CREDIT RATING REPORT

Eastern Caribbean Home Mortgage Bank

CariCRIS
Caribbean Information & Credit Rating Services Limited

June 2017

INSTRUMENT RATED	RATING ASSIGNED	OUTLOOK
USD 30 Million Bond Issue	*Cari***BBB+** (Foreign and Local currency)	Stable

RATING HISTORY			
Date	**Foreign Currency**	**Local Currency**	**Instrument/ Remarks**
June 23, 2017	*Cari***BBB+**	*Cari***BBB+**	USD 30 million Debt Issue
June 14, 2016	*Cari***BBB+**	*Cari***BBB+**	USD 30 million Debt Issue
June 30, 2015	*Cari***BBB+**	*Cari***BBB+**	USD 30 million Debt Issue
June 9, 2014	*Cari***A**	*Cari***A**	USD 30 million Debt Issue
March 31, 2010**	*Cari***AA-**	*Cari***AA-**	USD 30 million Debt Issue
February 11, 2008*	*Cari***AA**	*Cari***AA**	USD 30 million Debt Issue

** Initial rating assigned.*
*** Rating Reaffirmed on March 28, 2011, March 29, 2012 and May 27, 2013*

RATING DRIVERS

Supporting Factors

- Good progress made in the Bank's transition to its new business model
- Improved financial performance supported by declining cost of funds, adequate liquidity and a diversified asset base.
- Adequate risk management and governance structure, guided by updated policies and strong oversight by the Board of Directors

Constraining Factors

- Declining mortgage portfolio continues to impact earnings, though new business model serves to mitigate the impact

Rating Sensitivity Factors

- A drop in investment yields by 100 basis points or greater (downgrade)
- A reduction in interest spreads to 0.5% (downgrade)
- Successful implementation of the new business model (upgrade)

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COMPANY BACKGROUND

Eastern Caribbean Home Mortgage Bank (ECHMB) was created pursuant to the ECHMB Agreement Act (1995) and commenced operations on April 22, 1996. It is a privately managed corporation and the current 65 shareholders are all financial institutions from the Organisation of Eastern Caribbean States (OECS) as well as the wider Caribbean. These financial institutions include the Eastern Caribbean Central Bank (ECCB), commercial banks, social security agencies, insurance companies, mortgage companies, building and loan associations and credit unions. The largest shareholder is the ECCB, which currently holds 24.9% of ECHMB's total shareholding.

ECHMB was established with the primary objective of developing the secondary mortgage market within 8 participating member countries of the OECS, namely Anguilla, Antigua & Barbuda, The Commonwealth of Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and St. Vincent and the Grenadines. The main activity of the Bank has traditionally been the purchase and sale of mortgages so as to develop and maintain a secondary market for residential mortgages in the member territories. In FY2016, following years of deteriorating mortgage market conditions, ECHMB expanded its mandate so as to become more relevant to its changing external environment. Given its considerably increased cash and investment portfolio in relation to its mortgage assets, the Bank, with the support of its Board of Directors, has decided to place more emphasis on the investment side of the business by broadening the range of financial assets in which it can invest and simultaneously widening the permissible jurisdictions for its investments to include the wider Caribbean region and the United States.

RATIONALE

Caribbean Information and Credit Rating Services Limited (CariCRIS), has reaffirmed the ratings of *Cari***BBB+** (Foreign and Local Currency Ratings) on the regional scale to the USD 30 million debt issue of Eastern Caribbean Home Mortgage Bank (ECHMB), with a **stable** outlook. These ratings indicate that the level of creditworthiness of this obligation, adjudged in relation to other obligations in the Caribbean, is **adequate**.

The stable outlook is based on our expectation of continued profitability and no major change in the credit metrics of ECHMB over the next year, as the Bank continues its transition to an expanded and more relevant business model.

