CHAPTER X: MINISTRY OF HOUSING AND URBAN POVERTY ALLEVIATION

Housing and Urban Development Corporation Limited

10.1 Fund Management and Financing Activities

HUDCO mobilised ₹ 37128.32 crore during 2010-11 to 2014-15, but it suffered from heavy concentration on bank loans, which carried high interest. In assessing fund requirement, critical elements of fund inflow/outflow were not given due cognisance resulting in excess mobilisation and additional interest of ₹30.39 crore. Lower credit rating due to higher NPA and lower net interest margin resulted in higher coupon rate and consequent additional financial burden of ₹134.97 crore was also noticed. In lending operations, amount disbursed ranged between 38.40 and 69.72 *per cent* of loans sanctioned during the five years ended 2014-15. Violations of directions issued by National Housing Bank and deficiencies in internal guidelines affected quality of assets. Deficiencies in appraisal mechanism, system of disbursement, monitoring of financed projects and waiver of critical pre-disbursement conditions led to non-performing assets, which increased from ₹ 1227.60 crore in 2010-11 to ₹ 2029.33 crore in 2014-15 and ranged between 5.46 and 6.76 *per cent*, during the same period.

10.1.1 Introduction

Housing and Urban Development Corporation Limited (HUDCO/Company) was incorporated on 25 April 1970 in order to facilitate housing and infrastructure development in the country with a social thrust on meeting the housing needs of economically weaker sections and low-income groups. It extends financial assistance in three categories, *viz.*, housing[1], housing related infrastructure[2] and otherinfrastructure[3]to the State government agencies, primarycooperativesocieties, individuals, public and privatesector agencies. HUDCO operates under the regulatory oversight of National Housing Bank (NHB). During 2010-11 to 2014-15 HUDCO mobilized ₹ 37128.32 crore, sanctioned loans of ₹ 74950 crore and disbursed ₹ 33111 crore. As at 31 March 2015, the outstanding loans stood at ₹ 32465 crore. Against this backdrop, a need was felt to review in audit the process of fund management and financing activities.

10.1.2 Audit objective and scope

All activities from assessment of fund requirements, its mobilisation and management, lending operations and management of non-performing assets (NPAs) during April 2010

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[1] *All housing projects and composite projects having 50 percent or more components towards housing.*

[2] *Water Supply, Sewerage, Drainage, Sanitation, Solid Waste Management, Educational, Health, Recreational facilities, Community Centres, Bus Stands, Terminals, City Road network including ring roads, bye-passes and transport infrastructure, Metros, Shopping Complex, Markets and such other centres catering to the day to day needs of the residents of the housing colonies and forming part of a housing project, Distribution of Power and other services.*

[3] *Highways, airport, Commercial Malls, Power Generation and Transmission, Telecom, Industrial Infrastructure, Oil and Gas pipelines etc.*

to March 2015 were examined in order to assess whether (i) mobilisation of funds was done after proper planning and was commensurate with business requirements, (ii) due diligence and economies were ensured while borrowing, and utilisation of funds was done effectively and efficiently, (iii) controls relating to appraisal of applications, sanction and disbursement of loans were sound, effective and adequate to cover the associated risks, and (iv) adequate monitoring mechanism existed to ensure timely recovery of dues, initiation of legal action against defaulters and for adherence to directions of the Regulator.

The sample for audit was selected through Interactive Data Extraction and Analysis (IDEA) software based on amount of borrowings, financing and Non Performing Asset (NPA) belonging to both private and public sector. The sample selected for examination in audit contributed 36.78 *per cent* of borrowings, 10.71 *per cent* of financingand of 8.70 *per cent* of NPAsas shown in Table-1.

Table-1: Sample selected in audit

Particulars	Population		Selected in audit		Sample in *per cent*	
	Number of cases	Amount (₹ in crore)	Number of cases	Amount (₹in crore)	Number of cases	Amount (₹in crore)
Borrowings	87	37128.32	32	23155.81	36.78	62.36
Financing	868	33111.02	93	14432.15	10.71	43.59
NPAs	184	2029.33	16	1459.74	8.70	71.94

10.1.3. Audit findings

10.1.3.1 Fund management

(a) Resource mobilisation

The Table-2 below indicates the mobilisation of funds by HUDCO during five years from 2010-11 to 2014-15through the sources of bonds, loans from banks, loans from financial institutions (FIs) and public deposits (PDs).

Table-2: Details of fund mobilisation

Year	Mix of borrowings*(Amount in ₹ crore)*						
	Tax free bonds	Taxable bonds	Loans from banks	Commerci al papers	Loans from FIs	Public deposits	Total
2010-11	-	-	4339.00	-	-	464.97	4803.97
2011-12	5000.00	667.40	4146.76[1]	-	250.00	331.79	10395.95
2012-13	2401.35	500.00	2079.37[2]	-	500.00	582.34	6063.06
2013-14	4987.12	700.00	1080.71	-	1000.00	266.78	8034.61
2014-15	-	-	2815.37[3]	2700.00	1700.00	615.36	7830.73
Total	**12388.47**	**1867.40**	**14461.21**	**2700.00**	**3450.00**	**2261.24**	**37128.32**
(per cent)	**33.37**	**5.03**	**38.95**	**7.27**	**9.29**	**6.09**	**100**

Source: *Annual Reports of HUDCO*

[1] ***Including cash credit/overdraft limits of ₹1137.76 crore outstanding as on 31 March 2012.***
[2] ***Represents cash credit/overdraft from banking sector.***
[3] ***Represents cash credit/overdraft from banking sector outstanding as on 31 March 2015.***

From the table, it is evident that HUDCO has mobilised 38.95 *per cent* of funds from high interest bearing source *i.e.*, loan from banks at an average cost of 9.18 *per cent*. While more than 90 *per cent* of fund requirement was met from bank loans in 2010-11, it did not use the potential of low interest bearing sources *like* taxable bonds, commercial papers, loan from FIs in all the years, as the overall fund mobilised from these sources were between 5.03 and 9.29 *per cent.* In all the years, the cost of funds borrowed through bank loans was higher than those from other sources by one to two *per cent*. Thus, HUDCO failed to contemplate initiatives for cost optimisation of mobilised funds so as to offer competitive rates for lending.

