CREDIT RATING REPORT

EASTERN CARIBBEAN HOME MORTGAGE BANK

Caribbean Information & Credit Rating Services Limited

May 2013

INSTRUMENT RATED	RATING
US $30 million Bond Issue	*Cari***AA-** (Foreign Currency**)**

RATING HISTORY			
Date	**Foreign Currency**	**Local Currency**	**Instrument/Remarks**
May 27, 2013	*Cari***AA-**	*Cari***AA-**	US $30 million Debt Issue
March 29, 2012	*Cari***AA-**	*Cari***AA-**	US $30 million Debt Issue
March 28, 2011	*Cari***AA-**	*Cari***AA-**	US $30 million Debt Issue
March 31, 2010	*Cari***AA-**	*Cari***AA-**	US $30 million Debt Issue
March 26, 2009	*Cari***AA**	*Cari***AA**	US $30 million Debt Issue (Notional)
February 11, 2008*	*Cari***AA**	*Cari***AA**	US $30 million Debt Issue (Notional)

*Initial Rating Assigned

RATING DRIVERS

Strengths

- Low credit risk business model leading to excellent asset quality
- Strong operational and underwriting systems emanating from strict adherence to legislative and policy guidelines
- Good profitability with stable interest rate spreads and increasing return on assets
- Experienced and qualified management team well supported by a reputable Board of Directors
- Regional financial institution with support from the premier financial institution in the Organization of Eastern Caribbean States

Weaknesses

- Relatively tight liquidity conditions and strong credit concerns of delayed payments by Primary Lenders
- High exposure to non-bank financial institutions, albeit declining
- Asset concentration with heavy exposure to one Group

Rating Sensitivity Factors

- Removal of the "with recourse" feature in mortgages purchased
- Relaxation of the mortgage underwriting standards
- Significant reduction in interest spreads
- Significant changes in the liquidity situation
- Performance of the Primary Lenders

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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. Its primary objective is the development of the secondary mortgage market within 8 participating member countries of the Organization of Eastern Caribbean States (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 is the purchase and sale of mortgages so as to develop and maintain a secondary market for residential mortgages in the member territories.

ECHMB is a privately[1] managed company and the current 65 shareholders are all financial institutions from the 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, development banks and credit unions. The largest shareholder, the ECCB, holding 24.9%, is the premier financial institution in the OECS.

RATING RATIONALE

Caribbean Information and Credit Rating Services Limited (CariCRIS), the Caribbean regional credit rating agency, has reaffirmed the ratings for Eastern Caribbean Home Mortgage Bank (ECHMB) of *Cari***AA-** (Foreign Currency Rating) and *Cari***AA-** (Local Currency Rating) on the regional rating scale to the debt issue of the size of US $30 million. These ratings indicate that the level of creditworthiness of this obligation, adjudged in relation to other obligations in the Caribbean[2] is **high**.

[1] *The company does not offer or trade its company stock to the general public on the stock market exchanges.*

[2] *The term Caribbean as used here covers the following countries: Bahamas, Barbados, Belize, Costa Rica, Dominican Republic, Guyana, Haiti, Jamaica, Panama, Suriname, Trinidad and Tobago and the following countries in the OECS: Anguilla, Antigua & Barbuda, Dominica, Grenada, Montserrat, St. Kitts & Nevis, Saint Lucia and St. Vincent & the Grenadines. Refer www.caricris.com for a more detailed explanation on CariCRIS ratings and rating definitions.*

The factors supporting the rating are:

Low credit risk business model leading to excellent asset quality

ECHMB's business model is underpinned by a "with recourse" feature for all mortgages purchased for its portfolio from Primary Lenders (PLs) leading to low credit risk and excellent asset quality. All 955 mortgages purchased from the 12 PLs (as at March 2013) are monitored on a daily basis and any mortgage which has been in default for 3 consecutive months is either replaced with a performing loan or the PL remits the cash to ECHMB. As a result the mortgage pool should always consist of 100% performing loans leading to excellent asset quality. In addition, the PLs are contractually obliged to remit mortgage payments to ECHMB at the end of every month whether or not the PL has received payment from the mortgagors, further enhancing the low credit risk model. CariCRIS believes the maintenance of the "with recourse" feature is critical for the business model's low credit risk.

