CREDIT RATING REPORT

Eastern Caribbean Home Mortgage Bank

CariCRIS
Caribbean Information & Credit Rating Services Limited

June 2018

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 22, 2018	*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 Reaffirmed on June 14 2016, June 23 2017 and June 22 2018.*

RATING DRIVERS

Supporting Factors:

- The Bank's transition into its new business model has resulted in the resumption of growth in its asset base, underpinned by a moderately diversified investment portfolio when compared to the prior years
- Adequate liquidity levels and improving cost of funds
- Healthy financial performance supported by continued growth in income and profitability
- Adequate risk management and governance structure guided by updated policies with oversight by the Board of Directors

Constraining Factor:

- Heightened exposure to financial risks arising from significant exposure to the prevailing economic challenges in the OECS

Rating Sensitivity Factors:

Factors that can lead to an improvement in the ratings:

- Improving business conditions over the next 12 months in the OECS, thereby leading to rising profit margins and sustained earnings growth for ECHMB
- Full implementation of the new business model allowing for further diversity in income streams through the launch of new products
- Further diversification of investment portfolio by asset class as per targets stipulated in the IPS and reduced exposure to the OECS
- Achievement of an average annual portfolio yield of at least 5% over a 3-year period

Factors that can lead to a lowering of the ratings:

- A sustained increase in interest rates by 75 basis points or greater over the next 12 months , thereby leading to a significant tightening of the net interest spread earned on investments and a material decline in profitability
- A material increase in impairment provisioning by EC $1 million or greater arising from the implementation of IFRS 9 which can negatively impact its profitability and capitalization positions

Analytical Contacts:

André Joseph
Tel: 1-868-627-8879 Ext. 227
E-mail: ajoseph@caricris.com

Kathryn Budhooram
Tel: 1-868-627-8879 Ext. 226
E-mail: kbudhooram@caricris.com

Website: www.caricris.com
Email: info@caricris.com

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 from 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[1], 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, 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.

[1] *Financial Year refers to April 1 to March 31.*

RATING RATIONALE

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

CariCRIS has also maintained a **stable** outlook on the ratings. The stable outlook is based on our expectation that ECHMB will continue to display comfortable profitability and capitalization levels over the next 12 months as the Bank fully transitions into its new business model.

The factors supporting the ratings are:

The Bank's transition into its new business model has resulted in the resumption of growth in its asset base, underpinned by a moderately diversified investment portfolio when compared to the prior years

Over the past year, ECHMB made significant strides towards fully transitioning into its new business model following its Board of Directors' (BOD) approval in January 2017 to expand the Bank's mandate[2]. This progress was reflected in the resumption of growth in the Bank's asset base following 5 consecutive years of contraction. In FY2017/18[3], ECHMB recorded a 7.2% rise in its asset base compared to declines of 1.5% and 3.9% in FY2016/17 and FY2015/16 respectively. Growth in assets was mainly on account of a 3.1% (or EC $6.1 million) increase in its investment portfolio coupled with a 14.6% (or EC $5.5 million) rise in its mortgage loans portfolio. The expansion of ECHMB's investment portfolio was primarily driven by additional investments in corporate bonds of approximately EC $58.1 million, the impact of which was tempered by the disposal of term deposits, regional bonds and T-Bills totalling EC $49.8 million[4]. During FY2017/18, the Bank launched a new product called the mortgage pledge

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[2] *ECHMB in January 2017 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. Under its new mandate ECHMB will not only be authorized to participate in the secondary mortgage market, but will now be able to invest in the money and capital markets of the OECS.*

[3] *Financial Year refers to April 1 to March 31.*

[4] *Figures exclude the provision for impairment (EC $4 million) and interest receivable (EC $4.4 million).*

loan[5]. This product contributed to an EC $10.5 million increase in the mortgage loans portfolio, which was somewhat offset by an EC $5 million decline in mortgage backed securities.

ECHMB continued with the process of rebalancing and repositioning its investment portfolio by asset class and geographical allocation, as per its revised Investment Policy Statement (IPS) [6] during FY2017/18 (Tables 1 & 2). The Bank's investment portfolio, which constituted 78% of total assets as at March 31 2018, is considered to be moderately diversified by asset class when compared to the previous years and is moving towards the targets stipulated in its IPS. Though the Bank is currently in breach of some of its target ranges, these exposures have been approved by the BOD as they are seen as transient. CariCRIS expects ECHMB to be in compliance with the revised IPS target limits over the next 2 years as new and viable investment opportunities arise.

