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INDO-US HOUSING FINANCE EXPANSION PROGRAM
(ABT. ASSOCIATES INC.)

REPORT ON GUIDELINES FOR EQUITY SUPPORT TO HOUSING FINANCE COMPANIES

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A. F. FERGUSON & CO.
NEW DELHI

A. F. FERGUSON & CO.
HANSALAYA
BARAKHAMBA ROAD
NEW DELHI - 110001

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REPORT ON

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TEL: 331 - 3543, 5256, 5266 GRAMS: AFFCON, NEW DELHI TELEX: (031) 62972 FAX: 91-11-3325437
OFFICES AT : BANGALORE, BOMBAY, CALCUTTA, MADRAS, NEW DELHI, VADODARA

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1.00 INTRODUCTION

1.01 A.F. Ferguson & Co. (AFF) have been retained by Abt Associates Inc. under the Indo-US Joint Housing Expansion programme to frame guidelines for equity support to Housing Finance Companies (HFC) by National Housing Bank (NHB).

1.02 AFF has now completed the study. This report contains the analysis of NHBs current equity investment, HFC industry analysis, venture capital analysis and draft guidelines for NHB's equity support to HFCs in line with the terms of reference for the study.

TERMS OF REFERENCE

1.03 The terms of reference for the study were :

(1) Research the history, rationale and impact of NHB equity support for housing finance companies to date.

(2) Meet with senior NHB management to understand the bank's current promotional and investment objectives and how NHB wishes to link those objectives to its program of equity support.

(3) Briefly survey the housing finance industry to provide a synopsis of current practices, difficulties, and other issues in generating start-up capital (scale, sources, costs, plans for augmenting capital over the first five years of operations).

(4) Meet with executives of recently established and in the process of being established housing finance companies and community based institutions and NGOs interested in establishing an HFC to discuss their experience with or plans for raising the equity

(5) Research and evaluate the effectiveness of guidelines and procedures used by existing public purpose venture capital funds in India, such as IDBI's and ICICI's venture capital funds.

(6) Prepare a report presenting the findings of this research and recommend options for NHB guidelines on extending equity support to new housing finance ventures in future. The report should include :

(a) Options on the size and structure of equity contributions

(b) Need for periodic evaluation and revision of the guidelines over time

(c) An indicative measure of the market/need for NHB equity support

APPROACH

1.04 The broad approach followed by AFF for the assignment comprised :

(1) Understanding the promotional and investment objectives of NHB

(2) Carrying out a review of the existing operations of NHB in the area of equity support to HFCs

(3) Carrying out a secondary and a primary survey of the HFCs and NGOs engaged in housing finance with a view to study :

(a) Existing sources of finance
(b) Problems faced in raising funds
(c) Need for NHB's equity support

(4) Evaluating the effectiveness of the existing equity support by other public sector financial institutions e.g. ICICI venture capital funds

(5) Framing guidelines for NHB's equity support scheme based on (1) to (4) above.

METHODOLOGY

1.05 Based on the approach as outlined above, the methodology that AFF followed for the conduct of the study is discussed in the subsequent paragraphs.

Understanding of NHB's objectives

1.06 AFF obtained an in-depth understanding of NHB's objectives in terms of its promotional and investment activities. For this purpose AFF held discussions with senior management staff to assess the qualitative factors (with the help of structured questionnaires).

1.07 The above provided the broad framework for developing the guidelines for equity support.

Research of existing equity support

1.08 The existing equity support by NHB was evaluated in terms of the following parameters :

(1) Reasons/objectives for giving the support

(2) Evaluation criteria adopted for providing equity support to HFCs

(3) Size of equity support

(4) Ability of the HFCs to raise additional resources based on NHB's support

(5) Factors used for post subscription monitoring of HFCs by NHB

HFC industry analysis

1.09 AFF undertook a primary survey covering the major HFC players. The main focus of the survey was :

(1) To evaluate the financial performance of HFC

(2) To ascertain their capital structure

(3) To ascertain their present sources of funds

(4) To identify the difficulties faced by HFCs

(5) To estimate the demand-supply gap in funds required

(6) To assess the future scenario for funding of HFCs

1.10 AFF carried out an analysis of the findings of the above survey to get an understanding of the HFC industry.

Analysis of venture capital guidelines

1.11 AFF evaluated the major venture capital fund schemes operating in India (restricted to 2 funds) through a secondary and primary survey. The evaluation was done in respect of the following factors :

(1) Factors considered for providing funds to a project

(2) Basis of allocation of funds (both inter and intra industry)

(3) Ability of the promoters seeking funds to raise additional resources based on the support provided by venture capital funds

(4) Success in meeting the end objectives of the funded project

(5) Repayment experience

(6) Methods of post subscription monitoring - MIS reports. financial returns, etc.

INPUTS FROM DR. HANDORF

1.12 Dr. William Handorf a consultant to Abt Associates, was associated with AFF to provide the following inputs for this study.

(1) Analyse conceptual and empirical literature applicable to apex housing units providing equity support.

(2) Develop equity options available for NHB and analyse the strengths, weaknesses, opportunities and threats of such a program.

GUIDELINES

1.13 Based on the issues mentioned above in paras 1.06 to 1.12, AFF framed guidelines for NHB equity support to HFCs, taking into account the following:

(1) Objectives of NHB

(2) Needs of the HFC industry

(3) Experience of the venture capital funds

(4) SEBI guidelines

(5) Other legal aspects such as requirements of the Companies Act, NBFC guidelines, Banking regulation Act.

1.14 Specifically, the guidelines address the following :

(1) Information required from HFCs

(2) Evaluation criteria

(3) Other terms and conditions such as representation of NHB on HFC's Board of Directors, accounting practices to be followed by HFC, etc.

(4) Post subscription monitoring

(5) Period of NHBs support

(6) Quantum of NHBs investment

(7) Pricing decision

(8) Exit routes for NHB

2.00 OBJECTIVES OF NHB

2.01 The broad activities carried out by NHB. the types of schemes through which it promotes the housing finance industry and the main objectives of NHB for providing equity support to HFCs are discussed briefly in subsequent paragraphs.

BUSINESS OF NHB

2.02 NHB draws its powers from the NHB Act. 1987. The main business of NHB as per the NHB Act, 1987 are :

(1) To promote, establish and support the promotion and establishment of housing finance institutions

(2) To provide financial assistance through loans. advances and equity to the Housing finance institutions

(3) To guarantee the financial obligations of the housing finance institutions and underwrite the issue of stocks. shares. bonds. debentures and securities by housing finance institutions

(4) To formulate schemes for the purpose of resource mobilisation and extension of credit for housing finance purposes

(5) To provide technical and administrative assistance to the housing finance institutions

(6) To provide broad guidelines to the housing finance institutions to facilitate their growth .

SCHEMES OF NHB

2.03 NHB has evolved various schemes as part of its business to promote, regulate and supervise the housing finance industry. These are as follows :

(1) Home Loan Account Scheme

(2) Refinance Scheme

(3) Direct lending through

- (a) Land Development and Shelter projects
- (b) Housing infrastructure projects
- (c) Slum development projects

(4) Schemes for NRI Investments

(5) Equity participation

OBJECTIVES FOR EQUITY PARTICIPATION

2.04 NHB participates in the equity of HFCs as a part of its business to promote the housing finance industry.

2.05 NHB has till now invested about Rs 8 crores in its equity support programme. It has invested mainly in the equity of public sector HFCs (Out of the total of 7 HFCs, 5 are in the public sector) which account for 80% of NHB's total investment.

2.06 NHB now wants to expand its equity participation programme to include private sector HFCs including community based organisations (for its equity programme) in order to :

(1) Expand the operations of the housing finance industry

(2) Provide funds to private sector players having specified promotional objectives (as defined by NHB)

2.07 NHB wishes to develop its equity support programme in a manner that ensures a proper balance between the following two :

(1) Promotional objectives of NHB (within the overall framework of objectives as envisaged in National Housing Bank Act, 1957)

(2) Self sustainability of the equity support programme.

2.08 As discussed with the senior officials of NHB, equity support programme would focus on certain pre-identified promotional objectives. These objectives are proposed to be reviewed periodically. Some of the objectives which are currently envisaged to be met through the equity support programme are :

(1) Promotion of HFCs

(a) in certain underdeveloped regions of the country and/or areas not covered by existing HFCs e.g. North East region

(b) set up by women entrepreneurs

(c) from the joint/private sector particularly in cases where the market is not prepared to provide equity capital

(d) which would reach groups of borrowers not adequately served by the present companies e.g. rural areas

(2) Promoting the HFC industry by providing need based funds

(3) Facilitating development of stronger linkages between NHB and HFCs (as NHB would be more actively involved in the operations of the HFC if it has an equity stake as compared to refinance support to the HFC)

(4) Augmenting HFCs ability to raise/mobilise additional funds (due to associated NHB's credibility leading to better financial leverage)

2.08 However, NHB would like that its equity support programme is self-sustainable on a long term basis. Therefore it would not like to invest in ventures which are inherently weak and are not likely to operate profitabily even in a longer run. For example, NHB will not like to invest in a HFC which does not even fulfill the minimum capital adequacy ratio.

