

For Information

Legislative Council Panel on Financial Affairs

Review of the Concessionary Interest Rates for Certain Government Loan Schemes

Purpose

This paper reports the findings of a review of the concessionary interest rates for certain government loan schemes operated on the “no gain, no loss” principle, and in the light of this informs Members that Government proposes not to change the existing basis for determining the interest rates for such schemes.

Background

2. The interest rate for loans for civil servants granted under the Home Purchase Scheme (HPS), Housing Loan Scheme (HLS) and Home Financing Scheme (HFS) has been set on the principle that the Government should not seek to make a profit out of the loans, nor incur a loss. This “no gain, no loss” interest rate also applies to other loan schemes, including -

- (a) loans to civil servants under Civil Service Regulation 633 which requires loans to be secured against the officer’s final leave salary and either contract gratuity in respect of the leave or commuted pension gratuity;

- (b) the Non-means-tested Loan Scheme for eligible students of Government-funded tertiary institutions and the Open University of Hong Kong, etc.;
- (c) the Comprehensive Building Safety Improvement Loan Scheme;
- (d) the Slope Improvement Loan Scheme for Private Schools; and
- (e) the bridging loan to the Employees Compensation Assistance Fund Board.

3. Prior to April 1999, the “no gain, no loss” interest rate was linked to the return on the fiscal reserves. While this approach reflected the “no gain, no loss” principle in its purest terms, it became clear that its continued implementation could cause practical difficulties in view of the fluctuation in investment return following linkage in 1998 of the return on the fiscal reserves to the return achieved by the entire Exchange Fund (EF)¹.

¹ The return on the fiscal reserves for the past two financial years has fluctuated from about 11% for 1999-2000 to about 5% for 2000-01. This has confirmed our view that it is not appropriate to link the “no gain, no loss” rate to the return on the fiscal reserves as it is not fair to ask borrowers to accept wide fluctuations in interest rates that arise from volatility in investment performance.

4. We therefore conducted a review in early 1999 and concluded that it would be more appropriate to set the interest rate by reference to the market, at a fixed percentage (“X”) below the average of the best lending rates (BLRs) of the note-issuing banks. As the BLRs incorporated a profit element for the banks, we considered it reasonable to discount the BLRs by “X” to conform with the “no gain, no loss” principle.

5. After consulting Members in February 1999², we implemented the new formula on 1 April 1999. The value for “X” was set at 2% at that time, based on the average differential between the BLRs and the interest rates for the government housing loan schemes over the ten-year period from 1989 to 1998. The average differential between the 12-month Hong Kong Dollar Inter-Bank Offered Rates (HIBOR) and BLRs between 1993 and 1998 was also close to two percentage points.

6. To strike a balance between administrative efficiency and concerns about possible frequent fluctuation in the BLR, we have adopted a review mechanism whereby the interest rate will be adjusted only if the rate calculated under the formula differs from that prevailing by one percentage point or more, or when the prevailing interest rate has remained stationary for six months.

2 LC Paper No. CB(1) 816/98-99(02)

Review of the existing Formula

7. In establishing the existing formula, we undertook to conduct a review of the suitability of “X” after two years.

8. We have therefore updated the average differential between the 12-month HIBOR and BLRs, taking into account the latest ten-year period figures. The result, as indicated at **Annex**, is that the average differential is still close to 2%. Furthermore, based on the Hong Kong Monetary Authority’s projections, the differential between the 12-month HIBOR and BLR in the longer term will still be maintained at around 2%.

9. We note that since the middle of 2000, the market mortgage rates have been easing. Before that, mortgage loans were mostly granted at BLR plus. At present, according to the Hong Kong Monetary Authority’s Residential Mortgage Survey Results, about 75% of new loans are granted at mortgage rates set at BLR minus 2% or slightly more. The decline in the mortgage rates is mainly due to keen competition for mortgage business among banks. As these mortgage rates are determined by banks on commercially competitive grounds, we do not consider it appropriate to benchmark the government “no gain, no loss” rate with them.

Conclusion

10. The available evidence does not support an adjustment to the value of “X” at this time. The “no gain, no loss” rate will therefore remain at BLR minus 2%. We will review it again in two years’ time. Meanwhile, under this formula and the review mechanism, the “no gain, no loss” rate will be reduced from 6.5% to 5.5% with effect from 1 June 2001 to reflect the two most recent reductions in BLR (assuming that BLR will not be changed further between now and end May). The formula will continue to reflect any future changes in the BLR.

Consultation

11. We have informed the four central staff consultative councils of the result of our review. The Senior Civil Service Council (SCSC) does not agree with the Administration’s decision and considers that the Government’s interest rate charged on housing loans should not be higher than the prevailing market mortgage rates. We have carefully considered this view. In view of the fact that the market mortgage rates are determined by banks commercially on competitive grounds which is very different from our principle of not seeking a profit or incurring a loss in government loans to civil servants, we maintain that the current level of “X” is appropriate. We expect that the financial pressure on the staff concerned will be lessened considerably following the forthcoming reduction of the “no gain, no loss” rate as described in para. 10 above.

12. Both SCSC and the Model Scale 1 Staff Consultative Council have requested the Administration to adjust the Government's "no gain, no loss" interest rate whenever there is a change in BLR. We have reviewed the present arrangements and would streamline them with a view to ensuring that the interest rate can be adjusted more in tandem with revisions in BLR. We shall consult the staff sides shortly on details of the proposed improvements.

Finance Bureau
Government Secretariat
14 May 2001

**Differential Between 12-month HIBOR and Best Lending Rates
from 1991 to 2000
(Period Average Figures)**

During	12-Month HIBOR (A)	Best Lending Rate (B)	Differential (B) - (A)
1991	6.96	9.41	2.45
1992	4.63	7.33	2.70
1993	4.03	6.50	2.47
1994	5.64	7.26	1.62
1995	6.64	8.95	2.31
1996	5.88	8.52	2.64
1997	7.47	8.83	1.36
1998	9.31	9.94	0.63
1999	6.88	8.49	1.61
2000	6.63	9.22	2.59
Average	<u>6.41</u> =====	<u>8.45</u> =====	<u>2.04</u> =====