



# Report and Recommendation of the President to the Board of Directors

---

Project Number: 49212-001  
November 2015

## Proposed Loan PNB Housing Finance Limited Low-Cost Affordable Housing Finance (India)

This RRP contains information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011. Recipients should therefore not disclose its contents to third parties, except in connection with the performance of their official duties. Upon Board approval, ADB will make publicly available an abbreviated version of this RRP, which will exclude confidential business information and ADB's assessment of project or transaction risk.

Asian Development Bank



## CURRENCY EQUIVALENTS

(as of 30 October 2015)

Currency unit	–	Indian rupee/s (Re/Rs)
Rs1.00	=	\$0.01528
\$1.00	=	Rs65.4340

## ABBREVIATIONS

ADB	–	Asian Development Bank
CAGR	–	compound annual growth rate
ECB	–	external commercial borrowing
GDP	–	gross domestic product
HFC	–	housing finance company
LCAH	–	low-cost affordable housing
LTV	–	loan-to-value
NHB	–	National Housing Bank
NPA	–	nonperforming asset
PNB	–	Punjab National Bank
PNBHF	–	PNB Housing Finance Limited
RBI	–	Reserve Bank of India
TCG	–	The Carlyle Group
US	–	United States

## NOTES

- (i) The fiscal year (FY) of the Government of India and PNB Housing Finance Limited ends on 31 March. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2015 ends on 31 March 2015.
- (ii) In this report, “\$” refers to US dollars.

<b>Vice-President</b>	D. Gupta, Private Sector and Cofinancing Operations
<b>Director General</b>	T. Freeland, Private Sector Operations Department (PSOD)
<b>Director</b>	C. Engstrom, Capital Markets and Financial Sector Division, PSOD
<b>Team leader</b>	P. Bracey, Principal Investment Specialist, PSOD
<b>Team members</b>	A. Kumar, Investment Officer, PSOD
	A. Porras, Senior Safeguards Officer, PSOD
	B. Quang, Safeguards Specialist, PSOD
	B. Raemaekers, Principal Guarantees and Syndications Specialist, PSOD
	S. Ranelle, Safeguards Officer, PSOD
	T. Rees, Counsel, Office of the General Counsel
	S. Sasaki, Senior Safeguards Specialist, PSOD

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.



## CONTENTS

	<b>Page</b>
PROJECT AT A GLANCE	
I. THE PROPOSAL	1
II. THE FINANCIAL INTERMEDIARY	1
A. Investment Identification and Description	1
B. Business Overview and Strategy	3
C. Ownership, Management, and Governance	4
D. Financial Performance	5
III. THE PROPOSED ADB ASSISTANCE	6
A. The Assistance	6
B. Implementation Arrangements	6
C. Value Added by ADB Assistance	7
D. Risks	7
IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT	7
A. Development Impact, Outcome, and Outputs	7
B. Alignment with ADB Strategy and Operations	8
V. POLICY COMPLIANCE	8
A. Safeguards and Social Dimensions	8
B. Anticorruption Policy	9
C. Investment Limitations	9
D. Assurances	9
VI. RECOMMENDATION	9
APPENDIXES	
1. Design and Monitoring Framework	10



## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed senior loan of up to \$150 million (or its Indian rupee equivalent) to PNB Housing Finance Limited (PNBHF) in India, the proceeds of which will be exclusively used to finance prospective owners of individual low-cost affordable housing (LCAH) units.<sup>1</sup>

## II. THE FINANCIAL INTERMEDIARY

### A. Investment Identification and Description

2. **Economy.** Real gross domestic product (GDP) expanded at an average annual rate of 7.8% from FY2005 to FY2014, helping the country reduce poverty from 37.2% in FY2005 to 21.9% in FY2012.<sup>2</sup> Although India weathered the global financial crisis relatively well, growth slackened during FY2012–FY2014 as a result of tighter monetary policy to counter persistently high inflation, lack of consensus on some policy and regulatory issues, and the adverse effects of a decrease in global demand.<sup>3</sup> During FY2015, growth has rebounded, helped by increased political certainty, several policy actions, lower commodity (oil and non-oil) import prices, improved business and consumer confidence, and reduced external vulnerabilities. GDP growth was 7.3% for FY2015. According to Asian Development Bank (ADB) estimates, India's GDP growth is expected to edge up further to 8.2% in FY2016, benefiting from lower inflation, the result of supportive monetary policy, and increased capital expenditure.<sup>4</sup> The return to sustainable high growth rates, however, will be predicated on continuing to address supply-side bottlenecks and structural challenges through legislative changes and policy implementation.

