ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 42926
August 2008

Proposed Equity Investment India Mortgage Guarantee Company (India)

In accordance with ADB's public communications policy (PCP, 2005), this abbreviated version of the Report and Recommendation of the President excludes confidential information and ADB's assessment of the project or transaction risk, as well as other information referred to in paragraph 126 of the PCP.

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 1 July 2008)

Currency Unit	–	rupee/s (Re/Rs)
Re1.00	=	$0.23226
$1.00	=	Rs43.05500

ABBREVIATIONS

AAB	–	ABN AMRO Bank
ADB	–	Asian Development Bank
AIG	–	American International Group
ARM	–	adjustable rate mortgage
bp	–	basis point
CIBIL	–	Credit Information Bureau (India) Limited
COBP	–	country operations business plan
CPS	–	country partnership strategy
CRISIL	–	Credit Rating Information Services of India Limited
CRO	–	chief risk officer
DSA	–	direct sales agent
DST	–	direct sales team
EMI	–	EMI-Ezer Mortgage Insurance Company
GDP	–	gross domestic product
HDFC	–	Housing Development Finance Corporation
HFC	–	housing finance company
HKMC	–	Hong Kong Mortgage Corporation
IFC	–	International Finance Corporation
IMGC	–	India Mortgage Guarantee Company
IRR	–	internal rate of return
IT	–	information technology
LICHF	–	LIC Housing Finance Corporation
LTV	–	loan-to-value
MBS	–	mortgage-backed securitization
MGA	–	master guarantee agreement
NHB	–	National Housing Bank of India
NPL	–	nonperforming loan
NPW	–	net premiums written
RBI	–	Reserve Bank of India
ROA	–	return on assets
ROE	–	return on equity
SHF	–	Sociedad Hipotecaria Federal
UGC	–	United Guaranty Corporation

NOTES

(i) The fiscal year (FY) of the Government and its agencies ends on 31 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2008 ends on 31 March 2008.

(ii) In this report, "$" refers to US dollars.

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CONTENTS

INVESTMENT SUMMARY

Investment Proposal	An equity investment of up to Rs800 million (approximately $18.58 million) in the India Mortgage Guarantee Company (IMGC) of India.
Classification	Targeting classification: General intervention Sector: Finance Subsector: Housing finance Themes: Sustainable economic growth, private sector development Subthemes: Promoting economic efficiency and enabling markets, private sector investment
Environment and Safeguard Policies	Environment: Category C Indigenous peoples and resettlement: Category C
Use of Proceeds	The funds will be used to establish IMGC, a private limited company that will provide guarantees to mortgage lenders in India against borrower defaults. The United Guaranty Corporation (UGC), a fully owned subsidiary of the American International Group, the National Housing Bank of India (NHB), and the International Finance Corporation, will also be shareholders of IMGC.
Rationale and Justification	**Increase Access to Housing.** Demand for housing in India is high. However, access to housing is limited to certain segments of the population, such as middle- and higher-income groups (typically located in urban areas), with an emphasis on salaried employees of large companies or well-established employers. By sharing risk with mortgage lenders through guarantees, lenders will be encouraged to penetrate broader market segments, where demand is equally high, and offer access to mortgage loans on more flexible terms and conditions. **Improve Affordability.** Typically, mortgage lenders require a minimum down payment of 20% or more of the house value. In practice, lenders' down payment requirements are much higher for nontraditional borrower segments. Many borrowers in lower-income or self-employed segments are either denied loans or have had to aggregate large down payments through family contributions or expensive quasi-legal funding sources. The proposed investment will help to improve the affordability of homes, as a lender will be able to provide larger loans, while being protected from this additional risk through a mortgage guarantee. A larger loan will reduce the overall cost of housing to a borrower over the life of the loan. Additionally, with the risk protection offered through a mortgage guarantee, a lender may be more willing to offer lower interest rates to borrowers. **Meet Need for Housing Stock in India.** Housing is in chronic shortage in India due to pressures from population growth and high urbanization rates. The 11th Five Year Plan Working Committee for the Government noted that in 2007 there was a shortage of 24.71 million housing units in urban areas and 47.43 million units in rural areas. By expanding the availability of mortgage financing, the pace and number of home

construction projects is likely to increase. This will, in turn, increase employment in the construction and real estate sectors. In India, the construction sector is a large contributor to gross domestic product (GDP). It is estimated that for every Indian rupee invested in housing, Rs0.78 is added to the GDP.

Broaden and Strengthen the Housing Finance Sector. A mortgage guarantee industry is an important component of housing finance systems in many developed markets. Mortgage guarantees will diminish risk in the banking system in India through the reduction of credit risk on banks' portfolios. Additionally, mortgage lenders are expected to benefit from a reduction in capital risk weights under Basel II through the use of mortgage guarantees. Finally, market underwriting practices are expected to be standardized and strengthened, given that IMGC will require lenders to adhere to its underwriting standards and reporting requirements. Over the long term this standardization may help to broaden the secondary market for mortgage portfolios, including the securitization market.

Support Government Objectives. The proposed investment will support Government and regulator objectives. First, IMGC will help to address the severe shortage of housing and housing finance in India, which is acknowledged by the Government to be one of the most pressing issues in India today. Second, recognizing the value of creating a healthy housing finance sector, the Government has spent considerable time studying and developing guidelines for a mortgage guarantee industry. Regulators have released final guidelines for the creation of this industry and IMGC is expected to be the first mortgage guarantee company established in India. Given that IMGC will have databases that capture loan performance, it may also provide value to regulators by keeping them apprised of higher risk lending trends which could have an adverse impact on the mortgage market.

Risks

The Asian Development Bank (ADB) has conducted comprehensive due diligence to determine the viability of the proposed financial assistance. Overall, the risks outlined below can be regarded as acceptable.

(i) **Start-up.** IMGC may encounter risks generally associated with start-up companies, including insufficient demand for its product, operational inefficiencies, and credit risk. These risks are considered to be reasonable and are expected to be mitigated, in part, by the participation of the strategic investor, UGC, which has a history of successful operations in international markets. IMGC will work closely with lenders to tailor its products and services to each lender's needs, thereby increasing the attractiveness of its mortgage guarantee product. Additionally, market demand is expected for the product, given its ability to provide capital relief for banks under Basel II.

(ii) **Mortgage industry performance.** A severe downturn in the economy and the mortgage market would impact on the profitability of IMGC. Although relatively young, India's mortgage market has performed well. The percentage of loans that are nonperforming in the mortgage market is currently at about 2.5%. Underwriting practices, although not uniform, are considered to be good. IMGC will help to improve underwriting standards. Thus, this risk is considered to be acceptable.

(iii) **Regulatory risk.** Regulatory risk is considered acceptable. Local laws allow foreclosure through an extra-judicial process and a title deed registration system is in existence in India. Guidelines for the mortgage guarantee industry were issued in February 2008. While the guidelines are considered to be acceptable to industry participants, there is a risk (given that the regulations have been tailored for a new industry in India) that there may be some ambiguities in the guidelines that will need to be clarified as IMGC begins operations. Regulatory risk can be mitigated, in part, by the presence of ADB (as well as IFC and the NHB), as shareholders in IMGC, who will assist the company in clarifying any uncertainties.

(iv) **Potential conflict of interest.** The NHB will initially be the single largest equity investor in IMGC, and it is also the regulator of housing finance companies, which are expected to be customers of IMGC. NHB will not regulate the mortgage guarantee industry. Contractual documentation will include safeguards to prevent the NHB from having any undue influence on the company.

(v) **Macroeconomic risk.** The Indian economy has performed strongly since 2003, making it one of the fastest-growing global economies. Major challenges include containing inflation, managing budget deficits, and further appreciation of the rupee, which would be likely to have an adverse impact on exports and corporate profitability in export-oriented sectors.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation for an equity investment of up to Rs800 million (approximately $18.58 million) in the India Mortgage Guarantee Company (IMGC) located in India.[1] IMGC will be established to provide guarantees to housing finance companies (HFCs) and banks with respect to their mortgage loans.[2] The design and monitoring framework for this investment is in Appendix 1.

II. RATIONALE: BACKGROUND, CHALLENGES, AND OPPORTUNITIES

A. The Economy

1. Overview and Outlook

2. **Overview.** India has one of the world's fastest-growing economies with average growth rates of 8% since 2003. The country has also made substantial progress in reducing absolute poverty by half, and improving literacy and health conditions. The Indian economy is experiencing structural changes with the decline in agricultural productivity, which has been a historic contributor to the economy. By 2007, gross domestic product (GDP) growth was supported by the services sector, which represented 56% of GDP, and the industry sector, which represented 27% of GDP. The private sector continues to expand in India as a result of the improved investment climate. From FY2002 to FY2006, private sector investment as a percentage of gross capital formation increased from 18.6% to 27%.

3. The Government has also made progress in its fiscal performance. The fiscal deficit of the central Government has declined from 5.9% in FY2002 to 3.1% in FY2007, while revenue deficit has declined from 4.4% to 1.4%. The overall fiscal deficit of states has fallen from 4.1% in FY2002 to 2.3% in FY2007. The tax-GDP ratio of the central Government has improved, increasing from 8.8% of GDP in FY2002 to 11.7% in FY2007.

4. The Indian economy has become more competitive externally as a result of significant trade liberalization and reductions in tariff and nontariff barriers over the years. The trade-GDP ratio has increased from 23.3% of GDP in FY2002 to 33.5% in FY2007, which is a reflection of the growing openness of the Indian economy. Foreign exchange reserves have increased rapidly, from less than $100 billion in FY2003 to $314 billion as of 16 May 2008.

5. **Outlook.** The economy is currently experiencing inflationary pressures and a marginal slowdown; however, given the solid fundamentals of the economy, it is expected that growth will be maintained at strong levels. Moderation of growth in the economy is primarily due to external developments, including a rise in interest rates, global financial problems, a slowing of the US economy, and steep increases in commodity prices. Thus,

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[1] A name for the company has not been determined, as the company can only receive approval from the Registrar of Companies after board approvals have been obtained from the respective shareholders.

[2] An investment of $10 million for IMGC was initially approved by ADB's Board of Directors in 2002 (ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Equity Investment to India for the India Mortgage Guarantee Company*. Manila [EI 7180-IND]. IMGC was not established because the regulatory framework for the mortgage guarantee industry was never introduced.

the rate of GDP growth is expected to be about 7.5% for 2008.[3] Inflation has been above 7% since March 2008. The Reserve Bank of India (RBI) has been using monetary policy measures, such as an increase in the cash reserve ratio and interest rates, to moderate inflation. It will be important for the Government to maintain control of its subsidies, particularly for food and oil, during this inflationary period.