The factors supporting the ratings are:

Good progress made in the Bank's transition to its new business model

In our last report (June 2016), CariCRIS detailed the difficult mortgage market conditions in the Eastern Caribbean Currency Union (ECCU), characterised by persistent excess liquidity, high and rising levels of non-performing loans and low loan demand. This in turn resulted in a contraction of ECHMB's traditional purchase of mortgages business, as commercial banks opted out of financing their mortgage portfolio growth through the sale of mortgages to ECHMB. In recognition of the changing industry trend and the material shift in the composition of its interest earning assets and revenue streams (Table 1), ECHMB in FY2016/17 sought and received approval from its Board of Directors (BOD) to restructure its operations and expand its mandate to place more emphasis on the investment side of the business. Over the past year the Bank has made good progress in transiting to its new business model. Under its new mandate ECHMB will not only be authorized to participate in the secondary mortgage market, but will now be able to participate in the money and capital markets of the ECCU. The BOD has also given approval to the Bank to invest in the wider Caribbean and the United States, subject to limits stated in its new Investment Policy Statement (IPS). Previously the Bank was restricted to EC dollar denominated investments, however the new IPS allows ECHMB to invest up to 50% of its portfolio in US $ denominated instruments. ECHMB has started the process of rebalancing and repositioning its existing asset portfolio, in accordance with the requirements of the new IPS (Chart 1). On the funding side, over the last year the Bank issued commercial paper in 2016/17 in order to replace existing funding instruments, improve liquidity and reduce the cost of funding.

Table 1
Allocation of Interest Earning Assets and Income for FY2012/13-FY2016/17

Asset	FY2016/17*		FY2015/16		FY2014/15		FY2013/14		FY2012/13	
	EC $'000	*%*	*EC $'000*	*%*	*EC $'000*	*%*	*EC $'000*	*%*	*EC $'000*	*%*
Mortgages	31,396	13.0	51,807	21.2	78,759	30.6	148,484	45.3	200,459	60.9
Investments	204,157	84.3	149,377	61.1	170,525	66.2	150,936	46.1	73,262	22.2
Cash	6,700	2.8	43,428	17.8	8,231	3.2	28,262	8.6	55,622	16.9
Total Earning Assets[a]	**242,253**	**100**	**244,612**	**100**	**257,515**	**100**	**327,681**	**100**	**329,343**	**100**
Income	**FY2016/17***		**FY2015/16**		**FY2014/15**		**FY2013/14**		**FY2012/13**	
	EC $'000	*%*	*EC $'000*	*%*	*EC $'000*	*%*	*EC $'000*	*%*	*EC $'000*	*%*
Interest Income from Mortgages	3,318	29.8	4,847	39.0	8,648	55.9	14,775	71.4	16,228	66.4
Interest Income from Investments	7,812	70.1	7,530	60.6	6,228	40.3	5,064	24.5	3,142	12.9
Interest Income from Banks	12	0.1	46	0.4	585	3.8	850	4.1	5,066	20.7
Total Interest Income[b]	**11,142**	**100.0**	**12,424**	**100.0**	**15,461**	**100.0**	**20,690**	**100.0**	**24,436**	**100.0**

Source: ECHMB's Financial Spreads

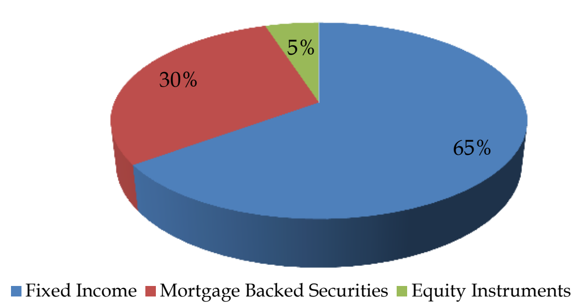
** Financial Year (FY) refers to April 1st to March 31st.*

[a] *Excludes Accounts Receivables and Prepayments, as well as Fixed Assets (net of revaluation)*

