Underwriting Guidelines

For Affordable Housing Loans

Definition for Affordable Housing Loans

For the purpose of these underwriting guidelines, Affordable Housing Loans are defined as loans that:

- Are provided to individuals (either self-employed or salaried) for the purpose of purchase of existing residential property or for new construction of new residential property, or for renovation or extension of own residential property;
- Have a ticket size between INR 25,000 to INR 20,00,000; and
- Are secured by means of a mortgage either through deposit of title deeds with the Originator (usually referred to as equitable mortgage) or by way of a registered mortgage (*usually referred to as* simple mortgage)

Eligibility Criteria

Criteria	Standard
Governance, strategy and organisational aspects	*The promoters must have:* *i. Credible reputation* *ii. Track record in retail lending/financing (secured or unsecured loans) of at least five years.* *iii. Proven ability to raise financial resources in the form of equity and/or debt.*
	The Originator should have an experienced Board with at least one Independent Director. The Board should play an active role in guiding management.
	Audited financial statements must be available within three months of audit. Audit must have been conducted by a reputed firm.
	The business/sales, credit and credit-operations/back-office functions must be clearly separated, both in terms of the organisation structure and operations. *The Originator must have clearly specified policies with respect to:* *i. Acquiring from an in-house or external qualified legal expert, a legal opinion to establish that valid title will be transferred to the borrower (either from seller or from builder), based on the current title document and any document evidencing possession by the seller (e.g.,* Patta or Khata Khatouni or Saath Baarah etc.) *and the historical trail of transfers of the property and a valid certificate of non-encumbrance from the registration department of the state ("Title");* *ii. Acquiring from an in-house or external resource, opinion with regard to the marketability of the property (from the point of view of resale in case of default), giving due consideration to the building area clearance (Floor Space Index or FSI), availability of common facilities around the property, planned development around the property (as per the Master Plan or other similar local development plan) and market value of the property in comparison to the contracted value at the time of the purchase transaction and the guideline value as prescribed by the registration department of the state ("Valuation")* *In accordance with the Title and Valuation as determined above, the Originator must have clearly specified policies with respect to:* *i. The procedure to be followed and documentation to be obtained, to effect a mortgage in favour of the Originator, either through deposit of valid title documents along with a Memorandum of Deposit of Title Deeds (i.e, equitable mortgage) or through a Mortgage Deed registered with the registration*

Criteria	Standard
	department of the state; and *ii. The maximum permissible loan size against the assessed valuation of the property (i.e., Loan To Value or LTV), giving due consideration to any regulatory restrictions on the same* *In the case of financing purchase of flats within apartment projects where the construction has not been completed at the time of loan sanction:* *i. The Originator must have put in place, criteria for evaluation of the builder and the project, based* inter alia *on:* *a. Builder's vintage in the business* *b. Extent of equity contribution for the project by the builder* *c. Appreciation in market value of property in previous projects constructed by the builder* *d. FSI and other clearances from the local municipal/town planning/development authorities and approval on layout/building plan and builder obtaining commencement certificate from competent authority* *e. Quality of construction, as assessed by in-house or external technical expert* *f. Access to facilities (sewage disposal, water, electricity) and infrastructure (roads, school, public transport hubs etc.)* *g. Market valuation in comparison to cost quoted by builder* *ii. The Originator must have policies/procedures in place for 1) deposit of registered Agreement To Sell (ATS), or 2) entering into an agreement with the builder to effect resale of property in case of default by the borrower and post handing over of possession, effect an equitable mortgage or registered mortgage that is created in favour of the borrower.* *In the above case, the Originator must also evaluate the builder's right to develop the land, either as owner of the land or through a registered agreement with the land owner.*
	The Originator must have a strong second line of leadership. Specifically, the heads of key functions – business/sales, finance, HR, MIS, operations and internal audit/risk – must have at least five years' experience in their respective functions, preferably in financial services in the housing finance sector. *In addition, the Head of the credit function must have at least five years of specific experience of having appraised loan/investment proposals of ticket sizes and type similar to the proposed line of business.*
	Adequate training must be provided to the business/sales team staff as well as to the credit team staff. Training to credit staff must cover in sufficient detail, modules related to business assessment, risk assessment and household cash-flow analysis. In addition, credit staff must be provided training on any specific business types/segments that the Originator has studied, covering the value chain and typical sale price and margins. Training must also specifically cover personal discussion techniques aimed at

