RATING REPORT

House Building Finance Company Limited (HBFCL)

REPORT DATE:
June 28, 2021

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	Stable		Stable	
Rating Date	*June 28, '21*		*June 12, '20*	

COMPANY INFORMATION

Incorporated in 2006	**External auditors:** Grant Thornton Anjum Rahman
Unlisted Public Limited Company	**Chairman of the Board**: Board not functional
Key Shareholders (with stake 5% or more):	**Managing Director/CEO**: Mr. Imran Ahad
State Bank of Pakistan – 90.3%	
Government of Pakistan – 9.7%	

APPLICABLE METHODOLOGY(IES)

Rating Criteria: Government Supported Entities (June 2016)
http://vis.com.pk/kc-meth.aspx

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 for housing purposes.

Profile of Chairman

N/A

Profile of Managing Director

Mr. Imran Ahad is a seasoned banker with vast experience of working in senior leadership roles in many countries across the Middle East as well as in Pakistan. He has been associated with some of the leading international banks throughout the span of his career, including BCCI, Standard Chartered Bank and NIB Bank where he held various senior level positions. He has recently moved back to Pakistan from the UAE to take up this assignment.

RATING RATIONALE

The ratings assigned to House Building Finance Company Limited (HBFCL) take into account its strong sponsor profile with the institution being entirely owned by the Government of Pakistan (GoP) directly and indirectly through State Bank of Pakistan (SBP). Over the years, implicit support from the sponsor on the financial front has been evidenced. Given the demographics of the target market, the institution opted for a portfolio consolidation strategy and a conservative approach towards disbursements amid challenging economic conditions and uncertainty posed by pandemic. The ratings reflect improvement in asset quality marked by reduction in non-performing loans coupled with higher subjective provisioning charged during the review period. The ratings derive strength from sizable investment portfolio entailing negligible credit risk, sound liquidity profile and minimal reliance on borrowings. In addition, the ratings take comfort from strong capitalization indicators reflected from one of the highest capital adequacy ratios in the industry; the same demonstrates significant loss absorption capacity coupled with ample room for growth. The ratings factor in improvement in profitability indicators; the same is a function of change in loan pricing strategy, which now pertains to floating pricing regime as opposed to fixed pricing in previous years. It is expected that with Board of Directors becoming functional in the near term, strategic level goal-setting can be achieved.

Key Rating Drivers:

Advances portfolio of the institution remained at prior year's level owing to cut in disbursements as the economic environment was not conducive for lending amid ongoing pandemic: Gross portfolio of HBFCL exhibited a declining trend although the same was recorded largely at previous year's level at Rs. 15.0b (FY19: Rs. 15.2b) at end-FY20; the same was an outcome of discrepancy in principal recovery and disbursements. Lower disbursements made by the institution at Rs. 1.8b (FY19: Rs. Rs. 2.8b) along with sizable recoveries amounting of Rs. 4.2b (FY19: Rs. 2.9b) translated into reduced net portfolio of Rs. 11.2b (FY19: Rs. 11.7b) at end-FY20. Given the repayment capacity of middle income households was adversely impacted in line with prevailing unfavorable economic landscape amid pandemic crisis, the management decided to restrict lending and focus more towards portfolio consolidation. The same was an active maneuver towards curtailing incremental infection in an already vulnerable portfolio. Stemming from the same uncertainty HBFCL did not introduce any new product during the review period. Ghar Asaan Flexi Scheme remains the flagship product as it constitutes the highest proportion of gross advances portfolio at 53% (FY19: 64%); however, the proportion and total loan size of the product declined to Rs. 7.7b (FY19: Rs. 9.4b) at end-FY20 given funding under the product line has been shelved. Owing to slight stabilization of economic situation coupled with successful rollout of vaccine, disbursement target of Rs. 4.0b has been set for FY21 against which Rs. 950.0m has been rolled out till May'21 while another Rs. 310.0m has been approved. The highest disbursements till May'21 have been made under Ghar Pakistan and Ghar Pakistan Plus schemes amounting to Rs. 250.0m and Rs. 192.0m respectively; the trend has been in sync with disbursement made in the outgoing year. The management is hopeful in achieving the target set for FY21 given relaxations by the government for house financing, any local citizen with a valid national identity number and not owning a house can procure debt under Mera Pakistan- Mera Ghar scheme, have enhanced affordability for middle class. Gross portfolio of HBFCL remained stable at Rs. 15.0b with slight growth manifested in net advances to Rs. 11.3b at end-1QFY21. Going forward, the management is going to increase its focus on alternate delivery channels and corporate business development; the efficacy of the same will be ascertained over time.

