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June 24, 2013

Industry View
In-Line

India Financial Services

Lower Risk Weights: Adding to the Sweet Spot for HDFC

The RBI has lowered risk weights on certain categories of individual housing loans: It also carved out a new segment, 'CRE – Residential Housing (CRE-RH)', within the commercial real estate sector. Loans to this segment will carry lower risk weights and standard asset provisioning. This will help release some capital on existing loans for banks and lower capital requirements on new loans. The benefit to HFCs, especially HDFC, is likely to be much higher, if the NHB follows up with similar regulations (we expect it to follow the RBI).

Lenders with high exposure to medium / large ticket home loans will benefit: The RBI has reduced risk weights on individual housing loans > Rs2 mn and up to Rs7.5 mn to 50% from 75%. It has also marginally relaxed the loan to value (LTV) cap on these loans to 80% from 75% previously. Further, loans > Rs7.5 mn will now attract a risk weight of 75% provided LTV is not higher than 75% (the previous risk weight was 125% irrespective of LTV).

This is a positive move given the appreciation in property prices across the country. Private banks are likely to benefit more than SOE banks given higher exposure to medium / higher ticket loans. However, HFCs, being mono-line lenders, will benefit more (once the NHB follows up with similar norms).

Lenders to residential housing projects will also benefit: Because loans to residential housing projects are less risky and volatile, the RBI has carved out a separate category, CRE-RH, within the commercial real estate sector. Loans to this segment will attract a risk weight of 75% and standard provisioning of 0.75% vs. 100% and 1% respectively for other CRE loans. CRE exposure in the banking system is relatively limited (~2.5% of system loans).

The key beneficiary will be HDFC: According to management ~15% of loans will qualify as CRE-RH.

Key Changes in Risk Weights and Standard Asset Provisioning with respect to Individual Housing Loans & CRE Loans

	LTV Ratio Cap (%) to be eligible for prescribed Risk Wts.		Risk Weight (%)		Standard Asset Provisioning (%)	
	OLD	NEW	OLD	NEW	OLD	NEW
(a) Individual Housing Loans						
(i) <= Rs. 2 mn	90	90	50	50	0.4	0.4
(ii) > Rs. 2 mn & <= Rs. 3 mn	75	80	50	50	0.4	0.4
(iii) > Rs. 3 mn & <= Rs. 7.5 mn	75	80	75	50	0.4	0.4
Loans <= Rs 7.5 mn with LTV > 75%			*100*	*No Mention*		
(iv) > Rs 7.5 mn	NA	75	125	75	0.4	0.4
(b) CRE-RH	NA	NA	100	75	1.0	0.75
(c) CRE	NA	NA	100	100	1.0	1.0

Source: RBI, Morgan Stanley Research

HDFC is the key beneficiary (cont'd): On our calculations, this move will release around 200 bps of Tier 1 (our discussion with management also suggested that the benefit is likely to be around 2ppt). Tier I ratio will move up to ~16% from 13.9% currently. This will structurally take up HDFC's ROE. There will be some release of standard asset provisioning on CRE-RH loans (~1% of F13 PBT on our computations). HDFC may decide not to release these provisions.

Our view on HDFC is that it is in a sweet spot – loan growth is strong and spreads are looking up. This makes it amongst the fastest-growing financial institutions in terms of revenue. The capital release adds to the positive momentum for HDFC's fundamentals, in our view.

Impact on other lenders

According to LICHF management, ~10% of outstanding individual housing loans are between Rs2 mn to Rs7.5 mn. Further, ~80% of CRE loans are likely linked to residential housing and hence might benefit from lower risk weights. On our computations, this could translate into a capital release of ~40 bps of RWAs.

We do not have details on individual housing loan split by ticket size and CRE loans that qualify as CRE-RH loans for banks. Further, we do not have details of loan against property (which are unlikely to benefit).

In our view, benefits are unlikely to be material for banks because mortgages form a much smaller part of overall their portfolios (unlike HFCs). If we assume that ~50% of individual housing loans are between Rs2 mn to Rs7.5 mn and that ~75% of CRE loans qualify as CRE-RH, the increase in Tier I ratio would be around 10-20 bps for SOE banks and around 40 bps for private banks.

