Shelter Afrique

Final Issuer Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

Shelter Afrique

Issuer Ratings:

A(ken)

A+(ngr)

Outlook: Stable
Issue Date: 21 Sep 2023
Expiry Date: 30 Jun 2024
Previous Rating: A(Ken) A+(ngr)

Industry:
Real Estate Finance

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RATING RATIONALE

Agusto & Co. affirms the "**A(ken)**" and "**A+(ngr)**" national scale ratings assigned to Shelter Afrique ("SHAF" or "the Company"). The rating is hinged on the Company's multilateral legal ownership and relationship with 44 African Governments as well as SHAF's critical developmental mandate to drive affordable housing demand and supply in Africa. The Company's adequate capitalisation, low leverage and acceptable liquidity profile also supports the rating affirmation. However, SHAF's rating is constrained by weak asset quality which has been negatively impacted by legacy delinquent loans. We have also considered the inconsistent capital contributions from the member countries and frequent changes in senior management as rating negatives.

SHAF is a supranational development financial institution owned by 44 African governments, Africa Development Bank and African Reinsurance Corporation. The Company is governed by an 11-member Board comprising seven Class 'A' directors representing the interests of the member countries, two Class 'B' directors representing the institutional shareholders and two independent directors. SHAF's two largest shareholders are the Republic of Kenya and the Federal Republic of Nigeria with 16.3% and 15.3% equity stakes respectively. The African Development Bank, which is rated "**Aaa**" is the third largest shareholder with an 11.7% stake. The Company has a mandate to support affordable housing and urban development in Africa through the provision of lines of credit to fund mortgage related activities and project finance loans for the construction of housing estates, commercial buildings and infrastructure.

As at the 2022 FYE, SHAF's gross loans stood at $269.5 million, a moderate 10% growth from the prior year. However, non-performing loans (NPLs) remained significant and accounted for 53% of gross loans. The NPLs were legacy exposures largely to developers who were unable to complete projects after SHAF stopped funding following breaches in the terms of the loan agreement. Nonetheless, the Company has continued to drive recoveries with collections of $2.8 million in 2022, a marginal increase from the $2.5 million reported in 2021. SHAF's loss provisions covered 80.8% of NPLs, with the uncovered amount equating to 17.1% of shareholders' funds, which we consider significant. In our opinion, the Company's asset quality is weak – constrained by the legacy non-performing credits and the expected high loan impairment charges.

In the review period, SHAF issued a Naira bond equivalent to $110 million and due 2029 in the Nigerian capital markets at interest rates of 13% and 13.25% per annum for the floating and fixed portions respectively. Thus, the Company's debt-to-equity ratio was 0.7x (2021: Nil), which was significantly below our threshold for DFIs. Nevertheless, we anticipate an uptick in leverage as SHAF obtains borrowings predominantly from DFIs in the near term and to a lesser extent, from capital markets and commercial banks to drive developmental impact.

SHAF's developmental role makes profitability a secondary goal. In the 2022 FY, the profitability indicators were significantly below our benchmarks as the Company recorded an $11.8 million loss due to high impairment charges. Unaudited accounts for the six months ended 30 June 2023 indicated that SHAF remained in a loss-making position, with a lower loss before tax of $78,612. Given the non-performing loan balance of $141.8 million and SHAF's delinquent credits write-off practice, we do not anticipate a swing to profitability in the near term.

As at 31 December 2022, SHAF had $158.4 million in shareholders' funds, which funded 58.6% of total assets. The Company's shareholders' funds predominantly comprised issued share capital given the sizeable accumulated losses of over $32.6 million as at the same date. SHAF had a Basel II capital adequacy ratio of 25.6% (2021: 28.6%), which was better than our benchmark and at par with the internal minimum standard of 25%. Capitalisation profile in the review period was supported by shareholders' equity injection totalling $8million. However, there were sizeable outstanding capital calls of $280 million as at the 2022 FYE as the capacity of member countries to meet these commitments continue to dwindle due to weak finances and macroeconomic headwinds. Notwithstanding, the Company continues to benefit from moderate shareholder support, with over $110 million in capital received from 2017 to 2021 and $7million received as of 30 June 2023.

Based on the aforementioned, we hereby attach a "**stable**" outlook to the rating. We are aware that the inconsistent and low level of capital injections to SHAF may continue given that this is an era where many shareholder countries are facing precarious headwinds. However, our **stable** outlook is hinged on the expectation that there will be an effective implementation of the 'New Dawn' strategy to bolster capitalisation through improved asset quality, profitability and retention of profits. In particular, we expect that the enhanced staffing and risk management processes will ensure little or no migration of new loans to the Stage 3 (non-performing) class. The rating is susceptible to change if in the next 12-18 months, the high volume of delinquent loans, high turnover in senior management cadre and weak profitability persist.