2. Challenges

6. Despite strong growth in recent years, there remain a number of developmental challenges for India. First, there have been regional disparities in growth and social indicators. India will need to support employment creation throughout the entire country. Second, the agriculture sector has performed weakly and will need to be supported through rural development initiatives. Third, education and health initiatives require continued emphasis. Finally, India continues to have infrastructure bottlenecks, particularly in urban areas, and suffers from a lack of adequate long-term funds for infrastructure investment. As the country urbanizes rapidly, infrastructure will continue to be strained and the availability of affordable and adequate housing will continue to diminish if not supported through a variety of public and private initiatives.

B. The Housing and Mortgage Market

1. Housing Demand and Supply

7. **Demand.** Demand for housing in India is high and is expected to continue to increase. There are a number of trends that support growth in demand. Foremost among these factors is the strong performance of the economy and subsequent increase in personal income levels. Salary increases for individuals in metropolitan areas have averaged about 20% per year since 2005. [4] More broadly, McKinsey Global Institute estimates that average real household disposable income in India will grow from Rs113,744 per annum in 2005 to Rs318,896 per annum by 2025, which represents a compound annual growth rate of 5.3%. [5] As a result, the middle class is rapidly growing in India. Concurrent with the growth of the middle class is a shift in the traditional aversion to debt, particularly for home ownership. Combined with strong household savings (currently at approximately 28% of disposable income), people are increasingly aspiring to own homes (footnote 5).

8. Changes in the demography of India are also expected to bolster demand for housing. India is still in the initial stages of urban growth; in 2003, only 26% of the population lived in urban areas. By 2023, the number of people living in urban centers is expected to grow to 33% (an increase of 225 million people), which is still a lower urbanization rate than that of many developed countries.[6] In addition to traditional urban centers in India, urbanization is also expected to occur in smaller and medium-sized towns. The population growth rate, which will likely overtake that of the People's Republic of China, will also put pressure on housing stock in India. Estimates indicate that India's population will increase from 1.22 billion by 2013 to 1.37 billion by 2023 (footnote 6).

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[3] Economist Intelligence Unit. 2008. *Country Briefings India Forecast.* London (3 July).
[4] Shanker, Rupali. 2007. *Mortgage Finance: Declining Affordability and Rising Debt Burden.* Mumbai: CRISIL Ratings.
[5] Narayanswamy, Subbu, and Adil Zainulbhai. 2007. India's Consumer Evolution. *Business Standard*. 7 May.
[6] ING Real Estate Investment Management. 2005. *Asia Pacific View: Asia Pacific Real Estate Investment Strategy*. Hong Kong (September).

Another demographic factor that is contributing to demand for housing includes a youthful population. With the average age below 30 years old until 2023, India will have one of the youngest populations in Asia. Given that the standard age for purchasing a home is between 20 and 39 years old, and that younger people in India are moving away from traditional extended-family living arrangements, it is anticipated that demand for new housing will remain strong.

9. **Supply.** Housing stock in India has historically lagged behind demand. The housing construction sector has been relatively unorganized, with most construction undertaken by small, local contractors and often by individuals themselves. Builders in certain areas have been required to obtain more than 50 approvals, thus delaying the approval process to between 120 and 450 days and prohibiting formal construction. Until approximately 2006, the unorganized sector accounted for 70% of all housing units that were constructed. [7] The larger-scale developers active in the market were niche players and typically focused on specific cities. Another factor that has limited the supply of housing stock has been regulations that have created an artificial scarcity of land in India. For example, the Urban Land Ceiling and Regulation Act of 1976 was introduced to ensure that large tracts of land were not concentrated in a few hands. Land in excess of certain limits was turned over to the state for development. The act resulted in preventing tracts of land from entering the market and inefficient redistribution of land after acquisition. In Mumbai, 1,300 hectares of land were acquired by the state, but only 5% was used over a period of 20 years, which has created overcrowded conditions and high property costs in this growing city.

10. Housing construction increased markedly in 2005 with the introduction of amendments impacting the real estate regulations. First, 100% foreign direct investment in housing and construction projects was permitted, which created badly needed sources of funding for real estate. Second, the Securities and Exchange Board of India allowed venture capital funds to invest in real estate. With increasing demand and the aforementioned regulatory changes, the real estate development sector has become more organized, and larger developers with projects on a broader scale throughout India can now be found. Supply of housing stock was also facilitated by the easing of some land restrictions with the repealing of the Urban Land Ceiling and Regulation Act of 1976 by most states. [8]

11. Housing stock growth is expected to be strong in the short and medium term. Current housing stock is about 130 million units and is projected to grow at a compounded annual growth rate of 3.37% until 2012. The Credit Rating Information Services of India Limited (CRISIL), one of India's leading rating agencies whose majority shareholder is Standard and Poor's, notes that between 2007 and 2011 approximately 4.6 million units per annum will be added to the base housing stock.[9] This will increase the housing stock to approximately 153 million units by the end of 2011. Despite the solid growth pattern, there is still a severe shortage of housing units in India. The 11th Five Year Plan Working Committee for the Government noted that there was a shortage of housing units in 2007 of 24.71 million units in urban areas and 47.43 million in rural areas.[10]

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[7] Karnad, Renu S. 2006. *Housing Finance Mechanisms in India*. Mumbai: United Nations Human Settlements Program.

[8] The central Government repealed the act in 1999 but some states, such as West Bengal, have not repealed it.

[9] Deodhar, Rahul, and Sudhir K. Nair. 2007. *Housing Annual Review*. Mumbai: CRISIL Research (May).

[10] CRISIL Research. 2007. *Retail Finance – Housing Finance Annual Review*. Mumbai (November).

C. Home Prices and Affordability

12. Until recently, property prices in India had increased since 1999 due to demand and a shortage of housing and available land. In particular, there has been a steep escalation in home prices in metropolitan areas since about 2005. Home prices increased at a compounded annual growth rate of between 30% and 40% during this period. For instance, in South Mumbai, the price increased from Rs18,000 per square foot (ft^2) in 2005 to Rs25,000 per ft^2 in 2006.[11] Other cities, such as Bangalore, Chennai, Delhi, and Hyderabad, have experienced price increases, but at lower levels.

13. Affordability, particularly in Delhi and Mumbai, has deteriorated since the beginning of 2006 as a consequence of high property prices. Thus, although salaries have increased by an average of 20% per year since approximately 2005, the affordability index has declined from 4.4 times to up to 5.5 times.[12] Some buyers simply cannot afford homes in urban areas, while others will have a higher debt burden upon obtaining a mortgage loan. Some banks and HFCs have offered mortgage loans at higher loan-to-value (LTV) ratios to accommodate more borrowers, while other banks have been reluctant to take on additional risk associated with higher LTV levels.[13] Overall, and despite the sharp increase in property prices, housing affordability has greatly improved in India. In 1996, the value of a home in India was about 16 times an individual's annual income.

14. More recently, property prices in India have started to decrease slightly in some locations. This is primarily due to higher inflation and interest rates. However, property prices in suburbs of large cities are increasing as people are relocating offices from downtown areas. In general, affordability in the medium term is expected to remain stable due to the continued growth in incomes coupled with a moderation in property prices.

15. **Mortgage Market.** At approximately 6% of GDP, India currently has one of the lowest mortgage penetration rates in Asia.[14] Historically, a number of factors have hampered the growth of the housing construction industry (as noted above), and the development of the mortgage market. With respect to the mortgage market development, the legal and regulatory framework for foreclosure, titling, and registration has been weak. High transaction costs associated with registering a home discouraged home buyers. Finally, the economy was not conducive to mortgage lending due to high interest rates and the absence of a mass consumer class that demanded housing. Consequently, financial institutions simply did not offer mortgage products in large quantities for a number of years.

16. The mortgage market has grown substantially since FY2002. The sector has expanded as a result of an improved regulatory environment that strengthened the ability of banks to foreclose more quickly on nonperforming assets. Additionally, macroeconomic growth and lower interest rates have led to increases in mortgage lending. Other factors contributing to the expansion of the mortgage market include government tax incentives

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[11] Global Property Guide. 2008. *House Price Increases Stall.* Available: www.globalpropertyguide.com (25 April).

[12] The affordability index is calculated as the property cost divided by the average net annual income. A lower affordability index indicates that a property is more affordable to the buyer.

[13] Market commentary noted that some banks were offering loans with LTVs of up to 90% and 100%.

[14] Warnock, Veronica C., and Francis E. Warnock. 2007 Markets and Housing Finance. *NBER Working Paper Series, Working Paper 13081*. Cambridge, Massachusetts (May).

for home buyers. CRISIL reports that the estimated growth rate in mortgage lending for FY2007 was 18% with total mortgage disbursements at $25 billion (footnote 10). Mortgage disbursements are projected to grow at an annual rate of 15%–20% to over $40 billion by 2012 (footnote 10). Growth rates have started to slightly slow as a result of higher interest rates; however, the overall outlook for the market remains very positive.

17. Despite the rapid increase in mortgage lending, the percentage of nonperforming loans (NPLs) is low in India and represents approximately 2.5% of lenders' mortgage portfolios.[15] As seen in Table 1, NPLs for HFCs are currently below 2% on average. However, it should be noted that loans offered since 2004 comprise 71% of India's total outstanding portfolio, and have thus not had a chance to age for long. Additional details of the mortgage market are provided in Appendix 2.

Table 1: Nonperforming Loans for Housing Finance Companies
(%)

	Gross NPLs					
Item	**2000/01** (180 dpd)[a]	**2001/02** (180 dpd)	**2002/03** (180 dpd)	**2003/04** (180 dpd)	**2004/05** (90 dpd)	**2006/07** (90 dpd)
HDFC	0.85	0.95	0.99	0.95	1.14	0.92
LICHF	3.44	3.90	4.11	3.59	4.43	2.58
Canara Bank	3.52	3.62	3.21	2.70	2.87	1.56
DHFL	1.50	1.40	1.01	1.18	1.74	1.33
Average GNPL	1.66	1.80	1.84	1.66	2.00	1.71

dpd = days delinquent, DHFL= Dewan Housing Finance Corporation, GNPL = gross nonperforming loans, HDFC = Housing Development Finance Corporation, LICHF = LIC Housing Finance Corporation, NPL = nonperforming loan.

[a] Until 2004, loans were considered to be nonperforming after being delinquent for more than 180 days.

Sources: Annual reports, CRISIL Research.

