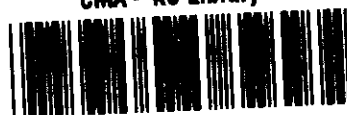


CONTENTS

	PAGE
Directors, Officers and Administration	2
Board of Directors	3
Senior Management	4
Members of the Board Profile	5
Notice of Annual General Meeting	6 - 7
Memorandum to Shareholders on Resolutions	8 - 9
Chairman's Statement	10 - 14
Report of the Directors	15 - 16
Corporate Governance	17 - 18
Statement of Directors' Responsibilities	19
Report of the Independent Auditors	20
Consolidated Profit and Loss Account	21
Consolidated Balance Sheet	22
Company Balance Sheet	23
Consolidated Cash Flow Statement	24
Consolidated Statement of Changes in Equity	25
Company Statement of Changes in Equity	25
Notes to the Financial Statements	26 - 45
Housing Finance Product News	46 - 48

CMA - Ke Library



AR0370

CMA-LIBRARY

HG
3399
K44
HGS
2005
C2

1. Housing Finance Company of Kenya Limited
2. Housing Finance Company of Kenya Limited
3. Housing Finance Company of Kenya Limited

DIRECTORS, OFFICERS AND ADMINISTRATION

DIRECTORS

Kung'u Gatabaki

Chairman

Peter J W Lewis-Jones*

Resigned 27 April 2005

Frank Ireri

Appointed 1 July 2006

Anne A W Amisabuo (Mrs)

David R Ansell**

The Permanent Secretary to the Treasury

Paul B M Ngugi

Alternate to the Permanent Secretary to the Treasury

Naftali Magere

Mary Kimatho M' Mukindia (Mrs)

*British

**American

COMPANY SECRETARY

Fiona C. Fax

Chunga Associates

7th Floor, Rahimtulla Tower

Upper Hill

PO Box 41968

00100 Nairobi GPO

Walker Kontos Advocates

Hakika House

Bishops Road

PO Box 60680

00200 Nairobi City Square

SHARE REGISTRAR

Anne Matu, CPS(K)

Housing Finance Company of Kenya Limited

Rehani House

Kenyatta Avenue/Kainange Street

P. O. Box 30088

00100 Nairobi GPO

REGISTERED OFFICE

Plot No. LR 209/9054

Rehani House

Kenyatta Avenue/Kainange Street

P.O. Box 30088

00100 Nairobi GPO

AUDITORS

KPMG Kenya

16th Floor, Lonrho House

Standard Street

P.O. Box 40612

00100 Nairobi GPO

BANKERS

Barclays Bank of Kenya Limited

Barclays Plaza

P.O. Box 46661

00100 Nairobi GPO

Citibank NA

Upper Hill Road

P.O. Box 30711

00100 Nairobi GPO

PRINCIPAL LEGAL ADVISORS

Kaplon and Stratton Advocates

Williamson House

4th Ngong Avenue

P.O. Box 40111

00100 Nairobi GPO

SUBSIDIARIES

Kenya Building Society Limited

First Permanent (EA) Limited

2007/0390



Kung'u Gatabaki
Chairman



David R. Ansell



Anne A. W. Amisabur (Mrs)



Naftali Mogere



Mary M. Mukindia



Joseph Kinyua
The Permanent Secretary to the Treasury



Frank Iremi
Managing Director

SENIOR MANAGEMENT



Front row from left to right

- | | | |
|---|-------------|-----------------------------|
| 1 | Rose Simani | Director of Human Resources |
| 2 | Frank Ireri | Managing Director |
| 3 | Julius Muia | Director of Finance |

Back row from left to right

- | | | |
|---|----------------|----------------------------------|
| 1 | Ken Kinyua | Director of Business Development |
| 2 | Charles Kamari | Director of Risk |
| 3 | Patrick Mbabuh | Director of Operations |

MEMBERS OF THE BOARD PROFILE

Kung'u Gatabaki

Appointed Chairman in 2004. Mr Gatabaki retired from Actis/CDC (formerly Commonwealth Development Corporation) in 2004 after 30 years service where he acquired wide experience in project finance, portfolio management and corporate board business. He remains a consultant for Actis and serves on various company boards including: Chairman of Micro Kenya, Director of Mumias Sugar Co, TPSEA (Serena Hotels), Development Bank of Kenya, Grain Bulk Handlers Ltd, Shelter Afrique among others. Mr Gatabaki read economics, project finance and management at Legon and Bradford Universities. He is 57 years old, married with four grown up children.

David R Ansell

BA Mathematics

Was appointed Director in October 2001. He retired from Citibank in February 2001, after over 30 years service, including on assignment as Director of Citibank's African businesses, based in Nairobi. He was also previously Managing Director of Ecobank Transnational Inc. based in Lagos, Togo. He is 60 years old and married with 2 grown up children.

Naftali Mogere

Was appointed Director in July 2004. He was formerly the Managing Trustee of NSSF, and currently Managing Director of National Cereals and Produce Board. He has a wide experience in Finance having served many organizations in various capacities. He was Finance and Administration Director of Preferential Trade Area Reinsurance Company for 10 years; and Finance Director/Company Secretary of African Medical Research Foundation (AMREF) for 5 years. He has been the Chief Accountant with Kenya Reinsurance Corporation and Principal Accountant at IDB.

He is member of Kenya Institute of Management (K.I.M) and the British Institute of Management (B.I.M). He read Accounting at University of Nairobi and is a certified Public Accountant (C.P.A), Certified Public Secretary (C.P.S). He is married with 5 children.

Anne A W Amisabour (Mrs)

LLB, LL.M

Was appointed as a Director in 1995. Member of International Bar Association (IBA) Section on Business Law which includes Banking Law, Section on Legal Practice and on Human Rights. Member of the Private Sector Corporate Governance Trust (PSCGT), Good Corporate Governance, Member of Federation of Kenya Women Lawyers (FIDA), Director of Institute of Directors (K) and Member of Law Society of Kenya.

Joseph Kanja Kinyua

MA (Econ)

Took up the position of Director after appointment as the Permanent Secretary Treasury on July 1, 2004. He has served in many capacities at the Central Bank, IMF, Ministry of Finance, Ministry of Planning and Ministry of Agriculture. He was a key driver of the 1996-1999 Policy ESAF supported GDK programme, the production of the Economic Recovery strategy for Wealth and Employment Creation (ERS) and the Strategy for Revitalisation of Agriculture (SRA). He has presented several publications on economic and monetary policy and public finance. He is a member of the Programme Committee of the African Economic Research Consortium (AERC) and is also Alternate Governor, World Bank Board of Governors. He is married with 3 children.

Mary Kimotho M'Mukindia (Mrs)

Bcom. (Hons)

She began her career in the Oil Industry, where she has served for over 23 years in various capacities and locations with Exxon Mobil, the Petroleum Institute of East Africa, and Enercan Consultants. She is currently the Managing Director of National Oil Corporation of Kenya.

She is active in private sector organization and serves on several boards that include Watoto Kwanza Trust, Kenya School of Professional Studies, the Petroleum Institute of East Africa, and the Kenya Petroleum Refineries Mombasa.

She is involved as a steering committee member in various government appointed Task Forces including: The Petroleum Bill-2000, The Marine Laws Review Task Force-2002, The Economic Recovery Strategy-2003, The Kenya Energy Sector Development Strategy Task Force, The East Africa Community Private Sector Development Strategy Study and lately in 2003/2004 the Transport Policy Committee. She is married with two children.

Frank Ireri

B.Com (Hons), CPA (K)

Was appointed Managing Director in July 2006. He is a seasoned Banker of 17 years standing and joined from Barclays Bank of Kenya where he was Head of Barclay Card Africa, covering Kenya, Botswana, Zambia, Mauritius, Seychelles and Egypt. Prior to this, he worked with Citibank and Commercial Bank of Africa. During his banking career, he has had international exposure in Poland, Sri Lanka and Zambia.

Mr. Ireri is a Honorary Counsel member of AIESEC and previously held the role of Chairman to the AIESEC Board of Advisors. Between 2001 and 2002 he was also the Chairman of the Kenya Institute of Bankers. He is married with 2 children.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the 40th Annual General Meeting of the Company will be held at the **Amphitheatre Kenyatta International Conference Centre, Harambee Avenue, Nairobi** on **Wednesday 26 July 2006 at 11.00am** to conduct the following business:

1. To table the proxies and note the presence of a quorum.
2. To read the notice convening the meeting.
3. To receive and, if approved, adopt the audited Balance Sheet and Accounts for the year ended 31 December 2005 together with the Chairman's, the Directors' and Auditors' Reports thereon.
4. To elect Directors:
 - a. Frank Marangu Ireri, who was appointed the Managing Director and Chief Executive Officer of the Company on 1 July 2006, retires in accordance with Article number 104 of the Company's Articles of Association and, being eligible, offers himself for re-election.
 - b. Anne AW Amissabour retires by rotation in terms of Article number 105 of the Company's Articles of Association and, being eligible, offers herself for re-election.
 - c. David Raymond Ansell retires by rotation in terms of Article number 105 of the Company's Articles of Association and, being eligible, offers himself for re-election.
5. To approve the Directors' Remuneration.
6. To note that the auditors, KPMG Kenya, will continue in office in accordance with Section 159(2) of the Companies Act (Cap 486) and Section 24(1) of the Banking Act (Cap 488) and to authorise the directors to fix their remuneration.

Special Business

7. To consider and, if thought fit, pass the following resolutions:

As Ordinary resolutions:

 - a) that, subject to the approval of the Capital Markets Authority, the Directors are empowered to establish for the benefit of employees of the Company a trust scheme comprising an employee share ownership plan (ESOP) pursuant to which the trustees thereof shall be authorized to issue units representing ordinary shares of Kenya Shillings Five (KShs.5.00) of the Company to eligible employees in accordance with rules for the ESOP and as more particularly described in a memorandum to the shareholders on page 8 of the Company's annual report.
 - b) that the terms of a Trust Deed and Scheme Rules ("trust deed and rules") for establishment of the ESOP as briefly described and explained in the aforesaid memorandum be approved.

c) that the Board of Directors of the Company be and is authorised to sign all documents and to do all such things as may be necessary to give, establish and carry into effect the ESOP trust, including the making of such amendments to the trust deed and rules as may be necessary to obtain its registration with and approval by the Kenya Revenue Authority and the Capital Markets Authority.

As a Special Resolution:

That the Memorandum of Association be altered by the insertion of a new objects clause (u)(a) between (u) and (v) as follows:-

"To establish and maintain, and to contribute to, any trust or other scheme for encouraging or facilitating the holding of shares or debentures in the Company by or for the benefit of its employees or former employees, or those of its subsidiaries or holding company or other subsidiaries of its holding company or by or for the benefit of such other persons as may from time to time be permitted by law, or any trust or other scheme for sharing profits with its employees or those of its subsidiaries and/or associated companies, and so far as the same may be permitted by law to lend money to the Company's employees with a view to enabling them to acquire shares in the Company, its subsidiaries or its holding Company."

BY ORDER OF THE BOARD

Fiona C Fox
Secretary
27 March 2006
PO Box 41968
Nairobi

NB

In accordance with Section 136 (2) of the Companies Act (Cap 486) every member entitled to attend and vote at the above meeting is entitled to appoint a proxy to attend and vote on his behalf. A proxy need not be a member. A form of proxy is enclosed and should be returned to The Registrar, Housing Finance Company of Kenya Limited, Rehani House, Kenyatta Avenue, PO Box 30088, Nairobi, to arrive not later than 48 hours before the meeting or any adjournment thereof.

If the appointer is a corporation or Government office, the instrument appointing the proxy shall be given under its common seal or under the hand of an officer or duly authorised attorney of such corporation or Government office.

NOTISI YA MKUTANO WA KILA MWAKA

TUNAWAJULISHA kwamba, mkutano wa Nne wa Kila Mwaka wa Kampuni utafanyika kotika Jumba la Mikutano la Kenyatta, chumba cha Amphitheatre, barabara ya Harambee, Nairobi, mnamo Jumatana, Julai 26, 2006, saa nne asubuhi. Ajenda za mkutano huo ni pamoja na:

1. Kuwatambua wawakilishi na watakaohudhuria.
2. Kusoma notisi ya kuandaa mkutano
3. Kusoma na ikwa itakubaliwa, kuidhinisha Ripoti ya Matumizi ya Pesa ya mwaka uliomalizika Desemba 31, 2005, pamoja na ripoti ya Mwenyekiti, Mkurugenzi na mkaguzi wa matumizi ya pesa
4. Kuchagua wakurugenzi wapya

a) Frank Marangu Ireri ambaye aliteuliwa kuwa Mkurugenzi Mtendaji na Afisa Mkuu wa kampuni kuanzia Julai 1, 2006, anastaafu kulingana na masharti ya sheria nambari 104 za chama cha kampuni, na kwa kuwa inakubalika, anajitangaza kuwania cheo hicho tena.

b) Anna AW Amissabour anastaafu kulingana na masharti ya Sheria nambari 105 za Chama cha Kampuni, na kwa kuwa inakubalika, anajitangaza kuwania cheo hicho tena.

c) David Raymond Ansell anastaafu, kulingana na masharti ya Sheria nambari 105 za Chama cha Kampuni na kwa kuwa inakubalika, anajitangaza kuwania tena cheo hicho.

5. Kukubali malipa ya Wakurugenzi.

6. Kutilia maanani kwamba wakaguzi wa matumizi ya pesa-KPMG Kenya, wataendelea kutekeleza wajibu wao, kulingana na Kifungu nambari 159 (2) cha Sheria za Kampuni (Cap 486) na Kifungu nambari 24 (1) cha Sheria za Benki (Cap 488) na kuwaruhusu wakurugenzi kujitokea kiwango cha malipo yao.