Positive Rating Triggers

- Improved non-performing loan ratio of below 5%
- Positive profit before tax value and sustained profitability indicators
- Shareholders' clearance of outstanding capital arrears and enhanced capitalisation metrics
- Should the rating of the two principal sovereigns improve

Negative Rating Triggers

- Non-performing loan ratio above 25% by 2023FYE
- Loss before tax by 2023 year end
- Significant deviation from the 'New Dawn' strategy plan
- High staff turnover (above 5%) in senior management cadre as at 2023FYE

Table 1: Financial Data for SHAF

	31 December 2021	31 December 2022
Total Assets	$167 million	$270 million
Net Earnings	$11.3 million	$475,354
Pre-tax return on average assets	1.1%	-5.4%
Pre-tax return on average equity	1.2%	-7.4%

Figure 1: Strengths, Weaknesses and Challenges

Strengths

- Strategically important developmental mandate
- Multilateral legal ownership and relationship with 44 African Governments
- Significant tax benefits including full exemption from any taxation in Kenya
- Strong brand recognition in most countries with a SHAF presence
- Adequate capitalisation
- Acceptable liquidity profile
- Low leverage

Weaknesses

- Sluggish capital receipts from member countries
- Asset quality is constrained by the high volume of impaired legacy loans
- Weak profitability
- Frequent changes on the Board

Challenges

- Improving income sustainably
- Raising considerable (and inexpensive) funding
- Challenging macro environment in member countries
- Growing competition from larger DFIs in the housing space
- Weak investment climate and regulatory environment for housing in Africa

COMPANY PROFILE

Shelter Afrique ("SHAF" or "the Company"), also known as the Company for Housing and Habitat in Africa, is a pan-African housing finance and development institution. SHAF was established by African Governments, the African Development Bank, the African Reinsurance Corporation and the CDC Company Plc to address the need for innovative and sustainable housing delivery systems in Africa. The Company is an international body with a juridical personality and full legal capacity established by the Constituent Charter of Shelter Afrique. The Shelter Afrique Act, which provides for the carrying out of the Company's obligation was assented to on 23 December 1985, when SHAF began its operations. The Company's principal office is located at the Shelter Afrique Centre, Logonot Road, Upper Hill, Nairobi, Kenya. SHAF also has two regional offices, which are situated in Abuja, Nigeria and Abidjan, Cote d'Ivoire.

SHAF supports social housing programs in client countries. The Company also supports integrated affordable housing solutions for mixed use - mixed income housing developments, rental housing developments, and construction of large scale housing projects.

Business Strategy

'Stabilisation, modest growth towards sustainable resilient and inclusive development' is SHAF's key theme for the next five years. This theme has been broken down into three broad goals, which will help the Company deliver its mandate and enhance shareholder value.

1. **Enhance Housing Development Impact and Shareholders' Value**
   This goal will be achieved through the provision of affordable housing finance solutions and technical assistance. Specifically, SHAF aims to enable the delivery of 15,000 housing units focusing on the social and affordable segments.

2. **Achieve Financial Sustainability**
   SHAF plans to generate and maintain robust positive financial returns and position by posting and monitoring key performance indicators in the areas of liquidity, profitability, asset quality, efficiency and productivity.

3. **Improve Organisational Sustainability**
   SHAF plans to adopt and entrench best corporate governance standards, ethical business practices and climate-friendly investments that shape strategic decision-making.

In line with these goals, four business units will drive the execution of SHAF's strategy for affordable housing finance solutions:

- **Financial Institutions Group (FIG):** This team will primarily focus on investments with financial institutions, including microfinance institutions and cooperatives across Africa, offering best in class solutions and products that address both housing demand and supply gaps.

- **Project Finance Group (PFG):** This business line will primarily focus on project finance structuring and direct investments across Africa's housing value-chain.

- **Public Private Partnerships (PPP) and Sovereign**: This business line will focus on the design and delivery of finance solutions in collaboration with member states for housing supply and social housing needs.

- **Fund Management Group (FMG):** This business unit will assist in raising concessional or blended funding to provide finance solutions for affordable housing demand and supply. FMG will prioritise themes including green/resilient climate financing, gender, small/medium-sized enterprises (SMEs) and trade finance in the housing value-chain and infrastructure solutions.

Business Structure

In line with the new strategic focus, SHAF is now structured along seven major units:

- Corporate Functions (comprising Internal Audit, Company Secretary and Enterprise Risk Management)
- Office of the Managing Director (comprising the Executive Assistant, Communications & External Affairs, Investor Relations, Strategy, Policy, Research & Partnerships and Advisory)
- Business Sector/Industries (FIG, PFG, FMG and PPP & Sovereign)
- Finance
- Credit and Operations
- Human Capital Management
- Legal & General Counsel

The four business sector units – FIG, PFG, FMG and PPP & Sovereign – will be led by four different heads, who will report directly to the Managing Director/CEO. All heads of departments at SHAF report to the Managing Director/CEO except for the heads of the Enterprise Risk Management, Company Secretary and Internal Audit units, who report functionally to the Board and administratively to the CEO.

Information Technology

SHAF uses Oracle Cloud Enterprise Resource Planning (ERP) as the core enterprise application for treasury, procurement, human resources & performance management and accounting. The ERP also incorporates Oracle Loans for credit administration. Other solutions used by the Company include Microsoft Office365, World Check One AML, Auto Audit, ICT Helpdesk and Intranet. The "SHAF Anywhere" programme enables staff to work from any location using solutions that include virtual private networks, video conferencing and DocuSign esignature. In the review year, SHAF commenced the integration of the SWIFT payment system with the Oracle Cloud ERP, which is set to be completed by December 2023. The Company plans to improve disaster recovery processes by implementing a cloud-based storage system and automate loan management, monitoring and compliance processes in the near to medium term.