Table 1
Composition of Investments by Asset Class – Targeted vs Actual as at March 2016 to 2018

Investment by Asset Class	Target Range of Portfolio	March 2018	March 2017	March 2016
	%			
Corporate Bonds	20-60	41.1	12.5	5.0
Sovereign Bonds & T-Bills	20-30	32.7	35.8	33.5
Term Deposits	5-10	26.2	51.0	61.4
Equities	0-5	0.05	0.6	0.1

Source: ECHMB

The investment portfolio is also considered to be moderately diversified across different countries when compared to prior years and is compliant with its internal maximum country limit of 20% of the total portfolio. Significantly, over the past year the Bank reduced its exposure to the Organisation of Eastern Caribbean States (OECS) to 44.1% from 73% in the prior year. Currency wise, approximately 48.1% of the Bank's investment portfolio consisted of US $ denominated instruments as at March 31, 2018 relative to 19.9% one year earlier, more in line now with the IPS limit of 50%. Foreign currency risk is considered minimal given the EC $ peg to the US $ and there is a natural currency hedge in that US $ investments are backed by US $ funding. Generally, the Bank maintained an average credit rating of *Cari***BBB** for the investment portfolio as at March 2018, consistent with its IPS.

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[5] *The mortgage pledge loan is a loan provided by ECHMB to regulated mortgage-lending institutions in the OECS for the origination of mortgages. The mortgages generated from the funds are not sold to ECHMB; instead, a pool of performing mortgages is pledged as collateral for the loan.*

[6] *The main revision to the IPS during FY2017/18 consisted of changes in the asset class limits for sovereign fixed income instruments to a target range of 20 to 30% of the total investment portfolio from 20 to 60% previously and corporate fixed income instruments to a range of 20 to 60% from 20 to 30% previously.*

Table 2
Investment Portfolio Concentration by Country as at March 2017 and 2018

	Mar-18	Mar-17
Saint Lucia	18.2%	25.6%
United States	15.0%	8.2%
St. Vincent & the Grenadines	9.6%	12.6%
Dominica	8.9%	9.0%
Jamaica	7.2%	4.4%
Bermuda	6.3%	2.7%
Trinidad & Tobago	5.9%	4.7%
Grenada	5.0%	9.5%
United Kingdom	4.1%	-
France	2.8%	-
Bahamas	2.2%	2.2%
Canada	2.1%	-
Antigua & Barbuda	1.9%	10.4%
Australia	1.4%	-
Barbados	1.3%	3.6%
Chile	1.4%	-
Aruba	1.4%	1.4%
Colombia	1.4%	-
Netherlands	1.3%	-
China	1.4%	-
India	0.7%	-
St. Kitts & Nevis	0.6%	5.7%

Source: ECHMB

In line with its strategic plan and consistent with its shift to increase its focus on investment management, ECHMB will seek to formally rebrand itself to 'ECHMB Capital Limited' by September 2018. The Bank plans to increase its product range to include repurchase agreements and wealth management products by 2021. Amendments to its enabling legislation, the ECHMB Agreement Act of 1995 (The Act), have been drafted to reflect the many changes made and proposed to the operations and structure of the Bank since January 2017. Parliamentary approval is required from all eight (8) OECS member countries. Though this process that could take up to three years, it does not prevent the Bank from proceeding with its plans.

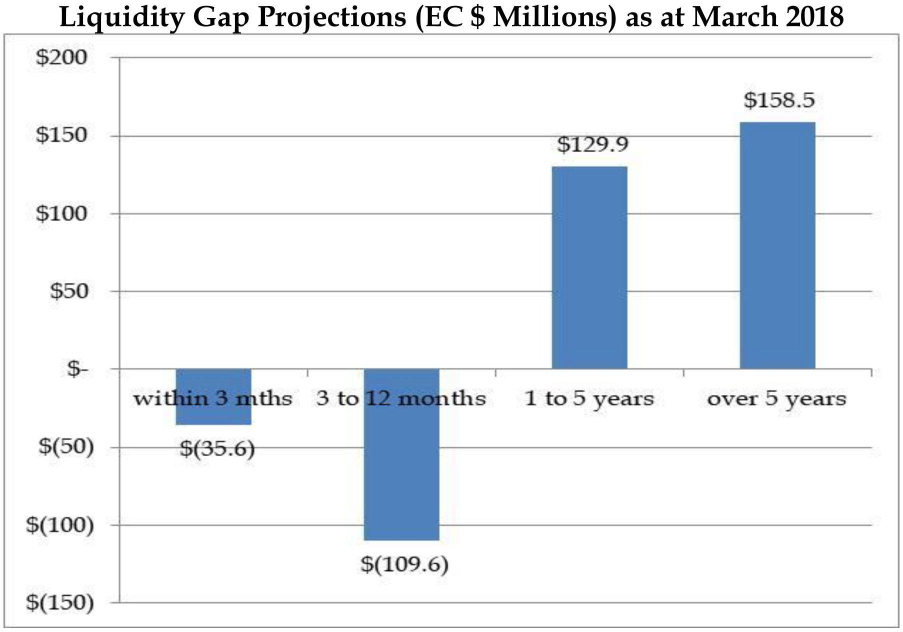
Adequate liquidity levels and improving cost of funds