18. Underwriting practices in India are considered to be good and are generally conservative. The market is relatively young and, at 6% of GDP, lenders have not pursued offering mortgage loans to borrowers considered to be of low credit quality. For instance, lenders do not engage in mortgage lending to borrowers on a low documentation, no documentation, or stated income basis, as was recently common in the United States for borrowers who were considered to be subprime. LTVs have been low and are at an industry average of 75%. LTVs are often overstated because fees, such as stamp duties, are included in the principal amount. Payment shocks to borrowers due to adjustable rate mortgages (ARMs) are not common, despite the prevalence of ARMs in the Indian market. Lenders adjust the tenor of a loan subsequent to changes in interest rates. Additional details of the mortgage market are provided in Appendix 2.

D. Structure

19. The mortgage market in India is divided broadly into two segments: HFCs, and public and private sector banks.[16] HFCs are regulated by the National Housing Bank (NHB), which is wholly owned by the Reserve Bank of India (RBI), while the RBI directly regulates the banks. There are currently 45 HFCs registered with the NHB, the largest

[15] Nayak, Mahesh. 2008. *Life After Bad Debt.* Business Today (5 February). India.

[16] Foreign banks have withdrawn from retail assets businesses as their distribution network is limited and costs of funds is higher than that of Indian players.

being the Housing Development Finance Corporation (HDFC, the mortgage market leader in India) and the LIC Housing Finance Corporation (LICHF). Other HFCs are much smaller and focus on niche markets or geographic regions. Prior to 1998, commercial banks were not permitted to offer mortgage loans. Thus, HFC's were the dominant mortgage lenders in India for a number of years.

20. With rising demand for mortgages and growing incomes, banks began to focus on rapidly building their mortgage portfolios and have now surpassed HFCs as the dominant lender segment.[17] Additionally, capital adequacy requirements, access to liquidity, and tax treatment differ between HFCs and banks, giving banks a competitive edge in the market. Sources of funding for HFCs have included deposits, institutional borrowings (both domestic and international), commercial bank borrowings, refinancing from the NHB, and their own capital. Some of the larger HFCs, such as HDFC, have been able to gain access to multilateral funding, the syndicated bank market, and funds from investors through bonds backed by mortgages.

21. Despite the number of participants in the market, 70% of all new home loans are currently originated by four lenders: HDFC, LICHF, ICICI Bank, and the State Bank of India. The commonalities between these top-tier lenders are access to large pools of reasonably priced funds, and proficiency of local knowledge on home construction rules and land laws. Additionally, advanced information and communications technology has played an important role in augmenting the geographical spread of these lenders.

22. The phenomenal growth in mortgage disbursements in recent years has been supported by the availability of alternative distribution channels. In the past, the major distribution channel has been the branch network of the HFCs; the number of branches was limited and distribution reach was not very wide. Over the last few years, however, there has been a significant increase in the number of banks' own distribution centers. Additionally, direct sales team (DST) models have become more popular. DST models have offices in specific locations with sales agents under direct management of lender sales managers at that office. There has also been a proliferation of direct sales agents (DSAs), which have contributed greatly to expanding lender reach. DSAs typically target individuals who want doorstep service. As competition has intensified in the housing finance industry, several large lenders have delegated sales to DSAs in order to build business.

23. The distribution model for most lenders is in the form of a hub and spoke model, where branches, DSTs, and DSAs focus on sourcing business while credit appraisal is handled by specialized units of underwriters at central lender locations. This enables specialization within the organization and improves efficiencies. The branch locations are typically aligned with regional offices, which are commonly located in major cities (Bangalore, Chennai, Calcutta, Delhi, Mumbai, and Pune). Given that land and building laws vary from state to state, local knowledge is very important in order to successfully penetrate specific markets.

E. Legal and Regulatory Framework

24. The legal system of India provides a framework for transfer of property and recognition of title. There is a lengthy history in India of private ownership of property and

[17] CRISIL Ratings. 2007. *Mortgage Finance: A Safe Haven for Lenders?* Mumbai.

land. Real estate is heavily regulated, with over 100 laws that address various aspects of the real estate sector. While the central Government may issue guidelines, individual states have the option, but not the obligation, to implement such guidelines. Foreclosure laws were strengthened in India with the introduction of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002, which improved the ability of banks to foreclose more quickly on nonperforming assets through an extra-judicial process. Appendix 3 has additional information on the legal and regulatory framework for the property sector.

25. **Mortgage Guarantee Industry Guidelines.** In February 2008, the RBI released the Guidelines on Registration and Operations of a Mortgage Guarantee Company under Section 45(1)(b) of the Reserve Bank of India Act 1934.[18] The guidelines provide the necessary regulatory framework for establishing a mortgage guarantee industry in India. The primary provisions are summarized below:

(i) A mortgage guarantee company will function essentially as a monoline guarantee company (90% of a mortgage guarantee company's gross income must be derived from the mortgage guarantee business).

(ii) The maximum LTV of a loan that can be guaranteed is 90%.

(iii) Capital adequacy is set at 10% of risk in force.[19]

(iv) A mortgage guarantee company will create and maintain contingency reserves and shall appropriate each year at least 40% of the fees earned during that accounting year or 25% of the net profit, whichever is higher. These amounts will be appropriated for a minimum period of seven years. Additionally, the contingency reserve must be built up to 5% of the total outstanding mortgage guarantee commitments.

(v) Provisions will be set aside when a guarantee is invoked in an amount equal to the amount of invocation.

(vi) Provisions will also be established for those incurred but not reported losses or for those loans where there is a potential for a loss when a default has occurred. The amount of provision will be determined on an actuarial basis.

(vii) The timing for a claim payment is not clearly specified and will be negotiated between the mortgage guarantee company and the guaranteed lenders; however, a claim may be invoked after a loan is 90 days delinquent.

(viii) The mortgage guarantee will be in the form of a tripartite agreement between the individual borrower, the lender, and the mortgage guarantee company.

(ix) Mortgage guarantee companies will be responsible for verification of customer data and collateral.

[18] The guidelines may be accessed on the Reserve Bank of India's website at www.rbi.org.in.
[19] Risk in force represents the maximum dollar or local currency amount of principal loss covered by a mortgage guarantee.

26. While the guidelines are considered acceptable by industry participants, there are a few issues that are not clearly specified or addressed. For instance, capital relief is not a specific feature of the regulations; however, the Basel II Revised International Capital Framework (Basel II) does qualify rated guarantees as a risk mitigating tool and allows capital relief. Basel II guidelines will come into force in India in calendar year 2008-2009. Second, guarantees are not mandatory, regardless of LTV levels.[20] Finally, given the tripartite nature of the mortgage guarantee agreement, it would be difficult to provide mortgage guarantees on a pooled basis (where a mortgage guarantee would cover a portfolio of loans).

III. INDIA MORTGAGE GUARANTEE COMPANY

27. **Overview.** IMGC will offer a single product—mortgage guarantees—issued in favor of mortgage lenders against borrower default. Revenues for this company will be primarily generated through fee income. IMGC's clients will be banks and HFCs. IMGC will support the expansion of housing in India.

28. The primary objective of IMGC will be to offer tailored credit mitigation products to mortgage lenders in India, and this will achieve the following:

(i) Make housing more accessible to qualified younger buyers.

(ii) Increase accessibility to mortgage loans in underserved regions and communities.

(iii) Increase accessibility to mortgage loans for entrepreneurs and the self-employed.

(iv) Stimulate the housing resale market.

(v) Encourage lenders to bring yields lower on loans that have a mortgage guarantee.

A. Ownership and Management

1. Proposed Shareholding Structure

29. IMGC will be organized as a private limited company. It will require an initial estimated capital base of Rs1.2 billion (approximately $27.9 million). IMGC will have the following initial shareholders: the NHB, the United Guaranty Corporation (UGC), ADB, and the International Finance Corporation (IFC). UGC is the strategic shareholder in IMGC, and is a wholly owned subsidiary of the American International Group (AIG), which is globally one of the largest financial and insurance companies. UGC also has extensive experience in mortgage insurance and guarantee markets in the US and elsewhere internationally. Details of the initial shareholders are presented in Appendix 4. The estimated initial investment commitments and shareholding structure are shown in Table 2.

[20] For instance, in Hong Kong, China, loans with LTVs of over 70% are required to obtain mortgage insurance.

Table 2: Initial Investment Commitments and Shareholding Structure

Shareholder	Initial Equity Contribution ($ million)	Ownership (%)
National Housing Bank	11.98	43.00
United Guaranty Corporation	11.43	41.00
Asian Development Bank	2.23	8.00
International Finance Corporation	2.23	8.00
Total	**27.87**	**100.00**

Source: Asian Development Bank.

2. Board of Directors and Management

30. **Board of Directors.** IMGC's board of directors, expected to be composed of eight members, will be the company's governing body. ADB and IFC will each have one director, and the NHB and UGC will each have three directors. The chairman of the board will be nominated by the NHB after consultation with the initial shareholders and upon approval by the board of directors. An audit committee will be established and will report directly to the board. The audit committee is expected to be comprised of at least three nonexecutive directors, at least one of whom will be a chartered accountant.

31. **Employees.** It is expected that the managing director will be identified by UGC and will then be approved by the board of directors. The managing director will have an executive team of approximately five directors reporting to him or her, including a chief operating officer, chief risk officer, vice-president of finance, chief commercial officer, and company secretary and head of legal affairs. UGC has a representative office in New Delhi and is conducting preliminary work in anticipation of IMGC's incorporation. Several experienced mortgage staff have been hired and will become key members of IMGC.

B. Corporate Governance

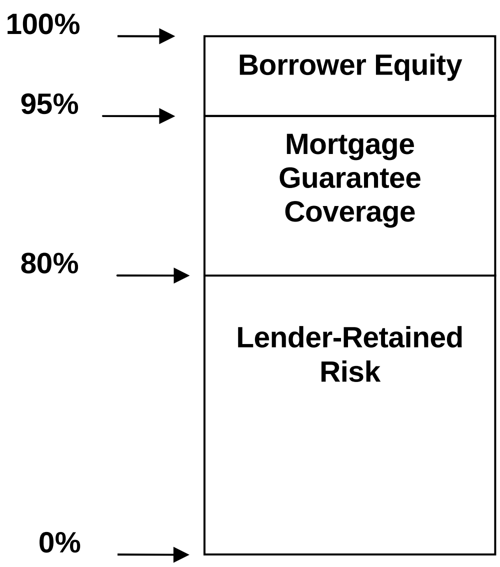
1. Risk Management

32. IMGC will develop a comprehensive risk management system that covers credit and operational risk. A separate risk management unit will be formed under a chief risk officer (CRO). The risk management unit will consist of approximately three divisions: credit policy and portfolio analytics, underwriting, and claims and recovery. The CRO will report directly to the managing director and will also report to the head global risk officer of UGC located in the US.