Criteria	Standard
	enabling the credit staff understand household cash-flows in the absence of any documents evidencing income.
Management, Systems and Technology	*In case of the self-employed customers,* *through house visits, business visits and personal interviews and income documentation (such as income tax returns and bank statements), the origination process must be structured towards evaluating:* i. *The main business or profession, covering:* a. *Level of capital investment and installed capacity,* b. *Average units sold & size/quantity of each unit sold, supported by bills/vouchers/other documents where available* c. *Average income per service transaction (e.g., plumbing, electrical works, performance of specific worship* (pooja) *etc . and number of clients serviced during a period (e.g., per month)* d. *Quality of the product sold & any seasonality in sales* e. *Market to which products are sold (any captive linkages?)* f. *Number of years of successful operation* g. *Number of years of experience of the entrepreneur in this business* h. *Raw material costs* i. *Labour costs* j. *Cost of other inputs (land & building, plant & machinery, electricity)* k. *Maintenance & repair cost* l. *Cost of insurance required (if any)* *In case of salaried customers, through documented evidence of income such as pay slip, income tax returns and bank statements, the origination process must be structured towards evaluating the cash inflows and outflows of the borrower and his/her household.* ii. *The creditworthiness of the individual borrower should be evaluated based on:* a. *Educational background* b. *No. of persons in the household* c. *Average earnings of all earning members including that of the borrower/applicant* d. *Average household expenses* e. *Household assets and liabilities* f. *Repayment history on other loans (including credit bureau data if available)* g. *Past credit record and record of business interactions (through interviews with suppliers and buyers)* h. *Credit score and track record (e.g., no of loans with overdues and ageing of overdue instalments) of the borrower and of any guarantor or co-applicant as shown in credit bureau reports*

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	This information must form an input for the appraisal of loans.
	Proof of identity and residential address must be collected from every client and this must be admissible under the RBI and NHB "Know Your Clients" guidelines.
	The loan origination process must have sufficient "maker-checker" arrangements, to ensure that the sales/sourcing team's activities are checked at the branch level and the branch level activities (especially, preparation of loan forms and collection of KYC documents) are also checked centrally.
	The product features, rules and regulations, including those related to effective interest rates, upfront fees and other charges, any security or pledge against the loan, penalties for delays in repayment or for prepayment/pre-closure, must be clearly mentioned in the loan agreement and/or sanction letter, as per NHB's Fair Practices Code for HFCs or RBI's Fair Practices Code for NBFCs. These must also be clearly explained to the customer by the sales staff, prior to loan sanction.
	All loans must require at least one a/c payee post-dated cheque, preferably of the borrower's main operative bank account drawn in favour of the Originator, to aid in the process of recovery of loans as per provisions under Indian law and legal precedents.
	The Originator must have a computerised MIS. The MIS software must be tamper proof, with differential access facility for staff at different levels. The MIS must provide for a clear process for checking the demand-collection-balance (DCB) and any balance must be reported to the HO immediately.
	The MIS must be capable of 'flagging' of loans to different funding sources. MIS should also provide the ability to change the 'flagging' from one source to another.
	The MIS must have the capability to link every loan to the sourcing and/or credit personnel, and keep the link active till the loan is closed. *The performance assessment of the sourcing personnel must also be based on the quality of the loans originated by each staff member.*
	MIS must correctly report on amount of arrears, PAR and ageing of the portfolio.
	The Originator must have a clear process for collecting & collating accounting information from the branches and preparing consolidated accounting statements. Consolidated financial statements should be ideally prepared

