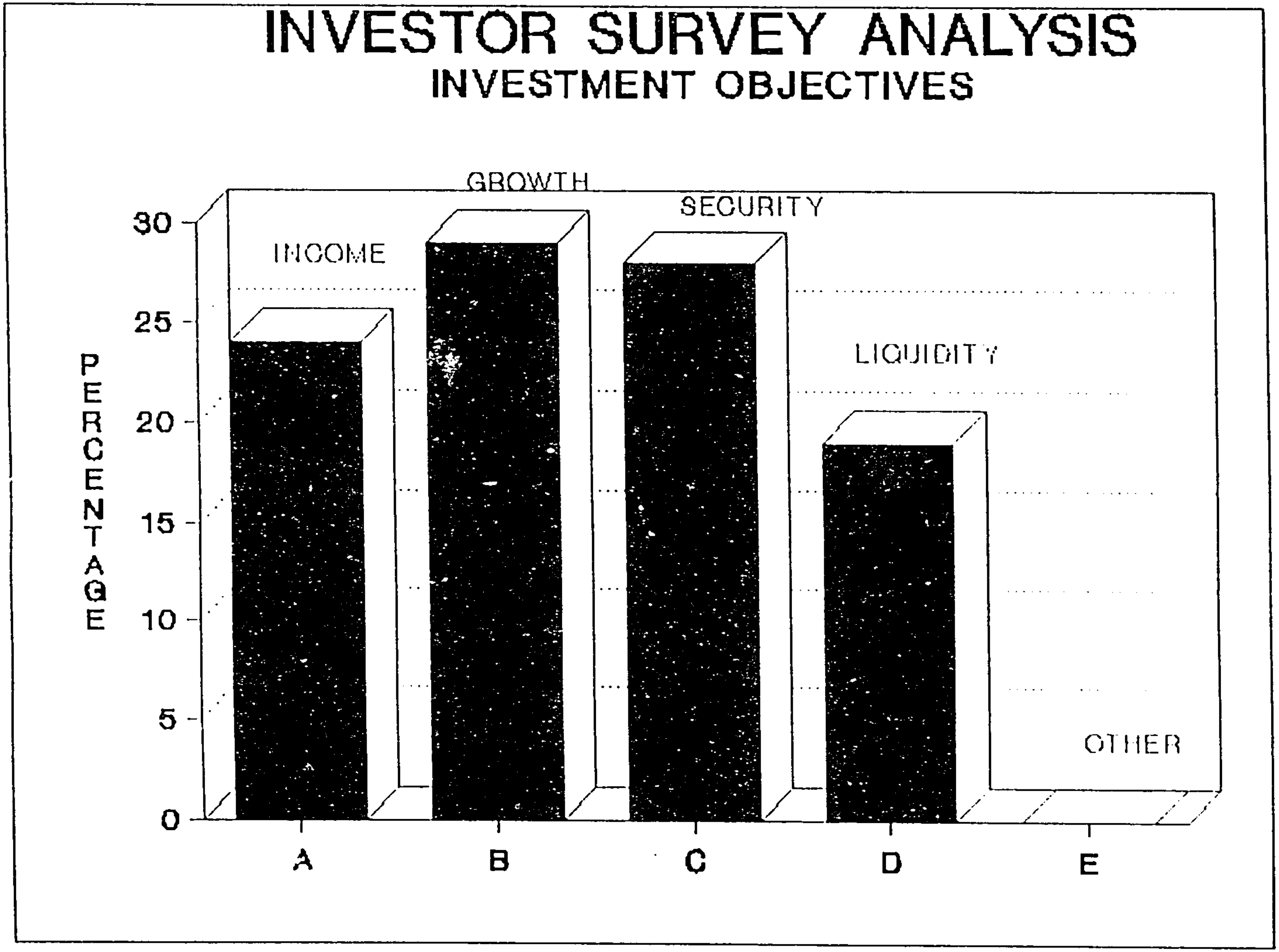
a) Steady Return (Income)

b) Faster Growth

c) Security

d) Liquidity

e) Any other (Please specify)

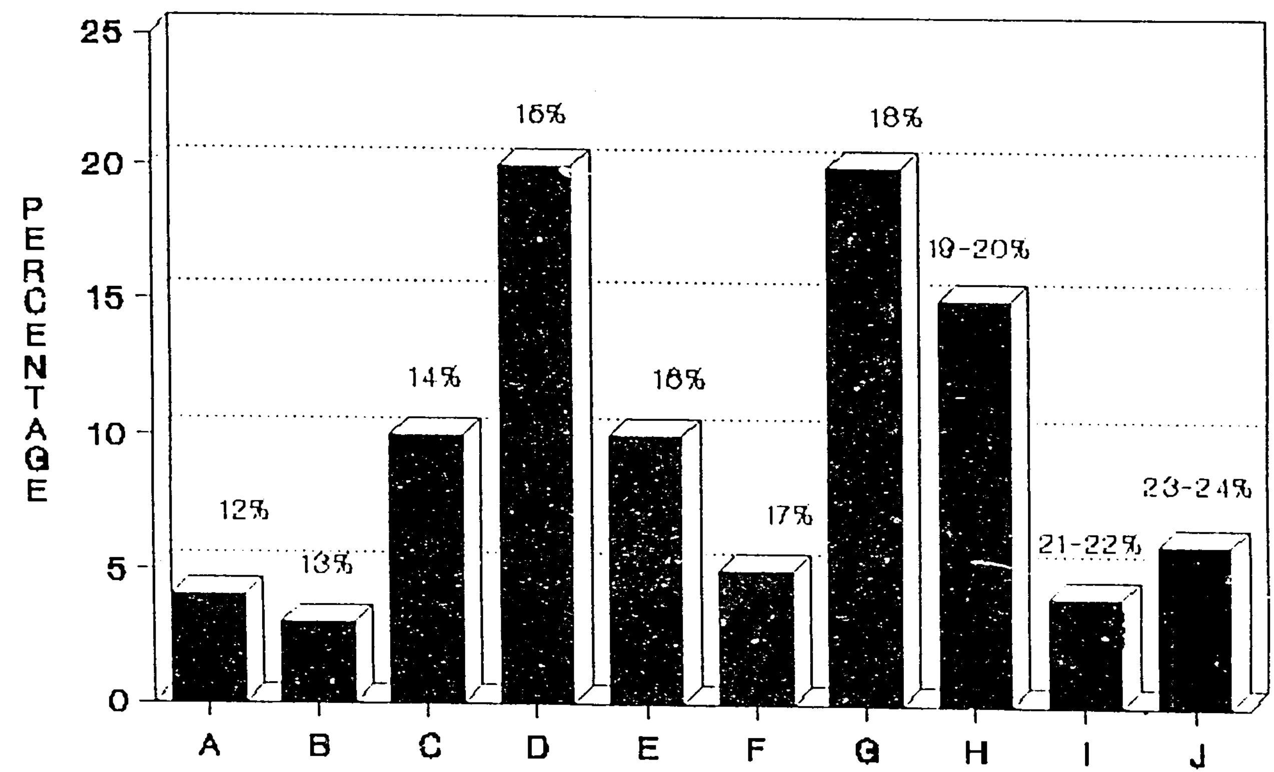

INVESTOR SURVEY ANALYSIS
INVESTMENT OBJECTIVES
PERCENTAGE
30
25
20
15
10
5
0
INCOME
GROWTH
SECURITY
LIQUIDITY
OTHER
A
B
C
D
E

What is the minimum rate of interest which you expect from fixed income instruments ?

a) 12% b) 13% c) 14% d) 15% e) 16%

f) 17% g) 18% h) 18-20% i) 20-22% j) 22-24%

INVESTOR SURVEY ANALYSIS
MINIMUM RATE OF RETURN EXPTD FROM FI's



What is the desired mode of return ?
(Please rank your choice in order of preference)