C. Concept

33. A mortgage guarantee guarantees lenders against partial loss from borrower default. It is typically used when LTV ratios are higher than 75%–80%. Mortgage guarantees are not a form of property insurance, payment protection in the event of unemployment or illness, or life insurance. Figure 1 gives an example of how a mortgage guarantee would provide coverage for an individual mortgage loan where the value of the property is $100,000 and a guaranteed loan of $95,000 is made to the borrower.

Figure 1: Example of Mortgage Guarantee Coverage



Assumptions

(i) The Borrower provides $5,000 in equity.
(ii) The mortgage is $95,000.
(iii) The value of the property is $100,000.

Mortgage Guarantee Coverage

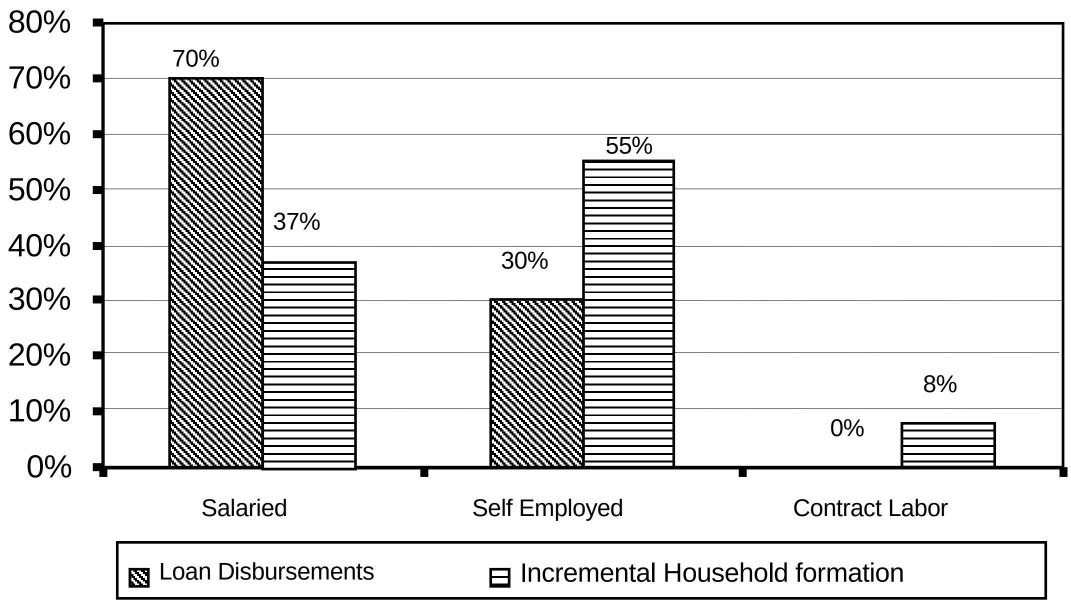
In this example, the mortgage guarantee initially covers losses of up to 15.8% of the loan, which is equal to $15,000/$95,000. Depending upon the structure of the guarantee, coverage may change as the loan ages.

Note: Recoveries will be shared between the mortgage guarantee company and the lenders according to terms that will be specified in the master guarantee agreement.
Source: Asian Development Bank.

34. **Market Demand for Product.** In order to meet its objectives, IMGC must be commercially viable to achieve success. There are three factors that are expected to generate demand for a mortgage guarantee product: (i) high levels of demand from all segments for housing in India, (ii) capital relief for lenders, and (iii) credit enhancement for mortgage-backed securitizations (MBS).

35. First, as noted, housing is in great demand in India. Demographic trends and a positive macroeconomic outlook contribute to projected growth in the market. The larger lenders are currently competing in the upper- and middle-income salaried and self-employed segments of the market. Consequently, lenders have been reducing fees and margins and, as a result, are earning lower yields in this market. Some lenders are starting to expand into the lower-middle income and the self-employed nonprofessional segments where yields are higher but, with the exception of a few niche HFCs, most lenders have yet to really tap this market. As can be seen in Figure 2, the self-employed market has the highest level of household formation but one of the lowest mortgage penetration rates. Thus, there is ample demand and opportunity for growth in this market segment, which is expected to become an increasingly important target market for lenders.

Figure 2: Market Segments Household Formation and Mortgage Penetration Rates



Source: CRISIL Research.

36. Second, lenders will benefit from a mortgage guarantee due to the reduction of credit risk on their portfolio. The lower risk enables them to reduce the provisions for losses on their portfolio. Lenders will also benefit substantially from the reduction in capital risk weights under Basel II if a mortgage guarantee is provided by a company that is rated AA or higher.[21] Banks are currently required to hold 9% capital on a loan risk weighted at 75%, which is an effective capital requirement of 6.75%. Under Basel II, the reduction to 20% risk weight would lower the effective capital to 1.8% on the covered portion. HFCs are required to hold capital of 12% of the loan amount risk weighted at 50%. Therefore, the effective capital requirement is 6%. If the risk weight is reduced to 20%, the effective capital requirement would be reduced to 1.2% on the covered portion of the loan. Savings on costs associated with capital and provisions requirements can then be deployed to originate new mortgage loans. An example of the actual cost savings to an HFC using a mortgage guarantee is presented in Appendix 6.

37. Finally, the benefit from mortgage guarantees may be expanded to the MBS market at a later date. As previously mentioned, the RBI guidelines require the mortgage guarantee to be in the form of a tripartite agreement between the individual borrower, the lender, and the mortgage guarantee company. Currently, this requirement makes it difficult for a mortgage guarantee company to provide guarantees on a pool or portfolio of mortgage loans. However, should the regulators modify this requirement, mortgage

[21] The Government has stated that Basel II guidelines will be introduced in calendar year 2008 to 2009 for banks. NHB has yet to come out with similar guidelines for HFCs. However, it has indicated that it will be releasing similar guidelines concurrent with the implementation of Basel II.

guarantees could become an important form of credit enhancement for bonds backed by mortgages or MBS. In many developed countries, mortgage guarantees or mortgage insurance are used in a first-loss position in MBS structures.

D. Operational Framework

1. Products

38. IMGC will offer a partial guarantee on mortgage loans covering a predetermined percentage of the outstanding mortgage value. The guarantee will be tailored to specific lenders' needs. It may take the form, for instance, of amortizing at the same rate as a mortgage loan so that a lender’s risk exposure would remain constant at 80% for the life of the mortgage loan. Another possible product is for the mortgage guarantee coverage to remain constant while the lender’s exposure declines. The various product alternatives will be refined after the company is incorporated.

2. Pricing

39. Guarantee fee pricing is expected to be the foremost concern for lenders and borrowers in selecting to use a mortgage guarantee product. The fee will be paid upfront at the point when the mortgage is closed. The borrower will be responsible for paying the guarantee fee. The mortgage guarantee fee is expected to be included in the full amount of the mortgage loan. Initial pricing of the product will be critical to its uptake and for the establishment of benchmarks in the market for this product. IMGC will focus on preserving the integrity of its pricing model by pricing risk accurately, taking into account the full lending cycle and reaching the threshold return on equity for all programs.

3. Guarantee Eligibility

40. IMGC will guarantee only those loans that meet its own underwriting standards. Banks and HFCs will provide IMGC with predetermined data from the borrower’s application, which IMGC will then use to analyze and underwrite each mortgage loan through an automated process. Given that borrower qualifications vary by lender, IMGC’s undertaking will help to standardize the market. Bank or HFC underwriting practices and associated technology will be reviewed to ensure that they are in line with prudent mortgage practices and are acceptable to IMGC. A master guarantee agreement (MGA) will be signed with each lender, and this will cover the key risk issues that the lender is expected to address at the time of its assessment of the loan.

4. Portfolio Monitoring

41. IMGC will monitor the loans that it has guaranteed. It will receive data files on a periodic basis (expected to be monthly) that include all information required to satisfy its monitoring needs. This information may include, for example, current loan balances, prepayment, and delinquency data. The specific dataset for this file will be based on the UGC Standard International Dataset and will be predetermined with each lender.

5. Claims Settlement

42. According to the RBI guidelines for the mortgage guarantee industry, the timing for a claims payment is not specified and will be negotiated between the mortgage guarantee company and the lenders; however, it will occur no earlier than after a loan is 90 days delinquent. IMGC will be made aware of the first monthly default by a notice from the lender. Additionally, data from clients uploaded into IMGC's system on a continuous basis will indicate early defaulting loans. Settlement of claims with a lender will take place only after the lender has completed the foreclosure process and disposed of the foreclosed property through public auction. The claims settlement process will be clearly outlined with the lender under the MGA. Disputed cases will also follow a procedure set forth in the MGA.

E. Risk Management

1. Credit Risk

43. As noted, IMGC will develop guidelines to manage the credit risk of both the borrower and the lender. With respect to borrower risk, IMGC will require the lender to undertake specific verifications, such as bank statements and evidence of employment. For nonsalaried employees where a significant portion of income is received in cash, it is often difficult to assess their real income. Self-employed individuals will often not declare their real income to avoid income taxes. Thus, due diligence that includes a thorough examination of a borrower's income, established through accounting records and visits to the borrower's premises, may be required. Credit risk will also be assessed through borrower ratings from India's credit bureau, the Credit Information Bureau (India) Limited (CIBIL). CIBIL collects both positive and negative credit information. Historical data is somewhat limited since CIBIL launched its consumer credit bureau operations in 2004; however, by May 2005 CIBIL had already accumulated 20 million records from 30 members.

44. Lender risk will be managed through IMGC's lender approval and monitoring processes. Through random quality checks, IMGC will ensure that lenders are adhering to the underwriting processes established for borrowers. Additionally, IMGC will develop a detailed lender evaluation mechanism to assess lenders prior to signing an MGA. The MGA will help to mitigate key risk issues through the compliance of the lender with certain underwriting criteria.

2. Portfolio Risk

45. Portfolio risk is expected to be managed in a variety of ways. Data management will be important; significant emphasis will be placed on data capture and analysis. Apart from system validations of data, the data used for underwriting will be sample validated through the lender quality assurance process. Through the portfolio monitoring tasks that will be undertaken on a continuous basis (as previously described), IMGC will be able to assess the performance of its portfolio at almost any time. Adverse selection, which would negatively impact IMGC's overall portfolio performance, would be mitigated by lender audits, as well as through the MGA, which will specifically prohibit adverse selection. Portfolio risk for many mortgage insurers or guarantors can also be decreased through reinsurance arrangements. At this time, however, the RBI guidelines do not allow for such reinsurance.