OWNERSHIP, MANAGEMENT & STAFF

SHAF is a pan-African development finance institution (DFI) that exclusively supports the development of the housing and real estate sector in Africa. The Company is owned by 44 African governments and two African financial institutions – the African Development Bank (AfDB) and Africa Reinsurance Corporation ('Africa Re'). SHAF's ownership is moderately concentrated with the five largest shareholders – Kenya, Nigeria, AfDB, Ghana and Mali – holding 53.3% of the equity while the balance of 46.7% is held by the other 40 African countries and one institution. In our view, the concentration in ownership results in an imbalance that limits the ability to raise significant funding via capital calls from a large section of members.

SHAF is governed by an 11-member Board of Directors ("the Board"), which is chaired by Dr Patience Chika Akporji, who represents AfDB. The members of the Board are all non-executive directors. The Board comprises seven Class 'A' directors representing the interests of the member countries, two Class 'B' directors representing the institutional shareholders and two independent directors. The Company has established and documented terms of reference and process for the appointment of independent directors including a maximum tenure of two terms of three years, which we view positively. In the review year, an independent member, Dr Stephen Mainda, voluntarily resigned from the Board in July 2022 and was replaced by Mr Lionel Zinsou. In addition, Mr. Ephraim Kiiza Bichetero and Mr. Phocas Nyandwi were elected as Director and Alternate Director respectively in July 2023 representing Africa Re's on the Board for a period of three (3) years. Additionally, Dr. Theresa Tufuor was appointed as the Alternate Director to represent Group 3 on the Board for a period commensurate to the term of the substantive Director, Mr. Alain Kossi Gbati Ouadja from Togo. We view positively the satisfactory representation of shareholders on the Board. However, we believe the appointment of additional independent members would enhance the overall quality of governance. We also note that the frequent changes on the Board negatively impacts the stability and oversight of SHAF's strategic direction.

The Company has four board committees: the Audit and Risk Committee, the Finance, Credit & Investments Committee, the Strategy, Business Conduct and Ethics Committee, and the Human Resources, Governance and Nominations Committee, which are all chaired by Class 'A' and 'B' directors.

Table 2: Board of Directors

Directors	Position	Country/Representing
Dr. Chii Akporji	Board Chairperson	AfDB
Vacant	Vice Chairperson	-
Mr. Babatunde Sanda	Member	Nigeria/Independent
Mr. Lionel Zinsou	Member	Benin/Independent
Mr Ephraim K. Bichetero	Member	Uganda/Africa Re
Mr. Issa Sissoko	Member	Mali/Group 7 countries
Mr. Charles Hinga Mwaura	Member	Kenya/Group 1 countries
Mr. Edward Kyazze	Member	Rwanda/Group 2 countries
Mr. Ouadja Gbati	Member	Togo/Group 3 countries
Mr. Ahmed Belayat	Member	Algeria/Group 4 countries
Mrs. Eucharia Alozie	Member	Nigeria/Group 6 countries

There were changes to SHAF's executive management in the review period. Following the resignation of Mr. Andrew Chimphondah on 17 February 2022, the Company's Chief Financial Officer – Mr. Kingsley Muwowo – served in an acting capacity as the Managing Director until 9 January 2023, when he retired. A new Managing Director – Mr. Thierno Habib-Hann, took the helm on 10 January 2023 while Mr. Muwowo was replaced by Mrs Beatrice Mburu, who was the Acting Chief Finance Officer. Mr. Alfred Nicayenzi's contract, the erstwhile Chief Operations Officer's contract was not renewed and the role was replaced by a Head of Credit and Operations, to which Mr. Christopher Chege was appointed. Agusto & Co. remains concerned about the frequent changes in senior management team which could significantly disrupt the implementation of SHAF's turnaround strategy. Nonetheless, we note that the Company's management team comprises skilled professionals, with over 15 years of experience on average. In 2022, SHAF had 48 employees (2021: 46 staff), who are citizens of 17 of the member African countries. Staff productivity, measured by the number of times net earnings covered staff cost was 0.1x (2021: 2.1x), which was below our expectation of at least 3times for a DFI. Nevertheless, we believe that the Company's management has good depth of experience.

MANAGEMENT TEAM

Mr. Thierno-Habib Hann joined Shelter Afrique from the International Finance Corporation, where he served as the Asia/Pacific Lead for housing finance, based in Bangkok, Thailand. Mr. Hann has extensive international experience in housing finance, capital markets/investment banking and structured finance spanning over 20 years. Mr. Hann began his career at the consulting firm Arthur Andersen, LLC as a Senior Consultant in Financial Services and Capital Markets in New York, USA. He worked at JPMorgan Chase and Goldman Sachs as Manager and Vice President respectively and led investment teams issuing mortgage-backed securities (RMBS/CMOs) and credit derivatives (CDS). He has also served at the World Bank Group as the Private Sector Development Program Manager in Guinea, responsible for designing and implementing the investment climate improvement program while developing a bankable pipeline of investments and government advisory projects.

Mr. Hann is a Guinea national who holds Master's degree in Accounting and Finance (M.S.T.C.F) and a Bachelor's degree in Management and Applied Economics (GEA) from the University of Paris IX Dauphine, France. He also holds an MBA in Finance & Investments from the Zicklin School of Business, Baruch College, New York, USA.