Shughuli Maalumu

7. Kutilia maanani, na itakubalika, kuidhinisha maamuzi yafuatayo kama mapendekezo ya kawaida;

a. kwamba, kuambatana na Halmashauri ya Masoko ya Pesa, wakurugenzi wamepewa mamlaka, kuanzisha, kwa manufaa ya wafanya kazi wa Kampuni, Mpango wa udhamini ambao unahusisha mpango wa wafanya kazi kumiliki hisa (ESOP), ambapo wadhamini watakubaliwa kutoa viwango vinavyowakilisha hisa za kawaida za shilingi tano za Kenya (Ksh5.00) za Kampuni kwa wafanya kazi wanaotimiza masharti, kulingana na sheria za ESOP na haswa zinazoeleza katika Memoranda kwa wenyehisa, iliyoambatanishwa na ripoti ya Kampuni ya kila mwaka na notisi ya mkutano.

b. Kwamba, masharti ya Hoti za Udhamini na Masharti ya Mpango (hoti ya udhamini na masharti) kwa kuanzishwa

kwa ESOP kama ilivyotajwa kwa muhtasari, kuelezwa na kufafanuliwa katika memoranda, uidhinishwe.

c. Kwamba Halmashauri ya wakurugenzi wa Kampuni ikubaliwe na ipewe mamlaka ya kutia sahihi stakabadhi zote na kutekeleza majukumu yote ya kuipa, kuanzisha na kuendeleza mpango wa udhamini wa ESOP, pamoja na kufanya marekabisho katika hoti za udhamini na masharti pale haja inapotokea, ili kupata usajili na kuhlalishwa na Halmashauri ya mapata ya Kenya (KRA) na Halmashauri ya Masoko ya Pesa.

Azimio Maalumu;

Kwamba Memoranda ya Chama ibadilishwe kwa kuwekwa vifungu vipya (u) (a) Kati- kati (u) na (v) kama ifuatavyo;

"Kuanzisha na kusimamia, na kuchangia kwa hazina yoyote au mpango wowote ili kuhimiza au kushirikisha kumiliki kwa hisa au hati za wadani wa Kampuni au kwa manufaa ya wafanya kazi wa Kampuni, wa sasa na wa zamani, au wa matawi au matawi ya kampuni kuu kwa manufaa ya watu hao, kulingana na ruhusa ya sheria, au hazina yoyote au mpango wowote wa kugawana faida na wafanya kazi ama matawi au/na kampuni shirika, na hilo pia linaweza kukubaliwa na sheria, kuwakopesha pesa wafanya kazi wa Kampuni, kukiwa na lengo la kuwawezesha kumiliki hisa katika Kampuni, tawi au kampuni kuu.

KWA MAAGIZO YA HALMASHAURI

Fiona C Fox
Katibu
27 Machi 2006
PO Box 41968
Nairobi

Kumbuka:

Kuambatana na Kifungu nambari 136 (2) cha sheria za Kampuni (Cap 486), kila mwanachama mwenye mamlaka ya kuhudhuria na kupiga kura katika mkutano uliotajwa anakubaliwa kutuma mwakilishi kuhudhuria kwa nlaba yake. Mwakilishi anastahili kuwa mwanachama. Fomu ya mwakilishi pia imetumwa na inatajikana kurejeshewa Msajili, Kampuni ya Housing Finance of Kenya Limited, Jumba la Rehani, barabara ya Kenyatta, SLP 30088, Nairobi, na ifike katika muda wa saa 48 kabla ya mkutano au kuahirishwa kwake.

Ikwa mteuaji ni shirika au afisi ya Serikali, famu ya kumteua mwakilishi, itakuwa na mhuri wa kawaida au itakuwa na sahihi ya afisa wa mamlaka au wakili aliyehalalishwa wa shirika au afisi hiyo ya Serikali.

MEMORANDUM TO SHAREHOLDERS ON RESOLUTIONS

THE PROPOSED RESOLUTIONS

The Directors are proposing the passing of the following Ordinary Resolutions:

- A resolution establishing an Employee Share Ownership Plan Unit Trust (ESOP)
- A resolution adapting the terms of the Trust Deed and the Scheme Rules.
- A resolution authorising the Board of Directors to sign all documents and to do all such things as may be necessary to establish and carry into effect the ESOP.

Each of these will be explained to ensure that you make an informed decision.

ESTABLISHMENT OF AN EMPLOYEE SHARE OWNERSHIP PLAN (ESOP) RESOLUTION 1.

The phrase Employee Share Ownership Plan (ESOP) is used to describe a variety of arrangements that facilitate the ownership of shares by employees. The object of any ESOP is the acquisition and retention of a Company's shares by the employees of that same Company.

The proposed ESOP in the Company is structured as a Unit Trust whereby employees hold units that represent shares held on their behalf by trustees. Eligibility for employees only extends for as long as one remains an employee of the company. This is to ensure compliance with the Capital Markets Act and the Capital Markets (Collective Investment Schemes) Regulations ("the Regulations").

It is intended that the ESOP will purchase shares of the Company for which employees will make payment as the Company will not finance the purchase. The establishment of the ESOP requires your approval under the provisions of the Regulations.

ADOPTION OF THE TERMS OF THE TRUST DEED AND THE SCHEME RULES RESOLUTION 2.

Your approval of the terms of the Trust Deed and the Scheme rules constituting the ESOP is also required under the Regulations.

The trust deed contains the following terms

A. CREATION OF TRUST AND TRUSTEES.

As noted above, the ESOP is to be structured as a Unit Trust. The Trust Deed creates this trust by providing for the appointment of trustees who will hold shares on behalf of employees. As provided in the Regulations, the trustees will be appointed and removed by the Company's Board. A trustee may also retire out of choice.

Further, the trust deed grants the trustees incidental powers including the power to open bank accounts for the ESOP and the power to sue. The remuneration of trustees will be met by the Company.

There are certain restrictions placed on the trustees as they hold the shares on behalf of employees. The trustees are disallowed from purchasing shares in any other company for the purpose of the ESOP. They are also prohibited from pledging shares that they acquire unless it is in relation to their acquisition.

B. UNITS AND EMPLOYEE OWNERSHIP – SCHEME RULES

As noted above, employees will only hold units in the Company and not shares directly. The trust deed prescribes that the units will be equal in number to the shares that are held by the trustees. This is also required under the Regulations.

The details of the creation of, eligibility for, maximum individual entitlement, issuance of and valuation of the units are contained in the Scheme rules. The Scheme rules emphasize that the units are to be offered only to employees who have completed their probation period. Qualifying employees will be required to apply for their units after which allotments shall be made by the trustees. For the units issued the Trustees will issue a Certificate of Entitlement. The valuation of units will be based on the share price at the Nairobi Stock Exchange. The Scheme Rules also make provision for the rights that accrue to Unit Holders. These rights include the right to dividend, the right to new shares in a rights issue or a bonus issue and the right to participate in any amount remaining after winding up. These rights are the same as other shareholders. The Unit Holders may also sell the units they have but only to other Unit Holders.

C. RECORDS, AUDIT AND REPORTS.

Under the terms of the Trust Deed, the Trustees are required to maintain a register of Unit Holders in the Company. This register will record the employees who hold units in the ESOP Unit Trust.

The Regulations require that the accounts of the ESOP be audited annually. This will be done by the Company's auditors. Further the Company's Annual Report will contain details of the ESOP's dealings in the course of the year.

AUTHORIZATION OF DIRECTORS RESOLUTION 3.

Upon grant of your approval for the establishment of the ESOP and adoption of the terms of the Trust Deed, your Board will take steps towards putting into operation the ESOP. These steps include obtaining final approval of the Capital Markets Authority (including appointment of Trustees), setting up the initial offices of the ESOP and convening of the first meeting of the Trustees. For this purpose the Board requires your approval to proceed with carrying into effect the resolutions.

EXPECTED BENEFITS OF THE ESOP.

The Employee Share Ownership Plan would be expected to have the following benefits:

- It will motivate employees to assist in improving the Company's share value for their own benefit as well as that of other shareholders;
- It is an alternative to making bonus payments to employees;
- Since the shares to be held by the ESOP will be purchased from an existing shareholder, the Company will avoid dilution of earnings per share;

Kung'u Gatabaki (Mr.)

CHAIRMAN.

MEMORANDA YA WENYEHISA KUHUSU MAZIMIO

MAAZIMIO YALIOPENDEKEZWA

Wakurugenzi wanapendekeza kuitathinisha Maamuzi ya Kawaida yafuatayo;

- Azimio la kuanzisha Kitengo cha hazina ya mpango wa wafanya kazi kumiliki hisa (ESOP)
- Azimio la kukubali masharti ya hati ya udhamini na ya mpango
- Azimio la kuwaidhinisha wakurugenzi wa Halmashauri katika sahihi stakabadhi zote na kutekeleza wajibu wao inavyopaswa ili kuanzisha na kuendeleza shughuli za ESOP

Kila azimio litatathinuliwa ili uweze kufanya uamuzi bora.

AZIMIO LA KUENZISHA KITENGO CHA HAZINA YA MPANGO WA WAFANYA KAZI KUMILIKI HISA (ESOP) AZIMIO LA 1

Maneno "Mpango wa Wafanya Kazi Kumiliki hisa" (ESOP) yanatumiwa kumaanisha mipango ambayo itashirikisha umilikaji wa hisa na wafanya kazi. Lengo la ESOP ni kuwafanya wafanya kazi wa kampuni kupata na kuhitadhi hisa za kampuni hiyo hiyo.

Azimio la ESOP lililopendekezwa katika Kampuni kama kitengo cha hazina ambapo wafanya kazi wana vijishehemu (Units) vinavyowakilisha hisa ambazo wamewekewa na wadhamini. Mtu anaweza kumiliki tu hisa wakati akiwa mwanajiri wa Kampuni. Hili ni kuambatana na sheria za Masake ya Pesa (Mpango wa Uwekezaji Rasimali Pamoja).

Ni matumaini kuwa Mpango wa ESOP utanunua hisa za kampuni na wafanya kazi watajiipia kwa kuwa kampuni haitafadhili ununuzi huo. Kuanzishwa kwa ESOP kunahitaji ruhusa yako, kuambatana na sheria zilizoko.

AZIMIO LA KUKUBALI HATI YA UDHAMINI NA MASHARTI YA MPANGO AZIMIO LA 2

Kuambatana na masharti, tunahitaji pia ruhusa yake kuitathinisha hati ya hazina na sheria za ESOP. Hati ya udhamini ina masharti yafuatayo;

A. KUBUNIWA KWA HAZINA NA WADHAMINI

Kama ilivyoelezwa awali, ESOP itaundwa kuwa kitengo cha hazina. Hati ya udhamini inabuni hazina hii kwa kupendekeza wadhamini kuteuliwa. Wadhamini hao watahitadhi hisa kwa niaba ya wafanya kazi. Kuambatana na masharti, wadhamini wataeleuliwa na kuondolewa na halmashauri ya Kampuni. Mdamini akitaka, anaweza kuamua kustaafu.

Tena, hati ya udhamini inawapa wadhamini mamlaka zaidi yakiwemo ya kufungua akounti katika benki kwa niaba ya ESOP na uwezo wa kushtaki.

Kampuni itagharimia malipo ya wadhamini.

Hata hivyo, wadhamini wamefungwa na masharti fulani wanapohitadhi hisa kwa niaba ya wafanya kazi. Wadhamini wanakatazwa kununua hisa katika kampuni nyingine kwa niaba ya ESOP. Kadhalika, wanakatazwa kutumia hisa walizo nazo kama mdamini isipokuwa tu ikiwa suala la jinsi walivyozipata likizuka.

B. VIJISEHEMU NA UMILIKAJI WA MFANYA KAZI-MASHARTI YA MPANGO

Kama ilivyotajwa awali, wafanya kazi wataruhusiwa kumiliki vijishehemu, wala sio hisa moja kwa moja. Hati ya udhamini inasema vijishehemu vitakuwa na idadi sawa na hisa zinazohitadhiwa na wadhamini. Hili pia linahitajike chini ya masharti.

Maelezo zaidi ya kubuniwa kujunga na idadi ya juu ya mfanya kazi binafsi, kutolewa na kutathimiwa kwa vijishehemu, yanapatikana katika masharti ya mpango. Masharti hayo yanasisitiza kwamba vijishehemu vitatolewa tu kwa wafanya kazi ambao wamekamiliwa muda wao wa probesheni. Wafanya kazi wanaohitimu watahitajika kuomba vijishehemu, kisha watengewe na wadhamini. Wadhamini watatoa hati ya kumiliki ikidnyesha vijishehemu vya mtu binafsi. Utathimini utategemea bei ya hisa katika Soko la Ubadilishanaji Hisa la Nairobi.

Tena, masharti ya mpango yanasema wamilikaji vijishehemu watapata haki fulani zikiwa pamoja na kupata faida, haki ya kupata hisa mpya, haki ya kupata marupurupu, haki ya kupewa mapata zaidi hazina ikifungwa. Haki hizi zinafanana na za mamilikaji hisa yeyote. Wamilikaji vijishehemu pia wanaweza kuvuza, lakini tu kwa wamilikaji vijishehemu wenzao.

C. REKODI, RIPOTI NA UKAGUZI

Kuambatana na hati ya udhamini, wadhamini wanahitajike kuwa na rejista ya wamilikaji vijishehemu katika Kampuni. Rejista hiyo itakuwa na rekodi za wafanya kazi walio na vijishehemu katika Hazina ya ESOP.

Kuambatana na masharti, rekodi za matumizi ya pesa za ESOP zinapaswa kuchunguzwa kila mwaka. Hili litatekelezwa na wakaguzi wa Kampuni. Istoshe, ripoti ya Kila Mwaka ya Kampuni itakuwa na maelezo ya shughuli za ESOP.

KUWADHINISHA WAKURUGENZI AZIMIO LA 3

Baada ya kutoa ruhusa ya kubuniwa kwa ESOP na kukubali masharti ya hati ya udhamini, Halmashauri yake itachukua hatua ili ESOP kuanzisha shughuli zake. Hatua hizo ni pamoja na idhini ya mwisho ya Halmashauri ya Masoka ya Pesa (ikiwemo ya kuwateua wadhamini), kutayarisha afisi za ESOP na kuandaa mkutano wa kwanza wa wadhamini. Kwa lengo hili, halmashauri inahitaji idhini yake kuanza kutekeleza mazimio.

FAIDA ZA ESOP ZINAZOTARAJIWA.

Mpango wa wafanya kazi kumiliki hisa unatarajiwa kuzaa matunda yafuatayo;

- Utawapa wafanya kazi motisha kusaidia kuimarisha idadi ya hisa za Kampuni kwa manufaa yao wenyewe pamoja na ya wenyehisa wengine.
- Ni njia nyingine ya kuwalipa wafanya kazi marupurupu.
- Kwa kuwa hisa zitakazohitadhiwa na ESOP zitanunuliwa kutoka wenyehisa walioko, Kampuni itajipusha na suala la thamani ya kila hisa kupunguka.