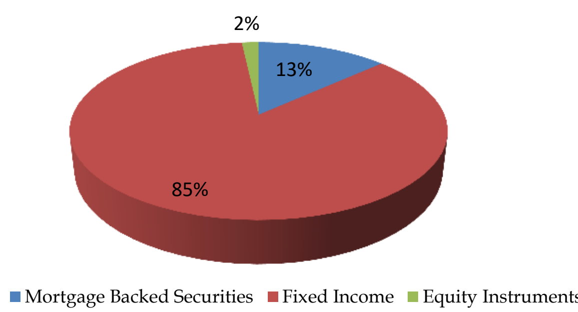
[b] *Includes Interest Income from Banks*

Chart 1
Composition of Interest Earning Asset Portfolio –Targeted vs Actual as at March 2017

Targeted Composition of Interest Earning Assets



Actual Composition of Interest Earning Assets



Source: ECHMB

As part of the organisational restructuring, the investment management function, which was previously held jointly by the Chief Executive Officer (CEO) and the Chief Financial Officer

(CFO), will now be managed by a specialist Investment Officer who was recruited in FY2016/17. During the past year the Bank also hired a Treasury Officer who will focus on Asset Liability Management, an even more critical function now given the new business model.

Many of the changes being made to the structure and operations of ECHMB require amendments to its enabling legislation, the ECHMB Agreement Act of 1995 (The Act). While the legislation does not explicitly guide the Bank's participation in the money and capital markets, Article 4 of the Act (*Purpose of the Bank)* makes provisions for the growth and development of money and capital markets in the OECS region. The Bank has received full Board approval to operate under the new business model while arrangements are being made for these requisite amendments to the Act. In order for the Act to be fully amended, parliamentary approval is required in all eight (8) of the OECS member countries which could take up to three years.

Improved financial performance supported by declining cost of funds, adequate liquidity and a diversified asset base.

ECHMB successfully maintained a 23 year record of profitability in FY2016/17. Further, the Bank recorded a 22.2% increase in profit after tax (PAT) in FY2016/17 following 5 years of contraction (Table 2); the profit outturn in FY2016/17 exceeded CariCRIS' base case projected profit. The improvement in PAT was driven by a 9.8% increase in total income which was positively impacted by an increase in net interest income (NII), up 7.7% to EC $6.4 million from EC $5.9 million previously. The increase in NII was driven by a 26.6% decline in interest expenses to EC $4.8 million which more than offset a 10.3% decline in interest income. Interest income fell primarily due to interest income from mortgages falling by 31.5% to EC $3.3 million from EC $4.8 million in the preceding financial year, precipitated by a 39.4% contraction in the mortgage portfolio to EC $31.4 million as at March 2017. The fall in interest expenses was due largely to the Bank replacing its matured medium term debt with commercial paper and also due to the repayment of a Caribbean Development Bank (CDB) loan facility.

The Bank's liquidity remains adequate as evidenced by a ratio of interest earning assets to interest bearing liabilities of 1.3 times as at March 2017, unchanged from one year earlier; the ratio of total interest earning assets to interest bearing liabilities has averaged 1.3 times for the past 5 years. ECHMB generated cash flows of around EC $2.4 million from operations in FY2016/17 and utilized approximately EC $47.8 million of cash resources in the same period as it sought to expand its investment portfolio in accordance with its new mandate.