Other members of SHAF's senior management team include:

▪ Mrs Beatrice Mburu	Chief Finance Officer
▪ Mrs. Juliet Kavaruganda	Company Secretary
▪ Mr. Bernard Oketch	Head of Enterprise Risk Management
▪ Mr. Yankho Chitsime	Head of Project Finance Group
▪ Mr. Charles Kazuka	Head of Human Resources and Administration
▪ Dr. Muhammad Gambo	Head of Policy, Research and Partnerships
▪ Ms. Houda Boudlali	Head of Legal Services
▪ Mr Christopher Chege	Head of Credit and Operations
▪ Mr Edmond Adjikpe	Head, Public & Private Partnerships and Sovereign Lending Group

Analysts' Comments

Asset Quality

SHAF focuses on originating lines of credit and project finance loans while ensuring sufficient liquid assets to meet disbursement requirements. As at 31 December 2022, the Company's total assets stood at $270.4 million, a 62% growth from the end of the prior year. The increase in total assets was largely driven by the proceeds from SHAF's $110 million debut bond issuance in Nigeria's capital market under the $481.3 million issuance programme. Nevertheless, as at 31 December 2022, the Company's gross loans stood at $269.5 million, which represented a moderate 10% growth from the previous year and the dominant asset class, constituting 99.7% of total assets. In the year under review, SHAF disbursed loans of $80.7 million against a target of $130 million, representing a 62% achievement. Despite the 'below target' achievement, $80.7 million disbursed in 2022 was the highest disbursement level since 2014, when $104 million was disbursed. In addition, from the ₦46 billion ($100 million) bond proceeds, ₦15 billion ($33 million) was disbursed in the 2022FY and the balance of ₦31 billion will be disbursed in 2023. We note the prudence in loan disbursements aimed at avoiding past lending mistakes that now threatens SHAF's sustainability. Nevertheless, SHAF's conservative approach constrains profit margins. We expect notable growth in the loan book in the near term as SHAF aims to deploy an additional $31 million from the proceeds of the debut bond by December 2023.

As at the 2022 FYE, the Company's exposures were largely skewed to Francophone West/Central Africa (41%) and Anglophone West Africa (35%), with loans to borrowers in these regions jointly accounting for 76% of the portfolio. Exposures to obligors in Eastern (14%) and Southern Africa (10%) constituted the balance of the loan book. We expect to see greater concentration in the loan portfolio in near term with the ongoing disbursement of the bond proceeds in Nigeria. However, we expect better diversification of the loan portfolio in the medium term as SHAF prioritises an even spread of its developmental impact across the 44 member countries.

The bulk (74.4%) of the Company's loans comprised short to medium-term lines of credit to financial institutions to on-lend for mortgage related activities while medium-term project finance loans to developers made up a much smaller share (23%). A small fraction (2.6%) of SHAF's loan book consisted of staff loans. We expect this trend to continue in the near term given the lower risk of lines of credit to financial institutions compared to project finance loans, which are provided for the often-challenging construction phase and dependent on successful offtake. Notwithstanding, we expect project finance loans to contribute significantly in the medium term in line with SHAF's mandate as the Project Finance Group (PFG) and PPP & Sovereign units are properly resourced and ramp up activities. The Company's loans were well diversified by obligors, with exposures to the top 20 borrowers constituting only 8.6% of the portfolio. In addition, loans were dominated by USD and Euro denominated exposures which represented 83% of the portfolio while matched exposures in member country currencies (Kenyan Shillings, CFA, Naira and South African Rand) made up the balance of 17%.

As at 31 December 2022, SHAF's stage three or non-performing loans (NPLs) remained significant at $141.8 million. This translated to a very high NPL to gross loans ratio of 53%, albeit lower than the 66% recorded in the prior year due largely to the growth in the loan book. Over 94% of NPLs were project finance loans, with the bulk comprising legacy loans related to incomplete projects that had funding withdrawn because the obligors were in breach of terms of the loan agreement. The Company wrote off $6.9 million of the legacy loans in the review year. Nevertheless, SHAF continues to drive recoveries, with collections of $2.8 million in 2022, a marginal increase from the $2.5 million reported in 2021. In our view, given the Company's member countries' limited foreclosure laws and drawn-out court processes, the NPLs are unlikely to be recovered in the near to medium term. So, we expect asset quality to remain weak. Unaudited accounts as at 30 June 2023 indicate that the NPL ratio remained high at 58%, with additional credits classified under stage 3. Management has recently revised and revamped the NPL recovery strategy to ensure quicker exits of delinquent loans from the portfolio. For instance, for legal cases, targeted re-engagement of borrowers is undertaken. There are also undergoing negotiations with obligors with a view to amicable resolutions. In addition, for incomplete projects that account for circa 60% ($ 83.9 million) of the NPLs, a review of the portfolio has been carried out and notably, 5 out of the 11 cases have been revisited to push for quicker resolutions and exits. Furthermore, assets classified as available for sale, about 124 housing units with an estimated value of $8.5 million are in the market for planned sell outs. Regarding the proposed liquidation of the available for sale assets, government support has been solicited and there is a possibility of a bulk purchase from the sovereigns.

