



Report and Recommendation of the President to the Board of Directors

Project Number: 48234
October 2014

Proposed Loan Dewan Housing Finance Corporation Low-Cost Affordable Housing Finance (India)

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 22 September 2014)

Currency unit	–	Indian rupee/s (Re/Rs)
Re1.00	=	\$0.0164
\$1.00	=	Rs60.917

ABBREVIATIONS

ADB	–	Asian Development Bank
ALCO	–	asset–liability management committee
CAR	–	capital adequacy ratio
CPS	–	country partnership strategy
DHFL	–	Dewan Housing Finance Corporation
ECB	–	external commercial borrowing
GDP	–	gross domestic product
HFC	–	housing finance company
LCAH	–	low-cost affordable housing
NHB	–	National Housing Bank
NPA	–	non–performing assets
RBI	–	Reserve Bank of India

NOTES

- (i) The financial year (FY) of Dewan Housing Finance Corporation ends on 31 March. “FY” before a calendar year denotes the year in which the financial year ends, e.g., FY2014 ends on 31 March 2014.
- (ii) In this report, "\$" refers to US dollars unless otherwise stated.

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PROJECT AT A GLANCE

1. Project Name: Low-Cost Affordable Housing Finance		2. Project Number: 48234															
3. Country: India		4. Department/Division: Private Sector Operations Department/ Capital Markets and Financial Sectors Division															
5. Sector Classification:																	
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Private sector development		Private sector investment															
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Regional	Not applicable																
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10. Safeguard Categorization:																	
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OCR = ordinary capital resources.																	
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13. Counterpart Financing: Not applicable																	
14. Aid Effectiveness: Not applicable																	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan of up to \$125,000,000 (or in Indian rupee equivalent) to Dewan Housing Finance Corporation for the Low-Cost Affordable Housing Finance in India.¹

II. THE FINANCIAL INTERMEDIARY

A. Investment Identification and Description

2. India suffers from an acute housing shortage, which stood at 18.78 million units in 2012. According to the country's Ministry of Housing and Urban Poverty Alleviation, more than 95% of the households affected by this shortage were those with annual incomes of Rs200,000 or less. The shortage of housing is compounded by a lack of housing finance. India's mortgage penetration rate was a very low 7.6% at the end of FY2013, compared with rates of 20% in the People's Republic of China and 81% in the United States.² Most of India's financial institutions target their housing finance products primarily at the medium- and high-income groups. Consequently, the country's housing unit owners are mostly from the middle- and high-income brackets—i.e., with monthly incomes of at least Rs25,000. This group makes up only about 8% of the urban population. Of the 73 million households in the low income categories, 24 million earn Rs10,000–Rs25,000 per month and have the capacity to purchase private housing. About 40%–45% of these households live in low-quality rented accommodations and would like to buy their own homes.³

3. The government and India's private sector need to work together to increase the supply of housing stock to meet the huge potential demand for affordable housing from low-income households and, at the same time, alleviate the obstacles low-income customers face in accessing housing finance. This is particularly important for those with low-salaried jobs or working in the informal sectors. Mortgage loans with terms longer than those now available can help address the financing constraints because they reduce monthly installments and thereby make home ownership more affordable. However, commercial banks and housing finance companies (HFCs) typically rely on short-term funding, and the long-term nature of housing loans increases the potential problem of a maturity mismatch between asset and liabilities. This limits the ability of lenders to lengthen loan tenors and expand mortgage operations, particularly in underserved markets. While many commercial banks also provide mortgage loans, they tend to focus on middle- and high-income borrowers. This means that to give India's low-income households better access to housing finance and to maximize development impact, strong HFCs that have a successful record in reaching low-income customers need to be supported.

