

HOME GUARANTY CORPORATION NOTES TO FINANCIAL STATEMENTS

1. GENERAL INFORMATION

Home Guaranty Corporation is tasked to operate a credit guaranty program in support of government's effort to promote home ownership. Since its creation in 1950 as the Home Financing Commission, the HGC has institutionalized a viable system of credit guarantees that has become an integral component of the shelter program of the government. With the enactment of its new Charter, Republic Act 8763, otherwise known as the Home Guaranty Corporation Act of 2000, the corporate life of the HGC was extended for another 50 years.

HGC is a government-owned and controlled corporation, with its principal office located at 335 Jade Building, Sen. Gil Puyat Avenue, Makati City. The Corporation is governed by a Board of Directors composed of seven members. It has corporate powers and functions, among others, to guaranty the payment of any and all forms of mortgages, loans and other forms of credit facilities and receivables arising from financial contracts exclusively for residential purposes and necessary support facilities and to assist private developers to undertake socialized, low and medium cost mass housing projects by encouraging private funds to finance such housing projects through a viable system of long-term mortgages, guarantees and other incentives.

HGC offers the following guaranty programs:

- developmental loan guaranty – a guaranty facility covering loans extended for the development of subdivisions, townhouses, dormitories, apartments and other residential dwellings;
- retail loan guaranty – guaranty coverage on loans/credit facility extended for the purchase/acquisition of a single-family residence;
- guaranty for securitization schemes – guaranty coverage on securities or financial instruments backed-up by a pool of assets such as receivables from loans/mortgages and/or real estate properties.

The Republic of the Philippines fully and unconditionally guarantees guaranty obligations of the Corporation as to principal and as to interest of up to 11%.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Recognition of income

a. Insurance premiums

The Corporation uses the accrual basis of accounting for premium on credit insurance/guaranty. HGC guarantee fees collected upon issuance of the Certificate of Mortgage Insurance and annually thereafter at rates of 0.5% to 2.5% (applicable to enrollments against guaranty lines approved prior to charter amendment) and 1.25% to 2.75% (applicable to enrollments on new guaranty lines approved after charter amendment) of client's outstanding obligations, depending on the credit risk and type of guarantee, are credited to Deferred Income account and amortized to Insurance Premium monthly.

b. Interest income

Interest on loans and other interest bearing instruments are recognized on the basis of the accrual method of accounting. No interest is accrued on past-due accounts, in accordance with Bangko Sentral ng Pilipinas Circular No. 645.

c. Other service income

Application, inspection and appraisal fees are directly credited to other service income account when collected.

2.2 Property and equipment

The equipment, furniture and fixtures are stated at cost less accumulated depreciation. Allowance for depreciation is computed on a straight - line method based on the estimated useful lives of the assets. Only additional expenses that will enhance usefulness of assets are capitalized and amortized over the remaining life of the asset, otherwise these are charged to operations.

2.3 Cash dividends

In accordance with Section 6-A of Republic Act No. 7656, at least 50% of net income for the period is declared and remitted as cash dividends to the Bureau of the Treasury (BTr). For CY 2006, while the Corporation reported income from operations of P237.26 million, actual net loss amounted to P773.48 million due mainly to the related cost incurred in the flotation of Zero Coupon Bonds. As such, no cash dividend was declared for the current period.

2.4 Taxation

The Home Guaranty Corporation is subject to 32% Corporate Income Tax. On the other hand, interest income on investment in government securities and bank deposits, is subject to the 20% final tax while gain on sale of real property is subject to 32% income tax less creditable withholding tax.

In addition, the Corporation paid 5% Gross Receipt Tax (GRT) in the amount of P23.07 million for CY 2006.

