Ref. RBI/2004-05/ 503

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June 29, 2005

The Chief Executives
All Scheduled Commercial Banks (excluding RRBs)

Dear Sir,

Exposure to Real Estate Sector

The position relating to risk management, reporting requirements and balance sheet disclosures in respect of real estate exposure of banks has been reviewed and the following instructions are being issued for the guidance of banks.

1. Risk Management System

In view of the growing need for putting in place proper risk management system for identification, assessment and containing risks involved in the banking business, and also with a view to sensitizing the banks in this regard, Reserve Bank of India has been issuing instructions / guidance notes on various risks for the benefit of the banks. However, a recent review revealed that though the advances of the banks to the housing sector, particularly to the land developers and builders, are on the rise, a corresponding control mechanism required to be in place for managing the risks involved in this sensitive sector has not been adopted by majority of the banks. In view of the above, your bank may put in place the following system for managing the sensitive sector portfolio. These instructions are indicative in nature and banks may adopt a system depending upon their portfolio size, business complexities, risk appetite, etc.

i. Banks should have a Board mandated policy in respect of their real estate exposure.

ii. The policy may include exposure limits, collaterals to be considered, margins to be kept, sanctioning authority / level, sector to be financed, etc., though the actual limits / margins may vary from bank to bank depending upon the individual bank's portfolio size, risk appetite and risk containing abilities, etc.

iii. Banks should have risk management system in place for containing risks involved in this sector, including price risk, etc.

iv. Banks should have a monitoring mechanism to ensure that the policy stipulations are being followed by field level functionaries and that their exposure to this sensitive sector is within the stipulated limits.

2. Reporting to RBI

It has also been decided that henceforth, banks should report to RBI {OSMOS - Return IV – Section 7 (C) of DSB returns} their real estate exposure under the following heads -

a) Direct exposure

i. Residential Mortgages – Lendings fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented; (Individual housing loans up to Rs.15 lakh may be shown separately)

ii. Commercial Real Estate – Lendings secured by mortgages on commercial real estates (office buildings, retail space, multi-purpose commercial premises, multi-family residential buildings, multi-tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction, etc.). Exposure would also include non-fund based (NFB) limits;

iii. Investments in Mortgage Backed Securities (MBS) and other securitised exposures –

a. Residential,

b. Commercial Real Estate.

b) Indirect Exposure

Fund based and non-fund based exposures on National Housing Bank (NHB) and Housing Finance Companies (HFCs).

Since the current OSMOS package does not provide for reporting of banks' real estate exposures in the above fashion, banks will be separately advised in regard to the reporting requirement.

3. Balance sheet disclosure

Further, banks may disclose their gross exposure to real estate sector as well as the details of the break-up as mentioned in para 2(a) and (b) above, in their annual report.

Yours faithfully,

(Raju Kurian)
Deputy General Manager