

**PRICING OF RESIDENTIAL MORTGAGE  
BACKED SECURITIES: A STUDY ON  
HOUSING FINANCE SECTOR IN INDIA**

**By**

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**Submitted for the award of degree of**

**Doctor of Philosophy**

**To the**



**INDIAN INSTITUTE OF TECHNOLOGY, DELHI**

**INDIA**

**DECEMBER 2009**

***DEDICATED***

***TO***

***My Mother***

***Late Srimati Prabhavati Tripathi***

## **CERTIFICATE**

This is to certify that the thesis entitled “**Pricing of Residential Mortgage Backed Securities: A Study on Housing Finance Sector in India**” being submitted by **Mr. Gireesh Chandra Tripathi** to the Indian Institute of Technology, Delhi for the award of the degree of Doctor of Philosophy, is a record of bonafide research work carried out by him. He has worked under my guidance and supervision and has fulfilled the requirements for submission of this thesis, which to my knowledge, has reached the requisite standard.

The results contained in this thesis have not been submitted in part or in full, to any other university or institute for award of any degree or diploma.

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## **ACKNOWLEDGMENT**

This study could be embodied with the help, encouragement, cooperation and guidance of a lot many people and I convey my heartfelt thanks to all of them. At the outset, I would like to thank the almighty for his kind blessings which inspired and kept me motivated to achieve this academic endeavor.

I would like to express my deepest gratitude to respected Guruji Prof. K. Chandrashekhra Iyer, Department of Civil Engineering, for his valuable and timely guidance, inspiration, motivation and fatherly support to develop a researcher out of me. His clinical, analytical and writing skills have been a great source of inspiration for me. In spite of his busy schedule, he continuously kept on extending his meticulous attention. Through his all round help he played the most crucial role in my growth as a researcher, teacher as well as a person. I am deeply indebted and grateful to my Guruji and his family members.

I would also like to take this opportunity to record my sincere indebtedness to Prof. Surrender S. Yadav and Prof. P.K. Jain (Department of Management Studies, IIT Delhi), Prof. S G. Deshmukh (Department of Mechanical Engineering, IIT Delhi - Currently Director, IIITM Gwalior) and all the faculty members of the department who spared their valuable time for providing useful insights for carrying out this research effort. Special thanks to Prof M Y Khan (Visiting Professor, Department of Management Studies, IIT Delhi), Prof Suresh Chandra and Prof B R Handa, (Department of Mathematics, IIT Delhi) and Prof Karmeshu (School of Computer Sciences, Jawaharlal Nehru University Delhi) for their valuable inputs as and when it was required. I express my heartfelt thanks to Prof. Wagish Shukla of Department of Mathematics, IIT Delhi for his valuable insights, time and continuous support.

I am obliged to all the respondents of the survey, who took out time from their busy schedules to provide data for this research. I am particularly obliged to Mr. P. R Jaishankar, Mr. Aditya Sharma and Mr. Balaji Prabhu of National Housing Bank for providing their valuable inputs in this research work. I am deeply indebted to Mr. Predeep Srinivas for providing useful comments and necessary suggestions on the statistical techniques used in this research work.

I take this opportunity to express gratitude to my respected father, who has always been a source of strength and inspiration for me. All my family members, Shailja, Pragati, Anupam and Piyush, have extended their continuous support throughout this study by sacrificing their claims on my time. I extend my love and affection to them from the bottom of my heart and thank them for their kind gestures.

I am thankful to P G Sections, DMS staff and co-researchers for their kind co-operation and encouragement. I especially thank Alok Dixit and Ravinder Arora from the core of my heart for their continuous motivation and brotherly support throughout my research work right from the course work. I express my gratitude to the IIT system for this great opportunity of learning.

Date: December 14, 2009

(Gireesh Chandra Tripathi)

## ABSTRACT

In a developing country like India, housing is a major economic issue. Funds for housing are in short supply while its demand is continuously rising. As a result there has been an acute shortage of dwelling units. Specialized Housing Finance Institutions (HFIs) have been created to ease the problem, but they are also constrained by shortage of funds. Thus there is a need for evolution of new ways for continuous fund generation. Securitization of home loans is one such method, through which capital market funds can be channelized to housing through instruments termed as Residential Mortgage-Backed Security (RMBS).

The first RMBS instrument in India came to existence in 2000, when National Housing Bank (NHB) securitized a pool of housing loans originated by Housing Development Finance Corporation (HDFC) Limited. However, RMBS market could not develop due to absence of necessary financial infrastructure. As a result, only a handful of pools are securitized so far and only Pass Through Certificates (PTCs) are being transacted through the private placement route. This prompted the researcher to undertake the present study towards development of a ready to use model for pricing of securitized instruments.

The scope of study is limited to 13 NHB pools, data of which was collected for the period between June 2000 and September 2008. Since the pools commenced on different dates, the data set represents an unbalanced panel with 13 cross sections. Questionnaire survey has been conducted to evaluate stakeholders' perception on risk premiums. The cash-flows are estimated based on prepayment, default and prepayment penalty variables. These cash-flows are discounted by the required rates

and summed up to generate the equilibrium price. It has been illustrated with the help of a test pool with similar characteristics as the running pools.

Important findings of are that the prepayment is autoregressive and indifferent to the current level of interest rate. Prepayments ensure that the actual maturity period of the pools is only 65% of the scheduled maturity period. Yield on Government of India Bonds with 10-year maturity is favored as a proxy for the risk free rate and also has been found to follow ARIMA model with reasonable accuracy. The risk premium for PTC-A and PTC-B has been perceived to be 250 and 370 basis points respectively.

*Keywords: Residential Mortgage Backed Securities; Prepayment Models; Securitized Instruments; Pricing; Interest Rate Risk.*

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