

FINANCIAL ANALYSIS

A. Qishloq Qurilish Bank

1. The Qishloq Qurilish Bank (QQB) was established in 2009.¹ More than 90% of its shares are owned by the state or state-owned companies.² QQB has an 11-member supervisory council³ and a 7-member management board. QQB's financial statements are prepared in accordance with International Financial Reporting Standards and audited by PriceWaterhouseCoopers.⁴ QQB has 41 branches (including branches in Tashkent City and the capitals of each of Uzbekistan's 12 provinces and the autonomous Republic of Karakalpakstan), 70 minibanks, and 63 currency exchange kiosks. QQB's wholly owned subsidiary, Qishloq Qurilish Invest (QQI),⁵ is mandated to supervise the construction of rural houses financed by QQB under the government's Rural Housing Scheme (RHS).⁶ In 2010, QQI established 13 wholly owned subsidiaries to produce construction materials—12 brick companies and a factory which produces doors, windows, and roofing materials.⁷

2. As a state policy bank,⁸ QQB acts as a conduit of funding to lend to rural households for housing finance under the RHS at tenors and interest rates determined by the government.⁹ According to its charter, QQB may (i) extend loans and other banking services to individuals and legal entities in rural areas for housing, utilities, and other social purposes; (ii) extend loans and leasing services to specialized contractors who are constructing and maintaining individual houses and social infrastructure in rural areas; (iii) finance construction and maintenance of rural public infrastructure and utility services; and (iv) extend loans and other banking services to industries manufacturing construction material for housing and public infrastructure. Thus,

¹ Established under Presidential Decree NPP1083 largely through the restructuring of Gallabank.

² Ministry of Finance (53.8%), Fund for Reconstruction and Development of the Republic of Uzbekistan (23.7%), AK Uzdonmahsulot (4.1%), Uzbekistan Temir Yollari (4.0%), Uzbek National Company of Export-Import Insurance (2.3%), Uzagrosugurta (1.8%), and Uzvinpromholding (1.3%). The remaining shares are owned by 3,776 individuals (mainly bank employees) and 2,375 companies, none of which has holdings greater than 1.9%.

³ As defined under Cabinet of Ministers Resolution N 90 (31 March 2009), members of the supervisory council are government officials, appointed as members in accordance with official appointments (including the Minister of Finance [chair], the First Deputy Minister of Economy, and the Deputy Chair of the Central Bank), and representatives of state-owned enterprises who are major shareholders.

⁴ QQB has a seven-member Internal Audit Department which audits all the bank's branches at least once a year. The department reports to a four-member audit committee of the bank's supervision council, which meets at least quarterly.

⁵ QQI was established under the same presidential decree as QQB in 2009 (footnote 1).

⁶ QQI has established sufficient management capacity and systems to supervise the construction of over 7,000 houses annually. Its organization, management structure, and staffing levels (over 350 employees, 80% of whom are technical or professional staff, including 130 site inspectors) appear adequate for its mandated responsibilities, and its corporate governance, financial disclosure, and audit arrangements appear satisfactory. QQB has agreed that QQI will be established as an independent legal entity by 1 January 2014 (for tranche 3).

⁷ These companies were established to provide a reliable supply of affordable building materials, especially during peak construction months, to contractors building houses under the RHS. The cost of building materials produced by these companies is about 25%–35% lower than those produced by other companies, largely because QQI-controlled companies are exempt from profit taxes.

⁸ Uzbekistan's financial sector policies are directed to support macroeconomic goals of economic growth and employment generation. State-owned banks are mandated by the government to increase lending to critical sectors. The government's policies of injecting equity into state-owned banks and providing concessional lending, while legislating norms for the adoption of internationally recognized financial disclosure and rating requirements for financial institutions, underlie its commitment to encourage growth with systemic stability.

