Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

RATING REPORT

House Building Finance Company Limited (HBFCL)

REPORT DATE:
June 28, 2016

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A	A-2
Rating Outlook	Negative		Positive	
Rating Date	*June 28, '16*		*June 30, '15*	

COMPANY INFORMATION

Incorporated in 2006	**External auditors:** M/s Riaz Ahmed & Co (2014)
Unlisted Public Limited Company	**Chairman of the Board**: Mr. Saeed Ahmed
Key Shareholders (with stake 5% or more):	**Chief Executive Officer**: Mr. Pervez Said
Government of Pakistan – 62.5%	
State Bank of Pakistan – 37.5%	

APPLICABLE METHODOLOGY(IES)

Rating Criteria: Government Supported Entities *http://jcrvis.com.pk/images/gse.pdf*

House Building Finance Company Limited (HBFCL)

OVERVIEW OF THE INSTITUTION

Incorporated in 2006 as an unlisted public limited company, House Building Finance Company Limited (HBFCL) provisions finances to the lower income group.

RATING RATIONALE

House Building Finance Company Limited (HBFCL) is owned by the Government of Pakistan (GoP) directly and through State Bank of Pakistan (SBP). HBFCL provides financing for construction, renovation and purchase of residential properties especially to the lower income strata. The company operates through 50 branches spread throughout Pakistan.

During 2015, the Board of Directors became competent with appointment of directors. Post reconstitution, financial statements for 2011-2014 were approved during the year.

Rating Drivers

- **Sponsor support:** Although ratings of HBFCL account for the sponsor support enjoined upon the institution with GoP as its parent, the company's financial profile has shown deterioration on a stand-alone basis.
- **Financial Restructuring:** In July 2014, HBFCL obtained approval from SBP for a prospective debt-equity swap which entailed conversion of borrowings from SBP and relevant accrued interest into ordinary shares amounting Rs. 11.2b and Rs. 2.1b respectively. However, the terms were revised in April 2016; as per the new instructions preference shares (redeemable in 10 years and offering a return of 7.5% per annum semi annually) would be issued against the debt totaling Rs. 11.2b in lieu of the previously planned ordinary shares. Furthermore, accrued interest to the tune of Rs. 4.1b will be converted into ordinary shares. Issuance of preference shares instead of ordinary shares imposes an additional claim on company's constrained income. Although approved by SBP, the execution of proposed restructuring is subject to approval from Ministry of Finance, an application has been filled for the same.
- **Advances:** On the back of enhanced efforts to accelerate lending, Gross Advances increased to Rs. 15.0b (2014: Rs. 13.1b) in 2015. The portfolio was concentrated in Southern region with Karachi garnering over one-fourth of advances. Currently, HBFCL has only one active scheme in its portfolio titled Ghar Asan Flexi Scheme (GAF), accounting for approximately 58% of total advances.
  As of December 2015, Non Performing Loans (NPLs) declined by around 16% to Rs. 4.8b (2014: Rs. 5.7b) attributable to higher recovery and subsequent reclassification of debtors as active. However, infection for the active portfolio has not shown any improvement. Un-provided for NPLs stood at Rs. 2.1b (2014: Rs. 3.1b) which may lead to future economic losses.
- **Key position recruitment:** Since the management was not able to attract quality Human Resource (HR), the management resorted to appoint key executives on two years secondment from United Bank Limited (UBL) and Habib Bank Limited (HBL). Opting for this high cost alternative will further augment already proportionately higher administrative costs. Management has made efforts to address gaps in the senior management team. In 2016, positions of Chief Financial Officer, Chief Internal Auditor, Chief Information Officer, Head of HR and Head of Risk & Credit have been filled.
- **Profitability:** HBFCL posted a loss of Rs. 529.7m (2014: Rs. 152.2m) for 2015 largely driven by substantial administrative costs. Furthermore, comprehensive loss was aggravated to Rs. 1.2b (2014: Rs. 0.3b) owing to pension fund obligations which pose a significant drain on future earnings. Since the organization is overstaffed with a major proportion of employees heading to retirement age, these costs are expected to increase going forward. Additionally, hiring executives on secondment from private banking institutions and offering premiums would further draw the earnings down.
- **Capitalization:** The company's net equity depleted to Rs. 952m (2014: Rs. 2.2b) as at end 2015 on account of comprehensive losses which included re-measurement pertaining to defined benefit pension plan. Moreover, the company falls short of minimum capital requirement by over Rs. 5b; the management expects to bridge the gap through financial restructuring. However, in face of increasing obligations stemming from issuance of preference shares and hiring resources, even materialization of the company's plans to meet the shortfall would not suffice.

