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Risk Management In Housing Finance Companies -A Comparative Study Of Hdfc & Lichfl

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ABSTRACT: *India's Urban Population has grown over the past 4 decades from 109 million in 1971 to 377 million in 2011 and is expected to grow to almost 600 million by 2030. India is expected to emerge as the third largest economy in the world by 2030 with an estimated 600 million people inhabiting in cities. Housing is an important sector for any economy as it has inter linkages with nearly 600 other industries. The development of housing sector can have direct impact on employment generation, GDP growth and consumption pattern in the economy. To help develop housing in the country, there is need to have a well-developed housing finance market. In India, housing finance market is still in its nascent stage compared to other countries. The outstanding amount of housing finance from all sources accounts for less than 8 per cent of GDP when compared with 12 per cent in China, 29 per cent in Malaysia, 46 per cent in Spain and 80 per cent in the US. HUDCO, HDFC,NHB,LICHFL, and all commercial banks are taking part in providing home loans. Economic conditions in the country are playing key role in performance of the HFCs. NPAs are the major risk factor in the HFCs. 'All for the Housing' slogan given by the HDFC in 1977 has turned as a favourite slogan of the Indian Prime Minister 'Housing for All by 2022'.*
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KEY WORDS: *HFC, NPA,Financial Risk, Credit Risk, Risk Management,Disbursement.CRR, Repo Rate.*

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I. HOUSING IN INDIA:

India's Urban Population has grown over the past 4 decades from 109 million in 1971 to 377 million in 2011 and is expected to grow to almost 600 million by 2030. India is expected to emerge as the third largest economy in the world by 2030 with an estimated 600 million people inhabiting in cities. Housing is an important sector for any economy as it has inter linkages with nearly 600 other industries. The development of housing sector can have direct impact on employment generation, GDP growth and consumption pattern in the economy. To help develop housing in the country, there is need to have a well-developed housing finance market. In India, housing finance market is still in its nascent stage compared to other countries. The outstanding amount of housing finance from all sources accounts for less than 8 per cent of GDP when compared with 12 per cent in China, 29 per cent in Malaysia, 46 per cent in Spain and 80 per cent in the US. Housing is one of the basic necessities of mankind, it not only promotes the socio-biological interaction, but also house-hold based economic activities. Global Shelter Strategy (GSS) highlighted the importance of shelter for the human being.

Housing and Urban Development Act, 1970 was enacted in public sector to cater the housing needs of India. As a follow up action, Housing and Urban Development Corporation (HUDCO) was established in 1970, by the Government of India, in public sector. Housing Development Finance Corporation (HDFC) was set up in 1977, in private sector to provide housing finance. To show the increasing importance of housing day by day, the World Habitat Day is being celebrated on every first Monday of October since 1985. There is a global housing crisis, approximately 1.6 billion people worldwide are living in the substandard housing and almost 100 million people are homeless. It indicates that it is very to take some serious actions otherwise the number of slum inhabitants will continuously increase all over the world. And every year one new theme is being declared to show the

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II. SIGNIFICANCE OF THE STUDY:

For the purpose of study, the two housing finance companies, i.e. Housing Development Finance Corporation Limited (HDFC) and LIC Housing Finance Limited (LICHFL). The major focus is given to study the risk related activities of the companies only.

III. METHODOLOGY:

Most of the data is collected from the secondary data, from the annual reports of the respective companies. Some aspects of primary data is also collected in the form of interviews and opinions of the staff of the respective organisations.

IV. OBJECTIVES OF THE STUDY:

The main objectives of this study are risks and NPA of the companies. The other objectives are;

1. To study the major activities of the selected companies.
2. To focus on the risks of the housing finance companie.
3. To study the risk mechanisms available in the companies.
4. To advice some methods to come out of the risks.
5. To study the NPA pattern of the companies.

V. LIMITATION OF THE STUDY:

The HDFC and LICHFL are the two major housing finance companies in private sector and public sector respectively.

