



RPLR NOTE

STAR HFL

RPLR Note

PREPARED BY:
RECOMMENDED BY:
APPROVED BY:
BOARD OF DIRECTORS
<p>On behalf of Board of Directors:</p> <p>Ashish Jain Managing Director DIN: 02041164</p>

Title	Star RPLR Note
Date of Latest Release	
Version	1.0

1. Objective

STAR HFL operates with a stated vision of contributing meaningfully towards increasing housing stock in India by providing institutional housing credit to deserving customers. The Target customers of the Company are the first-time home buyers who have remained outside the ambit of formal financial channels and are looking to purchase affordable housing units in Tier I, Tier II, Tier III cities or outside the peripheries of main metros.

The primary business of STAR HFL is long term lending. It becomes imperative to define a benchmark lending rate on the basis of which the lending rate to these customers would be defined. It is extremely important to define this prime lending rate known as SRPLR (STAR Retail Prime Lending Rate) taking in to account the following a. cost of borrowings b. earning spread c. operating expenses d. provisions and e. return on minimum risk weighted capital.

This document calculates the SRPLR for business operations. This document is dynamic in nature and would be updated regularly taking into account the changes in characteristics of the Company. Any change in SRPLR will have to be approved by MD & CEO and presented in the Asset Liability Management Committee (ALCO). Once approved, the same will be forwarded to the board for final ratification and approval.

2. Introduction

BPLR (Benchmark Prime Lending Rate) is the interest rate that Banks and Financial Institutions charge to their prime customers. BPLR constituted of various components namely cost of borrowing, expected Net Interest Margin (NIM), operating expenses and provisions & contingencies and return on minimum risk weighted capital as per the regulatory requirements. The sum of these major components gives a BPLR for a Bank / Financial institution. The financial institutions can offer loans at a premium or a discount to the BPLR.

With an objective to bring more transparency in banking system, The Reserve Bank vide its circular DBOD.No.Dir.BC88/13.03.0/2009-10 dated April 9, 2010 introduced the Base Rate system with effect from July 1, 2010. The Base Rate is the minimum interest rate of a Bank below which it cannot lend, except in cases allowed by the Regulator.

The Base Rate included all those elements of the lending rate that are common across all categories of borrowers. Banks were allowed to determine their actual lending rates

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on loans and advances with reference to the Base Rate and by including such other customer specific charges as considered appropriate. All categories of loans were required to be priced only with reference to the Base Rate. The Base Rate system is applicable for all new loans and for those old loans that come up for renewal. Since the Base Rate was the minimum rate for all loans, financial institutions are not permitted to resort to any lending below the Base Rate.

While previously, banks had base rate as their benchmark lending rate, the same has been replaced with MCLR (Marginal Cost of Lending Rate) beginning from 1st April 2016, with an intent to make the benchmark lending rate calculation more transparent and make the lending rate more responsive to the changes in benchmark lending rate

MCLR is a tenor linked internal benchmark (reset frequencies of overnight, one month, three months, six months, 1 year, 2 years and 3 years) which when compared to erstwhile base rate is much more responsive to the changes in the interest rates. Also, since the MCLR is calculated for different maturities, the borrower has the option to choose the reset period. For eg: for a reset period of 6 months, the interest rate will be fixed at a definite rate for the period of 6 months (Any change in MCLR during this period will not alter the interest rate on the loan. Post 6 months, the loan will be reset based on prevailing MCLR and so on).

Factors that Determine the MCLR*

- **Marginal Cost of Funds:** It comprises of marginal cost of borrowings, along with return on net worth. The marginal cost of borrowings holds 92 percent influence, while the other component holds only 8 percent. It also depends on repo rate and the interest rates charged by banks.
- **Operating Costs:** These costs are associated with providing the loan, raising funds, and running the day to day operations.
- **Cost of Carry in the Cash Reserve Ratio (CRR):** The banks have to take into consideration the cash deposits they need to keep with the Reserve Bank of India.
- **Tenor Premium:** This is essentially the premium that will be charged for long-term loans to mitigate the risk associated with long-term lending.

**Source: Bankbazaar.com*

STAR HFL Retail Prime Lending Rate (SRPLR)

STAR HFL is being regulated by the National Housing Bank (NHB) and is required to comply to the directions and regulations as mandated by the NHB from time to time. NHB mandates the housing finance companies to link their lending rate to a benchmark lending rate. Till the time, there is a clear direction from the NHB in regards to usage of Base Rate or MCLR, STAR HFL will be adopting STAR HFL will be adopting STAR HFL Retail Prime Lending Rate (SRPLR), the constituents of which include:

- a. cost of borrowings,
- b. earning spread,
- c. operating expenses,
- d. provisions and
- e. return on minimum risk weighted capital as per the NHB regulations. This is shown as below

STAR HFL Retail Prime Lending Rate (SRPLR) Calculation	
	Weighted Average Cost of Funds
+	Net Interest Margin (NIM)
+	Operating Expenses
+	Provisions and Contingencies
+	Return on Minimum Risk Weighted Capital
=	SRPLR

The Asset Liability Management Committee (ALCO) would be meeting at regular intervals in order to determine changes to SRPLR, if any, depending on the macroeconomic & money market conditions and would be presenting the same to the Board for ratification and final approval.

