

Underwriting practices key to controlling credit risks in affordable housing loans segment: Moody's: The Business Line

Underwriting practices of housing finance companies are vital to controlling credit risks in India's affordable housing loans segment, Moody's Investors Service has said.

This international credit rating agency has noted in a report that better underwriting standards for 'affordable housing' loans can help differentiate residential mortgage-backed securities (RMBS) performance.

In India, housing finance companies (HFCs) are the main affordable housing loan lenders and some have started securitizing their loans via RMBS. Banks are reluctant to lend to the segment because of the lack of documentation.

Moody's expects the affordable housing loan market to grow to Rs. 4,00,000-Rs 8,00,000 crore (\$60 billion to \$120 billion) by 2022 from Rs. 59,300 crore in March 2015, bolstered by government measures.

Affordable housing loans accounted for 14 per cent of the total home loan books of housing finance companies as on March 31, 2015.

Affordable housing loans' segment is set to grow strongly over the next few years-- as the government tries to increase home ownership among underprivileged groups.

"Moreover, 'affordable housing loans' present unique credit risks for lenders and -- when securitized -- for residential mortgage-backed securities (RMBS), because of the nature of the borrowers," said Georgina Lee, a Moody's Assistant Vice President -- Research Writer.

Such loans -- which are mortgages for low-income earners - are typically taken out by first-time home buyers, who are often self-employed in small unregistered enterprises or work for small companies.

Many borrowers do not have previous banking transaction records and, for the self-employed, they do not disclose their incomes or file tax returns.

As such, the formal documentation or records needed to verify income and the ability to service loans is absent, similar in some ways to "low-doc" mortgage loans in other jurisdictions.

"In this context, the underwriting practices of lenders -- in this case, housing finance companies (HFCs) -- are vital to controlling credit risk", said Lee. "Some key credit considerations for HFCs when they originate affordable housing loans include income assessments and the quality of the construction firms involved when the loan is for the purpose of funding an individual's purchase of a home; some HFCs prefer to extend loans to the specific building projects of construction firms that they have pre-approved."

Moody's conclusions were contained in a just-released report on RMBS in India.

The "know your customers" (KYC) guidelines and procedures are the first point of operational and credit risk control for HFCs when underwriting affordable housing loans.

In this regard, HFCs follow the KYC guidelines set by their regulator, the National Housing Bank (NHB), to verify the identity of borrowers, an important initial step, given the lack of documentation typically associated with affordable housing loans.

In recent years, HFCs have also started using e-KYC -- using online verification to check a borrower's 12-digit unique identification number called Aadhaar -- to help them minimize the risk of identity fraud and document forgery.