# RATING REPORT

## Pakistan Mortgage Refinance Company Limited

**REPORT DATE:**
May 7, 2019

**RATING ANALYSTS:**
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| RATING DETAILS | | |
|---|---|---|
| | Initial Rating | |
| **Rating Category** | **Long-term** | **Short-term** |
| **Entity** | AAA | A-1+ |
| **Rating Outlook** | Stable | |
| ***Rating Date*** | *7th May 2019* | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 2015** | **External auditors:** KPMG Taseer Hadi & Co Chartered Accountants |
| **Public Unlisted Company** | **Chairman of the Board:** Rehmat Ali Hasnie |
| **Key Shareholders (with stake 5% or more):** | **Chief Executive Officer/Managing Director:** Mudassir H. Khan |
| Private & Public Sector Institutions – 67.2% | |
| Government of Pakistan – 32.8% | |
| **Aggregate Public Sector Shareholding – 49%** | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **Applicable Rating Criteria: Government Supported Entities (June 2016)**<br>http://www.vis.com.pk/kc-meth.aspx |

# Pakistan Mortgage Refinance Company Limited

## OVERVIEW OF THE INSTITUTION

Pakistan Mortgage Refinance Company Limited (PMRC) operates as a non-depository Development Finance Institution under State Bank of Pakistan (SBP) regulations. Additionally, Securities & Exchange Commission of Pakistan (SECP) oversees PMRC's capital market operations.

**Profile of Chairman**

Mr. Rehmat Ali Hasnie serves as Group Head - Investment Banking Group and Senior Executive Vice President at National Bank of Pakistan (NBP). He possesses over 20 years of financial markets experience in Pakistan along with over 5 years' experience of leading NBP's Investment Banking & Project Finance business. Mr. Hasnie also chairs the boards of Agritech Limited, First Credit and Investment Bank Limited and First National Bank Modaraba.

**Profile of CEO/Managing Director**

Mr. Mudassir H. Khan is the MD/CEO of Pakistan Mortgage Refinance Company. With over 28 years of diversified banking experience primarily covering Retail, Corporate & Investment Banking, Operations, Risk and Development Banking. Before joining PMRC, Mr. Khan worked with National Bank of Pakistan for four years as SEVP/Group Chief Retail & Commercial Banking and as Group Chief Payments & Digital Banking. Prior to that, he was with HBL for nine years, holding different portfolios as SEVP Group Head Global Operations, CIO, CCO and Head of Basel and Operational Risk. He also

## RATING RATIONALE

**Corporate Profile:** Pakistan Mortgage Refinance Company Limited (PMRC) was established by State Bank of Pakistan (SBP) in 2015 as Pakistan's first national mortgage refinance institution for provision of long-term funding to both conventional and Islamic Primary Mortgage Lenders (PMLs). PMRC was granted Business Commencement Certificate by SBP on June 12, 2018. Shareholding structure of the company depicts that around 67.21% stake is vested with 9 PMLs including private & public sector institutions while remaining interest is held by Government of Pakistan (GoP) through Ministry of Finance (MoF). Aggregate public sector shareholding is 49%.

**Government and Regulatory Support:** The assigned ratings are underpinned by PMRC's special policy role in promoting and facilitating home ownership & housing finance in the country and close linkages with SBP and GoP. Strong government and regulatory support to PMRC is evident from relaxation in meeting minimum equity requirement, foreign currency risk on World Bank loan being borne by GoP, low risk charge of 10% for PMRC on exposure to PMLs and investors for investment in PMRC bonds, inclusion of PMRC bonds in level 2A high quality liquid assets and exemption from maintenance of general reserve against portfolio refinanced by PMRC.

**Pakistani Mortgage Industry:** Pakistan is the 7th largest country by population with more than 60% of the population being less than 25 years of age. The housing gap in Pakistan is currently estimated at 10-12 million units with demand growing at a rate of 0.7 million units every year. Mortgage market in the country has grown at around 30% and 16% during 2017 and 2018, respectively. However, Pakistan's mortgage to GDP ratio at 0.2% is well below 3.4% in South Asia. While pace of growth in mortgage finance is projected to slow-down given the sharp rise in benchmark rates, low mortgage finance penetration along with significant and growing deficit of housing units in the country should facilitate in increasing housing financing in the country. PMRC is targeting to increase its market share in outstanding mortgage portfolio to over 15% by 2022 from ~5% currently.

**Product Mix & Refinancing Portfolio:** PMRC will provide refinancing through both Conventional and Islamic refinancing loans. Focus of PMRC would be on disbursing financing through Islamic mode which over the long-term will constitute majority of the refinancing portfolio. Recently, PMRC concluded its first Islamic financing transaction through a disbursement of Rs. 1billion to an Islamic PML. In order to reduce cash flow shocks and lower incidents of defaults, management plans to promote fixed rate mortgages. However, product portfolio also includes a mix of products to cater to varying market conditions. PMRC also envisages undertaking programme based lending for middle and low income groups (1st disbursement to low income group was undertaken in 1Q2019). Broad parameters, eligibility criteria and pricing for the same have been developed and documented. During the first six month of operations, PMRC has disbursed Rs. 6.2 billion in financing with gross refinancing portfolio targeted at Rs. 18.6b by end-2021.

