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Potential stress in non-bank wholesale book well above reported NPAs

Slowdown hasn't spared retail loans either; asset quality remains a monitorable there too

Non-performing assets (NPAs), measured as 90+ days past due (dpd) for non-banks (comprising non-banking finance companies (NBFC) and housing finance companies, but excluding government-owned NBFCs), are expected to continue to rise by another 30 to 150 basis points (bps) by March 2020, depending on the asset class. This is on the back of 20 to 150 bps increase seen in the first half of fiscal 2020.

Amidst the challenging economic environment, even the traditional retail segments – such as vehicle and home loans, which constitute over half the non-banks' assets under management (AUM) – have seen NPAs inching up.

But it is not the traditional segments where the material concerns lie. It is the wholesale loan book where more significant slippages are expected to manifest as portfolios come out of moratorium.

To be sure, real estate and structured credit comprise only ~16% of the AUM of non-banks (~Rs 3.8 lakh crores as on March 31, 2019). But these segments are experiencing heightened headwinds as the financial flexibility of many underlying operating companies in the structured debt space and real estate developers have been impacted due to overall slowdown in business. Moreover, a major chunk of the loan book is under moratorium. That means NPAs could jump when loans come out of it.

Reported NPA in real estate segment is estimated to have increased to 3.3% as on September 30, 2019, from 1.8% as on March 2019. About 40% of the book (including lease rental discounting (LRD)) was still under moratorium as on September 30, 2019. As the book under moratorium and the LRD books have low delinquencies, to understand the true level of stress in the real estate loan book, CRISIL has considered the NPAs on the base of the book out of moratorium (and excluding LRD). This results in NPAs standing at ~10% as on September 30, 2019; almost thrice the reported NPAs.

Adjusted 90+ dpd for the real estate portfolio

	Share to AUM	Mar-19	Sep-19
Book in moratorium	~40%	~0%	~0%
Lease rental discounting	~30%	<0.5%	<0.5%
Book out of moratorium	~30%	5.8%	10.2%
Reported NPA		**1.8%**	**3.3%**

Said Krishnan Sitaraman, Senior Director, CRISIL Ratings, "Of the 40% of loan book under moratorium, around half, is expected to come out of moratorium by March 2021 which will result in incremental slippages. Refinance for the segment has also slowed down in the current environment, thus further aggravating matters. In this context, the Rs 25,000 crore support fund for the real estate sector announced by the government could provide a breather for stuck projects, though the timeliness of this remains critical. Given the headwinds being faced by the sector, the incremental funding in these segments is expected to come mainly from newer sources such as alternate investment funds".

Further, loans against property (LAP) portfolios (~9%) have been in the red for the past few years, with the NPAs inching up ~1.75 times to ~3.3% as on September 30, 2019 from ~1.9% as on March 31, 2016. Given current funding challenges, reduction in balance transfer, together with cash flow problems affecting self-employed borrowers, could also lead to an amplification in underlying stress.

If it's any comfort, delinquency in the traditional retail loan portfolios of non-banks look more manageable.

Home loans, the largest chunk (~34%, ~Rs 8 lakh crores as on March 31, 2019), continue to demonstrate why this segment has been considered among the safest asset classes. NPAs inched up by a mere 20 bps in the first half of fiscal 2020. But delinquencies are expected to rise from here for three reasons: the overall economic slowdown, an increase in self-employed portfolios, and rise in share of affordable housing loans in the overall credit pie. That said, they would still remain comfortable and relatively lower than other asset classes.

In vehicle financing, the second-largest segment (~21%, ~ Rs 5 lakh crores as on March 31, 2019), 90+ dpd has increased ~70 basis points from March 2019 to September 2019. These are mainly in the commercial vehicles, cars and utility vehicles portfolios, where there is a high co-relation of delinquencies with the economic environment. To be sure, the performance of the players varies based on the segment of operation. Nevertheless, it is pertinent to note that non-banks in vehicle finance have weathered many such cycles in the past and have re-oriented their collection infrastructure based on experience. So, while there could still be some slippages, NPAs would still be lower than the peak witnessed 4-5 fiscals earlier (~10%).

Said Rahul Malik, Associate Director, CRISIL Ratings, "Nevertheless, with investor confidence about non-banks still a key determinant for funding, asset quality performance will be the differentiator in the near to medium term."

Trend in 90+ dpd across segments

	March 31, 2017	March 31, 2018	March 31, 2019	March 31, 2020 (E#)
Home Loans	0.6%	0.7%	0.9%	~1.2%
Vehicle Finance	9.7%	7.5%	4.8%	~5.8%
Loans Against Property	2.6%	2.7%	2.9%	~3.5%

 # Estimated

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