What next – lower rates for residential mortgages & loans to CRE-RH? On our approximate computations, banks can afford to lower lending rates by around 25-50 bps for residential mortgages (>Rs2mn up to Rs7.5mn). However, in the case of SBI, the yield differential between loans in this bracket and the lowest bracket (for which there has been no reduction in risk weights) is only 15 bps. Hence there is unlikely to be any material change in rates in our view.

Banks with a higher pricing differential across various brackets may consider narrowing the spread. For residential loans > Rs7.5mn, the scope to reduce rates is higher, given the lowering of risk weight to 75% from 125%. However, the proportion of loans in this bracket for the major players is likely to be low.

In the case of CRE-RH loans, the scope to lower rates is around 50-75 bps on our computations. Given the stress in the developer segment, there is a case to lower rates.

Finally, given that capitalization levels at SOE banks is already low, they may choose to use the benefit of the new norms to conserve capital rather than lower rates or expand lending to the CRE segment.

(Please see table with computations on impact on capital for the various banks / HFCs in the next page)

Exhibit 1

Capital benefit across banks and HFCs in MS Coverage from lower risk weights on individual housing loans and CRE-RH

Rs bn	A O/s Individual Housing Loans	B O/s Non Individual loans	C O/S Housing Loans (>Rs 2 mn) Qualifying for Lower Risk Wts.	D Non Individual Loans Qualifying as CRE-RH	E = A*C + B*D Overall loans where Risk Wts. Will reduce by 25%	F Reported Risk Weighted Assets (RWAs)	G = F - E*25% RWAs using new Risk Wts.	H Reported Tier I Capital (Rs bn)	I Reported Tier I Ratio	J = H / G Tier I Ratio based on new Risk Wts.	K = J - H Capital Release (As % of RWAs)
Banks											
			Assumption	*Assumption*							
BOB	160	68	*50%*	*75%*	131	3048	3015	309	10.1%	10.2%	0.1%
BOI	103	71	*50%*	*75%*	105	2806	2780	230	8.2%	8.3%	0.1%
Canara	131	16	*50%*	*75%*	77	2458	2439	240	9.8%	9.8%	0.1%
OBC	63	77	*50%*	*75%*	89	1375	1352	126	9.2%	9.3%	0.2%
PNB	143	136	*50%*	*75%*	173	3244	3200	317	9.8%	9.9%	0.1%
SBI (Parent)	1195	250	*50%*	*75%*	785	10009	9813	950	9.5%	9.7%	0.2%
Union	124	35	*50%*	*75%*	89	2039	2017	168	8.2%	8.3%	0.1%
Axis	361	114	*50%*	*75%*	266	2584	2517	316	12.2%	12.6%	0.3%
HDBK	168	81	*50%*	*75%*	145	3059	3023	339	11.1%	11.2%	0.1%
ICBK	576	278	*50%*	*75%*	496	4419	4295	566	12.8%	13.2%	0.4%
ING Vysya	33	14	*50%*	*75%*	27	424	417	45	10.5%	10.7%	0.2%
Kotak (Parent)*	103	61	*50%*	*75%*	97	610	586	90	14.7%	15.3%	0.6%
HFCs											
HDFC	1113	587	*50%*	43%	812	1702	1499	236	13.9%	15.7%	1.9%
LICHF	751	27	10%	80%	96	621	597	63	10.1%	10.5%	0.4%

Source: RBI, Company Data, Morgan Stanley Research; Above data is as of Mar-13. **Note: a)** Data on outstanding commercial real estate loans is not available and hence we have used fund based exposure to commercial real estate provided in the annual report. **b)** We do not have data on loans qualifying as CRE-RH across banks / HFCs and neither do we have the split of individual housing loans by ticket size. Hence we have made assumptions as mentioned in column C and D in the above table. Assumptions for LICHF are based on conversation with the company. **c)** We do not have data on "Loan against property" within individual housing loans for banks / HFCs which may not necessarily qualify for the lower risk weights (with the exception of Axis and ING Vysya. **d)** *Proportion of LAP for Kotak is likely to be higher than other banks. We do not have details on the same and hence the capital benefit as per the above table looks higher at ~60 bps

