RATING REPORT

House Building Finance Company (HBFC)

REPORT DATE:
May 21, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A	A-1
Rating Outlook	Positive		Stable	
Rating Action	Maintain		Reaffirm	
Rating Date	*May 13, '19*		*May 14, '18*	

COMPANY INFORMATION

Incorporated in 2006	**External auditors:** Deloitte Yousuf Adil Co. Chartered Accountants
Unlisted Public Limited Company	**Chairman of the Board**: 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://www.vis.com.pk/kc-meth.aspx

House Building Finance Company (HBFC)

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 HBFC, 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. 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

House Building Finance Company (HBFC) was incorporated in 2006 as an unlisted public limited company. HBFC is primarily owned by State Bank of Pakistan (SBP) with direct holding of 90.3% and indirect stake of 9.7% through Government of Pakistan (GoP). The company provides financing facilities for construction, renovation and purchase of houses through a network of 51 branches and 3 regional offices across the country.

In February 2019, the company signed master finance agreement with Pakistan Mortgage and Refinance Company (PMRC). Under this agreement, PMRC will provide long-term fixed rate funding of up to Rs. 3.6b to HBFC for providing home loans. The markup is repayable annually while principal is payable in bullet form over period of 20 years.

Key Rating Drivers:

Sovereign ownership reflects strong sponsor profile.
The assigned ratings derive strength from ownership structure of the company with entire shareholding vested with GoP. Capital restructuring in the form of additional equity injection to retire outstanding debt has demonstrated sovereign support to the company in the past.

Senior management vacancies have been filled. Performance monitoring system has been implemented while hiring of resources is planned in the ongoing year.
Senior management includes individuals hired on deputation or secondment/contractual basis. Following turnover in 2017 at both operational and management, in 2018, vacancies were filled at senior level positions of Head of Business, Head of Compliance, Head of Information Technology (IT) and Head of Credit as detailed below.

- Mr. Tariq Rehman was appointed as Head of Human Resource.
- Mr. Faisal Murad was appointed as Head of Business & Operations, and was given additional charge of Credit Management.
- Khawaja Ehrar ul Hassan was appointed as Head of Compliance and Risk Management.
- Mr. Ayaz Ahmed was appointed as Head of Information Technology.
- Mr. Malik Zasir Ayyaz was appointed as Head of Legal.

The company added 41 employees taking the total staff strength to 499 (2017: 458; 2016: 670) as at end-December 2018. Going forward, hiring of 20 management trainee officers and 40 junior officers (on permanent basis) and 50 middle management & senior level resources (on contractual basis) is planned by end of ongoing year. As a result, number of employees will increase to 608. In order to improve productivity, a performance management system has recently been implemented. In addition to this, training programs and recovery incentive programs have been established. Implementation of these initiatives has complimented business growth and higher recoveries. Continued stability of management, along with consistency and continuity of human resource policies is considered important for future business viability and effective corporate governance.

With implementation of loan application scoring mechanism, automated loan management system and revamp of information technology infrastructure, risk management and controls have improved.
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. Since last review, a manual loan application scoring mechanism has been completely implemented. During ongoing year, HBFCL plans to migrate to an automated loan management system. Moreover, due diligence procedures for existing third party agencies, as well as selecting prospective agencies (for purposes such as clients' income estimation and

real estate valuation) have been strengthened. Lastly, the management has planned to conduct training sessions for operational staff to manage and gauge loan applications better.

In order to increase operational efficiency, HBFC has embarked on an information technology (IT) transformation initiative. As part of this project, a Chief Digital Officer has been hired to head the IT department. The function has been reorganized to include divisions addressing digital operations, products, infrastructure, information security, governance, database management, project management, network connectivity and system acquisition. Compliance with implemented risk management & control frameworks and impact of the same on portfolio quality is considered important and will be evaluated over time.

Disbursements have depicted growth although overall portfolio growth remains stagnant on account of sizeable recoveries. Strengthening of human resources, enhancement in credit administration and launch of new products can augment disbursements.