Kung'u Gatabaki (Mc)

CHAIRMAN.

CHAIRMAN'S STATEMENT/TAARIFA YA MWENYEKITI

Dear Members,

It is my pleasure to address you again as we review our company's performance in 2005 and the prospects ahead of us. We are currently celebrating our 40th birthday, having turned 40 in November 2005. In doing so we take pride that the re-branded company has reaffirmed its dominant position in the mortgage market, and is steadily and increasingly creating higher brand value. This higher value is bound to be a rewarding return for all our stakeholders and especially you, our dedicated and supporting shareholders.



The Chairman Kung'u Gatabaki

Kwa wanachama,

Ni furaha yangu kuwahutubie tena tunepochunguza matekeo ya Kampuni mwaka wa 2005 na matumaini yetu ya siku zijaza. Kwa sasa tunesherehekea kubuniwa kwetu baada ya kutimiza miaka 40 mnema Novemba 2005. Kwa kufanya hivyo, tunajivunia kwamba kampuni yetu iliyezinduliwa upya, imethibitisha nafasi ya mbele katika soka la utaji mikapa ya kununua nyumba. Isitashe, kampuni inaendelea kutoa huduma za thamani ya juu. Bile sheka, matekee ya thamani hii ni zawadi kwa washika dau wetu wote, haswa wewe mwenyehisa embaye umebaki mwaminifu na kutuunga mkono.

Financial Results

Kenya's money market remained relatively stable in 2005. However, interest rates were under an upward pressure following the huge deficit disclosed in the national Budget. Despite this trend your company did not rush to increase mortgage interest rates. We took this decision in recognition of the fact that in the past it has been difficult for many Kenyans to access the mortgage product on the premise of relative expense. The strategy we are currently following is meant to ensure that we sustain a captive demand for our product and expand affordability to groups that previously felt excluded from borrowing to buy good homes. In the short term this may have put pressure on the profits, but we are confident that this strategy is going to prosper us for many years going forward.

Ladies and gentlemen, we returned another profit during the year, thereby reinforcing my message that Housing Finance is a profitable company and has made the turn from the losses posted a few years ago. All the primary ratios that manifest the health of a business in the banking sector have improved in 2005 over 2004. Profit after tax was Kshs. 59m, cash inflow increased by Kshs.967m and we realized a 4% growth in assets. On the funding side we enjoyed a Kshs. 400m increase in our deposit base again showing the better public confidence we enjoy as the premier brand in the mortgage market. Owing to delays in the completion of house units for sale in Kamarock, our property development company, Kenya Building Society witnessed reduced activity in the period. The role of the subsidiary remains an important part of our overall vision and I will be talking about this in the later part of this statement.

Matakeo ya Kifedha

Soka la pesa la Kenya lilikuwa imara mnema 2005. Hata hivyo, viwango vya riba vilikabiliwa na shirikiza la kupanda juu kufuatia deni kubwa lililetekea katika bajeti ya taifa. Hata kukiwe na hali hiyo, Kampuni haikukimbilie kuongeza riba ya nyumba. Tulichukua uamuzi huu tukitambue kuwa, miaka ya juzi imekuwa vigumu kwa Wakenya wengi kupata mikape kununua nyumba kutokana na kupanda kwa gharama. Mbinu tunayazingatia sasa inalenga kuhikikisha kwamba tumeongeza idadi ya wateja wa huduma zetu na hata kupanua mikape kwe mekundi embayo aweli yalitengwa kununua nyumba nzuri. Hili huenda likathiri faida kwa muda, lakini sote tuna imeni, mbinu hii itatufaidi miaka mingi ijava.

Mabibi na mabwana, tulikuwa na faida nyingine mwaka jana, na hivyo kuthibitisha ujumbe wangu kuwa Housing Finance ni Kampuni yenye faida na iliyajitufua kufuatia hesera iliyepote miaka kadhe iliyapita. Idara zote zinaenyeshwa kuimarika kwa biashara katika kampuni iliya kwenye sekta ya benki mwaka 2005 kulika mwaka wa 2004. Faida baada ya ushuru ilikuwa shilingi milioni 59, mtaji ukoongezeka kwa shilingi milioni 967 na kuwakilisha ukwaji wa esilimia 4. Upande wa ekiba, tulikuwa na ongezeko la shilingi milioni 400 hivyo tena kudhihirisha imani walio nayo wananchi kwetu tunapeendelea kuongeza katika soka la mikope ya nyumba. Kutokana na kuchelewa kukamilishwa kwa ujenzi wa nyumba za kuuzwa eneo la Kamarock, kampuni yetu ya kustawisha meli-Kenya Building Society, ilikuwa na shughuli duni. Mchango wa tawi hile bado ni sehemu muhimu ya jumla ya ndoto yetu na nitazungumzia jamba hili katika taarifa yangu baadaye.

CHAIRMAN'S STATEMENT/TAARIFA YA MWENYEKITI (Continued)

Business Environment

I have said in previous addresses to you that I consider my statement as an opportunity to share the vision of the company with you and also to inform you of the plans that are in the pipeline for the future growth of your company. In recent years we informed you of the changes that needed to be made to put the company back on a firm footing. I am pleased to report that we have reached the point where these issues are no longer our predominant focus: we have moved on to utilize the new structure to deliver our corporate mission. Members may have noticed that the mortgage landscape in Kenya has changed very rapidly over the recent past and today we are the only specialized independent mortgage finance institution. Recently the government advertised for consultancy services to write separate regulatory frameworks for Banks and Long-term lenders demonstrating the importance the government attaches to the mortgage industry.

Management

Following Mr. Peter Lewis-Jones departure last year your Board has recruited Mr. Frank Ireri as the new MD. Mr. Ireri, aged 43, is a seasoned banker having served with international and local banks both locally and abroad in the last 17 years. We have received him with enthusiasm and have challenged him to deliver the vision and an improved performance. On behalf of the Board, I am pleased to introduce to you Mr. Frank Ireri, our newly appointed Managing Director of Housing Finance.

Operational Improvements

Last year we reported significant investment in the change of the core Banking system to enable us carry an expanded and improved level of services. The new system, called Equinox, is running a more efficient front-end service and financial reporting module. Our systems are now comparable in service efficiency delivery to the international banks operating in Kenya. This achievement is significant by any standards and I would like to thank the Management for making conscious efforts to fully utilize the capacity that the new investment has created.

The investment in Equinox has accorded us the opportunity to roll out contemporary products. One of the first and most exciting to our customers was the implementation of an ATM facility. We are live on the Kenswitch solution and have installed our own ATM machines in most of

Hali ya Biashara

Katika hetuba zangu za awali, nimewaambia kuwa nina imani kwamba taarifa yangu inatoa nafasi ya kuwaeleza ndoto ya kampuni na pia kuwajulisha mipango inayoandaliwa kuistawisha siku zijazo. Miaka kadha iliyepita, tuliwafahamisha kuhusu marekebisha yaliyohitajika kuimarisha kampuni. Nina furaha kuwajulisha kuwa tumefikia hatua ya kujigamba kuwa maswala hayo si muhimu tena. Tumepiga hatua na kutumia mabadilika kutekeleza lengo letu la kampuni. Huenda wanachama wametombua kuwa hivi majuzi hali ya soko la mikopo ya nyumba imebadilika haraka ndani Kenya. Kwa sasa, sisi ndiyo taasisi maalumu na huru inayotoa huduma za kifedha za kununua nyumba. Hivi majuzi, serikali ilitoa tangazo la kutaka huduma za ushauri wa kuandika mwangoze tofauti wa benki na wakapeshaji mikopo ya muda mrefu. Tangazo hilo limeongeza umuhimu ambao serikali imezingatia katika sekta ya mikopo ya ununuzi wa nyumba.

Usimamizi

Kufuatia kuendoka kwa Bw Lewis-Jones mwaka jana, Halmashauri yenu imemwandika Bw Frank Ireri kuwa mkurugenzi mkuu mpya. Bw Ireri, mwanaye umri wa miaka 43 ana tajriba ya miaka mingi katika sekta ya benki. Katika miaka 17 iliyopita, amehudumia benki za kimataifa na ndani. Tumemkaribisha kwa furaha na kumpa chunga mata ya kutimiza ndoto yetu ya kuimarisha matokeo. Kwa niaba ya Halmashauri, nina furaha kuwajulisha Bw Frank Ireri kuwa mkurugenzi mkuu wa Housing Finance.

Uimarishaji wa Shughuli

Mwaka jana, tuliripoti kwamba tuliongeza uwekezaji rasimali katika lengo letu kuu la mtamba wa kompyuta ili kutuwezesha kutekeleza huduma zilizopanuliwa na kuborashwa. Mtamba mpya, kwa jina, Equinox, unaendeleza huduma bara zaidi za benki na usimamizi wa fedha. Huduma zetu sasa zinaweza kulinganishwa na benki za kimataifa zilizoka ndani Kenya. Matokeo haya ni muhimu kwa ubora wowote na ningependa kuwashukuru wasimamizi kwa kujitahidi kutumia vilivyo nafasi ambazo zimejitokaza katika uwekezaji rasimali mpya.

Uwekezaji rasimali katika Equinox umetupa fursa ya kupanua huduma zetu. Baadhi ya huduma zilizowavutia wateja wetu ni kuanzishwa kwa mitambo ya ATM. Tumuonganishwa na Kenswitch na

CHAIRMAN'S STATEMENT/TAARIFA YA MWENYEKITI *(Continued)*

our branches. By taking advantage of the ATM machines of other members of Kentswitch, our customers can now access their money countrywide from several outlets. We encourage all our shareholders to maintain savings accounts with us and apply for ATM cards. This will enable you to enjoy this service from what is undoubtedly the cheapest account to maintain in Kenya. You will not only be helping grow your company, but also enjoy a very unique and superior service. I can positively reveal that there is plenty more product rollout excitement to come.

We achieved a 100% increase in new mortgages and took Kshs 2 Bn worth of new business. There is every indication that we will have an even better year in 2006 giving us the optimism that we have truly triumphed from the burdens of the past maladies. We also re-launched the construction loan product and have seen very quick and heightened demand for it. Indeed, many developers have taken advantage of our loan for multi unit developments and we feel confident that we are a major player in increasing the supply of housing in Kenya today.

Through concerted efforts of our staff during the last few years in debt management and effective provision of solutions to customers facing repayment difficulty we have managed to reduce non performing debt to levels much closer to the current industry average. In this process there have been occasions when some customer felt that we are not being very accommodating. However you need to appreciate that we face several stringent regulatory and business performance predicaments when these debts stay in the books without any tangible flow of repayments. The collections are channeled to investments that will bring us the return we so keenly desire.

Staffing continues to be the backbone on which these reform efforts find success. The staff complement has reduced to 229 today from 380 in 2001. This reduction in staff numbers has not put pressure on our operational efficiency because our recruitment process ensures that we hire qualified and industrious individuals. Even with the hiring of these new individuals at management levels, the overall cost of staff every year has been contained at flat levels, removing bottlenecks that were a threat to our survival, and positioning our business back onto the growth path.

We cannot omit a mention of the cost discipline that has been inculcated in the organization today. Cost management systems are an integral part of our daily practices and we have created a significant level of awareness as regards the responsible usage of the available resources.

tumeweka mitamba yetu katika karibu matawi yetu yote. Kwa kutumia mitambo ya ATM ya wanachama wengine wa Kentswitch, wateja wetu sasa wanaweza kupata pesa zaa kupitia matawi kadha kote nchini. Tunawahimiza wenyehisa wetu kufungua akaunti za akiba nasi na kuamba kadi za ATM. Hili litakuwzesha kufurahia huduma hii, ambayo bila shaka, ni akaunti rahisi mna kuwa naya nchini Kenya. Mbali na kusaidia kampuni yaka kukua, utafurahia huduma bara za kipekee. Ninakutangazia kwamba bada kuna huduma moto moto ambazo zitazinduliwa hivi karibuni.

Tulipata nyangeza ya asilimia 100 katika mikapo mipya na kuchukua shilingi bilioni 2 za biashara mpya. Kuna kila dalili tutakuwa na mapata zaidi mwaka wa 2006. Tuna matumaini tumeshinda masauibu ya zamani. Pia tulizindua upya huduma za mikapo ya ujenzi na tumeshushudia angezeka la haraka la wateja wanaoitaka. Kweli, wastawishaji wengi wanatumia mikapo yetu kuendeleza miradi tafauti. Tuna imani kuwa sisi ni washika dau muhimu katika kutimiza mahitaji ya nyumba yanaoongezeka ndini Kenya.

Kupitia jitihada za wafanya kazi wetu miaka kadha iliyapita, haswa katika usimamizi wa madeni na kutaa suluhisha muafaka kwa wateja wanaokumbwa na matatizo ya kulipa, tumefanikiwa kupunguza madeni yaliyapuuzwa hadi viwanga vya kawaida katika sekta yetu. Katika harakati hizi, kumekuwa na wakati ambapo baadhi ya wateja walihisi hatuna huruma. Hata hivyo, hamna budi kukumbuka kuwa tunakabiliwa na masharti magumu na vikwazo vinavyoathiri biashara, madeni haya yakibaki katika rekodi bila kugharamiwa. Mapata yanayokusanywa yanaelekezwa kwa uwekezaji rasimali utakaokuletea matokeo tunayotamani.

Wafanya kazi wanaendelea kuwa chombo muhimu cha kuendelea mabadilika. Idadi ya wafanya kazi imepungua kutaka 380 (2001) hadi 229. Upungufu huu wa wafanya kazi haujaathiri shughuli zetu kwa kuwa harakati zetu za usajili zinahakikisha tunaandika wafanya kazi wenye ujuzi na bidii. Hata tukiajiri wafanya kazi wapya katika viwanga vya usimamizi, jumla ya gharama za wafanya kazi, kila mwaka, zimehhibitiwa na kuondoa vikwazo vilivyotisha ustawi wetu na hivyo, kurejesha biashara yetu katika njia ya maendeleo.