HUDCO/Ministry of Housing and Urban Poverty Alleviation (MoHUPA) stated (December 2015/March 2016) that cost of borrowing from banks was lower than corporate bond yields during 2010-11, and bank loans offered much more operational flexibility. In respect of other years, it was stated that though it took loan from banks, it was repaid or foreclosed in the same year itself. However, the fact remains that HUDCO resorted to bank loans during 2010-11 at weighted average rate of interest of 9.18 *per cent* when other organizations[1] of AA+ rating mobilized funds through corporate bonds at the interest rate of 8.35 to 8.95 *per cent* during April to December 2010. HUDCO did not mobilize funds during 2010-11 from any other source, except public deposits (PD) of ₹ 464.97 crore. Further, no guidelines were put in place nor any cost-benefit analysis of various products carried out while mobilizing funds in order to optimize the overall cost of borrowed funds. It is pertinent to note that while the cost of borrowing from taxable bonds and FIs ranged between 6.25 *per cent* and 9.64 *per cent* during 2011-12 to 2013-14, HUDCO resorted to bank loans with cost ranging between 10.22 *per cent* and 10.40 *per cent* during the same period.

(b) Assessment of fund requirement

The resource mobilisation was planned by HUDCO on annual basis through a 'resource plan' approved by Board of Directors (Board). HUDCO assessed requirement of funds for the period 2010-11 to 2014-15 on the basis of (i) targets fixed for disbursement of loans corresponding to targets fixed in MoU with Ministry of Housing and Urban Poverty Alleviation (MoHUPA), (ii) estimated repayment of principal and interest payable on borrowings, (iii) estimated recovery of principal and interest from the loanees, and (iv) estimated principal and interest receivable from investments made. However, audit observed that HUDCO did not consider net cash income (interest receivable *minus* interest payable) from 2011-12 onwards, repayments of PDs, interest receivable on bonds while planning resource mobilisation. There were also mismatches in estimating repayment of borrowings and repayment from investments from 2010-11 to 2014-15 as depicted in Table-3.

[1] ***L&T Infra, TATA Capital, IDBI Bank and Indian Bank***

Table-3: Statement showing excess borrowing

(Amount in ₹ crore)

Year	Net cash income (interest receivable - interest payable)	Mismatch in estimating repayment of borrowings	Repayment of public deposits	Opening bank balances (other than earmarked fund)	Repayments from investment	Interest receivable on bonds	Borrowing requirement after considering (2 to 7)	Actual borrowing without overdraft	Excess borrowing
1	2	3	4	5	6	7	8	9	10=(9-8)
2010-11	-	1144.43	626.87	584.73	-	137	5420.43	4697.23	(-) 723.20
2011-12	1226.65	917.87	1256.85	552.44	-	123.33	6073.30	9258.19	3184.89
2012-13	1037.31	(-) 205.24	-	2603.08	250	107.32	4530.79	3983.69	(-) 547.10
2013-14	834.33	(-) 698.67	-	515.37	-	54.01	6654.25	6719.64	65.39
2014-15	2255.11	1096.59	-	-	400	54.01	7418.05	7445.73	27.68

Thus, there was excess borrowing of ₹ 3184.89 crore in 2011-12 and shortfall of ₹ 723.20 crore and ₹ 547.10 crore in 2010-11 and 2012-13 respectively. The shortfall was met by resorting to overdraft from banks. HUDCO availed average overdraft of ₹ 218 crore, ₹ 1314.97 crore and ₹ 385 crore during 2012-13, 2013-14 and 2014-15 respectively. This resulted in avoidable interest cost of ₹ 30.39 crore.

HUDCO/MoHUPA stated (December 2015/March 2016) that interest receivables has been considered while estimating resource requirement in the resource plan for 2015-16. Excess borrowing in 2011-12 occurred mainly due to mobilising funds through tax-free bonds at the end of financial year and HUDCO had no option but to issue the bonds as it would have otherwise lost the opportunity to mobilise funds through tax-free bonds. It was added that due to volatile interest rate movement, it opted for cash credit/overdraft facility as per actual funds requirement and repaid as and when surplus was generated. On the other hand, if it had issued bonds, it would have committed to a fixed liability for the entire tenor of the bond.

While appreciating the corrective action taken, Audit notes that the reply was silent on why items other than interest receivables as indicated in the table were not considered while estimating fund requirement. The excess borrowing was ascertained on account of not considering some sources of funds, which were known and ascertainable by HUDCO. Therefore, reasons attributed in the reply were not tenable. Moreover, fact remains that though there were excess borrowing, it resorted to cash credit or overdraft facilities entailing additional interest burden, which is indicative of the fact that the resources planning was not done judiciously.

(c) Extra cost of ₹134.97 crore due to lower credit rating

HUDCO has been assigned credit rating of AA^+ for its financial instruments issued during 2011-12 to 2013-14. This was mainly due to presence of high NPAs, concentration of loan portfolio to only 20 borrowers (194 *per cent* of equity capital as of March 2013), lower net interest margin, and significant exposure in vulnerable sectors like energy and real estate. As a result, HUDCO incurred an extra expenditure of ₹ 134.97 crore on issue of tax free and taxable bonds during 2011-12 to 2014-15. In this connection, Audit appreciates that HUDCO was rated as AAA during 2015-16, as it could reduce NPAs from 5.3 *per cent* in 2013-14 to 3.4 *per cent* in 2014-15 in respect of housing loans and increase net interest margin (*i.e.*, difference between average yield of loan and average cost of funds) from 1.59 *per cent* in 2013-14 to 2.21 *per cent* in 2014-15.

HUDCO/MoHUPA stated (December 2015/March 2016) that while there has been constant growth in loan portfolio, consistent efforts to mobilise low cost fund together with constant improvement in operational performance over all the years resulted in getting higher rating for 2015-16. However, reply is to be viewed against the fact that in spite of having been incorporated in 1970 as a premier Government agency, HUDCO could not succeed in obtaining and maintaining higher rating primarily due to higher levels of NPA and poor operational efficiencies in terms of high cost of funds, low net interest margin, etc., which resulted in mobilisation of funds at higher coupon rates.