Conclusion

2.11 Thus, NHB wants to aim its equity support programme towards :

(1) Achievement of certain pre-defined promotional objectives

(2) Ensuring adequate returns to NHB on its investment so that the programme is overall self-sustainable.

3.00 NHB's EXISTING EQUITY INVESTMENT

3.01 This chapter contains an analysis of the current equity investment by NHB in terms of:

(1) Total investment
(2) Evaluation criteria for selecting HFCs
(3) Ability of the HFCs to raise additional funds
(4) Post-subscription monitoring

TOTAL INVESTMENT

3.02 NHB has invested approximately Rs. 8 crores through equity in seven housing finance companies (till May 1996). The paid up equity capital and percentage holding by NHB (before and after rights offer, if any) is given below:

(Rs. in Crores)

SL. NO.	NAME OF THE HFC	PROMOTER	PAID UP SHARE CAPITAL		%AGE OF HOLDING		TOTAL NHB INVESTMENT	
			BEFORE Rts	AFTER Rts	BEFORE Rts	AFTER Rts	BEFORE Rts	AFTER Rts
	Public Sector							
1	Vibank Housing Finance Ltd.	Vijaya Bank	6	NA	20	NA	1.2	1.2
2	Cent Bank Home Finance Ltd.	Central Bank	5	10	16	16	0.8	1.6
3	BOB Housing Finance Ltd.	Bank of Baroda	10	NA	25	NA	0.25	0.25
4	A.B. Homes Finance Ltd.	Andhra Bank	10	NA	19	19	1.9	1.9
5	CanFin Homes	Canara Bank					1.7	1.7
	Private Sector							
6	Vysya Bank Housing Fin. Co. Ltd.	Vysya Bank	3	4.5	10	8.33	0.3	0.56
7	GruH Fin Ltd.	HDFC & Aga Khan Fund	2	5.15	NIL	3.38 (Excl. FCDs)	NIL	0.8 (Incl. FCDs)
	TOTAL					6.15		8.01

NA - Not applicable
Rts - Rights issue

3.03 Out of the seven HFCs, five have been promoted by public sector banks, one by a private sector bank and one by HDFC. In all of the above, NHB was involved right from the formation stage of the HFC and subscribed to their equity at par (except in the case of GRUH Finance Ltd. wherein NHB subscribed for the first time in their Rights-cum-Public Issue in 1992).

3.04 NHB has also subscribed in the rights issue of the following HFCs:

(1)	Cent Homes Finances Ltd.	:	At par
(2)	Vyasa Bank HFC	:	At premium
(3)	GRUH Finance Ltd.	:	At premium

The subscription to the rights issue of Vyasa Bank and GRUH Finance has been at a premium which was in accordance with the prevailing market price/book value of shares as on the date of the issue.

EVALUATION CRITERIA FOR GIVING EQUITY SUPPORT

3.05 At present there are no documented guidelines in respect of NHB's equity support to HFCs. However, NHB considers the following factors. before making an investment in the equity of a HFC :

(1) Compliance with RBI's recommendations on equity support to HFC promoted by a scheduled bank in respect of :

  (a) Shareholding pattern
  (b) Total paid up equity share capital
  (c) Infrastructure and manpower requirement

(2) Compliance with the NHB's directions including interalia the adoption of the model Memorandum of Association

(3) Total housing loan disbursements by HFCs alongwith the details relating to the repayment period and different interest rates for different loan sizes.

(4) Ability of the approved HFCs to mobilise household savings and reduce their dependence on the parent bank for funds in terms of amount collected, brokers network etc. (for HFCs promoted by banks).

(5) Housing loan portfolio

(6) Financial analysis in terms of return on net worth, debt-equity ratio, EPS, dividend, P/E ratio etc.

(7) Achievement of social objectives (e.g. housing finance in rural sector) by the HFC.

ABILITY OF THE HFCs TO RAISE ADDITIONAL FUNDS

3.06 NHB's current equity investment has been primarily in the pubic sector. Out of a total 7 HFCs in which NHB has participated. 5 have been promoted by public sector banks. However, none of the public sector banks have raised additional capital after NHBs investment. It should be noted that the policy decisions regarding sourcing of additional funds are made by the parent banks which are in turn governed by the RBI guidelines.

3.07 Out of the 2 private sector HFCs in which NHB has invested, GRUH Finance has raised an additional Rs. 3 crores in the form of equity from institutional investors and general public. On discussions with the officials of GRUH Finance, AFF were given to understand that the additional funds could be raised primarily because of the following two reasons:

(1) NHB's involvement (in the form of equity participation) in the company lent credibility to its operations

(2) Management of the company by HDFC's professionals

3.08 In contrast to the above Orrisa Rural Housing and Development Corporation Ltd., a new HFC formed about a year back to promote rural housing in Orrisa, is still finding it difficult to attract investors to provide funds for the project due to lack of any institutional backing (This company has not been provided either equity or refinance by NHB as yet). As a consequence this HFC is not able to expand its operations and is running primarily on government owned funds.

Impact of NHB's equity support

3.09 NHB has till now (as a policy) invested mainly in public sector HFCs. These HFCs already had their sources of funds tied up through their respective promoting banks. Also these public sector HFCs have an established name in the market and enjoy certain level of public confidence. Therefore, it is difficult to assess the impact of NHB's equity support in their fund raising capacity.

3.10 However, in the case of GRUH Finance Ltd. a private sector HFC formed to extend housing finance in the rural areas of Gujarat, NHB's contribution in equity lent credibility to the venture. Although at the time of its launching, GRUH was the first to provide rurl housing finance. NHB's name helped in raising additional funds subsequently.

POST SUBSCRIPTION MONITORING

3.11 The post subscription monitoring is undertaken by NHB on an ongoing basis. It appoints one nominee-director on the board of the HFCs in whose equity it participates. Besides, it uses the inspection report and quarterly returns for the purpose of analysing/monitoring the working of the HFC on the following :

Inspection Reports

(1) Balance sheet and the profit and loss account for ensuring accuracy and completeness of the data

(2) Analysis of performance through financial ratios such as return on net worth, capital employed, debt equity ratio and P/E ratio

(3) Details of the spread of the business in Housing loan activities

(4) Compliance of NHB's Directions to HFCs (to the extent applicable)

(5) Effectiveness of audit and internal control system followed by HFCs

(6) Agenda, minutes and the frequency of the meetings of the BOD.

(7) Follow up on complaints received from the public.

Quarterly Returns

(8) Housing loans

(a) Loan to cost ratio
(b) Extent of housing loans to individuals, projects/construction, others and their recovery status

(9) Cash flow analysis

(10) Assets and liabilities maturities composition.

Returns to NHB

3.12 The dividend and EPS track record of the HFCs is given below :

Name of the HFC		Dividend (%)			E P S (Rs.)		
		94-95	93-94	92-93	94-95	93-94	92-93
1	Vijaya HFC	8	6	5	1.17	1.16	18.15
2	Cent Bank	8	7	5	2.71	1.94	1.00
3	BoB	NA	4	-	NA	1.12	1.38
4	AB Homes	-	-	-	0.17	0.32	1.38
5	Canfin Homes	NA	18	16	NA	3.77	2.65
6	Vysya	15	10	6	4.75	2.55	2.11
7	GRUH	12.5	10	8	2.16	2.17	1.53

NA Not available

3.12 As can be seen from the table, the return to NHB from private sector HFCs have been more in comparison with the public sector HFCs.

Conclusion

3.13 At present, there are no specific guidelines in respect of equity support by NHB. Further, NHB has till date primarily invested in the equity of public sector HFCs.

3.14 Since NHB now wants to invest in the equity of HFCs in a major way particularly in the private sector, specific guidelines need to be adopted by NHB. The guidelines should specifically include :

(1) Basis of selection of HFCs
(2) Quantum of NHB's contribution
(3) Period of NHB's investment in equity
(4) Post subscription monitoring criteria
(5) Exit policies

4.00 HOUSING FINANCE COMPANIES - INDUSTRY ANALYSIS

4.01 This chapter contains an overview of the housing finance industry.

4.02 The Indian housing finance system primarily includes :

(1) Regulatory body - NHB

(2) Institutions like HUDCO, Scheduled Banks, State Housing Finance Institutions/Boards, etc. and

(3) Housing Finance Companies (HFCs) like Housing Development Finance Corporation (HDFC), LIC Housing Finance, etc.

HOUSING FINANCE INDUSTRY - BACKGROUND

4.03 An HFC is defined as a company registered under the Indian Companies Act, 1956 whose principal object is to provide finance for housing, whether directly or indirectly.

4.04 At present, there are around 350 Housing Finance Companies in India. Out of these around 100 are active HFCs. As of June 1996, 21 HFCs had been approved by NHB.

PRIMARY SURVEY

4.05 AFF conducted a primary (sample given in Exhibit 4.01) and a secondary survey of the HFCs with a view to :

(1) Ascertain existing sources of funds
(2) Evaluate financial performance of HFCs
(3) Identify difficulties faced by HFCs
(4) Assess the future scenario of HFCs.
(5) Arrive at a ball park estimate of total capital requirement

The findings of the survey are discussed in the subsequent paragraphs.