(a) Cumulative Return

(b) Periodical Return

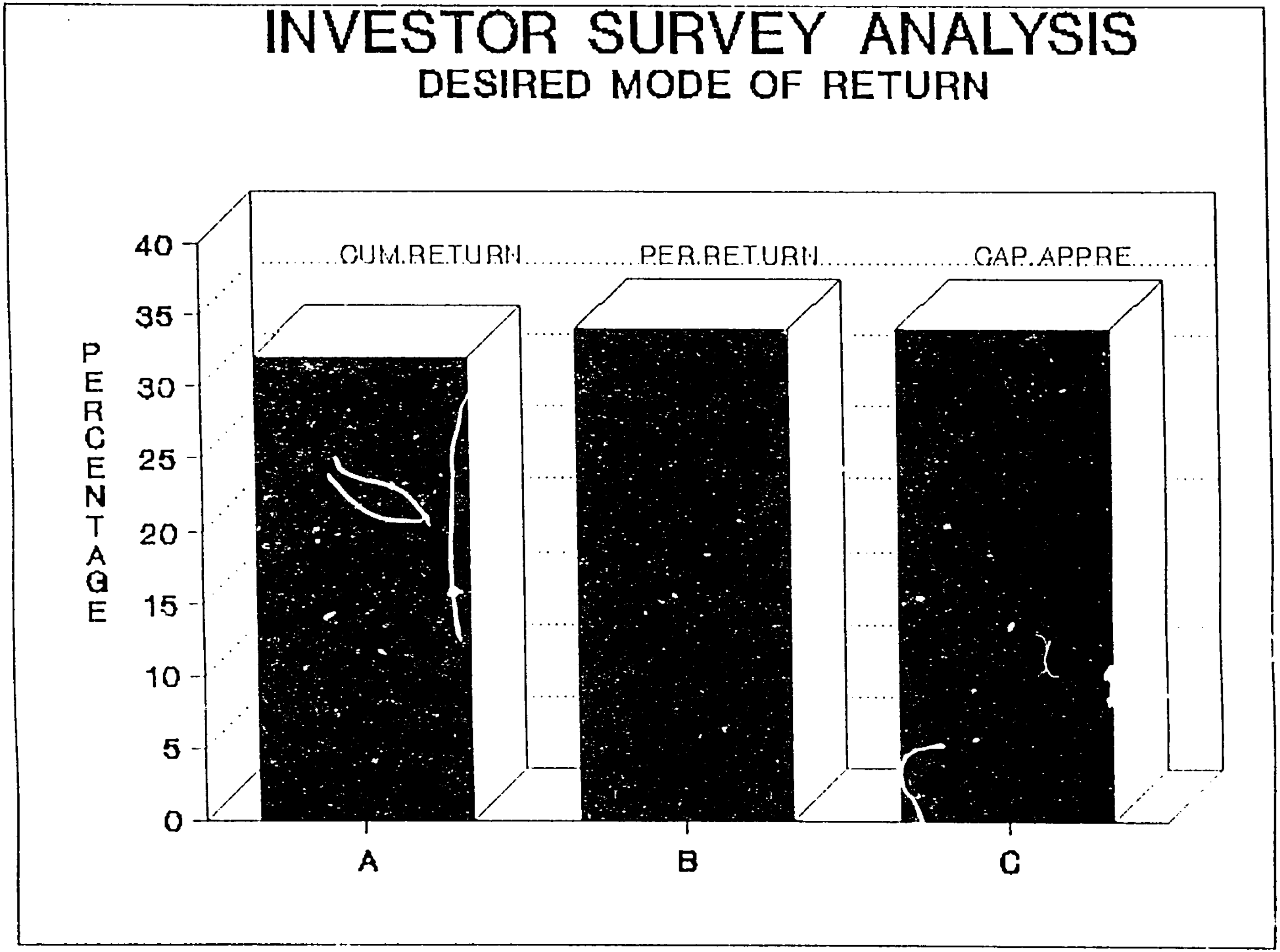
i) Monthly

ii) Quarterly

iii) Half Yearly

iv) Annually

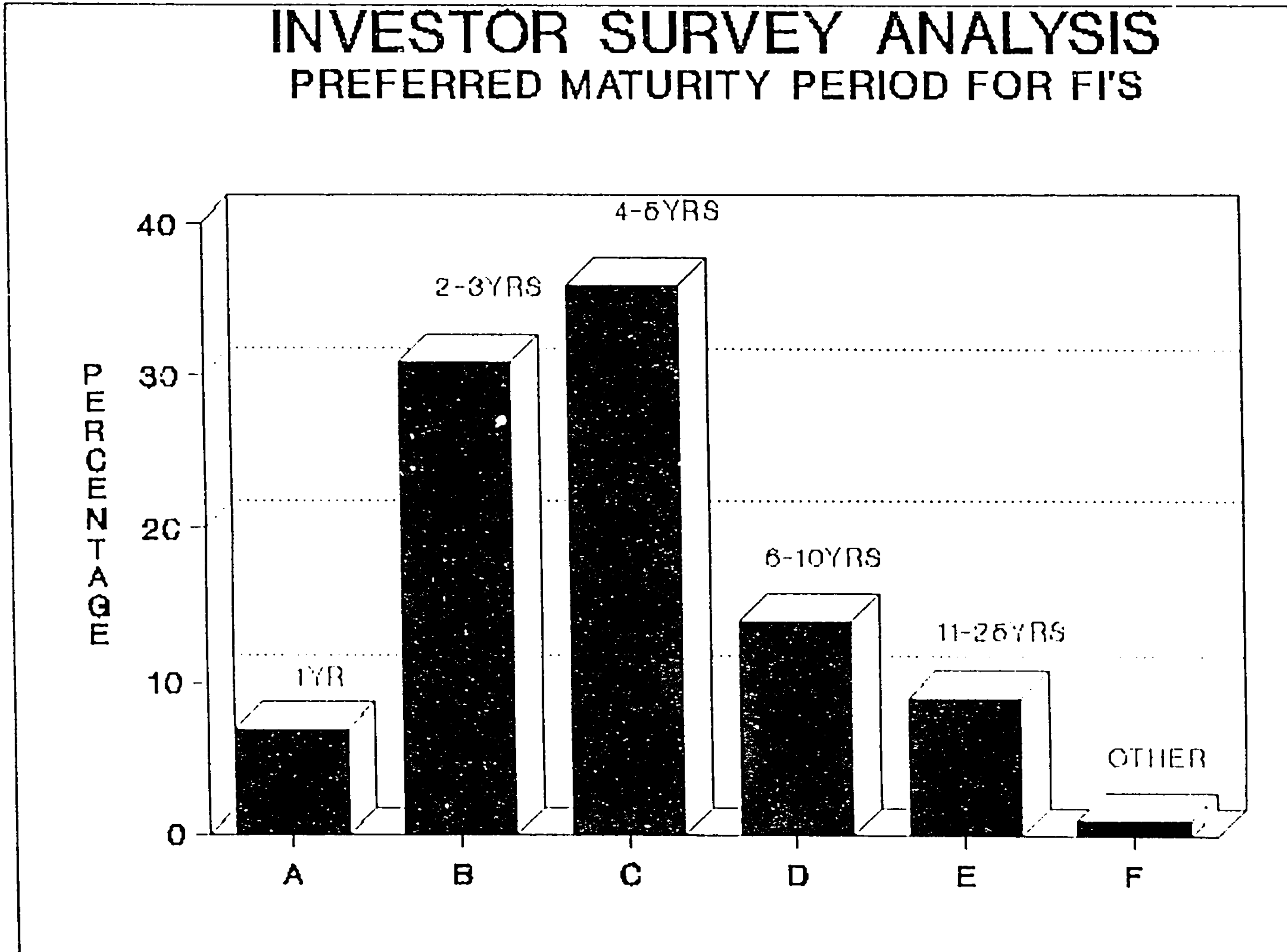
(c) Capital Appreciation


INVESTOR SURVEY ANALYSIS
DESIRED MODE OF RETURN
PERCENTAGE
0
5
10
15
20
25
30
35
40
CUM.RETURN
PER.RETURN
CAP.APPRE
A
B
C

What is the maturity period of the fixed income instrument that you would prefer to invest in ?

a) 1 year b) 1-3 years c) 3-5 years d) 5-10 years

e) 10-25 years f) Any other (Please specify)


INVESTOR SURVEY ANALYSIS
PREFERRED MATURITY PERIOD FOR FI'S
PERCENTAGE
40
30
20
10
0
1YR
2-3YRS
4-5YRS
6-10YRS
11-25YRS
OTHER
A
B
C
D
E
F

Where would you prefer to invest your surplus funds ?
(please rank your choice in order of preference)

(a) Equity

(b) Debentures

- i) Fully Convertible Debentures
- ii) Partly Convertible Debentures
- iii) Non-convertible Debentures

(c) Company Deposits

(d) Deep Discount Bonds/Debentures

(e) Floating Rate Bonds/Debentures

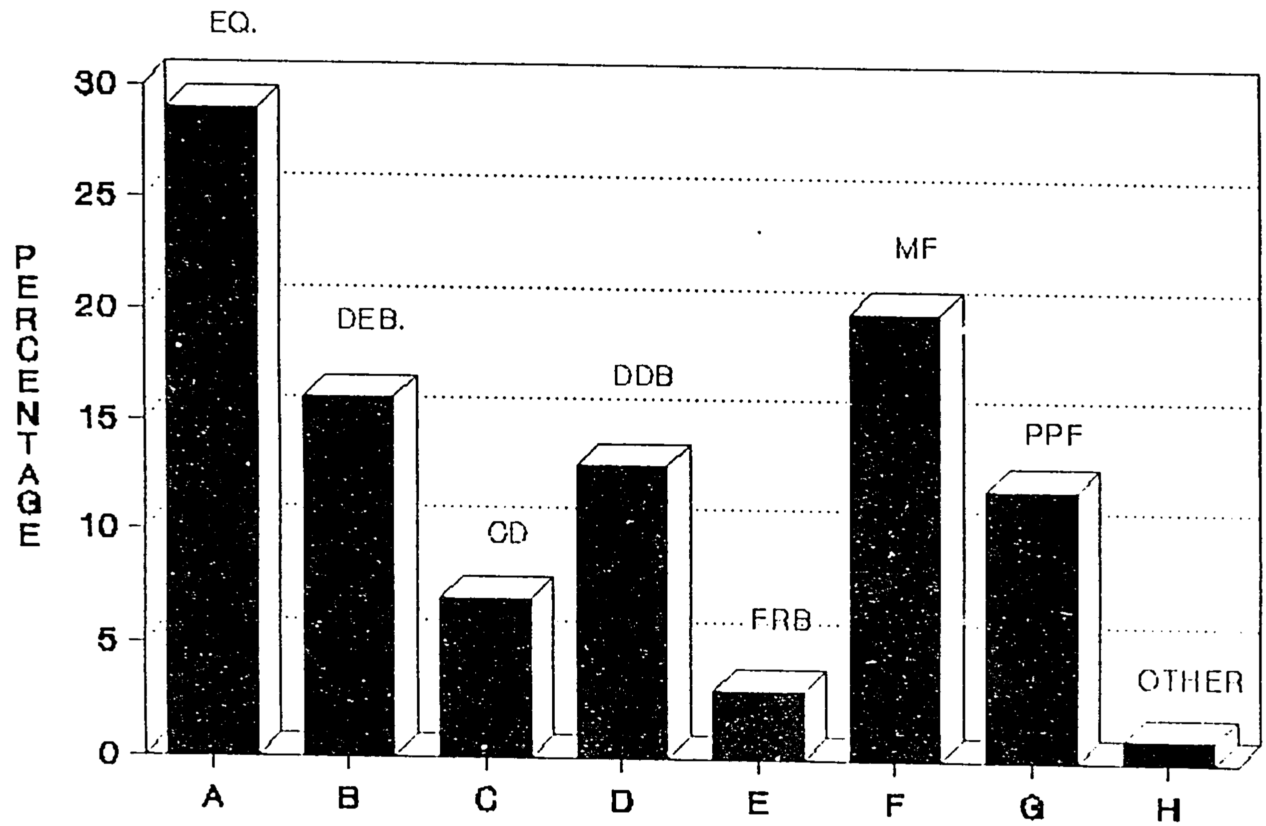
(f) Mutual Fund Schemes

(g) PPF, Bank Deposits (etc.)

(h) Others (Specify)

INVESTOR SURVEY ANALYSIS

INVESTMENT OF SURPLUS FUNDS



What percentage of your total investment do you expect to invest in the primary market (New Issues)?