Table 2
ECHMB Summary of Financial Performance for FY2012/13–FY2016/17

	FY2016/17* (EC$ '000)	Chg %	FY2015/16 (EC$ '000)	Chg %	FY2014/15 (EC$ '000)	Chg %	FY2013/14 (EC$ '000)	Chg %	FY2012/13 (EC$ '000)	CAGR (%)	5-Year Average (%)
Interest Income from Mortgages	3,318	(31.5)	4,847	(44.0)	8,648	(41.5)	14,775	(9)	16,228	(27.2)	(31.5)
Interest Income from Investments	7,812	3.7	7,530	20.9	6,228	23.0	5,064	61	3,142	20.0	27.2
Interest Income from Banks	12	(73.6)	46	(92.1)	585	(31.3)	850	(83)	5,066	(70.0)	(70.0)
Total Interest Income	**11,142**	**(10.3)**	**12,424**	**(19.6)**	**15,461**	**(25.3)**	**20,690**	**(15.3)**	**24,436**	(14.5)	(17.6)
Interest Expense	(4,790)	(26.6)	(6,524)	(23.9)	(8,570)	(29.3)	(12,122)	(12.3)	(13,822)	(19.1)	(23.0)
Net Interest Income	6,352	7.7	5,900	(14.4)	6,891	(19.6)	8,568	(19.3)	10,614	(9.8)	(11.4)
Total Operating Expenses	(3,461)	0.7	(3,435)	(0.9)	(3,466)	(18.4)	(4,247)	(10.7)	(4,758)	(6.2)	(7.3)
Total Income [a]	6,520	9.8	5,940	(14.2)	6,925	(19.6)	8,609	(19.0)	10,630	(9.3)	(10.8)
PAT	3,060	22.2	2,505	(27.6)	3,459	(20.7)	4,362	(24.3)	5,759	(11.9)	(12.6)
	As at Mar-17 (EC$ '000)	**Chg %**	**As at Mar-16 (EC$ '000)**	**Chg %**	**As at Mar-15 (EC$ '000)**	**Chg %**	**As at Mar-14 (EC$ '000)**		**As at Mar-13 (EC$ '000)**	**CAGR (%)**	**5-Year Average (%)**
Mortgages	31,396	(39.4)	51,807	(34.2)	78,759	(47.0)	148,484	(25.9)	200,459	(31.0)	(36.6)
Investments	204,157	36.7	149,377	(12.4)	170,525	13.0	150,936	106.0	73,262	22.7	35.8
Cash and Cash Equivalents	6,700	(84.6)	43,428	427.6	8,231	(70.9)	28,262	(49.2)	55,622	(34.5)	55.7
Total Assets [b]	244,173	(1.5)	247,811	(3.9)	257,799	(21.4)	327,992	(0.5)	329,696	(5.8)	(6.8)
Total Interest-Bearing Liabilities	184,660	(2.6)	189,553	(5.2)	199,917	(25.8)	269,305	(1.3)	272,783	(7.5)	(8.7)
TNW [b]	59,158	1.8	58,107	0.9	57,609	1.4	56,828	3.0	55,179	1.4	1.8
	FY2016/17 (%)		**FY2015/16 (%)**		**FY2014/15 (%)**		**FY2013/14 (%)**		**2012/13 (%)**	**5-Year Average (%)**	
Funding Costs [c]	2.6		3.4		3.7		4.5		5.1	3.8	
Net Interest Rate Spread	2.0		1.6		1.6		1.8		2.4	1.9	
Cost to Income	53.1		57.8		50.0		49.3		44.8	51.0	
ROA[b]	1.2		1.0		1.2		1.3		1.8	1.3	
ROCE	5.2		4.3		6.0		7.8		NA	5.8	
TNW to Total Assets [b]	24.2		23.4		22.3		17.3		16.7	20.8	
	FY2016/17 (Times)		**FY2015/16 (Times)**		**FY2014/15 (Times)**		**FY2013/14 (Times)**		**FY2012/13(%)**	**5-Year Average (Times)**	
Gearing	3.1		3.3		3.5		4.7		4.9	3.9	