ECHMB exhibits adequate liquidity evidenced by a healthy ratio of total earning assets to interest-bearing liabilities that stood at 1.3 times as at March 2018, unchanged over the past 3 years. Furthermore, the Bank has maintained relatively good operating cash flows that averaged EC $2.8 million over the FY2013/14 to FY2017/18 period. Funding costs have fallen consistently year-on-year (y-o-y) over the last 5 years to 2.1% in FY2017/18 from a high of 5.4%

in FY2011/12. This improvement in the cost of funds was driven by the Bank replacing its matured medium term debt with lower cost corporate paper with a maximum tenor of 365 days. In keeping with its expanded mandate to develop the Eastern Caribbean capital and money markets, and in an effort to continue to reduce its funding cost, the Bank issued additional 1-year corporate paper during the past year, increasing its debt by EC $15 million to EC $199.1 million as at March 31, 2018.

As a result of this funding strategy, the Bank reported a significant negative liquidity gap in the 3–12 months maturity bucket as at March 2018 (Chart 1). While the bulk of ECHMB's debt comes due within 3-12 months, the Bank expects to successfully rollover more than 95% of maturing funds. With no more than EC $31.2 million maturing in any 1 month during the financial year, the Bank, should it need to, can comfortably utilize its sizeable portfolio of liquid assets which includes cash and cash equivalents as well as short-term marketable securities totalling approximately EC $39.5 million, to meet any shortfall. Furthermore, as a liquidity buffer, the Bank also has 2 revolving credit facilities i.e. 1) A US $ Line of Credit[7] from Raymond James Financial Inc. and 2) An EC $30 million facility with a regional commercial bank. As such, CariCRIS expects ECHMB to continue to adequately meet both its US $ and EC $ debt obligations as they come due over the next year.

Chart 1
Liquidity Gap Projections (EC $ Millions) as at March 2018



Source: ECHMB

[7] *The Raymond James Securities Based Line of Credit is a flexible USD line of credit that can be collateralized by one or more Raymond James brokerage accounts (pledged accounts), which allows ECHMB access to liquidity at highly competitive prices.*

ECHMB continues to exhibit adequate capitalization as evidenced by a ratio of tangible net worth (TNW) to total assets of 23.4% as at March 2018, down slightly from 24.2% a year earlier. Leverage also remained comfortable despite a marginal deterioration to 3.3 times as at March 2018, from 3.1 times previously. This was on account of an 8.2% increase in borrowings, which exceeded the 3.7% increase in TNW to EC $61.3 million for the year ended March 2018. Despite the slight deterioration in FY2017/18, the leverage ratio was still well below the internally imposed maximum ratio of 8 times. Going forward, CariCRIS expects leverage to slip further to 3.4 times in FY2018/19, with the assumption that the Bank increases its debt by another EC $15 million and that TNW will further strengthen by approximately 4.5% through profit accretion. CariCRIS expects ECHMB to continue to remain adequately capitalized over the next 12 months.

Healthy financial performance supported by continued growth in income and profitability

ECHMB recorded increased profitability in FY2017/18, with a 37.8% rise in Profit After Tax (PAT) to EC $4.2 million compared to a 22.2% increase in the prior year, exceeding CariCRIS' FY2017/18 projected profit (Table 3). The increase in PAT was led by an 18.8% uptick in total income which was positively impacted by an 18.4% increase in net interest income (NII) to EC $7.5 million from EC $6.4 million previously. The growth in NII was driven by the combined impact of a 3% rise in total interest income to EC $11.5 million, coupled with a 17.3% decline in interest expenses to EC $4 million. Total interest income grew primarily on account of a 12.9% increase in interest income from investments following the 3.1% growth in the investment portfolio, while on the funding side, the fall in interest expenses was due largely to the Bank replacing its matured medium term debt with lower cost corporate paper. As a result, net interest spread improved by 50 bps to 2.5% for the year ended March 31 2018, the 3rd consecutive year of improvement.