2.5 HGC adopted the following applicable Philippine Accounting Standards (PAS) in 2006:

- a. PAS No. 1 - Presentation of Financial Statements
- b. PAS No. 2 - Inventories
- c. PAS No. 7 - Cash Flow Statements
- d. PAS No. 8 - Accounting Policies, Changes in Accounting Estimates and Errors
- e. PAS No. 12 - Income Taxes
- f. PAS No. 16 - Property, Plant and Equipment

3. CASH ON HAND AND IN BANKS

This account consists of the following:

	<u>2006</u>	<u>2005</u>
Cash in banks	P 279,690,442	P 195,524,377
Collecting officers	78,767,531	55,144,087
Disbursing officers/others	5,270,193	847,541
	<u>P 363,728,166</u>	<u>P 251,516,005</u>

4. INVESTMENTS AND SINKING FUND

4.1 Short-term

	<u>2006</u>	<u>2005</u>
Treasury Bonds	P 9,884,966	P 121,139,033
10-Year Agrarian Reform Bonds	114,123,725	96,276,850
Other investments	<u>145,732</u>	<u>145,732</u>
	124,154,423	217,561,615
Sinking Fund	<u>7,000,000,000</u>	<u>441,825,517</u>
	<u>P 7,124,154,423</u>	<u>P 659,387,132</u>

4.2 Long-term

Sinking Fund	1,450,012,715	-
Stocks	<u>8,020,663</u>	<u>8,020,663</u>
	<u>P 1,458,033,378</u>	<u>P 8,020,663</u>

Investment in 10-year Agrarian Reform bonds includes investment of the Provident Fund (PF) amounting to P26,976,177 as of December 31, 2006. The PF fund is recorded in the HGC books under the Intra-Agency Payables, Due to Other Funds account.

The sinking funds with the Bureau of the Treasury are allocated for the payment of the Zero Coupon Bond maturing in August 2007 and May 2011.

Investment in stocks account represents subscription in the shares of stocks of HGC (Subic) Corporation, a wholly-owned subsidiary of the Corporation. The authorized capital stock of HGC Subic amounts to P32.0 million divided into 320,000 shares with a par value of P100 per share of which 25% or P8.0 million was subscribed and 25% of the subscribed or P2.0 million was paid-up. It was incorporated in October 2002 purposely created to handle the operations of acquired properties in Subic Bay Freeport Zone.

5. RECEIVABLES – NET

This account includes the following:

	<u>2006</u>	<u>2005</u>
5.1 Current		
Accounts receivable – guaranty call	P 44,214,976	P 119,342,042
Accounts receivable - installment	72,301,346	67,717,177
Other receivables (net of allowance for doubtful accounts of P22,163,568 in 2006 and 2005)	382,062,527	385,739,130
National government agencies Government owned and controlled corporations (net of allowance for doubtful accounts of P245,777 in 2006 and 2005)	57,263,018	59,026,783
Notes receivable	47,076,570	47,322,348
Interest receivable	36,792,624	35,799,687
Due from national treasury	5,861,548	11,252,196
Due from other funds	1,900,015,696	-
Local government agencies	7,844,715	7,844,715
Due from officers and employees	3,210,266	3,490,341
	<u>5,828,839</u>	<u>430,910</u>
	P <u>2,562,472,125</u>	P <u>737,965,329</u>
5.2 Non-Current		
Accounts receivable – guaranty call	P 397,934,778	P 1,074,078,382
Accounts receivable - installment	<u>650,712,110</u>	<u>668,070,721</u>
	P <u>1,048,646,888</u>	P <u>1,742,149,103</u>

The decrease in Accounts receivable-guaranty call was due to the reclassification of accounts which have been the subject of extra judicial foreclosure to Other Assets-Foreclosed accounts.

Due from national treasury represents NG Equity released under SARO No. D-06-10288 and NCA No. 252427-0 both dated December 29, 2006.

The 10% of the Accounts receivable-Guaranty call and Installment are presented as current assets while the 90% as non-current assets.

6. PREPAYMENTS

Breakdown of this account is as follows:

	<u>2006</u>	<u>2005</u>
6.1 Current		
Prepaid insurance	P 5,357,727	P 5,502,037
Prepaid rent	-	21,225
Other prepaid expenses	<u>188,538,343</u>	<u>121,109,365</u>
	<u>193,896,070</u>	<u>126,632,627</u>
6.2 Non-Current		
Other prepaid expenses	P <u>149,902,146</u>	P <u>3,454,775</u>

Other prepaid expenses represent creditable withholding taxes and unamortized portion of bond issue cost incurred in the flotation of HGC Zero-Coupon Bond.