Criteria	*Standard*
	The must should have systems in place for safe storage of loan files, original property documents and instalment and security cheques, giving due consideration to: *a. Traceability of cheques to customer's loan account* *b. Filing of cheques in accordance with cheque date or in accordance with customer loan file number* *c. Maintaining a stock of cheques based on cheque number, so as to enable audit of cheques* *d. Ensuring restricted and controlled access to cheques and property documents* *e. Protection of storage vault from fire or other natural disasters*
	The Originator must have an internal audit system, which is designed with a focus on operational risk management. The audit system must especially check for the possibility of 'ghost' loans, loans disbursed without proper KYC or without equitable mortgage having been created or an without entering into an agreement with the builder protecting the interests of the Originator in case of default by the borrower or without proper analysis of business and household cash flows and borrower's creditworthiness. The scope of audit must also cover audit of cheques stock, in order to prevent misuse of cheques received from customers.
	Strong arm tactics must not be used for collections.
	The Originators must have robust systems for storage of cash in branches and the same must be regularly monitored centrally and also be subject to frequent physical checks by the audit/risk management team. *Cash at branches beyond pre-specified retention limits must be deposited in bank the same day or the next day, so as to minimise overnight balance of cash.*
	The Originator must have availed of adequate insurance of cash-in-transit and cash-in-premises.
	The Originator must operate in compliance with applicable law and guidelines, e.g. NHB guidelines for HFCs and RBI guidelines for NBFCs.
Financial Performance	*The Originator must regularly map its Asset-Liability Mismatch (ALM) and must have means of financing negative mismatches (i.e., liquidity gaps).*
	The Originator must have a capital adequacy ratio of at least 18%, measured as defined under the Prudential Norms prescribed for HFCs by the National Housing Bank.

Guidelines for Evaluation

Criteria	Standard
Governance, strategy and organisational aspects	*The legal structure of the originator should preferably be an HFC, NBFC or Bank, as the structure provides for:* • *Regulation* • *Incentive structures due to the presence of shareholders* • *Capital adequacy* • *Ability to raise additional capital* *While NBFC/HFC/Bank is the preferred structure, IFMR Capital would also look at working with Originators organised in legal forms such as a cooperative society or a co-operative bank or NGOs, to the extent permitted by law.* *The Originator should have applied to the Ministry of Finance for registration under the the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 and should have received notification of registration vide publication in the Gazette of India. The Originator should also ensure that every transaction where a security interest is created is registered with the Central Registry created under the SARFAESI Act.*
	The Originator should have a business plan including financial projections. The projections should be supported by: i. *Details of new geographies to enter into, including branch locations* ii. *Fundraising plans - debt and equity*
	The Originator should have clear delegations of authority, and oversight mechanisms to insure these are properly adhered to.
Management, Systems and Technology	*The Originator should have a clearly defined recruitment policy for field staff and staff at other levels. This policy should be followed, with the involvement of senior HO staff & regional level field staff.*
	The Originator should have put in place a proper process for hand-over of customer relationships and job responsibilities in case of change in front-line staff on account of transfer, termination or general attrition. Specific cases of such hand-over should be checked by the internal audit or risk management team of the Originator at least on a sample basis.
	All loans should require at least one guarantor who is preferably neither a client of the Originator nor a relative of the borrower.
	The origination process should consist of the following steps: i. *Sourcing of potential clients*

Criteria	*Standard*
	ii. Collection of information - business strength and entrepreneur's creditworthiness *iii. House and business visit by sourcing personnel* *iv. Collection of KYC documents* *v. Collection of documents as evidence of running business* *vi. Preparation of loan application form (including information on guarantor, if any)* *vii. "Health check" of application form by Operations/Back-office* *viii. Credit appraisal of loan application by credit department personnel* *ix. Cross-checking of business and entrepreneur's household information through site verification/house visit by credit department personnel (including visit to guarantor, if any)* *x. Triangulation of information and evaluation of "willingness to pay" through interviews of relatives, neighbours, traders, suppliers etc.* *xi. Cross-checking of surplus business and household cashflows, through documented evidence of saving or investment* *xii. Obtaining an opinion on valuation of the property, as detailed above* *xiii. Obtaining an opinion on title of the property and creation of mortgage, as detailed above* *xiv. Final credit decision-making (should ideally be centralised at region or HO level), supported by a tele-call with the customer by senior credit department staff* *xv. Execution of loan agreement* *xvi. Issue of sanction letter to client* *xvii. Disbursement, preferably into client's operative bank account or into the builder's bank account*
	The product features, rules and regulations, including those related to effective interest rates, upfront fees and other charges, any security or pledge against the loan, penalties for delays in repayment or for prepayment/pre-closure, must be clearly communicated to each borrower. The understanding of the borrower may also be verified at the branch level or at the central level by the internal audit/risk management team of the Originator.
	The Originator should have: *i. Identified specific market segments, including the business types and businesses that will be catered to and those that are in the exclusion list* *ii. Documented the typical sale price and margins (across all product quality types) that are made in the businesses* *iii. Documented the typical capital and working capital investment required for different scales of operations of the business* *iv. Identified the common market linkages specific to each business and the typical trading levels for each type of market linkage* *This information should form an input to credit decision making.*
	All customer level and loan level information should be stored in an electronic format with periodic backups, and should be regularly updated to a centralized location. *In case of disbursement in tranches, the tentative loan disbursement*

