RATING REPORT

House Building Finance Company Limited (HBFCL)

REPORT DATE:
May 18, 2018

RATING ANALYSTS:

Talha Iqbal
talha.iqbal@jcrvis.com.pk

Ibad Desmukh
ibad.deshmukh@jcrvis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Date	*May 14, '18*		*June 23, '17*	

COMPANY INFORMATION

Incorporated in 2006	**External auditors:** Deloitte Yousuf Adil Chartered Accountants
Unlisted Public Limited Company	**Chairman of the Board**: Mr. Mansur-Ur-Rehman Khan
Key Shareholders (with stake 5% or more):	**Managing Director**: Syed Basit Aly
State Bank of Pakistan – 90.3%	
Government of Pakistan – 9.7%	

APPLICABLE METHODOLOGY(IES)

Rating Criteria: Government Supported Entities (June 2016)
http://jcrvis.com.pk/docs/Meth-GSEs201606.pdf

House Building Finance Company Limited (HBFCL)

OVERVIEW OF THE INSTITUTION

HBFCL was incorporated in 2006 as an unlisted public limited company with a mandate to provide financing to middle and lower income groups for construction, renovation and purchase of properties.

Profile of Chairman

Mr. Mansur-Ur-Rehman Khan is a central banker having served the State Bank of Pakistan in various capacities for over 41 years. He left Deputy Governorship of SBP in 2009 on his appointment as Banking Mohtasib; a post he held for three years. Mr. Khan holds a Master's degree in Mathematics, a degree in Law and Professional qualification of DAIBP. Previously, he has served on the boards of HBFCL, Small Business Finance Corporation and Pak Kuwait Investment Company.

Profile of Managing Director

Syed Basit Aly has over 20 years of work experience. He joined civil service of Pakistan as an Assistant Commissioner in 1995. He held various field assignments in Baluchistan and later served in Ministry of Finance, GOP before joining the State Bank of Pakistan in 2003. He was director Infrastructure, Housing & SME Finance Department of State Bank of Pakistan prior to joining House Building Finance Company Limited. He holds a Bachelor's degree in Electrical Engineering from UET Lahore and a Master's degree in Development Economics from Williams College, Massachusetts, USA.

RATING RATIONALE

In 2006, House Building Finance Company Limited (HBFCL) was incorporated as an unlisted public limited company. HBFCL is primarily owned by State Bank of Pakistan with direct holding of 90.3% and indirect stake of 9.7% through Government of Pakistan. The company operates through a network of 50 branches and 3 regional offices across the country.

Board Profile

Board of Directors (BoD) was reconstituted in 2017 and comprises 8 members. Mr. Mansur-Ur-Rehman Khan was appointed as Chairman in place of Mian Asif Said who retains membership of the Board. Barring Managing Director (MD), all directors are non-executive in nature. All board level committees were also reconstituted during the BoD meeting held on March 28, 2018.

Rating Drivers

Strong sponsor profile

The assigned ratings factor in sovereign ownership and in the outgoing year, demonstrated support of GoP in the form of capital restructuring.

Management working on resolving HR issues

Senior management includes individuals hired on deputation or secondment/contractual basis. In October 2017, Syed Basit Aly was appointed as MD on deputation by SBP for three years to replace Mr. Saeed Khan, who had assumed the acting charge in May 2017. Given expiration of contractual terms, resignations and exercise of Voluntary Severance Scheme (VSS) by senior management members, turnover was witnessed during the period under review with positions of Head of Business, Head of Compliance, Head of Information Technology (IT), Head of Credit and Head of Recovery being currently vacant. Currently, internal staff has been given these positions. Total number of employees on permanent and contractual basis decreased to 455 (2016: 621) and 8 (2016: 47) respectively at end-2017. Thus, a human resources constraint exists at both the operational and management level. In this regard, the company is working to fill gaps in senior management, revising policies, revamping performance evaluation procedures, regularizing third-party employees and directly hiring lower grade employees. A new organogram has also been approved by the board during ongoing year. Going forward, stability of management is considered crucial for implementation of business strategy, ensuring consistency in governance and in turn, ensuring that business growth is complemented by sound underwriting guidelines and management of risks in line with institution's loss absorption capacity.