Apart from 'Ghar Aasan Flexi' scheme which was the only active product till end-2018, the company launched a new scheme called 'Ghar Pakistan' in 2019. This is a fixed rate (12%) mortgage product with tenor of 20 years. The maximum loan size has increased to Rs. 2.5m. Other planned product launches include housing finance schemes for sharia compliant segment, working women, young professionals as well as high net worth customers. Gross advances decreased to Rs.14.8b (2017: Rs. 14.9) in 2018. On net basis, advances stood at Rs. 11.6b (2017: Rs. 11.5b) at end-2018. With resolution of staffing issues and completion of disbursement process restructuring, total disbursements increased by 66% to Rs. 2.0b (2017: Rs. 1.2b) vis-à-vis target of Rs. 2.7b in 2018, although overall portfolio growth remained stagnant on account of sizeable recoveries. Going forward, HBFCL is geared to augment its disbursements to Rs. 3.1b by end-2019. Management expects new product launches and recent organizational restructuring to aid achieving business growth targets.

Asset quality indicators have depicted improvement. Gross and net infection ratios decreased to 31.8% (2017: 44.5%) and 14.9% (2017: 28.8%) in the outgoing year. With a largely stagnant financing portfolio, reduction in infection is attributed to lower quantum of non-performing loans (NPLs). As at end-2018, total NPLs were reported lower at Rs. 4.7b (2017: Rs. 6.7b). Of this reduction, Rs. 870m was contributed by cash recoveries while remaining Rs. 1.13b decrease is attributed to regularization of NPLs. Total recoveries amounted to Rs. 3.9b in 2018 vis-à-vis target of Rs. 4.3b. For 2019, management has set recovery target of Rs. 3.8b.

Profitability has weakened on account of stagnant markup income vis-à-vis higher administrative expenses.

In 2018, the company reported lower profit after tax of Rs. 1.0b (2017: Rs. 1.6b). Major chunk of mark-up income continued to be derived from advances, followed by investment in securities. Moreover, the company booked reversal against NPLs amounting to Rs. 348.0m (2017: Rs. 655.5m). Nevertheless, overall profitability declined on account of a sizeable 42.7% increase in administrative expenses to Rs. 1.4b (2017: Rs. 1.0b), as a result, efficiency ratio weakened to 45% (2016: 40.0%). Major contributor to rise in expenses was Rs. 266.6m increase in charge for defined benefit plan to Rs. 337.5m (2017: Rs. 70.9m). As per management projections, defined benefit plan is expected to remain around current levels over the coming years. However, with additional hiring planned in 2019, administrative expenses are projected to increase. Moreover, the company will record markup expense due to utilization of funding line from PMRC. 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.

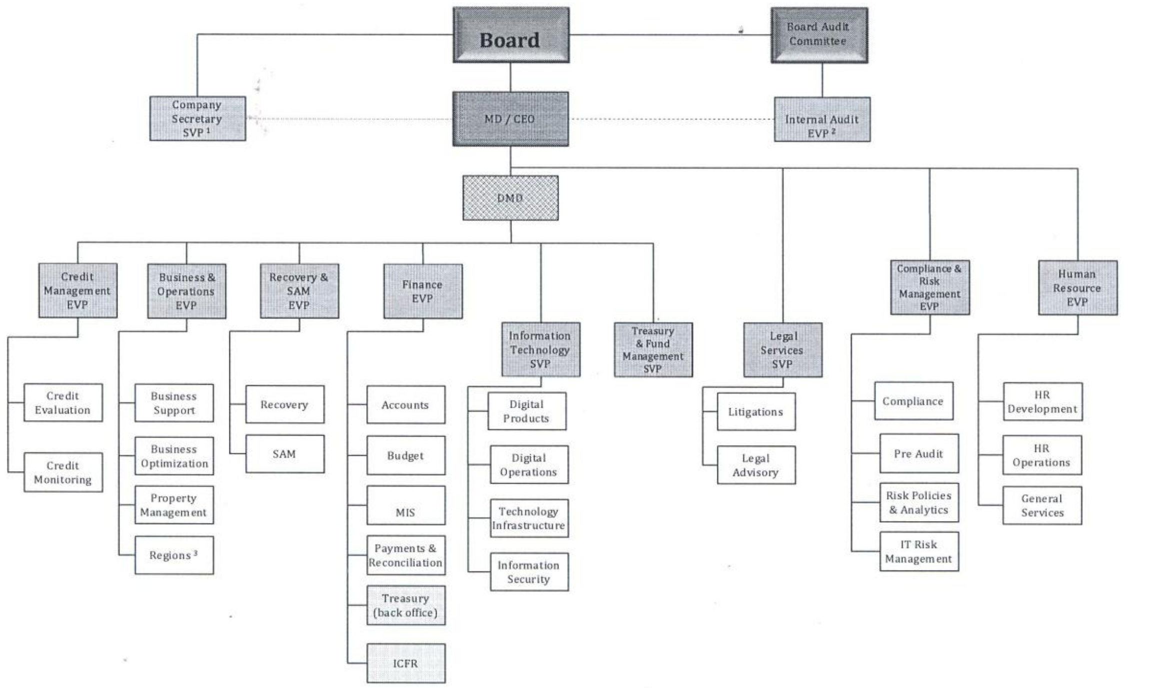
Capitalization indicators have remained robust while liquidity is expected to further strengthen on the back of additional funding line.