As at 31 December 2022, the Company's loss provisions covered 80.8% of NPLs, with the uncovered amount equating to 17.1% of shareholders' funds, which we consider significant. Given SHAF's housing and real estate focus, we expected a minimum NPL coverage ratio of 100% which indicates a proactive recognition of losses. In our view, a 100% and above NPL coverage ratio should moderate the impact of impairments on future earnings. Management has affirmed that the uncovered portion is fully secured through the legal charge on property which SHAF has and this should mitigate any impact on future earnings.

As at the 2022 FYE, liquid assets totalling $86.8 million was the second largest asset class and predominantly (88%) comprised placements with well-rated financial institutions. Federal Government of Nigeria (FGN) Naira bonds, which are of "Aaa" credit quality on the national rating scale, made up the balance (12%). In the year under review, a significant 70% of placements were denominated in Naira, largely representing the proceeds from the debut bond issuance in Nigeria. These placements were domiciled in investment grade Nigerian banks on our national rating scale. A smaller share (20%) of placements were held in US Dollars in Kenyan banks to provide significant protection against foreign currency risk relative to the domestic currencies of member countries. However, only 92% of the USD placements were in rated Kenyan banks with 8% impaired and held in Chase Bank Limited Kenya, a financial institution that was placed under statutory administration on 7 April 2019 by the Central Bank of Kenya. The balance (10%) of placements was mostly denominated in Kenyan shillings and held in rated Kenyan banks. We also note the short tenured nature of the placements (with maturity within 90 days) and the FGN bond which matures within one year.

Overall, we consider SHAF's asset quality to be weak given the huge portfolio of legacy non-performing loans, which remains a drag. Loan impairment charges will continue to be high pending when the problematic loans have been removed from the Company's books.

Risk Management

The Board is responsible for the establishment and review of the effectiveness of the Company's risk appetite, risk management framework and system of internal control. The Board carries out this responsibility through four committees: Audit and Risk Committee (ARC), Strategy, Business Conduct and Ethics Committee (SBCE), Finance, Credit, And Investment Committee (FCIC), Human Resources, Governance and Nominations (HRGN). The Board also delegates some powers to ad-hoc committees where necessary. The responsibility for the day-to-day running of SHAF is delegated by statute to the Managing Director, who is supported by a team of nine professionals. The business units are the first line of defence in the management of risks while the Enterprise Risk Management (ERM) unit and the Internal Audit team provide the second and third lines of defense respectively.

In the review year, a credit department was created to enhance credit underwriting and portfolio monitoring and the new Head of Credit and Operations, Mr Christopher Chege took office on 2 April 2023. Based on SHAF's new structure, the Financial Institutions Group (FIG), Project Finance Group (PFG) and Public-Private Partnerships (PPP) & Sovereign business units will be responsible for loan origination while the Treasury team will manage placements. Credit origination will rely on internal credit risk assessments conducted by the credit and ERM teams, which appraise the prospective counterparties subject to financial and non-financial criteria covering areas including capital, earnings and liquidity.

The Company only provides lines of credit to financial institutions that are deemed to have acceptable risk. The origination process for project finance loans is more intensive, involving multiple stages and requirements including due diligence, KYC, valid and unencumbered title to the land, project documentation (social impact assessment, cash flow analyses and financial projections), technical information and on-site reviews. Project finance loans must be reviewed by SHAF's technical committee and loans committee and secured to at least 130% of the loan value either by collateral such as prime property and fixed income securities or guarantees. Unsecured lines of credit may be provided depending on the risk profile of the institution. All lines of credit and project finance loans must be approved by the Board.

The Treasury unit only makes placements in eligible currencies including the US Dollar, Nigerian Naira and Kenyan Shilling. Placements are largely made with tier one and tier two Kenyan and Nigerian banks deemed to have acceptable risk.

The Internal Audit unit reviews business and risk management processes and reports to the Board through the Audit and Risk Committee, which approves the annual work programme. SHAF conducts regular Risk and

Control Self Assessments (RCSA) for all the units, with the business teams collaborating with ERM to record and mitigate the identified risks. The departmental risk & compliance champions drive the RCSA process and the ERM team further assesses the likelihood and impact of identified risks crystallising to provide an overall risk rating. The results are reported to the executive management team and board committees quarterly.

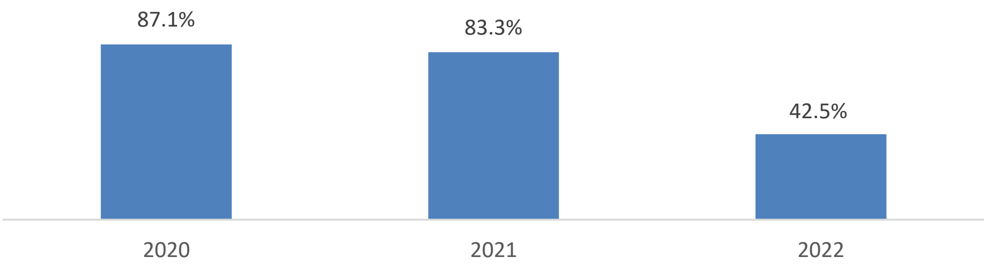
In our opinion, SHAF has an adequate risk management framework for affordable housing financing in member countries with weak macroeconomic and credit profiles. However, the Company's risk management structure is yet to witness significant underwriting activities due to the restricted operations over the last five years.