RPLR of Competition

The table below gives Retail Prime Lending Rate of some of the major HFCs operating in the Indian mortgage industry:

Prime Lending Rate of Competition	
DHFL	19.42%
IIFL	17.50%
L&T Housing Finance	17.35%
Indiabulls Housing Finance	23.00%
HDFC	16.65%

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Shriram Housing Finance	15.00%
GIC Housing Finance	15.00%
LIC Housing Finance	14.60%
MHFI	13.62%

From above table, it is clear that every HFC has its own methodology to calculate Retail Prime Lending Rate and are not correlated. This is evident from the fact that even the HFCs having similar target segment, geography and size differ in their RPLRs.

Consequently, it would not be prudent to club the above HFCs under different groups depending on similar characteristics and refer to the average RPLR of similar group as a base for calculation of SRPLR. Therefore, it may not be logical to refer to RPLR of competition and consider the same as an input for the calculation of FPLR.

SRPLR has to be unique and specific to STAR HFL and should be derived from the asset creation, liability origination and business operations.

Components of SRPLR

1. Weighted Average Cost of Funds

STAR HFL intends to disburse 4,000 crs in the first five years of business operations. With Rs.270 crs of equity capital (Rs.120 crs infused in first year and Rs.150 crs infused in second year), STAR HFL would be borrowing more than Rs.3,400 crs from Banks / Financial institutions / Debt Markets. In the first year of business operations, STAR HFL aims to borrow Rs.75-100 crs through various public and private sector banks. The table below gives an overview of MCLR of major banks.

MCLR Rate Overview (1 Year)			
Public Sector Banks		Private Sector Banks	
State Bank of India	8.40%	HDFC Bank	8.75%
Bank of India	8.60%	ICICI Bank	8.80%
Union of India	8.50%	Axis Bank	8.65%

The average base rate is around 8.50%, for public sector and is around 8.70% for private sector banks. The banks are expected to charge a mark-up in the range of 250-350 bps over and above their base rate (considering BBB+/A- credit rating on long term borrowing facilities). Therefore, the weighted average cost of funds would be

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10.50-11.50%. For calculation of SRPLR, we take expected weighted average cost of borrowing as 11.00%.

2. Net Interest Margin (NIM)

Given below are the cost of funds and NIM earned by the industry players:

HFC	Cost of Funds	NIM	HFC	Cost of Funds	NIM
HDFC	7.47%	4.40%	Gruh Finance	Sub 8.00%	4.00%
LIC HF	8.31%	2.54%	GIC HF	7.82%	3.80%
DHFL	8.44%	2.91%	PNB HF	7.71%	3.18%
Canfin Homes	7.65%	3.58%	REPCO HF	8.40%	4.40%

As seen above, it is difficult to make a correlation with size of HFC, cost of funds and the net interest margin earned by them. Consequently, it may not be feasible to do a comparable analysis for estimating an average expected NIM to be earned by the Company in first year of operations.

As stated initially, STAR HFL would be targeting potential first time home owners, majority of whom are in EWS / LIG / MIG (I & II) segments and looking to purchase affordable housing units in Extended suburbs of metros/mini metros/urban agglomerations, Tier I/II/III cities, Satellite towns and Semi urban areas. Accordingly, bulk of disbursements in would be in housing loans with an average ticket size of Rs.10-15 lakhs with a maximum of Rs.50 lakhs.

Considering the target segment and the geographies of operations, STAR HFL would be looking for an average expected NIM of 3.00% in its operations.

3. Operating Expenses

STAR HFL would be operating in a specialised segment which entails higher operating expenses that would be incurred in appraising the customer and the property to be financed. As per the STAR HFL business plan, the operating expense as a % of disbursement comes to 1.00%.

4. Provisions & Contingencies

Considering the customer segment, provision of 0.75% including 0.25% to the standard assets (as per NHB regulations) is considered.

5. Return on Minimum Risk Weighted Capital

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STAR HFL would be starting its operations with an equity capital of Rs.150 crs. Considering the minimum capital adequacy requirements of 12%, risk weight of 50% (conservative) and the industry standard ratio of 20%, the return on the minimum risk weighted capital comes to 1.80% (calculated as: $150 \times 12\% \times 75\% \times 20\% / 100$).

SRPLR Computation

On the basis of above components, the SRPLR is calculated as follows:

STAR HFL Retail Prime Lending Rate (SRPLR) Calculation		
	Weighted Average Cost of Funds	12.50%
+	Net Interest Margin (NIM)	5.00%
+	Operating Expenses	1.50%
+	Provisions and Contingencies	1.50%
+	Return on Minimum Risk Weighted Capital	1.00%
=	SRPLR	21.50%