Tax Free Bonds – Tranche – 1

January 25, 2012

Summary: Housing and Urban Development Corporation Limited has come up with the public issue of tax free secured redeemable non convertible bonds of face value of Rs 1,000 each in the nature of debentures having tax benefits under section 10 (15) (iv) (h) of the Income tax act, 1961, as amended ("bonds") not exceeding an aggregate amount of Rs. 4,684.72 crores by way of bonds in one or more tranches in FY12.

The NCB Tranche 1 Issue will open for subscription on **January 27, 2012 and close on February 06, 2012**. The issue consists of two series of Bonds – 10 year and 15 year carrying interest @ 8.22% and 8.35% p.a. respectively for retail investors and 8.10% and 8.20% p.a respectively for other investors.

Rating agencies CARE and FITCH have given 'AA+' rating for the NCBs. Instruments with this rating are considered to have the high degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk. 'AA+' national ratings denote the high rating assigned in its national rating scale. Such instruments carry very low credit risk.

Such bond issuances have attracted more investors' attention given the expectation of falling interest rates. Power Finance Corporation (PFC) came up with a similar issue earlier this month, which got subscriptions worth Rs 9,791 crore, which is 2.4 times higher than the base size, within three days since the opening of the issue. Even NHAI's Rs.10,000 cr taxfree bonds issue elicited a good response with the corporate segment getting oversubscribed by more than 4 times in the first 3 days.

Taxation: The Bonds are tax free in nature (exempt u/s 10(15)(iv)(h) of the Income Tax Act, 1961 and the interest on the Bonds will not form part of the total income. Since the interest Income on these bonds is exempt, no Tax Deduction at Source is required. Under section 195 of the Income Tax Act, Income Tax shall be deducted from sum payable to non-residents on the long-term capital gain and short term capital gain arising on sale and purchase of bonds at the applicable rate.

The Hon'ble Finance Minister has presented the Direct Tax Code Bill, 2010 ('DTC Bill') on August 30, 2010, which is proposed to be effective from April 1, 2012. The DTC Bill is likely to be presented before the Indian Parliament thereafter. Accordingly, it is currently unclear what effect the Direct Tax Code would have on the investors.

Tax-free bonds differ from tax saving bonds. The interest income from the instrument is not taxed in tax-free bonds while investible amount does not form part of the total income in tax saving bonds. Also, there is no upper limit to invest in tax-free bonds. This financial year, infrastructure companies like National Highways Authority of India (NHAI), Power Finance Corporation (PFC), Housing and Urban Development Corporation (Hudco) and IRFC were given permission to raise Rs 30,000 crore via tax free bonds.

Objects of the Issue: : The funds proposed to be raised through the Issue shall be utilized towards lending purposes, augmenting the resource base of HUDCO and other operational requirements. Pending utilization of the proceeds out of the Issue for the purposes described above, it intends to temporarily invest funds in deposits with banks or as may be approved by the Board. Such investment would be in accordance with the Board approved guidelines prepared on the basis of directions received from DPE.

Issue Terms:

Issuer	Housing and Urban Development Corporation Limited
Issue	Public issue of tax free bonds of face value of Rs 1,000 each, in the nature of secured, redeemable, non-convertible debentures, having benefits under section 10(15)(iv)(h) of the Income Tax Act, to be issued at par in one or more tranches on the terms and conditions as set out in separate Tranche Prospectus (es) for each such Tranche.
Stock Exchanges proposed for listing	NSE and BSE
Issuance	Both physical and dematerilased form
Trading	Compulsorily in dematerialized form
Trading Lot	1 (one) Bond
Depositories	NSDL and CDSL
Rating	'CARE AA+' from CARE and 'Fitch AA+ (ind)' from Fitch.
Security	The Bonds proposed to be issued are secured by a floating first pari-passu charge on present and future receivables of the Company to the extent of amount mobilized under the Issue. HUDCO reserves the right to create first pari-passu charge on present and future receivables for its present and future financial requirements.

Step-down clause: To promote the retail participation and prevent malpractices in the application process, the issue bestows higher coupon rate only for primary retail subscribers who apply upto Rs.5 lakhs (category III only). Accordingly, the Series I and Series II Bonds will be allotted to Category III investors with an aggregate coupon rate of 8.22% p.a. and 8.35% p.a., respectively.

This additional interest of 0.12% p.a. and 0.15% p.a., shall only be available to the original allottees and shall not be available in the following instances:

1. In case the Bonds are sold in the secondary market by the original allottee the buyer will not be entitled to receive the interest at the coupon rate of 8.22% p.a. and 8.35% p.a., for the Series I and Series II Bonds respectively and shall only be entitled to receive the interest at the coupon rate of 8.10% p.a. and 8.20% p.a., respectively.