4. Among 10 HFCs identified by Deloitte Touche Tohmatsu as active lenders in the low-cost housing market (unit costs of below Rs1 million), Dewan Housing Finance Corporation (DHFL) is the undisputed market leader (footnote 3).⁴ At the end of FY2013, its total lending was 4.5 times that of the second largest HFC and more than 81 times that of the third largest HFC in this group. While DHFL started operations in 1984 with a focus on low- and middle-income borrowers, 8 out of the 10 HFCs in this segment were established after 2007. These

¹ The design and monitoring framework is in Appendix 1.

² Mortgage penetration is measured by the total mortgage loans-to-GDP ratio. ICRA. 2013. *Indian Mortgage Finance Market Update for H1, FY14*. New Delhi.

³ Deloitte Touche Tohmatsu India. 2013. *State of the Low-Income Housing Market: Encouraging Progress & Opportunities to Realize Dreams of Millions*. Mumbai.

⁴ Among all the 56 HFCs in India, DHFL ranks the second in terms of total assets.

new companies have experienced rapid growth but remain small, have limited geographical reach, are still developing risk management systems, and have higher credit risks.

5. DHFL is a strong candidate for Asian Development Bank (ADB) funding due to its successful track record and competitive advantage in providing financing for low-cost affordable housing (LCAH).⁵ It has concentrated on low- and middle-income borrowers since its establishment. DHFL has developed an extensive nationwide branch network, formulated comprehensive credit policies and procedures, and built up an experienced underwriting and portfolio team that has a deep understanding of the target segment and provides superior services to its customers. This focus and expertise have enabled DHFL to be selective in underwriting and proactive in portfolio monitoring. As a result, it has consistently maintained excellent credit quality.

6. ADB has developed a good relationship with DHFL through a \$20 million loan approved in 2003 for private housing finance sector development.⁶ ADB is keen to support the company's continuing growth and particularly in the low cost affordable housing segment. The loan will help improve DHFL's access to long-term finance, which remains a key challenge for HFCs and is critical to expanding affordable housing loans. The project will allow ADB to help widen DHFL's access to financing in less-developed states, where the problem can be particularly acute, because 40% of the loan proceeds will be put to work in these parts of the country.

B. Business Overview and Strategy

7. This paragraph has been redacted due to commercially sensitive information.

8. This paragraph has been redacted due to commercially sensitive information.

C. Ownership, Management, and Governance

1. Ownership

9. This paragraph has been redacted due to commercially sensitive information.

2. Management

10. This paragraph has been redacted due to commercially sensitive information.

11. This paragraph has been redacted due to commercially sensitive information.

3. Governance Structure

12. The board of directors, which provides leadership and strategic guidance, consists of eight members, including five independent non-executive directors. The chairman and managing director, Kapil Wadhawan, is the only executive director on the board. While he is involved in the day-to-day management of DHFL, the non-executive directors provide wider external perspective in decision making, as well as independence. The board members are seasoned professionals with diverse backgrounds in such fields as finance, accounting,

⁵ National Housing Bank and Reserve Bank of India define LCAH as housing units with a floor area of up to 60 square meters and a cost of up to Rs3 million.

⁶ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Private Sector Housing Finance Project in India*. Manila. The earlier ADB loan will be fully paid in November 2014.

regulation, and government. DHFL has constituted five committees that focus on important areas and functions: an audit committee, a shareholders and investors' grievance committee, a remuneration and compensation committee, a finance committee, and a corporate social responsibility committee. DHFL's corporate governance policy aims to ensure that the board remains well-informed, independent, and actively involved in the important decisions pertaining to the company.

D. Financial Performance

13. **Capital adequacy.** This paragraph has been redacted due to commercially sensitive information.

14. **Asset quality.** This paragraph has been redacted due to commercially sensitive information.

15. **Earnings.** This paragraph has been redacted due to commercially sensitive information.

16. **Liquidity and asset–liability management.** This paragraph has been redacted due to commercially sensitive information.