F. Information Technology and Management Information System

46. Information technology (IT) systems will be critical for the successful operation of IMGC, which will be working with established, sophisticated lenders. Thus, it is very important that IMGC does not impede their origination processes. The IT system will be a web-based application that will be integrated with the lender partners' systems and also have application interfaces with CIBIL. The system will be designed as a true web-based application having three-tier architecture with a common logon server (web server), an application server (performing basic applications and logic), and the database server (storing historical data). The system will be designed to be scalable as the business grows, including taking a load of 20–100 concurrent users over the first 3 years. The system will be designed so lenders can transmit data either on a flow or batch data basis.

47. The mortgage guarantee applications will include a strong rule-based review and approval system. It will contain a robust document management system and the ability to store document images. It will interface with a general ledger system and have the ability to generate accounting and management reports.

48. IMGC's IT system will have the highest level of security and availability in order to build the business. The web application will be built with a highly redundant network configuration to ensure that there is no single point of failure. Disaster recovery and business continuity plans will be in place. The system will have three levels of security (physical, operational, and system) to ensure that customer data is protected. Physical access will be restricted, and dedicated firewalls will be used to block unauthorized access. A managed system will be in place to provide data security.

G. Head Office and Branch Locations

49. IMGC's corporate head office will be in Delhi, and this will also serve as a regional office. There will be two other regional offices—Mumbai and Bangalore—which will centralize risk and underwriting operations. As IMGC expands operationally, it is expected that additional branch offices will be established and these will operate as sales and marketing outlets. IMGC's proposed structure mirrors the regional branch offices of the major lenders. Due to the vast size of the country, large population, and the operational model of most large banks, an extensive "bricks and mortar" operation is needed to ensure success in India.

IV. THE PROPOSED EQUITY INVESTMENT

A. ADB's Proposed Investment

1. Equity Investment

50. ADB proposes to make an equity investment of up to Rs800 million. ADB's maximum commitment will not exceed 19% of IMGC's share capital. The initial target capitalization was set based upon the projected business volume and regulatory capital requirements. ADB's initial equity investment will be Rs96 million (approximately $2.23 million). Successive infusions of equity up to each shareholder's committed amount will

occur as IMGC's business grows and certain performance targets are met, as determined by its board of directors.

51. An investment for IMGC was initially approved by ADB's Board of Directors in 2002.[22] Board approval was given for up to $10 million representing an equity position of up to 25% in IMGC. IMGC was not established because the regulatory framework for the mortgage guarantee industry was not introduced until February 2008. New Board approval is being sought given that the prior Board approval has lapsed and also in consideration of the higher amount of funding that is now needed and the change in the initial shareholding structure.[23] Due diligence was recently undertaken for this project due to changes in the market and subsequent revisions to assumptions for IMGC's financial performance.

B. Exit Strategy

52. ADB will consider the disposal of its shares in IMGC once the developmental role of ADB has been fulfilled and after the expected holding period of 5 years. Terms and conditions for ADB's exit strategy are still under negotiation. However, it is anticipated that ADB may have the right to dispose of its investment through exercise of a put option. The put price is anticipated to be calculated on a fair market value basis.

53. Another exit option for ADB will be through an initial public offering. Should market conditions permit, ADB could dispose of its shares via an initial public offering at any time during and after the initial 5-year holding period. ADB may also seek to sell its shares to a strategic investor.

V. INVESTMENT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS

A. Justification

1. Development Outcome

54. The ADB assistance will promote significant development in India.

55. **Increase Access to Housing**. Demand for housing in India is strong and growing. However, access to housing is currently limited to certain segments of the population, such as mid-to-higher income groups (typically located in urban areas), with an emphasis on salaried employees of large companies or well-established employers. For instance, the rate of household formation is particularly high in the self-employed segment; however, mortgage penetration rates are quite low. By providing mortgage lenders with risk protection in the form of a guarantee, lenders are expected to be encouraged to penetrate broader market segments and offer mortgage loans on terms and conditions that are more flexible for borrowers.

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[22] ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Equity Investment to India for the India Mortgage Guarantee Company*. Manila (EI7180- IND).

[23] The Canadian Housing Mortgage Corporation (CHMC) withdrew from the transaction as both an equity investor and technical services provider. CHMC is owned entirely by the Canadian government. The Canadian government has altered its stance and has prohibited CHMC from taking equity positions in overseas ventures.

56. **Improve Affordability**. Typically, mortgage lenders require a minimum down payment of 20% or more of the value of the house. For nontraditional borrower segments, lenders in India have required much larger down payments. Many potential borrowers in lower-income or self-employed segments are either denied loans or have had to aggregate large down payments through family contributions or expensive quasi-legal funding sources. IMGC will help to improve the affordability of homes as the lender will be able to provide loans in higher amounts, while being protected from this additional risk through a mortgage guarantee. A higher loan amount will reduce the overall cost of housing to a borrower over the life of the loan. Finally, with a guarantee a lender may be more willing to provide lower interest rates on mortgage loans to some of these underserved borrower segments.

57. **Meet Need for Housing Stock in India**. Housing is in chronic shortage in India due to pressures from population growth and high urbanization rates. As mentioned, the 11th Five Year Plan Working Committee for the Government noted that in 2007 there was a shortage of 24.71 million housing units in urban areas and 47.43 million units in rural areas. By expanding the availability of mortgage financing, the pace and number of home construction projects is likely to increase.

58. **Broaden and Strengthen the Housing Finance Sector**. The establishment of a mortgage guarantee (or insurance) industry is an important component of housing finance systems in developed markets. Mortgage guarantees and insurance exist not only in the US but also in Australia, Canada, the Republic of Korea, and Hong Kong, China. Mortgage guarantees diminish risk in the banking system through the reduction of credit risk on their portfolio, thereby allowing a lender to penetrate new markets and deepen lending in those markets in which they are already active. Additionally, mortgage lenders in India are expected to benefit from a reduction in capital risk weights under Basel II through use of mortgage guarantees. Finally, market underwriting practices can be standardized and strengthened, given that IMGC will require lenders to adhere to its standards with respect to credit information and delinquency management systems, for instance. In the long term this standardization may help to broaden the secondary market for mortgage portfolios, including the securitization market.

59. **Support Government Objectives**. IMGC will directly address Government and regulator objectives. First, it will help to tackle the severe shortage of housing and housing finance in India, which is acknowledged by the Government as one of the most pressing issues in India today. Second, recognizing the value to the housing finance sector and the ultimate borrower, the Government has spent years studying and developing guidelines for a mortgage guarantee industry. Regulators have released final guidelines for the creation of a mortgage guarantee industry and IMGC is expected to be the first mortgage guarantee company established in India. Additionally, a mortgage guarantee company will be in a position to apprise regulators of high-risk lender practices that may have an adverse impact on the mortgage market.

60. **Generate Jobs and Additional Revenue.** Mortgage lending is an important development activity. A healthy mortgage market enables a country to generate multiple sources of employment, and employment related to the construction and home improvement industries is supported. Consumption of consumer goods also increases. Importantly, mortgage lending also serves as a vehicle to create one of the most important sources of capital for an individual or family. Capital for the establishment of small and medium-sized enterprises can be accessed through a mortgaged property. By providing

funding for IMGC, the proposed ADB investment will contribute to expanding India's economic base through supporting employment in the construction and real estate sectors in a number of areas throughout the country. In India, the construction sector is one of the largest contributors to GDP. It is estimated that for every Indian rupee invested in housing, Rs0.78 is added to GDP.[24]

2. Value Added by ADB

61. Although ADB's equity investment is small, the value of its participation is, and has been, significant. First, ADB has worked with the shareholders and the Government for a number of years to establish a commercially viable mortgage guarantee industry, which will broaden the housing market in India. ADB's activities have included providing input on draft regulations for the industry. ADB will continue to work with the Government and regulators, as needed, to clarify any issues concerning the regulations. Second, given that IMGC is likely to be the first mortgage guarantee company to be established in India, ADB's presence will improve the visibility and acceptance of IMGC in the market. Finally, IMGC will need to obtain a rating of AA for lenders to avail themselves of capital relief as per Basel II guidelines. When the company begins the rating process, ADB's presence and its AAA rating is likely to have a positive impact on the overall rating of IMGC.

3. Measures for Development Impact

62. ADB has prepared a design and monitoring framework and measured the expected development impact of the investment (Appendix 1), in accordance with ADB's guidelines for preparing a design and monitoring framework.[25]

4. Fit to Sector and Country Strategy

63. The country operations business plan for 2008–2010 (COBP)[26] broadly outlines ADB's strategy in India and is part of the larger draft country partnership strategy for 2008–2012 (CPS).[27] The COBP and the CPS are aligned with India's 11th Five Year Plan for 2007–2011. Critical areas for development include infrastructure and social, agricultural, and rural development. Generating employment, improving public service delivery, and balancing protection of the environment with growth is also emphasized. The COBP notes that ADB will continue to support infrastructure development in India through transport, energy, and urban projects. ADB will also support agribusiness infrastructure and rural and urban development, and improved water resources management. ADB will continue to support nonsovereign investments, particularly in these sectors.

64. IMGC directly addresses the Government's concern for tackling housing shortages as outlined in the 11th Five Year Plan for 2007–2011, and is within the core ADB targets of supporting urban and rural development projects through access to housing for a broader spectrum of people. Additionally, IMGC's objectives are supported by the Government, as concerted efforts were made by the regulators to develop regulations for this industry.

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[24] Karnad, Renu S. 2006. *Housing Finance Mechanisms in India*. Paper for United Nations Human Settlements Program, 2006. Mumbai.
[25] ADB. 2006. *Guidelines for Preparing a Design and Monitoring Framework*. Manila.
[26] ADB. 2007. *Country Operations Business Plan (2008–2010): India.* Manila.
[27] ADB. July 2008. *Draft Country Partnership Strategy (2008–2012): India.* Manila.

65. ADB’s investment in IMGC expands, and is complementary to, ADB’s ongoing and prospective initiatives in the housing sector in India. These include a nonsovereign loan of $20 million equivalent in local currency to the Dewan Housing Finance Limited Corporation that was approved by the ADB Board in December 2003. Dewan Housing Finance Limited Corporation provides loans to the self-employed and the lower-middle income class. ADB’s investment in IMGC is complementary to ADB’s efforts to help India broaden its housing market. ADB’s South Asia Department is planning to provide technical assistance to the Ministry of Housing and Poverty Alleviation to improve urban development, including basic shelter and services. Thus, IMGC will expand the activities of ADB's Private Sector Operations Department in the housing sector and complement the public sector project related to low-income housing.