(d) Fixing higher coupon rate resulted in excess expenditure of ₹12.42 crore

During 2011-12, HUDCO issued taxable bonds Series-B amounting to ₹ 413.90 crore at the rate of interest of 9.75 *per cent* for a tenor of five years through arrangers on private placement basis and the allotment was made on 18 November 2011. In order to ascertain the competitiveness of coupon rate, National Stock Exchange (NSE) data in this regard was examined and it was observed that some institutions had issued bonds at lesser coupon rates around the same time as HUDCO. While one issue (₹ 2500 crore and date of allotment 21 November 2011) related to Indiabulls Housing Finance Limited for a tenor of 3 years having coupon rate of 9.50 *per cent,* another issue (₹ 250 crore and allotment date 15 November 2011) related to L&T Infrastructure Finance Company Limited for a tenor of 5 years with coupon rate of 9.15 *per cent*. It was also noticed that both the institutions were having similar credit rating (AA+) as HUDCO. While similarly rated private institutions mobilized ₹ 250 crore at 9.15 *per cent* approximately at the same time (within a gap of three days), HUDCO mobilized ₹ 413.90 crore at 9.75 *per cent* at comparatively higher coupon rate by 0.60 *per cent* and thereby had to absorb an extra payout of ₹ 12.42 crore (0.60 *per cent* x 5 years x ₹ 413.90 crore) as interest over a period of five years.

HUDCO/MoHUPA stated (December 2015/March 2016) that the issue by private institutions cannot be compared, as the same was allotted with put/call option at the end of 13 months and the period after which put/call option was exercisable was construed as tenor of the bond for pricing by market/investors. The reply, however, is to be viewed against the fact that any issue with put/call option normally carry higher coupon rate, as the option could be exercised by either of the party. Therefore, the private institutions issued bonds with put/call option at a lesser coupon rate than HUDCO.

(e) Engagement of arrangers

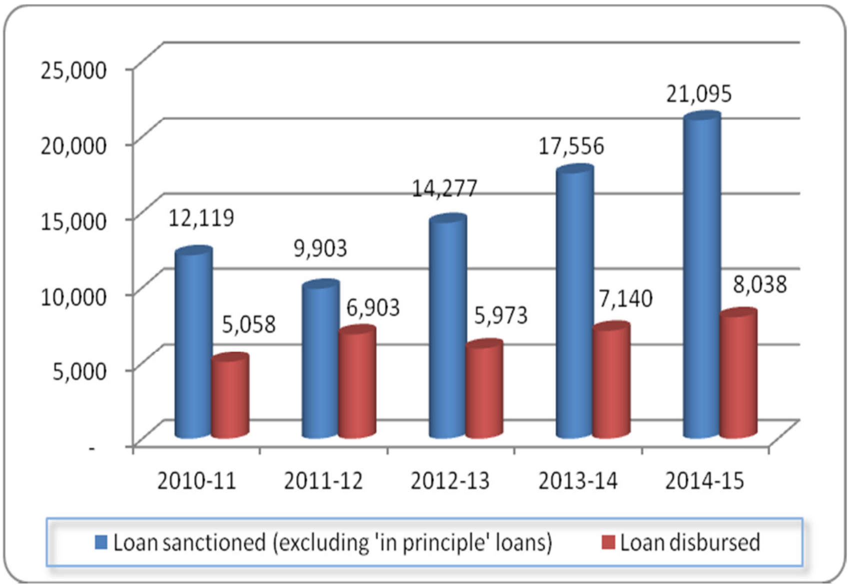
HUDCO had issued taxable bonds on private placement amounting to ₹ 1867.40 crore during the period 2011-12 to 2013-14 at interest rates ranging from 8.14 *per cent* to 9.75 *per cent* using the services of arrangers for fund mobilization while loans of ₹ 7186.84 crore from the banks were mobilised at interest ranging from 10.22 *per cent* to 10.40 *per cent* during the same period. In the two series of bonds valuing ₹928.50 crore during 2011-12 to 2013-14, where the services of arrangers had been availed, the arrangers themselves or their group entities invested ₹563.40 crore (60.68 *per cent*). Conflict of interest is a risk to be managed in an arrangement where the arranger is also the investor.

HUDCO stated (December 2015) that funds by way of private placement were mobilized through arrangers, who submitted firm commitment at offered terms prior to opening of the issue. Further, it was also added that coupon rate arrived at was verified for its competitiveness with reference to benchmark rates and corporate bond yields before the same was finalised. The reply, however, needs to be viewed against the fact that coupon rate was higher by 0.60 *per cent* as referred to in para 3.1.4 above when HUDCO and a private institution issued bonds within a gap of three days.

10.1.3.2 Lending operations

(a) Loan sanctions and disbursements

Details of loan sanctioned and disbursed by HUDCO during the five years ending 31March 2015 are depicted in the Chart below. It can be seen that actual disbursements during 2010-11 to 2014-15 ranged from 38.40 (2014-15) to 69.72 *per cent* (2011-12) of sanctioned loans whereas the corresponding *per cent* ranged in peer institutions like LHFL and HDFC from88.10 *per cent* to 94.62*per cent* and 78.88 *per cent* to 80.25 *per cent* respectively during 2010-11 to 2013-14. Even though the business models of these institutions do not match with HUDCO completely, the percentage disbursement of HUDCO was comparatively lower. As per information furnished by HUDCO, (i) 18 out of 21 regional offices lost business of ₹ 14019.49 crore during 2010- to 2014-15 due to higher lending rates, while information about three[1] offices was awaited (January 2016), (ii) loan of ₹ 2847.25 crore were automatically closed due to lapse of sanction period and loan of ₹ 3139.32 crore were closed due to non-completion of legal documentation, while reasons for early closure of loan of ₹ 1755.00 crore was awaited (January 2016), and (iii) separate targets were not fixed for housing finance scheme named "HUDCO Niwas". The above indicated that HUDCO did not analyse the reasons for non-availing of loans by parties even after its sanction.