Control infrastructure depicts room for improvement

All loan applications are filled at branches. Subsequently, these applications are sent to head office where they are approved by a management level credit committee. However, around half of the policies have not been updated for over 5 years. Moreover, while a loan application scoring mechanism is in place, it has not been completely implemented. Thus, HBFCL's risk management, control and compliance framework, including support required from IT, will also need to be enhanced.

Lending activity remains subdued due to staff turnover while a new recovery plan has been implemented

Ghar Aasan Flexi Scheme remains the only active product of the company. Gross advances decreased by 6.4% to Rs. 14.49b (2016: Rs. 15.5b) in 2017. On net basis, advances stood at Rs. 11.4b (2016: Rs. 11.8b) at end-2017. Total disbursements were reported at Rs. 1.2b (2016: Rs. 3.1b) vis-à-vis target of Rs. 2b in 2017. Pace of lending remained subdued on account of staff turnover. In 1Q2018, HBFCL achieved disbursements of Rs. 417m against full-year target of Rs. 2.74b. Management expects disbursements to pick up pace following restructuring and resolution of staffing issues.

Asset quality indicators of HBFCL remain weak. Gross and net infection ratios have increased to 44.7% (2016: 42.3%) and 28.9% (2016: 23.2%) respectively. Provisioning coverage stands at 51.8% (2016: 61.0%) as at end-2017. Total recoveries in 2017 amounted to Rs. 2.4b vis-à-vis target of Rs. 3.7b. During 1Q2018, NPLs were reduced by Rs. 303m against quarterly reduction target of Rs. 195m. Full-year NPL reduction target for new schemes is Rs. 1.6b. Gross infection ratio during 1Q2018 has also been reduced from 45.81% to 44.11%. The recovery department has been merged with legal function to the extent of customer related litigation. Recovery staff has been inducted on contractual basis to ensure adequate resources are in place. A recovery incentive plan has also been implemented which entails performance-based rewards. Management expects these initiatives to aid in achieving higher recoveries over the coming years.

Business strategy has been realigned

HBFCL has developed a new business plan aimed at growth in volumes while remaining focused on meeting housing finance needs of modest and low-income groups. Instead of relying only on walk-in customers, the company is now providing bulk financing to institutions. This comprises two areas: financing of low cost housing projects and funding to government employees. Ongoing initiatives include projects in Faisalabad, Peshawar and provision of house financing to employees of Khyber Pakhtunkhwa government. The marketing plan has been revamped with introduction of new channels such as web marketing, mobile banking, smart branches, branch relocation and development of alliances with non-competing institutions. With significant unmet housing demand in Pakistan, improved financial risk profile and a revamped business plan, the team will have the necessary platform to pursue growth.

Profitability has improved post debt-equity swap with absence of interest cost and lower administrative expenses

Post debt-equity swap in 2017, the company posted a positive bottom line for the first time in three years with earnings of Rs. 1.6b (2016: Loss of Rs. 842.9m; 2015: Loss of Rs. 852.0m). Major chunk of mark-up income continued to be derived from advances (2017: Rs. 1.8b; 2016: Rs. 2.1b), followed by investment in securities (2017: Rs. 433.3m; 2016: Rs. 490.9m). Moreover, the company booked reversal against NPLs amounting to Rs. 655.5m. Further support to profitability resulted from 42.1% decline in administrative expenses to Rs. 1.0b (2016: Rs. 1.8b; 2015: Rs. 1.7b), as a result, efficiency ratio improved to 40.0% (2016: 97.0%; 2015: 113.7%). However, with hiring & promotion of senior management staff, regularization of third party employees, direct hiring of lower grade employees, administrative expenses are expected to rise. Future direction of earnings will be a function of quantum of disbursements and credit quality of the same, recovery from non-performing portfolio and level of administrative expenses.