2. This is same in the case of transfer where the transferee will not be entitled to receive the interest at the coupon rate of 8. 22% p.a. and 8.35% p.a., for the Series I and Series II Bonds respectively and shall only be entitled to receive the interest at the coupon rate of 8.10% p.a. and 8.20% p.a., respectively. However, in case of any transfer by a permanently disabled allottee to their legal heir(s), the transferee shall continue to be entitled to receive interest at the coupon rate of 8.22% p.a. and 8.35% p.a., respectively.

3. Where the Bonds are held in joint names and subsequently there is a change in the sequence of the names of the joint holders, the joint holders subsequent to such change in sequence of names, will no longer be entitled to receive the interest at the coupon rate of 8.22% p.a. and 8.35% p.a.

This clause is more beneficial for retail investors who want to hold the bonds till maturity or long term. However this also means that category III investors will get to participate less in the price upside if the interest rate cycle turns down.

In practice, HNIs/QIBs will miss out the arbitrage opportunity between the rates of retail and HNIs/QIBs issue by the step down clause. It could be difficult for HNIs who use such opportunities to garner good returns through dummy applicants from these instruments.

Issue Details:

Options	Tranche 1 Series I	Tranche 1 Series II
Frequency of Interest Payment	Annual	Annual
Minimum Application	Rs. 10,000 (10 Bonds)	Rs. 10,000 (10 Bonds)
In Multiples of	Rs. 1,000 (1 Bond)	Rs. 1,000 (1 Bond)
Face Value of NCDs & issue price	Rs. 1,000	Rs. 1,000
Tenor	10 years	15 years
Redemption amount (per NCD)	Repayment of the Face Value plus any interest that may have accrued at the Redemption Date	
Options	Additional Coupon Rate for Category III Investors: 0.12% p.a.	Additional Coupon Rate for Category III Investors: 0.15% p.a.
	Aggregate Coupon Rate for Category III Investors: 8.22% p.a.	Aggregate Coupon Rate for Category III Investors: 8.35% p.a.
Annualised Yield	For Category I Investors: 8.10%	For Category I Investors: 8.20%
	For Category II Investors: 8.10%	For Category II Investors: 8.20%
	For Category III Investors: 8.22%	For Category III Investors: 8.35%
Coupon Rate (%) per annum for Category I, II and III	8.10% per annum	8.20% per annum
Effective pre-tax yield (per annum) for tax payers in 10% income tax bracket *	9.00%	9.11%
Effective pre-tax yield (per annum) for tax payers in 20% income tax bracket *	10.13%	10.25%
Effective pre-tax yield (per annum) for tax payers in 30% income tax bracket *	11.57%	11.71%
Aggregate Coupon Rate (%) per annum for Category III (investing in primary issue)	8.22% per annum	8.35% per annum
Effective pre-tax yield (per annum) for tax payers in 10% income tax bracket *	9.13%	9.28%
Effective pre-tax yield (per annum) for tax payers in 20% income tax bracket *	10.28%	10.44%
Effective pre-tax yield (per annum) for tax payers in 30% income tax bracket *	11.74%	11.93%
Mode of payment	Direct Credit, NECS, RTGS, NEFT and. Cheques or Demand drafts.	

* = without considering education cess & secondary and higher education cess

Who can apply?

Category I

- Public Financial Institutions, Statutory Corporations, Commercial Banks, Co-operative Banks and Regional Rural Banks, which are authorised to invest in the Bonds;
- Provident Funds, Pension Funds, Superannuation Funds and Gratuity Fund, which are authorised to invest in the Bonds;
- Insurance companies registered with the IRDA;
- National Investment Fund;
- Companies
- Bodies corporate and societies registered under the applicable laws in India and authorised to invest in the Bonds
- Public/private charitable/religious trusts which are authorised to invest in the Bonds;
- Scientific and/or industrial research organisations, which are authorised to invest in the Bonds;
- Partnership firms in the name of the partners; and
- Limited liability partnerships formed and registered under the provisions of the Limited Liability Partnership Act, 2008.

Category II
The following investors applying for an amount aggregating to above Rs 5 lakhs across all Series in each tranche
- Resident Indian individuals; and
- Hindu Undivided Families through the Karta.

Category III
The following investors applying for an amount aggregating to up to and including Rs 5 lakhs across all Series in each tranche
- Resident Indian individuals; and
- Hindu Undivided Families through the Karta.