NHB's REGULATIONS PERTAINING TO HFCs

4.06 NHB is the apex body regulating the HFCs which frames guidelines from time to time to regulate the industry. Some of the highlights of NHB's major directives, which are of relevance for NHB's equity support to HFCs are provided below :

EXHIBIT 4.01

LIST OF PRIMARY SURVEY CONTACTS

Western Region

1. Lokhandwala Housing Finance (India) Pvt. Ltd. Mumbai
2. Lok Housing Finance Company Ltd. Mumbai

Eastern Region

3. Dewan Housing Finance. Mumbai
4. Ganesh Housing Finance Corporation Ltd.. Ahmedabad
5. Raja Vir Housing Finance Corporation Private Ltd. Rajkot
6. VCL Housing Ltd. Calcutta
7. SBI Home Finance

Southern Region

8. Weizmann Homes Ltd. Bangalore
9. Abhiman Housing Finance Corporation Ltd. Bangalore
10. Anup Housing Finance and Investment company Pvt. Ltd. Bangalore

Northern Region

11. PSB Housing Finance Ltd, New Delhi
12. Oriental Housing Devt. Finance Corporation Ltd. New Delhi
13. SMIFS Housing Finance Ltd., New Delhi
14. Crystal Corporation, New Delhi
15. Canbank Home Finance, New Delhi

Capital (for being eligible for obtaining financial assistance from NHB)

(1) HFCs should have a minimum issued and paid-up capital of Rs.3 crores. The contribution from the promoters in the total issued and paid up capital of the HFC should be in conformity with the guidelines issued by the Securities and Exchange Board of India (SEBI). The existing guidelines issued by the SEBI require promoters contribution to be not less than 25 per cent where post-issue capital does not exceed Rs.100 crores and 20% where it exceeds Rs.100 crores. The promoters will have to maintain their existing contribution in the capital as long as any money remain due by the concerned HFC to NHB.

(2) HFCs should have their shares listed in at least one of the recognised Stock Exchanges in India. The existing listing arrangements stipulate that the company desiring official quotations of its securities. should offer at least 25% of its equity through a prospectus for public subscription. NHB may, however, relax this requirement at its discretion in the case of HFCs promoted by Central/State Government, scheduled commercial banks or a public financial institution (as defined under Section 4A of the Companies Act, 1956). In the case of HFCs promoted by corporate groups, they must be sufficiently sound, financially and managerially, in the initial stages of their working.

Deposits (for all HFCs)

(3) The following restrictions are put on acceptance of deposits by HFCs:

(a) Maturity period cannot exceed 7 years

(b) Total deposits cannot exceed 10 - 15 times of the net owned funds (slab rates)

(c) Interest rate cannot exceed 15 per cent p.a.

(4) Rates of brokerage or commission (linked to the amount of deposits) or other incentives/benefits for mobilising deposits shall not exceed 1% of such deposits for a period of 12 months, 1.5% for a period exceeding 12 months but not exceeding 24 months and 2% for a period exceeding 24 months.

Prudential norms (for HFCs with net owned funds of more than Rs. 50 lakhs)

(5) NHB has laid down prudential norms for HFCs. The main aspects are listed below :

(a) Assets classified as :

- Standard
- Sub-standard
- Doubtful
- Loss

(b) Capital adequacy norm of 8%. Capital divided into :

- Tier I : Core capital
- Tier II : Non-permanent capital

with the ceiling that Tier-II capital cannot exceed 100% of Tier-I capital.

(c) Risk weightages laid down for all categories of balance sheet items and off-balance sheet items

(d) The fresh deposit instruments should have a minimum credit rating of FA-/MA-/BBB.

MAIN ISSUES FACING THE INDUSTRY

4.07 The major issues that the housing finance industry is faced with are :

Asset-liability mismatch

(1) Most of the housing finance companies find that asset liability mismatch is one of the biggest problems of the industry. These mismatches have arisen because a major portion of existing liabilities have been built through borrowing - primarily in the form of deposits. Under existing regulations HFCs are allowed to raise deposits upto a tenure of seven years, at a maximum rate of 15%. (long-term deposits are entitled to tax benefits under section 80L of the Income Tax Act, which exempts interest earnings from tax liability of the depositor).

(2) However not many investors make long-term deposits despite the above tax benefit. Most of them prefer to invest in deposits for shorter periods (mostly one year)

(3) The asset maturity profile for HFCs is extended over a period of 10 to 15 years, at a fixed rate - reflected in the form of equated monthly instalments. Effectively, HFCs are financing assets through short term deposits. These deposits are then continuously refinanced through new deposits on their maturity. This results in an assets - liabilities mismatch.

Margins

4.08 Housing finance companies find that the margins in the industry are low. The average rate at which the HFCs borrow is around 12-13% per annum, whereas the interest earned on loans granted ranges from 15-16% per annum. Thus the margins are squeezed. The interest spread for some of the HFCs are given below :

Name of the HFC	Interest spread (%)
HDFC	2.42
LIC Housing	2.65
Canfin Homes	3.27
Dewan Housing	2.31
SBI Homes	5.11
GIC Housing	4.80
PNB Housing	4.30
AB Homes	3.56
Cent Homes	3.96

SOURCES OF FINANCING

4.09 The major funding options available to HFCs are :

(1) Equity
(2) NHB refinance
(3) Debentures/Bonds
(4) Public deposits
(5) Loans from banks/insurance company, FIs etc.
(6) Institutional loans

4.10 The funding pattern of 13 sample HFCs covered in AFF's survey is given below:

(1)	Promoters funds	16%
(2)	Public deposits	28%
(3)	Loan from banks etc.	25%
(4)	NHB refinance	13%
(5)	Debentures/bonds	9%
(6)	Foreign funds	9%
		100%

4.11 As can be seen from the above table, the major sources of finance are deposits and loans followed by promoters funds. However HFCs would prefer to have promoter funds i.e. equity as the main source of finance due to the following:

(1) Asset - Liability mismatch
(2) Low margins

Equity Financing would help HFCs by :

(1) Correcting the asset-liability mismatch situation as there is no commitment to repay equity after a fixed length of time

(2) Increasing proits that can be appropriated as interest costs will reduce

EQUITY FINANCING

4.12 The need for equity financing and the problems faced by HFCs in raising equity is discussed in the subsequent paragraphs.

Need for equity financing

4.13 The NHB has introduced the prudential norms whereby capital is divided into two tiers. Tier I capital is the core capital which provides a permanent base to support unexpected or large losses. It comprises of paid-up equity capital, and free reserves unrelated to the revaluation of assets. Tier II capital consists of elements that lack the permanence of Tier I. Tier II capital comprises of preference shares, a portion of revaluation reserves, general provisions/loss reserves not exceeding 1.25 percent of risk-weighted assets, and subordinated debt. Subordinated debt is to be computed subject to a discount based on remaining maturity, and can not exceed 50 percent of Tier I capital. The total amount of Tier II capital cannot exceed 100 percent of Tier I capital. The minimum capital adequacy norm was six percent of assets until March 1996, when it was increased to eight percent.

4.14 The above stipulation restricts the amount that can be raised by HFCs by way of Tier II capital, as it is linked to Tier I capital. Till now HFCs have been taking public deposits, loans etc. to repay existing liabilities or to make new housing loans. With the introduction of prudential norms a ceiling has been placed on the amount that can be raised by HFCs by way of loans, deposits etc. This has led to the need for increased equity financing.

Problems faced by HFCs

4.15 The main problems faced by HFC are :

(1) Lack of institutional and public investors to provide financial support

(2) Changes in SEBI guidelines

Lack of institutional and public investors

4.16 HFCs particularly the new ones, whose main aim is to provide housing finance in line with the promotional and social objectives of NHB find it difficult to attract institutional and public investors. This is mainly because of the following reasons.

(1) Apprehension on success of the housing finance project (particularly if its objective is to cater to not so lucrative segments e.g. rural areas etc.)

(2) Fear of blockage of funds for a long time

(3) Low returns to investors (as margins of HFCs are generally less as compared to NBFCs)

Change in SEBI guidelines

4.17 SEBI has introduced the condition of prior approval by NHB before a HFC can go for a public issue. This places hindrance on new HFCs which want to tap the Initial Public Offerings (IPO) market as they have to first apply to NHB for registration.

Options for equity financing

4.18 The following are available to HFC for raising funds through the equity route :

(1) Equity stock
(2) Preference stock
(3) Convertible debentures

The main advantage and disadvantages of each of these are given in Exhibit 4.02.

BALL PARK ESTIMATE OF ADDITIONAL CAPITAL REQUIREMENTS

4.19 The demand for total housing finance was estimated at around Rs. 3300 crores for the year 1995-96. It is likely to increase to around Rs. 4200 crores for the year 1996-97. Against this, supply of housing finance from HFCs is estimated to be around Rs. 2630 crores and Rs. 3580 crores in 1995-96 and 1996-97 respectively. Exhibit 4.03 gives the break up of the total demand and supply and the demand supply gap for housing finance.