EARNINGS AND PERFORMANCE

The Company's earnings are predominantly generated from the interest charged on project finance loans and lines of credit granted for real estate related activities. SHAF also generates considerable interest income from holding a portfolio of liquid assets which are placed with financial institutions domiciled in Kenya and Nigeria. Recoveries have also been a major source of income as the Company has prioritised collections as part of its turnaround strategy.

In the financial year ended 31 December 2022, SHAF generated interest income of $17.4 million, a 44% growth from the prior year, with 73% representing earnings from core lending activities and 27% realised from bank placements. However, there was a 394% spike in interest expense to $10 million in the review period following the bond issuance in Nigeria. In addition, SHAF recorded loan loss expense of $8 million which weakened performance considerably. Consequently, SHAF's net interest income declined by 27% to $7.4 million in 2022FY and translated to a significantly lower net interest spread (NIS) of 42.5% compared to the 82.5% recorded in the prior year. Given that in the year under review, 70% of the $76.4 million placement portfolio were denominated in Naira, largely representing the proceeds from the debut bond issuance in Nigeria, we have also attributed the lower NIS to the low average return on bank placements in the country in 2022. Our estimate of SHAF's average return on placements was 7% (2021FY: 3% and 2020FY: 17%) in 2022 despite the 142% increase in gross placements year-on-year. By 2023FYE, we anticipate that interest income from placements will contribute up to 30% to SHAF's earnings given the uptick in interest rates in Nigeria.

Figure 2: Net Interest Spread (2020-2022FY)



Notably, in 2022, the Company wrote off $6.9 million worth of non-performing loans which led to a considerable rise in loan loss expense to $8.2 million. Higher loan loss expense was due to more prudent assessment (and in compliance with IFRS 9 guidelines) of the impairments on long outstanding NPLs. This is a necessary step to clean up the legacy NPL book. In addition, in 2022, there was also a higher impairment charge on joint ventures with some Kenyan real estate companies of US$1.07 million, a 100% increase from a nil figure recorded in the year 2021.Thus, loan loss expense in the review period amounted to 47% of net interest income, a significant deterioration from the prior year's 1%. The mortgage industry in Africa remains bedevilled by difficulties in foreclosures across member states. Thus, disposing real estate collateral to defray NPLs appear to be ineffective for mortgage financiers. Therefore, with SHAF's new strategy to write off legacy debts in order to improve asset quality, we anticipate more aggressive loan loss expenses, which should continue to pressure profitability in the near term. Ancillary income of $1.3 million comprising fees (81%) and other income (19%) also recorded a 7% dip year-on-year in 2022 due to the decline in rental income following SHAF's reduction in rates charged after COVID at the Shelter Afrique Centre in Kenya, which is an investment property held for long-term rental yield. Thus, overall, in the 2022 FY, net earnings were a lower $475,354, a 96% decline from the prior year.

In 2022, the Company incurred operating expenses of $9.5 million, which represented a 17.7% rise from 2021 due to higher consultancy fees, software costs and one-off reporting adjustments for actuarial loss valuation. SHAF also recorded foreign exchange losses of $1.4 million and loss in joint ventures of $1.1 million. Thus, in 2022, the cost-to-income ratio (CIR) declined considerably to 129.6%[1] (2021: 81.4%), higher than the Company's target of 70%. In the review year, SHAF recorded a loss before tax of $11.8 million (2021: $1.8 million profit). Whilst we recognise that profit maximisation is secondary to the Company's developmental objectives, the profitability indicators were significantly below our expectations for DFIs. Based on unaudited accounts for the first six months of 2023, SHAF remained in a loss-making position, with a loss before tax of $78,612.

In our view, the Company's profitability is weak. In our view, given the high level of impaired and lower credit quality loans in SHAF's lending portfolio, we believe its profitability will continue to be weak in the near term.

CAPITAL & LEVERAGE

SHAF relies on its shareholders for funding through periodic capital calls. The Company has a callable capital of $500 million and an internal leverage ratio (debt to equity) not exceeding 300% of called capital. In our opinion, the relatively small callable capital and conservative leverage ratios also contribute to SHAF's minimal developmental impact.

As at 31 December 2022, the Company had issued and called capital of $288.2 million with $125.5 million fully paid. SHAF's policy is to give shareholders a period of five years to meet capital call obligations. However,

[1] *We note that if we calculate cost to income ratio (CIR) as operating expenses divided by net earnings (including impairments), CIR deteriorates considerably to 2577% (2021: 84.1%), significantly worse than our expectation and the Company's target of 70%.*

we note that of the capital calls of $160 million made in 2013 and $252 million made in 2017, 48.7% ($78 million) and 83.3% ($210 million) respectively remain outstanding or in arrears given weak finances of several member countries. Nonetheless, following its aggressive capital call mobilisation, the Company has received over $110 million in capital cumulatively from its shareholders between 2017 and 2021. As of July 2023, SHAF had received additional $7.5 million in capital calls from three countries: Nigeria ($7.1 million), Swaziland ($317,000) and Burkina Faso ($34,000), which we view positively. However, in our opinion, the Company's shareholders need to demonstrate greater consistency in the payment of the arrears to achieve the developmental mandate. As the finances of African governments improve and shareholders show greater willingness to inject more equity into SHAF, we expect capital to continue to rise.