Source: ECHMB's Financial Statements

** FY - Financial Year refers to April 1 to March 31*

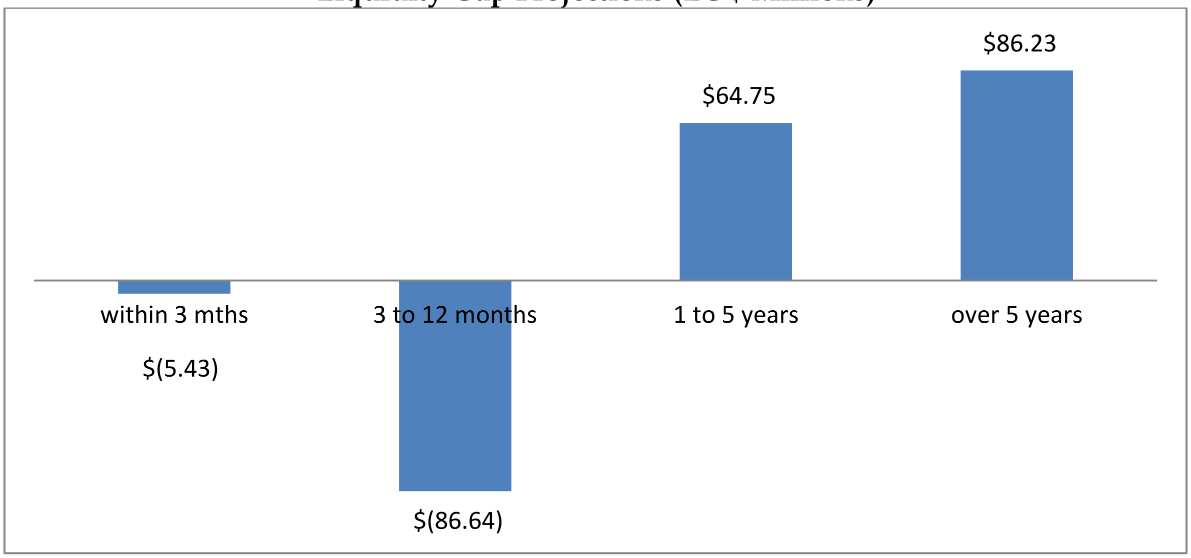
[a] Total Income = (Interest Income - Interest Expense) + Other Income

[b] Total Assets and Tangible Net Worth have been adjusted to exclude Intangible Assets and Revaluation Reserves.

[c] Calculated as Interest Expense/ Average Interest-Bearing Liabilities

Total funding costs fell by 80 basis points (bps) to 2.6% in FY2016/17, consistent with the Bank's objective as matured medium term debt was replaced with lower cost commercial paper with a maximum tenor of 365 days. As a result, consistent with this new funding strategy, the Bank has a significant negative liquidity gap in the 3–12 months maturity bucket (Chart 2). ECHMB has indicated that while the bulk of its debt matures within 3-12 months, the Bank expects to successfully rollover more than 95% of maturing funds when they become due. In April 2017, EC $30 million in matured funds were rolled over for another 12 months and another EC $30 million coming due in June 2017 are also expected to be rolled over for another year. As a liquidity buffer, the Bank also maintains an EC $30 million revolving credit facility with a regional commercial bank.

Chart 2
Liquidity Gap Projections (EC $ Millions)



Source: ECHMB

Capitalization, as measured by the ratio of tangible net worth (TNW) to total assets, improved to 24.2% as at March 2017 from 23.4% one year earlier; TNW/total assets has improved every year for the last 5 years. Leverage also improved to 3.1 times as at March 2017 from 3.3 times one year earlier and has improved every year for the last 5 years on account of the continuous reduction in funding.

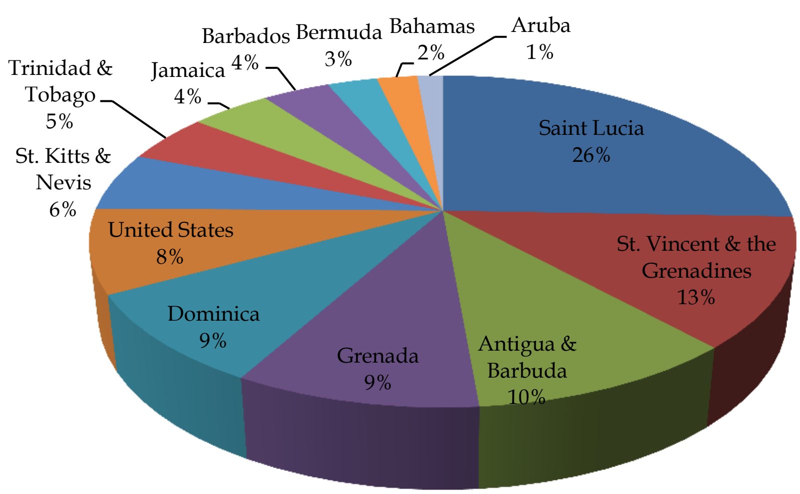
Adequate risk management and governance structure, guided by updated policies and strong oversight by the Board of Directors