Hatuwezi kusahau kutaja faida ya nidhamu ya kudhibiti gharama ambayo imehimizwa katika kampuni yetu. Mifuma ya kudhibiti gharama ni sehemu ya shughuli zetu za kila siku. Kadhalika, tumewahamasisha wafanya kazi umuhimu wa kutumia kwa njia bara rasimali iliyoaka.

CHAIRMAN'S STATEMENT/TAARIFA YA MWENYEKITI (Continued)

Other Topical Issues

Your Board, in keeping with best corporate practices, has supported the creation of an Employee Share Ownership Plan (ESOP). The blue chips all of which you see winning 'company of the year' awards in Kenya are running these programs. An ESOP also allows the Board to roll out popular reward systems that recognize shareholder value creation, increase and stimulate re-investment in the brand. It is our sincere appeal to you to pass the resolution presented to you which aims to ensure that your company will be able to retain competitive, modern people and practices for the accelerated improvement in the value of your investment.

Last year I reported the Board's initiative to re-capitalise the Company. To assist us in this process we appointed transaction advisors in 2005 to provide professional direction. The Advisors have completed the initial phase of their assignment and we are at the juncture where we are able to consider an execution of a suitable strategy for capital expansion. I want to be brief on this one at this stage but let me point out that members are expected to participate when the time comes. We will come back to you at the appropriate time to seek your support and endorsement.

Kenya Building Society

I mentioned earlier that this subsidiary has faced some difficulties in turning a positive financial performance. It is our intention to bring to fruition the potential benefits of KBS but its operational arrangements must be restructured. The Board has therefore decided to integrate KBS within the main mortgage business. KBS will continue to exist as a legal entity but will be managed as a unit within Housing Finance. The KShs 1 Bn project which is a joint venture of KBS and Santack property developers faced some logistical difficulties initially but we are looking forward to the delivery of houses over the next year or two.

Maswala Mengine

Halmashauri yenu, kulingana na mitinde bora ya kampuni, imeanzisha Mpango wa wafanya kazi kumiliki hisa (ESOP). Kampuni kubwa mnazoonza zikishinda tuze za 'Kuwa Kampuni bora ya Mwaka' ndini Kanya zina mpango huu. Mpango wa ESOP pia unakubali Halmashauri kuanzisha mifumo ya kutuza inayatambua kubuni/kuangaza thamani ya mwenyehisa na kumhimiza kurejesha pesa katika hazina hiyo. Tuna matumaini mtaidhinisha azimie lililowasilishwa mbele yenu ambale linakusudia kuhakikisha kampuni yenu itaweza kuhifadhi watu wenye ujuzi, wa kisasa na pia kutekeleza mbinu za kubaresha thamani ya uwekezaji rasimali.

Mwaka jana, niliripoti kuwa Halmashauri ilikuwa na nia ya kuongeza mtaji wa kampuni. Kutusaidia katika mkakati huu, mnamo 2005, tulitua washauri kutuelekeza kibiashara. Washauri wamekamilisha awamu ya kwanza ya jukumu lae. Tumefikia mahali ambapo tunaweza tena kutilia maanani mbinu muafaka ya kuongeza mapata. Sitazungumzia hili kwa undani wakati huu, ingawa tunahitaji mtaji haraka na kuwahitaji nyote kushiriki. Tutawarajelea wakati ufaao kuwaomba idhini ili kutuunga mkana.

Kenya Building Society

Awali, nilitaja kuwa tawi hili limekumbwa na matatizo ya kujiimarisha kifedha. Ni nia yetu kutufua na kustawisha faida za KBS lakini mipango yake ya shughuli haina budi kurekebisha. Hivyo, Halmashauri imeamua kujumuisha KBS kwenye biashara yake kuu ya nyumba. KBS itazidi kudumu chini ya sheria lakini itasimamiwa kama kitengo kilicho ndani ya Housing Finance. Mradi wa shilingi Bilioni moja ambao ni ushirikiano wa KBS na wastawishaji wa Santack ulikumbwa na matatizo fulani mbaleni lakini tuna imani kwamba, tutakuwa tumekamilisha ujenzi wa nyumba mwaka mmoja au miwili ijayo.

CHAIRMAN'S STATEMENT/TAARIFA YA MWENYEKITI *(Continued)*

Corporate Social Responsibility

Housing Finance is a very conscientious citizen and is continually aware of the under-privileged both by way of destitution and the unfortunate imbalance in the social cost equation. There are several interventions that we make to provide relief and a sense of decency to this group. Their situation may arise because of the unfortunate level of underdevelopment in the housing sector and the inevitable growth of informal urban settlements. We actively look to participate in activities that foster dreams of a good home to this group, in keeping with our slogan. We have supported programs for slum dwellers, some of the charities working in slums, the slum lighting projects, and several self help groups aimed at making decent shelter available to these groups.

Dividend

Although we are firmly in the profit mode, it is still felt that the time to distribute these resources is hampered by the allocation of some of our reserves into a statutory reserve in accordance with regulatory requirements. Many of you may have heard that the Central Bank issued new guidelines for banks and we are also governed under these rules. The need to have separate regulatory guidelines becomes even more important if long term lending and in the mortgage sector especially is to be stimulated. The Board therefore does not recommend the declaration of a dividend.

I thank you all and wish you a pleasant and prosperous 2006.

Chairman

Kung'u Gatabaki

Wajibu wa Kampuni kwa Jamii

Kampuni ya Housing Finance ni mzalende anayejali na kila mara inawazingatia wasiabahatika aidha kutakana na kutowajibikiwa vyema au kutokuweka kwa usawa wa usambazaji wa huduma za kijamii. Kuna mamba kadhaa tunayofanya ili kuzipa utulivu jamii kama hizi. Hali yaa inotokana na kiwanga duni cha ukwaji kwenye sekta ya nyumba na hali isiyoweza kuepukika ya makaa duni maeneo ya mijini. Kuambatona na msemu wetu, tunaangazia kwa dhati shughuli ombazo zitaharakisha ndoto kwa makundi hayo ya kuwa na makaa bora. Tumesaidia mipanga kwa wakazi wanaoishi vitongaji duni, mashirika ya kujitolea, miradi ya uwekaji taa na makundi mengine ya kujisaidia ambayo lengo lake ni kuboresha makao kwa watu hawa.

Mgao wa Faida

Ingawa tuka katika mfumo wa kupato faida, bade tunahisi kwamba usambazaji wa rasilimali hizi unatatizwa na mahitaji yanayotakana na kanuni zilizowekwa. Wengi wenu mmesikia kwamba, Benki Kuu imeweke kanuni zinafoa kufuatwa na mabenki. Hoto sisi tunaangazwa na kanuni hizi. Haja ya kuwa na kanuni badala zenye kutaa mwangoza ni muhimu sana endapa tutatarajia kuimarisha huduma za utajiri mkepa wa muda mrefu na hasa kwenye sekta ya ujenzi wa nyumba. Hivya, Halmashauri haipendekezi kutolewa kwa mgao wowote wa faida.

Nawashukuru nyate na kuwatakia ufanisi mwaka wa 2006.

Mwenyekiti

Kung'u Gatabaki.

REPORT OF THE DIRECTORS

FOR THE YEAR ENDED 31 DECEMBER 2005

The directors have pleasure in submitting their report together with the audited financial statements for the year ended 31 December 2005.

1 Principal activities

The company is licensed to operate as a mortgage finance institution under the Banking Act (Cap.488) and seeks to encourage and promote the flow of both private and public savings into financing home ownership.

The subsidiaries' principal activities are development and selling of residential houses and rent of residential houses.

2 Results and appropriations

	2005 Kshs'000	2004 Kshs'000
Gross income	1,199,205	1,370,260
Profit/(Loss) before taxation		
Housing Finance Company of Kenya Limited	101,725	98,572
Kenya Building Society Limited	(10,888)	(10,469)
First Permanent (East Africa) Limited	(349)	(247)
Group profit before taxation	90,488	87,856
Taxation	(31,689)	(27,880)
Profit after taxation	58,799	59,976
Revaluation surplus realised on disposal of investment property	-	-
Retained profit brought forward	368,042	308,066
	426,841	368,042
Dividends - proposed	-	-
Retained profit carried forward	426,841	368,042

3 Dividend

The Directors do not recommend the payment of a dividend (2004 - Nil).

4 Directors

The Directors who served during the year are set out on page 3.

5 Auditors

The auditors, KPMG Kenya, have indicated their willingness to continue in office in accordance with Section 159(2) of the Kenyan Companies Act (Cap. 486) and subject to Section 24(1) of the Banking Act. (Cap 488)

6. Approval of financial statements

The financial statements set out on pages 21 to 45 were approved by the Directors on 27 March 2006

BY ORDER OF THE BOARD

Company Secretary

Date: 27 March 2006

RIPOTI YA WAKURUGENZI

KWA KIPINDI CHA MWAKA ULIOMALIZIKIA DESEMBA 31, 2005

Wakurugenzi wanafuraha kutoa ripoti yao pamoja na taarifa ya uhasibu iliyokaguliwa kwa kipindi cha mwaka uliomalizikia Desemba 31, 2005.

1 Shughuli muhimu

Kampuni imepewa leseni kuendesha shughuli za utoaji mkepo wa ujenzi wa nyumba chini ya sheria za benki (kifungu nambari 488) na imejitalea kuhimiza na kusaidia uwekaji wa akiba kwa watu binafsi na umma ili kugharamia ujenzi wa makaa.

Shughuli nyingine ndogo ni pamoja na kustawisha na uuzaji wa nyumba za kuishi.

2 Matokeo na Matumizi

	2805	2004
	Kshs'000	Kshs'000
Mapato kwa Jumla	1,199,205	1,370,260
Faida/(Hasara) kabla ya ushuru		
Housing Finance Company of Kenya Ltd	101,725	98,572
Kenya Building Society Limited	(10,888)	(18,469)
First Permanent (East Africa) Limited	(349)	(247)
Faida ya kampuni kabla ya ushuru	90,488	87,856
Ushuru	(31,689)	(27,880)
Faida baada ya ushuru	58,799	59,976
Thamani ya ziada iliyapatikana baada ya uuzaji wa rasilimali	-	-
Jumla ya Faida iliyowasilishwa	368,042	308,066
	426,841	368,042
Mgao wa faida uliopendekezwa	-	-
Faida iliyohifadhiwa	426,841	368,042

3 Mgawo wa faida

Wakurugenzi hawapendekezi malipo ya mgao wa faida (2004- sufuri)

4 Wakurugenzi

Wakurugenzi waliohudumu mwaka huu wameangaziwa ukurasa wa tatu.

5 Wahasibu

Wahasibu wa kampuni ya KPMG Kenya wameonyesha nia yao ya kutaka kuendelea na jukumu hili kwa mujibu wa kifungu nambari 159(2) sheria za kampuni za Kenya (cap 486) na kwa mujibu wa sehemu ya 24 (1) ya sheria za benki (cap 488).

6 Kuidhinishwa kwa Taarifa ya Mwisho ya Hesabu

Taarifa za kifedha zilizoka ukurasa wa 21 hadi 45 ziliidhinishwa na wakurugenzi Machi 27, 2006.

KWA AMRI YA HALMASHAURI

Katibu wa Kampuni

Imenukuliwa Machi 27, 2006

CORPORATE GOVERNANCE

The Company is committed to the standards of Corporate Governance. The following disclosures aim at emphasizing this commitment.

1 Role of the Board

The Board is responsible for drawing and implementing strategies for the long-term success of the company. Continuous performance measurement is the key towards ensuring that shareholders' value is maximized. In so doing the Board holds regular meetings to discuss performance and chart the way forward for the company. Notices and agenda for all Board meetings are circulated to all directors on a timely basis together with the respective documents for discussion.

2 Composition of the board

The Board is composed of five non-executive directors in addition to the chairman. Mr. Frank Ireri is the Managing Director. All the non-executive directors are considered to be independent of management influence and do not engage in any business or interest that could impair their participation in the management of the company.

3 Re-election and resignation of Directors

All the non-executive directors are required to submit themselves for re-election every three years. The managing director's performance is measured continuously in line with the company's performance management framework. Any impending resignation of directors and the underlying circumstances are disclosed in the annual report.

4 Board and Management Committees

The Board has constituted sub-committees chaired by either non executive directors or the executive director to assist it in the discharge of its role of identifying the current and future business risks while ensuring that the necessary systems and controls are in place to enable such risks to be monitored and effectively managed. The key board Committees include:

Board Audit Committee (to be renamed Board Audit and Risk Committee)

This is composed of four non-executive directors:

- David Ansell (Chairman)
- Paul Ngugi
- Mary Kimatha M'Mukindia
- Naftali Magere

The Board audit and risk committee is responsible for assisting the Board to discharge its corporate governance responsibilities as follows:

- Relationship with and independence of the external auditors;
- Reliability and appropriateness of the disclosures in the financial statements and other external financial communication;
- Implementation of an effective business risk management framework;
- Ensuring compliance with internal controls;

Nomination and Remuneration committee

This is a Board Committee comprising of three Non executive directors. The Chief Executive is an ex officio member. The three non executive directors are :

- Kung'u Gatabaki (Chairman)
- Mary Kimatha M'Mukindia
- Anne Ammissabour

The Committee's responsibilities are in particular to consider matters related to the proposing of new nominees for the Board, assessing the performance and effectiveness of the Board of Directors, the Chief Executive Officer and Senior Management as well as managing the recruitment and the appointment of the Executive Director and Senior Management

Credit Committee

This is a Board Committee comprising of four Non executive directors. The committee's main function is to sanction all applications for large loans.

The four non executive directors are:

- David Ansell (Chairman)
- Naftali Mogere
- Mary Kimatha M'Mukindia
- Anne Ammissabour

A number of other Management committees have been established by the Board to oversee operations in some critical areas. These are:

- Risk Monitoring Committee
- Rescheduling Committee
- Lending Committee
- Asset and Liability Committee

The board appoints other committees as and when the necessity arises.

CMA - BRAR

CORPORATE GOVERNANCE (Continued)

5 Internal audit function

The group has a fully operational internal audit function that is led by a senior member of staff. The function is responsible for evaluating business and operating risks and internal controls put in place to mitigate the risks. It is also responsible for supervising documentation and reviews of the Company policies and procedures.