⁹ For the RHS (as detailed in Presidential Decree PP1483, 26 November 2010), the loan amounts are capped at 1,000 times the minimum monthly wage and offered for a 15-year term (that includes a 6-month grace period) at 50% of the Central Bank of Uzbekistan's refinancing rate.

while QQB is licensed as a universal commercial bank in Uzbekistan, its charter narrows its operational focus to financing rural physical and social infrastructure primarily through directed credit at administered interest rates and terms.

3. Under the RHS, QQB provides loans to individuals residing in rural areas to finance private houses of approved standard designs, built by contractors selected by *hokimiyats* (local governments).¹⁰ To fund the directed lending, the government has provided QQB with a subordinated loan of SUM170 billion (about \$100 million) for a 15-year term (including a grace period of 5 years) at an interest rate of 3%.¹¹ QQB is exempt from paying income tax on interest from rural housing loans made before 1 January 2012. Rural housing borrowers (who obtain loans before the same date) are also exempt from paying property tax on the financed property and duties on approved materials imported for house construction.

Table 1: Loan Portfolio by Region

Region	2008	2009	2010 (unaudited)
Republic of Karakalpakstan	9.3%	8.8%	6.3%
Andijan	10.4%	5.6%	7.9%
Bukhara	6.3%	5.7%	6.9%
Jizzak	5.3%	3.6%	4.7%
Kashkadarya	8.5%	7.1%	8.8%
Navoi	4.4%	3.9%	5.3%
Namngan	7.2%	5.8%	7.0%
Samarkand	5.9%	6.6%	8.0%
Surkhandarya	8.1%	7.1%	9.3%
Sirdarya	5.8%	4.2%	4.0%
Fergana	8.0%	7.6%	7.7%
Khorezm	4.5%	5.3%	6.6%
Tashkent Region	10.0%	17.3%	12.0%
Tashkent city	6.1%	11.5%	5.5%
Total	100%	100%	100%

Note: 2008 data is for Gallabank, QQB's predecessor.

Source: Qishloq Qurilish Bank.

4. QQB's loan portfolio is geographically dispersed countrywide (Table 1), and increasingly concentrated in residential mortgages,¹² almost all linked to the RHS (Table 2). Despite the

¹⁰ QQB's loans are made in accordance with its loan policy which requires that an inquiry on each loan applicant be made to the National Institution of Credit Information and provides that mortgage loans are made in accordance with (i) the Statute on Procedures of Making Mortgage Loans for Home Construction, Reconstruction, and Purchase, approved by Resolution No. 2 of the Cabinet of Ministers dated 3 January 2007; (ii) Procedures of Granting Privileged Mortgage Loans by QQB to Individual Developers for the Purposes of Home Construction According to Approved Standard Designs, approved by Resolution No. 148 of the Cabinet of Ministers (25 May 2009); and (iii) the Statute on the Procedures of Individual Construction of Homes with the Participation of QQI Engineering Company, approved by Resolution No. 280 of the Cabinet of Ministers (26 October 2009).

¹¹ The Ministry of Finance extended a \$2 million credit line to QQB's predecessor, Gallabank, under the World Bank's Agricultural Enterprises Finance Project. QQB does not have any other credit lines from international financial institutions or foreign banks.

¹² Sectoral concentration limits are not imposed by law or financial sector regulation. Loan portfolios of a number of other state-owned banks are also highly concentrated. For Agrobank, agricultural loans exceed 70% of the total loan portfolio. Similarly for Alokabank and Asakabank, loans to the telecommunications and automotive sectors account for 25% and 22% of each of the respective bank's loan portfolios. Source: Moody's Ratings Reports (2010).

more than eight-fold increase in QQB's mortgage lending,¹³ its portfolio quality at the end of 2010 remained stable (Table 3). However, the rapid expansion of its rural mortgage portfolio (by over eight times in 2010) to subborrowers with seasonal income appears to have led to a recent increase (to 8%) in the percentage overdue by more than 30 days.¹⁴ QQB is taking a number of actions to improve its underwriting and risk management of its rural loan portfolio (Table 3).¹⁵ In addition to the Central Bank of Uzbekistan (CBU) (as part of its regulatory oversight role) and the Ministry of Economy (as the multitranches financing facility executing agency), QQB will, during loan implementation, closely monitor its portfolio to help ensure that its quality is maintained or improved further.