To mitigate potential credit risk in its mortgage pool ECHMB conducts due diligence on every mortgage to ensure strict adherence to the criteria listed in its policy guidelines. In FY2012/13[3], this process was further enhanced by requiring all PLs with new mortgage pools to fill out a pre-approval assessment form prior to ECHMB conducting an on-site due diligence. Some of the attributes that must be met are as follows: all mortgages must be residential, owner-occupied properties; the value of the mortgage loan must not exceed EC $1.25 million; and the property must be secured by a 1st lien. With respect to the terms of the mortgage: the maturity must not exceed 30 years; the maximum allowable loan to value ratio is 90%; and all properties must be insured. The Bank retains the right to decline applications if a mortgage pool does not meet the stipulated requirements as was the case during FY2012/13 when only 2 pools were evaluated and purchased.

While stringent adherence to the operating policy guidelines significantly reduces exposure to the credit risk of individual mortgage holders, ECHMB is exposed to the credit risks of the PLs. To mitigate this risk, the Bank strictly adheres to a list of criteria that must be met by the PLs. These criteria are as follows: a capital of a minimum of EC $3 million and a capital to asset ratio of not less than 8%; must be subject to the regulations of an approved regulatory body; must have operational experience and expertise in loan underwriting and administration of at least 3 years; and must agree to submit to periodic audits and reviews of its mortgage underwriting process. Additionally, all PLs must commit to improve and maintain mortgage underwriting standards via prescribed training. The PLs must also maintain proper mortgage security

[3] *Financial year runs from April 1, 2012 - March 31, 2013. FY2012/13's assessment was based on unaudited financials.*

documentation and a minimum delinquency ratio within its mortgage portfolio. Only 1 PL has ever defaulted to ECHMB in its history. That PL, now under the control of the ECCB, slipped into arrears in July 2010 and had an amount outstanding to ECHMB as at March 2013. In February 2013, another PL went under the management and control of the Financial Services Authority (FSA) but was not in arrears to ECHMB as at May 2013. In CariCRIS' opinion, delays in payment or outright payment failures by the PLs represent a source of risk that can increase in the current economic environment and could lead to deterioration in ECHMB's mortgage portfolio.

Strong operational and underwriting systems emanating from strict adherence to legislative and policy guidelines

ECHMB's strong risk management systems are underpinned 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 ECHMB's Policy Statement of General and Operational Policies. This policy statement (first developed by the International Finance Corporation (IFC) as a shareholder) lists all the criteria requirements for selection of both the mortgages purchased as well as PLs. CariCRIS believes ECHMB's stringent adherence to the policy statement with respect to criteria requirements for the mortgages and PLs have added to the low credit risk of the business. ECHMB's manual of mortgage underwriting standards governs selection and review of mortgages as well as the due diligence process for the PLs. Prior to the purchase of each pool, ECHMB's staff conducts an onsite due diligence to determine whether all the criteria listed in its operational policy are met by the PLs, borrowers and mortgage loans. Subsequent to the due diligence exercise, a PL may extend additional funds on an existing loan to a mortgagee and in the past, no further reviews were undertaken by ECHMB. In FY2012/13, the Audit Committee recommended that the Procedures Manual be updated to include an offsite review for any loan extension in excess of EC $50,000. Annual onsite or offsite financial and mortgage reviews are also conducted on all existing PLs in ECHMB's mortgage portfolio; as of March 2013, this requirement was met with the exception of 1 PL scheduled to be reviewed in July-August 2013. The financial review for new and existing mortgages involves the collection of audited financial statements, verification of an ECCB review and proof that ratios such as liquidity and reserve requirement were met. The Bank retains the right to decline applications by financial institutions that do not meet the stipulated requirements. The relationship with the PLs is governed by a legally constituted "Sales and Administration Agreement". In addition to the criteria for the mortgage and PLs, the following are examined for the borrower: the applicant's sources of income, total income, credit history, debt to income ratio (which should not exceed 40%) and the valuation of the mortgaged property.

ECHMB ensures that international underwriting standards are maintained in the industry by conducting Mortgage Underwriting Seminars in conjunction with the Canada Mortgage and Housing Corporation (CMHC) and the Real Estate Institute of Canada (REIC), along with local and regional resource persons. These seminars target all financial players in the mortgage industry and afford participants the opportunity to gain an internationally recognised qualification – Certified Residential Underwriter (CRU). Two such seminars are held annually and in FY2012/13 these took place in Dominica and Grenada. To date, approximately 221 professionals from the OECS, Barbados and Jamaica have participated in the training with 56 persons attaining the CRU designation. To maintain standards, PLs are obligated to ensure that all mortgage underwriters become professionally certified.