Basis of Allotment:

- Applicants belonging to the Category I, in the first instance, will be allocated Bonds upto 45% of Overall Issue Size on first come first serve basis (determined on the basis of date of receipt of each application duly acknowledged by the Bankers to the Issue);
- Applicants belonging to the Category II, in the first instance, will be allocated Bonds upto 25% of Overall Issue Size on first come first serve basis (determined on the basis of date of receipt of each application duly acknowledged by the Bankers to the Issue);
- Applicants belonging to the Category III, in the first instance, will be allocated Bonds upto 30% of Overall Issue Size on proportionate basis;

Applicants belonging to all three Categories will be allocated as given in the table below:

Particulars	Category I	Category II	Category III
Reservation for each Portion	45% of the Overall Issue Size	25% of the Overall Issue Size	30% of the Overall Issue Size

Further, Allotment shall be on first cum first serve basis for Category I and II and proportionate basis for Category III, with Hudco having the discretion to close the Issue early irrespective of whether or not any of the Portion(s) are fully subscribed.

Credit Rating:

CARE has assigned a rating of 'CARE AA+' to the Bonds vide letter dated December 30, 2011. Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk. Fitch has assigned a rating of 'Fitch AA+ (ind)' to the Bonds vide letter dated December 29, 2011

Security: The Bonds proposed to be issued are secured by a floating first pari-passu charge on present and future receivables of the Company to the extent of amount mobilized under the Issue. HUDCO reserves the right to create first pari-passu charge on present and future receivables for its present and future financial requirements.

Payment of Interest: Payment of interest on the Bonds will be made to those Bondholders whose name appears first in the Register of Bondholders on the Record Date. The record date for the payment of interest or the Maturity Amount shall be 15 days prior to the date on which such amount is due and payable.

Interest on application money: Interest @ 8.00% p.a. shall be paid on amounts allotted from the date of realization of the cheque(s)/demand draft(s) or 3 (three) days from the date of receipt of the application (being the date of submission of each application as duly acknowledged by the Bankers to the Issue) whichever is later upto one day prior to the Deemed Date of Allotment.

Interest on application money that is liable to be refunded (on valid applications) shall be paid @4% p.a. from the date of realization of the cheque(s)/demand draft(s) or 3 (three) days from the date of receipt of the application (being the date of presentation of each application as acknowledged by the Bankers to the Issue) whichever is later upto one day prior to the Deemed Date of Allotment

Liquidity and Exit Options: Each Series of Bonds will be listed NSE and BSE.

Company Background: Hudco is a financial institution engaged in the financing and promotion of housing and urban infrastructure projects throughout India. It was established on April 25, 1970 as a wholly owned government company with the objective to provide long term finance and undertake housing and urban infrastructure development programmes. It is a public financial institution under section 4A of the Companies Act and has been conferred the status of Mini-ratna. Hudco has a pan-India presence through its wide network of zonal, regional and development offices and occupies a key position in the GoI's growth plans and implementation of its policies for the housing and urban infrastructure sector.

Business of Hudco is broadly classified into two business platforms: Housing finance and Urban infrastructure finance. It also provides consultancy services in the field of urban and regional planning, design and development, environmental engineering, social development, government programmes and others. Its business is supported by capacity building activities through HSMI, and alternative building materials and cost-effective technology promotion.

As on December 31, 2011, Hudco has provided finance for over 15 million dwelling units and over 1,600 urban infrastructure projects in India. Further, up to December 31, 2011, it has sanctioned loans of Rs 37,464 crores for housing and Rs 84,906 crores for urban infrastructure on a cumulative basis, of which Rs 29,835 crores and Rs 46,692 crores has been disbursed respectively. As part of consultancy services, up to December 31, 2011, It had appraised 1,236 projects with a project cost of Rs 27,515.34 crores under JNNURM.

Competitive Strengths:

- Key strategic position in the GoI's plans for growth of the housing and urban infrastructure sector.
- Strong financial position.
- Pan-India presence.
- Established track record.
- Varied consultancy services in housing and urban infrastructure sector.
- Wide pool of skilled and professional workforce.

Strategy:

- Enhance participation in implementation of government programmes on housing and urban infrastructure
- Increase financing of the housing and urban infrastructure projects
- Develop strategic alliances with various agencies.
- Enhance income from fee-based activities.