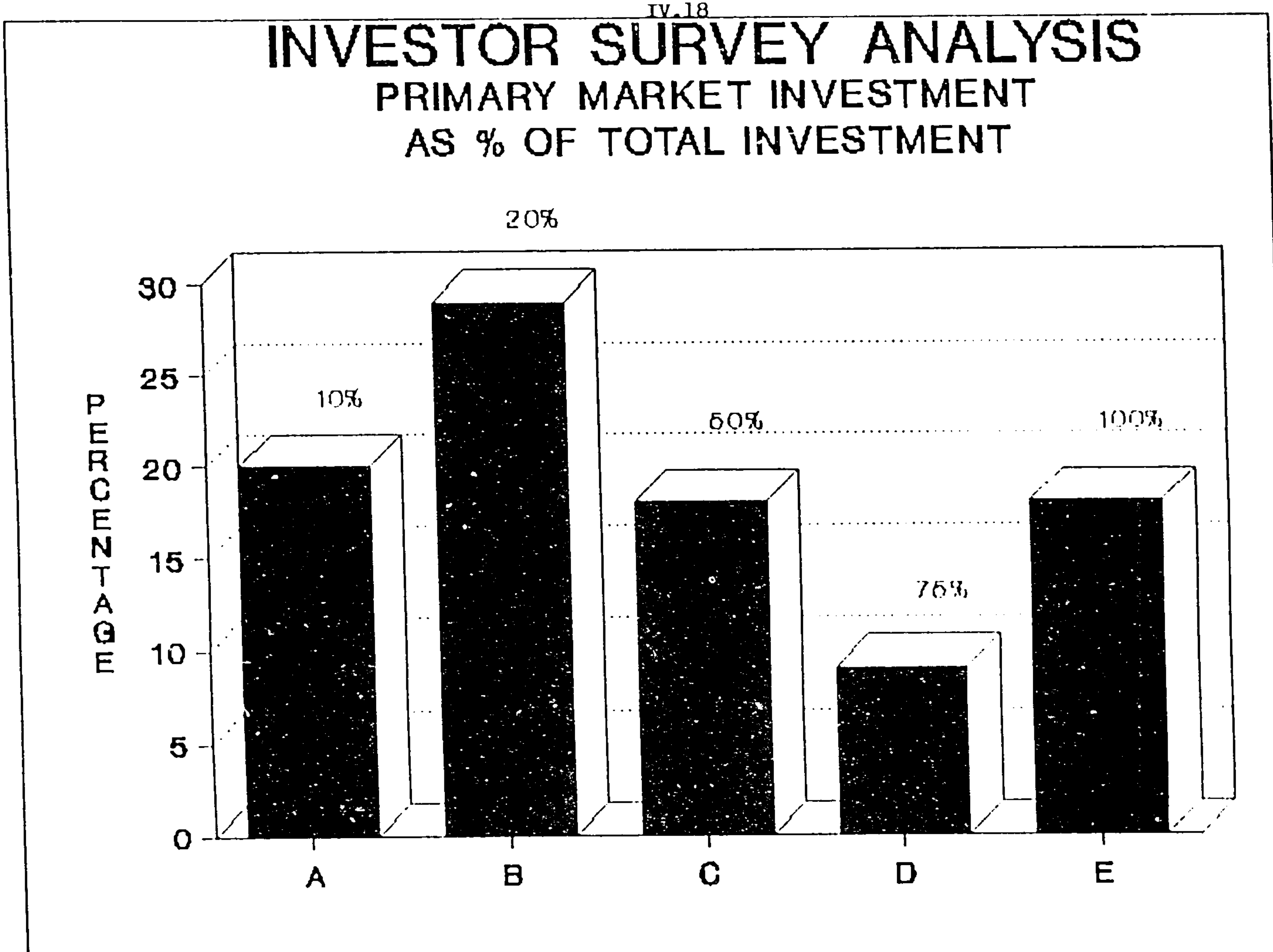
a) 10%

b) 20%

c) 50%

d) 75%

e) 100%


INVESTOR SURVEY ANALYSIS
PRIMARY MARKET INVESTMENT
AS % OF TOTAL INVESTMENT
PERCENTAGE
0
5
10
15
20
25
30
10%
20%
60%
75%
100%
A
B
C
D
E

Can you indicate probable amount you would invest in primary issues of bonds/ debentures ?

(a) Nil

(b) Upto 5,000

(c) 5,000-10,000

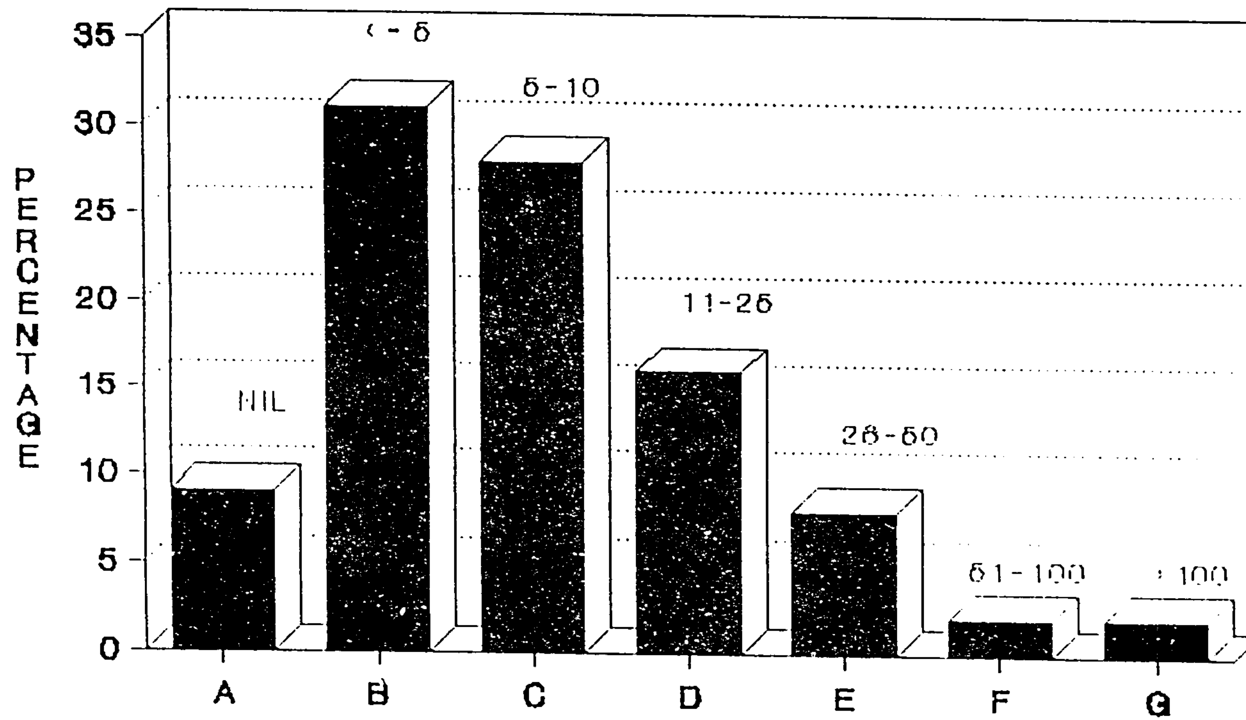
(d) 10,000-25,000

(e) 25,000-50,000

(f) 50,000-1,00,000

(g) Over 1,00,000

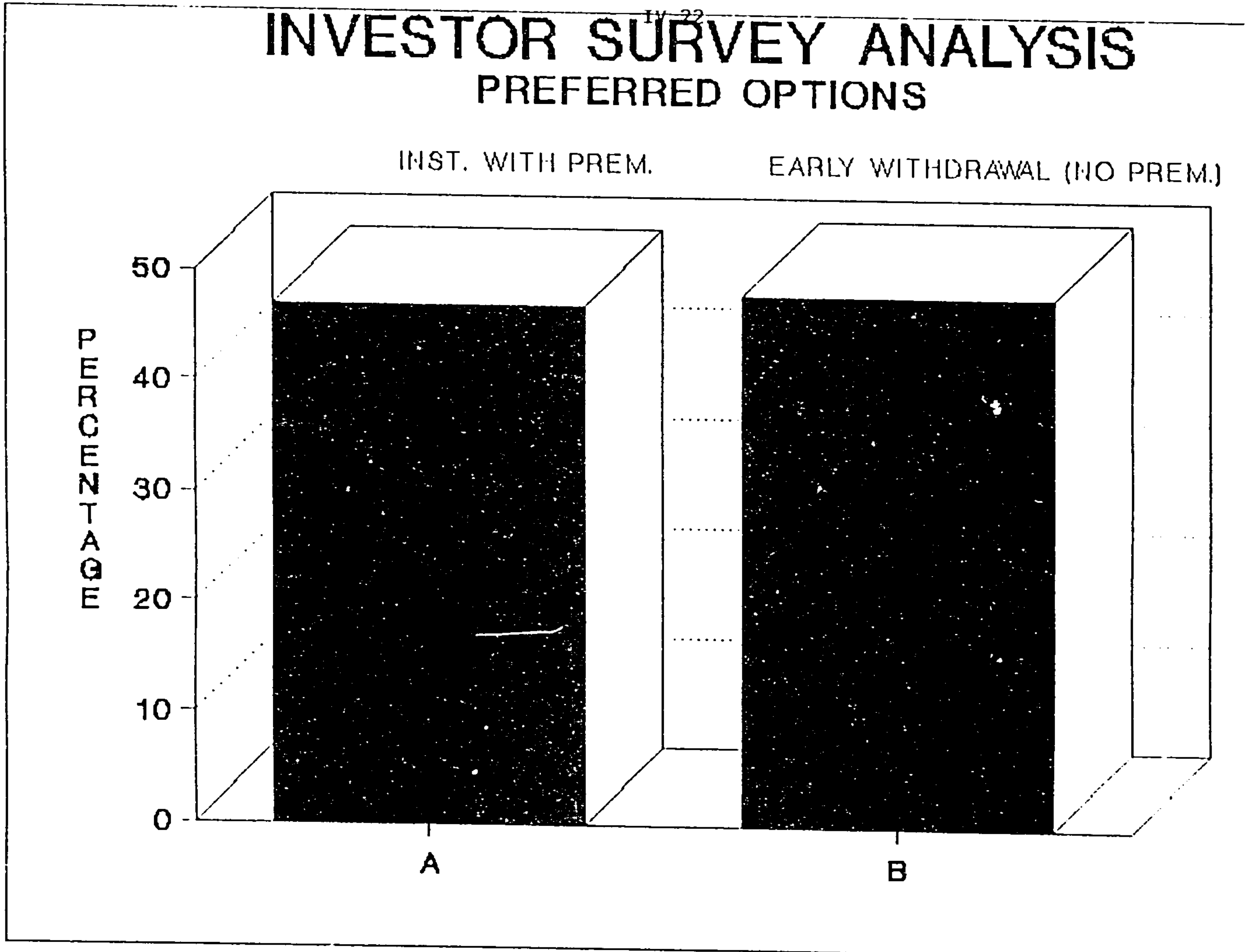
INVESTOR SURVEY ANALYSIS
PROBABLE INVESTMENT AMOUNT IN PRIMARY ISSUES



Which one of the two options would you prefer more ?