HUDCO/MoHUPA stated (December 2015/March 2016) that in view of time taken for completion of various projects, comparing sanction and disbursement of a particular year

[1] ***Bhopal, Dehradun, and Lucknow***

might not provide the right picture. Infrastructure projects get delayed or closed due to various reasons and affects disbursements, and as a matter of policy, it did not disburse funds where a government agency was in default of above 5 *per cent*. In view of these, disbursement of earlier sanctioned schemes got delayed or held up, but it had to continue sanctioning schemes in anticipation of future improvement of recovery and state of finance. Regarding housing loans, majority of portfolio of HDFC and LHFL were in retail housing sector and they sanction a project after completion of all permissions and land acquisitions, and separate targets were not fixed for HUDCO Niwas, since it was not the major focus area.

The reply is to be viewed against the fact that test check of 14 cases[1] has shown that disbursement was completed between one and 28 months in respect of infrastructure funding. Audit has also not included loan sanctioned in principle, *i.e.,* loans which were not disbursed due to election and state/national level policy issues like land acquisition, departmental permissions in availing the disbursement, *etc*. Further, HUDCO could not disburse ₹1917 crore in two[2] regional offices due to default by State agencies. This default constituted only 4.64 *per cent* of amount (₹41839 crore) not disbursed.In comparison with the peers[3] involved in retail housing loans, the performance of HUDCO varied between 18.05 and 30.41 *per cent* of housing loans sanctioned.

(b) Violation of directions of NHB

(i) As per clause 28 and 32 of NHB Directions 2001/2010, housing finance company should not lend to any single borrower in excess of 15 *per cent* of itsnetowned funds (NoF)and to any single group of borrowers in excess of 25 *per cent* of NoF. However, Board of Directors approved (May 2005) exposure limits of 50 *per cent* of NoF for government agencies, while no limit was prescribed for each State government citing that the principle of 'group' would not apply to them. Despite this violation being pointed out in Report No.22 of 2007 of CAG of India and refusal of any concession by NHB in this regard, HUDCO continued to entertain loans beyond the prescribed limits involving an amount of ₹2570 crore as noticed in four out of 93 cases test checked in audit. Meanwhile, NHB acceded to HUDCO's request in April 2011 and allowed 50 *per cent* of NoF to government agencies only for housing and housing related infrastructure and 100 *per cent* of NoF to individual State government. Audit further noticed that HUDCO sanctioned ₹375 crore in July 2011 and ₹300 crore in May 2012 to Uttar Pradesh Power Corporation Limited (UPPCL) despite having an increase in cumulative loss from ₹ 7169.89 crore in 2006-07 to ₹ 26988.75 crore in 2010-11. Due to liquidity problem consequent to non-receipt of grant from State government, UPPCL defaulted in servicing the loan and as a result, the loan became NPA. Similarly, HUDCO released a loan of ₹ 750 crore in 2014-15 to Uttar Pradesh Rural Housing Board (UPRHB) even when it was defaulting (since 1999) on an earlier loan which was backed by government guarantee. HUDCO had failed to recover the amount from the earlier loan even after invoking the government guarantee.

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[1] ***Loan Scheme Numbers: 19713, 19847, 19919, 19945, 19954, 20022, 20067, 20120, 20172, 20171, 20090, 20121, 20051, and 20212.***

[2] ***Jammu and Thiruvananthapuram***

[3] ***LHFL between 88.10 per cent and 94.62 per cent, and HDFC between 78.88 per cent and 80.25 per cent***

The reply that NHB relaxation has been obtained needs to be viewed in light of the fact that Secretary, MoHUPA observed[1] that although the relaxation would enable HUDCO to lend more to government agencies, it would also shift onus to ensure due diligence and careful risk assessment before exposing themselves to single/individual borrowers to this extent. The Secretary further suggested that HUDCO should review its internal norms to ensure that exposure beyond 15 *per cent* was covered by greater internal controls for careful risk assessment and security requirements. However, extending loans to agencies of Uttar Pradesh Government indicated that the suggestion of the Secretary was not given due cognisance.

(ii) As per clause 22(2) of NHB Directions2010, interest/discount or any other charges on NPA shall be adjusted/recognized only when it was actually realized. However, HUDCO adjusted ₹134.07 crore during 2014-15 from loan accounts of M/s RKM Powergen Private Limited and M/s KVK Nilachal Power Private Limited after these accounts became NPAs.

HUDCO stated (December 2015) that necessary changes in the procedures/guidelines were being done to prevent such occurrence in future. MoHUPA stated (March 2016) that HUDCO amended (January 2016) its internal instructions about non adjustment of interest during construction period for accounts which are NPA. Audit appreciates that HUDCO took corrective action in this regard.

(iii) As per NHB Directions 2001/2010, where delay in completion of a project was caused by factors beyond the control of project implementing agency, terms of loan agreement regarding interest and/or principal might be rescheduled once before the completion of project and such loans might be treated as standard asset, subject to the condition that such re-scheduling is permitted only once by Board of Directors and that interest on such loan was paid regularly and there was no default. However, HUDCO introduced (July 2005) internal guidelines not in consonance with the directives of NHB and concessions were granted to parties. Audit noticed 71 deferment cases involving principal default of ₹ 1551.80 crore without the approval of Board, including 22 cases where deferment was allowed twice or more. In addition to this, Board allowed four deferment cases involving principal default of ₹ 287.28 crore,of which one case was allowed twice. On this being pointed by NHB Inspection Team in their report for 2010-11, the guidelines were withdrawn on 27 July 2013.

HUDCO confirmed (December 2015) the audit observation. However, fact remains that the impact of violations still continued and as on 31March 2015, there were 25 cases out of total 75 cases which continued to be in default and out of these 25 default cases, 18 were NPA.

(c) Deficiencies in internal guidelines

HUDCO laid down guidelines for appraisal of loan applications received and disbursement thereof. Shortcomings noticed in the control system in this regard are discussed in succeeding sub-paras:

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[1] ***Letter dated 4 July 2011 addressed to Director (Finance) HUDCO.***

(i) The guidelines did not indicate any benchmark for debt service coverage ratio (DSCR), breakeven point (BEP), and return on equity (RoE), *etc.* in respect of real estate projects, though the same were prescribed for other loans. HUDCO stated (December 2015) that having one benchmark to judge all projects was impractical. However, absence of this in real estate did not facilitate transparent and judicious selection of projects.