3. Urbanization has been an engine of growth for the Indian economy. During 2001–2011, the urban population of India grew at a compound annual growth rate (CAGR) of 2.8%, increasing the level of urbanization from 27.8% to 31.2%. According to the 2011 census, India had a population of 1.2 billion, out of which 377.1 million lived in urban areas.<sup>5</sup> By 2030, 590 million people are projected to live in urban areas.<sup>6</sup> Rapid urbanization has, however, led to land shortages, housing shortfalls, traffic congestion, and stress on other basic infrastructure such as water and electricity in towns and cities.

4. **Housing sector overview.** As a result of these rapidly changing demographics, India suffers from an acute shortage of adequate housing. According to the Ministry of Housing and Urban Poverty Alleviation, the estimated housing shortage in India was close to 60.0 million in 2012, of which 18.8 million were in urban areas. Housing shortages are heavily skewed toward poor socioeconomic groups, with economically weaker sections, i.e., households with annual incomes of Rs100,000 or less, accounting for 56.2% of the housing shortage, while low-income groups (those with annual incomes of Rs100,000–Rs200,000) accounted for 39.4% of the shortage.<sup>7</sup> Limited housing supply and poor affordability have led to many lower-income people

---

<sup>1</sup> Housing units with floor area of up to 60 square meters and cost of up to Rs3 million, and maximum loan amount of Rs2.5 million, under Reserve Bank of India (RBI) guidelines.

<sup>2</sup> World Bank. 2014. *World Development Indicators*. Washington, DC.

<sup>3</sup> GDP growth of 6.2% in FY2012, 5.1% in FY 2013, and 6.9% in FY2014.

<sup>4</sup> ADB. 2015. *Asian Development Outlook 2015: Financing Asia's Future Growth*. Manila.

<sup>5</sup> Jones Lang LaSalle. 2012. *Affordable Housing in India: An Inclusive Approach to Sheltering the Bottom of the Pyramid*. Mumbai.

<sup>6</sup> United Nations World Population Prospects estimate.

<sup>7</sup> Government of India, Ministry of Urban Housing and Poverty Alleviation. 2012. *Report of the Technical Group on Urban Housing Shortage, 2012–17*. Delhi.

(and lower-middle income families in very large cities such as Mumbai) living in cramped, substandard, and often rented accommodation with limited access to basic amenities. A large number are forced to occupy marginal lands with poor housing stock without sanitation facilities or live in urban slums. Interest in constructing housing for lower- and moderate-income customers has increased in recent years. The previous slowdown of the Indian economy and the dampened demand for upscale real estate development forced developers to focus increasingly on affordable housing. According to Deloitte, at least 30,500 units below Rs1 million were launched in 132 projects across 22 cities from June 2011 to January 2013. The potential for affordable housing is compelling because of rapid urbanization, rising disposable income, and a preference for home ownership (for those who can afford it) in India.