Criteria	Standard
	schedule should be input in the MIS.
	The MIS should be able to track historical loan information for each client.
	Details of all cheques received from each borrower should be entered and stored in the system, so as to enable retrieval of cheques and audit of cheque stock. In case of ECS based payment, the ECS order form should be generated from the system.
	The Originator should have clearly laid down policies and procedures for checking utilisation of loan (if applicable) and for maintaining regular contact with borrowers, including but not limited to visits to the client's place of business, in order to be up-to-date with and/or anticipate any changes to the business that could affect the client's ability to service the loan. *In case of disbursement in tranches matching construction, the Originator should also have clearly laid down policies for evaluation of completion of work against amount of loan already disbursed and disbursement based on margin money payment by clients and completion of agreed construction milestones.*
	The Originator must have a clearly defined policy for follow-up on overdue accounts, which should ideally consist of the following steps in accordance with the number of days of delay in payment: *i. Follow-up visit to client's house and business site by staff* *ii. Make contact with guarantor(s)* *iii. Written intimation of default (with copy to guarantor), including therein, the penalties and charges due as well as notice of placing post-dated cheques (if any)* *iv. Placing of post-dated cheque (if any)* *v. Legal notice for bouncing of cheque, as required under relevant legal provisions* *vi. Legal notice for filing of suit for recovery of all dues, including penalties and charges* *vii. Legal notice for repossession of property* *viii. Initiation of Arbitration or other suit in accordance with relevant legal provisions* *While following the above steps, regular personal contact must be maintained with the borrower and the guarantor(s).* *Sufficient escalation mechanisms to either more senior sales staff or the credit/recovery/delinquency management team must be in place during each step of the above process.* *The Originator may allow for out-of-court settlement of cases of delinquency and rescheduling/restructuring of the loan. The process for such settlement or restructuring of loan should be clearly laid out and must involve a recommendation from the customer relationship management team, approval from senior credit department staff as well as from senior*

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	the recovery/collections department.
Financial Performance	*PAR (>90 days) should not be more than 3.0% of the gross total loan portfolio, as measured prior to any write-off or rescheduling of portfolio.* *The PAR (>180 days) should not be more than 1% of the gross total loan portfolio* *The volatility of PAR, as measured by the maximum historical PAR (>30 days) on loans originated at different points of time and the variation between the PAR from different origination periods must not be significantly high.*
	Loan loss provisions should be as per NHB specifications from time to time
	The Originator should maintain a robust liquidity position, as assessed by the analysis of static liquidity (projected month-on-month cash outflows and inflows in terms of maturity of assets and repayment of existing liabilities, assuming no further inflow of external funds and no further disbursement of new loans).
	The Originator should aim for a diversified loan portfolio at least in terms of different localities and source of earnings of the borrowers who are financed to mitigate concentration risk. *The Originator should also be protected from loss in case of death of the client, through insurance.*
	The Originator should demonstrate ability to continue operations in the following stress scenarios: • *Inability to access additional funding for a period of 6 months* • *Decline in net spread of 2%* • *Increase in default rates of 5% for a period of 12 months*