III. THE PROPOSED ADB ASSISTANCE

A. The Assistance

17. ADB will provide a senior secured term loan to DHFL of up to \$125 million (or in Indian rupee equivalent). (This sentence has been redacted due to commercially sensitive information.) A portion of the risk on ADB's loan may be transferred to counterparties that are eligible under ADB's policies.⁷

18. The proceeds of ADB's loan will be used to finance the purchases by prospective owners of LCAH units in India. In accordance with the applicable NHB and the RBI regulations, LCAH is currently defined as housing units with a maximum floor area of 60 square meters and a maximum cost of Rs3 million. LCAH loan to individual subborrowers is also subject to a current cap of Rs2.5 million in terms of maximum loan amount. At least 40% of the proceeds of the ADB loan will be onlent to subborrowers in some of India's least-developed states, including Andhra Pradesh, Chattisgarh, Jharkhand, Madhya Pradesh, Rajasthan, Uttarakhand, Uttar Pradesh and West Bengal. DHFL agrees that at least 50% of the subborrowers whose loans are financed by ADB's loan will be women or include women as coborrowers with their husbands.

B. Implementation Arrangements

19. **Use of proceeds.** The use of proceeds will follow the RBI regulation on external commercial borrowing (ECB). DHFL will use the proceeds of the ADB loan exclusively to finance LCAH unit owners' mortgage loans.

20. **Monitoring.** Monitoring of the project will be carried out by ADB's Private Sector Operations Department. DHFL will provide ADB with financial reports at predetermined regular intervals and as requested. These reports will include (i) unaudited financial statements on a quarterly basis, (ii) audited financial statements on an annual basis, (iii) compliance certificates for financial covenants on a semiannual basis, (iv) reporting on mortgage portfolio on a

⁷ The terms of the risk transfer arrangements, if any, will be endorsed by ADB's Investment Committee.

semiannual basis, and (v) annual reporting on selected development indicators agreed on by ADB and the borrower.

21. **Evaluation.** Pursuant to ADB's operations manual, monitoring reports will be prepared and submitted to ADB's Office of Risk Management regularly and at least annually.⁸ The first such report will be submitted no later than 12 months after the first disbursement.

C. Value Added by ADB Assistance

22. ADB's loan for DHFL will add value by helping to achieve the following:

- (i) **Providing long-term finance for low-cost affordable housing.** The project will provide critically needed long-term funding to support the scaling up of DHFL operations in underserved market segments. India's capital markets are still in the early stages of development, and access to long-term funding is thus a challenge for HFCs.⁹ The funding bottleneck hampers the HFCs' growth. This is particularly the case in their LCAH finance businesses, due to the lower profit margins. The government has recognized this market constraint and, given that this is a priority sector, the RBI has provided a \$1 billion ECB quota for LCAH in FY2014. International commercial banks are not willing to lend for longer tenors, and ADB is thus filling this market gap. (This sentence has been redacted due to commercially sensitive information.)
- (ii) **Catalyzing private sector participation.** ADB is in discussions with insurers to mobilize risk participation, which would increase private sector confidence and exposure in DHFL and, more broadly, in the housing sector in India
- (iii) **Incorporating gender elements in LCAH finance.** ADB's presence has helped incorporate a number of elements in the project to improve access to housing finance and housing ownership by women.

D. Risks

23. Key risks include the following:

- (i) **Operational environment.** (This sentence has been redacted due to commercially sensitive information.)
- (ii) **Asset quality.** (This sentence has been redacted due to commercially sensitive information.)
- (iii) **Funding and liquidity risk.** (This sentence has been redacted due to commercially sensitive information.)
- (iv) **Foreign exchange risk.** (This sentence has been redacted due to commercially sensitive information.)

24. This paragraph has been redacted due to commercially sensitive information.

IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

⁸ ADB. 2013. Nonsovereign Operations. *Operations Manual*. OM D10/BP. Manila.