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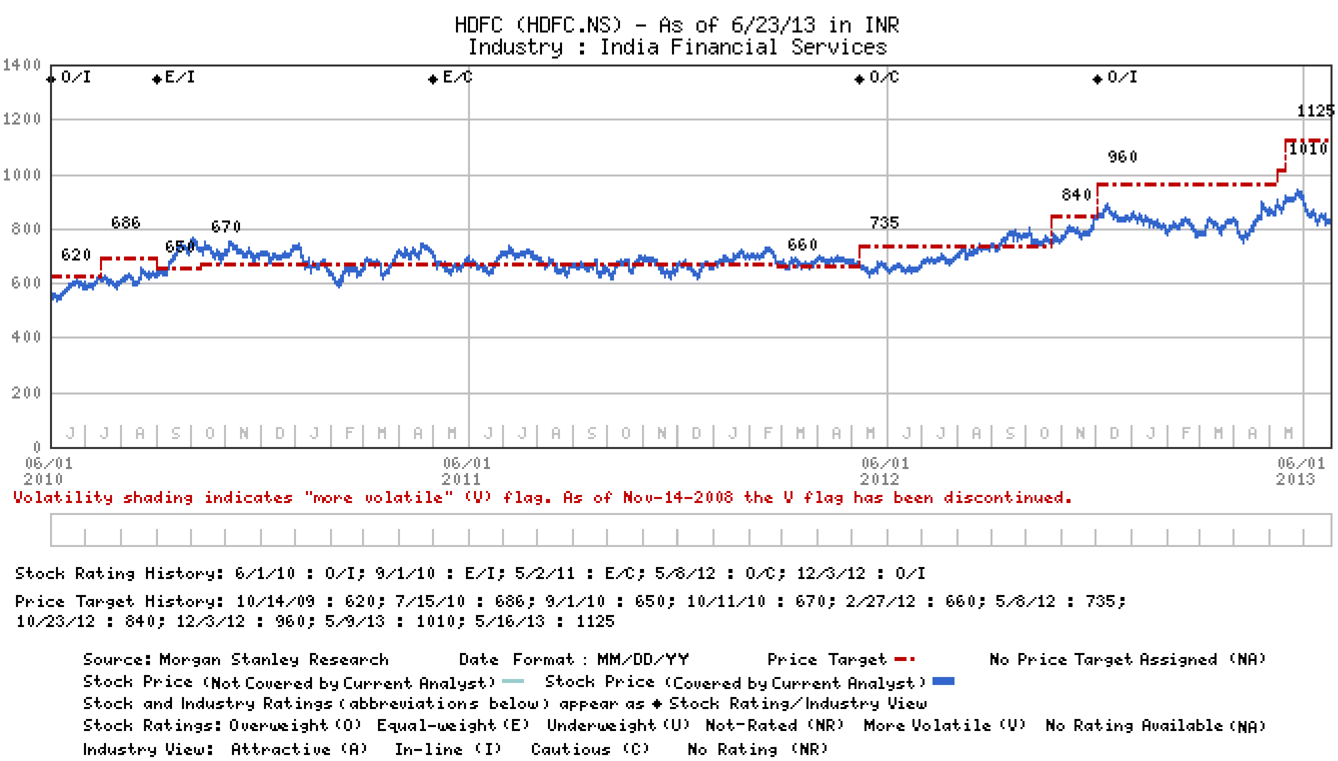

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State Bank of India (SBI.NS)	U (05/02/2011)	Rs1,989.1
Subramanian Iyer		
IDFC (IDFC.NS)	E (10/28/2012)	Rs136.35
LIC Housing Finance Ltd. (LICH.NS)	O (12/03/2012)	Rs257.75
Multi Commodity Exchange of India Ltd (MCEI.NS)	E (04/10/2012)	Rs829.3
Shriram Transport Finance Co. Ltd. (SRTR.NS)	O (07/25/2012)	Rs719.85
Sumeet Kariwala		
Bank of Baroda (BOB.NS)	E (07/16/2012)	Rs549.7
Bank of India (BOI.NS)	U (05/02/2011)	Rs243.8
Canara Bank (CNBK.NS)	U (05/02/2011)	Rs354.65
ING Vysya Bank Ltd. (VYSA.NS)	E (12/22/2010)	Rs616.2
IndusInd Bank (INBK.NS)	O (12/03/2012)	Rs464.3
Oriental Bank of Commerce (ORBC.NS)	U (12/03/2012)	Rs214.7
Punjab National Bank (PNBK.NS)	U (05/02/2011)	Rs667
Union Bank of India (UNBK.NS)	U (12/03/2012)	Rs194.15
Yes Bank (YESB.NS)	O (10/20/2009)	Rs452.75

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.