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Panel on Financial Affairs

Meeting on 29 January 2008

Background Brief on the 70% Mortgage Cap on Residential Property

Purpose

This paper highlights some key issues about the 70% cap on mortgage loans for residential property, and summarizes the major concerns raised by Members during past discussions of the subject.

About the 70% mortgage cap

2. According to information of the Hong Kong Monetary Authority (HKMA) and the Administration, the background for the 70% loan-to-value ratio can be traced back to 1991, when bank loans for residential mortgages were increasing drastically and property prices were soaring. In view of this, a number of banks adopted a loan-to-value ratio of 70% for residential mortgage loans extended to their borrowers. The 70% cap was adopted by the banking industry in November 1991 and has since been fully endorsed by HKMA as a prudent measure adopted by banks against over-exposure to the property market.

3. In the past decade or so, when explaining its policy on property lending, HKMA has restated its support for the 70% loan-to-value ratio for residential mortgage loans. For example, in its letter to the Hong Kong Association of Banks (HKAB) in September 1995[1], HKMA made it clear that it supported the maximum 70% ratio which had become the industry standard for residential mortgage lending. In its guideline issued in July 1997[2] and in a press release issued in July 1998[3],

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[1] See http://www.info.gov.hk/hkma/eng/guide/guide_no/guide_591b.htm.

[2] See http://www.info.gov.hk/hkma/eng/guide/guide_no/guide_594b.htm.

[3] See http://www.info.gov.hk/hkma/eng/press/1998/980731e.htm.

HKMA expressed a similar stance and considered that the 70% guideline had worked well in protecting authorized institutions[4] from fluctuations in property prices during past economic cycles. It also expected the banking sector to adhere strictly to the 70% loan-to-value ratio.

4. In the wake of the Asian financial crisis, Hong Kong's property prices fell significantly and there was considerable public concern over the predicament faced by homeowners in negative equity[5]. The Government took a number of measures to stabilize the property market. To facilitate banks which might wish to offer relief to these homeowners, HKMA introduced a new measure in October 2001 to allow authorized institutions to refinance residential mortgage loans[6] for homeowners in negative equity up to 100% of the current market value of the mortgaged property. Notwithstanding this relaxation, HKMA has pointed out that the 70% loan-to-value guideline remains generally appropriate as a long-term prudential measure and would continue to apply to new residential mortgage loans.

5. Noting that there were calls in the community for the relaxation of the 70% loan-to-value ratio of mortgage bank loans, the Chief Executive of HKMA (CE/HKMA) explained HKMA's position in his column "Viewpoint" posted on HKMA's website on 5 December 2002[7] that the 70% loan-to-value ratio refers to the degree of risk that the banks should accept, not the percentage of the mortgage loan to the value of the residential property. For illustration, CE/HKMA advised that if the bank extends a mortgage loan representing, say, 90% of the value of the property, it has to offload the 20% excess risk to a third party. This can be done by buying insurance against any loss arising from default for the 20%. This insurance service has been available at a price through the Hong Kong Mortgage Corporation (HKMC) for some time.

6. After completing a round of on-site examinations on authorized institutions which were active in the residential mortgage lending business, HKMA reported in October 2004 that individual institutions were found to have breached the 70% guideline. HKMA took the opportunity to remind the banking sector that it took a serious view of non-compliance with the 70% guideline and urged authorized institutions to ensure strict compliance for both new residential mortgage loans and "top-up" loans secured by a mortgaged property[8].

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[4] An "authorized institution" is defined under section 2 of the Banking Ordinance (Cap. 155) to mean a bank, a restricted licence bank or a deposit-taking company. Authorized institutions are under the supervision of HKMA.

[5] According to HKMA, this refers to homeowners whose outstanding residential mortgage loans with an authorized institution exceeds the current market value of the mortgaged property.

[6] Residential mortgage loans are loans (which include refinancing loans) to private individuals for the purchase of residential properties, including uncompleted flats, but other than flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme.

[7] See http://www.info.gov.hk/hkma/eng/viewpt/20021205e.htm.

[8] See HKMA's open letter to all authorized institutions at http://www.info.gov.hk/hkma/eng/guide/circu_date/20041019e1.htm.

Concerns raised by Members

7. Members note that the 70% loan-to-value ratio for residential mortgage loans is a non-statutory guideline voluntarily adopted by the banking industry in November 1991 amidst excessive speculative activity and for the purpose of safeguarding the banks' interests. The guideline has the support of the Administration and the endorsement of HKMA which also monitors the strict adherence of the banking sector to the guideline.

