Publication: BloombergQuint
Headline: Home Loan Firms Seek Guarantee Cover As They Tread Into Riskier Segments
Date: May 08, 2019

Banks and housing finance companies, which are slowly expanding the pool of customers that they are willing to give home loans to, are experimenting with mortgage guarantees as a way to reduce the risk of default.

Mortgage guarantees—a product common and, in some cases, mandatory in developed markets—is relatively new to India. The India Mortgage Guarantee Corp. was the first such firm to be set up in 2014 as a joint-venture between the National Housing Bank, International Finance Corporation, Asian Development Bank and Genworth Financial Inc.

In the five years since, IMGC has seen its portfolio grow to nearly Rs 7,000 crore as of March 2019, Sovan Mandal, chief commercial officer at IMGC told BloombergQuint. The amount of guarantees outstanding has nearly doubled compared to Rs 3600 crore as of March 2018, Mandal said.
Most of the guarantees are for loans in the affordable housing segment.

Close to 84 percent, or Rs 5,800 crore in guarantees, are backing affordable housing loans, shows IMGC data. The remaining 16 percent of IMGC's have been sought by lenders to secure loans in the premium home-loan segment.

A mortgage guarantee helps lenders underwrite risks better, particularly in the affordable housing segment, where their experience may be more limited, said Mandal.

"Essentially this is a credit-loss guarantee given to lenders for better risk-management. If there is a default on a home-loan, the lender will receive the outstanding loan amount, up to the extent of guarantee they have taken," he added.

How It Works?
The guarantee could be structured in different ways—on a loan-by-loan basis or portfolio basis—where the security cover for the lender could range from 10 percent, 20 percent or 30 percent. Most lenders are taking a cover of either 20 percent or 30 percent of the principal loan amount, Mandal added.
The fee for the guarantee is paid upfront by the lender at the time of the loan. While charges vary based on the loan, the borrower's credit profile and kind of cover provided, they are close to 100-200 basi spoints of the loan amount, said Mandal. Some of this may be passed on to the customers in the form of interest rates or management charges.

The guarantee can be invoked if repayments are overdue by 90 days.

While lenders benefit by securing payments against possible delinquencies, borrowers benefit by getting access to a loan they would have otherwise struggled to secure or via a higher loan relative to the price of the property.

Who Is Using These Guarantees?

Lenders that have used these guarantees include ICICI Bank Ltd., Dewan Housing Finance Ltd., India Shelter Finance, Shriram Housing Finance Ltd., Tata Capital Ltd., Reliance Home Finance Ltd. and Bank of Baroda, among others.

Anil Kaul, managing director of Tata Capital, told BloombergQuint that mortgage guarantees are prudent
as lenders sharpen their focus on low-ticket home loans. At Tata Capital, mortgage guarantees have been used to back portfolios where there is an additional risk. Additionally, the tie-up with IMGC gives the firm access to a wider target audience, Kaul said.

“Bank of Baroda did one transaction with IMGC for a small pool of home-loans in 2017 on a “test” basis”, said VK Sethi, head–mortgages & retail assets at the lender. “The bank was keen to see how these mortgage guarantees work when borrowers face unforeseen circumstances”, Sethi said.

ICICI Bank, Dewan Housing Finance, Shriram Housing and Reliance Home Finance did not respond to queries sent by BloombergQuint.

Karthik Srinivasan, senior vice president at ICRA Ltd. said lenders are testing mortgage guarantees as a way to mitigate risk.
HFCs and banks are looking at taking these guarantees to secure loans in specific geographies, where they may not have a presence, or for certain types of borrowers where they want an additional credit protection. Karthik Srinivasan, Senior Vice President, ICRA Ltd

Over the past few years, the government has pushed the affordable housing sector using the Credit Link Subsidy Scheme on home loans under the Pradhan Mantri Awas Yojana. This has prompted several HFCs and banks to increase focus on small-ticket loans.

However, some of these loans have proved to be riskier. A Reserve Bank Of India study in 2018 had shown that delinquencies are at over 10 percent for small-ticket loans of below Rs 2 lakh. For loans upto Rs 5 lakh, delinquencies are at about 4 percent.

A senior executive at a housing finance company, while speaking on condition of anonymity, said that the government’s push for affordable housing loans economically weaker segment has presented an underwriting challenge. The guarantee helps a borrower secure a home loan, which would have otherwise been rejected on the basis of a pure credit-risk analysis. Instead we ask customers to take a mortgage guarantee with their home loan, which will decrease their credit burden and help the lender reduce risk.

IMGC works alongside lenders to underwrite and value the borrowers, said Mandal.

These are not bad customers but there are challenges in terms of estimating their future incomes and the probability of default. Through a mortgage guarantee, the borrower can get the same principal loan amount over a longer tenure, which will reduce their monthly repayments.
Sovan Mandal, Chief Commercial Officer, IMGC