Asset quality indicators exhibited improvement on a timeline basis; provisioning coverage also increased: Asset quality indicators exhibited improvement during the period under review as a combined outcome of lower quantum of non-performing loans (NPLs) coupled with higher provisioning charge, therefore net infection ratio declined to 4.8% (FY20: 4.2%; FY19: 7.4%) by end-1QFY21. The higher provisioning expense was driven by progression of npls to successive loss categories, entailing higher charge as per prudential regulations, along with subjective provisioning done by the management to present a transparent picture of advances book. As a result, provisioning coverage was recorded higher at 85.7% (FY20: 88.2%; FY19: Rs. 78.4%) during 1QFY21. On the other hand, only slight improvement was evident in gross infection owing to reduction in npl quantum being lower than incremental provisioning booked along with reduction in gross loan portfolio. Since FY18, the institution has re-strategized its business plan and decided to provide bulk financing to institutions for its employees instead of relying only on walk-in customers. Resultantly, the infection in new disbursements post FY18 has been recorded lower at 4.0% (FY17: 46%); moreover, 2.6% default rate was recorded on disbursement of outgoing year and 0% on current year's. In that aspect, the institution is on the road of recovery, albeit slow, with stringent checks and vigilant monitoring of asset quality. No write-offs have were recorded till date and none are expected to be made during the rating horizon, therefore the institution will continue to keep its fully provided infected portfolio on its books.

As per the regulatory relief of one year extension on repayment provided by the central bank to dampen the impact of COVID-19, the institution reported deferred portfolio amounting to Rs. 122.4m at end-FY20; the same represents only around 1% of the performing advances and is one of the lowest in the industry. Out of the deferred portfolio, comprising of 1,181 accounts, portfolio worth Rs. 102.0m is already regular as the institution did allow extension up to six months and not for a year. Hence, probability of infection cases spurring from aforementioned roll over portfolio is negligible therefore there is no added stress on asset quality going forward. Further as per the management, HBFCL plans on renewing the golden exit scheme during the ongoing year where customers can retrieve their property documents by having settlement plans with haircuts on amount due; the same is likely to improve recovery of provided portfolio coupled with positively impacting the bottom line.

Credit risk emanating from investment portfolio is negligible as in the local context as almost the entire portfolio is vested in sovereign securities during the review period. Further, market risk is also considered manageable given short-term nature of securities.

Profitability indicators improved on account of higher return on its advances portfolio; efficiency levels also improved during the outgoing year: Despite decline in average benchmark rates during the period under review, higher return on advances portfolio owing to disbursements in products entailing higher markup rate, pegged with Kibor, along with non-continuation of products under fixed rate regime translated into slightly improved profitability profile. However, the same is not getting reflected in the absolute number of bottom line for the outgoing year on account of one-off event incurred in FY19 involving sizable tax asset of Rs. 1.8b in line with timing differential on provision of employee related expenses and non-performing advances. The higher core income generation amounting to Rs. 3.4b (FY19: Rs. 3.0b) along with rationalization of operating expenses in respect to scale of operations resulted in improvement of efficiency ratio to 49.0% (FY19: 54.2%) during FY20. Efficiency ratio was not hampered with the one-off event as taxation expense is not part of operating expenses of the institution.

The return on credit portfolio improved to Rs. 2.2b (FY19: Rs. 1.8b) on account of differential in rates of historical and fresh disbursements. On the other hand despite quantum increase in average investment portfolio, the return on investments largely remained at prior year's level, albeit slight increase evident, of Rs. 1.1b (FY20: 1.0b) due to significant slash in policy rate during the outgoing year. The institution expensed financing cost of Rs. 198.3m (FY19: Rs. 137.5m) primarily on account of higher average utilization of funding line from Pakistan Mortgage Refinance Company; HBFCL has fully utilized this fund amounting Rs. 3b. Further, the institution booked fresh provisioning of Rs. 304.0m (FY20: Rs. 368.6m) against its NPLs. The non-markup income was recorded at Rs. 135.5m (FY19: Rs. 130.1m) largely pertaining to premium refund from insurance company and rental income. Subsequently, profit before tax was recorded higher at Rs. 1.4b (FY19: Rs. 953.7m) during FY20.

The institution reported lower net markup income of Rs. 620.0m during 1QFY21 as opposed to Rs. 791.2m in the corresponding period last year owing to reduction in benchmark interest rates; however, the same has picked up pace post first quarter. On the other hand, the bottom line improved to Rs. 266.4m (FY19: 204.9m) during 1QFY21 primarily as a function of reversal of provisioning amounting to Rs. 144.3m booked as compared to provisioning expense of Rs. 100.0m incurred in 1QFY20. Future direction of earnings will be a function of quantum and credit quality of disbursements coupled with recovery from non-performing portfolio and maintenance of operating expenses at around current levels.