(ii) No system was in place to ensure the veracity of data in project proposals *vis-à-vis* industry norms and financial parameters. HUDCO stated (December 2015) that the appraisal team takes these factors into account. However, this was not the case as seen in the test checked case as discussed in para 10.1.3.2 (e) (vi)

(iii) The internal guidelines did not provide for independent appraisal of application involving consortium lending and depended upon the lead lender's project appraisal/Project Information Memorandum (PIM). HUDCO stated (December 2015) that as it did not have sectoral expertise in areas *like* power, road, *etc.*, it decided to follow the lead lenders. Moreover, it undertook exposure of around 5 *per cent* only of total project cost in individual projects. However, the reply is not tenable as its exposure was more than 5 *per cent* of project cost in five cases[1] test checked in audit and the same ranged between 7.51 and 26.67 *per* cent. MoHUPA stated (March 2016) that there were no guidelines limiting HUDCO's exposure to 5 *per cent* of project cost in case of consortium projects which also confirms that HUDCO was not mitigating its risk through limited exposure of around 5 *per cent* only of the total project cost in the individual projects. The fact, therefore, remains that only independent appraisal of proposals even in cases of consortium lending could ensure protection of HUDCO's financial interest, as the risk exposure cannot be shared with lead lender.

(d) Recovery and NPAs

Quality of assets is the primary consideration while assessing credit risk by financing institutions, and therefore, level of NPA indicates quality of assets. As per NHB Directions 2010, a loan asset in respect of which interest or instalment remained overdue for 90 days was classified as NPA. As such, higher level of NPA amounts to lower revenue. Table-4 below indicates the age of default and percentage of NPA for the five years ended 31 March 2015.

Table-4: Age of default *vs.* NPA

Age (Months)	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**
	(Amount in ₹crore)				
0-3	138.05	110.26	200.23	273.76	198.24
3-6	52.38	10.84	393.25	12.41	1.87
6-30	163.94	284.92	539.36	831.03	593.69
Above 30	3412.48	3966.30	3509.01	4171.21	4001.23
Total	**3766.85**	**4372.32**	**4641.85**	**5288.41**	**4795.03**
NPA *(Per cent)*	**5.46**	**6.07**	**5.69**	**6.76**	**6.30**

[1] (i) RKM Powergen Private Limited, (ii) KVK Nilachal Power Private Limited, (iii) Himachal Sorang Power Private Limited, (iv) Shree MaheshwarHydel Power Corporation Limited, and (v) Nagarjuna Oil Corporation Limited.

It is evident from the above that percentage of NPAs to gross outstanding has been above five *per* cent in all the five years with a high of 6.76 *per cent* in 2013-14 and low of 5.46 *per cent* in 2010-11. Though the business model of HDFC and LHFL functioning in the same business segment was different from HUDCO, a comparison revealed that these institutions had much lower levels of NPA, which ranged between 0.40 to 0.70 *per cent* during the same period. Similarly, default of loan above 30 months accounted for 83.45 *per cent* of the total default as on 31 March 2015 indicating a higher risk of recovery.

HUDCO stated (December 2015) that a comparison with HDFC and LHFL does not appear to be justified, as more than 90 *per cent* of its portfolio was bulk loan, while HDFC and LHFL were majorly retail lending institutions. Further, HUDCO was also operating in infrastructure sector like power, road, transport, *etc.* and during the period under review this sector has been suffering due to policy and regulatory issues and even PSU banks and FIs have posted higher NPAs in these sectors.

The reply is to be viewed against the fact that the comparison was made to highlight the magnitude of NPA *vis-a-vis* other Public Financing Institutions. The alarming position of NPA can further be corroborated with the fact that the NPA of IIFCL and IDFC (institutions engaged in financing of infrastructure projects) during 2012-13 to 2014-15 ranged between 0.94 and 3.79 *per cent* in case of IIFCL, and 0.15 and 0.70 *per cent* in case of IDFC, while the same for HUDCO was 5.68 and 7.53 *per cent*. In respect of loans in housing sector, where a comparison with HDFC and LHFL was justifiable, as against NPA between 3.40 and 9.50 *per cent* of HUDCO during 2011-11 to 2014-15, it ranged between 0.5 to 0.8 *per cent* for HDFC and LHFL in the same period.

(e) Illustrative cases of default and NPAs

Audit observed instances of deficient appraisal of loan applications and pre-disbursement system, lack of benchmarks, deficient monitoring mechanism to ensure utilisation of loan and exposure in excess of ceiling fixed and other deficiencies noticed in the internal guidelines coupled with violations of NHB Directions. Resultantly, the projects, otherwise not eligible for financing, had been financed or greater exposure had been taken, leading to NPAs or to legal issues as discussed below:

(i) M/s RKM Powergen Private Limited

Two loans of ₹ 200 crore and ₹ 300 crore were sanctioned (March 2008 and May 2010) to M/s RKM PowergenPvt. Ltd under consortium lending for a power project (Phase I and II) to be implemented by September 2010 and November 2012 respectively. Audit observed lapses in sanction of loan *like*(i) DSCR[1] being decreased from 4.39 to 0.70 as against 1.5 based on REC guidelines and (ii) non adherence to lending cap of up to five *per cent* of project cost. Further, ₹ 493.34 crorewas disbursed during August 2009 to February 2015 relaxing essential pre disbursement conditions of signing Fuel Supply Agreement (FSA) along with coal linkage and Power Purchase Agreement (PPA) by August 2010. Due to delay in implementation, project cost has escalated (February 2015) to ₹ 2389.18 crore and ₹ 7988.15 crore from ₹ 1487 crore and ₹ 5166.11 crore for Phase

[1] ***DSCR denotes repayment capacity of the borrower. Higher ratio denotes better repayment capacity of the borrower and consequently safety of the repayment of principal and interest.***

I and II respectively, and the project is yet to become operational (January 2016). Meanwhile, the loan with an outstanding amount of ₹482.57 crore became NPA in July 2014.