4.20 As can be seen from Exhibit 4.03 the total demand-supply gap for housing finance works out to Rs. 670 crores and Rs. 620 crores in the years 1995-96 and 1996-97 respectively.

4.21 Based on the capital adequacy norm of 8%, the minimum additional requirement of equity support comes to approximately Rs. 50 crores.

FINANCIAL ANALYSIS OF HFCs

4.22 Based on AFF's survey, the industry standards for the HFCs in respect of the key financial parameters are as follows :

Interest spread	2-3%
Net profit ratio	19-20%
Return on assets	3%
Return on equity	16-17%

Exhibit 4.04 provides the highlights of financial statements of select HFCs.

Conclusion

4.23 Housing finance industry is faced with the problem of asset-liability mismatch, low margins and lack of institutional support for new ventures. With the introduction of prudential norms and SEBI guidelines, the need for equity support by NHB has become crucial.

EXHIBIT 4.02

OPTIONS OF CAPITAL FINANCING

	ADVANTAGES		DISADVANTAGES
A.	**EQUITY STOCK**		
(1)	Tier I capital, hence increases the leverage to raise Tier II capital	(1)	Risk is high as the returns are not guaranteed
		(2)	SEBI guidelines states that prior recognition from NHB is required before making a public issue
(2)	More control over the operations	(3)	Exit routes for the HFC difficult
B.	**PREFERENCE STOCK**		
(1)	Lower risk than equity stock		Does not provide the advantage of Tier I capital to leverage more finance
(2)	Assured returns		
(3)	Exit route available		
C.	**CONVERTIBLE STOCK**		
(1)	Guaranteed returns initially		Exit routes difficult after conversion
(2)	Provides the advantages of both Tier I and Tier II capital (in phases)		

EXHIBIT 4.03

PROJECTED DEMAND-SUPPLY GAP

	1995-96 Rs. Cr.	1996-97 Rs. Cr.
Demand	3300.00	4200.00
Supply		
Finance from HUDCO	440.00	465.00
Finance from Banks/Institutions	155.00	195.00
Finance from HFCs		
- HDFC	1280.00	1540.00
- LICHF	610.00	670.00
- CAN FIN Homes	170.00	210.00
- Dewan Housing	140.00	160.00
- SBI Home Finance	115.00	140.00
- OTHERS	170.00	200.00
DEMAND - SUPPLY GAP	670.00	620.00
EQUITY CAPITAL (ON CAPITAL ADEQUACY OF 8%)	53.40	50.40

SOURCE : Portfolio Guardian

EXHIBIT 4.04

FINANCIALS FOR YEAR ENDING MARCH 31, 1995

Rs. Crores

PARTICULARS	HDFC	LIC Housing	Canfin Homes	Dewan Housing	SBI Home	GIC Housing	PNB Housing	AB Homes	Vysya Housing	Centbank Homes	GLFL	Parshwanath Housing	Hometrust Housing
No. of branches	28	66	27	28	17	14	10	11	7	9	4	3	
Cumulative disbursements	5,695	1,688	545	368	355	138	131	54	43	42	11	7	
Paid up capital	101.25	74.87	20.48	27.8	15.00	17.64	10.00	9.00	3.00	10.00	3.00	2.00	10.0
Networth	874.86	255.69	46.58	50.2	25.33	55.93	24.28	10.87	4.87	11.95	3.74	3.07	10.0
Total borrowings	4436.33	1,639.91	423.25	291.13	269.16	119.2	109.39	53.8	41.39	38.63	15.59	15.59	15.5
Total Income	780.34	258.39	70.8	50.77	42.53	21.14	32.58	7.68	6.54	6.95	2.17	2.43	0.1
PBT	184.39	55.5	13.56	6.71	8.61	7.95	10.47	0.9	1.96	1.81	0.74	0.91	0.1
PAT	146.15	41.35	10.84	5.9	8.3	6.23	9.58	0.66	1.44	1.38	0.67	0.61	0.1
Interest earned on average loans	16.00%	15.34%	16.76%	16.72%	18.60%	16.33%	21.70%	17.05%	18.47%	17.22%	17.48%	16.48%	5.83
Income earned on investments	21.57%	19.13%	18.20%	23.62%	23.69%	25.87%	32.98%	6.12%	32.89%	14.26%		92.31%	
Interest paid on average borrowings	13.58%	12.69%	13.49%	14.41%	13.49%	11.53%	17.40%	13.49%	13.15%	13.26%	13.15%	10.77%	
Interest spread	2.42%	2.65%	3.27%	2.31%	5.11%	4.80%	4.30%	3.56%	5.32%	3.96%	4.33%	5.71%	5.83
Investment income/Total income	27.81%	9.39%	4.16%	0.58%	2.48%	2.24%	5.03%	0.31%	0.57%	0.18%	0.09%	0.02%	
PBT/Total income	23.63%	21.48%	19.15%	13.22%	20.33%	37.61%	32.14%	11.72%	29.97%	26.04%	34.10%	37.45%	77.78
PAT/Total income	18.73%	16.00%	15.31%	11.62%	19.60%	29.47%	29.40%	8.59%	22.02%	19.86%	30.88%	25.10%	77.78
Operating margin/ Average assets	4.18%	3.68%	3.15%	12.91%	12.59%	12.33%	6.85%	1.58%	5.46%	4.05%	4.34%	5.72%	-2.46

Operating expenses/Avg. Assets	0.64%	0.56%	0.79%	1.64%	1.54%	1.04%	0.67%	0.95%	1.17%	0.98%	2.82%	1.23%	4.22
PAT/Average assets	2.96%	2.38%	2.43%	1.84%	3.37%	4.48%	6.24%	1.15%	3.91%	3.07%	5.10%	3.76%	1.38
PAT/Avg. Networth	16.71%	16.17%	23.27%	11.75%	32.77%	11.14%	39.46%	6.07%	29.57%	11.55%	17.91%	19.87%	1.39
Debt/Equity (Times)	5.07	6.41	9.09	5.8	10.63	2.13	4.51	4.95	8.5	3.23	4.17	4.44	

5.00 VENTURE CAPITAL

5.01 This chapter contains a broad overview of the venture capital industry in India in the context of venture capital guidelines for providing equity support.

VENTURE CAPITAL - AN OVERVIEW

5.02 At present, there are 12 venture capital companies in India. These companies can be classified into the following four categories :

S No	Promoters	Names	Stage of financing
1.	Companies promoted by All India DFIs	1. Risk Capital and Technology Finance Corporation Ltd. (RCTFC)	Seed
		2. IDBI - Venture Capital Fund Scheme (VCF)	All
		3. Technology Dev. & Info. Co. India Ltd. (TDICI)	Seed, Start-up
		4. ILFS	All
2.	Companies promoted by State DFIs	5. APIDC Venture Capital Ltd.	All
		6. Gujarat Venture Finance Ltd.	All
3.	Companies promoted by Commercial Banks	7. Canbank Venture Capital Fund (CVCF)	Start-up
		8. SBI Venture Capital Fund	Start-up and later stage
		9. India Investment Fund	Start-up
4.	Companies in Private Sector	10. Credit Capital Venture Fund	Start-up
		11. 20th Century Venture Capital Corporation Ltd.	Later stage
		12. Indus Venture Capital Fund	Start up

Financing Spectrum

5.03 Venture capital funds provide finance at the following investment stages :

(1) Early stage investments like seed stage, start up etc.
(2) Later stage investments such as turn around finances, etc.

The various kinds of finance under each investment stage is discussed in the paragraphs below.

Seed Stage

Seed stage financing includes funding to new companies for use in product development and initial product marketing. These companies are generally in the process of setting up the project or may have been in business for a short time, but have not started commercial production.

Start-Up

Start-up financing is provided to new companies for manufacturing and commercialising the product developed. This finance is extended for creation of new infrastructure and meeting the working capital margin.

Other Early Stage

Other early stage financing includes funds provided to companies that have just started commercial activities and require further funds to meet working capital requirements.

Later Stage Financing

Later stage financing includes funds provided for the growth and expansion of an established company. The funds may be used to finance increase in production capacity, market or product development and/or provide additional working capital. This would also include financing for product diversification, forward/backward integration besides creation of additional capacity. Capital provided for turnaround situations is also included in this category.