ECHMB's operational and risk management systems are guided by its legislative and operational framework. During FY2016/17, ECHMB developed and documented an Enterprise Risk Management (ERM) framework to integrate the risk management policies, structures and systems of its various business lines as well as to better align its risk tolerance with its capital requirements and expected returns. A risk register compiled for all functional areas identifies the owner(s) of each risk event and potential losses resulting, and will be updated on an ongoing basis. The BOD is responsible for the implementation of the ERM framework and for ensuring adequate and timely reporting by management on existing and emerging risks in the Bank.

A new Board-approved IPS seeks to emphasize preservation of capital and as such has biased the investment portfolio towards lower risk fixed income instruments. The policy requires that 80% of the investment portfolio be classified as held to maturity which reduces the impact of price changes on earnings and the balance sheet. The Investment Officer is responsible for updating the IPS and for ensuring that all investment activities are in line with the provisions of the policy, which explicitly identifies the types of investment transactions that ECHMB is permitted to undertake, including the asset class, credit quality and limits of exposure permitted by these classes along with permissible markets and entities. Given the small size of ECHMB, CariCRIS considers the provisions of the new IPS to be sufficient to meet its risk management requirements. The Investment Officer is responsible for identifying viable investments and making written recommendations to the Board for approval. Management currently has the authority to conduct equity trades without Board approval, and this asset class comprises approximately 5% of the targeted asset portfolio. The Bank's BOD continues to provide strategic oversight of all operations through the Executive Committee.

As at March 2017 the Bank's investment portfolio was heavily biased towards the OECS (Chart 3). The Bank's investments in St. Lucia comprised 26% of the portfolio and over 80% of capital, both above their respective 20% limits. These exposures have been approved by the Board as they are seen as transient, and ECHMB expects to be in compliance with its IPS limits in FY2017/18, as new and viable investment opportunities arise.

Chart 3
Investment Portfolio Concentration by Country



Source: ECHMB

ECHMB is in the process of revising its existing policies to better align with the ERM framework and this exercise is expected to be completed in FY2017/18.

The factor constraining the ratings is:

Declining mortgage portfolio continues to impact earnings, though new business model serves to mitigate the impact

Over the past 5 years credit to the private sector in the OECS countries has contracted at an increasing rate from 0.7% in 2012 to 8.9% in 2016. High liquidity and tepid economic growth following the 2008 global financial and economic crisis have underpinned the flagging demand for credit. The low credit demand has resulted in ECHMB's clients, the Primary Lenders, resorting to repurchasing mortgages and not seeking its assistance to provide funding for underwriting new mortgages. As a result, the Bank's mortgage portfolio has contracted by an average of 36.6% per annum over the last 5 years, with interest income from mortgages also falling by 31.5% per annum and by 31.5% to EC $3.3 million from EC $4.8 million in the prior year. The fall in interest income from mortgages has been a tempering factor on NII and total income.

Prospects for a return to portfolio growth remain low in the medium term despite the prevailing low interest rates and increased rate of economic expansion in the OECS. As such, ECHMB will continue to grow its investment portfolio to offset the impact of the contracting mortgage portfolio. Further, the IPS has limited the Bank to a maximum portfolio exposure of 30% to mortgages, which will serve to minimize the impact of changes in the mortgage portfolio on earnings going forward. CariCRIS is of the view that over the next year, full implementation of the Bank's revised policies and procedures as per its new IPS, and the ERM framework would be critical, and we will be following the Bank's progress in these areas closely.

June 23, 2017