The Pakistan Credit Rating Agency Limited

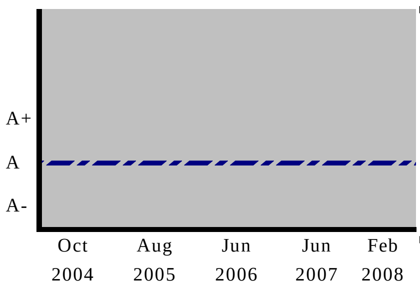
House Building Finance Corporation Limited (HBFC)

RATINGS (FEBRUARY 2008)

HOUSE BUILDING FINANCE CORPORATION LIMITED

	New	Previous
Entity		
Long Term	A	A
Short Term	A1	A1
Sukuk		
PKR 1,500mln	A+	–

LT-RATING HISTORY



FINANCIAL DATA

PKR (mln)

	30-Sep-07*	31-Dec-06
Total Assets	18,606.9	18,335.1
Equity	3,803.0	3,617.4
Net Income	184.7	144.3
Equity /Assets %	20.4	19.7
Liquid Assets/ Borrowings %	36.8	38.4

** based on results for 9 months*

ANALYSTS

Adnan Dilawar
+92 42 5869504
adnan@pacra.com

Shahzad Saleem
+92 42 5869504
shahzad@pacra.com

***SUKUK* ISSUE:** HBFC is issuing a secured privately placed *Sukuk* of PKR 1,500mln. The *Sukuk* proceeds would be utilized for expanding the Corporation's core financial operations. The *Sukuk* issue is for a tenor of 6 years, carrying profit at the rate of 6-months KIBOR plus 100bps, payable semi-annually in arrears. The principal redemption would be in ten equal instalments commencing from the 18th month after the date of issuance. The instrument would be secured by way of a first charge over specific assets (loans) with 25% margin. The underlying collateral would be a portfolio of loans with good payment history. HBFC would ensure that the underlying security structure remains intact through the tenor of the *Sukuk*.

RATING RATIONAL AND KEY DRIVERS

- HBFC's ratings reflect its ownership structure – fully owned by the Government of Pakistan's (GoP) through State Bank of Pakistan (SBP) and Ministry of Finance – and given HBFC's pivotal role in GoP's commitment in expanding the housing stock in the country, the government is likely to continue supporting the Corporation. Meanwhile, the ratings recognize the Corporation's strong equity base signifying high risk absorption capacity, robust underlying security against loans, and high liquidity. The ratings also take into account the recent corporatization of HBFC and ongoing restructuring process of the entity that are expected to bring the requisite level of efficiency in operations.
- Mr. Zaigham Rizvi, recently completed his three-year tenor as the Managing Director of the Corporation. He was instrumental in the turnaround of HBFC and spearheaded the restructuring process. The renewal of his contract, or in case a new MD is appointed, the management's steadfast commitment to the reforms process – including maintaining the recovery momentum and good quality fresh loan disbursements – is crucial for the future viability of the Corporation. HBFC is in negotiations with SBP for re-profiling of its outstanding financing, the outcome of which remains critical for future prospects of the corporation.

ASSESSMENT

- Hitherto the major source of the Corporation's funding was its borrowings from SBP, which were being repaid gradually (total outstanding at end Dec-07: PKR 11.2bln). HBFC, with its current recovery levels and sizeable liquid funds retains adequate capacity to meet these obligations. However, given that the Corporation has limited diversity in its funding base, the repayment of these lines, according to the agreed schedule, would adversely impact the level of fresh disbursements and long-term sustainability of operations. Recognizing the implications, the management has requested SBP for restructuring on favourable terms and consultations are in process. Meanwhile, HBFC has not paid the scheduled instalments to SBP due in Jun 06 and Sep 07 (total PKR 3.2bln). The management is negotiating with SBP to convert these instalments into equity. During 2007, the corportization of HBFC was finalized and it was converted into a limited liability company, named House Building Finance Corporation Limited. All the assets and liabilities of HBFC were transferred to the new company.
- During 3Q07, HBFC made further progress on the path of revival and the management's initiatives of improving the Corporation's performance are now producing tangible results. The disbursements under the *Ghar Aasan* Scheme (GAS) and *Shandar Ghar* Scheme (SGS) have remained strong (disbursements during 3Q2007: PKR 2.2bln 2006: PKR 2.25bln). With increasing level of disbursements under the new schemes and strong recoveries, the proportion of NPLs in the total finances portfolio is showing a declining trend (3QCY07: 41.9% CY06: 43.1%). However, the NPLs ratio, in respect of the previous housing schemes remains high, constituting more than three-fourth of the total outstanding dues in respect of these schemes. Under the recently revised criteria for provisioning against NPLs, HBFC is required to make substantial additional provisions. HBFC is seeking exemption from this and discussions are underway with SBP. In case the Corporation has to make these provisions, it would be a one-time non-cash impact of around PKR 2bln on its equity.
- Under the reforms program, there has been enhanced emphasis on the level of recoveries. HBFC made recoveries of around PKR 2.4bln in 3Q07 (CY06: PKR 3.3bln; CY05: PKR 3bln). On the back of the improving recovery trend due to the management's strong stance and various incentive and settlement packages being offered, it is expected that the Corporation would achieve its yearly recovery target (targeted recovery for 2007: around PKR 3.2bln). The restructuring process and improvements in systems and monitoring are expected to help ensure high recoveries against chronic loans, while ensuring lower infection in new disbursements.
- Going forward, the management is embarking on a multi-prong strategy to improve the Corporation's performance. This includes a) introduction of new products to attract a wider customer base, b) increase HBFC's outreach by establishing more representative offices (increase the existing network to 50 outlets), especially in the semi-urban areas, c) offering insurance products (HBFC has acquired 30% stake in Takaful Pakistan, an Islamic Insurance Corporation), d) financing large housing projects of reputed builders to provide economical residential property to the lower and middle income class, and e) rationalizing the workforce. With the current shortage of housing units in the country, the demand for HBFC's products is expected to remain strong. The management intends to increase its disbursements in the medium-term and above-mentioned initiatives are expected to augur well for the future performance of the Corporation. The Corporation is also pursuing various options for raising further long-term funds including flotation of mortgage backed *Sukuk's* and REITs. HBFC, currently, is benefiting from preferential rate credit lines from SBP. However, aggressive market based funding, if the respective spreads are not managed effectively, could dampen its performance due to high debt servicing requirements.
- During the year, the Corporation issued bonus shares to increase its share capital to PKR 3.5bln, though the matter is pending SBP's approval. However, HBFC would remain dependent on its shareholders to increase its paid-up capital to the SBP's requisite level, as the Corporation would not be able to meet these requirements through internal generation.

PROFILE

- The House Building Finance Corporation (HBFC), established in 1952 under the HBFC Act, was transformed into a limited liability company in 2007. The primary objective of the Corporation is to provide financial facilities for the construction, re-construction, repair and purchase of houses, particularly to the low and middle-income groups of the economy. The GoP and the SBP jointly hold the share capital of the Corporation.
- The general direction and administration of the Corporation and its affairs are vested in the Board of Directors appointed by the GoP. HBFC has a large network of 80 offices spanning across the country, managed through 12 zones with headquarters at Karachi. Meanwhile, for expanding the outreach in a cost effective manner, the management has established more than 25 representative offices in different cities, through appointment of service agents on commission basis. The Corporation employs more than 1300 personnel.
- The bulk of the loan disbursements of HBFC are to low-income groups, and for construction of houses, as against outright purchase and renovation. Under its new mission, the HBFC aims to be the preferred housing bank for Small & Medium Housing (SMH) finance.