B. Social and Environmental Safeguard Policies

66. As a financial intermediation investment which is expected to result in insignificant environmental impacts, the proposed investment is assigned a classification of C for environment according to ADB’s *Environment Policy* (2002). The investment has also been assigned a category C in respect of safeguards policies addressing indigenous people and resettlement issues.

67. With respect to the poverty analysis impact, the investment has been assigned a classification of general intervention. The investment will indirectly contribute to poverty reduction by supporting private sector growth and promoting mortgage financing in India. The social impact of the investment is high, as it will enable banks and HFCs to provide mortgage lending to a broader spectrum of borrowers in India. Moreover, mortgage lending enables a country to generate multiple sources of employment in the construction and real estate industries. A summary of ADB’s poverty reduction and social strategy is presented in Appendix 7.

C. Anticorruption Policy, Combating Money Laundering and the Financing of Terrorism

68. UGC was advised of ADB’s *Anticorruption Policy* (1998, as amended to date) and *Combating of Money Laundering and the Financing of Terrorism Policy* (2003), and these will be discussed with senior management of IMGC (once formed). Consistent with its commitment to good governance, accountability, and transparency, ADB will require IMGC to institute, maintain, and comply with internal procedures and controls following international best-practice standards for the purpose of preventing corruption or money laundering activities or the financing of terrorism. Further, IMGC will be required to covenant with ADB to refrain from engaging in such activities. The investment documentation between ADB and IMGC will further allow ADB to investigate any violation or potential violation of these undertakings.

D. Transaction Risks

69. ADB conducted comprehensive due diligence to determine the viability of the proposed equity investment. Overall, the risks can be regarded as acceptable for a transaction of this kind. The main risks identified during due diligence, as well as the steps taken to mitigate them, include the following:

(i) **Start-up.** IMGC may encounter risks generally associated with start-up companies, including insufficient demand for its product, operational inefficiencies, and credit risk. These risks are considered to be reasonable and are expected to be mitigated, in part, by the participation of the strategic investor, UGC, which has a strong history in international markets, including in emerging countries. IMGC will work closely with UGC risk management staff to develop credit risk and operational guidelines. Credit risk will, in part, be mitigated through application of stringent and conservative underwriting standards by IMGC. Additionally, UGC will provide IT systems and support, which will be critical to IMGC's ability to capture mortgage data and to interface with lenders.

With respect to market demand, IMGC will benefit from the untapped segments of borrowers in India. IMGC will work closely with each lender to tailor its products and services to each lender's needs in order to increase the attractiveness of the mortgage product. It is anticipated that lenders will seek higher yields in underserved markets and will avail themselves of the mortgage guarantee product to reduce risk. Moreover, lenders are expected to consider the mortgage guarantee product highly beneficial because of the reduction of capital provision under Basel II. Borrowers are expected to be attracted to the mortgage guarantee product because it will allow them access to housing more rapidly and less expensively than is currently the case.

(ii) **Mortgage industry performance.** A severe downturn in the economy and the mortgage market would impact on the profitability of IMGC. Although relatively young, India's mortgage market has performed well. The percentage of NPLs in lenders' portfolios is currently at about 2.5%. Mortgage lenders are just starting to expand into different income segments, other than the upper and upper middle classes. Underwriting practices, although not uniform, are considered to be good and have traditionally been conservative. IMGC will help to improve underwriting practices through its lender requirements and is expected to contribute to the establishment of industry underwriting standards. Thus, this risk is considered to be acceptable.

(iii) **Regulatory risk.** Regulatory risk is considered acceptable. Indian law allows foreclosure through an extrajudicial process, and a title deed registration system exists. Guidelines for the mortgage guarantee industry were issued in February 2008. While the guidelines are considered to be acceptable to industry participants, there is a risk (given that the regulations have been tailored for a new industry in India) that there may be some ambiguities in the guidelines. These may need to be clarified as IMGC begins operations. Regulatory risk can be mitigated, in part, by the presence of ADB, IFC, and the NHB as shareholders in IMGC.

(iv) **Potential conflicts of interest.** NHB will initially be the single largest equity investor in IMGC. It is also the regulator of HFCs, which are expected to be customers of IMGC. The NHB will, however, not regulate the mortgage guarantee industry, but it could implement new regulations with the HFCs that would make the mortgage guarantee product more attractive. Conversely, NHB could increase the risk profile of IMGC through the introduction of regulations that would effectively encourage HFCs to adversely select only the most risky mortgage loans. To mitigate potential conflicts of interest, UGC will have a significant role in IMGC with the right to appoint a managing director (subject to board approval). The risk for adverse selection will be mitigated through the MGA with the lender, which will seek to exclude demands arising as a result of adverse selection. Compliance will be confirmed through IMGC random audits of lenders. Finally, IMGC's governance structure will include safeguards to prevent the NHB from having any undue influence on the company, and the NHB will be requested to covenant that it will not hold more than 49% of IMGC's shares.

(v) **Macroeconomic risk.** The Indian economy has performed strongly since 2003, making it one of the fastest-growing global economies. Major challenges include containing inflation, managing budget deficits, and further appreciation of the rupee, which would be likely to have an adverse impact on exports and corporate profitability in export-oriented sectors.

VI. EXPOSURE LIMITS

70. Once approved by the Board, the equity investment will represent 0.36% of ADB's total nonsovereign exposure, and increase ADB's exposure in the nonbanking financial subsector to 3.42%. ADB's nonsovereign exposure in India following approval of the equity investment will be $1.12 billion. The proposed equity investment is within ADB's aggregate, country, industry, group, and single-project exposure limits for nonsovereign operations.

VII. ASSURANCES

71. Following the approval of the proposed investments by ADB's Board of Directors, ADB will enter into suitable investment documentation, and ensure that such documentation will be on terms and conditions satisfactory to ADB and consistent with all relevant ADB policies.

72. Consistent with the Agreement Establishing the Asian Development Bank, the Government of India will be requested to confirm that it has no objection to the proposed equity investment in IMGC. No funding will be disbursed until ADB receives such confirmation.

VIII. RECOMMENDATION

73. I am satisfied that the proposed equity investment would comply with the Articles of Agreement of the Asian Development Bank and recommend that the Board approve the equity investment of up to Rs800 million to the India Mortgage Guarantee Company from ADB's ordinary capital resources, on terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Haruhiko Kuroda
President

01 August 2008

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
Impact A broader spectrum of borrowers in India will have access to housing on a more affordable basis.	Provision of guarantees for approximately 220,000 borrowers during the first 5 years of the India Mortgage Guarantee Company's (IMGC) operations	IMGC financial reports, Reserve Bank of India, National Housing Bank of India	**Assumptions** • Increased access to mortgage finance from banks, leading to more individuals receiving mortgage loans thereby stimulating the supply of housing in the economy • Stable or increased economic growth in India **Risks** • Construction of housing units slows • Employment and income levels decrease in the country and interest rates increase markedly
Outcome Mortgage lenders will be more inclined to move down market with mortgage guarantees that shift some risk of borrower default to IMGC. Mortgage lenders will have increased capital for more lending activities because mortgage guarantees give capital relief under Basel II.	Increase of 10% in mortgage lending to untapped market segments (nonsalaried self-employed and lower-tier salaried employees) over the next 5 years for those lenders utilizing mortgage guarantees Increase of mortgage lending of 10% per annum over the next 5 years for those lenders utilizing mortgage guarantees	IMGC reports, Reserve Bank of India, National Housing Bank of India	**Assumptions** • Demand for mortgage loans from individuals continues • Property prices do not to escalate substantially • No adverse economic developments occur in India • No adverse regulatory changes affect the financial sector • No adverse regulatory changes affect the legal and regulatory framework governing the property sector or the mortgage guarantee industry
Outputs 1. ADB provides an equity investment in IMGC.	As of October 2008, IMGC has access to Rs800 million of ADB funds	IMGC quarterly and annual financial statements Reporting specifically requested by ADB	**Assumptions** • Prevailing market conditions are stable • All regulatory approvals are in place for ADB
Activities with Milestones 1.1 ADB executes legal agreements. 1.2 Provision of initial equity infusion of Rs96 million followed by subsequent capital infusions of up to Rs800 million, as necessary. 2.1 Utilization of proceeds by IMGC through issuance of mortgage guarantees (ongoing). 2.2 Marketing to lenders. 2.3 Assessment of borrowers. 2.4 Execution of mortgage guarantee agreements with clients. 2.5 Disbursement of funds to lenders in the event of borrower default.			**Inputs** • ADB: Up to Rs800 million, representing no more than 19% of IMGC.

ADB = Asian Development Bank, IMGC = India Mortgage Guarantee Company.

CHARACTERISTICS OF THE MORTGAGE MARKET IN INDIA

1. **Nonperforming Loans.** In India, an asset is considered nonperforming when the borrower fails to pay one or more installment of principal and interest within 90 days of the last date on which that installment was due to be paid to the lender. Despite the rapid increase in mortgage lending, nonperforming loans (NPLs) are low in India and are at approximately 2.5% of lenders' portfolios. As seen in Table A2, NPLs for housing finance companies (HFCs) are currently below 2% on average. However, loans offered over the last 3 years account for 71% of India's total outstanding portfolio, and have thus not aged.

Table A2: Nonperforming Loans for Housing Finance Companies
(%)

	Gross NPLs					
	FY2001	**FY2002**	**FY2003**	**FY2004**	**FY2005**	**FY2007**
Item	(180 dpd)[a]	(180 dpd)	(180 dpd)	(180 dpd)	(90 dpd)	(90 dpd)
HDFC	0.85	0.95	0.99	0.95	1.14	0.92
LICHF	3.44	3.90	4.11	3.59	4.43	2.58
Canara Bank	3.52	3.62	3.21	2.70	2.87	1.56
DHFL	1.50	1.40	1.01	1.18	1.74	1.33
Average GNPL	1.66	1.80	1.84	1.66	2.00	1.71

[a] Until 2004, loans were considered to be nonperforming after being delinquent for more than 180 days.
DHFL= Dewan Housing Finance Corporation, GNPL = gross nonperforming loans, HDFC = Housing Development Finance Corporation, LICHF = LIC Housing Finance Corporation, NPL = nonperforming loan.
Sources: Annual reports, CRISIL Research.