Strong capitalization and liquidity profile post capital restructuring

With total equity of Rs. 14.3b, the company stands comfortably above the regulatory Minimum Capital Requirement (MCR) of Rs. 6.0b at end-2017. Around three-fourth of the asset base has been funded through equity as at end-December'2017. As a result, capitalization indicators of the company remain strong while liquidity profile is also comfortable with liquid assets amounting to Rs. 8.2b (2016: Rs. 8.1b; 2015: Rs. 7.9b) as at end-2017. Net NPL to Tier 1 Equity ratio stands at 22.1% (2016: -144.2%) as at end-2017. Deficit on the company's pension fund continues to be sizeable at Rs. 2.4b (2016: Rs. 2.8b; 2015: Rs. 2.9b) as at December 31, 2017.

Profile of Board of Directors Annexure A

Mr. Mansur-Ur-Rehman Khan – Chairman
Mr. Mansur-Ur-Rehman Khan is a central banker having served the State Bank of Pakistan in various capacities for over 41 years. He left Deputy Governorship of SBP in 2009 on his appointment as Banking Mohtasib; a post he held for three years. Mr. Khan holds a Master's degree in Mathematics, a degree in Law and Professional qualification of DAIBP. Previously, he has served on the boards of HBFCL, Small Business Finance Corporation and Pak Kuwait Investment Company.

Syed Basit Aly – Executive Director
Syed Basit Aly the Director HBFCL Board has taken over the charge of MD/CEO, House Building Finance Company Limited (HBFCL) as on Tuesday the 31st October, 2017. Mr. Basit Aly has over 20 years of well diversified work experience. He joined civil service of Pakistan as an Assistant Commissioner in 1995. He held various field assignments in Baluchistan and later served in Ministry of Finance, GOP before joining the State Bank of Pakistan in 2003. He was director Infrastructure, Housing & SME Finance Department of State Bank of Pakistan prior to joining House Building Finance Company Limited. He holds a bachelor's degree in electrical engineering from UET Lahore and a master's degree in development economics from Williams College, Massachusetts, USA.

Syed Muhammad Shabbar Zaidi – Non-Executive Director
He is a certified Chartered Accountant and has vast experience in various high level positions such as Caretaker Minister for Finance Board of Revenue & Excise and Taxation Government of Sindh, Member- Developing Nations Committee International Federation of Accountant (IFAC) New York USA, Federal Government Task Force - Reform of Tax Administration, Central Audit Committee - State Bank of Pakistan, Member Council - Institute of Chartered Accountants of Pakistan, Founder Director Pakistan - Institute of Corporate Governance, President-South Asian Federation of Accountants of Pakistan (SAFA). Mr. Zaidi has extensive interactions with regulatory authorities on domestic and international levels.

Mian Asif Said – Non-Executive Director
He holds a Master's Degree in Economics from Islamabad University and MBA Degree (Finance & Accounting) from Cornell University, New York. He has 42 years of extensive exposure and experience in Banking, Textile and Dairy Industries. During his professional carrier he served as Group Head Wholesale Banking Silk Bank Limited, CEO-Haleeb Foods Limited Lahore, Chairman & CEO- Cornell Consultants, Chairman &CEO - National Development Finance Corporation (NDFC),Chairman- Industrial Development Bank of Pakistan (IDBP), Managing Director- Haleeb Foods Limited Lahore, Senior Executive Vice President-Habib Bank Limited, Managing Director-Gulf Textiles Company Limited UAE, Managing Director-Gulf Denim Limited UAE, Vice President- Citi-Bank N A Corporate Banking & Treasury UAE, Resident Vice President- CitiBank N A Corporate Banking Pakistan and Egypt, and Assistant Accountant General Punjab & Assistant Director - WAPDA Audit.