Table 2: Loan Portfolio by Sector

Sector	2008	2009	2010 (unaudited)
Individuals (for mortgages)	13.0%	33.6%	60.8%
Trading and Catering	9.5%	19.9%	8.8%
Production and Reprocessing	50.5%	18.3%	12.7%
Agriculture	22.9%	9.2%	4.5%
Construction	1.6%	8.7%	4.1%
Transportation and Communicati	1.7%	4.7%	2.0%
Financial Services	0.0%	4.2%	a)
Other	0.8%	1.4%	7.1%
Total	100%	100.0%	100.0%

Notes: 2008 data is for QQB's predecessor, Gallabank.

a) In 2010, QQB did not have a separate classification for financial services lending.

Source: Qishloq Qurilish Bank.

Table 3: Loan Portfolio Classification by Quality

Quality	2008		2009		2010⁽¹⁾	
	SUM'000	(%)	SUM'000	(%)	SUM'000	(%)
Good	116,131,671	81.2%	190,963,475	94.7%	476,236,700	95.9%
Standard	4,642,741	3.2%	1,725,056	0.9%	16,781,800	3.4%
Substandard	991,035	0.7%	1,080,970	0.5%	2,901,994	0.6%
Doubtful	1,162,251	0.8%	1,428,515	0.7%	631,900	0.1%
Loss	20,116,831	14.1%	6,552,859	3.2%	-	0.0%
Total	143,044,529	100%	201,750,875	100%	496,552,394	100%

(1) Unaudited and based on national accounting rules.

Note: Loans are classified in accordance with Statute 632 on Asset Quality Rating by Commercial Banks, Formation, and Utilization of Reserves to Make Up for Losses Incurred, registered by the Ministry of Justice (11 February 1999).

Source: Qishloq Qurilish Bank

¹³ In 2010, 6,800 RHS mortgages were issued, compared to 847 in 2009.

¹⁴ In 2010, farmers accounted for about 50% of all mortgages approved, compared to about 20% in 2009. Rural lending is subject to seasonality of rural household income flows, with high income flows in summer and autumn when crops are sold, and very high expenditures in winter and spring when farmers have main expenditure requirements to purchase seed and other agricultural inputs. In summer, outstanding payments are typically paid in full and often paid in advance of payments due in winter or spring. The QQB reports that this was the payment trend in 2009, with a number of mortgages (about 2%–3% of the total) paid off in full (interest due as well as all outstanding principal) following an exceptional crop for some farmers.

¹⁵ QQB strengthened its credit policy in March 2011.

5. QQB's financial statements for the past three calendar years are summarized in Table 4. Analysis of QQB's financial statements shows it to be reasonably solvent, comfortably liquid, and marginally profitable.

Table 4: Summary Financial Information, 2008–2010
(SUM '000)

Item	2008 (audited)	2009 (audited)	2010 (unaudited)
Balance Sheet			
Cash and cash equivalents	24,635,107	115,812,565	151,045,183
Loans	136,088,338	195,522,798	494,004,867
Other assets	1,066,255	1,299,896	13,484,538
Total Assets	171,196,314	379,299,766	720,306,716
Deposits	65,764,292	259,769,839	312,989,950
Other liabilities	2,345,724	1,212,435	34,106,062
Capital	30,960,116	67,303,646	180,306,847
Total Liabilities and Capital	171,196,314	379,299,766	720,306,716
Income Statement			
Net profit	5,149,064	1,063,662	7,116,850
Ratios			
Risk-based capital (%)	21.1	25.5	25.0
Return on average assets (%)		0.4	1.3
Loans to deposits (%)	177.9	87.8	157.8

Source: Qishloq Qurilish Bank

6. QQB was rated by Moody's in December 2009 and again in September 2010 as E+ for overall bank financial strength, B1/NP (nonprime) for domestic currency deposits, and B2/NP for its foreign currency deposits. Its overall outlook was rated *stable*.