2. **Loan Products.** Mortgage lenders offer loans on fixed and floating rate (adjustable rate mortgage) bases. The interest rate charged on an adjustable rate mortgage (ARM) is linked to the benchmark prime lending rate of the bank or the HFC. The rate changes depending on the changes in the benchmark prime lending rate, and frequency of change varies across lenders (on average between 3 and 6 months). With the growth of commercial bank participation in the market, floating-rate loans were offered with regularity and became popular with borrowers. Commercial banks had access to floating-rate funds from their demand deposits; therefore, they were more likely to offer ARMs to borrowers to reduce asset-liability mismatches. As interest rates declined in the market, HFCs began to offer ARMs to meet customer demand. According to Credit Rating Information Services of India Limited (CRISIL), India's leading rating agency, the percentage of home loans that were ARMs was 79% in FY2005. This percentage increased to 85% in FY2007 and is estimated to increase further to 90% in FY2008. By FY2012, it is projected that the percentage of mortgage loans that are ARMS will decrease to about 86%.

3. In the event of interest rate increases or decreases, the tenor of the loan will be increased or decreased to maintain the same payment installment. This option is available for people up to the age of 65. If the tenor cannot be increased, the installment is increased or there can be a combination of tenor and installment increases. Given that the average life of a mortgage loan in India is 8–10 years, there is the possibility to provide for such tenor increases.

4. **Interest Rates.** The average yield on the benchmark 10-year Government security (risk free return) was about 5.5% in FY2004, and it increased to about 6.2% in FY2005. The average interest rate on a 10-year mortgage loan was about 7.4% in FY2005, which represented a premium of 122 basis points (bps) over the risk-free return. Subsequently, most lenders increased

the rate of interest on their housing loan products (both fixed and ARMs) by about 50 bps across all tenors in FY2006. Despite the increase in home loan rates, the premium declined sharply to 98 bps in FY2006 because of the rise in the yield on 10-year Government security to 7.1%. The yield on the Government security was about 7.5% in FY2007 and, after a further rise of 50 bps in FY2008, it is expected to decrease. This resulted in an increase in mortgage loan interest rates to about 11%–12% in mid-2007.

SUMMARY OF THE LEGAL AND REGULATORY FRAMEWORK FOR PROPERTY AND MORTGAGES

1) The legal system in India provides a framework for transfer of property and recognition of title. There is a lengthy history in India of private ownership of property and land. Real estate in India is heavily regulated with over 100 laws that deal with various aspects of the real estate sector. While the central Government may issue guidelines, states have the option to implement such guidelines. Some applicable real estate legislation dates back to the 19th century[1] and has often led to lengthy litigation and created an artificial scarcity of land.

A. Deed Registration

2) India has two types of land: freehold and leasehold. Lease tenures and terms vary throughout the country. In some locations, such as Mumbai, the Government does not sell its land, but rather leases it on a long-term renewable basis for a fee. Lessees are allowed nearly all of the rights as a property owner, including the right to mortgage and develop the property.

3) With respect to titling, India has a deed registration system whereby title is established through previous transfers of the property if the transfers can be traced for a consecutive period of 13 years. Documents are recorded in the land registry and are the evidence of title, while registration of title is a system where the register itself serves as the primary evidence. Registration authorities are required to verify the authenticity of the property and its title while registering a document. Although authorities verify documents, they do not guarantee title ownership. Some states, such as Karnataka, are trying to computerize their registration systems to reduce inefficiencies. The deed registration system in India is not based on a cadastral mapping system whereby a map shows boundaries and ownership of parcels of land. City surveys do exist, but they typically show land and not buildings erected on a site; therefore, encroachments by neighboring owners can occur. Questions regarding titles of property are often handled by placing advertisements in local newspapers for potential claimants to come forward. Thus, title chains (or title due diligence) can be lengthy and typically involve a local attorney. Banks have in-house counsels to conduct title due diligence.

B. Mortgage Registration

4) Mortgages are created on property in India by the deposit of the title deeds and payment of fees. The registration process takes about 3 weeks. Transfer of property requires the appropriate conveyance documents to be stamped after payment of duty and registered with the government registration offices. Stamp duties are levied on a state level and thus can be as high as 15% of the value of the property (in most developed countries this fee is about 1%–2% of the value of the property). The central Government has called for rationalization of stamp duties, but states have been reluctant to lower the fees as they are a substantial contributor to state revenues. Due to the high stamp duties in some states, transaction values are often understated to minimize the costs associated with the property sale.

C. Foreclosure

5. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002 allowed secured creditors to pursue foreclosure outside the court system in

[1] The primary laws that are still applicable from the 19th and early 20th centuries include the Indian Contracts Act of 1872, the Transfer of Property Act of 1882, and the Registration Act of 1908.

India. Prior to 2002, the foreclosure process could take 2–3 years. However, the relatively new foreclosure process has greatly reduced the time that it takes to conclude foreclosure, and also gives banks and housing finance companies added impetus to increase mortgage lending. The process is clear; remedies can be exercised after giving 60 days notice to the borrower and specifying the assets in relation to which the secured creditor proposes to take action. The secured creditor is required to have considered all objections made by the borrower with respect to why enforcement should not be taken and if such objection is not acceptable, the secured creditor is required to communicate the same with reasons. Upon the expiry of the 60 day- notice, another 30-day notice is to be provided to the borrower of sale of the secured assets. If the loan is not paid during this period, the property is auctioned for the best price. According to the law, the bank must sell the property and cannot use the asset.

INDIA MORTGAGE GUARANTEE COMPANY INITIAL SHAREHOLDERS

1. The primary shareholders of the India Mortgage Guarantee Company (IMGC) are the following: the National Housing Bank of India (NHB), the United Guaranty Corporation (UGC), the Asian Development Bank (ADB), and the International Finance Corporation (IFC). UGC is the strategic shareholder in IMGC based upon its international experience as a mortgage insurer. Details of the shareholders are presented below.

A. National Housing Bank of India

2. The NHB was established in 1988 to act as an institution with a broad mandate that includes the mobilization of resources for housing finance companies (HFCs), regulation of HFCs, and development of the housing finance sector in India. The NHB is a wholly owned subsidiary of the Reserve Bank of India. It has provided financial assistance to 18 HFCs and about 40 commercial and cooperative banks. With respect to regulation of the HFCs, the NHB sets prudential norms for HFCs based on required capital adequacy ratios, income recognition, asset classification, and acceptable levels of nonperforming assets. The regulatory role of the NHB also covers the deposit acceptance activities of the HFCs. In FY2007, the NHB provided Rs12.1 billion of refinancing to HFCs. Its profit after tax was Rs1.14 billion and total assets were Rs215 billion as of the same period. The NHB's capital adequacy ratio was 22.58% as of 30 June 2007.

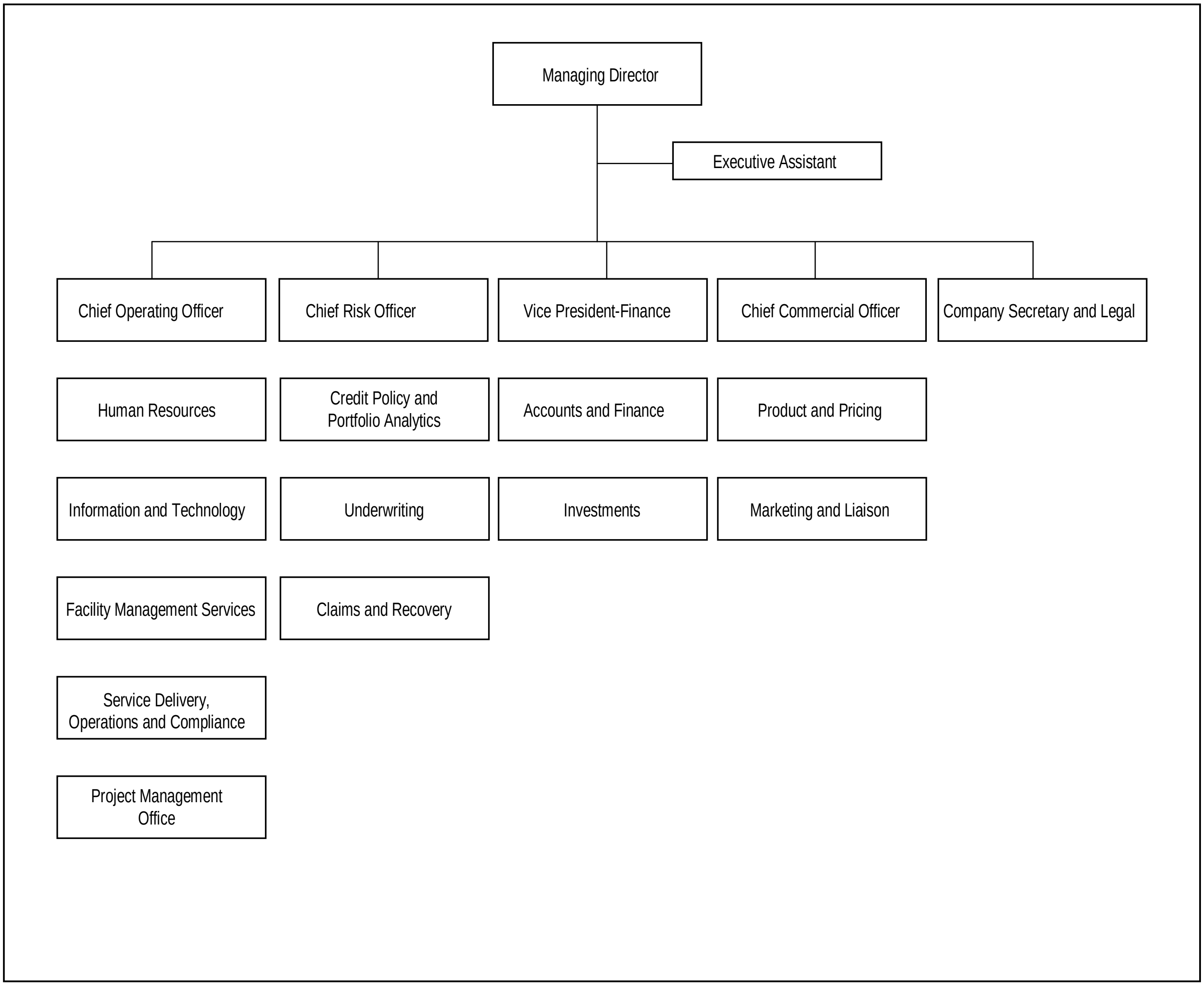
B. United Guaranty Corporation

3. Established in 1963, UGC is a leading private mortgage guarantee insurance company headquartered in the US. For the past several years, UGC has also been successful in developing operations in international markets including Australia, Canada, Israel, Mexico and Hong Kong, China, and is a wholly owned subsidiary of the American International Group (AIG), a leading global insurance and financial services company.