5. **Financial sector overview.** The Indian financial sector remains underdeveloped, with banks playing the dominant role. As of the end of FY2014, total assets of all scheduled commercial banks stood at Rs109.6 trillion and total equity was Rs8.1 trillion, implying a system-wide leverage ratio of 7.4%. Public sector banks, which account for 72.7% of the banking sector assets, face tighter capital constraints with an average leverage ratio of 5.8%. Notwithstanding the size of the banking sector, access to finance in India remains a key issue with 47.0% of people being unbanked.<sup>8</sup> Access to credit is even more limited, with less than 14.0% of borrowers accessing credit through formal channels.<sup>9</sup>

6. **Housing finance.** Similar to the broader financial sector, India's housing finance market is also underdeveloped, particularly with respect to the large demand and need for housing finance. Despite the doubling of total housing credit in the last 5 years to over Rs10.6 trillion, the mortgage penetration rate in India is very low, at 8.4% as of the end of FY2015, compared with 20.0% in the People's Republic of China and 81.0% in the United States (US).<sup>10</sup> While some commercial banks have become active in mortgage lending, overall they have tended to play a much smaller role in the housing finance market than their foreign counterparts. Housing finance companies (HFCs) also have an important role in addressing the financing gap in India.

7. Since FY2005, the number of HFCs, their geographic coverage, and loan portfolios have shown considerable growth. As of the end of FY2015, 64 HFCs were registered with the National Housing Bank (NHB), the industry regulator, up from 52 in 2011. The growth in HFCs is largely attributable to their focused approach, targeting of special customer segments (often outside urban areas) including affordable housing and the self-employed, and superior customer service.<sup>11</sup> HFCs have increased their market share in the provision of housing finance from 30.0% in FY2010 to 37.0% as of the end of FY2015 and this trend is expected to continue, although commercial banks are becoming more competitive in the sector following recent regulatory changes.<sup>12</sup> The largest five HFCs are HDFC Bank, LIC Housing Finance Limited,

<sup>8</sup> World Bank. Global Financial Inclusion Database. <http://www.worldbank.org/en/programs/globalindex>. The level of unbanked people in India has declined from 65% in 2011 following the launch by the government of the important initiative, the *Pradhan Mantri Jan Dhan Yojana* scheme (Prime Minister's People Money Scheme), which aims to open up hundreds of millions of bank accounts for poor families.

<sup>9</sup> World Bank. Global Financial Inclusion Database. <http://www.worldbank.org/en/programs/globalindex>. Of the people who borrowed money in the last 12 months, 27% borrowed from private moneylenders and the remaining borrowed from family or friends. June 2015.

<sup>10</sup> ICRA. 2014. *Indian Mortgage Finance Market Quarter 1, 2014–2015*. Delhi.

<sup>11</sup> HFCs have tended to focus their lending approach on lower value and higher volume (typically outside of major urban areas), leading to higher operating costs, particularly when lending to individuals in the informal sector who do not have formal documentation.

<sup>12</sup> The RBI issued guidelines in July 2014 providing commercial banks with incentives to issue long-term bonds for financing affordable housing.



Dewan Housing Finance, Indiabulls Housing Finance, and PNB Housing Finance. As of the end of FY2015, the aggregate outstanding housing loan portfolio for all HFCs stood at Rs3.9 trillion (CAGR of 23.1% from FY2011).<sup>13</sup>

8. **Rationale.** Traditionally, the private sector real estate market has focused on serving higher income segments of urban India. Housing finance was also mainly geared toward higher income groups, except for a few HFCs focusing on affordable housing finance. Consequently, real estate owners have largely been from the middle- and high-income population, with a monthly household income of at least Rs25,000, which accounts for about 8.0% of the urban population. Almost 40%–45% of the urban population lives in rented accommodation and would like to buy their own houses. An additional 15%–20% of non-renting households would also like to buy housing to upgrade their living conditions.<sup>14</sup> Given the urgent need for housing, the government has placed high priority on developing this sector and has increasingly recognized the role the private sector can play in addressing the housing needs of moderate to lower-income customers. To encourage such participation, the government has sought to address certain market constraints, such as the limited availability of long-term funding to HFCs in the local market. In 2014, the Reserve Bank of India (RBI) allowed external commercial borrowings (ECB) of up to \$1 billion for LCAH, and a similar amount has been allocated for 2015.