7. PROPERTY AND EQUIPMENT – NET

This account is composed of the following:

<u>Particulars</u>	<u>Land and Land Improve- ments</u>	<u>Information Technology Equipment</u>	<u>Office Furniture, Fixtures and Equipment</u>	<u>Transportation Equipment</u>	<u>Leasehold Improve- ments</u>	<u>TOTAL</u>
Cost:						
January 1, 2006	P 53,797,173	P 32,136,762	P 18,353,673	P 17,889,751	P 3,468,555	P 125,645,914
Addition		48,954	1,117,632	777,596	309,408	2,253,590
Disposal	-	-	-	-	-	-
December 31, 2006	<u>53,797,173</u>	<u>32,185,716</u>	<u>19,471,305</u>	<u>18,667,347</u>	<u>3,777,963</u>	<u>127,899,504</u>
Accumulated Depreciation:						
January 1, 2006	11,009,029	20,625,497	14,744,345	14,841,367	2,362,506	63,582,744
Restatements			54,057			
Depreciation	1,630,967	2,929,945	339,735	947,678	929,634	6,832,016
Disposal	-	-	-	-	-	-
December 31, 2006	<u>12,639,996</u>	<u>23,555,442</u>	<u>15,138,137</u>	<u>15,789,045</u>	<u>3,292,140</u>	<u>70,414,760</u>
Net Book Value:						
December 31, 2006	<u>41,157,177</u>	<u>8,630,274</u>	<u>4,333,168</u>	<u>2,878,302</u>	<u>485,823</u>	<u>57,484,744</u>
Net Book Value:						
December 31, 2005	P <u>42,788,144</u>	P <u>11,511,265</u>	P <u>3,609,328</u>	P <u>3,048,384</u>	P <u>1,106,049</u>	P <u>62,063,170</u>

8. OTHER ASSETS – FORECLOSED

This represents the book value of various called Asset Participating Certificates (APC) projects and foreclosed accounts/projects with expired redemption period or with waiver of redemption rights or projects under dacion en pago, the titles of which had already been consolidated in the name of HGC. These are considered real estate inventory available for sale to recover HGC's exposure on the projects as a result of payment of call on the guaranty. Balances as of CY 2006 and CY 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Foreclosed assets	P 22,177,132,040	P 21,211,661,277
Provision for losses	218,314,443	218,314,443
	<u>P 21,958,817,597</u>	<u>P 20,993,346,834</u>

9. OTHER ASSETS – ASSETS HELD-IN-TRUST

This account represents funds held as the designated Trustee for various housing/resettlement projects of the following:

	<u>2006</u>	<u>2005</u>
Department of Public Works and Highways (DPWH)/National Housing Authority (NHA)	P 467,742,612	P 468,927,475
Department of Public Works and Highways (DPWH)	200,630,366	200,346,099
Department of Transportation and Communication (DOTC)	226,284,059	226,176,650
DPWH (Baras)	87,702,590	87,701,371
Presidential Management Staff	80,088,495	80,087,357
	<u>P 1,062,448,122</u>	<u>P 1,063,238,952</u>

10. PAYABLE AND OTHER LIABILITY ACCOUNTS

This account consists of the following:

	<u>2006</u>	<u>2005</u>
Other liability accounts, current	P 5,825,398,794	P 6,084,506,624
Intra-agency payables, current	114,167,963	214,676,451
Other deferred credits, current	71,317,884	65,200,193
Interests payable	119,011,191	134,592,046
Inter-agency payables	24,167,299	22,087,756
Due to officers and employees	303,545	1,220,507
	<u>P 6,154,366,676</u>	<u>P 6,522,283,577</u>

The Other Liability account consists mainly of the recognized liability for call on HGC guaranty which has been approved for payment by the HGC Board where rights to

the property securing the guaranteed obligation have been conveyed to and/or claims of the mortgagee against the mortgagor have been assigned to the Corporation.

11. BONDS PAYABLE

This account consists of the following:

	<u>2006</u>	<u>2005</u>
11.1 Current		
HGC debenture bonds	P <u>1,093,531,423</u>	P <u>1,662,573,094</u>
HGC Zero-coupon bonds	7,000,000,000	7,000,000,000
Less: Bond discount – zeroes	<u>331,791,928</u>	<u>874,859,433</u>
	<u>6,668,208,072</u>	<u>6,125,140,567</u>
	P <u>7,761,739,495</u>	P <u>7,787,713,661</u>
11.2 Non-Current		
HGC debenture bonds	P <u>1,619,057,594</u>	P <u>1,786,568,363</u>
HGC Zero-coupon bonds	14,998,430,386	2,998,430,386
Less: Bond discount – zeroes	<u>4,985,968,343</u>	<u>1,136,102,438</u>
	<u>10,012,462,043</u>	<u>1,862,327,948</u>
	P <u>11,631,519,637</u>	P <u>3,648,896,311</u>

The HGC debenture bonds are issued by the Corporation in payment of call on HGC guaranty.