(a) The Issuer retaining the option to call in installments with premium

(b) The Investor being given an early withdrawal facility with no premium


INVESTOR SURVEY ANALYSIS
PREFERRED OPTIONS
INST. WITH PREM.
EARLY WITHDRAWAL (NO PREM.)
PERCENTAGE
50
40
30
20
10
0
A
B

If you are given an attractive redemption premium, would you stay with the scheme for the full duration ?

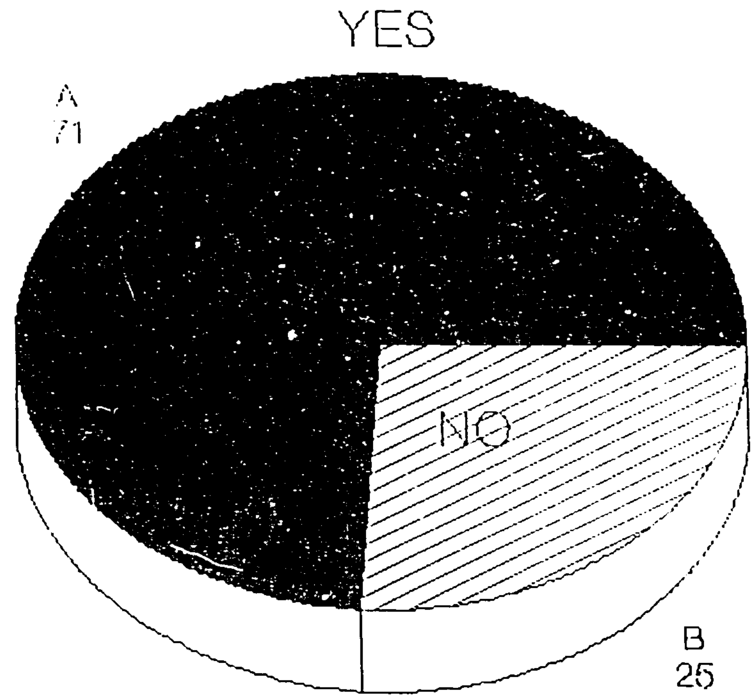
a) Yes

b) No

INVESTOR SURVEY ANALYSIS

STAY ON OPTION

(PERCENTAGE WISE)



What additional features of the following would be preferred ?
(Please rank your choice in order of preference)

a) Housing Loans at concessional rate of interest

b) Insurance & medical benefits

c) Tax Benefits

  i) Capital gain exemption

  ii) Income exemption

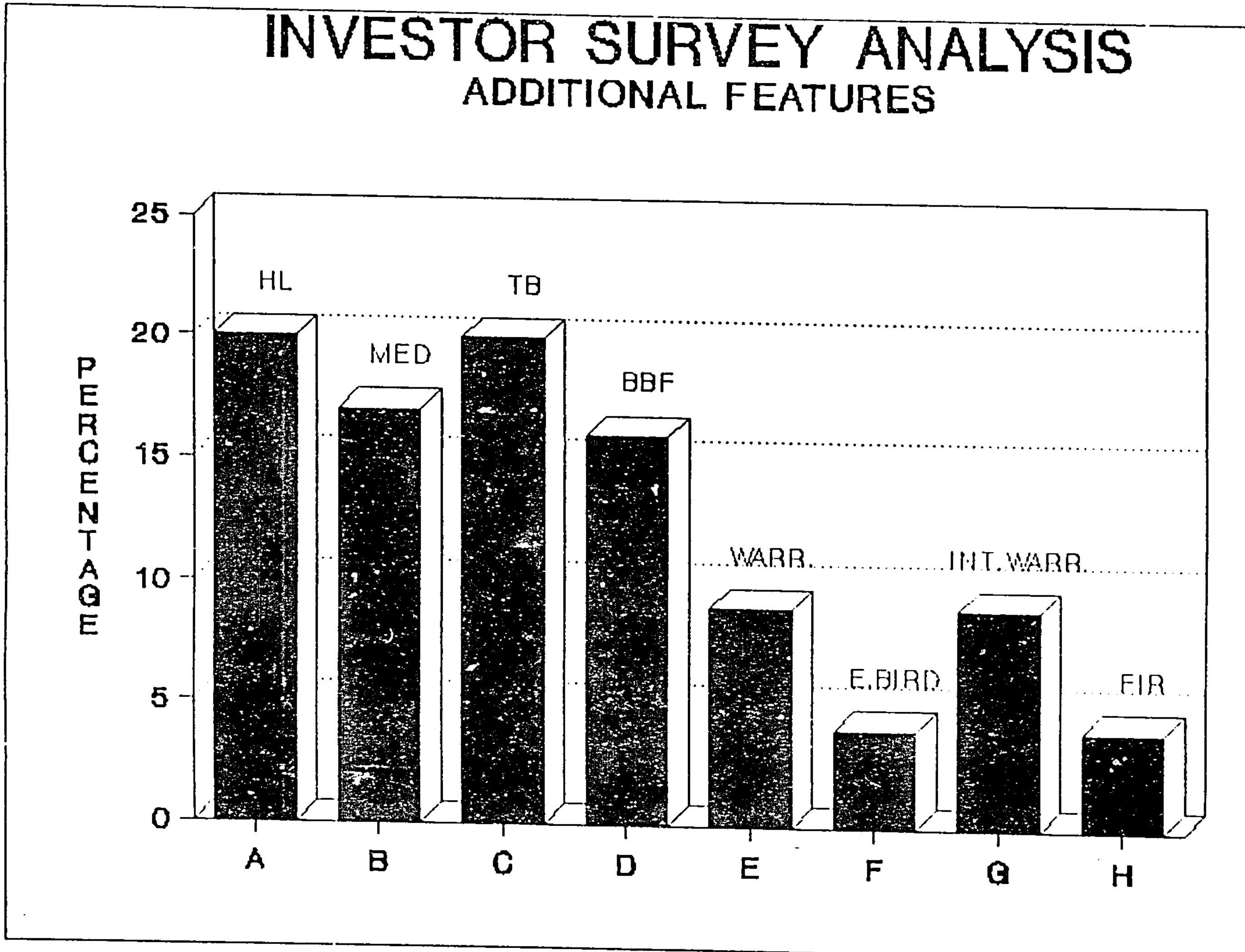
d) Buy-back facility

e) Attached Warrants

f) Early bird incentive commission

g) Interest warrants to be despatched for the entire year in advance

h) Floating interest rates


INVESTOR SURVEY ANALYSIS
ADDITIONAL FEATURES
PERCENTAGE
0
5
10
15
20
25
HL
MED
TB
BBF
WARR.
E.BIRD
INT.WARR.
FIR
A
B
C
D
E
F
G
H

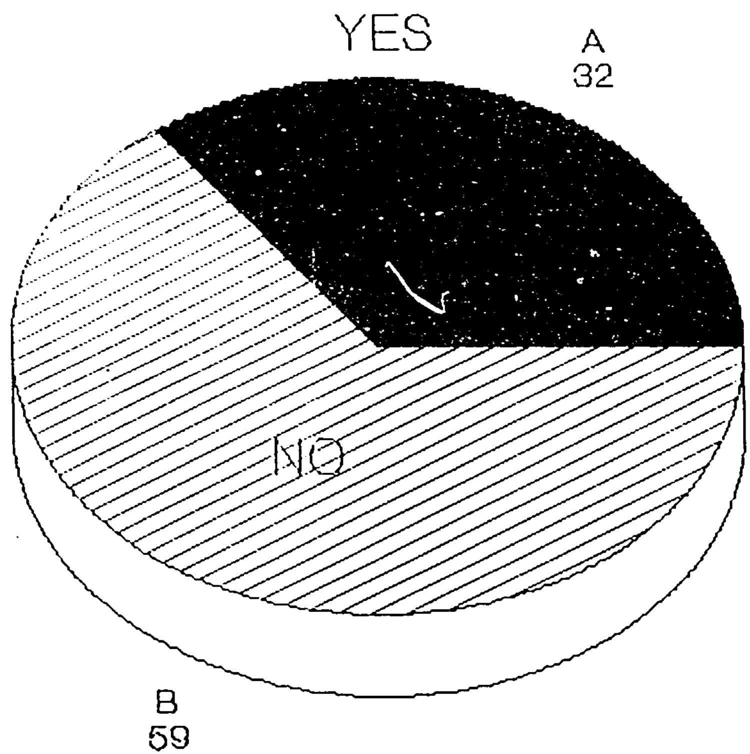
116

Did additional benefits given in unsecured bonds/Debentures influence your decision to invest in them in past ? If yes, what ?

a) Yes

b) No

INVESTOR SURVEY ANALYSIS
INFLUENCED BY ADDITIONAL BENEFITS
(PERCENTAGE WISE)

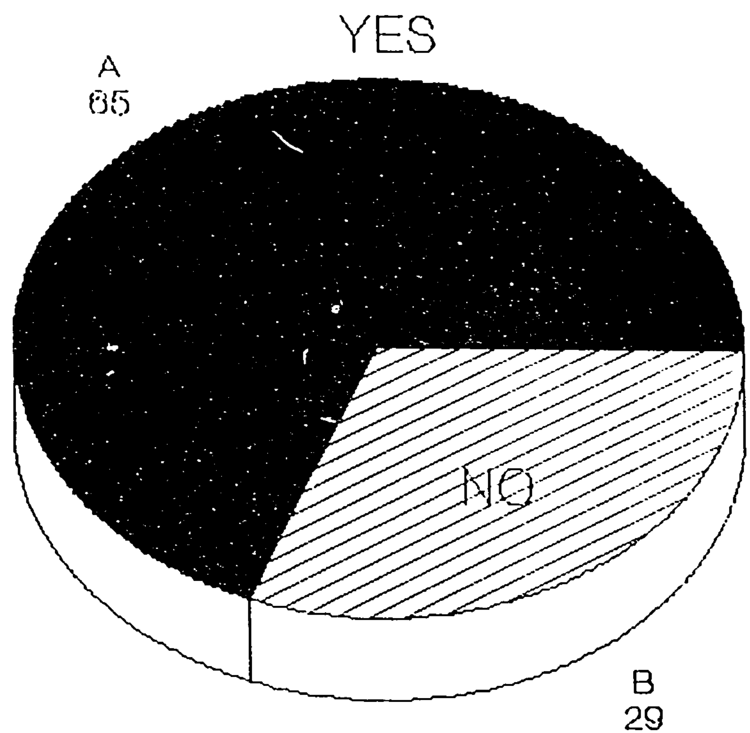


Do you attach any importance to credit rating in your investment decision making ?