1. Even then, they may not represent the entire housing finance industry.
2. The data collected from secondary sources, may contain some inherit errors.
3. The main focus given to two important but small aspects, i.e.risks & NPA.

VI. HOUSING DEVELOPMENT FINANCE CORPORATION LIMITED (HDFC):

The HDFC is the largest private sector, Indian financial conglomerate based in Mumbai. It was founded in 1977 as the first specialised mortgage company in India. HDFC was promoted by the Industrial Credit and Investment Corporation of India. It is a major provider of finance for housing in India. It also has a presence in banking, life and general insurance, asset management, venture capital and education loans. The company provides housing finance to individuals and corporates for purchase /construction of residential houses. ‘All for the Housing’ is the slogan by the HDFC in 1977. Now it has reversed as became the favourite slogan of the Indian Prime Minister ‘Housing for All by 2022’.

THE LIC HOUSING FINANCE LIMITED (LICHFL):

The LICHFL was incorporated in 1989, and is the second largest Housing Finance Companies in India with a key objective of providing long term finance to individuals for the purchase or construction of house/flat for residential purposes in India. LICHFL also provides finance on existing property for business/ personal needs and also gives loans to professionals for purchase/construction of Clinics/Nursing Homes/ Diagnostic Centers / Office Space and also for purchase of equipment. The Company also provides finance to builders and developers engaged in the business of construction of houses or flats for residential purpose and to be sold by them. The Company went public in 1994 and since then its stocks are listed and actively traded on the National Stock Exchange (NSE) and Bombay Stock Exchange Limited (BSE). LIC HFL is amongst the pioneers in India ensuring access to housing finance for home ownership. With a strong business foundation, an extensive distribution network and proven industry expertise, LIC HFL is a respected and trusted financial services company. The LICHFL has served over 21 lakh prudent home owners, through 275 marketing offices, including two abroad and more than 12000 marketing intermediaries.

Both the companies are engaging in longterm lending business and to large extent, they have similar problems, associated with finance lending. The problems or the risks may lead the organisation into problems or lower performance. The risk may be defined as occurance of unwanted incidence which leads the organisations into losses or lower performance. Both the companies are having internal Risk Managing Committees (RMC) which looks after the functions like risk identification, risk measurement and risk controlling and risk reduction techniques. The risk management process of the Companies will proactively manage the uncertainty and volatility in the net interest income of the Company by prescribing maximum exposure limits.

The HDFC and LIC Housing Finance are exposed to risks such as;
1.Liquidity risk.
2.Interest rate risk.
3.Forex risk.
4.Credit risk / increase in NPA and
5.Operational risk.

1.LIQUIDITY RISK:

The liquidity risk is also expressed in terms of funding liquidity, or a situation of shortage of funds, or if the funds are available at higher rate of interest. Hence the liquidity risk leads to pay the higher rate of interest.

Reduce potential costs of financial distress by making the Housing Finance companies less vulnerable to adverse movements in liquidity, interest rates, exchange rates (wherever applicable). Both the organisations are having goodwill to get cheaper funds from the economy.

Create a stable planning environment by ensuring that the business plan is not adversely affected during the financial year due to any adverse liquidity situations, interest rate and currency fluctuations by using various tools such as time-bucket analysis, liquidity statements, duration gap and forex exposure reports.

2. INTEREST RATE RISK:

The Reserve Bank of India (RBI), through its Monetary Policy Committee (MPC), declares the interests policy. Based on the Bank rate, PLR, REPO Rate, Reverse Repo Rate, Cash Reserve Ratio (CRR). Most of the financial instituions’ money is invested in bonds. The rate of interest on bonds will also fluctuate to the above MPC decisions. Interest rate risk is the risk that arises for bond owners from fluctuating interest rates. How much interest rate risk a bond has depends on how sensitive its price is to interest rate changes in the market. The sensitivity depends on two things, the bond's time to maturity, and the coupon rate of the bond. Purchasing high rate of interest yielding bonds and derivatives for rate of interest are best tools for fighting this risk.