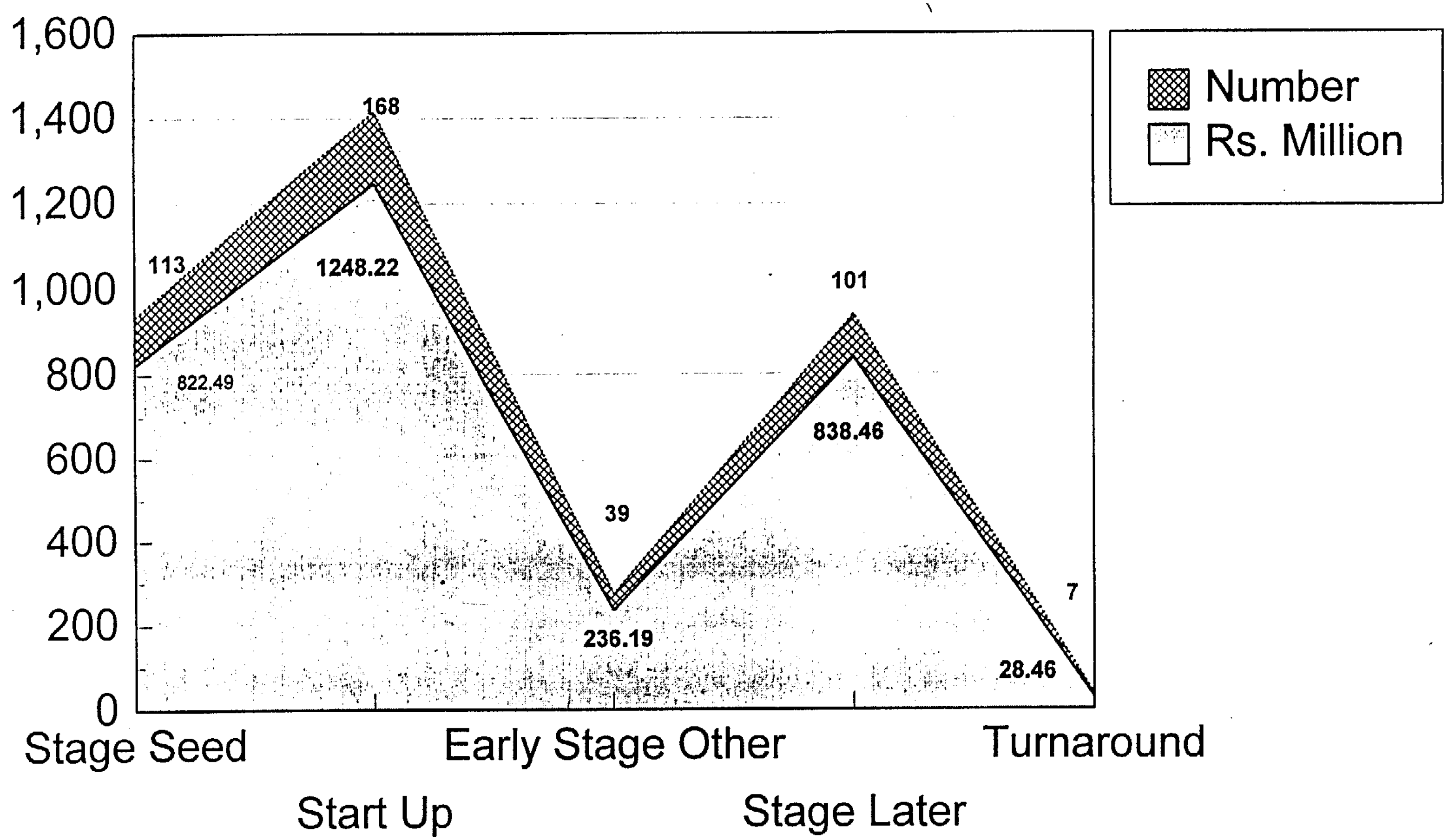
5.04 Exhibit 5.01 gives the total investment according to stages of financing by Indian Venture Capital Funds (VCFs).

INVESTMENT BY METHOD OF FINANCING

5.05 VCFs use the following methods of financing :

(1) Equity participation
(2) Preference shares
(3) Convertible instruments
(4) Debt

EXHIBIT 5.01
VCFs Investment by Stages of Investment



5.06 Exhibit 5.02 gives the total investment by Indian VCF by the method of financing.

5.07 Out of the total investment of Rs.3173.81 million, 62% (Rs.1974.35 million) has been made in equity shares. Debts accounted for 36% (Rs.1149.41 million) of the instruments of finance. These included conditional loans and conventional loans. Convertible instruments of finance (i.e. convertible preference shares and convertible debt) accounted for less than 2% (Rs.43.45 million) of the total financing and redeemable preference accounted for even less than 1% (Rs.6.60 million) of the total investment at the end of December 1993.

5.08 The Indian venture capital industry (IVCA) shows an overwhelming preference for investing in equity shares of projects.

INVESTMENT BY INDUSTRY

5.09 VCFs primarily invest in financing the unproven technology and high risk projects. Some of the industries in which VCFs have invested are :

(1) Industrial products and machinery
(2) Consumer related products
(3) Medical products
(4) Electronics
(5) Computer software
(6) Energy related areas, etc.

It may be noted that VCFs do not invest in projects such as a housing finance or non-banking/banking finance companies primarily because these projects do not involve technological risk/unproven technologies.

EVALUATION CRITERIA USED BY VENTURE CAPITAL COMPANIES

5.10 The various factors which are considered for evaluation of a project are :

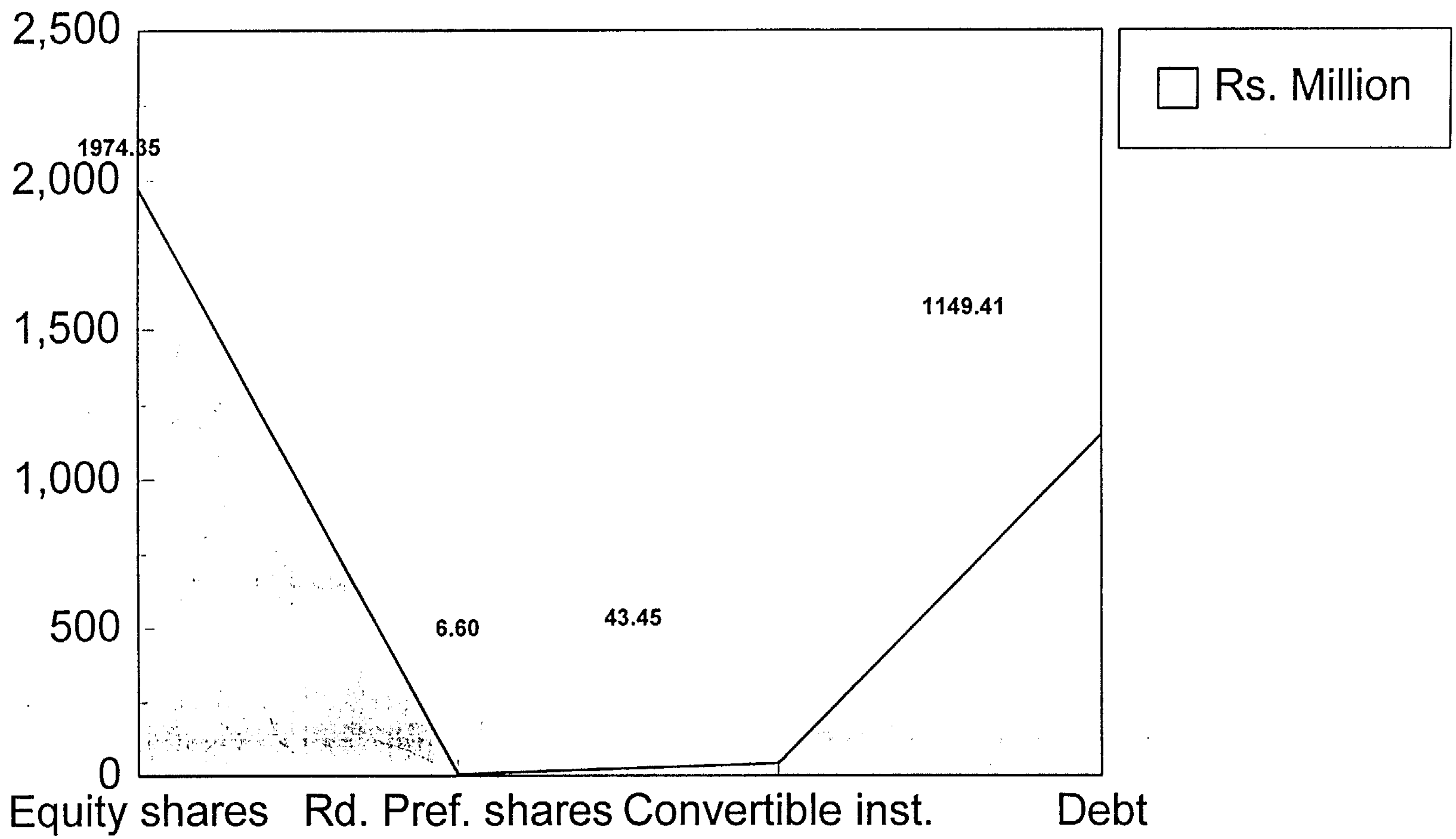
(1) Evaluation of business objectives
(2) Analysis of past operating performance
(3) Assessment of products, technologies, and markets
(4) Review of manufacturing, marketing and distribution network
(5) Financial projections
(6) Funds requirement
(7) Project implementation schedule
(8) Risk analysis in terms of returns, repayments etc.
(9) Promoters background
(10) Promoters contribution to total capital

The parameters for each of the above criteria depends primarily on :

(1) Industry
(2) Stage of financing
(3) Proposed level of investment by VCFs

EXHIBIT 5.02

VCFs Investment by Instruments of Finance



POST-SUBSCRIPTION MONITORING

5.11 Post-subscription monitoring by VCFs is done on the basis of the following :

Financial monitoring

(1) Ratio analysis (in comparison with industry standards)

- Gross profit ratio
- Net profit ratio
- Contribution analysis
- Return on investment

The above is done through monthly/quarterly returns, annual review of the financial statements.

