KfW Entwicklungsbank

# India: Housing Development Finance Corporation (HDFC) II

**Ex-post evaluation**

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| **OECD sector** | 24030 – Financial intermediaries of the formal sector | |
| **BMZ project ID** | 1993 65 800 | |
| **Project-executing agency** | Housing Development Finance Corporation (HDFC) | |
| **Consultant** | No information available | |
| **Year of ex-post evaluation** | **2005** | |
| | **Project appraisal (planned)** | **Ex-post evaluation (actual)** |
| **Start of implementation** | 1994 | 1994 |
| **Period of implementation** | 3 years | 7 years |
| **Investment costs** | No information available | No information available |
| **Counterpart contribution** | No information available | No information available |
| **Financing, of which Financial Cooperation (FC) funds** | EUR 15.3 million | EUR 15.3 million |
| **Other institutions/donors involved** | None | None |
| **Performance rating** | 2 | |
| **• Significance / relevance** | 2 | |
| **• Effectiveness** | 3 | |
| **• Efficiency** | 2 | |

**Brief description, overall objectives and project objectives with indicators**

The objective of the project “Housing Development Finance Corporation (HDFC) II“ was to provide adequate housing in rural and urban areas and to ensure the occupancy of the housing units constructed by the target group (project objective). The target group was defined as ”economically weaker sections“ (EWS) of the Indian population.[1] The purpose of the project is to make a contribution to improving the housing situation of lower income groups in India (overall objective).
In the context of the project refinancing lines were provided through HDFC for state and non-state organisations which offer housing finance for the EWS segment. Altogether funds in the amount of approx. EUR 15.3 million have been made available.

The following indicators were defined to measure the achievement of the programme objectives: I) at least 90% of the measures (construction of new buildings/house purchases) have been conducted properly and the housing units are in a proper condition and occupied by persons from the target group, II) at least 90% of rehabilitations and expansions have been conducted properly and the housing units are occupied by persons from the target group and III) the repayment rate for organisations offering housing financing to people in the EWS segment is at least 80%.

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[1] In order to be able to allocate the subsidized housing units adequately to the different targets groups the Indian government has divided the population into four income-based groups: Economically Weaker Section (EWS), Low Income Group (LIG), Middle Income Group (MIG), High Income Group (HIG).

**Programme Design / Major Deviations from the original Programme Planning and their main Causes**

HDFC was set up in 1977 and is the oldest private housing finance company (HFC) in India. HDFC has developed from a predominantly local institution to a joint-stock financing institution majority-owned by international shareholders. 78% of the shares are held by international institutional investors. The market capitalisation of HDFC amounts currently to around USD 2.0 billion. Thus, HDFC belongs to the 10 largest listed corporations in India. Moreove, HDFC is the only non-bank in India that has a AAA rating from the two leading Indian rating agencies CRISIL and ICRA. Housing finance is the main business area of the HDFC group. However, HDFC is active in other areas of the financial sector through several strategic company holdings.

In the context of the FC project the grant funds extended to HDFC were made available to refinance housing construction measures for economically disadvantaged sections of the population. HDFC did no extend the funds directly to the target group but extended them to different housing finance organisations (HFOs) as loans on EWS terms (interest rate of 9.0%, maximum term of 22 years). In individual cases, in the context of natural disasters, grants were also made available. HDFC obtained a margin of 2.5% from interest reflows.