3.FOREX RISK:

A common definition of foreign exchange rate risk relates to the effect of unexpected exchange rate changes on the value of the firm. Hedging through foreign currency futures and derivatives is the best way to come out of the forex risk.

4. CREDIT RISK:

A credit risk is the risk of default on a debt that may arise from a borrower failing to make required payments. In the first resort, the risk is that of the lender and includes lost principal and interest, disruption to cash flows, and increased collection costs. The loss may be complete or partial. In an efficient market, higher levels of credit risk will be associated with higher borrowing costs.

Minimise the credit risk by adopting scientific techniques for credit evaluation, prescribing exposure limits, portfolio composition and periodic review of the portfolio. Both the companies operate in the mid-market end-user segment where the delinquency rates have been lower. A large chunk of borrowers are in the salary group. The Company has been following stringent credit assessment processes like adoption of the application scoring system (scorecard), compulsory CIBIL checks, field checks, legal and technical due diligence, etc. which have helped to reduce incremental delinquencies. The average loan to value is in the range of 50-60% (as against the regulatory limit of 90% for loans upto ` 20 lakh and 80% for loans above ` 20 lakh. The low average ticket size of ` 15-16 lakh and pan India spread of Business adequately disperses the Risk. The Companies have the best recovery machineries in its category, which has addressed NPAs, supported by legislations such as SARFAESI Act. It includes measures initiated by RBI such as setting up Asset Reconstruction Companies (ARCs), Debt Recovery Tribunals (DRTs), Securitization Act, Compromise Settlement Schemes, etc. Risk Management Committee With the objective of ensuring that the risks impacting the business of the companies are identified and appropriate measures are taken to mitigate the same, the Companies have formulated and adopted an integrated risk management framework.

5.OPERATIONAL RISK:

Operational risk is "the risk of a change in value caused by the fact that actual losses, incurred for inadequate or failed internal processes, people and systems, or from external events (including legal risk), differ from the expected losses". This definition, adopted by the European union Solvency II Directive for insurers, is a variation from that adopted in the Basel II regulations for banks. In October 2014, the Basel Committee on Banking Supervision proposed a revision to its operational risk capital framework that sets out a new standardized approach to replace the basic indicator approach and the standardized approach for calculating operational risk capital. Minimise the operational risk by strengthening the internal control procedures and making systemic corrections to address the deficiencies reported by the Internal Auditors.

Some external factors, like high inflation, reduction in employment, incidents like subprime crisis, demonetization, introduction of GST, etc. All these factors lead the housing finance companies into troubles, like non-payment of EMI and postponement of payment of EMI, no demand or low demand for loans, etc. Non-payment of EMI leads to accumulation of Non-Performing Assets(NPA). The asset quality is a prime concern and impacts various performance indicators, i.e., profitability, intermediation costs, liquidity, credibility, income generating capacity and overall functioning of HFCs.. The reduction in asset quality results in Non-Performing Assets (NPAs). The Narsimham Committee Report opines that An advance/loan is treated as non-performing when it fails to satisfy its repayment obligations. If the borrower fails to pay the interest or the principal for 180 days, the loan is treated as NPA. Later the period was reduced to 90 days.Thus, non-performing assets are loans in jeopardy of default. The level of NPAs is an indicator of the efficiency of HFCs credit risk management and efficiency of resource allocation to productive sectors.

The Basel Committee on Banking Supervision defines credit risk as “potential default of a borrower to meet the obligation in accordance with the agreed terms” (BIS, 2005). Higher
non-performing assets resulted in many bank failures. NPAs represent a real economic cost in modern days as they reflect the application of scarce capital and credit funds to unproductive use.

Now, it is time to have a glipse at the NPAs of the both the companies. The table No.1, shows the NPAs of the both the companies. The NPA is expressed as a percentage to the outstanding loans. The NPAs of the HDFC are decreasing from 0.81 percent in the year 2008 to 0.69 percent in the year 2014 and increased thereafter. The NPAs of the LICHFL are also decreasing from 1.70 percent in the year 2008 to 0.42 percent in the year 2012 and slightly increased and decreased. And further the NPAs of the LICHFL are always lower than that of the HDFC.