The 7.0 billion HGC zero-coupon bonds issued by HGC in August 2002 at yield to maturity of 10.125% in scripless form represents direct and unconditional obligation of the Corporation to finance its guaranty servicing requirements. It carries the unconditional guaranty of the Republic of the Philippines and is maturing in 2007. The bonds also carry the following enhancements:

- Interest earned on the bonds shall be exempt from all taxation up to 10.15% p.a. pursuant to Section 19 of R.A. 8763.
- The Monetary Board of the Bangko Sentral ng Pilipinas (BSP) has approved the HGC zeroes to be eligible as alternative compliance with P.D. No. 717 or the Agri-Agra Law.
- The Housing and Land Use Regulatory Board (HLURB) approved HGC zeroes as an alternative form of compliance with the balanced housing provision under the Urban Development Housing Act (UDHA) of 1992 as approved by the HLURB Board.
- The HGC zeroes qualify as reserve investments of insurance companies.

HGC further, issued P3.0 billion special series zero-coupon bonds to government financial institutions (GFIs) in payment of call on HGC guaranty. The P3.0 billion bonds were issued on May 11, 2004 at a yield to maturity of 10% in scripless form and maturing in 2011. The bonds carry enhancements similar to the bonds issued in 2002.

The Corporation issued a 7-year P12.0 billion zero coupon bond in two tranches. The first tranche of P6.0 billion was issued on November 24, 2006 at a yield to maturity of 6.375% while the second tranche was issued on December 11, 2006 at a yield to maturity of 5.875%. The proceeds will be used in financing its corporate requirements. The bond issued in scripless form will mature in November 24, 2013.

12. DEFERRED CREDITS

	<u>2006</u>	<u>2005</u>
Trust – projects	P 560,982,160	P 399,967,963
Trust – insurance premium	380,272,478	332,788,825
Unearned income – installment sales	50,029,998	41,081,213
Other deferred credits	<u>214,069,938</u>	<u>212,034,248</u>
	P <u>1,205,354,574</u>	P <u>985,872,249</u>

The deferred credits account represent collections received in advance.

Trust–projects are collections received from buyers, consisting mainly of down payment, awaiting execution of contract to sell. The account will be reclassified to accounts receivable-installment for the principal portion and to income accounts for the interest and penalties portion.

Trust-insurance premium account will be reclassified to income-financing fees upon regularization of the enrolled accounts.

The other deferred credits account consists mainly of unrealized income from installment sale, collection from contract of lease with option to purchase (CLOP) and excess of book value over cost for the acquisition of Bliss Development Corporation.

13. DEFICIT

In consonance with PAS No. 8, on Accounting Policies, Changes in Accounting Estimates and Errors, the deficit of CY 2005 was restated as follows:

	<u>2005</u>
Balance at beginning of year as previously reported	P 396,867,214
Correction/adjustment of prior years' errors*	<u>180,240,905</u>
As restated	P <u>216,626,309</u>

*Correction/adjustment of prior years' errors consists of the following:

Operating income	P 144,376,894
Maintenance and other operating expenses	30,613,041
Other income	5,737,127
Personal services	<u>(486,157)</u>
	P <u>180,240,905</u>

Adjustment in operating income is the result of reclassification of collections in trust representing regularization of prior years' insurance premium.

Correction in maintenance and other operating expenses is due to reversal of P47 million representing gross receipt tax for CY 2000-2002. Other operating expenses consist mainly of prior years' project expenses.

14. OTHER PROFESSIONAL SERVICES ACCOUNT

This account consists of payments for the services of employees contracted under job order basis and collection service fees. The Corporation tapped the services of a collection agency to assist in the collection of non-moving/inactive/past due receivable accounts. Increase in the account was mainly due to service fees paid to collection agent.