Market assessment

(1) Sales trends
(2) Market share analysis
(3) Product perception analysis

No pre-determined evaluation form is being used. The level of monitoring level depends upon the following :

(1) Investment level
(2) Risk factors associated with the project

EVALUATION OF END OBJECTIVES

5.12 The projects financed by VCFs are evaluated by computing the average on the VCFs investment. The different evaluation categories are given below :

Category	Average compounded return on VCFs investment
1) Stars	Above 50%
2) Winners	25 - 50%
3) Moderate	10 - 25%
4) Losers	Below 10%

5.13 The average return on TDICI's investment (one of the leading venture capital funds in India) is given below :

Category	Proportion of TDICIs Investment
1) Stars	9%
2) Winners	6%
3) Moderate	45%
4) Losers	40%

5.14 Thus, in the case of TDICI, 45% of the projects are able to give moderate return (10-25%)

ABILITY OF PROMOTERS TO RAISE ADDITIONAL FUNDS

5.15 The details of additional funds raised by the promoters subsequent to the VCFs support is provided in Exhibit 5.03.

5.16 As can be seen from the above Exhibit, a large number of projects have been able to raise additional funds.

REPAYMENT EXPERIENCE

5.17 The repayment experience of the VCFs is presented in Exhibit 5.03.

5.18 As can be seen from the Exhibit, the total repayment amount as a proportion of total investment is around 12 - 13% in certain VCFs.

EXIT ROUTES

5.19 The exit routes used by the VCFs are :

(1) Buy-back by promoters
(2) Sale of equity to the public (IPOs) - Initial Public Offerings
(3) Corporate sale

Buy-back by promoters

5.20 This is a favoured exit route by VCFs. In this arrangement, the shares are repurchased by the promoters based on :

(1) Agreed purchase price at the time of investment
(2) Cost of investment plus reasonable return expected by VCFs
(3) Current market prices
(4) Intrinsic value of shares

Sale of equity to the public

5.21 Another route taken by the VCFs is to sell their shares to the public by making an offer of sale to them. This method is not the most favoured because of the following:

(1) Time and effort involved in the public issues
(2) Risk of not being able to off-load the entire equity
(3) Promoters not preferring this route as the exposure to takeovers is high

Corporate Sale

5.22 This route is followed when the VCFs find that the current management is not able to run the project successfully. The VCFs, holding is then offered to an alternative promoter (at times alongwith the transfer of management to the alternate promoter).

Conclusion

5.23 From the above analysis of VCFs in India, it can be concluded that :

(1) Investments are made based on the objectives of VCFs e.g. provide start up funds, turn around funds etc.

(2) Equity is the most preferred instrument of investment]

(3) VCFs do not invest in HFCs

(4) VCFs have pre-defined parameters for evaluation of the projects e.g. evaluation of business objectives, past performance analysis etc.

(5) VCFs carry out post-subscription monitoring mainly in respect of financial performance and market assessment

(6) The exit routes generally available to VCFs are buy back from the promoters, sale to public and corporate sale

The above shall provide inputs for framing guidelines for equity support by NHB.

EXHIBIT 5.03

ADDITIONAL CAPITAL RAISED BY VCC PROJECTS AND THE REPAYMENT EXPERIENCE OF VCCs

NAME OF VCC		% OF COMPANIES WHICH HAVE RAISED ADDITONAL FUNDS	REPAYMENT (AS A % OF TOTAL VCF INVESTMENT)
1	20th Century Capital Corporation	18	9
2	ANZ Grindlays	60	2
3	APIDC	-	-
4	Can bank	8	
5	Credit Capital	61	-
6	Gujarat Venture Capital	-	-
7	IFB	-	-
8	ILFS	29	14
9	Indus Venture Management Ltd.	-	-
10	IDBI	2	-
11	RETEC	6	-
12	TDICI	3	24

6.00 GUIDELINES FOR EQUITY SUPPORT

6.01 This chapter presents AFF's recommendations on the guidelines that NHB should follow for providing equity support to HFCs.

6.02 The proposed guidelines are provided under the following main heads :

(1) Information required from HFCs
(2) Evaluation parameters
  - Eligibility criteria
  - Approval criteria
(3) Final selection
(4) Other terms and conditions
(5) Quantum of NHB's investment
(6) Pricing of the shares
(7) Period of NHB's support
(8) Post-subscription monitoring
(9) Exit policy

INFORMATION REQUIRED FROM THE HFCs

6.03 The information required from HFCs relating to the background of the HFCs, promoters, financial data and expansion details is given in Exhibit 6.01.

EXHIBIT 6.01

INFORMATION REQUIRED FROM HFCs

Sl.No.	PARTICULARS	OBJECTIVE
1.00 GENERAL		
1.01	Name of the HFC	This section provides an overview of the HFC in terms of : ➢ Constitution and location ➢ No. of years since incorporation ➢ Business group it belongs to ➢ Sister concerns ➢ Main objects of the HFC
1.02	**Constitution** Public/Private Limited Co. **Enclose** : Copy of Memorandum of Association	
1.03	Date of incorporation/registration	
1.04	Date of commencement of business	
1.05	Sector : public sector/joint sector/private sector/co-operative sector	
1.06	Name of the business house/group to which the concern belongs to and the list of other companies in the same group	
1.07	**Location** : Give addresses of the following (Indicate village, tehsil, district and state) (a) Registered Office (b) Controlling (Head) Office (c) Branches	
2.00 PROMOTERS		
2.01	Give bio-data of the main promoters including name, address, age, educational qualifications, past business experience, experience in the HF industry, brief write-up on other companies, if any, promoted by them or with which they are associated with together with a copy of the annual accounts for the last 5 years (in respect of each of the main promoters).	To provide the basis of evaluation of promoters in terms of : ➢ Years of experience in housing finance ➢ Education ➢ Profile of other group companies promoted by the promoter
2.02	In case the promoter is a company, furnish a brief write-up on the activities and past performance of the company. Also provide details in respect of other expansion programme(s) contemplated by the promoters (if any).	

Sl.No.	PARTICULARS	OBJECTIVE
	Enclose: ➢ Audited balance sheet and profit and loss account for the past five years of the promoter company(s); ➢ Copy of agreement(s), if any, entered into among the promoters indicating share holding pattern, salary etc.	
2.03	Provide a list of directors alongwith a complete list of concerns with which they are associated as director, partner, proprietor, etc. Also furnish brief write-ups on the above concerns including information on the nature of business, turnover, profits for last 5 years.	To provide information on the Board of Directors of the HFC.
2.04	Provide a list of shareholders owning or controlling 5% or more of equity shares, indicating the amount owned and business relationship, if any, with the company. In case of preference shareholders, give a list of the ten largest shareholders.	To highlight major shareholders and thus provide the basis of selection/rejection based on shareholding pattern.
3.00	**PARTICULARS OF THE HFC**	
3.01	Give a brief history of the concern including any changes in name, business, management, etc. Also indicate any mergers, reorganisation, etc. which took place in the past.	This section will provide brief particulars of the concerned HFC in terms of : ➢ Past history ➢ Subsidiary company(s) and activities thereof ➢ Management structure
3.02	Provide a list of subsidiaries, showing percentage of holding in each of them and the nature of their business.	➢ Branches ➢ Shareholding pattern
3.03	In case the assets have been revalued or written up at any time during the existence of the company, furnish details of such revaluation together with the reasons thereof.	To provide the true asset base of the HFC.