Total operating expenses grew slightly by 2%, primarily due to a 2.8% increase in salaries and related expenses on account of an annual inflation allowance, as well as from increases to advertising/promotions, consultancy fees, and legal and professional fees associated with the rebranding of the Bank. The strong growth in PAT in FY2017/18 resulted in ECHMB reporting improved return on assets (ROA) and return on equity (ROE) ratios of 1.7% and 7% respectively. ECHMB's profitability metrics, though lower than that of the averages for CariCRIS' sample of regional non-bank financial institutions (ROA: 2.4%; ROE: 9.3%), are still considered good.

Table 3
ECHMB Summary of Financial Performance for FY2013/14–FY2017/18

	FY2017/18* (EC$ '000) (Draft Audited)	Chg %	FY2016/17 (EC$ '000) (Restated)	Chg %	FY2015/16 (EC$ '000)	Chg %	FY2014/15 (EC$ '000)	Chg %	FY2013/14 (EC$ '000)	Chg %	5-Year Average (%)
Interest Income from Mortgages	2,636	(20.6)	3,318	(31.5)	4,847	(44.0)	8,648	(41.5)	14,775	(9)	(29.3)
Interest Income from Investments	8,822	12.9	7,812	3.7	7,530	20.9	6,228	23.0	5,064	61	24.3
Interest Income from Banks	23	84.0	12	(73.6)	46	(92.1)	585	(31.3)	850	(83)	(39.2)
Total Interest Income	**11,480**	**3.0**	**11,142**	**(10.3)**	**12,424**	**(19.6)**	**15,461**	**(25.3)**	**20,690**	**(15.3)**	(13.5)
Interest Expense	(3,963)	(17.3)	(4,790)	(26.6)	(6,524)	(23.9)	(8,570)	(29.3)	(12,122)	(12.3)	(21.9)
Net Interest Income	7,518	18.4	6,352	7.7	5,900	(14.4)	6,891	(19.6)	8,568	(19.3)	(5.4)
Total Operating Expenses	(3,530)	2.0	(3,461)	0.7	(3,435)	(0.9)	(3,466)	(18.4)	(4,247)	(10.7)	(5.5)
Total Income [a]	7,746	18.8	6,520	9.8	5,940	(14.2)	6,925	(19.6)	8,609	(19.0)	(4.8)
PAT	4,216	37.8	3,060	22.2	2,505	(27.6)	3,459	(20.7)	4,362	(24.3)	(2.5)
	As at Mar-18 (EC$ '000)	Chg %	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)		5-Year Average (%)
Mortgages	42,849	14.6	37,396	(27.8)	51,807	(34.2)	78,759	(47.0)	148,484	(25.9)	(24.1)
Investments	204,271	3.1	198,157	32.7	149,377	(12.4)	170,525	13.0	150,936	106.0	28.5
Cash and Cash Equivalents	8,981	34.1	6,700	(84.6)	43,428	427.6	8,231	(70.9)	28,262	(49.2)	51.4
Total Assets [b]	261,873	7.2	244,173	(1.5)	247,811	(3.9)	257,799	(21.4)	327,992	(0.5)	(4.0)
Total Interest-Bearing Liabilities	199,828	8.2	184,660	(2.6)	189,553	(5.2)	199,917	(25.8)	269,305	(1.3)	(5.3)
TNW [b]	61,329	3.7	59,158	1.8	58,107	0.9	57,609	1.4	56,828	3.0	2.1
	FY2017/18 (%)		FY2016/17 (%)		FY2015/16 (%)		FY2014/15 (%)		FY2013/14 (%)		5-Year Average (%)
Funding Costs [c]	2.1		2.6		3.4		3.7		4.5		3.5
Net Interest Rate Spread	2.5		2.0		1.6		1.6		1.8		2.0
Cost to Income	45.6		53.1		57.8		50.0		49.3		50.1
ROA[b]	1.7		1.2		1.0		1.2		1.3		1.4
ROE	7.0		5.2		4.3		6.0		7.8		6.1
TNW to Total Assets [b]	23.4		24.2		23.4		22.3		17.3		21.2
	FY2017/18 (Times)		FY2016/17 (Times)		FY2015/16 (Times)		FY2014/15 (Times)		FY2013/14 (Times)		5-Year Average (Times)
Gearing	3.3		3.1		3.3		3.5		4.7		3.6

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

Looking ahead, CariCRIS expects ECHMB's financial performance to remain healthy in FY2018/19. Underpinning this is our expectation for continued growth in the Bank's investment portfolio with further diversification into other higher quality sovereign and corporate investments outside of the OECS, such as in Jamaica and the Cayman Islands. Notwithstanding this, we expect the increase in investment income to be somewhat tempered by the need for a material increase in the level of provisioning as the Bank adopts the required by IFRS 9[8] standard given that 70.1% of ECHMB's total investment portfolio consisted of fixed

[8] *IFRS 9 requires an entity to recognise a financial asset or a financial liability in its statement of financial position when it becomes party to the contractual provisions of the instrument. At initial recognition, an entity measures a financial asset or a financial liability at its fair value plus or minus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability.*

income instruments as at March 2018. Based on our discussions with management, the Bank is working closely with its auditors to determine the most effective way to implement the standard. CariCRIS will closely monitor the impact of ECHMB's adoption of IFRS 9 over the next year.