As at 31 December 2022, SHAF's shareholders' funds stood at $158.4 million, down by 2% from 2021 due to the loss accrued to retained earnings. The Company's shareholders' funds, which funded 58.6% of total assets, predominantly comprised issued share capital given the significant accumulated losses of over $32.6 million. SHAF had a Basel II capital adequacy ratio of 25.6% (2021: 28.6%), which was better than our expectation and at par with the internal minimum standard of 25%. The Company had a debt-to-equity ratio of 0.7x, which was significantly below our threshold for DFIs. However, we expect a rise in leverage as SHAF obtains borrowings predominantly from DFIs, commercial banks and bond issuances in member countries' capital markets to drive developmental impact.

In our view, SHAF's leverage is low and capitalisation is currently adequate. However, additional capital will be required to record significant development impact.

LIQUIDITY & FUNDING

SHAF is a non-deposit taking DFI, mainly funded by long-term capital from shareholders and borrowings. As at the 2022 FYE, the Company's debt financing, which funded 41.4% of total assets, primarily (94%) comprised borrowings while other liabilities made up a small share (6%). In the review year, SHAF issued a $110 million bond due 2029 in Naira in the Nigerian debt capital markets at interest rates of 13% and 13.25% per annum for the floating and fixed portions respectively. We note that SHAF is discussing additional borrowings with existing and potential DFI partners and expects this source to fund up to 80% of total assets in the medium term, while equity, commercial bank borrowings and debt issuances will finance the balance of 20%. We expect the newly established Fund Management Group to play a significant role in these concessional funds raising to drive affordable housing demand and supply.

As at 31 December 2022, SHAF had liquid assets of $86.8 million, representing a 175% growth from the prior year primarily due to the proceeds of the bond issuance, which were largely held in short-term placements with well-rated financial institutions and FGN bonds. Consequently, the liquidity ratio (liquid assets to total assets) improved to 31% (2021: 19%), which was above our expectation and the Company's internal benchmark of 15%. Unaudited accounts as at 30 June 2023 indicated that liquidity ratio remained stable at 31%. We also view positively that SHAF has a US$20 million contingent facility with a Nigerian bank that has international authorisation. Overall, in our opinion, SHAF's liquidity and funding profile is satisfactory.

OUTLOOK

In Africa, inflation, currency devaluation and other macroeconomic headwinds persists and the recent spate of sovereign debt crisis have heightened credit risk for pan-African DFIs. Therefore, new strategies are required for pan-African DFIs to sustain income and enhance shareholder value. In line with the macroeconomic realities in Africa, SHAF has introduced its "New Dawn" corporate plan with the goal of becoming a world-class premier pan-African housing development bank and delivering better shareholder value. Thus, through more efficient on boarding of clients and vigorous credit underwriting, the Company aims to restore financial sustainability while instituting Environmental, Social and Governance (ESG) standards.

By the 2024 FYE, SHAF plans to prudently scale up a quality loan book to reduce the hitherto high delinquency loans. Thus, Agusto & Co. anticipates an improvement in asset quality driven by the continued focus on recoveries. We expect a modest increase in shareholders' equity bolstered by capital calls from member countries and higher reserves from more profitable operations with the creation of better-quality risk assets. Furthermore, with plans to raise additional funding in the domestic debt capital markets of other member states in the near term, we expect the Company's funding to improve and leverage to rise but remain within acceptable limits. We believe that SHAF's liquidity profile should remain satisfactory in the near term given adherence to the internal policies.

We hereby attach a "**stable**" outlook to the rating.

FINANCIAL SUMMARY

SHELTER AFRIQUE						
STATEMENT OF FINANCIAL POSITION AS AT	**31-Dec-20**		**31-Dec-21**		**31-Dec-22**	
	$		**$**		**$**	
ASSETS						
Cash & equivalents	5,206,525	2.9%	5,912,851	4%	3,400,643	1.3%
Quoted investments		0.0%		0%	10,392,317	3.8%
Short-term placements	42,200,586	23.8%	25,677,981	15%	72,961,707	27.0%
Liquid Assets	47,407,111	26.7%	31,590,832	19%	86,754,667	32.1%
Gross Loans	228,149,132	128.6%	244,246,753	146%	269,541,177	99.7%
Less: Cumulative loan loss provision	(120,015,780)	-67.6%	(131,655,081)	-79%	(114,529,205)	-42.4%
Total loans & advances - net	108,133,352	60.9%	112,591,672	67%	155,011,972	57.3%
Interest receivable	431,607	0.2%	294,495	0.2%	153,274	0.1%
Other prepayments	786,434	0.4%	488,235	0.3%	540,613	0.2%
Other accounts receivables	2,084,994	1.2%	2,146,621	1.3%	3,482,371	1.3%
Unconsolidated subsidiaries & associates	3,687,279	2.1%	4,086,707	2.4%	2,823,239	1.0%
Other long-term investments	5,840,000	3.3%	5,458,000	3.3%	5,445,000	2.0%
Fixed assets & intangibles	10,054,707	5.7%	11,809,420	7.1%	17,421,783	6.4%
Total Assets	**177,448,079**		**167,317,852**		**270,422,450**	
CAPITAL & LIABILITIES						
Shareholders' Funds	136,245,141	77%	161,603,767	97%	158,399,320	59%
Total Borrowings	34,713,671	20%		0%	105,195,956	39%
Other Liabilities	6,489,266	4%	5,714,085	3%	6,827,264	3%
Total Capital & Liabilities	**177,448,078**		**167,317,852**		**270,422,450**	
AUDITORS	**Deloitte**		**PWC**		**PWC**	
Opinion	**Clean**		**Clean**		**Clean**	