9. To meet the large potential demand for affordable housing for moderate and lower income households, it is important to support housing development for these segments and to alleviate the constraints on access to housing finance.<sup>15</sup> One effective way to improve access to housing finance is to support strong HFCs capable of successfully reaching moderate and lower income customers. ADB partnered with Dewan Housing Finance Limited, the third largest HFC, in 2014 to assist in the provision of LCAH. ADB identified PNBHF, the fifth largest HFC, as another suitable candidate given its strong underwriting, solid asset quality, and expressed desire to grow its affordable housing loan portfolio, including in several underdeveloped states.

## B. Business Overview and Strategy

10. **Overview.** Founded in 1988, PNBHF is a deposit-taking HFC registered with the NHB. PNBHF provides housing loans to individuals for the construction, purchase, repair, and upgrade of homes, as well as loans against property, loans for commercial property, and loans for the purchase of residential plots. PNBHF also provides non-housing loans, such as construction finance loans, to developers. Among the fastest growing HFCs, PNBHF is the fifth largest HFC in India in terms of assets under management, with Rs172.9 billion at the end of FY2015. Organized structurally into a hub and spoke model, PNBHF's network consists of 16 underwriting hubs and 38 branches spread throughout the country. The company has its strongest presence in northern India, but as part of its business strategy, it is continuing its expansion into western and southern markets, specifically into tier II and tier III cities.

<sup>13</sup> Asset quality for housing loans among all HFCs has improved since FY2011, with a system-wide gross nonperforming assets (NPA) ratio of 0.6% as of the end of FY2015.<sup>13</sup> Median capital adequacy for all HFCs was strong at 18.4%. The return on assets for HFCs was 2.2% while return on equity stood at 20.3% for FY2015.

<sup>14</sup> Deloitte Touche Tohmatsu India. 2013. *State of the Low-Income Housing Market. Encouraging Progress and Opportunities to Realize Dreams of Millions.* Mumbai.

<sup>15</sup> ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Investment for the Shapoorji Affordable Housing Project in India.* Manila. The Private Sector Operations Department received Board approval for this project in July 2015, which will support housing construction for low-income families.

11. PNBHF's loan portfolio has more than doubled during FY2013–FY2015, in line with its adoption of a growth-oriented business model and strategic efforts to strengthen its competitive position. In FY2015, total loans increased by 58.8% to Rs168.2 billion. Housing loans comprised the largest portion of the total loan portfolio at 61.6% as of the end of FY2015, of which LCAH loans represented 18.0% (10.6% of the total loan portfolio). PNBHF sees this as a growth opportunity and seeks to increase LCAH loans as a percentage of housing loans to 30.0% during the next few years. Non-housing loans, including construction finance, accounted for the remaining 38.4% of the total loan portfolio.

12. **Business strategy.** Following its strategic partnership in 2009 with Destimoney Enterprises Private Limited (Destimoney), the Indian arm of Destimoney Enterprises, a new management team was brought into PNBHF. In 2011, the management team launched a comprehensive business process transformation and reengineering exercise, branded as Project Kshitij, to strengthen PNBHF's business and financial risk profiles by establishing a robust, growth-oriented business model. Under this initiative, the company's business processes, organizational structure, and policies were revamped and a new business plan was formulated to enhance PNBHF's competitive positioning and scale of operations. As part of the new strategy, PNBHF's customer focus has been refined—now targeting the emerging middle class—servicing self-employed professionals and nonprofessionals as well as salaried employees for its housing loans. Affordable housing loans are considered a subcategory within this general customer focus.

13. PNBHF has set a long-term target to become one of the top three HFCs. It expects the housing finance market to grow significantly over the coming years because of a number of macro factors and demographic trends, including government efforts to increase home ownership, projected softening of interest rates, and increasing demand for housing loans. PNBHF's new hub and spoke organizational structure is scalable and positions the company to benefit from sector growth. PNBHF intends to deepen its reach in existing regions as well as expanding to new regions—opening eight new branches in FY2015 with another eight planned in FY2016. Further expansion of its distribution network will quicken in subsequent years as it enlarges its market footprint.