⁹ The NHB, the regulator and provider of refinancing, provides access to long-tenor financing but not in large quantities. DHFL is able to mobilize deposits but these tend to be short term in nature. Given that more than 51% of DHFL's loan portfolio has tenors of more than 10 years, it needs funding with longer terms.

A. Development Impacts, Outcome, and Output

1. Impacts

25. Housing sector development supports poverty reduction and inclusive growth by generating employment, improving housing, and raising standards of living. According to a recent ADB study, Rs1 million invested in construction creates 22,000 unskilled, 23,000 skilled and semiskilled, and 9,000 managerial and technical person-days of employment in India.¹⁰ Housing finance also helps to develop the finance sector by improving its overall depth, diversity, buoyancy, and resilience. In particular, the project is expected to lead to two significant development impacts:

- (i) **Increased low-cost affordable housing ownership in India.** Funding constraints prevent millions of low-income households from becoming homeowners and thereby improving their living conditions. The project will contribute to the government of India's targets of increased home ownership by low income households. The project's success will also help improve access to finance by encouraging lending to low-income subborrowers who are underserved by the commercial banks, in the informal sector and in the country's least-developed states.
- (ii) **Broadened and deepened financial market with development of housing finance companies.** The project will promote finance sector development by supporting the growth of HFCs, which have a limited deposit base and a great need for long-term funding. DHFL has been a pioneer in housing finance; it availed of India's first mortgage guarantee in FY2014, which was provided by the India Mortgage Guarantee Corporation, an ADB-backed entity.¹¹ Such transactions not only helped optimize DHFL's balance sheet, but also played a role in further development of domestic capital markets. (This sentence has been redacted due to commercially sensitive information.) Many of the smaller new entrants in the market continue to replicate aspects of its business model. By helping DHFL continue to grow its low-income housing finance business in underserved regions, the project will demonstrate the commercial viability of this inclusive approach, which will lead to broadening and deepening of the housing finance market in India.

2. Outcome

26. The project's expected outcome is sustainable growth of DHFL's LCAH portfolio. This will be measured by an increasing share of LCAH in the overall loan portfolio as well as a low non-performing loan ratio. Steady portfolio growth and low levels of loan defaults due to prudent credit risk assessment and management will ensure continuing access to housing finance for low-income households from DHFL in India.

3. Output

27. The project's output is increased growth and geographical expansion of DHFL's lending activities for LCAH throughout India. India's mortgage market is very undeveloped with a low penetration rate of only 7.6% (para. 2). The loan will provide much-needed housing finance that

¹⁰ ADB. 2013. Housing and Housing Finance – A Review of the Links to Economic Development and Poverty Reduction. *ADB Economics Working Paper Series, No. 362*. Manila.

¹¹ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Equity Investment in India Mortgage Guarantee Company*. Manila.

will also target low-income households in less-developed states. In addition, the project will promote specialized services for women borrowers, joint titles for houses, and training of staff.

B. Alignment with ADB Strategy and Operations

1. Consistency with Midterm Review of Strategy 2020 and Country Strategy

28. ADB's Midterm Review of Strategy 2020 calls for strengthening financial sector development.¹² The project contributes to this objective by supporting the growth of HFCs, an important component of the nonbank finance sector in India. Midterm Review of Strategy 2020 also calls for sharpening ADB's operational focus on inclusive economic growth, for which the project supports. Without access to formal financial services, the poor will be excluded from the growth process and its benefits. By targeting low-income subborrowers and people in underdeveloped states, many of whom are part of the informal economy, the project will improve access to finance and contribute to inclusive growth.