HUDCO/ MoHUPA stated (December 2015/ March 2016) that the loan was sanctioned on the strength of financial viability as appraised by the lead lender and not merely on the financial health of promoter. Coal linkage was signed with SECL on 23 September 2013 and PPA for 490 MW with Chhattisgarh State Electricity Board (CSEB) had been signed and expression of interest for supply of 350 MW to UPPCL, Telangana and Andhra Pradesh had been received and the PPAs would be signed after obtaining bank guarantee. The reply confirms that the crucial pre-disbursement conditions were fully not adhered to by the borrower, while HUDCO had disbursed more than 98 *per cent* of the loan and absence of independent appraisal of loan application and dependence on lead lender has eventually exposed HUDCO to risky portfolio. Apart from this, lead lender appraised in its Investment Memorandum that CSEB may not procure the power under the executed PPA due to cost overrun.

MoHUPA further stated (March 2016) that FSA and PPA were required to be in place at the time of the project achieving commercial operational date (COD).

Reply of MoHUPA is to be viewed against the fact that this project is not able to generate the electricity in absence of FSA and PPA after achieving COD.

(ii) M/s KVK Nilachal Power Private Limited

HUDCOsanctioned (23 July 2007) a term loan of ₹360 crore to M/s KVK Nilachal Power Private Limited for setting up a power plant at ₹1350 crore. Audit noticed that (i) annual contribution ₹0.06 *per unit* of energy to Environment Management Fund (EMF) was not considered while estimating profit resulting in overestimation of profit between ₹ 8.45 crore and ₹11.27 crore *per annum*, which impacted repaying capacity of the borrower, (ii) pre-disbursement condition of promoters bringing in equity contribution of ₹270 crore and finalising FSA and PPA were relaxed, (iii) promoters failed to bring in additional contribution of ₹354.56 crore towards cost escalation, (iv) HUDCO extended (27 May 2011) buyers' line of credit (BLC) of ₹94.53 crore to UCO Bank to facilitate the borrower to purchase equipment without adhering to pre-disbursement conditions, and (v) lending cap of up to 5 *per cent* of project cost was not adhered to. The project could not be completed, and as a result project cost escalated to ₹2768.25 crore and implementation schedule got delayed from January 2010 to December 2016. Meanwhile, loan became NPA in October 2014 with an outstanding amount of ₹348.71 crore.

HUDCO/ MoHUPA stated (December 2015/ March 2016) that since the project was funded on consortium basis, no detailed appraisal was carried out and it relied on the Project Information Memorandum of the lead lender. Even after considering the transfer to Environment Management Fund, project profitability was positive and would not have affected the funding. It added that promoters had contributed equity of ₹243.20 crore against the envisaged equity of ₹270 crore. MoHUPA further stated that buyers' line of credit was extended to UCO Bank on terms of common loan agreement. The reply, however, needs to be viewed against the fact that though there was shortfall in bringing in additional equity, the additional contribution towards cost escalation was not even brought in. Non consideration of EMF adversely impacted cash flow of borrower which in return impacted recovery of loan. In order to safe guard its interest, Management was required to ensure compliance with its disbursement conditions. The reply that the time for finalising FSA and PPA were extended up to April 2012 confirms that pre-disbursement conditions were unduly relaxed, which eventually led the loan account to become NPA.

(iii) M/s Himachal Sorang Power Private Limited

A loan of ₹ 100 crore was sanctioned (March 2007) to M/s Himachal Sorang Power Private Limited for setting up of a power project at ₹ 580 crore. The loan had been disbursed during August 2007 to July 2010, while the project was to be implemented by March 2010. Audit observed that (i) requirement of having a PPA within 12 months from the first disbursement was relaxed, (ii) the requirement for assigning rights of forest lease hold land as well as pledging of 51 *per cent* of borrower's share capital was waived, and (iii) lending cap of up to five *per cent* of project cost was also not adhered to. Further, there was time overrun of more than 5 years and cost overrun of ₹ 673.90 crore (116.19 *per cent*). As a result, there was dilution in security available to HUDCO, though the project was in operation since 31 October 2015.

In their reply (December 2015), HUDCO maintained that the loan was sanctioned under consortium and no independent appraisal was made by it, and relaxation for assigning forest land was made in line with lead lender, while additional one *per cent* interest was levied for relaxation to assigning shares. However, the fact remains that approving projects and relaxing pre-disbursement conditions in line with lead lender cannot be considered as prudent, as every lender has to sanction and disburse loan based on an independent evaluation of risk *vis-a-vis* their acceptable benchmarks.

Apart from HUDCO's reply, MoHUPA stated (March 2016) that there was no guideline limiting HUDCO's exposure to 5 *per cent* of project cost in case of consortium projects.

The reply is to be viewed against the fact that HUDCO had claimed (December 2015) that it limited its exposure to the extent of 5 *per cent* only of the total project cost in case of consortium funding.

(iv) M/s Electosteel Steels Limited

HUDCO accorded (March 2007) '*in principle'* approval for a loan of ₹ 300 crore to M/s Electosteel Steels Limited for setting up of a steel plant based on PIM prepared by IL&FS Financial Services Limited (IFIN) as principal advisor to the project. The loan was sanctioned on 14 June 2007 for ₹ 295 crore after receipt of a letter from SBI agreeing to take up the role of lead lender based on PIM prepared by IFIN. As per the practice in vogue, no appraisal was required for a loan under consortium, provided the project had been appraised by lead lender. Audit, however, found nothing on record that indicated that the lead lender had appraised the project.

HUDCO/ MoHUPA confirmed (December 2015/ March 2016) the above and added that it followed the wisdom of lead lender who had expertise in the field of industrial financing. However, fact remains that no record was found that could suggest that the project was appraised by SBI.

(v) M/s Pipavav Defence and Offshore Engineering Company Limited

HUDCO sanctioned (May 2005) a loan of ₹ 271 crore to M/s Pipavav Defence and Offshore Engineering Company Limited. The loan became NPA in February 2014 and the outstanding principal and interest stood at ₹ 92.75 crore and ₹ 14.66 crore respectively as on 31 March 2015. Clause 15 of loan agreement (September 2005) provided HUDCO a right to convert their exposure, in part or fully, together with interest and other charges thereon into equity shares of the borrower company at a price of minimum face value or prevailing market price, whichever is less. Further, the pre-disbursement condition of the loan required the borrower to obtain requisite approvals from its shareholders through a special resolution and furnish the same to HUDCO. Moreover, loan to the borrower was neither covered under the main objective of HUDCO nor under the categories approved by Board in March 2012. No recorded reasons for sanctioning the sanction of loan to an ineligible sector were found in audit.