Adequate insurance coverage is also a critical component of its underwriting standard and is used as a risk mitigation tool by the Bank. In addition, all mortgage loans purchased for ECHMB's pool must have life insurance covering the loan balance. The purchased pool of mortgages must also have peril insurance on the mortgaged property in an amount equal to the principal balance of the loan or the replacement cost of the mortgaged property whichever is less. CariCRIS believes these high underwriting standards contribute significantly to the low credit risk of the business.

Moreover, ECHMB monitors the mortgage pools on a daily basis and PLs are obligated to report any changes to the pools as soon as they occur. As at March 2013, ECHMB's Mortgage Interface System was 95% completed providing read-only access to the PL's mortgage transactions thereby enabling real time monitoring of balances at ECHMB. Sometimes there are temporary mismatches in balances between ECHMB and the PLs as the PL may not have informed ECHMB of changes in the mortgages. This has been somewhat alleviated by ECHMB sending regular letters to the PLs to confirm balances after adjustments have been made by ECHMB. Currently, the mortgage system, Peachtree Accounting system and an Administration System run independently of one another.

In FY2010/11, the replacement of mortgages required ECHMB's approval with the Manager-Mortgage Underwriting exercising sole discretion in deciding which replacement mortgages were included in the portfolio. In FY2012/13, further enhancements were made as all replacements must be approved by the CEO and Chief Financial Officer (CFO). During FY2012/13, ECHMB re-registered most of its replaced mortgages, with only 6 pools at 1 PL pending re-registration and these are currently in progress. ECHMB has made this an on-going exercise by re-registering all pools in its portfolio on an annual basis.

Good profitability with stable interest rate spreads and increasing return on assets (ROA)

ECHMB has been profitable since its inception over 17 years ago. The Bank's tax-exempt status contributes to its profitability. Profits after tax (PAT) grew by 2.8% to EC $5.8 million in FY2012/13 mainly as a result of a fall in expenses by 3.8%. Total income[4] remained relatively flat at EC $10.7 million as there was almost no change in net interest income (NII) which grew by a marginal 0.03% to EC $10.6 million. This led to a stable interest spread of 2.4%, lower than the 3-year average (FY2009/10-FY2011/12) of 2.5% and its FY2005/06 peak of 3.2%. The weak economic performance of the OECS region has led to contractions in overall bond and asset yields in FY2012/13. Average funding cost declined to 5.1% from 5.4% with coupon rates on EC $21.7 million in bonds averaging 3.75% in FY2012/13. Average yield on assets declined to 7.5% from 7.8%. The growth in PAT resulted in a small rise in ROA to 1.8% from 1.7%, continuing its increase since FY2009/10.

Due to a lack of high quality mortgages in the market[5] in which ECHMB operates, the mortgage portfolio has been contracting since FY2010/11, declining by 1.5% to EC $198.7 million in FY2012/13. ECHMB has been investing its excess cash in short term investments leading to a growing investment portfolio since FY2009/10 which climbed by 72.6% in FY2012/13. If interest rates continue to fall in the market, ECHMB's rates on its short term investments stand to decline faster than its mortgage rates. In CariCRIS' opinion, it may be difficult for ECHMB to find suitable, high quality mortgages in the near term. In CariCRIS' worst case scenario, assuming the mortgage portfolio reduces by 5%, asset yields fall by 150 basis points and bond yields decline by 100 basis points, PAT would decrease by 69.2% to EC $1.8 million as a result of a decline in NII of around 35.2% with a spread of 1.6%. The operational policy statement stipulates that the company shall earn a positive spread of at least 2% per annum unless otherwise determined by the BOD. In FY2012/13, ECHMB has been able to maintain a 2% spread, and has never earned less than 2% in the history of its operations (Chart 1). ECHMB's partnership with the PLs is governed by a legally constituted "Sales and Administration Agreement" through which the PLs consent to administer and service the purchased mortgages for an administration fee. This fee allows ECHMB some degree of flexibility in achieving this 2% minimum spread. Administration fees ranged from 0.5-1% in FY2012/13. In FY2008, the