6 Communication with shareholders

The Company is committed to:

- Ensuring that shareholders and the financial markets are provided with full and timely information about its performance
- Compliance with regulations and obligations applicable to the Stock Exchange and the Capital Markets Authority

Information is distributed to the shareholders through an annual report and press notices following the release of quarterly, half yearly and annual results. Press releases are also produced whenever there are significant developments to report on.

7 Directors' benefits and loans

All the non-executive directors have continued to receive directors' fees. The aggregate amount of directors' fees is disclosed in Note 7 to the financial statements.

8 Major shareholders as at 31 December 2005

	Name of the Shareholder	No of shares	%age shareholding
1	CDC Group PLC	28,635,000	24.90
2	National Social Security Fund	12,961,901	11.27
3	Government of Kenya	8,422,850	7.32
4	Namura Nominees Ltd – A/C JMM	4,693,756	4.08
5	The Mbari Security Company Ltd	3,605,491	3.14
6	Finance Empire Company Ltd	3,082,133	2.68
7	Secumart Investments Ltd	1,637,079	1.42
8	Secumart Investments Ltd A/c Clients	1,327,729	1.15
9	Secumart Investments Account	1,295,000	1.13
10	Kibuwa Enterprises Ltd	947,849	0.82
	TOTAL	66,608,788	57.92

9 Distribution of shareholders as at 31 December 2005

Shareholder (Number of shares)	No of shareholders	No of shares held	%age shareholding
1-500	5,598	2,227,644	1.94
501-5,000	14,235	24,493,909	21.30
5,001-10,000	959	6,361,752	5.53
10,001-100,000	365	9,087,147	7.90
100,001-1,000,000	25	7,168,599	6.23
Over 1,000,000	9	65,660,949	57.09
TOTAL	21,191	115,000,000	100.00

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenyan Companies Act requires the directors to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the group and the company as at the end of each financial year and of the operating results of the group for that year. It also requires the directors to ensure that the group and the company keep proper accounting records, which disclose with reasonable accuracy the financial position of the group and the company. They are also responsible for safeguarding the assets of the group.

The directors accept responsibility for the financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the company and the group and of its operating results.

The directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

Nothing has come to the attention of the directors to indicate that the company and its subsidiaries will not remain a going concern for at least the next twelve months from the date of this statement.

Kung'u Gatabaki)
David R Ansell) Directors
Naftali Magere)
27 March 2006

TAARIFA KUHUSU WAJIBU WA WAKURUGENZI

Sheria za Kenya kuhusu makampuni zinawahitaji wakurugenzi kuandaa ripoti ya uhasibu itakayofafanua na kutoa mwangaza kuhusiana na shughuli za kundi na kampuni kwa kipindi chote cha mwaka uliomalizika. Sheria hizi zinawahitaji wakurugenzi kuhakikisha kwamba kundi na kampuni limehifadhi vyema rekodi zake za hesabu ambaza zitafichua hali halisi ya kifedha. Wakurugenzi pia wana jukumu la kulinda mali za kundi.

Wakurugenzi hukubali kuchukua jukumu la taarifa ya uhasibu ambayo imeandaliwa kwa kufuata sera za uhasibu ambaza zimefanyiwa uhakiki na makisio yanayofaa kwa kufungamana na viwango vya kimataifa na, kwa mujibu unaohitajika katika sheria za makampuni za Kenya. Wakurugenzi wanakubaliana kwa kauli moja kwamba taarifa ya uhasibu inatoa hali halisi kuhusiana na maswala ya kifedha na matakao ya shughuli za kampuni na kundi.

Zaidi ya hayo, wakurugenzi hukubali kuchukua jukumu la kudumisha rekodi za uhasibu zinazoweza kutegemewa wakati wa kuandaa taarifa ya hesabu pamoja na taratibu zinazofaa kudhibiti ukaguzi wa kila siku wa fedha.

Hakuna ishara zozote zilizojitokeza kuvutia hisia za wakurugenzi kuanyesha kwamba kampuni na washirika wake watasitisha shughuli zao kwa kipindi cha miezi kumi na mbili iliyoy kuanzia siku ya kutolewa kwa taarifa hii.

Kung'u Gatabaki)
David R Ansell) Wakurugenzi
Naftali Magere)
Machi 27, 2006

REPORT OF THE INDEPENDENT AUDITORS

TO THE MEMBERS OF HOUSING FINANCE COMPANY
OF KENYA LIMITED

We have audited the financial statements set out on pages 21 to 45 for the year ended 31 December 2005. We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit. The balance sheet of the Company is in agreement with the books of account.

Respective responsibilities of directors and independent auditors

As stated on page 19, the directors are responsible for the preparation of financial statements that give a true and fair view of the state of affairs of the group and the company and of the group's operating results. Our responsibility is to express an opinion on the financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing. These Standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by the directors, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, proper books of account have been kept and the financial statements give a true and fair view of the state of the group and company's financial position at 31 December 2005 and of the group's operating results and cash flows for the year then ended and comply with International Financial Reporting Standards and the Kenyan Companies Act.

KPMG KENYA

CERTIFIED PUBLIC ACCOUNTANTS

PO BOX 40612

NAIROBI

27 March 2006

RIPOTI YA WAHABISHA WA KUJITEGEMEA

KWA WANACHAMA WA HOUSING FINANCE COMPANY
OF KENYA LIMITED

Tumekagua taarifa ya uhasibu kwa kipindi cha mwaka kilichomalizika Desemba 31, 2005 kama ilivyoonyeshwa kupitia kurasa za 21 hadi 45. Tumekusanya habari na maeleza yote ambayo kwa imani yetu ni muhimu wakati wa kuandaa ripoti hii. Taarifa inayoelezea hali ya kifedha ya kampuni inaafikiana na ripoti ya hesabu iliyohifadhiwa kwenye vitabu.

Wajibu hususa wa wakurugenzi na wahabishi wa kujitegemea

Kama ilivyoelezwa kupitia ukurasa wa 19, wakurugenzi wana wajibu wa kuandaa taarifa ya uhasibu ambayo itafafanua hali halisi ya kundi na kampuni na matokeo ya shughuli zake. Wajibu wetu ni kutoa maoni kuhusiana na taarifa ya uhasibu itakayoongozwa na ukaguzi wetu.

Msingi wa Maoni

Tuliandaa ukaguzi wa hesabu kwa mujibu wa viwango vya uhasibu vya kimataifa. Viwango hivi vinatuhitaji kuandaa na kutekeleza ukaguzi ili kupata uhakika kwamba taarifa ya uhasibu haina udanganyifu wowote. Ukaguzi huu unahusu kufanya majaribio kwenye msingi wa kutahini na kupata ushahidi ili kuunga mkana hesabu zilizoonyeshwa kwenye taarifa ya uhasibu. Ukaguzi huu pia unahusu kufanyia makisio sera za uhasibu zilizotumika na makadirio yaliyofanywa na wakurugenzi wakati wa kuwasilisha taarifa yao. Tuna imani kwamba ukaguzi wetu unasimamia msingi halisi wa maoni yetu.

Maoni

Kwa maoni yetu, rekodi ya vitabu imetunzwa vyema na kwamba taarifa ya uhasibu ya kampuni na kundi kwa kipindi kilichomalizika Desemba 31, 2005 inadhihirisha hali halisi ya matokeo na shughuli za matumizi ya pesa na, inaafikiana na viwango vya kimataifa kwa mujibu wa sheria za makampuni za Kenya.

KPMG KENYA

CERTIFIED PUBLIC ACCOUNTANTS

SLP 40612

NAIROBI

Machi 27, 2006

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2005

		2005	2004
	Note	KShs'000	KShs'000
INTEREST INCOME	3	1,016,927	1,154,825
INTEREST EXPENSE	4	(353,380)	(249,576)
NET INTEREST INCOME		663,547	905,249
IMPAIRMENT LOSSES ON MORTGAGE			
ADVANCES	13(b)	(138,681)	(374,670)
NET INTEREST INCOME AFTER IMPAIRMENT			
LOSSES ON MORTGAGE ADVANCES TO CUSTOMERS		524,866	530,579
NON INTEREST INCOME	5	182,278	215,435
NON INTEREST EXPENSES	6	(616,656)	(658,158)
PROFIT BEFORE TAXATION	7	90,488	87,856
TAXATION	8	(31,689)	(27,880)
NET PROFIT AFTER TAX		58,799	59,976
BASIC EARNINGS PER SHARE	9	KShs 0.51	KShs 0.53
DIVIDEND PER SHARE	10	-	-

The notes set out on pages 26 to 45 form an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET

AT 31 DECEMBER 2005

	Note	2005 KShs'000	2004 KShs'000
ASSETS			
Cash and bank balances	11(a)	182,530	143,013
Placements with other banks	11(b)	1,780,471	502,639
Investment in Government Securities	12	796,196	1,346,308
Mortgage advances to customers (Net)	13(a)	6,443,855	6,583,041
Non current assets held for sale	16	16,165	-
Other assets	17	88,967	339,842
Housing Development Projects	18	9,430	9,208
Property and equipment	19(a)	302,090	242,386
Prepaid operating lease rentals	20	54,739	57,464
Intangible assets	21	62,595	81,002
Deferred tax asset	22(a)	57,743	58,186
Tax recoverable		46,413	77,659
Retirement benefit asset	23	19,884	19,884
TOTAL ASSETS		9,861,078	9,460,632
LIABILITIES			
Customers' deposits	24	8,433,503	8,062,191
Other liabilities	25	155,861	182,222
Dividends - payable		-	96,293
		8,589,364	8,340,706
SHAREHOLDERS' EQUITY (Page 25)			
Share capital	26	575,000	575,000
Reserves		645,964	494,176
Shareholders' income notes and loans	27	50,750	50,750
		1,271,714	1,119,926
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		9,861,078	9,460,632

The financial statements set out on pages 21 to 45 were approved by the Board of Directors on 27 March 2006 and were signed on its behalf by:

Kung'u Gatabaki)
David R Ansell) Directors
Naftali Mogere)
Chunga Associates Company Secretary

The notes set out on pages 26 to 45 form an integral part of these financial statements.

COMPANY BALANCE SHEET

AT 31 DECEMBER 2005

	Note	2005 KShs'000	2004 KShs'000
ASSETS			
Cash and bank balances	11(a)	182,455	142,179
Placement with other banks	11(b)	1,780,471	502,639
Investment in Government Securities	12	796,196	1,346,308
Mortgage advances to customers (Net)	13(a)	6,443,855	6,583,041
Investment in subsidiaries	14	130,020	55,020
Dividend receivable		15,000	15,000
Amounts due from subsidiary company	15(a)	-	64,368
Non current assets held for sale	16	16,165	-
Other assets	17	86,675	334,670
Property and equipment	19(b)	295,639	235,860
Prepaid operating lease rentals	20	44,064	46,666
Intangible assets	21	62,595	81,002
Deferred tax Asset	22(b)	3,945	7,058
Tax recoverable		25,888	57,134
Defined benefit asset	23	19,884	19,884
TOTAL ASSETS		9,902,852	9,490,829
LIABILITIES			
Customers' deposits	24	8,437,315	8,062,262
Amounts due to subsidiary company	15(b)	23,789	24,121
Other liabilities	25	150,760	177,519
Dividends - payable		-	96,293
		8,611,864	8,360,195
SHAREHOLDERS' EQUITY (Page 25)			
Share capital	26	575,000	575,000
Reserves		665,238	504,884
Shareholders' income notes and loans	27	50,750	50,750
		1,290,988	1,130,634
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		9,902,852	9,490,829

The financial statements set on pages 21 to 45 were approved by the Board of Directors on 27 March 2006 and were signed on its behalf by:

Kung'u Gatabaki)
David R Ansell) Directors
Naftali Mogere)
Chunga Associates Company Secretary

The notes set out on pages 26 to 45 form an integral part of these financial statements.

FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	2004
		Ksh'000
Net cash (inflow)/outflow from operating activities	28(a)	(148,695)
INVESTING ACTIVITIES		
Purchase of property and equipment		(42,040)
Proceeds from sale of prepaid operating lease rentals		310
Proceeds from sale of property and equipment		11,039
Additions to intangible assets		(44,130)
Net cash flow from investing activities		(74,821)
Net increase/(decrease) in cash and cash equivalents	28(b)	(223,516)

The notes set out on pages 26 to 45 form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2005

	Share capital Kshs'000	Revaluation reserve Kshs'000	Share premium Kshs'000	Statutory reserve Kshs'000	Retained profits Kshs'000	Total Kshs'000
At 1 January 2004	575,000	100,429	25,705	-	308,066	1,009,200
Net profit after taxation	-	-	-	-	59,976	59,976
At 31 December 2004	575,000	100,429	25,705	-	368,042	1,069,176
Net profit after taxation	-	-	-	-	58,799	58,799
Revaluation surplus realised	-	92,989	-	-	-	92,989
Reclassification of reserves	-	-	-	289,262	(289,262)	-
At 31 December 2005	575,000	193,418	25,705	289,262	137,579	1,220,964

The notes set out on pages 26 to 45 form an integral part of these financial statements.

COMPANY STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2005

	Share capital Kshs'000	Revaluation reserve Kshs'000	Share premium Kshs'000	Statutory reserve Kshs'000	Retained profits Kshs'000	Total Kshs'000
At 1 January 2004	575,000	100,429	25,705	-	311,443	1,012,577
Net profit after taxation	-	-	-	-	67,307	67,307
At 31 December 2004	575,000	100,429	25,705	-	378,750	1,079,884
Net profit after taxation	-	-	-	-	67,365	67,365
Revaluation surplus realised	-	92,989	-	-	-	92,989
Reclassification of reserves	-	-	-	289,262	(289,262)	-
At 31 December 2005	575,000	193,418	25,705	289,262	156,853	1,240,238

The notes set out on pages 26 to 45 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

1 SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

(a) Basis of preparation

The consolidated financial statements are prepared in accordance with and comply with International Financial Reporting Standards. The financial statements are prepared under the historical cost convention as modified by the revaluation of certain items of property and equipment. Available for sale financial assets and financial liabilities held at fair value through profit and loss account are stated at fair value.

The preparation of financial statements in conformity with International Financial Reporting Standards requires management to make judgement, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. The estimates and assumptions are based on the Directors' best knowledge of current events, actions, historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about the carrying values of assets and liabilities are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

(b) Consolidation principles

The consolidated financial statements comprise the financial statements of the parent company and its subsidiaries made up to 31 December 2005. Subsidiaries are entities controlled by the company. Control exists when the company has power, directly or indirectly, to govern the financial and operating policies so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. A listing of the subsidiaries is set out on page 34 (Note 15).