C. International Finance Corporation

5. The International Finance Corporation (IFC), a member of the World Bank, was established in 1956. It maintains a AAA rating. As of the end of June 2007, IFC had total assets of $40.6 billion, and shareholder's equity totaled $14.1 billion. IFC's net income for FY2007 was $2.6 billion as compared to $1.2 billion for FY2006. It has experience in the housing finance sector with a global portfolio of approximately $2 billion.

PROPOSED ORGANIZATIONAL STRUCTURE OF THE INDIA MORTGAGE GUARANTEE COMPANY



EXAMPLE OF COST SAVINGS TO A LENDER USING A MORTGAGE GUARANTEE

1. Lenders will benefit from a mortgage guarantee due to the reduction of credit risk on their portfolio. The lower risk enables them to reduce the provisions for losses on their portfolio. Lenders will also benefit substantially from the reduction in capital risk weights under Basel II if a mortgage guarantee is provided by a company that is rated AA or higher.[1] Savings on costs associated with capital and provisions requirements can then be deployed to originate new mortgage loans.

2. Table A8 illustrates the cost savings to a housing finance company (HFC) that uses a mortgage guarantee. The example uses a $100,000 mortgage loan with a tenor of 12 years. The mortgage guarantee provides coverage against default for 20% of the value of the sample loan.

3. With respect to capital relief, HFCs are required to hold capital of 12% of the loan amount risk weighted at 50%. Therefore, the effective capital to risk weighted asset ratio is 6%. If the risk weight is reduced to 20% due to the mortgage guarantee, the capital to risk weighted asset ratio is reduced to 1.2% on the covered portion of the loan. The average capital required on a loan without a mortgage guarantee is about $3,554 per year. With the mortgage guarantee, the average capital required is approximately $2,985. The reduction in capital of about $569 each year yields a savings of $682 over the life of the loan.

4. If a lender were to use a mortgage guarantee, the provisioning requirements for the covered portion of the loan would also be reduced. In the example in Table A8, the average provision held each year would be approximately $444 (0.75% of the average outstanding balance). With an assumed mortgage guarantee providing coverage for 20% of the loan, cost savings over the life of the loan are estimated at about $107.

5. Finally, if the loan were to default, IMGC would assume 20% of the loss at 6% of the total value of the loan, which is the projected industry standard. The savings in a default scenario total $1,200. The total savings to the HFC, including capital relief, provisioning, and defaults, for the sample $100,000 mortgage loan with a mortgage guarantee is approximately $1,989. If the loan has a high loan-to-value ratio with a higher capital requirement, the financial incentive to use a mortgage guarantee would be even greater.

[1] The Government has stated that Basel II guidelines will be introduced this year for banks. NHB has yet to come out with similar guidelines for HFCs, however, it has indicated that it will be releasing similar guidelines concurrent with the implementation of Basel II.

Table A6: Example of Cost Savings to a Housing Finance Company

Item	Cost Savings
Capital Relief	
Current capital to risk-weighted asset ratio (CRAR)	6%
CRAR with guarantee (assuming Basel II applies)	1.20%
Average capital required annually without mortgage guarantee[a]	$3,554
Average capital required annually with mortgage guarantee[b]	$2,985
Average savings annually by using mortgage guarantee	$569
Yield on capital[c]	10%
Capital cost savings over 12 years (A)	$682
Savings on Provisions	
Provisions held at mortgage origination without mortgage guarantee[d]	$444
Provisions held at mortgage origination with mortgage guarantee[e]	$355
Savings on provisions over 12 years[f] (B)	$107
Savings for HFC in Default Scenario	
Ultimate claim rate[g]	6%
Mortgage guarantee coverage	20%
Probable claim on loan (C)	$1,200.00
Total benefit (A) + (B) + (C) or about 2% on the $100,000 loan	**$1,989**

[a] The average annual outstanding balance of the sample loan is $59,227. To determine the average capital required annually, $59,227 is multiplied by 12% (which represents the capital to be held) multiplied by 50% (which is the current risk weighting).

[b] The average capital required for the sample loan when a mortgage guarantee is used is calculated by taking the $3,554 (the capital required without a guarantee) multiplied by 0.80 (to represent the uncovered portion of the loan) plus $3,554 multiplied by 0.20 (representing the guaranteed portion of the loan) multiplied by 0.20, which represents the reduction in the CRAR.

[c] An assumed yield is provided and applied to the difference between the two sample capital requirements and then multiplied by the tenor of the mortgage loan (12 years) to give the cost savings presented in (A).

[d] The provisions held at mortgage origination are calculated as per regulatory norms at 0.75% of the average outstanding loan balance of $59,227.

[e] Provisions at origination with a mortgage guarantee are calculated as per regulatory norms at 0.75% of the average outstanding loan balance of $59,227 multiplied by 0.80 (to represent the uncovered portion of the loan). The covered portion of the loan (20%) would not require provisioning.

[f] This savings on provisions over the life of the loan is calculated by using the amount of provisions on the loan at origination totaling $444 multiplied by 0.20, which represents the portion that would be guaranteed, multiplied by the assumed yield of 10% over a 12-year period.

[g] The claims rate is based upon projected industry performance.

Source: Asian Development Bank estimates.

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

Country/Project Title: India/India Mortgage Guarantee Company

Lending/Financing Modality:	Equity Investment	Department/ Division:	Private Sector Operations Department/ Infrastructure Finance Division 2

I. POVERTY ANALYSIS AND STRATEGY

A. Linkages to the National Poverty Reduction Strategy and Country Partnership Strategy

1. Based on the country poverty assessment, the country partnership strategy, and the sector analysis, describe how the project would directly or indirectly contribute to poverty reduction and how it is linked to the poverty reduction strategy of the partner country.

The project will contribute to the country's efforts to meet a substantial need for housing. There is a shortage of housing in India, particularly for lower-middle income and lower-income classes. Housing conditions in urban areas are problematic. The project will increase access to affordable and long-term individual housing loans by providing guarantees to banks making such loans.

The country operations business plan for 2008–2010 (COBP)[30] broadly outlines the strategy of the Asian Development Bank (ADB) in India and is part of the larger draft country partnership strategy for 2008–2012 (CPS).[31] The COBP and the CPS are aligned with India's 11th Five Year Plan for 2007–2011. Critical areas for development include infrastructure and social, agricultural, and rural development. Generating employment, improving public service delivery, and balancing protection of the environment with economic growth is also emphasized. The COBP notes that ADB will continue to support infrastructure development in India through transport, energy, and urban projects. ADB will also support agribusiness infrastructure, rural and urban development, and improved water resources management. ADB will continue to support nonsovereign investments, particularly in these sectors.

The proposed project directly addresses the Government's concern for addressing housing shortages as outlined in the 11th Five Year Plan for 2007–2011 and is within the core ADB targets of supporting urban and rural development projects through access to housing for a broader spectrum of people. Additionally, the project is supported by the Government, as concerted efforts were made by the regulators to develop regulations for this industry.

B. Poverty Analysis — Targeting Classification: General intervention

1. Key Issues
While India's poverty rate has decreased from 36% in FY1994 to 27.5% in FY2005, the pace of reduction is less than 1% per annum.a In absolute terms, nearly 302 million people remain below the poverty line. The project will indirectly contribute to poverty reduction by supporting private sector growth and promoting mortgage financing and accessibility to housing in India. ADB's support of this project will not only advance the country's infrastructure upgrading efforts but also lessen future public debt burden. By reducing the strain on the Government, more resources can be allocated for poverty reduction purposes.

2. Design Features.
The proceeds of the equity investment will be used to establish the India Mortgage Guarantee Company, which will provide guarantees for mortgage lenders who will then be able to expand their lending to a wider population base. The primary objective of the project is to meet the demand for individual housing loans throughout India.

C. Poverty Impact Analysis for Policy-Based Lending Not applicable.

II. SOCIAL ANALYSIS AND STRATEGY

A. Findings of Social Analysis

Key Issues. Mortgage lending is a highly developmental activity. A healthy mortgage market enables a country to generate multiple sources of employment. Employment related to the construction and home improvement industries is supported. Importantly, mortgage lending also serves as a vehicle to create one of the most important sources of capital for an individual or family which can be used to establish new businesses. Access to affordable housing will

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[30] ADB. 2007. *Country Operations Business Plan (2008-2010): India.* Manila.
[31] ADB. July 2008. *Draft Country Partnership Strategy (2008-2012): India.* Manila.

alleviate a shortage of housing in India.

B. Consultation and Participation

1. Provide a summary of the consultation and participation process during the project preparation.
Consultation undertaken with relevant government institutions.

2. What level of consultation and participation (C&P) is envisaged during the project implementation and monitoring?
☒ **Information sharing** ☐ **Consultation** ☐ **Collaborative decision making** ☐ **Empowerment**

3. Was a C&P plan prepared? ☐ **Yes** ☒ **No**
Information campaign on lending guidelines and requirements will be integral to IMGC's operations.

C. Gender and Development

1. Key Issues.
There are no legal impediments to women borrowing, as they are on equal terms with men.

2. Key Actions. Measures included in the design to promote gender equality and women's empowerment—access to and use of relevant services, resources, assets, or opportunities and participation in decision-making process:
☐ **Gender plan** ☐ **Other actions/measures** ☒ **No action/measure**

III. SOCIAL SAFEGUARD ISSUES AND OTHER SOCIAL RISKS

Issue	Significant/Limited/ No Impact	Strategy to Address Issue	Plan or Other Measures Included in Design
Involuntary Resettlement	No impact	None	☐ Full Plan ☐ Short Plan ☐ Resettlement Framework ☒ No Action
Indigenous Peoples	No impact	None	☐ Plan ☐ Other Action ☐ Indigenous Peoples Framework ☒ No Action
Labor ☒ Employment opportunities ☐ Labor retrenchment ☐ Core labor standards	Employment opportunities indirectly generated by housing construction and improvements	None	☐ Plan ☐ Other Action ☒ No Action
Affordability	No impact.	None	☐ Action ☒ No Action
Other Risks and/or Vulnerabilities ☐HIV/AIDS ☐Human trafficking ☐Others	None	None	☐ Plan ☐ Other Action ☒ No Action

IV. MONITORING AND EVALUATION

Are social indicators included in the design and monitoring framework to facilitate monitoring of social development activities and/or social impacts during project implementation? ☐ Yes ☒ No