Top NBFCs, HFCs opt for short-term fund raising on RBI rate cues, say experts

AAA-rated NBFCs and HFCs flooded the corporate debt market last week with short-term debt issuances. The trend is likely to continue, experts say

Top-rated non-banking finance companies (NBFCs) and housing finance companies (HFCs) are likely to continue raising funds via short-term corporate bonds, assuming the central bank's rate hike trajectory continues and to avoid high borrowing costs, experts told Moneycontrol on July 4.

AAA-rated NBFCs and HFCs flooded the corporate debt market last week with short-term debt issuances. The AAA rating is the highest assigned to an issuer's bonds by credit rating agencies. These instruments have a high degree of creditworthiness and have the lowest risk of default.

Housing Development Finance Corporation (HDFC) raised Rs 4,000 crore through 21-month bonds at 7.28 percent coupon last week, according to dealers. Tata Capital Financial Services raised Rs 250 crore via three-year and one-month bonds at 7.75 percent coupon, while LIC Housing Finance raised Rs 500 crore through three-year and one-month bonds at 7.61 percent coupon.

"It seems like these NBFCs do not want to get into very long duration as interest rates are cyclical in nature," said Mahendra Kumar Jajoo, chief investment officer (fixed income) at Mirae Asset Investment Managers (India). "They would also want to diversify their funding requirements and not solely depend on bank lending."

Jajoo added that most top-rated NBFCs lend for shorter or medium durations and their funding needs are skewed towards securities maturing in that period. They have to look at their asset-liability management, or ALM, he said.

Avoiding duration risks

Bond prices and yields move in opposite directions. An increasing interest rate affects borrowing costs across the yield curve. The Reserve Bank of India's Monetary Policy Committee (MPC), which raised the repo rate by 90 basis points (bps) in May and June, is likely to hike the repo rate in the coming months to keep a lid on soaring price pressures. One bps equals one-hundredth of a percentage point.

The repo rate stands at 4.90 percent. Barclays expects the MPC to deliver a 35 bps rate hike in August and raise the policy repo rate by another 25 bps to 5.50 percent in October, while also switching to a neutral stance.

In such a rate-tightening cycle, the impact is more severe on medium-to-longer duration debt than on the shorter ones. This is because the price fluctuation is relatively less in short-term instruments.

Hence, shorter-duration funding will entail relatively lower borrowing costs for better-rated NBFCs and HFCs compared with long-duration papers, said experts.

"In a lower interest rate environment, it was better to accumulate long-term funding to reduce the cost of borrowing. But during the interest rate reversal period, the borrowing cost of NBFCs goes up immediately," said Venkatakrishnan Srinivasan, founder of Rockfort Fincap, a Mumbai-based debt advisory firm. "This is also because large investors like insurance companies and provident fund organisations hesitate to invest in long-term tenor instruments and if so, they demand a risk premium or higher pricing."

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Tapping mutual funds

These NBFCs and HFCs could also be issuing shorter-duration papers to tap rising demand from mutual funds, said experts.

Corporate bonds are comparatively low-risk investments as they ensure capital protection. However, these bonds are not entirely safe and investors demand a certain premium to invest in these securities over and above the G-Sec or government security rate. The difference between the two rates is called the spread. The higher the spread, the riskier the investment.

When the 10-year government bond yield is hardening, it makes more sense for mutual funds investors to lock funds in shorter duration, better-rated paper, said experts.

"For mutual funds, the three-year segment seems a good option," said Mirae Asset's Jajoo. "So, top-rated NBFCs and HFCs are also taking advantage of that demand and issuing shorter duration papers to keep borrowing costs low."

According to Sanjay Pawar, fund manager-fixed income at LIC Mutual Fund Asset Management, mutual funds always prefer short-duration NBFC or housing finance issuers.

"With fewer supply at the long end, with compressed spreads and with a view that rate hiking cycle has not peaked, they may be preferring short assets in order to replace assets getting matured for diversification or scheme-specific requirements," said Pawar.

Trend likely to persist

Experts said top-rated NBFCs and HFCs are likely to continue this trend of issuing short-term papers, at least for some time, given that the RBI's rate hike cycle is expected to become more entrenched.

"Now that rates are increasing and the rate hike cycle could go on for some time, we do think that this trend of issuing short-term bonds is likely to continue," said Yogesh Kalinge, vice-president at AK Capital.

LIC Mutual Fund Asset Management's Pawar also expects the trend to persist.

"Long-term yields have already corrected by 80-to-100 bps and there is a general sentiment among issuers/market participants that there may be a shallow rate hiking cycle," Pawar said. "Hence, issuers will not be comfortable to raise long-term funds now with such higher interest cost when they can manage temporarily with shorter duration issuance unless there is an ALM risk."