### C. Ownership, Management, and Governance

14. **Ownership.** Prior to 2009, PNBHF was solely owned by Punjab National Bank (PNB), the fourth largest state-owned bank in India (in terms of total assets). In December 2009, PNB entered into a strategic partnership with Destimoney, which acquired a 49.0% shareholding in PNBHF.<sup>16</sup> In February 2015, Destimoney was purchased by The Carlyle Group (TCG),<sup>17</sup> a US-based global alternative asset manager,<sup>18</sup> and assumed the shareholding in PNBHF.<sup>19</sup> As of 30 June 2015, PNB had a majority 51.0% stake in PNBHF, with TCG holding the remaining 49.0% interest.

<sup>16</sup> Destimoney Enterprises is a financial services company in India, established in 2006 by New Silk Route—a leading Asia-focused growth capital firm also founded in 2006, with \$1.5 billion under management. Destimoney Enterprises Private Limited was a subsidiary of Destimoney Enterprises before being sold to The Carlyle Group.

<sup>17</sup> Founded in 1987 in Washington, DC, TCG is one of the world's largest and most successful investment firms, with more than \$194 billion of assets under management across 128 funds and 142 fund vehicles.

<sup>18</sup> Several issues relating to TCG and its investments have been identified and flagged in the checklists. However, because of the remoteness of the issues from PNBHF and the lack of corroboratory information, these pose little integrity risk to ADB.

<sup>19</sup> Acquisition of Destimoney by TCG was undertaken by a wholly owned TCG subsidiary, Quality Investment Holdings, a Mauritius-based entity.

15. **Management and governance structure.** PNBHF is controlled by a nine member board of directors, all with considerable professional expertise in banking, finance, and/or the mortgage industry. Three of the nine members are independent. Of the remaining six members, three are nominees of PNB, two are nominees of TCG, and one is an executive director—the managing director of PNBHF. The board is responsible for strategic direction, policy setting, and supervising PNBHF’s performance, as well as ensuring its compliance with laws and regulations. The board is supported by a system of appointed committees and subcommittees. In keeping with the private partnership model adopted in 2009, following the investment by Destimoney, PNBHF is managed by an independent team of experienced professionals with years of involvement in the housing finance sector.

16. **Risk management.** Under the hub and spoke model, branches focus on origination, collection, and customer service, while credit underwriting, administration, and monitoring is centralized and carried out at the regional hubs. As part of PNBHF’s enhancement to its credit risk management system, specialized vertical functional units, such as the Technical Service Group, Legal Appraisal Unit, Fraud Control Unit, and Wholesale Finance Unit, have been established.<sup>20</sup> In addition, a specialized Recoveries Unit was created to steer the monitoring and workout of problem loans. The board’s Credit Committee oversees the credit risk management function. Operational risk management is carried out through a comprehensive system of internal controls, separation of duties between key functions, and detailed standard operating procedures. PNBHF has just updated its information technology platform (enterprise core business suite), which automates all operations into a centralized system for timely management information system and reporting.

#### **D. Financial Performance**

17. **Capital adequacy.** As of the end of FY2015, PNBHF had total net worth of Rs15.8 billion and adequate capitalization, with a tier 1 capital ratio of 10.4% and a capital adequacy ratio of 13.8%, higher than the NHB requirements of 12.0% and an increase from the 13.0% recorded in FY2014. PNBHF’s capital position was strengthened during FY2015 as a result of a Rs7.0 billion rights issue from existing shareholders as a means to support loan portfolio growth. An additional Rs3.0 billion from this rights issue is expected to be infused during FY2016. The shareholders plan to undertake another rights issue in FY2016 to raise a further Rs5.0 billion. In addition to increasing share capital, PNBHF also has room to raise tier II capital to shore up its capital adequacy.

18. **Loan portfolio and asset quality.** PNBHF’s loan portfolio has grown rapidly during the past 3 years (CAGR of 59.4% for FY2013–FY2015), increasing by 58.8% in FY2015 alone to Rs168.2 billion. Housing loans (inclusive of LCAH loans), the largest portion of the total loan portfolio at 61.6%, showed the strongest growth, rising by 60.3% in FY2015. Non-housing loans (including construction finance), which comprised the remaining 38.4%, rose by 55.1%. Despite rapid loan growth, PNBHF’s asset quality has steadily improved since FY2011 as the company overhauled its credit risk management framework and intensified collection efforts and the focus on recoveries in the older portion of the portfolio.