The overall asset mix of the company witnessed a major shift in which composition of lending to financial institutions in the form of reverse repo increased to 20% in 2018 vis-à-vis 4% in 2017. The company undertook exposures in short maturity instruments due to rising interest rates however investments in T-Bills were cut down as reverse repo instruments offered better markup rates. As a result, composition of investments in the asset mix reduced to 19% in 2018 from 32% in 2017. In contrast, advances continued to dominate the overall asset mix during 2018.

More than 80% of the asset base is funded through equity which has resulted in strong capitalization indicators for the company. Net NPL to Tier 1 Equity stood at 10.4% during 2018 vis-à-vis 19.9% in 2017 exhibiting further improvement on account of reduction in NPLs. Investment in short maturity reverse repos and T-Bills has continued to provide solid liquidity support. However liquidity profile of the company is further strengthened by the induction of a funding line from PMRC.

Organogram

Annexure A



Board's Committees

- Credit/Operations and Procurement Committee
- Risk Management, Compliance & Corporate Governance Committee
- Audit Committee
- IT Committee
- HR & Nomination Committee

Legend

Board/ Committee | MD / CEO | DMD | Group Head | Department Head | Unit Head

Note

1. Company Secretary functionally reports to the Board.
2. Group Head – Internal Audit functionally reports to BAC.
3. South Region, Central Region, North Region

House Building Finance Company Limited (HBFCL) Appendix I

FINANCIAL SUMMARY		*(amounts in PKR millions)*
BALANCE SHEET	**DEC 31, 2017 (Restated)**	**DEC 31, 2018**
Total Investments	6,489.5	4,010.4
Lending to Financial Institutions	851.5	4,206.9
Net Advances	11,512.3	11,681.1
Total Assets	20,330.1	20,877.8
Borrowings	-	-
Total Liabilities	3,616.6	3,972.6
Tier 1 Equity	15,026.4	16,924.5
INCOME STATEMENT	**DEC 31, 2017 (Restated)**	**DEC 31, 2018**
Net Mark-up Income	2,281.9	2,241.4
Net Provisioning / (Reversal)	(678.3)	(348.1)
Non-Markup Income	177.2	147.8
Administrative Expenses	984.6	1,404.3
Profit (Loss) Before Tax	2,019.1	1,254.5
Profit (Loss) After Tax	1,625.3	1,041.2
RATIO ANALYSIS	**DEC 31, 2017 (Restated)**	**DEC 31, 2018**
Gross Infection (%)	44.5%	31.8%
Provisioning Coverage (including general prov.) (%)	51.8%	65.7%
Net Infection (%)	28.8%	14.9%
Net NPLs to Tier-1 Equity (%)	22.1%	10.4%
Capital Adequacy Ratio (C.A.R (%))	130.47%	143.36%
Efficiency (%)	40.0%	58.7%
ROAA (%)	8.0%	4.9%
ROAE (%)	9.7%	6.1%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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 (HBFC)
Sector	Development Finance Institution (DFI)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	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	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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
13-May-19	A	A-1	Positive	Maintained
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