



Extended Annual Review Report

Project Numbers: 37919 and 39935
Loan Number: 2155
Equity Investment Number: 7221
September 2014

Loan and Equity Investment Purchase and Resolution of National Home Mortgage Finance Corporation's Portfolio of Nonperforming Loans (Philippines)

This is an abbreviated version of the XARR which excludes commercially sensitive and confidential business information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

Currency Unit – peso (P)

		At Appraisal	At Project Completion
		1 October 2004	6 January 2014
P1.00	=	\$0.018	\$0.022
\$1.00	=	P56.4	P44.6

ABBREVIATIONS

ADB	–	Asian Development Bank
Balikatan	–	Balikatan Housing Finance
Bahay	–	Bahay Financial Services
DBGO	–	Deutsche Bank Real Estate Global Opportunities
IFC	–	International Finance Corporation
NHMFC	–	National Home Mortgage Finance Corporation
NPL	–	nonperforming loan
RMBS	–	residential mortgage-backed security

NOTE

In this report, “\$” refers to US dollars.

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BASIC DATA

Balikatan Housing Finance (Loan No. 2155 – Philippines)

Bahay Financial Services (Equity No. 7221 – Philippines)

Key Project Data	As per ADB Loan Documents (\$ million)	Actual (\$ million)
Total Project Cost		
Loan (Balikatan Housing Finance)	33.00	28.38
Equity (Bahay Financial Services)	1.00	0.17
Total Investment		
Committed	34.00	28.55
Disbursed		28.55
Outstanding		0.00
Key Dates	Expected	Actual
Concept Clearance Approval	2004	05 Jan 2004
Board Approval	2004	11 Nov 2004
Balikatan Housing Finance		
Loan Agreement	2005	30 May 2005
First Disbursement	2005	09 Nov 2005
Loan Payoff	2010	10 Dec 2013
Bahay Financial Services		
Equity Agreement	2005	02 Nov 2005
Equity Payoff	2012	26 Jan 2012
Financial and Economic Rates of Return on Invested Capital (%)	Appraisal	XARR
Financial internal rate of return (net): Loan	...	...
Financial internal rate of return (net): Equity	...	...
Project Administration and Monitoring	Number of Missions	No. of Person-Days
Concept Clearance	...	...
Due Diligence Mission	...	...
Private Sector Credit Committee Meeting	...	...
Board Approval	...	...

... = data not available, ADB = Asian Development Bank, XARR = extended annual review report.

EXECUTIVE SUMMARY

In November 2004, the Board of Directors of the Asian Development Bank (ADB) approved a nonsovereign investment of up to \$34 million equivalent, in Philippine pesos, to assist the Philippine government's National Home Mortgage Finance Corporation (NHMFC) in resolving its portfolio of nonperforming loans (NPLs). The project aimed to (i) provide funds for the creation of a private sector solution for NPL resolution in the Philippines market; (ii) help NHMFC repay its obligations to the Philippine pension system; and (iii) assist NHMFC in its restructuring efforts to focus exclusively on the secondary mortgage market in the Philippines.

The project's sponsor was Deutsche Bank Real Estate Global Opportunities (DBGO), a real-estate and mortgage investment specialist owned by Deutsche Bank. The International Finance Corporation (IFC) participated in the project on an equal footing with ADB. ADB's contribution of \$28.55 million comprised (i) a 5-year senior loan of \$28.38 million in Philippine pesos to Balikatan Housing Finance (Balikatan), a 51:49 joint venture between DBGO and NHMFC, to help Balikatan purchase the NHMFC NPL portfolio; and (ii) an equity investment of \$0.165 million in Philippine pesos for a 10% stake in Bahay Financial Services (Bahay), a mortgage servicing company established to resolve NHMFC's NPL portfolio.