---

<sup>20</sup> The Technical Services Group oversees property valuations, approvals for developers’ projects, and monitoring of approved projects. The Legal Appraisal Unit consists of legal experts that work to establish clear title to the property being financed. The Fraud Control Unit conducts fraud reviews all loan applications. The Wholesale Finance Unit oversees the underwriting of wholesale construction finance.

19. **Liquidity and funding gap.** PNBHF has a fairly diversified funding profile, raising money from a mix of retail deposits, bank borrowings, refinancing from NHB, and market borrowings. PNBHF's liquidity profile has been stable, with the liquid assets–short-term liability ratio being fairly steady at 32.0%.

20. **Earnings performance.** PNBHF has seen a steady rise in profitability during FY2013–FY2015, in line with its high growth business model, as operating revenues have paralleled expansion of the loan portfolio and been bolstered by a higher than the industry average (3.0%) net interest margin of 3.2% in both FY2014 and FY2015. Net income increased by 39.2% in FY2014 to Rs1.3 billion and by a further 53.9% to Rs1.9 billion as of the end of FY2015. Despite this sizable increase, PNBHF's overall profitability has been offset by the higher operating expenses associated with the implementation of Project Kshitij, including substantial investments in information technology systems, infrastructure, and human capital, as well as the expansion of its distribution network. The return on assets fell slightly to 1.28% as of the end of FY2015 from 1.31% as of the end of FY2014, as asset growth outpaced the increase in net income. Similarly, the return on equity declined from 16.39% in FY2014 to 15.59% at the end of FY2015 as a result of the rise in total equity outstripping that of net income.

### III. THE PROPOSED ADB ASSISTANCE

#### A. The Assistance

21. ADB will provide a senior secured term loan to PNBHF of up to \$150 million (or its Indian rupee equivalent).<sup>21</sup> The tenor of the loan will be up to 7 years from the date of the first disbursement of the loan. The proceeds of the ADB loan will be used to finance purchases by prospective owners of LCAH units in India. In accordance with applicable NHB and RBI regulations, LCAH is defined as housing units with a maximum floor area of 60 square meters and a maximum cost of Rs3 million. LCAH loans to individual sub-borrowers are subject to a cap of Rs2.5 million. Upwards of 40% of the proceeds of the ADB loan will be used to finance sub-borrowers in some of India's least-developed states, including Assam, Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Odisha, Rajasthan, Uttarakhand, Uttar Pradesh, and West Bengal.

#### B. Implementation Arrangements

22. **Use of proceeds.** The use of proceeds will follow the RBI regulation on ECB. PNBHF will use the proceeds of the ADB loan exclusively to finance LCAH unit owners' mortgage loans.

23. **Monitoring.** ADB's Private Sector Operations Department will carry out project monitoring. PNBHF will provide ADB with financial reports at predetermined regular intervals and as requested. These 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 quarterly basis, (iv) reporting on the mortgage portfolio on a semiannual basis, and (v) annual reporting on selected development indicators agreed by ADB and the borrower.

---

<sup>21</sup> The loan will be secured by PNBHF's a portfolio of mortgage receivables.

24. **Evaluation.** Monitoring reports will be prepared and submitted to ADB regularly and at least annually.<sup>22</sup> The first report will be submitted no later than 12 months after the first disbursement.