**Credit & Market Risk:** PMRC has implemented a sound credit risk management strategy which entails financing with recourse to PMLs, existence of collection account mechanism for receivables collected by PML in respect of each refinance loan and 25% overcollateralization on Mortgage Loan Portfolio (MLP). Ratings also acknowledge presence of regular monitoring & review procedures for both, PML and MLP along with clear provisions in the refinance agreement with respect to default by PML. Credit risk emanating from the investment portfolio is expected to be on the lower side as exposure is planned to undertaken only in instruments with high credit rating. Effective implementation of credit risk management strategy will be an important rating driver, going forward. Exposure to market risk is planned to be maintained on the lower side worked with the World Bank for more than fourteen years in the area of Financial Sector and Private Sector Development, South Asia Region, based in Pakistan and also worked in Afghanistan, Bangladesh, Nepal, Maldives; as well as in the Africa Region in Ghana, Uganda, Kenya and Sierra Leone. Before joining the World Bank, he worked in the field of Corporate and Investment Banking with Citibank, N.A and Bear Stearns in Pakistan and in USA.

with modified duration of the portfolio (including all financial assets & liabilities) capped at around 3 months as per policy. Sensitivity of ratings to credit and market risk while being present is considered low.

**Liquidity & Funding:** PMRC has received a subordinated loan of $58m at 3% with World Bank (WB) via GOP (fixed). The loan has a 30 year term with 5 years grace on Principal repayment. The foreign exchange risk on this loan is carried by GoP. WB will disburse an aggregate amount of $140m to PMRC over the rating horizon. In order to mitigate liquidity risk, stringent maturity matching of bonds and loans to customer is planned. Given that fixed-rate refinancing is projected to represent majority of the portfolio, PMRC's ability to access the capital market for fixed-rate funding in a cost-effective manner would be an important ratings consideration. While funding strategy entails close matching of the duration and maturity of assets and liabilities, liquidity buffer of PMRC projected to be satisfactory over the rating horizon, in terms of liquid assets available to meet unexpected shortfalls in cash flows.

**Capitalization:** Paid-up capital and net equity stood at Rs. 3.658b and Rs. 3.81b, respectively at end-March'2019. As per regulatory requirement, PMRC is allowed to operate with a minimum equity requirement of Rs. 3.5b for the first 5 year of operations subject to restriction on dividend payout. Resultantly, equity base is projected to grow over the next three years on the back of profit retention. With increase in refinancing portfolio, risk weighted assets are projected to grow but only at a limited pace given the low risk weight on financing extended to PMLs. Ratings incorporate projected Capital adequacy ratio of PMRC which will remain comfortably above statutory requirement over the rating horizon.

**Profitability:** Profitability will be driven by healthy spreads over the short-term (given availability of WB loan at concessionary rate) with volumetric growth projected to support profitability as spreads decline with raising of funds through market based borrowings. While remaining within manageable levels, operating expenses will increase as the company scales up its operations with general & administrative expenses representing the largest proportion of cost base.

**Board & Senior Management:** Board of Directors comprises senior bankers representing PMLs and a senior official from MoF. The institution has an adequate governance framework with board level committees set up for audit, human resources and risk management. Management team comprises seasoned professionals having experience in the financial services industry.

**Policy Framework & Internal Controls:** Policy framework of PMRC is considered satisfactory with board approved policies in place for key areas including risk management. In line with regulations, separate departments for internal audit and compliance have been set up. Going forward, the company plans to manage operational risk by establishing and maintaining internal controls & procedures that will be audited regularly.

## Pakistan Mortgage Refinance Company Limited Appendix I

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | |
|---|---|---|---|---|
| **BALANCE SHEET** | **31-Dec-18** | **31-Mar-19** | **31-Dec-19** | **31-Dec-20** |
| **Investments** | 1,010 | 1,992 | 7,580 | 9,863 |
| **Advances** | 1,200 | 5,199 | 4,222 | 10,925 |
| **Total Assets** | 3,750 | 10,926 | 11,901 | 20,885 |
| **Subordinated debt** | - | 7,051 | 7,676 | 9,927 |
| **PMRC Bonds** | | | - | 6,030 |
| **Total Liabilities** | 37 | 7,115 | 7,676 | 15,956 |
| **Net Equity** | 3,713 | 3,811 | 4,225 | 4,929 |
| | | | | |
| **INCOME STATEMENT** | **31-Dec-18** | **31-Mar-19** | **31-Dec-19** | **31-Dec-20** |
| **Net Mark-up Income** | 224 | 148 | 789 | 972 |
| **Operating Expenses** | 167 | 50 | 233 | 254 |
| **Profit (Loss) Before Tax** | 57 | 98 | 556 | 718 |
| **Profit (Loss) After Tax** | 55 | 98 | 545 | 704 |

## RATING SCALE & DEFINITION 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** | Pakistan Mortgage Refinance Company Limited |
| **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** | | | | |
| 7-May-2019 | AAA | A-1+ | Stable | Initial |