NHMFC was created in 1977 to develop and provide a secondary market for home mortgages. However, following an executive order mandating public pension fund systems to finance low-income housing in the late 1980s, NHMFC established the Unified Home Lending Program to meet the housing finance needs of members of three public pension fund systems. From 1988 to 1996, NHMFC originated home loans totaling P42.1 billion. Despite growth in meeting the country's housing backlog, the program increasingly faced challenges in terms of low repayment rates and uncollected loans. Due to the burden of administering these programs, in 1996 NHMFC ceased loan originations to focus on asset recovery. The Asian financial crisis of 1997–1998 prevented the asset recovery program of NHMFC from bearing results. In 1999 a government executive order directed all government-owned and -controlled housing corporations to prepare rationalizing and streamlining plans. The order also mandated NHMFC to redirect its operations to the development and provision of a secondary mortgage market to finance mortgage securitizations, and to fast-track the disposition of existing mortgages. The project was the first step in government efforts to restructure NHMFC and the housing finance system itself, an initiative to which the authorities attached great importance.

The impact of the ADB investment on private sector development and ADB's strategic development objectives met with the targets set at inception. The project was a landmark transaction and helped develop a novel financial concept in the Philippines market. The project is significant for several achievements: (i) the ADB loan required restructuring but ultimately reached its development and business goals for ADB, NHMFC, and Bahay; (ii) the transaction structure functioned as a commercially viable and demonstrative project to provide to the market previously unavailable information on time, cost, and legal processes needed to resolve NPL portfolios, and make the process cheaper and faster for later adopters; (iii) the loan contributed to helping NHMFC improve its balance sheet, and by extension, the health of the Philippines social security system; (iv) the project supported government policy efforts by reducing large systemic NPLs in the economy; and (v) the investment enabled NHMFC to establish a secondary mortgage market and operate a viable housing finance system.

The project's business and economic performance was judged to be adequate. NHMFC, the beneficiary of the transaction, was able to transform itself into a secondary mortgage market institution and operate a viable housing finance system through securitization of residential

home loans. With the sale of its most delinquent NPLs through the project, NHMFC began the process of reorganizing its operational structure. By 2007, NHMFC had laid the building blocks for its transformation into a participant in the secondary mortgage market, with the requisite training and updating of its internal systems and processes. In 2009, NHMFC issued its first residential mortgage-backed security (RMBS) for P2.06 billion. In 2012, NHMFC offered its first retail and publicly listed RMBS in the Philippines. NHMFC intends to continue RMBS securitizations in the Philippines, including a debut RMBS in 2014–2015 for a low-cost affordable mortgage program that allows squatters to buy their own land.

The project satisfactorily met ADB's environmental, social, health, and safety performance requirements. ADB's net returns were in line with the targeted returns at project inception.

The quality of ADB work for screening, appraisal, and structuring could not meet all internal parameters. As the deal was the first of its kind in the Philippines market, ADB had to explore multiple project architectures in parallel with legal counsel and project partners on deal structuring, risk analyses, legal opinions, and regulatory clarifications. However, while the transaction structure was a significant achievement for ADB and its partners at the time, with the benefit of hindsight certain structuring elements could have been handled more robustly up front. These pertain to, among others, assumptions regarding the foreclosure process, ADB contractual rights, and legal terms of the loan. ADB monitoring and supervision was commendable. After Balikatan expressed its inability to honor timely payments to ADB, in 2009 project management was transferred to ADB's investment recovery unit. The recovery team expended considerable efforts in restructuring and monitoring the loan to make the project an economic success, despite facing significant legal, operation, and negotiation hurdles.

ADB's additionality met project expectations as (i) without ADB and IFC involvement the transaction would not have occurred, as no private sector debt providers were available in the Philippine market at the time; (ii) ADB bridged the transaction's pricing gap and allowed DBGGO to leverage its own funds and thus provide a larger bid; (iii) ADB support lent credibility and provided considerable comfort to potential investors; (iv) ADB financing helped encourage DBGGO to enter the Philippine NPL market and became a condition precedent for its participation; and (v) ADB was instrumental in finding a third-party buyer for the ADB and IFC loans to Balikatan through extensive efforts and gathering of market intelligence. The overall outcome of the project met with ADB's internal parameters.