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

ECHMB's operational and risk management systems continue to be guided by its legislative and operational framework. The legislative framework provides broad guidelines for both the management and BOD. All major transactions undertaken by management require Board approval. The daily operations are guided by the company's General and Operational Policies Statement. The Bank's investment activities and risk management associated with these activities are governed by the revised IPS. The policy dictates the types of asset classes permitted for inclusion in the investment portfolio, the credit quality of the investments and limits of exposure permitted by these classes along with the investable markets and the limits of exposure permitted for each jurisdiction. Furthermore, the recently appointed Chief Investment Officer (CIO) is responsible for the design and implementation of the investment management strategy approved by the Bank's Executive Committee and ratified by the BOD. Given the small size of the organization, CariCRIS considers the provisions enunciated in the revised investment policy and governance structure to be sufficient to meet the risk management requirements of ECHMB.

Over the past year, ECHMB enhanced its Information Technology platform. The Bank now utilizes an online real time electronic Asset Management System (eAMS). The new system integrates the mortgage, investment and funding portfolios with the Bank's Accounting System. This represents an enhancement to the Bank's internal control and reporting framework by minimizing human error in data entry and allowing for the reconciliation of balances with all relevant departments in real time.

As part of ECHMB's enterprise risk management (ERM) framework, a comprehensive risk register is compiled on a quarterly basis for all functional areas which identifies the owner(s) of each risk event, potential losses resulting and how these risks can be mitigated. Notably, the full implementation of the ERM framework[9] was stalled as there has been a delay with the recruitment of a Risk Officer. Once hired, the Risk Officer will be required to provide oversight and lead the charge in development, implementation, maintenance and consistent application of the Bank's ERM framework. In CariCRIS' opinion, ECHMB should seek to fill this position in the shortest possible time given the criticality of this function.

The factor constraining the ratings is:

Heightened exposure to financial risks arising from significant exposure to the prevailing economic challenges in the OECS

ECHMB's performance continues to be highly linked to the performance of the OECS economies given that the majority of its revenue, investments and funding are still derived from this sub-region. Based on the latest available information[10], the OECS sub-region continued to experience tepid real GDP growth of approximately 1.8% in 2017, down from 2.9% in 2016, with contractions in economic activity reported in Anguilla (5.1%) and Dominica (4.2%). In September 2017, several countries in the OECS sustained significant infrastructural damage from the passage of Hurricanes Irma and Maria. The impact of these two hurricanes, which in many cases is still being assessed, would have exacerbated the already difficult economic circumstances that prevailed across the sub-region.

As at March 31, 2018, 44.1% of the Bank's investment portfolio originated from the OECS, down from 73% one year earlier. Investment opportunities in the OECS are limited as there are very few investment grade instruments available. Furthermore, capital market activity in this sub-region is low and highly concentrated, with the Government of Saint Lucia remaining the most active on the Regional Governments Securities Market (RGSM), accounting for the majority (30.5%) of the volume of auctions during 2017[11]. In response to this, the Eastern Caribbean Central Bank (ECCB) in its 2017-2021 strategic plan has identified a goal of deepening the money and capital markets in the OECS by modernising the capital market legal and regulatory frameworks and increasing the participation of market players on the Eastern Caribbean Securities Exchange (ECSE). Research will also be undertaken to identify the feasibility of the

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[9] 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.

[10] Source: ECCB Annual Economic & Financial Review 2017.

[11] Source: ECCB Annual Economic & Financial Review 2017

introduction of a Primary Dealer System (PDS) to improve the primary and secondary markets for Government securities. Notwithstanding these developments, the strained economic conditions combined with a falling interest rate environment could potentially result in lower investment returns from most of these territories over the next 12 to 15 months. CariCRIS is also mindful that the OECS continues to be challenged by one of the heaviest debt loads in the Caribbean. With an average debt to GDP ratio of 70.1% as at December 2017, the highly tourism and agriculture dependent OECS sub-region is more vulnerable to economic shocks when compared to many of its Caribbean and international peers.

June 22, 2018