Risks & Concerns:

- If the level of NPAs in Hudco's loan portfolio were to increase, its financial condition would be adversely affected.
- Hudco may not be able to foreclose on the value of its collateral on a timely basis, or at all, when borrowers default on their obligations to it and this may have a materially adverse effect on its business, results of operations and financial condition.
- Business of Hudco is vulnerable to interest rate volatility and will be impacted by any volatility in such interest rates in its operations, which could cause its net interest margins to decline and adversely affect the profitability.
- Any inability to meet debt finance obligations may have an adverse effect on Hudco's business and results of operations.
- Financing of Indian housing and urban infrastructure sector is very competitive and increasing competition may result in declining margins and market shares.
- Hudco may be unable to secure funding at competitive rates, which could adversely affect its growth, expansion and results of operations.
- Business of Hudco may be adversely affected by future regulatory changes.
- Hudco has high loan concentrations with its top ten borrowers contributing to 30.12% of its total loans outstanding as on March 31, 2011 and default by any one of them could significantly affect its business.
- In the event of Hudco failing to meet the capital adequacy and statutory liquidity requirements on account of any changes in the existing regulatory policy, its results of operation and financial condition could be severely affected.
- Hudco is subject to risks arising from exchange rate fluctuations and devaluation of the Indian rupee against any foreign currencies, which could increase its cost of finance, thereby adversely affecting its results of operation and financial condition.
- Hudco benefit from certain tax benefits available to it as a public financial institution and if these benefits are no longer available to it, its business, and financial condition, results of operations may be adversely affected.
- There has been no prior public market for the Bonds and it may not develop in the future, and the price of the Bonds may be volatile.
- Any downgrading in credit rating of Hudco's Bonds may affect the trading price of the Bonds.
- Changes in interest rates may affect the prices of the Bonds
- A debenture redemption reserve will be created, only up to an extent of 50% for the Bonds and in the event of default in excess of such reserve, Bondholders may find it difficult to enforce their interests.
- The proposed new Indian taxation system could adversely affect Hudco's business and the price of the Bonds.

Financials - P&L:

(Rs. in crore)

Particulars	FY11	FY10	FY09
Operating Income	2276.20	2509.94	2708.40
Other Income	2.39	18.41	4.78
Total Income	2278.59	2528.35	2713.18
Expenditure	172.93	326.41	34.84
% of sales	7.60	13.00	1.29
Operating Profit	**2105.66**	**2201.94**	**2678.34**
OPM %	92.51	87.73	98.89
Interest & Financial Charges	1273.06	1412.47	1902.45
Depreciation	11.41	4.52	4.67
Prior Period Adjustment (Net Income)	0.29	0.87	6.25
Deferred Tax Liability for prior years transferred to General Reserve	0.00	0.00	120.96
PBT	821.48	785.82	656.51
PBTM %	36.09	31.31	24.24
Tax (incl. FBT & DT)	271.45	290.51	255.52
Effective Tax Rate %	33.04	36.97	38.92
PAT	**550.03**	**495.31**	**400.99**
PATM %	24.16	19.73	14.81

Balance Sheet:

(Rs. in crore)

SOURCES OF FUNDS	2011	2010	2009
Share Holder's Funds			
Share Capital	2001.90	2001.90	2001.90
Reserves & Surplus	3519.07	3095.19	2665.96
	5520.97	**5097.09**	**4667.86**
Loans Funds			
Secured Loans	179.09	189.53	199.19
Unsecured Loans	15599.57	15330.95	19050.13
	15778.66	**15520.48**	**19249.32**
Deferred Tax Liability (Net of Asset)	**281.85**	**237.36**	**234.40**
Total	**21581.48**	**20854.93**	**24151.58**
APPLICATION OF FUNDS			
Gross Block	158.78	142.51	141.86
Less: Depreciation	84.57	73.62	69.89
Net Block	**74.21**	**68.89**	**71.97**
Capital Work in Progress	**11.81**	**9.58**	**9.07**
Investments	**1298.98**	**1523.99**	**2043.19**
Loans	**19988.77**	**19026.73**	**21426.97**
Current Assets, Loans & Advances			
Sundry Debtors	16.57	12.15	21.82
Cash and Bank Balances	716.20	755.87	1052.39
Other Current Assets	230.28	190.80	269.13
Other Loans and Advances	332.00	342.39	340.14
	1295.05	1301.21	1683.48
Less: Current Liabilities & Provisions			
Current Liabilities	844.30	916.34	940.03
Provisions	243.04	159.13	163.46
	1087.34	1075.47	1103.49
Net Current Assets	**207.71**	**225.74**	**579.99**
MISCELLANEOUS EXPENDITURE	**0.00**	**0.00**	**20.39**
Total	**21581.48**	**20854.93**	**24151.58**

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