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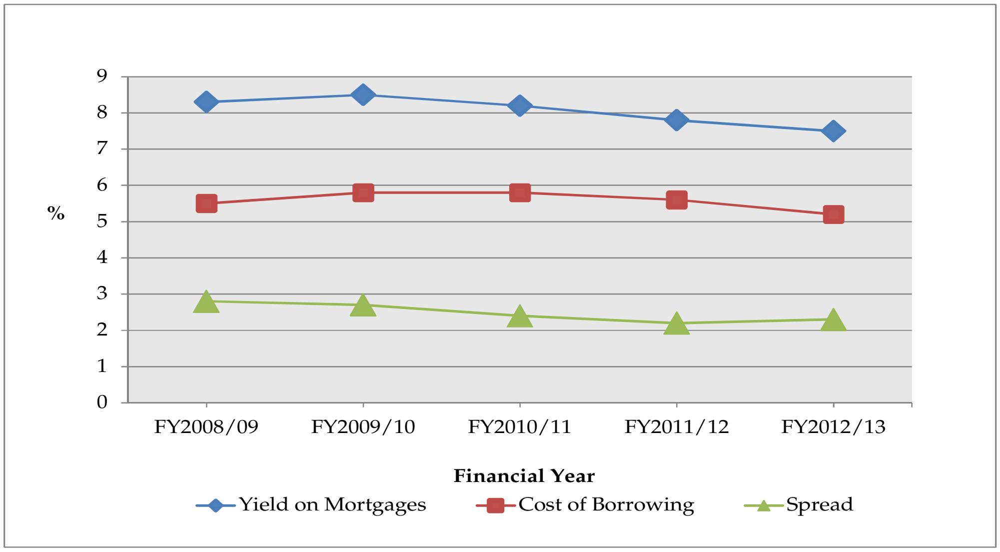
[4] *Total income = (Interest Income-Interest Expense) + Other Income.*

[5] *ECHMB's market includes the indigenous financial institutions in the OECS.*

"Sales and Administration Agreement" was amended giving ECHMB the right to reduce the administration fee when interest rates are falling ensuring that margins are maintained.

The Bank has paid dividends to shareholders every year since its 3rd year of operations; its first dividend was EC $7.50 per share. Since 2001 an annual dividend of EC $10 per share has been paid and CariCRIS expects no change in FY2013/14.

Chart 1
Interest Rate Spreads
FY2008/9 – FY2012/3



Source: ECHMB's Financial Statements

ECHMB continues to have a stable asset base, rising by only 0.02% to EC $330.2 million as at March 2013. Although tangible net worth (TNW) remains small at EC $55.1 million as at March 2013, ECHMB continues to remain well capitalized as evidenced by an increase in TNW to assets ratio to 16.7% from 15.8% in the prior year. ECHMB currently has one loan on its books leading to a gearing ratio of 4.9%, well below the Caribbean Development Bank (CDB)'s debt covenant of 8:1. In CariCRIS' projections for FY2013/14, if ECHMB's mortgage portfolio declines by 5% and yields contract by 20 basis points this will result in a 45.8% fall in profits.

Experienced and qualified management team well supported by a reputable BOD

The BOD is amply qualified and has extensive experience in the financial and business community in the region. Under the ECHMB Agreement Act (1995) Directors are appointed for 2-year terms. New Board appointments are due in 2014.

The management team is also well qualified and possesses extensive experience in the financial and business community within the OECS and the wider Caribbean. The Chief Executive Officer (CEO), who assumed the position in June 2007, has extensive international experience in a wide array of industries. The CEO's contract expired on May 31, 2013 and according to the Act, the CFO would oversee operations until such time that a successor has been identified. However, CariCRIS believes ECHMB's strategic direction will continue to receive strong BOD guidance as demonstrated in the past. The senior management team is well qualified to run their respective departments. Furthermore, the team is well supported by the BOD as all major transactions (inclusive of bonds issued and the purchase of pools of mortgages over EC $3 million) require Board approval.

ECHMB has been able to generate and grow profits from its first year of operations. Asset growth was marginal over the financial years FY2003/2004–FY2006/07. However, from June 2007, the CEO adopted a much more aggressive strategy resulting in a considerable increase in the mortgage portfolio over the last 5 years (166.7% growth from FY2006/7 to FY2012/13). The mortgage portfolio has declined since FY2010/11 due to the limited pool of high quality mortgages in the market. CariCRIS expects that the mortgage portfolio will decline further in light of the current challenging environment. ECHMB's foray into the credit union sector has provided another avenue to grow its mortgage portfolio.

The strategic focus for management in the medium term is to maintain a portfolio of high quality mortgages and to continue to provide training to market players towards improving the mortgage underwriting standards in the region.