Sl.No.	PARTICULARS	OBJECTIVE
3.04	Provide a list of existing key executive staff giving their names, age, qualifications, length of service with the company and previous experience. Furnish number of supervisory, skilled, semi-skilled and unskilled personnel employed by the HFC. **Enclose** : Organisation chart showing the lines of authority.	To provide details for evaluation of key personnel
3.05	Note on internal management systems covering : - Loan processing - Loan monitoring - Loan recoveries - Default recovery - MIS - Accounting along with extent of their computerisation. Further, attach a note on the internal audit function stating scope, extent and periodicity along with the major observatons of the same **Enclose** : Systems manual	To assess the system and procedures of the HFC
<u>IN CASE OF EXISTING HFC</u>		
4.00	**<u>HOUSING LOANS</u>**	
4.01	Give details of the various housing loan schemes in operation alongwith a brief description of each scheme covering : ➢ Applicability ➢ Loan slabs ➢ Interest rates ➢ Total outstanding loans under each scheme	To assess the loan portfolio of the HFC and to evaluate their relevance in relation to the promotional objectives of NHB of catering to specified groups such as - Low income group - Rural areas - Underdeveloped areas
4.02	Give details for the past five years of : ➢ Loan approvals ➢ Loan disbursements ➢ Outstanding housing loans	This section will provide the details of the housing loan activities of the HFC. To assess the quantum of loans given.
4.03	Give percentage of housing loans to total assets for the past 5 years.	To ensure that 75% of loans are made for housing purposes

Sl.No.	PARTICULARS	OBJECTIVE
4.04	Give the amount and type of loan sanctions made by each branch.	To assess the spread of activities of the branches
5.00	**FINANCIAL INFORMATION**	
5.01	Enclose certified copies of audited balance sheets and profit and loss account for the last five years together with proforma balance sheet and profit and loss account of as recent date as possible. Give brief explanations for year to year variations in income, profits and other financial highlights. Also give a note on the contingent liabilities, if any, shown in the balance sheet.	This section provides the input for financial evaluation of the HFC.
5.02	Give the capital adequacy ratio for the past 5 years.	To assess the adequacy of capital
5.03	Give the credit rating obtained for the deposits raised during the past 5 years	To assess the credit worthiness of the HFC
5.04	Give the following for the past 5 years ➢ Profit after tax ➢ Earning per share ➢ Dividend (%) ➢ Net worth (as per capital adequacy norms of NHB) ➢ IRR	To carry out a financial analysis in terms of : - Return on equity - P/E ratio - Dividend track record
5.05	Is the HFC listed? If yes, then give the following : ➢ Stock exchange at which it is listed ➢ High, low and average yearly market price for the past 3 - 5 years at each stock exchange	To assess the exit route for NHB To compute P/E ratio
6.00	**EXPANSION PROJECT - DETAILS**	
6.01	Give a brief write-up on the proposed project/expansion project for which the funds are being sought to be raised.	This will provide the basis for evaluation of the proposed project for which equity assistance is sought.
6.02	State the objectives of the proposed expansion project in terms of : ➢ New loan schemes ➢ Expansion of old loan schemes ➢ New branches	To have an overview on the proposed utilisation of capital sought

Sl.No.	PARTICULARS	OBJECTIVE
6.03	State the total project cost of the expansion project/the total amount to be raised. Give the funding pattern in the following matter: **% to total** **Equity** ➢ Promoters ➢ NHB ➢ Public ➢ Others **Debt** ➢ Debentures ➢ Bonds ➢ Deposits ➢ Others --------- Total project cost ---------	To assess the stake of each major shareholder in the equity of the HFC and the debt equity ratio
6.04	Give the promoters contribution before and after the expansion project.	To assess promoters stake before and after expansion
6.05	Attach a feasibility report of the expansion project.	To make qualitative assessment of the project

Sl.No.	PARTICULARS	OBJECTIVE
IN CASE OF NEW HFCs		
4.00	**<u>HOUSING LOANS</u>**	
4.01	Give total amount and percentage to housing loan for various categories of housing loans such as individuals, corporaters, builders, etc. proposed to be given by the HFC.	To assess the loan portfolio of the HFC and to evaluate their relevance in relation to the promotional objectives of NHB of catering to specified groups such as - Low income group - Rural areas - Underdeveloped areas
4.02	Give details of the various housing loan schemes to be operated by the HFC alongwith a brief description of each scheme covering : ➢ Applicability ➢ Loan slabs ➢ Interest rates	This section will provide the details of the proposed housing loan activities of the HFC.
5.00	**<u>FINANCIAL INFORMATION</u>**	
5.01	Give the capital adequacy ratio based on the projections for the next 10 years.	This will provide inputs for financial evaluation of the HFC. To assess the adequacy of capital
5.02	Give the details of the various loans and deposits proposed to be taken by the HFC giving details of : • Secured/unsecured • Average maturity period • Average interest rates • Value of securities offered (for secured debts only)	To assess the loans obtained/to be obtained by the HFC
5.03	Give the following for the next 10 years ➢ Profit after tax ➢ Earning per share ➢ Net worth ➢ IRR	To evaluate the financial feasibility of the project in terms of - Return on equity - EPS
6.00	**<u>PROJECT DETAILS</u>**	
6.01	Give a brief write-up on the proposed project for which the funds are being sought to be raised.	This will provide the basis for evaluation of the proposed project for which equity assistance is sought.

Sl.No.	PARTICULARS	OBJECTIVE
6.02	State the objectives of the proposed project in terms of : ➢ New Loan schemes ➢ New Branches, etc.	To have an overview on the proposed utilisation of capital sought.
6.03	State the total project cost and the total amount to be raised. Give the funding pattern in the following matter: **% to Total** **Equity** ➢ Promoters ➢ NHB ➢ Public ➢ Others **Debt** ➢ Debentures ➢ Bonds ➢ Deposits ➢ Others --------- Total project cost ---------	To assess the funding pattern
6.04	Attach a feasibility report of the expansion project.	To make qualitative assessment of the HFC

EVALUATION CRITERIA

6.04 The evaluation criteria for HFCs seeking equity support from NHB is divided into the following two categories :

(1) Eligibility criteria
(2) Approval criteria

The parameters to be considered for each of the above are explained in the subsequent paragraphs.

Eligibility criteria

6.05 Eligibility criteria will be the basic criteria which the HFCs shall have to meet to become eligible for equity suport from NHB. The evaluation parameters are given below.

In the case of existing HFCs

(1) The main object of the HFC should be housing finance

(2) The loan portfolio of the HFC should be in line with the promotional objectives of NHB.

(3) Minimum paid up capital of the HFC should be Rs. 3 crores or the same should be Rs.3 crores after NHBs contribution.

(4) The HFC should have obtained a credit rating for their deposits and the same should be a minimum of FA-/MA-/BBB.

(5) Capital adequacy norm should be a minimum of 8% computed in accordance with the prudential norms guidelines of NHB

(6) The accounting practices for income recognition, investment etc. followed by the HFC should be in accordance with the NHB's directives.

(7) The HFC should not have lent more than 15% of its Net Owned funds (NOF) computed as per prudential norms guidelines to any single party or 25% of its NOF to any single group of parties.

(8) The HFC should not have invested more than 25% of its NOF in shares/Debentures bonds of another company.

(9) The existing return on equity and IRR should be a minimum of 10% and 14%.

In the case of new HFCs

(1) The main object of the HFC should be housing finance

(2) The proposed loan portfolio of the HFC should be in line with the promotional objectives of NHB.

(3) Minimum paid up capital should be Rs. 3 crores or the same should be Rs. 3 crores after NHBs contribution

(4) Credit rating of deposits by the HFC should be obtained and the same should be a minimum of FA-/MA-/BBB

(5) HFC should give an undertaking that

(a) Accounting practices shall be in accordance with the NHB's directives

(b) Proposed capital adequacy shall be a minimum of 8%

(c) Norms laid down by NHB for loans given and investments made shall be adhered to.

(6) The projected return on equity and IRR should be a minimum of 10% and 14%.

6.06 The eligibility criteria as stated above should be satisfied in full by the HFC to be eligible for equity support from NHB. An auditors certificate to this effect should be obtained by the HFC and submitted to NHB.

6.07 The above eligibility criteria should be re-examined by NHB every year for any updation/deletion.

Approval criteria

6.08 Approval criteria include the parameters to be considered by NHB before providing equity support. These parameters are to be examined only after the eligibility criteria has been satisfied by the HFC.

6.09 The approval criteria is based on the following aspects :

Objectives of HFC

(1) Promotional target segments
(2) Geographical preferences

Financial

(1) Returns
(2) Market perception
(3) Interest coverage
(4) Liquidity

Promoters and Management

(1) Experience in Housing Finance
(2) Qualification of promoters
(3) Key personnel
(4) Internal System and controls of HFC

Housing loan activities.

(1) Branch networks
(2) Total loan disbursements

6.10 The parameters to be considered by NHB along with the standard norms against which comparison is to be made are given in Exhibit 6.02. (These norms should be reviewed on a quarterly basis). These assessment of the parameters by NHB shall be done based on the information obtained from the HFC.