The selected HFOs were mainly non-governmental organisations (NGOs) but also micro-finance institutions (MFIs) and public executing agencies. In the context of the FC project no uniform conditions were defined for the on-lending of the funds by the HFOs to sub-borrowers. Instead, the on-lending was carried out in the framework of the credit technologies used by the respective HFOs. Typically, the loans were extended as individual loans; the loan terms usually ranged between 10 and 15 years. In general land titles (many borrowers have quasi-legal and, thus, tradeable ownership titles) or the material consumed in the course of the construction works were used as security for the loans. The average interest rate charged to sub-borrowers were ranged between 12 and 16%. In view of the high credit risk in the context of housing loans extended to the EWS group we consider the margin for the HFOs as rather small. The housing loans extended by the HFOs covered in general about 75% of the total costs of the housing construction measure. The remaining costs were covered by the beneficiaries through savings, informal sources of finance (relatives, usurers) or personal contributions made in the course of the construction works. Repayments made under the HFO loans are allocated to a special account; the funds of this special account are then used on a revolving basis to refinance further loans. Taking into account the respective repayment deadlines 97% of loans extended in the first round of lending were actually repaid.

Altogether, a volume of INR 588.2 million (EUR 13.67 million) was handed out through the above-described mechanism under 111 loans granted to 66 HFOs. In addition, against the background of two regional natural disasters (Orissa Cyclone, Latur Earthquake) grants of altogether INR 110.7 million (EUR 2.5 million) were extended to two NGOs for the reconstruction of several settlements. Overall 58,978 housing units were financed with the FC funds. We assume that through the measures it was possible to improve the housing situation of some 350,000 beneficiaries. There is no indication that segments other than the EWS segment were the main beneficiaries of the housing loans provided.
As regards the achievement of the target indicators the following statements can be made: With regard to indicators I and II, at the level of the HDFC only data on the completion of the measures financed is collected (99%). However, due to satisfactory repayment rates at the level of the on-lending organisations and frequent – though not representative – on-site inspections it seems to be justified to assume that the target indicators were fulfilled. Indicator III in a narrower sense was not fulfilled because altogether 12 on-lending organisations of a total of 66 organisations had a repayment rate of less than 80%. On the whole, however, the average repayment rate of all 66 on-lending organisations was just under 90% (unweighted average).

**Key results of the impact analysis and performance rating**

With a market share of around 30% the HDFC is by far the largest supplier of housing finance in India. The insitution is managed professionally and has a high degree of financial stability. Thus, the HDFC can be assumed to be able to provide housing finance on a sustainable basis. However, the mortgage loans extended by the HDFC outside of the FC project are given mostly to population groups that are economically better off. The target group of the FC project is hardly taken account of in HDFC's normal business activities. The approach chosen in the context of the FC project, which is to reach the EWS segment through the refinancing of suitable HFOs, is only of minor importance as a business segment for HDFC, in terms of both total amounts and general business policy. It cannot be assumed that in the medium term HDFC will use its own funds in addition those provided on a revolving basis in the context of the FC project in order to refinance the HFOs.

Regardless of this aspect, however, structural effects on the financial sector can be recognized in the sense that part of the institutions refinanced by HDFC have already started to take out commercial loans from commercial banks in order to refinance their housing loan programmes. Here, the HDFC II project played an important pilot role. The commercial banks are increasingly seeing lending to the HFOs as a new area of business. Figures on the volume of this area of business are not available, however, it has to be assumed that the amounts involved so far are rather moderate, though encouraging.

The main impact of the programme is at the socio-economic level. The creation of additional and better housing helps to satisfy the basic need of “dignified housing”. This also offers better chances to the poorer sections of the population. Especially families with several children benefit in many ways from the extended and qualitatively better housing. The loans extended enable the beneficiaries to get along in their own responsibility. Moreover, the planning, financing and implementation of the housing measures were designed largely by the people from target group on their own account. Another positive effect from the viewpoint of the beneficiaries is that a large number of them were able to use the extended floor space available to take up an occupation (for instance by using it as a place of production for a small trade). Thus, due to the strong orientation to the needs of the target group the programme contributes directly to poverty reduction. Roughly half of the beneficiaries were women.