(c) Revenue recognition

Income is recognised on an accrual basis in the period in which it is earned.

(i) **Interest income and expense**

Interest income and interest expense are recognised on an accrual basis taking into account the effective interest rate of the interest earning assets and interest bearing liabilities.

(ii) **Fees and commission**

Fees and commission income is recognised when the service is provided.

(d) Impairment losses on mortgage advances

Mortgages are shown at the gross amount adjusted for any impairment losses. The provision for impairment losses is increased by charges to income and decreased by charge-offs (net of recoveries).

Provision for impairment losses is established if there is objective evidence that the company will not be able to collect all amounts due according to the original contractual terms of the mortgage loan. The amount of the impairment loss is the difference between the carrying amount and the estimated recoverable amount.

In addition, a portfolio impairment is made based on management's evaluation of the mortgage advances portfolio and other exposures in respect of losses, which, although not specifically identified, are known from experience to be present in any such portfolio.

When a mortgage advance is deemed uncollectable, it is written off against the related provision for impairment losses. Subsequent recoveries of advances that have been written off are credited to the income statement.

NOTES TO THE FINANCIAL STATEMENTS *(Continued)*

(e) Translation of foreign currencies

Items included in the financial statements are measured using the currency of primary economic environment in which the entity operates i.e Kenya shillings

Transactions in foreign currencies during the year are converted into Kenya Shillings at the rates ruling at the transaction dates. Assets and liabilities at the balance sheet date which are expressed in foreign currencies are translated into Kenya shillings at rates ruling at the balance sheet date. The resulting realised and unrealised differences from conversion and translations are recognised in the profit and loss account. Non-monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the date of the transaction.

(f) Property and equipment

Freehold land and buildings and buildings on leasehold land are included in the financial statements at their historical cost or amount of any subsequent valuation less accumulated depreciation and impairment losses.

Freehold land is not depreciated.

Depreciation is calculated on a straight line basis to allocate the cost or revalued amount to their residual values over their estimated useful lives as follows:-

Computers	20%
Motor vehicles	20%
Office equipment, fixtures and fittings	5% - 20%

Buildings on leasehold land are depreciated over the remaining period of the lease. Buildings on freehold land are depreciated over fifty years.

Excess depreciation is the difference between the depreciation charge for the year based on the revalued amount and the original cost of the related property and equipment. On an annual basis, the amount relating to the excess depreciation is transferred from revaluation reserves to retained earnings to recognise the use of the property and equipment.

The residual value, if not insignificant is reassessed annually.

(g) Intangible assets

Where computer software is not an integral part of the related computer hardware it is recognised as an intangible asset. The software are stated on the balance sheet at costs less accumulated amortisation and impairment losses.

Software costs are amortised over five (5) years on a straight line basis from the date they are available for use.

(h) Prepaid operating lease rentals

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Payments made under operating lease arrangements (whether pre-paid or post paid) are charged to the profit and loss account on a straight-line basis over the period of the lease.

(i) Retirement benefits obligation

The group operates a funded defined benefit plan for substantially all employees. The group's net obligation is calculated by estimating the amount of future benefits due to employees in return for their service in current and prior periods. The fair value of plan assets is deducted to obtain the net obligation. The calculation is carried out by an independent actuary every three years based on the projected unit credit method.

Where the calculation results in a benefit to the group, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs, and the present value of any future refunds from the plan; or reduction in future contributions to the plan. Actuarial gains and losses are charged to the profit and loss account over the average remaining working lives of employees participating in the scheme.

(ii) Taxation

Tax on the operating results for the year comprises the current charge and change in deferred tax. Current tax is provided on the results in the year as shown in the financial statements adjusted in accordance with tax legislation.

NOTES TO THE FINANCIAL STATEMENTS *(Continued)*

Deferred tax is provided using the balance sheet liability method on all temporary differences between the carrying amounts for financial reporting purposes and the amounts used for taxation purposes, except differences relating to the initial recognition of assets and liabilities which affect neither accounting nor taxable profit.

Deferred tax is calculated on the basis of the tax rates currently enacted.

(k) Cash and cash equivalents

For the purpose of presentation of cash flows in the consolidated financial statements, the cash and cash equivalents include cash in hand and at bank, net balances with banking institutions and investment in government securities with a maturity period within three months from date of acquisition.

(l) Financial instruments

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

(i) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money directly to a debtor with no intention of trading the receivable. These include mortgage advances to customers and placements with other banks.

(iii) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale. These include treasury bills, treasury bonds and government stock.

(iv) Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates or exchange rates. Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on trade-date the date on which the Group commits to purchase or sell the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity should be recognised in profit or loss. However, interest calculated using the effective interest method is recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS *(Continued)*

(m) Impairment

The carrying amounts of the group's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated and an impairment loss recognised immediately in the profit and loss account, whenever the carrying amount of an asset exceeds its recoverable amount.

(n) Segmental reporting

Segment information is presented in respect of the group's business segments, which is the primary format and is based on the nature of products and services which the group offers. The group has no distinguishable geographical segments.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Inter-segment pricing is determined on an arms length basis.

(o) Dividends

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity.

(p) Provisions

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

(q) Offsetting

Financial assets and liabilities are offset and the net amount reported on the balance sheet when there is a legally enforceable right to offset the recognised amount and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(r) Comparatives — information

Where necessary, comparative figures have been restated to conform with changes in presentation in the current year.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2. SEGMENT REPORTING

	Mortgage business KShs'000	House sales KShs'000	Other KShs'000	Eliminations KShs'000	Total 2005 KShs'000	Total 2004 KShs'000
Gross revenue (external)	1,199,205	-	-	-	1,199,205	1,370,260
Segment profit/(loss) before tax	101,725	(10,888)	(349)	-	90,488	87,856
Taxation	(34,359)	2,670	-	-	(31,689)	(27,880)
Segment profit/(loss) after tax	67,366	(8,218)	(349)	-	58,799	59,976
Other information:						
Segment assets	9,902,852	106,806	24,041	(172,621)	9,861,078	9,490,632
Segment liabilities	8,611,864	20,002	81	(42,601)	8,589,346	8,340,706
Depreciation /Amortisation Expense	(25,622)	(75)	-	-	(25,697)	(27,119)
Capital expenditure	6,530	-	-	-	6,530	42,040

3. INTEREST INCOME

	2005 Ksh'000	2004 Ksh'000
Advances to customers	865,864	1,071,445
Treasury bills	4,403	8,398
Treasury bonds	40,712	56,221
Placements with other banks	102,943	18,761
	1,016,922	1,154,825

4. INTEREST EXPENSE

	2005 Ksh'000	2004 Ksh'000
Customer deposits	349,194	245,385
Interest on borrowed funds	1,106	4,191
	353,388	249,576

5. NON-INTEREST INCOME

	2005 Ksh'000	2004 Ksh'000
House sales	16,044	16,044
Fees and commission income	39,121	39,121
Rental income	20,112	20,112
Other operating income	136,428	136,428
Gain on sale of investment property, property and equipment and prepaid operating lease rentals	3,730	3,730
	215,435	215,435

NOTES TO THE FINANCIAL STATEMENTS *(Continued)*

6. NON INTEREST EXPENSES

	2005 Ksh'000	2004 Ksh'000
Cost of houses sold	-	13,075
Salaries and employee benefits	360,869	357,349
Rental Expenses	20,313	28,513
Deposit Protection Fund	12,139	13,158
General administration expenses	223,335	244,081
Other expenses	-	1,982
	<u>616,656</u>	<u>658,158</u>

The average number of employees engaged by the company during the year was 229 (2004-235).

	2005	2004
Management	136	138
Unionisable	83	84
Contractual	9	11
Temporary	1	2
Total	<u>229</u>	<u>235</u>

Included in salaries and employees benefits are contributions to the defined benefits retirement scheme for employees. During the year, the group made contributions of KShs 21,188,485 (2004 – KShs. 20,166,861).

7. PROFIT BEFORE TAXATION

The profit before taxation is arrived at after charging/(crediting):

	2005 Ksh'000	2004 Ksh'000
Profit on sale of property and equipment, leasehold land and investment property	(674)	(3,730)
Directors' remuneration:		
- Fees	1,750	1,471
- Expenses	2,812	2,460
- As executives	24,677	26,512
Auditors' remuneration:		
- Current year	5,584	4,627
- Prior year over provision	477	-
Amortisation of prepaid operating lease rentals	657	657
Depreciation	<u>25,697</u>	<u>27,119</u>

CMA-LIBRARY

(Continued)

8.		2004 Ksh'000
	Current tax at 30%	-
	Deferred tax (Note 22(a))	27,880
		27,880

The tax on the group's profit before tax differs from the theoretical amount using the basic tax rate as follows:

	2004 Ksh'000
Accounting profit before taxation	87,856
Tax at the applicable corporation tax rate of 30%	26,357
Tax effect of non-deductible costs and non-taxable income	1,523
	27,880

9.	The calculation of earnings per share is based on:	2004 Ksh'000
	Net profit for the year attributable to shareholders	59,976
	Number of ordinary shares in issue (in thousands)	115,000
	Earnings per share	KShs 0.53

10.	Dividends	-
	Number of ordinary shares in issue (in thousands)	115,000
	Dividends per share	KShs. 0.00

11.		2004
	Group KShs'000	Company KShs'000
	Cash at hand	50,564
	Current account balances	92,449
		143,013
		142,179

	2004 KShs'000
Group and Company	
Due within 90 days	502,639

The weighted average effective interest rate on placement with other banks as at 31 December 2005 was 8.31% (2004 – 6.80%).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12. INVESTMENT IN GOVERNMENT SECURITIES

Group and Company	2005 KShs'000	2004 KShs'000
Held to Maturity		
Treasury bills due within 90 days	100,000	450,000
Treasury bonds due within 90 days	153,080	1,668
Treasury bonds due within 180 days	1,290	207,240
Treasury bonds due after 180 days	541,826	687,400
	696,196	896,308
	796,196	1,346,308

The weighted average effective interest rate on government securities as at 31 December 2005 was 6.31% (2004 – 5.55%).

13. MORTGAGE ADVANCES TO CUSTOMERS

a) Group and Company	2005 KShs'000	2004 KShs'000
Mortgages	9,876,465	10,865,208
Less: Provision for impairment losses	(3,432,610)	(4,282,167)
	6,443,855	6,583,041
Maturing:		
Within five years	2,205,144	2,355,491
Over five years to ten years	2,678,273	2,691,004
Over ten years to fifteen years	1,360,590	1,325,651
Over fifteen years	199,848	210,895
	6,443,855	6,583,041
b) Reserve for Impairment losses		
	Impairment losses KShs'000	Portfolio impairment KShs'000
At 1 January 2004	4,503,485	32,259
Release in the year	(314)	(912)
Made during the year	375,896	-
Net charge to profit and loss account	375,582	(912)
Written off against balance	(628,247)	-
At 31 December 2004	4,250,820	31,347
Direct write offs during the year	13,767	-
Made during the year	139,810	(14,896)
Net charge to profit and loss account	153,577	(14,896)
Written off against balance	(988,238)	-
At 31 December 2005	3,416,159	16,451
	2005 KShs'000	2004 KShs'000
Interest on impaired mortgages which has not yet been received in cash	3,515,854	3,806,812

The weighted average effective interest rate on mortgage advances to customers as at 31 December 2005 was 13.35% (2004 – 14.43%).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

13. MORTGAGE ADVANCES TO CUSTOMERS (Continued)

c) Mortgage advances

Mortgage advances include an amount of KShs 3,003,936,000 (2004 – KShs 3,479,626,000) net of impairment losses, which have been classified as impaired mortgages. The estimated realisable value of securities held against this net balance is KShs 4,174,249,000 (2004 – KShs. 5,100,368,000).

14. INVESTMENT IN SUBSIDIARIES

	2005 KShs'000	2004 KShs'000
Kenya Building Society Limited	22,484	50,000
First Permanent (East Africa) Limited	32,536	5,020
	<u>55,020</u>	<u>55,020</u>

15. ACCOUNTS DUE FROM/(TO) SUBSIDIARIES

	2005 KShs'000	2004 KShs'000
Company:		
a) Due from:		
Kenya Building Society Limited		64,368
b) Due to:		
First Permanent (East Africa) Limited	(12,121)	(24,121)

16. NON CURRENT ASSETS HELD FOR RESALE

	2005 KShs'000	2004 KShs'000
a) Group and Company		
Cost or valuation:		
At 1 January 2005	-	-
Transfer from Property and equipment	10,000	-
Transfer from Prepaid lease rentals	2,400	-
At 31 December 2005	<u>12,400</u>	<u>-</u>
Depreciation:		
At 1 January 2005	-	-
Transfer from Property and equipment	900	-
Transfer from Prepaid lease rentals	300	-
At 31 December 2005	<u>1,200</u>	<u>-</u>
Net book value:		
At 31 December 2005	<u>10,160</u>	<u>-</u>

The assets relate to cottages held for which negotiations for sale has already been entered into and down payments received. It is expected that the sale will be completed in 2006.

17. OTHER ASSETS

	2005		2004	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Exchange loss recoverable from the Government of Kenya	-	-	259,152	259,152
Staff debtors	36,655	36,644	34,831	34,729
Prepayments	18,010	18,010	14,136	14,136
Deposits and rent receivable	3,047	2,592	6,452	5,995
Other receivables	31,255	29,429	25,271	20,658
	<u>88,967</u>	<u>86,675</u>	<u>339,842</u>	<u>334,670</u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18. HOUSING DEVELOPMENT PROJECTS

	2005 KShs'000	2004 KShs'000
Group:		
Housing projects		
Komarack Housing Projects	9,430	9,208

Commitments in respect of these projects, authorised but not paid as at 31 December 2005 amounted to KShs Nil (2004 – Nil).