a) Yes

b) No

INVESTOR SURVEY ANALYSIS
IMPORTANCE TO CREDIT RATING
(PERCENTAGE WISE)



What is the minimum rating below which you would not be inclined to invest?

a) AAA

b) AA

c) A

d) BBB

e) BB

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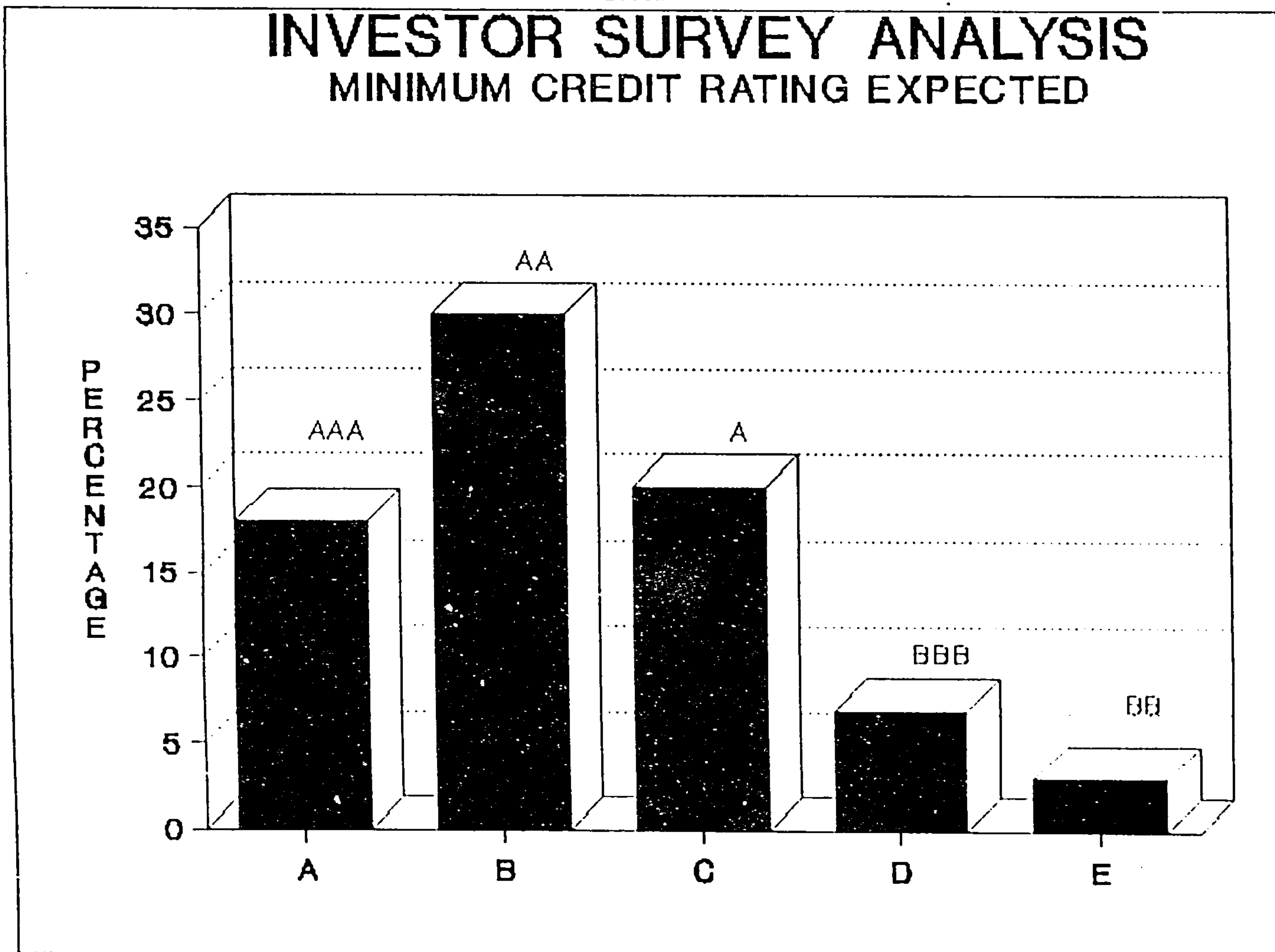

INVESTOR SURVEY ANALYSIS
MINIMUM CREDIT RATING EXPECTED
PERCENTAGE
35
30
25
20
15
10
5
0
AAA
AA
A
BBB
BB
A
B
C
D
E

122

Do you buy capital markets instruments on the advice of (Rank in order of importance)

a) Ads in Newspapers/Magazines

b) Writeups in Newspaper / Magazines

c) Friends & Relatives

d) Agents

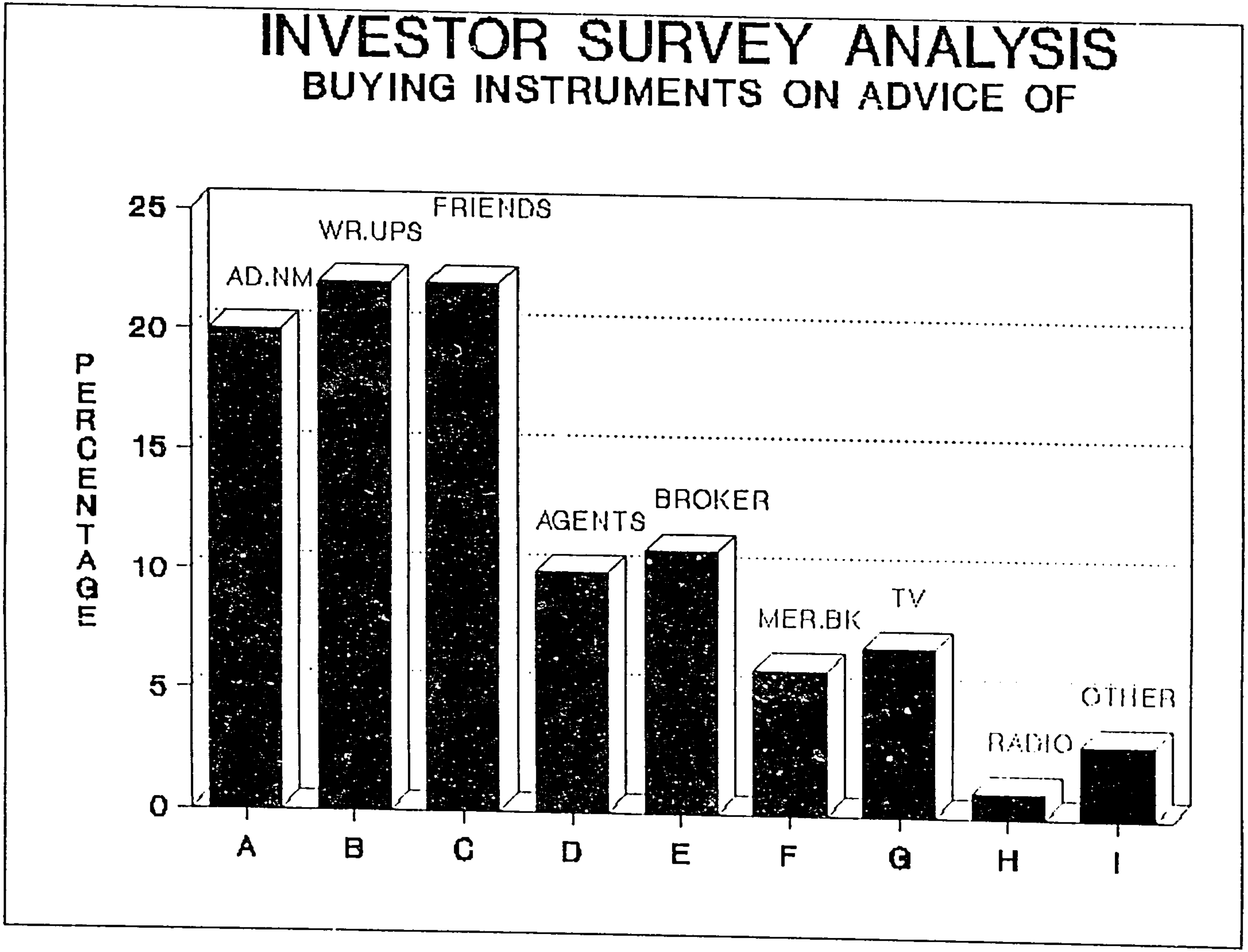
e) Brokers

f) Merchant Bankers

g) Ad on TV

h) Ad on Radio

i) Others (Specify)



INVESTOR SURVEY ANALYSIS
BUYING INSTRUMENTS ON ADVICE OF
PERCENTAGE
25
20
15
10
5
0
AD.NM
WR.UPS
FRIENDS
AGENTS
BROKER
MER.BK
TV
RADIO
OTHER
A
B
C
D
E
F
G
H
I