<u>EXHIBIT 6.02</u>
<u>APPROVAL CRITERIA</u>

	CRITERIA	CATEGORY	MAXIMUM MARKS	MARKS OBTAINED
	In case of existing HFCs			
1	**Promotional objectives of HFC**			
	• Promotional target segments	-Low income group - Rural areas - North east - Hilly regions - Any other (specify)	20	
	TOTAL (A)		20	
2	**Financial parameters**			
	• Internal rate of return (%) (IRR)	26 and above 24-26 22-24 20-22 18-20 16-18 14-16 less than 14	7 6 5 4 3 2 1 0	
	• Return on Equity (%)	22 and above 20-22 18-20 16-18 14-16 12-14 10-12 less than 10	7 6 5 4 3 2 1 0	
	• P/E ratio (times)	24 and above 22-24 20-22 17-19 15-17 13-15 11-13 Below 11	7 6 5 4 3 2 1 0	
	• DSCR (Times)	Above 1.25 1 - 1.25 0.75-1.00 0.50-0.75 0.25-0.50 Below 0.25	5 4 3 2 1 0	

	CRITERIA	CATEGORY	MAXIMUM MARKS	MARKS OBTAINED
	In case of existing HFCs			
	• Cash profit/Average housing loans (%)	10% and above 8-10 6-8 4-6 Below 4	4 3 2 1 0	
	TOTAL (B)		30	
3	**Promoters background/ management**			
	• No. of years of experience in housing finance	More than 10 years 5-10 years Less than 5 years	5 0	
	• Qualification If the promoter is a company then the above parameters should be applied to the main promoter of the company)	Professional degree Graduate Under graduate	5 3 0	
	• Systems documentation	Properly laid down Not laid down	2 0	
	• Extent of computerisation	Adequate Not in place	2 0	
	• Adequacy of internal audit	Adequate Inadequate	2 0	
	• Key personnel - Qualification - Years of experience in Housing finance	-High Proportion of Professional Degree holders -Low prorportion of professional degree holders More than 5 Less than 5	2 0 2 0	
TOTAL (C)			20	
	Spread of Housing loan activities			
	• No. of branches	Above 10 5-10 3-5 less than 3	4 3 2 0	

CRITERIA		CATEGORY	MAXIMUM MARKS	MARKS OBTAINED
	In case of existing HFCs			
	• Housing loans as a % of total loans	80 and above 75-80	3 1	
	• Capital adequacy	10% and above 9 8	3 2 1	
	• Repayment of housing loans as a % of total loans due	99 98 97 96 95 below 95	5 4 3 2 1 0	
	TOTAL (D)		15	
	Qualitative aspects • Quality of experience of ◦ Promoters ◦ Key personnel ◦ Promoter group • Major shareholders of the HFC/promoter group • Assessment of ◦ Subsidiary Co. • Qualitative assesment of reporting relationship • Qualitative assessment of the feasibility report • Impact of mergers, reorganisation on HFC • Assessment of the need of the HFC industry • Any other considered significant specify	Separate scores are not laid down for the assessment of these qualitative aspects.	15	
	TOTAL (E)		15	
	TOTAL (A+B+C+D+E)		100	

	CRITERIA	CATEGORY	MAXIMUM MARKS	MARKS OBTAINED
In case of new HFCs				
1	**Promotional objectives of HFC**			
	• Promotional target segments	- Low Income group - Rural areas - North east - Hilly regions - Any other (specify)	20	
	TOTAL (A)		20	
2	**Financial parameters**			
	• Internal rate of return (%) (IRR)	26% and above 24-26 22-24 20-22 18-20 16-18 14-16 Less than 14	7 6 5 4 3 2 1 0	
	• Return on Equity (%)	22% and above 20-22 18-20 16-18 14-18 12-14 10-12 Less than 10	7 6 5 4 3 3 1 0	
	• DSCR (Times)	1 and above 0.75-1.00 0.50-0.75 0.25-0.50 Below 0.25	4 3 2 1 0	
	• Cash profit/Average assets (%)	10 and above 8-10 6-8 4-6 Below 4	4 3 2 1 0	
	TOTAL (B)		22	

CRITERIA		CATEGORY	MAXIMUM MARKS	MARKS OBTAINED
In case of new HFCs				
3	**Promoters background/ management**			
	• No. of years of experience in housing finance	More than 10 years 5-10 years Less than 5 years	5 3 0	
	• Qualification If the promoter is a company then the above parameters should be applied to the main promoter of the company)	Professional degree Graduate Under graduate	5 3 0	
	• Key personnel - Qualification - Years of experience in finance Housing	-High proportion of Professional Degree holders -Low proportion of professional degree holders More than 5 Less than 5	2 0 2 0	
TOTAL (C)			14	
	• No. of branches	Above 10 5-10 3-5 less than 3	3 2 1 0	
	• Housing loans as a % of total loans	80 and above 75-80	3 1	
	• Capital adequacy	10 and above 9 8	3 2 1	
TOTAL (D)			9	

CRITERIA		CATEGORY	MAXIMUM MARKS	MARKS OBTAINED
In case of new HFCs				

	Qualitative aspects
	• Quality of experience of
	  • Promoters
	  • Key personnel
	  • Promoter group
	• Major shareholders of the HFC/promoter group
	• Assessment of
	  • Subsidiary Co.
	• Qualitative assesment of
	  • Reporting relationship
	• Qualitative assessment of the feasibility report
	• Impact of mergers, reorganisation on HFC
	• Assessment of the need of the HFC industry
	• Any other considered significant specify.
		Separate scores are not laid down for the assessment of these qualitative aspects.	15	

	TOTAL (E)		15	
	TOTAL (A+B+C+D+E)		80	

Notes (on computation and marking systems)

(1) IRR should be based on cash flows

(2) Return on equity = PAT/Networth

(3) P/E ratio = $\frac{\text{Average market price}}{\text{EPS}}$

(4) DSCR = $\frac{\text{PAT+Interest}}{\text{Interest + loan repayment}}$

(5) Cash profit/Housing loans = $\frac{\text{PAT + Non-cash items}}{\text{Housing loans}}$

(6) All ratios should be rounded off to the nearest whole number.

Final Selection

6.11 The individual marks for each parameter (financial, promoters and loan activities) including qualitative aspects should be totalled up to compute the total score. The final selection should be based on the following criteria.

Existing HFC	:	60 and above - Accept Below 60 - Reject
New HFC	:	55 out of 80 - Accept

6.12 In case the comparison is to be made between two HFCs then the weightage should be more for the HFC which has higher marks. If both the HFC have the same marks then the final selection should be based on the return on equity offered by the four HFCs to NHB.

6.13 It is recommended that NHB should approve the HFCs for equity support periodically - say on a quarterly basis (and not on as and when basis)

OTHER TERMS AND CONDITIONS ATTACHED TO HFCs

6.14 The other terms and conditions that NHB should impose on the HFCs before providing equity support are :

(1) Appointment of NHB nominee directors in the same proportion as NHBs equity in the paid up capital of the HFC.

(2) Listing on a recognised stock exchange in 2-3 years (in the cases of companies not already listed)

(3) Appointment/removal of auditors to be done with NHB's consent

(4) Administrative expense to be kept within 1.5% of outstanding loans.

QUANTUM OF NHBs SUPPORT

6.15 AFF recommends that NHB should invest in the paid up capital of HFC to the extent of

(1) 24% of the paid up capital of HFC (based on the limits adopted by Financial intitutions)

(2) Promoters contribution less 5% (so that the stake of the promoters remains substantially more than that of the NHB).

which ever is less.

Pricing of the shares

6.16 The price at which NHB should invest should be based on the following parameters.

In case of existing listed companies

(1) EPS (pre-issue)
(2) P/E ratio and comparison with industry P/E ratio
(3) Average return on networth
(4) Minimum return on increased networth required to maintain pre-issue EPS
(5) NAV and comparison of NAV with issue price

For all the above projected earnings should not be used as a basis of evaluation.

The issue price should be computed based on the above ratios by NHB.

In the case of new HFCs

It is suggested that in the case of new HFCs equity shares should be subscribed only at par and no premium should be paid.

PERIOD OF NHB SUPPORT

6.17 The time period of NHB equity support should be a minimum of one business cycle of HFC which is about 6-7 years.

6.18 NHB should therefore invest for a minimum of 5 years and upto a maximum of 10 years. Further, after the year 5 NHB should also consider disinvesting a portion of its equity in stages (say 20-30 percent per annum over the next 3-5 years).

POST SUBSCRIPTION MONITORING

6.19 NHB should monitor the working of the HFC on an ongoing basis. The parameters that NHB should consider are :

(1) **Through quarterly returns of NHB**

- Loans granted during the period
- Past overdues
- Cash flows
- Assets and liabilities maturing positions

(2) **Through Annual Statements**

- Ratio Analysis
    - Return on investment

- Return on equity
- Debt-equity ratio
- Housing loan to total assets
- Cash flows
- Margins
- EPS

- ➢ Capital adequacy computation
- ➢ Recover statement of past overdues
- ➢ Significant capital investments
- ➢ Changes in Board of directors
- ➢ Change in shareholdng pattern
- ➢ Significant expansion projects
- ➢ Systems evaluation
- ➢ Auditors report and comments thereon
- ➢ Legal cases pending against the company.

Any variation reported as per the above monitoring should be brought out and the concerned HFC should be asked to take corrective measures.

EXIT ROUTES

6.20 NHB should ensure exit routes for itself at the time of providing equity to the HFC. This can be done by entering into an agreement with the promoters for the buy back of shares. The various options available to NHB are

Sale through public offer/stock exchange

(1) NHB can sell its shares by making an offer for sale to public in respect of its holding. This should be done at a price which will maximise the return on equity to NHB. Further, if NHB decides to off load its share on a yearly basis, it can be do so on the stock exchange directly.

Buy-back by promoters

(2) NHB can also offload its holding in the HFC by way of a buy-back arrangement with the promoters of the HFC. The price at which NHB should negotiate such a deal should be based on

- Market price at the time of sale
- Price which miximises NHBs returns
- Mutually agreed price

Conclusion

6.21 The above guidelines will provide NHB a transparent and a consistent basis for HFC selection. NHB should carry out a regular updation/revision of these guidelines.