### C. Value Added by ADB Assistance

25. **Providing long-term financing for low-cost affordable housing.** The project will provide needed long-term funding to support the scaling up of PNBHF's operations in underserved market segments. India's capital markets are still in the early stages of development and access to long-term funding is a challenge for HFCs.<sup>23</sup> The funding bottleneck hampers the HFCs' growth and the affordability of mortgage loans—particularly in their LCAH finance business because of the lower profit margins. The government has recognized this market constraint and, given that this is a priority sector, the RBI provided a \$1 billion ECB quota for LCAH in 2014 and another \$1 billion in 2015. International commercial banks are not willing to lend for longer tenors and the appetite for longer tenor bonds among private sector investors decreases drastically as the tenor of bonds increase.<sup>24</sup> ADB is thus filling this market gap.

26. **Supporting the housing sector.** This project will support housing sector development, which contributes to poverty reduction and inclusive growth by generating employment, improving housing, and raising standards of living. Housing finance also helps develop the financial sector by improving its overall depth, diversity, buoyancy, and resilience.

**Risks**-(Deleted)

## IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

### A. Development Impact, Outcome, and Outputs

27. **Development impact.** Developing the housing finance market and increasing the provision of and private sector investments in low-cost affordable housing are aligned with the government's Twelfth Five Year Plan, 2012–2017, which highlights the impact of housing sector development in promoting poverty reduction and inclusive growth through employment generation, improved housing, and higher standards of living.<sup>25</sup> Housing is also a strong contributor to GDP growth.<sup>26</sup>

28. **Outcome.** The expected outcome of the project will be that PNBHF's lending activities for low-cost affordable housing in India will be demonstrated to be sustainable.

<sup>22</sup> ADB. 2013. Nonsovereign Operations. *Operations Manual*. OM D10/BP. Manila.

<sup>23</sup> The NHB, the regulator and provider of refinancing, provides access to long-tenor financing, but not in large quantities. PNBHF can mobilize deposits, but these tend to be short-term.

<sup>24</sup> Data accessed in September 2015 from Prime Database shows that only 35% of the bonds issued with maturities between 3-7 years were from private financial institutions, while at 7 years and longer, the number of financial institutions able to access the capital markets falls to just 10%.

<sup>25</sup> Government of India. Planning Commission. 2012. *Twelfth Five Year Plan, 2012–2017: Faster, More Inclusive and Sustainable Growth*. Delhi.

<sup>26</sup> According to an ADB study, Rs1 million invested in construction creates 22,000 unskilled, 23,000 skilled and semi-skilled, and 9,000 managerial and technical person-days in India. J. Doling et al. 2013. Housing and Housing Finance: A Review of the Links to Economic Development and Poverty Reduction. *ADB Economics Working Paper Series*. No. 362. Manila: Asian Development Bank.

29. **Outputs.** The expected output of the project will be to increase financing for LCAHs through PNBHF as evidenced by (i) PNBHF's number of low-cost affordable housing loans increasing from 21,830 in FY2015 to 30,400 in FY2022, (ii) PNBHF's portfolio of LCAH loans increasing from Rs23,241 million to Rs32,733 million by FY2022, and (iii) at least 30.0% of the new low-cost affordable housing allocated to women named on the title as owner or joint owner.

## **B. Alignment with ADB Strategy and Operations**

30. The Midterm Review of Strategy 2020 emphasizes ADB's support to the financial sector by helping to develop financial infrastructure, institutions, and products and services. The proposed project contributes to financial sector development by supporting the growth of HFCs, an important component of the nonbank financial sector in India. Strategy 2020 also seeks to promote inclusive growth.<sup>27</sup> Without access to formal financial services, lower income people or underserved segments will be excluded from the growth process and its benefits. Under the Midterm Review of Strategy 2020, cities also constitute a key focus in terms of promoting livable cities that are competitive and environmentally attractive. According to the India country partnership strategy, 2013–2017, ADB's nonsovereign operations will continue to support the infrastructure and financial sectors by undertaking selective projects for physical and social infrastructure and financial infrastructure.<sup>28</sup> The proposed project will support the development of housing finance in India, one of the financial infrastructures identified in the country partnership strategy and a high priority for the government with growing emphasis on including private sector financing.