19. PROPERTY AND EQUIPMENT

a) Group:

	Freehold land KShs'000	Buildings KShs'000	Furniture, fixtures, equipment & motor vehicles KShs'000	Total KShs'000
Cost or valuation:				
At 1 January 2005	7,000	165,862	386,775	559,637
Additions	-	-	6,530	6,530
Surplus on revaluation	-	82,789	-	82,789
Transfer to Non current assets held for sale	-	(15,000)	-	(15,000)
Disposals	-	-	(3,810)	(3,810)
At 31 December 2005	7,000	233,651	389,495	630,146
At cost	-	5,651	389,495	395,146
At valuation	7,000	228,000	-	235,000
Depreciation:				
At 1 January 2005	-	11,975	305,276	317,251
Charge for the year	-	2,277	23,420	25,697
On revaluation	-	(10,201)	-	(10,201)
Transfer to Non current assets held for sale	-	(903)	-	(903)
Disposals	-	-	(3,788)	(3,788)
At 31 December 2005	-	3,148	324,908	328,056
Net book value:				
At 31 December 2005	7,000	230,503	64,587	302,090
At 31 December 2004	7,000	153,887	81,499	242,386

The Group's land and buildings were professionally valued by the Group's valuer on an open market basis on 31 December 2005. The resulting surplus was credited to revaluation reserve.

The net book value (NBV) of properties at their historical cost is as follows:

	2005 KShs 000	2004 KShs '000
Freehold land	206	206
Buildings	53,109	55,311

Included in property and equipment are assets with a gross value of KShs 219,629,047 (2004 – KShs 193,892,840) which are fully depreciated and still in use. Such assets would have attracted a national depreciation of KShs 38,664,629 (2004 – KShs 32,474,499).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

19. PROPERTY AND EQUIPMENT (Continued)

b) Company:

	Freehold land KShs'000	Buildings KShs'000	Furniture, fixtures, equipment & motor vehicles KShs'000	Total KShs'000
Cost or valuation:				
At 1 January 2005	7,000	157,266	381,409	545,675
Additions	-	-	6,530	6,530
Surplus on revaluation	-	82,789	-	82,789
Transfer to Non current assets held for sale	-	(15,000)	-	(15,000)
Disposals	-	-	(3,810)	(3,810)
At 31 December 2005	7,000	225,055	384,129	616,184
At cost	-	(2,945)	384,129	381,184
At valuation	7,000	228,000	-	235,000
Depreciation:				
At 1 January 2005	-	9,905	299,910	309,815
Charge for the year	-	2,202	23,420	25,622
On revaluation	-	(10,201)	-	(10,201)
Transfer to Non current assets held for sale	-	(903)	-	(903)
Disposals	-	-	(3,788)	(3,788)
At 31 December 2005	-	1,003	319,542	320,545
Net book value:				
At 31 December 2005	7,000	224,052	64,587	295,639
At 31 December 2004	7,000	147,361	81,499	235,860

The company's land and buildings were professionally valued by the Group's valuer on an open market basis on 31 December 2005. The resulting surplus was credited to revaluation reserve.

The net book value (NBV) of properties at their historical cost is as follows:

	2004 KShs '000
Freehold land	206
Buildings	55,311

Included in property and equipment are assets with a gross value of KShs 219,629,047 (2004 – KShs 193,892,840) which are fully depreciated and still in use. Such assets would have attracted a notional depreciation of KShs 38,664,629 (2004 – KShs 32,474,499).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

20. PREPAID OPERATING LEASE RENTALS

	2005		2004	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Cost:				
At 1 January	60,332	48,106	65,259	4,857
Disposals in the year	-	-	(4,927)	(70)
Transfer to Non current assets held for sale	(2,400)	(2,400)	-	-
Transfer from/to subsidiary	-	-	-	43,319
	<u>57,932</u>	<u>45,706</u>	<u>60,332</u>	<u>48,106</u>
Amortisation:				
At 1 January	2,868	1,440	6,900	924
Charge for the year	657	534	657	534
Transfer to Non current assets held for sale	(332)	(332)	-	-
Disposals	-	-	(4,689)	(18)
	<u>3,193</u>	<u>1,642</u>	<u>2,868</u>	<u>1,440</u>
At 31 December	<u>54,739</u>	<u>44,064</u>	<u>57,464</u>	<u>46,666</u>

As at 31 December 2005 the un-expired lease period ranges from 67 years to 89 years.

21. INTANGIBLE ASSETS

	2005 KShs'000	2004 KShs'000
Group and Company		
Software costs		
At January	112,429	68,299
Additions during the year	2,583	44,130
Reclassification	(513)	-
	<u>114,499</u>	<u>112,429</u>
Amortisation		
At January	31,427	6,377
Amortisation during the year	20,477	25,050
	<u>51,904</u>	<u>31,427</u>
As at 31 December	<u>62,595</u>	<u>81,002</u>
Net book value as at 31 December		

NOTES TO THE FINANCIAL STATEMENTS (Continued)

22. DEFERRED TAX ASSET

a) Group

Movements in deferred tax assets and liabilities are as follows:

	At 31 December 2005 KShs '000	Recognised in income KShs '000	At 31 December 2004 KShs '000
Arising from:			
Plant and equipment	777	549	228
Other general provisions	(385)	1,922	(2,307)
General provision on mortgages	(10,424)	(1,020)	(9,404)
Defined benefit asset	5,965	-	5,965
Tax losses carried forward	(53,676)	(1,008)	(52,668)
	<u>(57,743)</u>	<u>443</u>	<u>(58,186)</u>

b) Company

	At 31 December 2005 KShs '000	Recognised in income KShs '000	At 31 December 2004 KShs '000
Arising from:			
Plant and equipment	744	300	444
Other general provisions	(230)	1,886	(2,116)
General provision on mortgages	(10,424)	(1,020)	(9,404)
Defined benefit asset	5,965	-	5,965
Tax losses carried forward		1,947	(1,947)
	<u>(3,945)</u>	<u>3,113</u>	<u>(7,058)</u>

23. RETIREMENT BENEFITS ASSET

Group and Company

In accordance with the group's policy, actuarial assessment is done after every three years. The next valuation shall be done in 2006. The actuarial valuation at 31 December 2003 is shown below:

	KShs'000
Present value of funded obligations	239,655
Fair value of scheme assets	(278,682)
Net over funding in the scheme	(39,027)
Unrecognised actuarial loss	19,143
Net asset in the balance sheet	(19,884)

Movements in the net (asset)/liability recognised in the balance sheet are as follows:

Net (asset)/ liability at 1 January 2003	22,281
Net expense recognised in the income statement	14,742
Employer contributions	(56,907)
Net asset in the balance sheet at 31 December 2003	(19,884)

The expense recognised in the income statement is as follows:

Current service costs	14,774
Interest on obligation	18,467
Expected return on plan assets	(18,499)
Total expense included in administration expenses	14,742

Discount rate (p.a.)	9%
Expected return on scheme assets (p.a.)	9%
Future salary increases (p.a.)	7%
Future pension increases (p.a.)	0%

NOTES TO THE FINANCIAL STATEMENTS (Continued)

24. CUSTOMERS' DEPOSITS

	2005		2004	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Government and parastatals:				
Payable within 90 days	345,751	345,751	107,122	107,122
Payable after 90 days and within one year	9,279	9,279	71,174	71,174
Payable after one year	1,019,159	1,019,159	1,313,422	1,313,422
Private sector and individuals:				
Payable within 90 days	5,579,487	5,583,299	4,341,057	4,341,128
Payable after 90 days and within one year	845,134	845,134	1,691,392	1,691,392
Payable after one year	634,693	634,693	538,024	538,024
	<u>8,433,503</u>	<u>8,437,315</u>	<u>8,062,191</u>	<u>8,062,262</u>

(a) Included in customers' deposits is KShs 3,811,533 (2004 – KShs 71,282) due to a subsidiary, Kenya Building Society Limited.

(b) The weighted average effective interest rate on customer deposits as at 31 December 2005 was 4.85% (2004 – 3.73%).

25. OTHER LIABILITIES

	2005		2004	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
The Government of Kenya - exchange risk assumption fees	125	125	18,073	18,073
Interest payable on the Government of Kenya Income Notes	2,093	2,093	31,402	31,402
Hause sales deposits	2,203	-	3,129	-
Land sale deposit	2,799	-	-	-
Withholding tax payable	11,675	11,675	15,080	15,080
Other liabilities	136,966	136,867	114,538	112,964
	<u>155,861</u>	<u>150,760</u>	<u>182,222</u>	<u>177,519</u>

26. SHARE CAPITAL

	2005 KShs'000	2004 KShs'000
Group and Company		
Authorised, issued and fully paid		
115,000,000 Ordinary shares of KShs 5.00 each	<u>575,000</u>	<u>575,000</u>

The holders of ordinary shares are entitled to receive dividends declared from time to time and are entitled to one vote per share at annual and general meetings of the company.

27. SHAREHOLDERS' INCOME NOTES AND LOANS

	2005 KShs'000	2004 KShs'000
Group and Company		
Government of Kenya – Income Notes	<u>50,750</u>	<u>50,750</u>
The Government of Kenya – Income Notes carry no redemption date.		

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28. NOTES TO THE CASH FLOW STATEMENT

a)	2005 KShs'000	2004 KShs'000	
Reconciliation of operating profit to net cash flows from operating activities			
Group profit before taxation	90,488	87,856	
Depreciation	25,697	27,119	
Amortisation of intangible asset	20,477	25,049	
Profit on sale of prepaid operating lease rentals	-	(72)	
Intangible asset expensed	513	-	
Profit on sale of property and equipment,	(674)	(3,553)	
Increase/(decrease) in customer deposits	371,312	(1,357,084)	
Net movement in mortgage advances to customers	139,186	515,973	
Investment in Government securities	200,109	527,660	
Decrease in other assets	250,877	25,576	
Decrease in other liabilities	(122,654)	(6,793)	
(Increase)/Decrease in housing projects	(222)	8,917	
Amortisation of prepaid operating lease rentals	657	657	
Net cash flows from operating activities	975,766	(148,695)	
b) Analyses of cash and cash equivalents			
	2005 KShs '000	2004 KShs'000	Change in the year KShs'000
Cash in hand and bank	182,530	143,013	39,517
Balances due from banking institutions	1,780,471	502,639	1,277,832
Investment in government securities	100,000	450,000	(350,000)
	2,063,001	1,095,652	967,349

29. CONTINGENT LIABILITIES

(a) The company is the defendant in a law suit claiming damages for breach of contract.

(b) As at 31 December 2005, the company had issued guarantees in the ordinary course of business to third parties amounting to KShs 1.26 million (2004 – KShs 3.1 million).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

30. OPERATING LEASE ARRANGEMENTS

Group and company

The bank as a lessor

Rental income earned during the year was KShs 19,300,793 (2004 – KShs 20,112,000). At the balance sheet date, the bank had contracted with tenants for the following future lease receivables:

	2005 KShs'000	2004 KShs'000
Within one year	3,266	-
In second to fifth year inclusive	29,937	24,620
After five years	19,904	12,501
	<u>53,107</u>	<u>37,121</u>

Leases are negotiated for an average term of 6 years and rentals are reviewed every two years. The leases are cancellable with a penalty when the tenants do not give three months notice to vacate the premises.

The bank as a lessee

At the balance sheet date, the bank had outstanding commitments under operating leases which fall due as follows:

	2005 KShs'000	2004 KShs'000
Within one year	1,537	2,227
In second to fifth year inclusive	14,920	8,045
After five years	10,033	7,260
	<u>26,490</u>	<u>17,532</u>

Operating lease payments represent rentals payable by the bank for its office premises. Leases are negotiated for an average term of 6 years.

31. MORTGAGE COMMITMENTS

Group and Company

Mortgage commitments amounting to KShs 727,940,000 (2004 – KShs 414,678,000) are analysed below:

	2005 KShs'000	2004 KShs'000
Commitment in principle but not authorised for payment	305,528	190,827
Authorised but not paid	422,412	223,851
	<u>727,940</u>	<u>414,678</u>

32. CAPITAL COMMITMENTS

Group and Company

	2005 KShs'000	2004 KShs'000
Authorised but not contracted	<u>135,884</u>	<u>125,058</u>

33. ASSETS PLEDGED AS SECURITY

As at 31 December 2005 there were no assets pledged by the group to secure liabilities and there were no secured group liabilities.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

34. RELATED PARTY TRANSACTIONS

Group and Company

The group has entered into transactions with its employees as follows:

	2005 KShs'000	2004 KShs'000
At 1 January	139,972	152,470
Loans advanced during the year	47,300	27,807
Reclassified third party loans	(15,639)	(26,766)
Loans repayments received	(14,346)	(13,539)
At 31 December	157,287	139,972

The related interest income in 2005 was KShs 9,784,782 (2004 – KShs 9,580,319).

In the normal course of business, transactions have been entered with certain related parties at commercial terms.

35. RISK MANAGEMENT

This section provides details of the group's exposure to risk and describes the methods used by management to control risk. The most important types of financial risks to which the group is exposed are credit risk, liquidity risk and market risk mainly interest risk.

(i) Credit risk

The group is subject to credit risk through its lending and investing activities.

The group's primary exposure to credit risk arises through its mortgage advances to customers. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the balance sheet. The group is also exposed to credit risk on debt investments. The current credit exposure in respect of the instruments is equal to the carrying amount of these assets in the balance sheet.

The risk that counterparties to instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the group deals with counterparties of good credit standings and obtains collateral. An assessment of the extent to which fair values of collaterals cover existing non performing mortgage advances is highlighted in Note 13 (c) of these financial statements.

The group also monitors concentration of credit risk that arise by customer in relation to mortgage advances to customers. The group has no significant exposure to any individual customer or counterparty.

(ii) Liquidity risk

Liquidity risk arises in the general funding of the group's activities. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The group has access to a diverse funding base. Funds are raised mainly from deposits and share capital. This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funds. The group strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The group continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall company strategy.

In addition the group holds a portfolio of liquid assets as part of its liquidity risk management strategy.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

(iii) Market risk

Interest rate risk

The group's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature or reprice at different times or in differing amounts. Risk management activities are aimed at optimizing net interest income given market interest rates levels consistent with the group's business strategies. The group does not have any significant interest rate risk exposures.

Risk measurement and control

Interest rate, credit, liquidity and other risks are actively managed by independent risk control groups to ensure compliance with the company's risk limits. The company's risk limits are assessed regularly to ensure their appropriateness given the company's objectives and strategies and current market conditions.