Regional financial institution with support from the premier financial institution in the OECS

ECHMB is a regional financial institution; its shareholders comprise 65 financial institutions domiciled throughout the Caribbean region, whilst its mortgage market is the 8 member countries of the OECS (excluding the British Virgin Islands (BVI). The Bank's credit risk profile is not linked to or constrained by any one sovereign as its mandate is to buy and sell mortgages in the 8 participating member countries of the OECS; currently it only has business in 6. As a regional player, the Bank has the advantage of borrowing in lower cost markets and investing in markets with higher yields which boosts its earnings.

The OECS region's premier financial institution, the ECCB, is ECHMB's largest shareholder accounting for 24.9% (as at March 2013). ECHMB's affiliation with the ECCB provides synergistic benefits for its operations particularly with respect to its bond issues. Additionally, it has also benefited from the experience and expertise of the ECCB's Governor who has held the position of Chairman of the BOD since ECHMB's inception. This association has increased the competitiveness of ECHMB's bonds in the regional capital market as investors have linked the risks of the 2 institutions. However, there is no formal support mechanism available to the ECHMB from any of its shareholders.

These rating strengths are tempered by the following:

Relatively tight liquidity conditions and strong credit concerns of delayed payments by PLs

In 2012, the ECCU recorded a slight easing of liquidity pressures as evidenced by an increase in the liquid assets to deposits plus liquid liabilities ratio to 32% in September 2012, from 30% in September 2011. The loans to deposit ratio fell to 85.1% from 86.4% over the same period. Pockets of tight liquidity remain in Dominica, St. Vincent and the Grenadines and Grenada. Poor financial performance by a PL was also evidenced by the first ever default on payments to ECHMB. This commercial bank was still in arrears to ECHMB as of March 2013.

Despite ECHMB's strict adherence to its due diligence process and its mortgage and financial reviews, CariCRIS believes the deterioration in the performance of some PLs represent a growing source of risk. In July 2010, a PL defaulted on its payments to ECHMB and is now under the control of the ECCB. In February 2013, another PL went under the control of the FSA but as at May 2013, had no arrears to ECHMB. Further, there has also been strain on some PLs to make timely lump sum payments to ECHMB. In CariCRIS' opinion, this deterioration is a reflection of the OECS' weak macroeconomic performance and any default or delays in payment could result in a weakening of ECHMB's asset quality and financial performance in the future.

The market is characterised by a limited pool of investors where several of the purchasers of ECHMB's bonds are listed as originators of mortgages, many of whom are also shareholders of ECHMB. Nevertheless ECHMB has demonstrated its ability to maintain a strong resource profile during periods of tight liquidity by successfully rolling over EC $40.3 million worth of bonds in the last year. ECHMB has reached its EC $250 million limit to issue tax exempt bonds as stipulated in the ECHMB Agreement Act (1995). Further, although the public auctioning system for bonds has contributed to ECHMB issuing bonds at lower rates, CariCRIS believes that overall borrowing costs in the region may rise if there are additional sovereign defaults following the default by the Government of Grenada on its 2025 bond.

High exposure to non-bank financial institutions (NBFI), albeit declining

ECHMB's exposure to the NBFIs in the ECCU region poses downside credit risks. The relatively weaker regulatory and supervisory framework for NBFIs raises a number of concerns for CariCRIS including the lack of liquidity support in the event of a crisis. Although progress has been made in the creation of Single Regulatory Units (SRU) apart from the Grenada Authority for the Regulation of Financial Institutions (GARFIN), the other SRUs are in their embryonic stage; not adequately staffed and not fully functional. NBFIs accounted for 26.7% of the mortgage portfolio as at March 2013, declining from 32.8% as at March 2012 (Table 1). Overall exposure to NBFI's decreased by 16.1% to March 2013 from March 2009 while exposure to Grenadian credit unions remained relatively flat, increasing by 0.2% in FY2012/13.

Table 1
Mortgage Portfolio by Financial Institutions

Institution	Mar-13			Mar-12			Mar-11			Mar-10			Mar-09		
	No.	EC $'000	%	No.	EC $'000	%	No.	EC $'000	%	No.	EC $'000	%	No.	EC $'000	%
Commercial Banks*	636	144,876	73.3	540	134,971	67.2	446	110,314	48.7	640	161,681	71.9	478	121,222	65.8
Credit Unions	137	29,352	14.8	170	34,994	17.4	181	37,389	16.6	161	33,700	15	160	31,767	17.2
Others **	182	23,529	11.9	223	31,032	15.4	393	78,618	34.7	216	29,502	13.1	219	31,280	17
Total	**955**	**197,757**	**100**	**933**	**200,997**	**100**	**1,020**	**226,321**	**100**	**1,017**	**224,883**	**100**	**857**	**184,269**	**100**