Outlook

Given the MCR shortfall, the restricted portfolio with stagnancy in underwriting quality further exerts downward pressure on company's performance. Although management endeavors to revamp the company's operations, resolution of financial restructuring is paramount from ratings perspective.

House Building Finance Company Limited (HBFCL) Appendix I

FINANCIAL SUMMARY				*(amounts in PKR billions)*
BALANCE SHEET	**DEC 31, 2015***	**DEC 31, 2014-R**	**DEC 31, 2014**	**DEC 31, 2013**
Total Investments	7.7	9.2	9.2	10.5
Net Advances	12.3	10.4	10.5	9.7
Total Assets	22.5	21.4	21.6	21.8
Borrowings	11.2	11.2	11.2	11.4
Deposits & other accounts	-	-	-	-
Subordinated Loans	-	-	-	-
Tier-1 Equity	1.0	2.2	4.0	2.8
Net Worth	1.0	2.2	4.1	2.8
INCOME STATEMENT	**DEC 31, 2015**	**DEC 31, 2014-R**	**DEC 31, 2014**	**DEC 31, 2013**
Net Mark-up Income	1.5	1.6	2.2	1.7
Net Provisioning / (Reversal)	0.03	(0.2)	(0.2)	(0.5)
Non-Markup Income	0.1	0.1	0.05	0.05
Operating Expenses	2.0	1.5	1.4	1.3
Profit (Loss) Before Tax	(0.5)	0.3	0.9	0.5
Profit (Loss) After Tax	(0.5)	0.2	0.9	0.5
RATIO ANALYSIS	**DEC 31, 2015**	**DEC 31, 2014-R**	**DEC 31, 2014**	**DEC 31, 2013**
Gross Infection (%)	31.9%	43.8%	36.8%	51.3%
Provisioning Coverage (%)	57.2%	46.6%	52.1%	42.8%
Net Infection (%)	17.8%	30.3%	22.1%	37.9%
Cost of borrowings (%)	9.5%	9.5%	4.7%	9.6%
Net NPLs to Tier-1 Capital (%)	503.2%	258.1%	57.5%	129.7%
Capital Adequacy Ratio (C.A.R (%))	5.5%	18.7%	26.3%	26.9%
Markup Spreads (%)	3.3%	3.7%	8.6%	4.5%
Efficiency (%)	78.3%	56.5%	66.3%	78.8%
ROAA (%)	-2.4%	0.7%	4.2%	2.2%
ROAE (%)	-33.3%	6.0%	26.6%	18.5%
Liquid Assets to Liabilities (%)	35.5%	36.5%	54.3%	56.6%

**Financial statements for 2015 have not been audited*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	**Appendix III**
Name of Rated Entity	House Building Finance Company Limited (HBFCL)
Sector	Development Finance Institution (DFI)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
28-Jun-16	A-	A-2	Negative	Downgraded
30-Jun-15	A	A-2	Positive	Maintained
12-Jun-14	A	A-2	Rating Watch - Developing	Reaffirmed on Rating Watch
06-Jul-12	A	A-2	Rating Watch - Developing	Reaffirmed on Rating Watch
14-Jun-11	A	A-2	Rating Watch - Developing	Reaffirmed
21-Jul-10	A	A-2	Rating Watch - Developing	Initial

Instrument Structure	N/A
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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House Building Finance Company Limited (HBFCL) Appendix IV

Table 1: Risk Management Committee (Management Level)

Name	Status
Mian Asif Said	C
Zaigham Mahmood Rizvi	M
Tasneem Ahmed Siddiqui	M
Parvez Said	O
Syed Khalid Mohiuddin	S

Table 2: Management Committee (Management Level)

Name	Status
Parvez Said	C
Sayef Hussain	S
Minhaj A. Qureshi	M
Tahir Siddiqui	M
Yousuf Nasir	M
Aadil Saleh	M

Key: C=Chairman, S=Secretary, O=Observer, M=Member