# Residential Mortgage Default at Housing Development Finance Corporation of Sri Lanka: EPF Security – A Review

**D.L.P.M. Rathnasingha**

Department of Finance, Faculty of Management and Finance, University of Colombo,

PhD Candidate, SGS, MSU, Malaysia,

**Ali Khatibi**

Faculty of Business Management and Professional Studies, MSU, Malaysia.

## Background

Housing is essential to man, and is recognized as one of the basic human needs. In current society it is offered at much higher standards than meeting the essential needs of humans, as a result of which many agencies have come to the field to work in this area. By now most governments accept that providing basic housing for all is often a priority for enhancing the social conditions of society. For an archetypal house-owner, the house is a foremost asset in his portfolio and for many households the purchase of a house represents the largest lifelong investment and a store of wealth. The provision of housing services depends mostly upon a well-functioning and affordable house financing system. Such financing systems however are often complicated and the beneficiary has to fulfill a set of criteria which are hard to meet as requirements for a housing loan. Further, the interest charged on the loan is exorbitant for the general working class of people, as it went up to 20% per annum as shown in industry reports. In this situation it can be seen that housing represents a large proportion of a household's expenditure and takes up a substantial part of lifetime income. According to the Census of Population and Housing 2011 in Sri Lanka, individual housing units in the country in 1981 was 2,943,610 units which has grown to 5,773, 678 units by the year 2011 indicating a high growth of total houses in the country. Further the expansion of housing units in the last three decades from 1981 to 2011 is 96.1% while growth from 2001 to 2011 was 23.2 %. It is an appreciable growth but it is important to pay attention to how these housing units were financed. There are a number of banks and financial institutions playing a vital role in this area by providing mortgage loans for housing.

Housing Development Finance Corporation (HDFC) is a listed company and the main share holder (51%) of the company is the government. Among the leading mortgage loan suppliers in Sri Lanka, HDFC is one of the market leaders in the country. Therefore, this study is focused on the HDFC loan portfolio repayment prototype for the sample period.

## Objectives

This study aims to review and understand the situation in HDFC Equated Monthly Installment loans as at beginning of February and end of April 2012. With the intention of analyzing the core substance of the loan portfolio of the bank, this study employed the analysis of statements, document evaluation and personal discussions as means of gathering the necessary data. The analysis examines the position of the loan repayment performance with the help of change ratios paying attention to compare EPF security loans and other security type loans.

## Results

As per the District-wise summary, there were 70,380 loans granted and out of this 36,713 was under EPF security which is 52.16% of the total loan portfolio and the balance 33,667 under other security types. There were 24,178 loans (34.35% of total loans) which were identified as defaulted and out of them 19,588 loans defaults had been granted under the EPF security (81.01% of total default loans). There were 4,590 default loans on non EPF security loans. At the branch level, out of the total loans disbursed minimum default rate was 0.16% while maximum was 57.57% which indicates a huge gap in loan default between branches while the industry average was only 3.8 percent. However, excluding EPF security loans, this range is only 1.22% to 19.91% among the different branches. Out of the total housing loans contracted 52% had been allocated to the Western province and 11% to the Central Province while all the other provinces report less than 10 percent each. The highest residential mortgage default rates considering the branch network reports of Nuwara-Eliya, Kandy, Rathnapura and Ampara, are in branches located in remote areas. These defaults occur as the default option is in the money for EPF member customers.

Interestingly, at the end of the period considered, total number of default loans comes down to 13,065 showing a 45.96% reduction of default loans compared with beginning of the period considered. With this change total percentage of default loans comes down from 23.29% to 13.16%. A sizeable change of non EPF security loan default levels of the bank cannot be observed within the period. However, bank reports show over 20% default loans in the last few years, a very high level as compared to the industry average. This situation brings up two important points. First, how is HDFC bank facing this situation? The answer is almost certainly by getting transfers for the due amount from EPF account balance for the EPF funded customers. HDFC bank does not provide for EPF non-performing loans as they are backed by the Central Bank. Secondly, while the government owns 51% share capital of HDFC, how far is this mechanism acceptable and how does it secure the EPF benefits for its customers at their retirement.

## Conclusions

Overall, a sizeable number of customers who have kept EPF balance as the security for the housing loans granted by HDFC bank and they have a higher probability of defaulting and allowing loans to be recovered from EPF fund account balance. As a result it is open to discussion whether the acceptance of EPF balances as security for housing loans at HDFC which has become an aperture for early withdrawal of EPF funds. This evidence need of reassess the expediency of accepting EPF fund balance as security for housing loans and need for recourse efforts for recovery and loan default minimization. Further, it makes it obvious that housing is a focal problematic area in Sri Lanka and policy level measures are needed to reduce this encumbrance on the population.