INCOME STATEMENT FOR THE YEAR ENDED	31-Dec-20		31-Dec-21		31-Dec-22	
	$		**$**		**$**	
Interest income	13,944,976	92.9%	12,092,354	89.8%	17,393,315	93.1%
Interest expense	(1,802,687)	-12.0%	(2,022,873)	-15.0%	(10,001,243)	-53.5%
Loan loss expense	(5,326,348)	-35.5%	(88,216)	-0.7%	(8,203,110)	-43.9%
Non-interest income	1,071,189	7.1%	1,377,322	10.2%	1,286,392	6.9%
NET EARNINGS	**7,887,130**	**52.5%**	**11,358,587**	**84.3%**	**475,354**	**2.5%**
Staff costs	(5,591,416)	-37.2%	(5,388,860)	-40.0%	(4,635,973)	-24.8%
Depreciation expense	(341,933)	-2.3%	(392,770)	-2.9%	(501,038)	-2.7%
Other operating expenses	(3,295,876)	-21.9%	(3,766,052)	-28.0%	(7,112,975)	-38.1%
TOTAL OPERATING EXPENSES	(9,229,225)	-61.4%	(9,547,682)	-70.9%	(12,249,986)	-65.6%
PROFIT (LOSS) BEFORE TAXATION	(1,342,095)	-8.9%	1,810,905	13.4%	(11,774,632)	-63.0%
TAX (EXPENSE) BENEFIT	-		-		-	
PROFIT (LOSS) AFTER TAXATION	**(1,342,095)**	**-8.9%**	**1,810,905**	**13.4%**	**(11,774,632)**	**-63.0%**
GROSS EARNINGS	**15,016,165**	**100%**	**13,469,676**	**100%**	**18,679,707**	**100%**

THE COMPANY FOR HABITAT AND HOUSING IN AFRICA (SHELTER - AFRIQUE)			
KEY RATIOS	**31-Dec-20**	**31-Dec-21**	**31-Dec-22**
PROFITABILITY & EARNINGS			
Net interest spread	87.1%	83.3%	42.5%
Loan loss expense/Interest income	-295.5%	-4.4%	-82.0%
Operating expenses/Net Earnings (excluding loan loss expense)	101%	81.4%	129.6%
Return on average assets (pre-tax)	-0.7%	1.1%	-5.4%
Return on average equity (pre-tax)	-1.0%	1.2%	-7.4%
Net interest income/average earning assets	2.9%	5.1%	-0.3%
LIQUIDITY & FUNDING			
Loans/Total Assets	60.9%	67.3%	57.3%
Liquid assets/Total borrowings (times)	1.4	N/A	0.8
Liquid Assets/Total Assets	26.7%	18.9%	32.1%
ASSET QUALITY RATIOS			
Performing Loans ($'Million)	76.2	63.7	127.8
Non-Performing Loans ($'Million)	88.2	144.5	141.8
Non-performing loans /Total loans - Gross	38.6%	59.2%	52.6%
Loan loss provision/Total loans - Gross	52.6%	53.9%	42.5%
Loan loss provision/non-performing loans & mortgages	136.1%	91.1%	80.8%
CAPITAL ADEQUACY & LEVERAGE RATIOS			
Risk-weighted assets/Total assets & contingents	12.1%	9.2%	22.7%
Debt/Equity (Gearing Ratio)	0.3	0.0	0.7
Net non-performing loans/shareholders' funds	-0.1	-0.2	0.1
Core capital/ Total Assets - Leverage	75.2%	94.6%	57.8%
Interest Cover	0.26	1.9	-0.2
STAFF INFORMATION			
Average number of employees	47	46	48
Staff cost per employee ($)	118,966	117,149	96,583
Net earnings per staff ($)	167,811	246,926	9,903
Staff costs/Operating expenses	60.6%	56.4%	37.8%

Rating Definitions

Aaa	A financial institution of the best financial condition and strongest capacity to meet obligations as and when they fall due relative to all other issuers in the same country.
Aa	A financial institution of very good financial condition and strong capacity to meet its obligations as and when they fall due relative to all other issuers in the same country.
A	A financial institution of good financial condition and strong capacity to meet its obligations relative to all other issuers in the same country.
Bbb	A financial institution of satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due relative to all other issuers in the same country.
Bb	A financial institution with satisfactory financial condition but limited capacity to meet obligations as and when they fall due relative to all other issuers in the same country.
B	A financial institution with weak financial condition and weak capacity to meet obligations as and when they fall due relative to all other issuers in the same country.
C	A financial institution with very weak financial condition and very weak capacity to meet obligations as and when they fall due are relative to all other issuers in the same country.
D	In default.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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