Mr. Azhar I. Kureishi – Non-Executive Director
Mr. Kureshi holds three Degrees, MBA from University of Louisville, Kentucky, USA; Post Graduate Diploma from Institute of Business Administration, Karachi & Bachelors in Science from University of Punjab, Lahore. He also has Banking Diplomas from Institute of Bankers, UK and Institute of Bankers, Pakistan. He has 33 years of banking experience with the last 16 years being served at the State Bank of Pakistan. He retired as Executive Director, Operations Group, SBP in January 2014. Prior to that he served as Director General, Financial Monitoring Unit , MOF / SBP (2007-2010); Executive Director, Development Finance Group (2006-2007); Director, Exchange policy Department (2003-2006); Director, Exchange Policy Department & Acting Director, Banking Inspection Department SBP. Before joining the State Bank, he served as Group VP of Prime Commercial Bank Limited, Karachi. He also served in commercial banks such as BCCI, Habib Bank Limited and Muslim Commercial Bank Limited in various capacities.

Mr. Arfa Waheed Malik – Non-Executive Director
Mr. Malik holds Master's Degree in Economics from Government College, Lahore. A retired Banker with 32 years of experience he at present is a Senior Partner in Financial Solutions Consulting (FSC) Integrated Services (Pvt) Ltd a consultancy extending Financial and HR services to the Banking and corporate entities of the country. In 2014 Mr. Malik became a Rating Committee Member (non-executive) of Pakistan's Credit Rating Agency (PACRA) country's premium rating agency. Arfa Malik was associated with Bank Al-Falah from 1998 to 2013 where he was part of the core team responsible for progression and transformation of the bank from a 3 branch bank to 5th largest commercial bank of the country. He last served Bank Al-Falah as Group Head – Corporate and Investment Banking Group. At BAL the last Commercial Bank he served he was a member of Key Management Committees of the Bank, such as Central Management Committee (2004-2012), Human Resource Management Committee (2004-2010), Asset & Liabilities Management Committee (2005-2012) & Central Credit Committee (2007-2012). Arfa Malik is a MTO of 8th batch trained by BCCI training academy, and served in the Middle East in the international cadre of Bank of Credit & Commerce International (BCCI) in the initial years of his career.

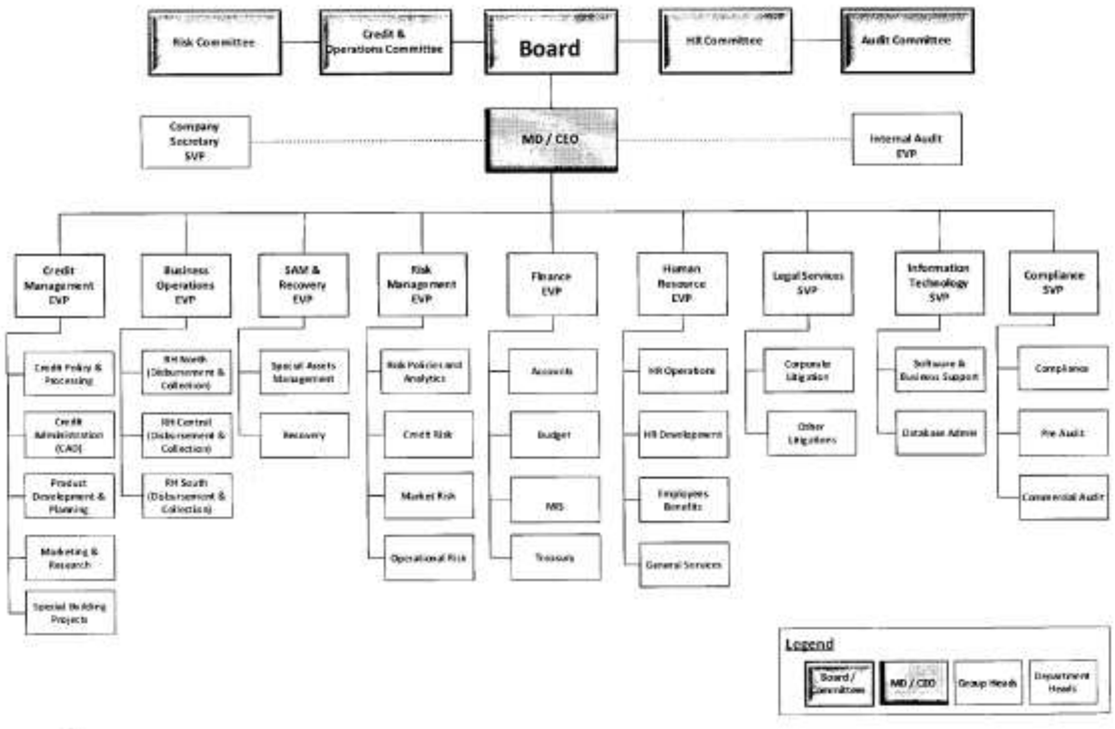
Mr. Ali Mehdi – Non-Executive Director
Mr. Ali Mehdi holds an MSC Finance from the London School of Economics and Political Sciences, in addition to an MBA from LUMS, Lahore University of Management Sciences. He also qualified for the CSS, Central Superior Services of Pakistan and left at his own accord to pursue a career in Finance. He has held strategic leadership roles in Dubai, London, Geneva and Zurich with key