In a summarized assessment of all the above impacts and risks we have arrived at the following rating of the project’s developmental effectiveness:

<u>Effectiveness</u>
The objective of the project “Housing Development Finance Corporation (HDFC) II - the provision of adequate housing in rural and urban areas and the occupancy of the housing units constructed through the target group – was achieved. Almost 500,000 housing units were built or rehabilitated with the FC funds provided. There are no indications that the housing units are not mostly occupied by people from the target group. We rate the programme’s overall effectiveness as satisfactory (**sub-rating 2**).

<u>Relevance/Significance</u>
The overall objective of the project was to improve the housing situation of lower income groups in India. The lack of access to adequate housing finance is still a major development bottleneck with regard to improving the housing situation for lower income groups. Through the refinancing of housing investments for approximately 350,000 beneficiaries the FC project made an important contribution to improving the situation. In addition, a market-conforming mechanism for the provision of housing loans for the EWS segment was developed in the context of the project. However, taking into consideration financial-sector aspects it has to be critically stated that is was only possible to successfully establish sustainable refinancing mechanisms for EWS loans at the level of HDFC in the sense that HDFC will use the FC funds provided on a long-term revolving basis to refinance HFOs. As we do not expect that HDFC will also employ its own funds for such refinancing business the broad-scale impact of this mechanism is limited. Overall, we rate the **significance/relevance** of the project as sufficient (**sub-rating 3**).

<u>Efficiency</u>
HDFC has highly efficient organisational and process structures. All cost-related indicators are excellent in international comparison. We also rate the production efficiency as very good. The repayment rate for the FC funds achieved at the level of HDFC is 97%, which is excellent. The repayment rate at the level of the HFOs is around 90%. The difference was made up 100% by the HFOs through other sources of finance. We hold the view that the lending process practiced at the level of the DFU and the individual HFOs is in general suitable and market-conforming and the on-lending conditions applied were altogether adequate. We equally rate the allocation efficiency as satisfactory. Therefore, we judge the project’s **efficiency a**s satisfactory (**sub-rating: 2**).

In the final analysis, accounting for the above-mentioned aspects, we judge the developmental effectiveness of the programmes as satisfactory **(overall rating 2**).

### General Conclusions and Recommendations

From today's point of view a housing project which is mainly implemented through financial sector institutions and which focuses on the provision of housing finance should be designed strictly adhering to the sectoral policy paper "Financial System Development". Objectives and indicators should be oriented equally to the project executing agencies (and their overall performance) and to effects on the real economy.

## Legend

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| **Developmentally successful: Ratings 1 to 3** | |
| **Rating 1** | **Very high or high degree of developmental effectiveness** |
| **Rating 2** | **Satisfactory developmental effectiveness** |
| **Rating 3** | **Overall sufficient degree of developmental effectiveness** |
| **Developmental failures: Ratings 4 to 6** | |
| **Rating 4** | **Overall slightly insufficient degree of developmental effectiveness** |
| **Rating 5** | **Clearly insufficient degree of developmental effectiveness** |
| **Rating 6** | **The project is a total failure** |

### Criteria for the Evaluation of Project Success

The evaluation of the "developmental effectiveness" of a project and its classification during the ex-post evaluation into one of the various levels of success described in more detail below concentrate on the following fundamental questions:

- Are the **project objectives** reached to a sufficient degree (aspect of project **effectiveness**)?
- Does the project generate sufficient **significant developmental effects** (project **relevance** and **significance** measured by the achievement of the overall development-policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?
- Are the **funds/expenses** that were and are being employed/incurred to reach the objectives **appropriate** and how can the project's microeconomic and macroeconomic impact be measured (aspect of **efficiency** of the project conception)?
- To the extent that undesired **(side) effects** occur, are these tolerable?

We do not treat **sustainability**, a key aspect to consider for project evaluation, as a separate category of evaluation but instead as a cross-cutting element of all four fundamental questions on project success. A project is sustainable if the project-executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms, or to carry on with the project activities on their own and generate positive results after the financial, organisational and/or technical support has come to an end.