HUDCO stated (February 2016) that since the loan was provided for development of infrastructure of the shipyard, it falls within the purview of main objective. The reply is not tenable as it belonged neither to housing nor to the urban infrastructure.

MoHUPA stated (March 2016) that the matter is under follow up with the agency for conversion of HUDCO's loan into equity. Audit appreciates MoHUPA's intention in taking corrective measures.

(vi) M/s Vikat Hotels Private Limited

HUDCO sanctioned (April 2007) a loan of ₹ 20.80 crore to M/s Vikat Hotels Private Limited for construction of a hotel in Bangalore. Audit observed that the loan was processed based on a project report provided by the borrower and no independent assessment was done to ensure the veracity of projections of occupancy rate and operation cost made therein. The loan was sanctioned taking occupancy rate of 75 to 91 *per cent* and projected operation cost of 33.73 *per cent* of total earnings before depreciation, interest and taxes. A survey report conducted by Federation of Hotel and Restaurant Associations of India (FHRAI) for the period 2005-06 and 2006-07, however, revealed that occupancy rate of hotels in Bangalore had decreased from 79 *per cent* in 2004-05 to 68 *per cent* in 2006-07 and the same was expected to decrease due to addition of 8000 to 9000 rooms during 2009-10. Moreover, cost of operation was to the extent of 68 *per cent* of total income. Audit also noticed that HUDCO disbursed ₹ 18.48 crore during July 2007 to August 2008 based on Chartered Accountants' certificate/site inspection of regional office. However, as per a report submitted by the regional chief after physical verification, excess disbursement of ₹ 8.36 crore was noticed due to overstatement of expenditure. The loan became NPA in November 2008 with an outstanding of ₹ 56.99 crore as on 31 March 2015.

HUDCO/ MoHUPA stated (December 2015/ March 2016) that details in the project report and supporting demand assessment reports/documents as well as reconnaissance survey details of similar projects were ascertained/analyzed and agency's project reports were also relied upon. Even though the loan was partly utilized, it levied penalty on unutilized amount from the date of release as per provisions of loan agreement. MoHUPA further stated that the study pointed by Audit pertains to the years 2005-06, 2006-07 and 2009-10 of Bangalore city which was reported after sanction of scheme in April 2007. The reply, however, is to be viewed against the fact that data/study from a private firm was obtained only after sanction of the loan while international/national level study was available which revealed significant variation from the data furnished by the borrower. Apart from this, the study report of FHRAI for the period 2005-06 which was published in February 2007 also included prediction for occupancy of rooms during 2006-07 and 2009-10. Further, levy of penalty does not take away the fact that excess amount was disbursed without ensuring real progress of the work or actual amount spent on the project. Further, the reply was silent on the aspect of dilution of security.

(vii) M/s Dreams Consultants Private Limited

HUDCO sanctioned (August 2007) a term loan of ₹ 25 crore to M/s Dreams Consultants Private Limited for construction of Nilai International College at Ranchi and ₹ 16.00 crore was disbursed between November 2007 and March 2009. Despite the project being in operation, the borrower defaulted (May 2009) and the loan became NPA in May 2009, and total outstanding including interest as on 31 March 2015stood as ₹ 42.67 crore. It was observed that the borrower transferred the mortgaged property to Nilai Educational Trust in which the borrower was also a trustee without informing or seeking permission from HUDCO, and the same came to the notice of HUDCO only in April 2009. Subsequently, a cancellation deed (May 2009) registered with District Sub Registrar was submitted to HUDCO with an explanation that the land was inadvertently transferred. The legal wing of HUDCO treated this as an act of fraud and suggested (June 2009) recall of the entire loan along with other dues and to take legal action. Accordingly, HUDCO recalled (5 May 2010) the entire loan together with interest and other monies as payable through legal notice, while criminal case was filed only in March 2015.

HUDCO/ MoHUPA stated (December 2015/ March 2016) that legal action was taken in May 2010 when the recall notice was issued, and to recover the outstanding amount, it invoked personal and corporate guarantee (24 May 2010) and bank guarantee (8 June 2010) of ₹ 25 lakh and process of filing a criminal case for fraud and breach of trust has been started. However, the fact remains that it took action as recommended by legal department in May 2010, while such action should have been taken after two quarters of persistent default since May 2009. Moreover, though it was termed (June 2009) as a case of intentional fraud, criminal case was filed only in March 2015.

(viii) M/s Sunil Ispat and Power Limited

HUDCO sanctioned a loan of ₹ 24.50 crore in March 2006 to M/s Sunil Ispat and Power Limited for construction of a captive power plant (CPP) as part of a proposed mini integrated steel plant under a consortium arrangement. As per norms in vogue, after first disbursal, subsequent releases were to be made after site inspection. HUDCO, however, failed to monitor utilization of loan, as borrower diverted the loan, while its officers from regional office at Raipur periodically furnished satisfactory reports and recommended further disbursements, and also endorsed false reports of lenders' engineer and Chartered Accountant. Meanwhile, it emerged (November 2008) in a consortium meeting that work had not been started for CPP. Despite likely fraud coming to notice, legal action was initiated only after lapse of more than 3 years in May 2012. The loan became NPA in May 2009, and the total outstanding stood at ₹ 75.59 crore as on 31 March 2015. Further, the realisable value of assets was assessed between ₹ 22.85 crore and ₹ 30 crore against outstanding amount of ₹ 144.14 crore to the consortium. Therefore, sufficient tangible security to recover this loan does not exist. It was also noticed that this loan has been picked by Corporate Vigilance Wing and Central Bureau of Investigation for investigation in February 2013.