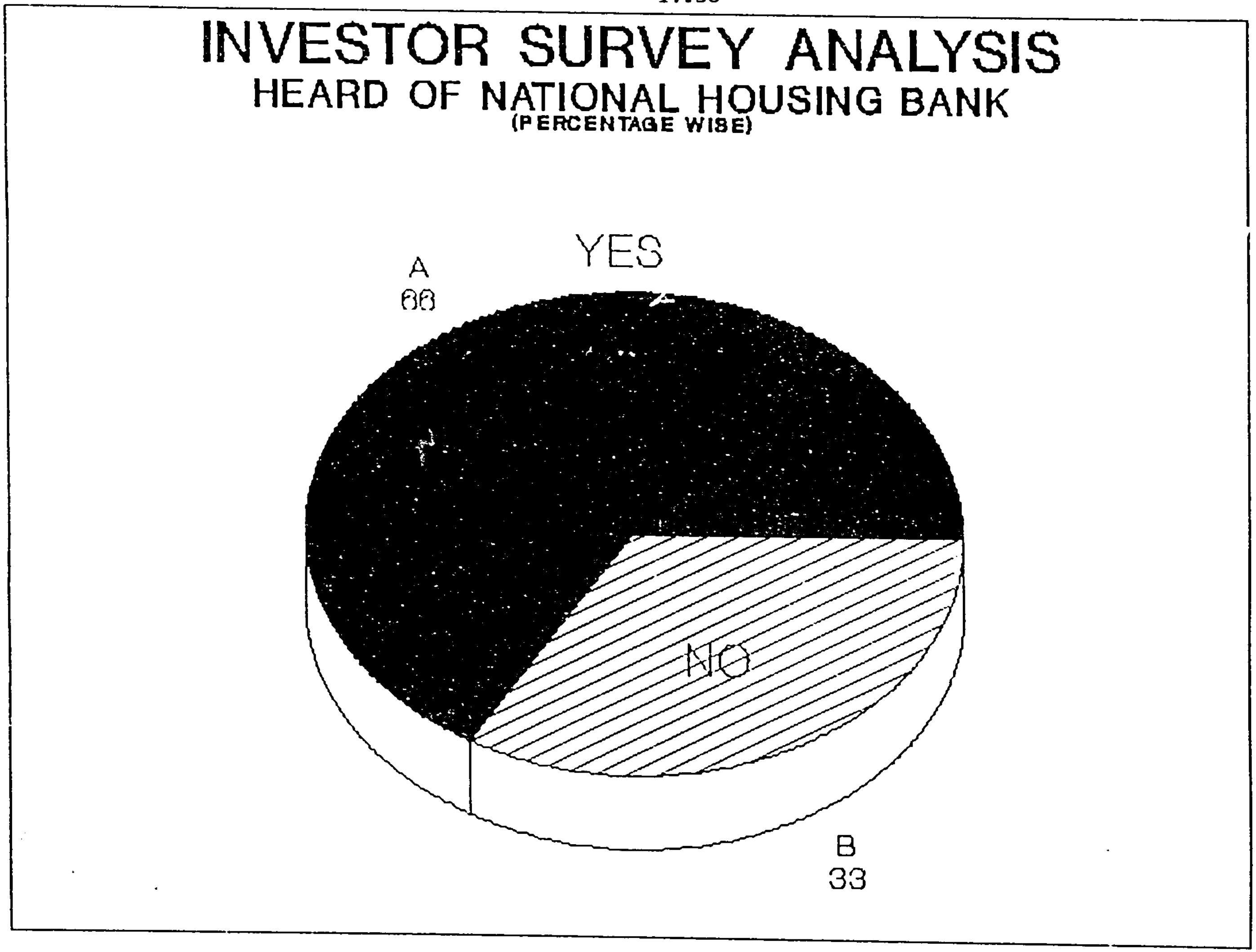
hel

THE INSTITUTE OF CAPITAL MARKETS

Have you heard of National Housing Bank ?

a) Yes

b) No


INVESTOR SURVEY ANALYSIS
HEARD OF NATIONAL HOUSING BANK
(PERCENTAGE WISE)
YES
A
66
NO
B
33

Do you consider National Housing Bank a good company to invest your savings in ?

a) Yes

b) No

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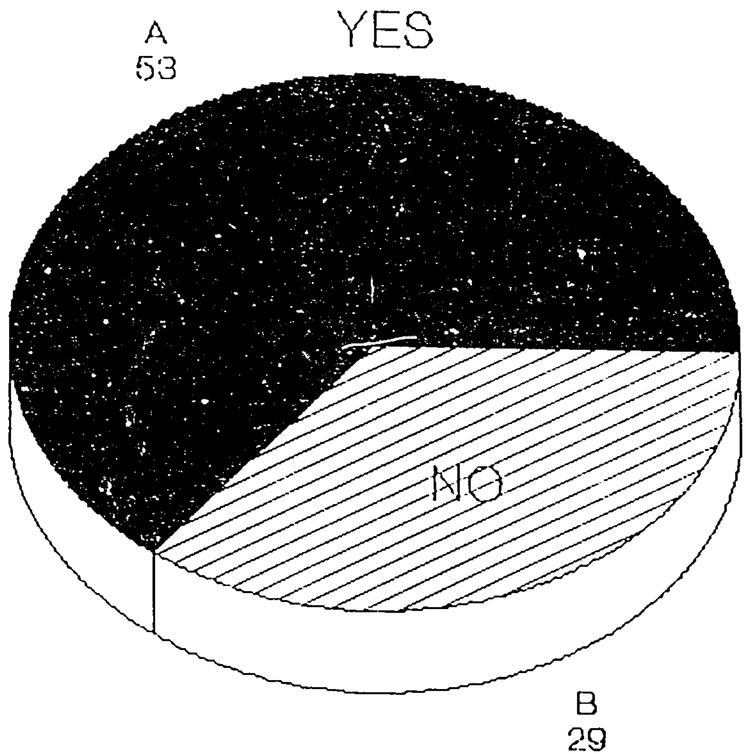
INVESTOR SURVEY ANALYSIS

NHB GOOD TO INVEST

(PERCENTAGE WISE)

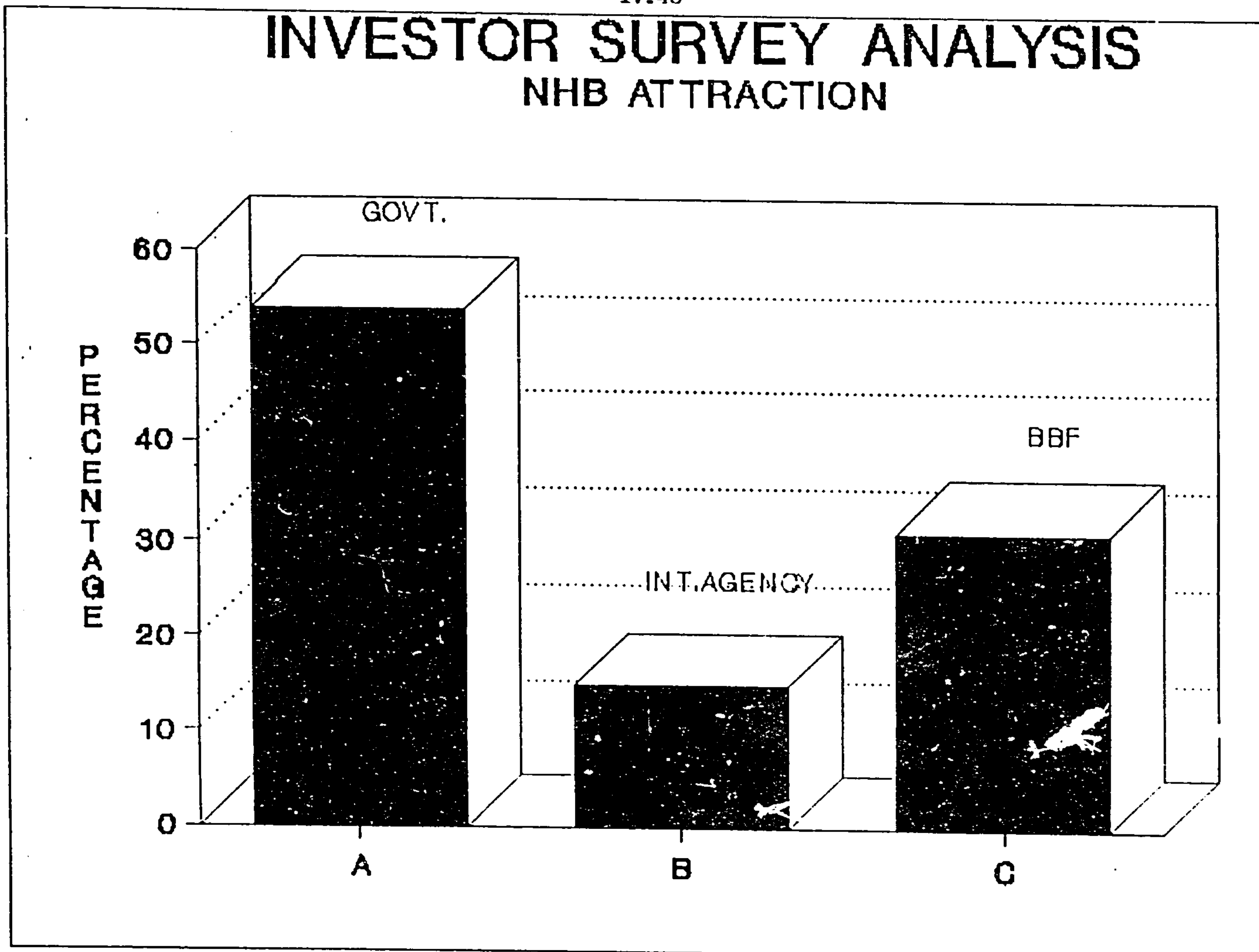


Which of the following would make investment in National Housing Bank more attractive to you ? (Rank in order of preference)

a) RBI / Govt. gives a guarantee for the instrument floated by NHB

b) If any international agency is funding it

c) If buy back facilities are guaranteed


INVESTOR SURVEY ANALYSIS
NHB ATTRACTION
GOVT.
INT.AGENCY
BBF
PERCENTAGE
60
50
40
30
20
10
0
A
B
C

130

How would you like future National Housing Bank instruments to be marketed?(Rank in order of preference)