29. ADB's country partnership strategy (CPS) for India for 2013–2017 calls for ADB's nonsovereign operations to align with the CPS priority areas and to continue to support the infrastructure and finance sectors by undertaking selective physical, social, and financial infrastructure projects.¹³ The project will support the development of housing finance in India, an area of financial infrastructure that the CPS identifies for support. By helping low-income households purchase homes that provide better living conditions, it will also help improve urban quality of life, which is the main objective of ADB's urban sector operations in India. By targeting less-developed states, it also supports inclusive growth, one of the three strategic pillars of the CPS. The project will help to improve access to affordable formal credit, as recommended by an RBI committee on comprehensive financial services for small businesses and low-income households.¹⁴ It also supports the government's priority of promoting affordable housing, which was identified in the country's twelfth five-year plan (2012–2017) as a particularly critical concern for low-income groups.¹⁵

2. Consistency with Sector Strategy and Relevant ADB Operations

30. Supporting finance sector development is a key focus of development assistance for ADB. ADB's private sector development strategy stated that ADB should play a role in strengthening the finance sector in developing member countries, including housing finance.¹⁶ ADB's enhanced poverty reduction strategy states that ADB seeks to promote sound and efficient financial markets to mobilize savings, ensure availability of long-term financing, and achieve pro-poor growth.¹⁷ ADB's operational plan for the finance sector calls for ADB to support broad household access to microfinance and housing finance.¹⁸ The project will improve the quality of life in the urban regions in India and is thus in line with ADB's urban operational plan.¹⁹

¹² ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

¹³ ADB. 2013. *Country Partnership Strategy: India, 2013–2017*. Manila.

¹⁴ Government of India, Reserve Bank of India (RBI). 2014. *Report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households*. Mumbai.

¹⁵ Government of India, Planning Commission. 2012. *Approach to the 12th Plan. The Challenges of Urbanization in India*. Delhi.

¹⁶ ADB. 2000. *Private Sector Development Strategy*. Manila.

¹⁷ ADB. 2004. *Enhancing the Fight against Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

¹⁸ ADB. 2011. *Financial Sector Operational Plan*. Manila.

¹⁹ ADB. 2013. *Urban Operational Plan, 2012–2020*. Manila (March).

3. Lessons from Previous Operations

31. ADB first supported DHFL through a \$20 million loan approved in 2003 (footnote 5). The project was rated *successful* by ADB's Independent Evaluation Department in 2008. The evaluation report highlighted the importance of having highly trained, experienced staff, and sound credit underwriting and portfolio policies for the success of the company. (This sentence has been redacted due to commercially sensitive information.)

V. POLICY COMPLIANCE

A. Safeguards and Social Dimensions

32. The project is classified as category FI (treated as C) for impacts on the environment, involuntary resettlement, and indigenous peoples under ADB's Safeguard Policy Statement (2009). The project is expected to have minimal or no adverse environmental impacts. DHFL will not finance real estate development or mass housing construction. It will onlend ADB's loan in the form of mortgage loans to individuals, primarily in urban and semi-urban areas. No land acquisition or physical or economic displacements are expected from the activities of the borrower, since the housing loans will be provided to individuals who have purchased the property with mortgage or are voluntarily making improvements to their dwellings. While a few of the beneficiaries may be identified as members of tribal groups based on their cultural identity, they are not expected to possess the characteristics of indigenous peoples as defined in ADB's Safeguard Policy Statement. DHFL will apply ADB's prohibited activities list and ensure that investments using ADB funds comply with applicable national laws and regulations and with ADB's Safeguard Policy Statement and Social Protection Strategy.²⁰

33. The borrower will need to comply with national labor laws and internationally recognized core labor standards. DHFL is an equal opportunity employer and has a gender-equal human resource policy. The transaction is classified as effective gender mainstreaming under ADB's guidelines. At least 50% of the new home loans funded by the project will be to women borrowers who have either single or joint (with husband) ownership and title of property. In addition, DHFL will implement the measures outlined in the gender action plan to promote gender equality in its operations.²¹

B. Anticorruption Policy

34. DHFL was advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance. India is a jurisdiction in which no strategic deficiencies have been identified by the Financial Action Task Force, and no integrity red flag has been identified.

C. Investment Limitations

35. The proposed loan is within the medium-term country, industry, group, and single investment exposure limits for nonsovereign investments.