HUDCO/ MoHUPA accepted (December 2015/ March 2016) that monitoring of the project failed and borrower was successful in diverting the loan as it largely depended on reports of lenders' engineer/auditor, who furnished false report and no adverse report was furnished even by its officials. As no consortium documents were executed, it was decided to file suit separately as accepted by all the lenders, and accordingly action was initiated. The reply, however, is to be viewed against the fact that HUDCO did not ensure that a common loan agreement was executed though the loan was under consortium, and failure on the part of lenders' engineer does not take away its responsibility of monitoring the progress of work. Further, it took three years to initiate legal action against the borrower while internal guidelines stipulated action after expiry of one quarter of loan becoming NPA. Moreover, the reply was silent on the action taken or proposed to be taken against its officers who furnished or endorsed false reports, based on which disbursements were made.

(ix) M/s Shree Maheshwar Hydel Power Corporation Limited

HUDCO disbursed a loan of ₹259.00 crore to M/s Shree MaheshwarHydel Power Corporation Limited for a power project under a consortium. While approving the loan, Board directed that release of loan instalments be made after the promoter brought in additional equity and acquired entire land including land for rehabilitation and resettlement (R&R) of affected villages. However, these were relaxed and loan was disbursed between June 2007 and January 2010. Meanwhile, borrower defaulted in servicing the loan from January 2011 and project activities were held up since March 2013. It is pertinent to note that estimated project cost and expected tariff from it has increased steadily from ₹ 736 crore and ₹ 2.76 *per unit* (1993) respectively to ₹ 2449 crore and ₹ 5.32 *per unit* (2006) and to ₹ 6793 crore and ₹ 13 *per unit* (2015) making the future of the project and recovery of loan uncertain, as Madhya Pradesh Power Management Company Limited refused to purchase at tariff beyond ₹ 5.32 *per unit*. A high level committee constituted (September 2014) to suggest the way forward for the project though recommended (May 2015) three measures, two of which did not materialise leaving only the third option of exiting of Madhya Pradesh government and its agencies from the project and managing it by lenders, a credible and clear roadmap for which is yet (December 2015) to be finalised. The loan became NPA in April 2011 with an outstanding amount of ₹ 490.29 crore as of March 2015.

HUDCO stated (December 2015) that promoters agreed to contribute additional equity and the existing lenders agreed to restructure their loan to make the project economically viable. It is to be noted that the loan account is under NPA in the books of all lenders because of non-infusion of fund by the promoters. Further, Board authorised the management to relax pre-disbursement conditions in line with the lead lender.

The reply needs to be viewed against the fact that while sanctioning the loan, HUDCO was aware that the project was delayed due to inability of promoters to bring in required funds, and was defaulting in servicing of existing loan, and therefore, relaxation of pre-disbursement conditions was not judicious.

MoHUPA stated (March 2016) that there is a proposal to invoke the pledged shares of the company thereby taking control of the project for completion and revenue generation.

Reply is to be viewed in light of the refusal by MP Power Management Company Ltd. (erstwhile MPSEB) to purchase the power at the tariff exceeding ₹ 5.32 *per unit*.

(x) M/s Ascot Hotel and Resort Limited

HUDCO sanctioned (June 2006) a loan of ₹ 80 crore to M/s Ascot Hotel and Resort Limited for construction of club-cum-banquet hall at Noida. Audit observed that the loan was sanctioned without ensuring adequate net-worth of promoters and accepted pledge of a property valued at ₹ 12 crore against promoters' share of ₹ 22.73 crore in borrowing company (51 *per cent* of total equity), resulting in inadequate security to the extent of ₹ 10.73 crore. The loan became NPA in February 2012 and the total outstanding stood at ₹100.84 crore as on 31 March 2015.

HUDCO/ MoHUPA stated (December 2015/ March 2016) that it accepted the mortgage of property in lieu of shares after approval of competent authority and that the total value of security was well beyond 150 *per cent.* Further, the shares were already pledged to other FIs and the promoters proposed initial public offer (IPO) of their shares. The fact, however,remainsthat acceptance of the alternate security was inadequate and resulted in dilution of security available to HUDCO.

Conclusion

HUDCO mobilised ₹ 37128.32 crore during 2010-11 to 2014-15, but the mobilization was not judicious, on account of higher proportion of bank loans, which carried interest rates higher than those for funds from other sources by one to two *per cent*. Assessment of requirement of fund was not made based on laid down policy or framework, and certain elements of fund inflow/outflow were not given due consideration resulting in excess mobilisation of ₹ 3277.96 crore and additional interest burden of ₹ 30.39 crore. Incidence of extra expenditure of ₹ 147.39 crore was also noticed due to lower credit rating and fixing of higher coupon rate. The exclusive dependence on arrangers for fund mobilisation instead of developing own capabilities with attendant benefits of reduced coupon and lending rate exposed HUDCO to possible risk of higher coupon rate arising from possible conflict of interest.

In lending operations, the amount disbursed ranged between 38.40 and 69.72 *per cent* of loans sanctioned during five years ended 2014-15. Audit examination revealed non compliance with directions issued by National Housing Bank, the Regulator. Deficiencies in internal guidelines also affected the quality of assets. Deficiencies in existing appraisal mechanism, system of disbursement, monitoring of financed projects and waiver of critical pre-disbursement conditions led to considerable loan accounts turning into non performing assets, which were in the range of 5.46 to 6.76 *per cent* during the five year period. In monetary terms, the amount in default increased from ₹ 3766.86 crore in 2010-11 to ₹ 4795.05 crore in 2014-15, while NPA increased from ₹ 1227.60 crore to ₹ 2029.33 crore during the same period.

Recommendations

Audit makes the following recommendations to address the shortcomings noticed and to improve the operations of HUDCO.

- ***Strengthen the procedure for assessment of requirement of funds;***
- ***Ensure that mobilisation of funds is carried out in an economical, efficient and effective manner through judicious selection of financial instruments, increasing the investor base and developing own mechanism to mobilise resources so as to optimise cost and return;***
- ***Independently evaluate loans granted under consortium lending and validate assumptions and projections furnished by borrowers or lending partners;***
- ***Examine the need for prescribing financial benchmarks for financing real estate and consortium funding; and***
- ***Strengthen the monitoring system to ensure proper utilisation of funds by borrowing institutions.***

HUDCO/ MoHUPA stated (December 2015/ March 2016) that the review and strengthening is an ongoing process which is being done regularly and all out efforts to improve on the above aspects shall be undertaken.