## **V. POLICY COMPLIANCE**

### **A. Safeguards and Social Dimensions**

31. The project is classified 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. PNBHF will not finance real estate development or mass housing construction. It will use ADB's loan to fund mortgage loans to individuals, primarily in urban and semiurban 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 a mortgage or are voluntarily making improvements to their dwellings. The project is not expected to have impacts on indigenous peoples. The investment's potential environment and social impacts, the risks associated with the borrower's existing and/or likely future portfolio, and its commitment and capacity for environmental and social management, have been assessed. PNBHF will enhance its staff capacity to carry out the assessment and oversight of the progress of the environmental (including climate change) and social risks screening and monitoring effectively. PNBHF will apply ADB's prohibited investment activities list<sup>29</sup> 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.<sup>30</sup> Information disclosure and consultation with affected people will be conducted in accordance with ADB requirements.

<sup>27</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>28</sup> ADB. 2013. *Country Partnership Strategy: India, 2013–2017*. Manila.

<sup>29</sup> Appendix 5 of ADB's Safeguard Policy Statement (2009).

<sup>30</sup> ADB. 2003. *Social Protection*. Manila (adopted in 2001).

32. The borrower will comply with national labor laws and internationally recognized core labor standards. PNBHF is an equal opportunity employer and has a gender-equal human resource policy. The transaction is classified as some gender elements under ADB's guidelines. At least 30% 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.

#### **B. Anticorruption Policy**

33. PNBHF 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**

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

#### **D. Assurances**

35. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),<sup>31</sup> the Government of India will be requested to establish the no objection of India to the proposed assistance to PNBHF. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board of Directors.

### **VI. RECOMMENDATION**

36. 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 \$150,000,000 (or in Indian rupee equivalent) to PNB Housing Finance Limited 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

16 November 2015

---

<sup>31</sup> ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

## DESIGN AND MONITORING FRAMEWORK

<b>Impact the project is aligned with:</b>			
Private sector investments in affordable housing increased (Government of India: 12th Five Year Plan) <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data and Reporting</b>	<b>Risks</b>
<b>Outcome</b>  Sustainability of PNBHF's lending activities for low-cost affordable housing in India demonstrated	a. NPLs (90 days past due) for LCAH housing loans no more than 1.0% on average from FY2015 to FY2023 (FY2015 baseline: 0.14%)  b. PNBHF's share of LCAH loans as a percentage of the housing loan portfolio increased to 30% by 2023 (2015 baseline: 18.0%)	a–b. Annual development effectiveness monitoring reports from PNBHF  a–b. Annual audited financial statements of PNBHF	PNBHF's asset quality deteriorates significantly
<b>Output</b>  Financing for low-cost affordable housing through PNBHF increased	a. PNBHF's number of LCAH loans increased to 30,400 in FY2022 (FY2015 baseline: 21,830)  b. At least 30% of the new LCAH loans are maintained for houses with women named in the title as owner or joint-owner (FY2015 baseline: 30%)  c. PNBHF's portfolio of LCAH loans increased to Rs32,733 million by FY 2022 (FY2015 baseline: Rs23,241 million)	a–c. Annual development effectiveness monitoring reports from PNBHF  a–c. Annual audited financial statements of PNBHF	Interest rates and inflation increase to high levels
<b>Key Activities with Milestones</b>  1.1 ADB executes legal agreements in Q4 2015. 1.2 ADB loan is fully disbursed by Q4 2015. 1.3 PNBHF uses the proceeds of the ADB loan to fund low cost affordable housing by Q4 2016.			
<b>Inputs</b>  ADB: \$150 million (loan)  Note: ADB will seek to mobilize commercial cofinancing in the form of risk participation.			



**Assumptions for Partner Financing**

Not applicable.

ADB = Asian Development Bank, FY = fiscal year, INR = Indian rupee, LCAH = low cost affordable housing, NPL = nonperforming loan, PNBHF = PNB Housing Finance Limited, Q = quarter.

<sup>a</sup> Government of India, Planning Commission. 2012. Twelfth Five-Year Plan, 2012-2017: Faster, More Inclusive and Sustainable Growth. Delhi.

Source: Asian Development Bank.