²⁰ ADB. 2001. *Social Protection Strategy*. Manila.

²¹ Gender Action Plan (accessible from the list of linked documents in Appendix 2.)

D. Assurances

36. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),²² the Government of India will be requested to confirm that it has no objection to the proposed assistance to DHFL. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the ADB Board of Directors.

VI. RECOMMENDATION

37. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of up to \$125,000,000 (or in Indian rupee equivalent) to Dewan Housing Finance Corporation for the Low-Cost Affordable Housing Finance in India, from ADB's ordinary capital resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao
President

27 October 2014

²² ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impacts Increased LCAH ownership in India^a</p> <p>Broadened and deepened financial market with development of housing finance companies</p>	<p>Total housing shortage for low-income groups reduced from 7.4 million housing units in 2012 to 6.5 million housing units in 2021</p> <p>Share of housing finance companies in India's total housing loan portfolio increased from 46% in 2012 to 48% in 2021</p>	<p>Reports from the Ministry of Housing and Urban Poverty Alleviation</p> <p>Reports from the National Housing Bank</p>	<p>Assumptions Regulatory framework will remain supportive of LCAH development and finance.</p> <p>More affordable land will be made available by the government for LCAH.</p> <p>Housing developers will have access to finance.</p> <p>Risk A deterioration of macroeconomic conditions could push more people in low-income groups into poverty.</p>
<p>Outcome Sustainable growth of DHFL's LCAH finance portfolio</p>	<p>This section has been redacted due to commercially sensitive information.</p>	<p>Reporting provided by DHFL</p> <p>Development effectiveness monitoring reports</p>	<p>Assumption There is strong demand for housing finance by low-income groups.</p> <p>Mortgage rate will remain affordable for subborrowers in low-income groups.</p> <p>Risk Large increases in interest rates and inflation could reduce the repayment capacity of borrowers.</p>
<p>Output Increased growth and geographical expansion of DHFL's lending activities in LCAH throughout India</p>	<p>This section has been redacted due to commercially sensitive information.</p>	<p>Reporting provided by DHFL</p> <p>Gender-disaggregated data collection</p> <p>Development effectiveness monitoring reports</p> <p>Audited financial statements</p>	<p>Assumptions Demand for housing finance by the low-income groups will remain strong</p> <p>Housing ownership and joint titles are issued smoothly</p>
<p>Activities with Milestones 1. Expansion of DHFL's lending activities in LCAH throughout India 1.1 ADB executes legal agreements in Q4 2014.</p>			<p>Inputs ADB: \$125 million</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
1.2 ADB fully disbursed loan by Q2 2015. 1.3 DHFL processes new mortgage loans from 2015-2018 1.4 ADB conducts monitoring and annual review missions.			

ADB = Asian Development Bank, DHFL = Dewan Housing Finance Corporation, LCAH = low-cost affordable housing, Q = quarter.

- ^a LCAH is defined by the Government of India as housing with (i) a floor area of up to 60 square meters; and (ii) a maximum cost of up to Rs3 million (approximately \$50,000).
- ^b Assuming average loan size of Rs2 million (approximately \$33,000).
- ^c These include the states of Andhra Pradesh, Chattisgarh, Jharkhand, Madhya Pradesh, Rajasthan, Uttarakhand, Uttar Pradesh and West Bengal.
- ^d DHFL's current initiatives include (i) less onerous requirements for substantiating the incomes of borrowers working in the informal sector, and (ii) schemes for women that offer lower interest rates and processing fees.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=48234-001-3>

1. Sector Overview
2. Ownership, Management, and Governance
3. Details of Implementation Arrangements
4. Contribution to the ADB Results Framework
5. Financial Analysis
6. Country Economic Indicators
7. Summary Poverty Reduction and Social Strategy
8. Safeguards and Social Dimensions Summary
9. Gender Action Plan