a) Agents

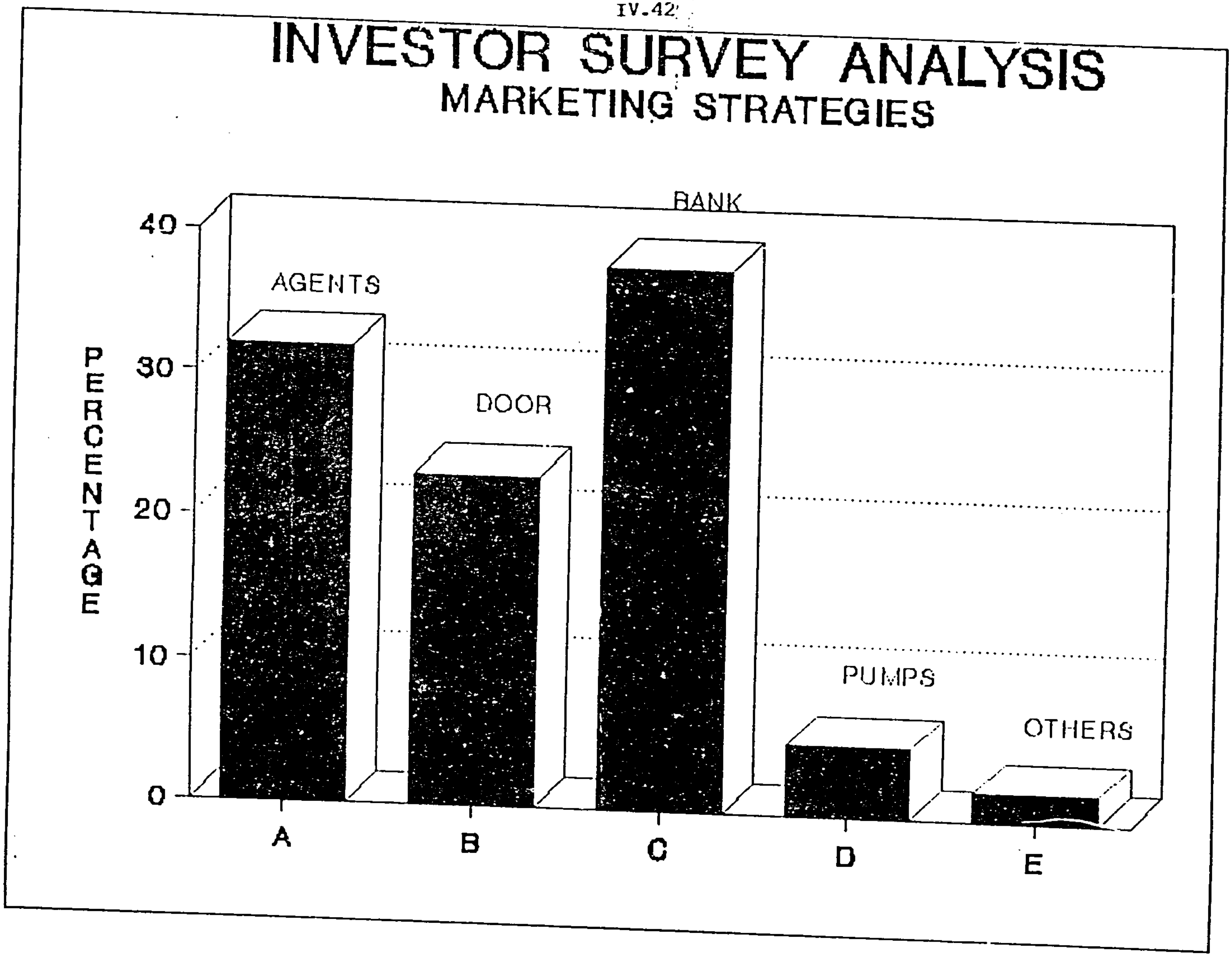
b) Door - to - Door

c) Bank Branches

d) Petrol Pumps

e) Any Other (Specify)

8


INVESTOR SURVEY ANALYSIS
MARKETING STRATEGIES
PERCENTAGE
40
30
20
10
0
AGENTS
DOOR
BANK
PUMPS
OTHERS
A
B
C
D
E

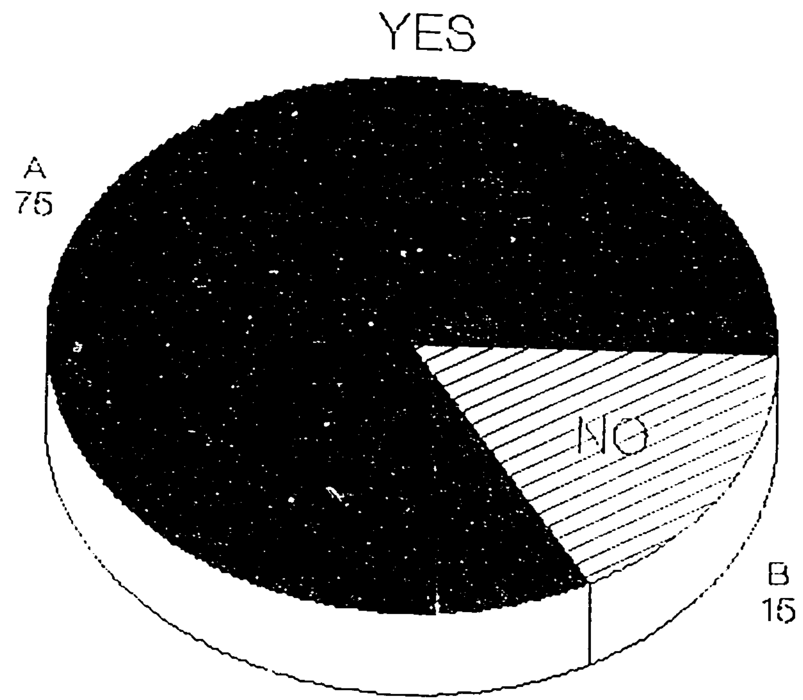
137

If the National Housing Bank instrument is considered as a collateral security against your Housing Loan by Housing Finance companies, would it influence your decision to invest in National Housing Bank ?

a) Yes

b) No

INVESTOR SURVEY ANALYSIS
COLLATERAL SEC. AGAINST HOUSING LOAN
(PERCENTAGE WISE)

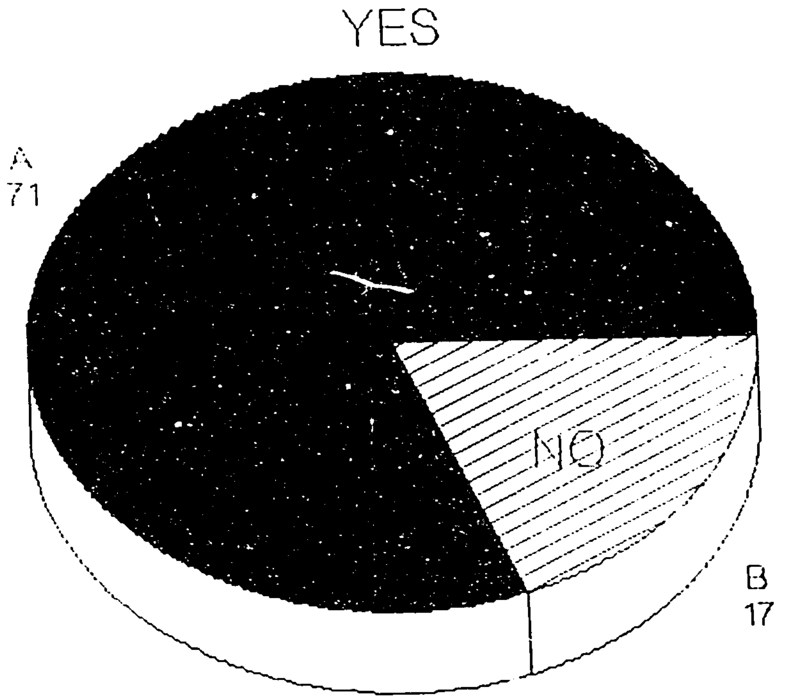


If a housing loan taken against NHB instrument as a collateral is accompanied by the housing insurance cover then would that be seen as a major influencing factor for subscription to the NHB instrument ?

a) Yes

b) No

INVESTOR SURVEY ANALYSIS
NHB INSTRUMENT WITH HOUSING INSURANCE
(PERCENTAGE WISE)



If National Housing Bank launches different instruments in the next year as indicated below, what would your preference be ? (Please rank your choice)

a. Equity Issue at Par

b. Equity Issue at Premium

c. Convertible Debentures/Bonds

d. Non-Convertible Debenture with Warrants

e. Unsecured Fixed Interest Bonds/Debentures

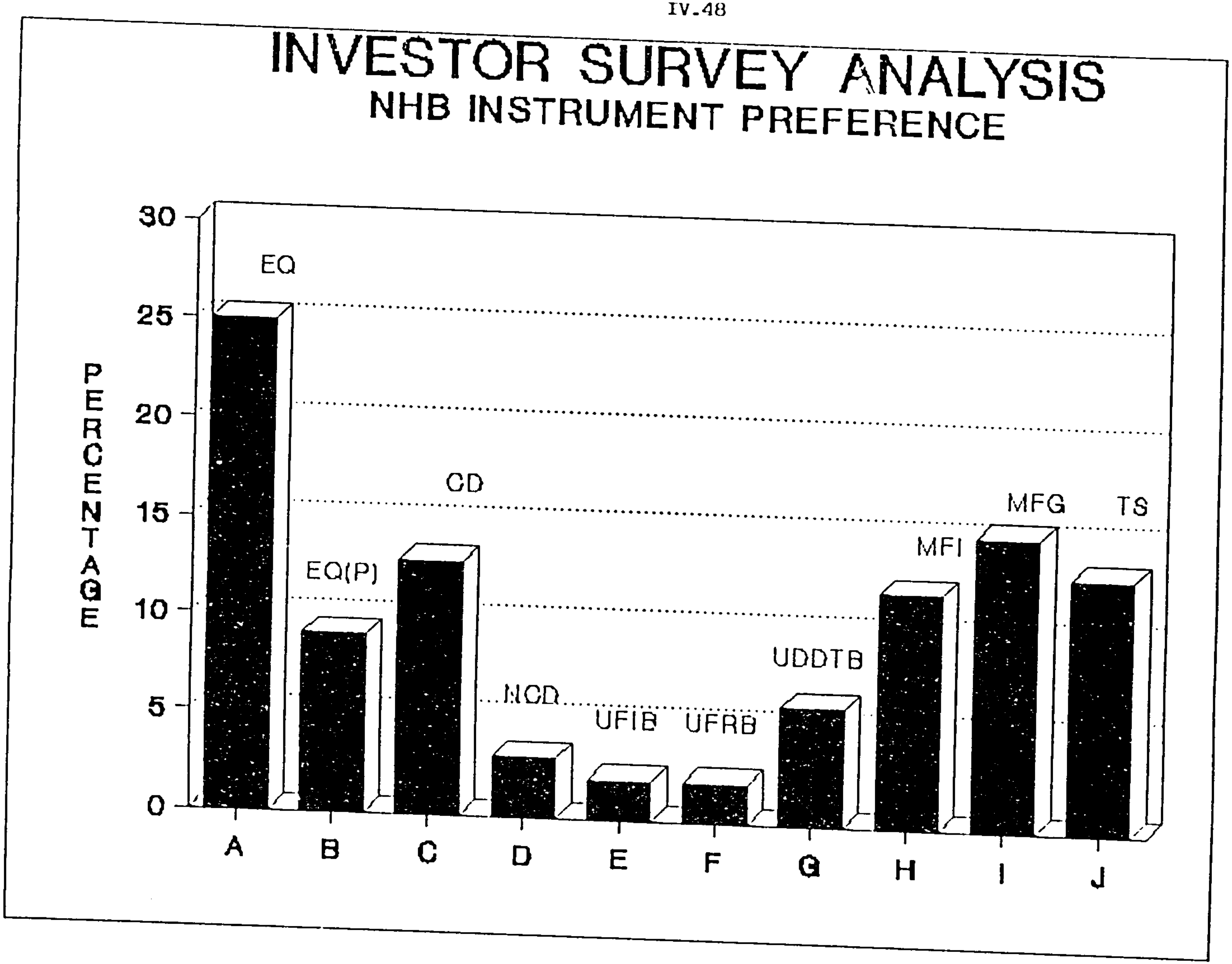
f. Unsecured Floating Rate Bonds/Debentures