Capitalization indicators have remained robust while liquidity strengthened on account of higher investment portfolio: Paid-up capital of the institution remained unchanged and was sizable at Rs. 19.4b at end-1QFY21. Further, Tier-I equity augmented to Rs. 21.1b (FY20: Rs. 20.9b; FY19: Rs. 20.1b) by end-1QFY21 in line with internal capital generation. By end-1QFY21, the accumulated loss of the institution reduced to Rs. 250.5m; (FY20: Rs463.6m; FY19: Rs.1.0b) with recovery of operations and curtailment of npls. The Capital Adequacy Ratio (CAR) remains strong at 140.9% (FY19: 133.4%); comfortably above the minimum regulatory requirement and exhibiting significant room for growth. With lower NPLs outstanding and higher specific provisioning charge coupled with higher equity base , net NPLs to Tier 1 Equity improved to 2.6% (FY20: 2.3%; FY19: 4.3%) at end-1QFY21. Given liquidity avenues of the institution include significant exposure in T-bills and PIBs, liquid assets as a proportion of total liabilities remained sizable; the same depicted an increasing trend improving to 218.0% (FY20: 202.7%; FY19: 208.7 %.) at end-1QFY21.

Board is non-functional; management depicted stability: The senior management has exhibited stability over the rating horizon; the same is considered crucial for steering the institution in a positive direction and maintaining future business viability. Mr. Imran Ahad replaced Syed Basit Aly during the period under review after completion of the latter's three year term. Mr. Ahad is a seasoned banker with vast experience of working in senior leadership roles in many countries across the Middle East and in Pakistan. He has been associated with some of the leading international banks throughout the span of his career, including BCCI, Standard Chartered Bank and NIB Bank. He has recently moved back to Pakistan from the UAE to take up this assignment. Other the aforementioned, there was no change at senior positions; moreover, no key position is currently vacant. Given the emergence of pandemic the recent, the management has put the hiring plans on hold. On the other hand, the Board is currently nonfunctional and is expected to be re-elected in the next two months. In order to improve productivity, HBFCL implemented a performance management system along with conducting training programs and recovery incentive programs. For risk assessment, credit scorecard model has been initiated for all new disbursements with vigorous checks on customer history, cash flow analyses and credit repayment capacity.

House Building Finance Company Limited (HBFCL) Appendix I

FINANCIAL SUMMARY					*(amounts in PKR millions)*
BALANCE SHEET	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Total Investments	6,489.5	4,010.4	10,283.8	10,414.2	11,083.5
Net Advances	11,512.3	11,681.1	11,707.2	11,177.5	11,283.4
Total Assets	20,330.1	20,877.8	25,201.8	26,802.3	26,478.2
Borrowings	-	-	2,000.0	2,960.0	2,945.1
Total Liabilities	3,616.6	3,972.6	5,093.8	5,904.4	5,317.4
Paid up Capital	19,365.0	19,365.0	19,365.0	19,365.0	19,365.0
Tier 1 Equity	16,711.3	16,926.1	20,115.8	20,906.5	21,172.9
INCOME STATEMENT	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Net Mark-up Income	2,281.9	2,241.4	2,850.3	3,249.5	620.0
Net (Provisioning) / Reversal	678.9	348.1	(368.6)	304.0	(144.3)
Non-Markup Income	177.2	147.9	130.8	135.9	16.3
Administrative Expenses	984.6	1,404.0	1,618.4	1657.5	394.8
Profit (Loss) Before Tax	2,019.1	1,254.5	953.7	1389.6	377.5
Profit (Loss) After Tax	1,625.3	1,042.2	2,762.0	1028.6	266.4
RATIO ANALYSIS	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Gross Infection (%)	44.7%	31.8%	27.8%	27.0%	27.3%
Provisioning Coverage (%)	51.8%	62.4%	78.4%	88.2%	85.7%
Net Infection (%)	28.9%	14.9%	7.4%	4.2%	4.8%
Cost of borrowings (%)	-	-	8.5%	7.7%	-
Net NPLs to Tier-1 Capital (%)	22.1%	10.4%	4.3%	2.3%	2.6%
Capital Adequacy Ratio (C.A.R (%))	130.5%	143.5%	133.4%	140.9%	-
Efficiency (%)	40.0%	45.9%	54.2%	49.0%	62.0%
ROAA (%)	7.9%	5.0%	12.0%	4.0%	4.0%
ROAE (%)	11.0%	6.0%	14.9%	5.0%	5.1%
Liquid Assets to Liabilities (%)	153.8%	218.0%	208.7%	202.7%	218.0%

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 Limited (HBFCL)
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, 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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	(see table below)

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
28-Jun-21	A	A-1	Stable	Reaffirmed
12-Jun-20	A	A-1	Stable	Maintained
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

Due Diligence Meetings Conducted

	Name	Designation	Meeting Date
1	Mr. Ashraf Ali Velji	Chief Financial Officer	June 11, 2021
2	Mr. Faisal Murad	Group Head Business Operations	June 11, 2021
3	Mr. Ehrar Khawaja	Head of Risk	June 11, 2021
4	Mr. Khalid Mohiuddin	VP Finance	June 11, 2021