36. FINANCIAL INSTRUMENTS

Liquidity risk

Contractual maturity analysis of assets and liabilities

The table below analyses the liquidity position of the group's financial assets and liabilities;

	Due on Demand KShs'000	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Total KShs'000
Assets						
Cash and bank balances	50,503	132,027	-	-	-	182,530
Placements with other banks	930,471	850,000	-	-	-	1,780,471
Investment in Government securities	-	253,080	1,290	141,826	400,000	796,196
Net Mortgage Advances to customers	-	484,974	151,563	1,568,607	4,238,711	6,443,855
Non current assets held for sale	-	-	16,165	-	-	16,165
Other assets	-	2,939	86,028	-	-	88,967
Housing development projects	-	-	-	9,430	-	9,430
Intangible assets	-	-	-	-	62,595	62,595
Property and equipment	-	-	-	-	302,090	302,090
Prepaid Operating Lease rentals	-	-	-	-	54,739	54,739
Deferred tax	-	-	-	-	57,743	57,743
Taxation	-	-	-	-	46,413	46,413
Retirement benefit asset	-	-	-	-	19,884	19,884
Total	980,974	1,723,020	255,046	1,719,863	5,182,175	9,861,078
Liabilities, shareholders' funds, loans and income notes						
Customer deposits	302,499	5,622,738	854,413	191,114	1,462,738	8,433,503
Other liabilities	-	16,692	139,169	-	-	155,861
Dividends payable	-	-	-	-	-	-
Share capital	-	-	-	-	575,000	575,000
Reserves	-	-	-	-	645,964	645,964
Shareholders' income notes	-	-	-	-	50,750	50,750
Total	302,499	5,639,430	993,582	191,114	2,734,452	9,861,078
Net liquidity gap	678,475	(3,916,410)	(738,536)	1,528,749	2,447,723	-
At 31 December 2004						
Total assets	351,620	1,225,048	434,158	1,972,362	5,477,444	9,460,632
Total Liabilities and Equity	-	1,921,825	2,161,404	2,476,689	2,900,714	9,460,632
Net liquidity gap	351,620	(696,777)	(1,727,246)	(504,327)	2,576,730	-

NOTES TO THE FINANCIAL STATEMENTS (Continued)

36. FINANCIAL INSTRUMENTS (Continued)

Interest rate risk

Contractual maturity analysis of assets and liabilities

The table below summarises the exposure to interest rate risks. Included in the table below are the group's assets and liabilities at carrying amounts, categorized by the earlier of contractual repricing or maturity dates:

	Average interest rate %	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Non - interest bearing KShs'000	Total KShs'000
Assets							
Cash and bank balances	3.70%	182,530	-	-	-	-	182,530
Placements with other banks	8.31%	1,780,471	-	-	-	-	1,780,471
Investment in government securities	6.31%	253,080	1,290	141,826	400,000	-	796,196
Net mortgage advances to customers	13.55%	6,443,855	-	-	-	-	6,443,855
Non current assets held for sale			16,165				16,165
Other assets		-	-	-	-	88,967	88,967
Housing development projects		-	-	-	-	9,430	9,430
Property and equipment		-	-	-	-	302,090	302,090
Prepaid operating lease rentals		-	-	-	-	54,739	54,739
Intangible assets		-	-	-	-	62,595	62,595
Deferred tax		-	-	-	-	57,743	57,743
Taxation		-	-	-	-	46,413	46,413
Retirement benefit asset		-	-	-	-	19,884	19,884
Total assets		8,659,936	17,455	141,826	400,000	641,861	9,861,078
Liabilities, shareholders' funds, loans and income notes							
Customers' deposits	4.85%	5,925,237	854,413	191,114	1,462,739	-	8,433,503
Other liabilities		-	-	-	-	155,861	155,861
Share capital		-	-	-	-	575,000	575,000
Reserves		-	-	-	-	645,964	645,964
Shareholders' income notes		-	-	-	-	50,750	50,750
Total liabilities and equity		5,925,237	854,413	191,114	1,462,739	1,427,575	9,861,078
On balance sheet interest sensitivity gap		2,734,699	(836,958)	(49,288)	(1,062,739)	(785,714)	-
At 31 December 2004							
Total assets		7,680,361	207,240	217,400	470,000	885,631	9,460,632
Total liabilities and equity		1,921,825	2,161,404	2,476,689	1,502,273	1,398,441	9,460,632
On balance sheet interest sensitivity gap		5,758,536	(1,954,164)	(2,259,289)	(1,032,273)	(512,810)	-

NOTES TO THE FINANCIAL STATEMENTS *(Continued)*

37. CENTRAL BANK OF KENYA (AMENDMENT) ACT 2000

The Central Bank of Kenya (Amendment) Act, 2000 received assent on 6th August 2001. Subsequent to that date the Kenya Bankers Association filed a constitutional application at the High Court of Kenya. The Court delivered its Judgment on 24th January 2002.

A Decree to confirm the Judgment was extracted on 22nd February 2002 and subsequently the Attorney General filed an application to have the Decree varied. A Consent Order to vary the Decree was granted, but was then challenged by the Central Bank of Kenya and the Kenya Bankers Association. The matter has not been determined to date and as such the Act continues to be inoperative.

A revised act was published in 2004 but has not yet received approval and has not yet become law. The financial statements have been prepared accordingly

38. INCORPORATION

The company is incorporated as a limited company in Kenya under the Companies Act.

39. CURRENCY

These financial statements are expressed in Kenya Shillings.

HOUSING FINANCE PRODUCT NEWS

HOUSING FINANCE **EasyCash**

EasyCash is the Housing Finance Debit card that allows you access to your money from any Kentswitch branded ATMs available countrywide. The card is also used for identification when accessing your account over the counter. Apply for your **EasyCash** card now at your nearest Housing Finance branch.

ITS MUCH EASIER TO SAVE AND ACCESS YOUR MONEY WITH JUHUDI ACCOUNT

You only require **Ksh 500** to open a Juhudi Account and enjoy 24 hours access to your funds countrywide. Visit any Housing Finance branch with the required amount of money and open the Juhudi account today.

ARE YOU LOOKING FOR A SAFE PLACE FOR YOUR CHILDREN'S MONEY?

Look no further; your children can learn how to save their money at Home! Treasure Account will provide them with their own HouseBank. To open a Treasure account for your child you need:

- Kshs 1,000
- Two copies of your recent passport sized photograph and National ID card
- A copy of your child's birth certificate

WESTERN UNION MONEY TRANSFER IS NOW AVAILABLE AT ALL BRANCHES

Western Union is a fast and easy transfer system to send and receive money within minutes. The service allows one to send and receive money worldwide, from any Western Union location. Visit any of our branches for a fast and friendly service.

SAFE DEPOSIT SERVICES

Are your important documents safe at home? Safe Deposit Services are now available for both existing and new customers for safe custody of:

- Titles deeds
- Marriage certificates
- Legal documents
- School certificate etc.

You can access your documents any time during business hours.

THE HOUSING FINANCE PROPERTY MART

Are you looking for property? We have a variety of properties on sale at different prices. Visit us at our Property Mart located in Rehani House (at the junction of Kenyatta Avenue/Koinage Street), or at any of our branches countrywide to view property available all over Kenya.

Details of these properties are also displayed in our website www.housing.co.ke

BUILDING YOUR HOME IS MUCH EASIER

Is the wait of building your dream home unbearably long? Then talk to Housing Finance. Our construction Loan Finance ensures you not only cover all costs and risks associated with construction, but also your house is built to plan, on budget and on time. So whether you are building your home or blocks of flats for sale or rental, we'll help you realize your dream sooner.

PAYING YOUR MORTGAGE IS EASIER THAN EVER!

Direct Pay is an automated payment solution that is cheaper and gives you the convenience to make your mortgage payments directly from your bank account.

All you need to do is make sure your account has sufficient funds to cover your monthly payments and you can rest assured that your mortgage payments are made.

To benefit from this payment solution, simply visit your Housing Finance branch and sign up for **Direct Pay**.

HOUSING FINANCE PRODUCT NEWS (Continued)

ATM PROJECT

Our Automated Teller Machines (ATM) are now live in the following branches: Rehani, Mombasa and Buruburu branches. For the last six months our customers have been enjoying this service, which has marked an imperative landmark in the use of our Equinox information technology (IT) platform. This is also crucial as we continue to widen and convey exciting products and services to our customers.

Putting up of the ATM's is an added advantage to the customers since they will be able to monitor and access their savings accounts 24 hours a day and 7 days a week as all machines are capable of giving you mini-statements.

We are members of the Kenswitch network, which is made up of a consortium of banks that includes; Consolidated Bank, K-REP Bank, Investment and Mortgage (I & M), Transnational Bank, Chase Bank, Bank of Africa, PostBank, Dubai Bank, City Finance, EABS, and Akiba Bank among others.

The installation of ATM machines in all the other branches is underway and will be complete by June 2006. This is geared towards increasing accessibility for our customers.

Currently, Kenswitch network is rolling out a strategy that is aimed at increasing the product offering through debit cards like EasyCash that operate on this network.

WHY WE CHOSE "EASYCASH"

The debit card solution has been branded Easycash. The name reflects convenience to customers and ease of access to their accounts through the wide ATM network countrywide and soon to expand to retail outlets through point of sale arrangements.

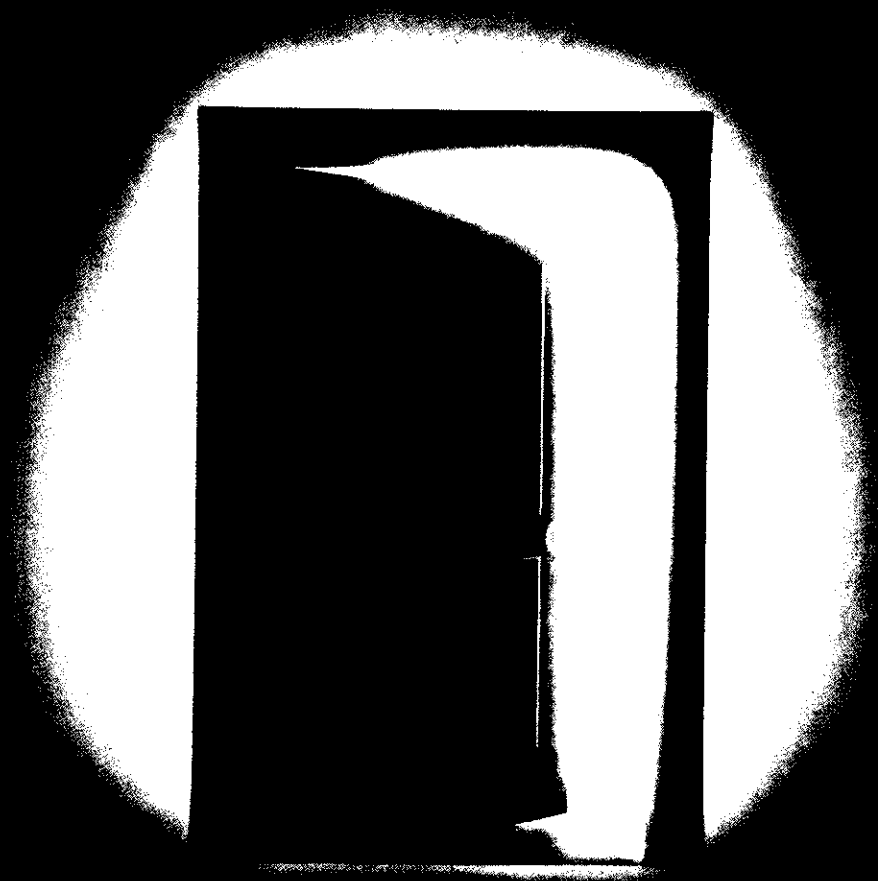
The Easycash card is issued to all savings account holders. The card will be used when accessing the following ATM services:

- * Fast cash withdrawals
- * Withdrawals
- * Mini statements
- * Balance inquiries
- * PIN change
- * POS retail outlets

You can now apply for your Easycash card from any of our branches.



Visit our website: www.housing.co.ke for more details on our various products



And open the door to your own home.



Turning dreams into homes

NOTES

A series of horizontal lines for writing notes, consisting of 25 lines in total. The lines are evenly spaced and extend across the width of the page.

NOTES

A series of horizontal lines for writing notes, starting from the top left and extending across the page. The lines are evenly spaced and cover most of the page area below the header.

To: The Registrar

Housing Finance Company of Kenya Limited

Rehani House

Kenyatta Avenue

PO Box 30088

00100 NAIROBI GPO



PROXY FORM

I/We _____

of _____

being a member/members of HOUSING FINANCE COMPANY OF KENYA LIMITED hereby appoint

of _____

or failing him _____

of _____

as my/our proxy to vote for me/us on my/our behalf at the 40th Annual General Meeting of the Company to be held on Wednesday 26 July 2006 and at any adjournment thereof.

Dated this _____ day of _____ 2006

Signed

Note:

- 1 In the case of a member being a corporation, the proxy must be under the Common Seal or under the hand of an officer or attorney duly authorised.
- 2 The proxy form should be completed and returned not later than 48 hours before the meeting or any adjournment thereof.

Kwa: Kwa Msajili,

Housing Finance Company of Kenya Limited

Rehani House

Kenyatta Avenue

S.L.P 30088

00100 NAIROBI GPO



FOMU YA UAKILISHI

Mimi/Sisi _____

Wa _____

Nikiwa mwanachama/Tukiwa wanachama wa HOUSING FINANCE COMPANY OF KENYA LIMITED namchagua/tunamchagua

wa _____

au akikasa yeye _____

wa _____

Kama mwakilishi wangu/mwakilishi wetu kupiga kura kwa niaba yangu/niaba yetu katika mkutana mkuu wa mwaka wa 40 wa shirika utakaofanyika siku ya Jumatano tarehe 26 Julai 2006 na hata kuahirishwa kwake.

Tarehe hii _____ siku ya _____ 2006

Sahihi

Ukumbusho:

- 1 Iwapo mwanachama ni shirika, mwakilishi sharti awe na idhini yenye muhuri wa shirika au sahihi ya afisa wa kampuni au wakili aliyeruhusiwa.
- 2 Hati hii ya uwakilishi lazima itumwe ili imfikie katibu kwa muda usiyopungua saa 48 ya kuanza kwa mkutana au kuahirishwa kwake.