g. Unsecured Deep Discount Taxable Bonds/Debentures

h. Income Oriented Mutual Fund Scheme

i. Growth Oriented Mutual Fund Scheme

j. Tax Saving Scheme of Mutual Fund


INVESTOR SURVEY ANALYSIS
NHB INSTRUMENT PREFERENCE
PERCENTAGE
0
5
10
15
20
25
30
EQ
EQ(P)
CD
NCD
UFIB
UFRB
UDDTB
MFI
MFG
TS
A
B
C
D
E
F
G
H
I
J

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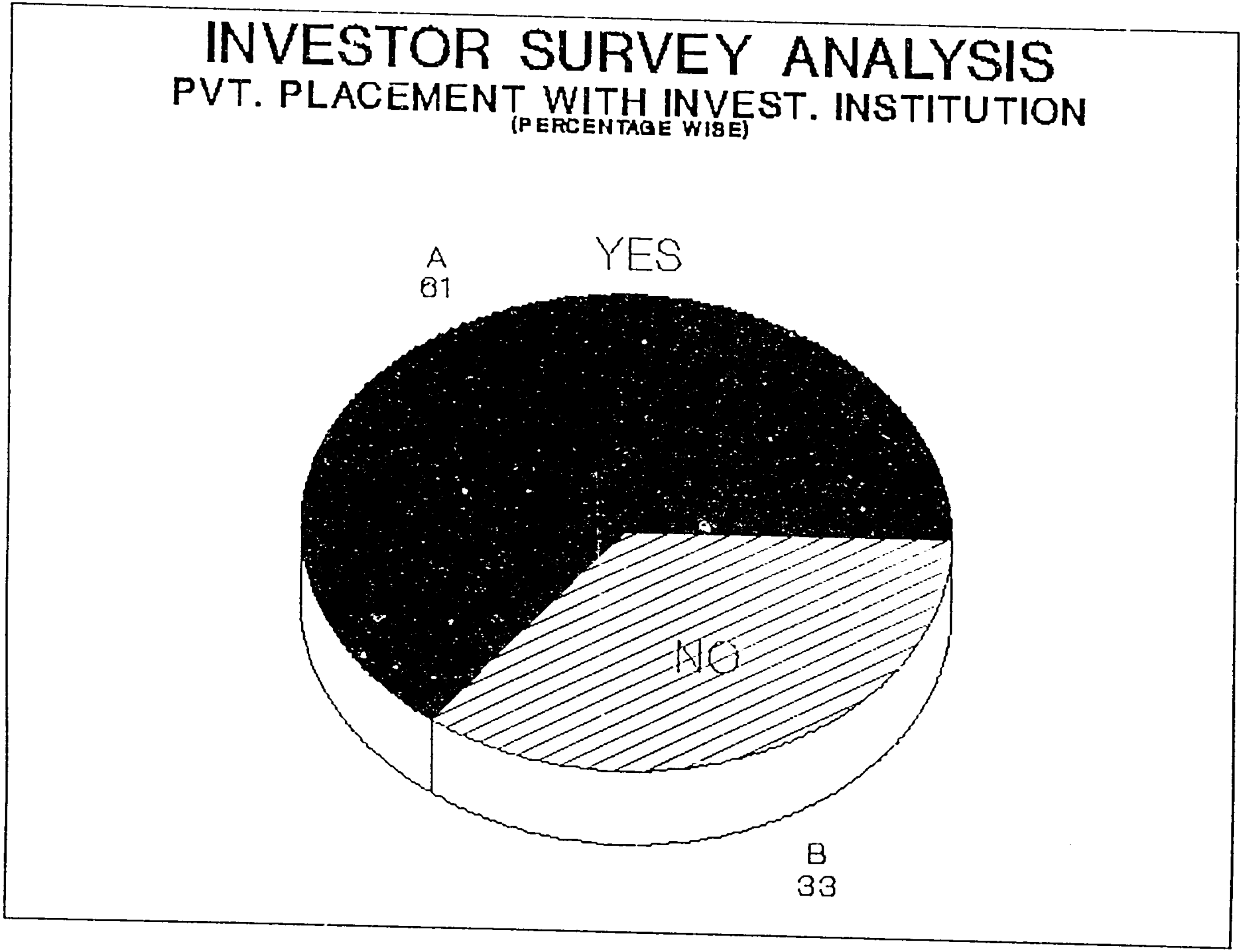
If a major portion of an issue is privately placed with investment institutions including foreign institutional investors, would you subscribe to the issue more confidently ?

a) Yes

b) No


INVESTOR SURVEY ANALYSIS
PVT. PLACEMENT WITH INVEST. INSTITUTION
(PERCENTAGE WISE)
YES
A
61
NO
B
33

How would you prefer the mode of registration of instrument ?

a) By endorsement and delivery.

b) By registration of certificates with organisation.

c) By lodging securities with a custodian and transfer through book entries.

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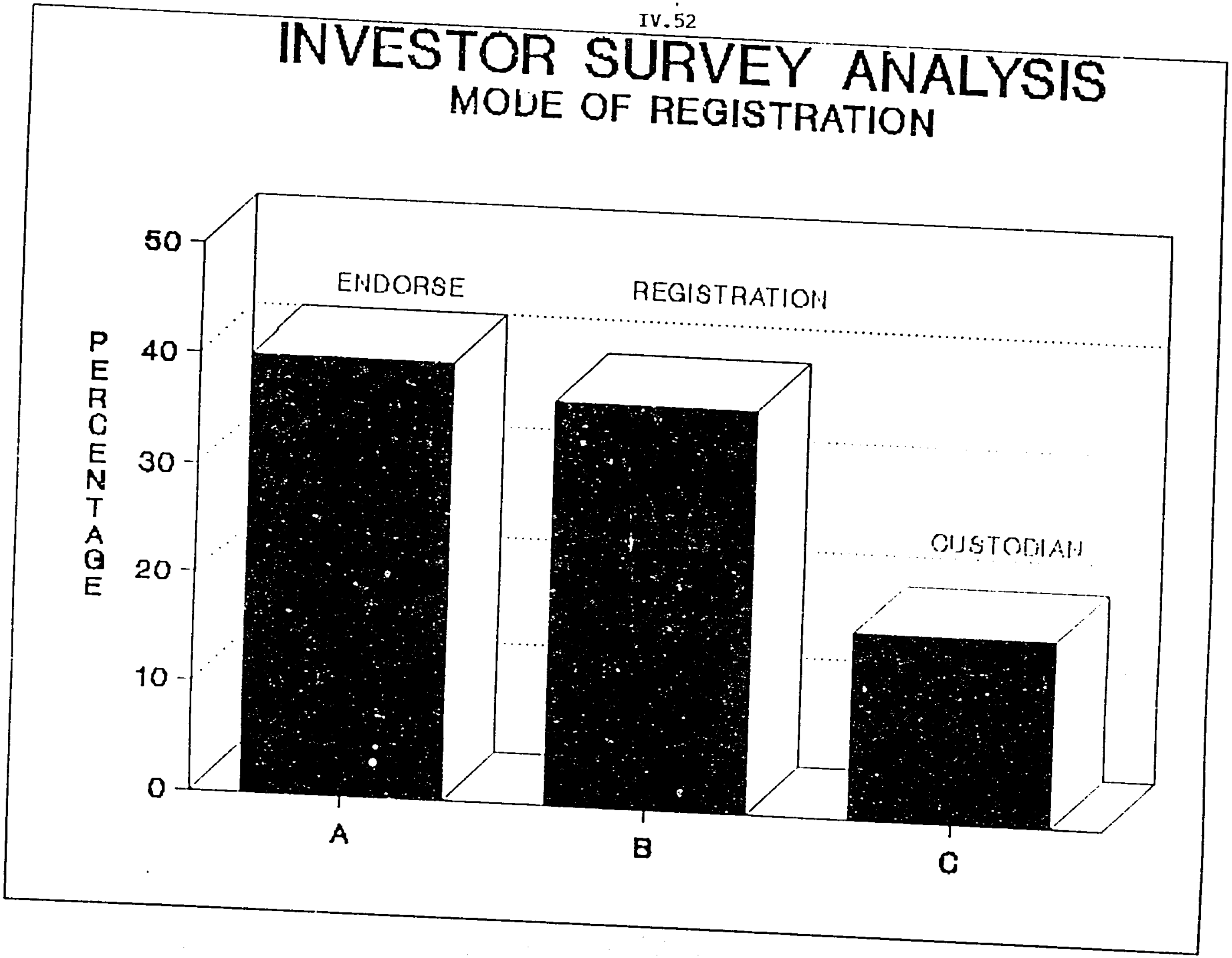
INVESTOR SURVEY ANALYSIS
MODE OF REGISTRATION
PERCENTAGE
50
40
30
20
10
0
ENDORSE
REGISTRATION
CUSTODIAN
A
B
C

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Would you prefer scripless trading ?

a) Yes

b) No

INVESTOR SURVEY ANALYSIS

SCRIPLESS TRADING

(PERCENTAGE WISE)