7. The consolidated financial position and financial performance of QQI and its subsidiaries are summarized in Table 5. For its construction management services, QQI receives a fee from each building contractor of 0.7% of the cost of the house. QQI's small profits for 2010 (0.1% of its year-end assets and year-end equity) reflect its purpose of providing construction management services and construction materials at break-even prices.

Table 5: Qishloq Qurilish Invest Summary Financial Information
(SUM million, unaudited)

Balance Sheet	31 December 2010
Cash and cash equivalents	46,663
Other current assets	20,961
Investments in affiliates	319,192
Other long-term assets	517
Total Assets	387,333
Liabilities to suppliers and contractors	46,429
Other current liabilities	386
Long-term loans	5,792
Total Liabilities	52,607
Equity	334,726
Total Liabilities and Equity	387,333
Net Income	428

Source: Qishloq Qurilish Bank

B. Other Participating Commercial Banks

8. Halkbank, Ipoteka Bank, and Mikrokreditbank have expressed interest in becoming participating commercial banks under the program. Each of these banks has some experience in individual mortgage lending and potentially meets the program's eligibility criteria with respect to capital adequacy and profitability.¹⁶ Each of these banks has rural outreach, an extensive network of branches located in rural regions of the country, and experience in mortgage lending. Subject to their continuing to meet the Asian Development Bank's eligibility criteria, when full due diligence is undertaken, they will be considered for participation in the program.¹⁷

1. Halkbank

9. Halkbank is the fifth-largest bank in the country, ranked by both assets and deposits (\$861 million and \$623 million respectively as of 31 December 2010). As of 1 January 2011, its risk-based capital ratio was 26.1%. The 100% state owned bank has the country's largest branch network and more than two-thirds of its 487 branches are located in rural areas. Housing loans constitute \$51 million (15.9%) of its loan portfolio. The bank received a counterparty credit rating of B/Stable/B from Standard & Poor's in November 2010. Reported impaired loans constituted 0.5% of gross loans as of 1 August 2010.

2. Ipoteka Bank

10. Ipoteka Bank is the sixth-largest bank in the country, ranked by both assets and deposits (\$660 million and \$412 million respectively as of 31 December 2010). As of 1 January 2011, its risk-based capital ratio was 24.6%. The bank is majority privately owned, with 28% government ownership. The bank has 36 branches located in all regions of the country and has been engaged in mortgage lending since it was established in 2005. Housing loans constitute \$52 million (16.3%) of its loan portfolio. In September 2010, the bank was rated B2/NP (foreign currency deposits), B1/NP (domestic currency deposits), and E+ (financial strength) by Moody's.

3. Mikrokreditbank

11. Mikrokreditbank is the eighth-largest bank in the country, ranked by both assets and deposits (\$378 million as of 31 December 2010). The bank was established in 2006 and 80% of its shares are owned by the government. The bank has 82 branches located in all regions of the country. The bank has the country's largest portfolio of loans to micro and small entrepreneurs. Housing loans constitute \$3 million (1.8%) of its loan portfolio. In December 2010, Fitch Ratings upgraded the bank's long-term foreign currency issuer default rating to B.

¹⁶ Relevant criteria are a risk-based capital adequacy ratio of at least 12% and a return on average assets for each of the last two completed fiscal years of at least 0.5%. Eligibility criteria also include a ratio of nonperforming loans of less than 5%. A full list of eligibility criteria is set forth in the facility administration manual (accessible from the list of linked documents in Appendix 2).

¹⁷ Data for this section has been provided by the Central Bank of Uzbekistan. Pending the completion of audits for 2010, ratios for 2010 are calculated based on unaudited numbers for each of the banks (excluding their subsidiaries).