Table 1 GROSS NON-PERFORMING LOANS OF HDFC & LICHFL (Rs.Crores)

YEAR	HDFC			LICHFL		
	Outstanding loans	NPL	%	Outstanding loans	NPL	%
2008	72997.94	613.18	**0.84**		372.91	**1.70**
2009	83856.08	701.55	**0.81**	27679.20	297.00	**1.07**
2010	97966.99	782.85	**0.79**	38081.30	263.15	**0.60**
2011	117126.62	903.85	**0.77**	51089.83	241.96	**0.47**
2012	140874.58	1069.00	**0.74**	63080.15	265.02	**0.42**
2013	170046.17	1199.00	**0.70**	77812.80	471.22	**0.61**
2014	197100.00	1357.00	**0.69**	91340.08	609.00	**0.67**
2015	228181.00	1542.00	**0.79**	108360.70	494.68	**0.46**
2016	259224.00	1833.00	**0.70**	125173.19	567.81	**0.45**
2017	296472.00	2378.00	**0.79**	144534.00	627.82	**0.43**

Source: Compiled from the Annual Reports of the HDFC & LICHFL.

The loan approvals and loan disbursals are shown in table No.2. The loan applicant completes primary eligibility, the loan shall be approved. And after completing all the formalities, the loan will be disbursed. In case of buying a home, the entire loan is disbursed at a time. But in case of a house construction, the loan is disbursed in three instalments as the work progresses. The percentage of loan disbursal in HDFC is ranging between 77.31 percent to 88.92 percent, showing an increasing trend. In case of LICHFL, the loan disbursal trend is also increasing. It is ranging between 82.05 percent to 95.63 percent. There is a higher rate of disbursal is visible in LICHFL, which is treated as better performance.

Table 2 LOAN APPROAVAL, DISBURSEMENTS OF HDFC & LICHFL

(Rs.Crores)

YEAR	HDFC			LICHFL		
	Approvals	Disbursements	%	Approvals	Disbursements	%
2008	42520.00	32874.99	**77.31**	8617.88	7071.48	**82.05**
2009	49166.66	39650.00	**80.65**	12447.73	10898.47	**87.55**
2010	60611.00	50413.00	**83.17**	18043.17	14852.92	**82.32**
2011	75185.00	60314.00	**80.22**	22602.92	19912.39	**88.09**
2012	90154.00	71113.00	**78.88**	22034.50	20027.07	**90.89**
2013	103260.00	82452.00	**79.85**	26477.27	24358.43	**92.00**
2014	115212.00	92455.00	**80.25**	26708.30	25271.23	**94.62**
2015	269201.00	228181.00	**84.76**	31712.90	30327.32	**95.63**
2016	291531.00	259224.00	**88.92**	36024.32	34529.33	**95.85**
2017	338478.00	296472.00	**87.60**	43575.29	41541.20	**95.33**

Source: Compiled from the Annual Reports of HDFC & LICHFL.

The average loan size of the two companies is also taken into consideration. The average loan size of the HDFC is increasing from Rs.14.70 lakh in the year 2008 to Rs.25.60 lakh. The average loan size of the LICHFL is also increasing from Rs.14.50 lakh in the year 2008 to Rs.20.00 Lakh in the year 2017. The average loan size is smaller in case of the LICHFL than that of the HDFC. It is also observed that 95 percent of the borrowers of the LICHFL are employees, where the employees category borrowers are limited to 73 percent in HDFC.

VII.CONLUSIONS & SUGGESSIONS

1. The HDFC is the largest HFC in private sector, whereas the LICHFL is the largest in public sector.
2. Both the companies are concentrating on employees category, the LICHFL is giving more priority to employees.
3. The NPAs are more in HDFC than in LICHFL.
4. The average loan size is higher in HDFC, i.e.Rs.25.60 lakh.
5. Both the companies are following similar risk management methods. But, it is managed better in case of LICHFL.

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