global financial institutions. He was SVP/Director Barclays Capital, Middle East Africa and Turkey MENAT, Vice President ABN-AMRO Bank, Global South Asia and Resident Vice President Citibank. He runs an advisory practice in strategy and corporate finance.

Mr. Munir Ahmed – Non-Executive Director

Mr. Munir Ahmed - Director HBFCL Board / CSP Officer has a Master's Degree in Zoology. Presently he is serving as Joint Secretary (Litigation) in the Finance Division. During his career, he has served in various government institutions as Deputy Secretary Prime Minister's Secretariat, Director - Intellectual Property Organization of Pakistan, Deputy Secretary Finance Division, Section Officer-Finance Division/Ministry of Commerce, Probationary Officer, and Lecturer at Government College Jhang.

Organogram **Annexure B**



House Building Finance Company Limited (HBFCL) — Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Total Investments	6489.5	6,841.0	7,730.0
Net Advances	11,449.4	11,816.9	11,512.9
Total Assets	20,330.1	20,906.5	20,682.5
Borrowings	-	-	11,242.3
Total Liabilities	5,301.0	6,587.4	21,437.2
Net Worth	15,029.1	14,319.0	(754.8)
INCOME STATEMENT	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Net Mark-up Income	2,268.6	1,538.8	1,441.8
Net Provisioning / (Reversal)	586.9	862.8	523.5
Non-Markup Income	185.3	281.2	61.6
Administrative Expenses	1,017.8	1,758.1	1,703.5
Profit (Loss) Before Tax	2,013.9	(835.9)	(728.7)
Profit (Loss) After Tax	1,620.1	(866.0)	(852.0)
RATIO ANALYSIS	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Gross Infection (%)	44.7%	42.3%	33.3%
Provisioning Coverage (%)	51.8%	61.0%	66.0%
Net Infection (%)	28.9%	23.2%	15.6%
Cost of borrowings (%)	-	9.5%	9.5%
Net NPLs to Tier-1 Capital (%)	22.1%	-144.2%	-169.4%
Capital Adequacy Ratio (C.A.R (%))	130.47%	-18.86%	-6.4%
Markup Spreads (%)	13.6%	5.5%	4.7%
Efficiency (%)	40.0%	97.0%	113.7%
ROAA (%)	7.9%	-4.2%	-4.1%
ROAE (%)	11.0%	-12.8%	-403.1%
Liquid Assets to Liabilities (%)	153.8%	127.4%	36.5%

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				
14-May-18	A	A-1	Stable	Reaffirmed
23-Jun-17	A	A-1	Stable	Upgraded
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.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, JCR-VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. JCR-VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Contents may be used by news media with credit to JCR-VIS.