Source: ECHMB – Underwriting Department

** Includes all financial institutions governed by the ECCB and operating under the FIA*

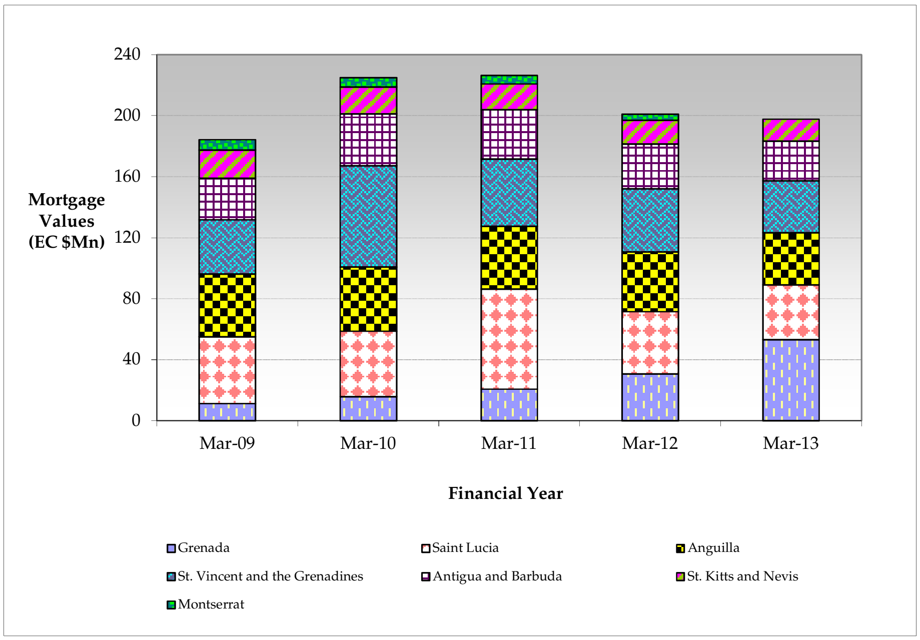
*** Includes other non bank financial institutions inclusive of development banks and loan and building associations*

Asset concentration with heavy exposure to one Group

ECHMB currently has business in 6 of the 8 participating member countries of the OECS in its mandate as high liquidity conditions in Dominica have resulted in low mortgage rates making it unviable for ECHMB to operate in that market. ECHMB also had no mortgages in Montserrat in FY2012/13. ECHMB's mortgage portfolio is well distributed among its top 4 countries: Grenada (26.8%), Saint Lucia (18.1%), St. Vincent and the Grenadines (17.1%) and Anguilla (17.1%) as at March 2013 (Chart 2). However, ECHMB's concentration risk in a single Group remained high, though falling slightly to 26% of the mortgage portfolio as at March 2013 from 27.9% one year earlier. Furthermore, investments in term deposits at this Group constituted

56.5% of total investments as at March 2013. ECHMB's policy statement of General and Operational Policies states that the limit on the exposure to any 1 PL in the mortgage portfolio shall not exceed 20% of the assets of ECHMB unless otherwise determined by the BOD. As at March 2013, this Group accounted for 15.6% of total assets.

Chart 2
Mortgage Value by Countries



Source: ECHMB – Underwriting Department

FINANCIAL PERFORMANCE

	FY2012/13*	FY2011/12	FY2010/11	FY2009/10	FY2008/09
	EC $'000				
Total Assets	330,250	329,388	330,193	293,440	216,908
Equity Capital	37,000	37,000	37,000	19,658	10,000
Tangible Net Worth	55,146	52,108	49,193	30,095	20,129
Total Income **	10,750	10,798	9,700	8,525	6,535
Operating Expenses (incl. Depreciation)	4,879	5,070	5,098	4,846	4,160
PAT	5,759	5,602	3,352	1,179	2,375
	%				
Total Expenses/Total Income	45.4	47	52.6	56.8	63.7
PAT/Average Earning Assets	1.8	1.7	1.1	0.5	1.2
Tangible Net Worth/Adjusted Assets	16.7	15.8	14.9	10.3	9.3
	Times				
Debt/Tangible Net Worth	4.9	5.3	5.6	8.6	9.6

Source: ECHMB Financial Statements

** FY - Financial Year runs from April 1 to March 31*

*** Total income = (Interest Income-Interest Expense)+Other Income*

June 5, 2013