8. During the past decade or so, the subject of the 70% guideline on loan-to-value ratio for residential property mortgages has occasionally been raised by Members of this Council, mainly in connection with their concerns about fluctuations in property prices, the Government's measures to stabilize the property market, facilitating prospective homeowners to purchase their own property, as well as the assistance to be rendered to homeowners in negative equity.

9. In their questions raised at the Council meetings on 3 March 1993, 26 June 2000 and 13 November 2002, Members enquired whether the Administration/HKMA would consider, inter alia, relaxing the 70% guideline so that home buyers would be able to obtain a higher mortgage and the property market could be boosted. Members also passed a motion on 16 September 1998 and on 11 December 2002 urging the Government to, inter alia, relax the 70% cap on residential mortgage loans so as to assist home buyers and boost property transactions. The terms of the motions carried are at **Appendix I.**

10. In its responses, the Administration reaffirmed that there was no intention to relax the 70% guideline as it was an integral part of prudential supervision of the banking sector. It had also proved to be very effective in reducing the credit risk faced by banks, assuring the quality of banks' mortgage loan assets and enhancing the stability of Hong Kong's banking system as a whole. Members were also informed that the 70% mortgage cap was a measure to maintain the stability of the banking system rather than to stimulate property transactions. According to the Administration, relaxation of the guideline could have the negative effect of authorized institutions being prompted by competitive pressure to lend imprudently, thereby increasing their credit risk. The Administration also highlighted that a number of options were available in the market to enable home buyers to borrow more than 70%, such as the mortgage insurance scheme operated by HKMC and the co-financing schemes provided by property developers.

11. During his regular briefings to the Panel on Financial Affairs on the work of HKMA, CE/HKMA has updated members on the prevailing situation regarding residential mortgages in negative equity as part of his report on banking sector performance. In this context, CE/HKMA informed members that adhering to the 70% loan-to-value ratio had contributed to sound risk management by the banks[9].

[9] For example, please see CE/HKMA's relevant remarks at the Panel meeting on 6 February 2006 under the topic of "Residential mortgage loans in negative equity" (paragraphs 18 to 20 of minutes at http://www.legco.gov.hk/yr05-06/english/panels/fa/minutes/fa060206.pdf).

Latest position

12. The Panel on Financial Affairs has invited the Administration, HKMA and HKAB to attend a meeting on 29 January 2008 to discuss the subject of the 70% mortgage cap on residential property. With a view to obtaining a fuller picture on the policy considerations, inception and implementation of the 70% loan-to-value ratio, the Panel has drawn up a list of questions and concerns as set out in the **Appendix II** on which responses are being sought.

Council Business Division 1
Legislative Council Secretariat
10 January 2008

Appendix I

Motions passed on 16 September 1998 and 11 December 2002

Council meeting on 16 September 1998

Motion on relaxing the ceiling for residential mortgage loans

> That, in view of the significant downturn in the property market in Hong Kong and the cessation of speculations on property, this Council urges the Government to relax the guideline on the 70% ceiling for residential mortgage loans, so that banks may, on the merits of individual cases and according to prudent principle, process residential mortgage lendings flexibly, with a view to assisting the public in buying their own homes.

Council meeting on 11 December 2002

Motion on the 70% ceiling for residential mortgage loans

> That, as the Government has introduced measures to stabilize the property market, secondary residential property prices have fallen by about 62% from their peak in 1997 and the public's ability in making property loan repayments has increased by about 73% in the same period, thereby considerably reducing the risk of defaults on mortgage loan, this Council asks the Government to adopt measures to assist needy mortgage applicants in securing more conveniently and speedily loans in excess of 70% of the value of their properties, including improving the conditions and procedures for vetting and approving applications under the mortgage insurance scheme or relaxing the guideline for banks on the 70% ceiling for residential mortgage loans, with a view to boosting property transactions, stabilizing the property market, easing deflation and reviving the economy.

Appendix II

Issues/questions to be addressed in connection with the 70% mortgage cap on residential property

1. a brief account of the historical background leading to the introduction of the 70% mortgage cap on residential property; the intended policy objectives of the cap and its effect on the residential property market;

2. the implementation and application of the mortgage cap 70% on residential property market and the circumstances, if any, under which the cap may be relaxed; the number of cases, if any, in which mortgage loans exceeding 70% of the value of property were approved;

3. details of the regulatory oversight by HKMA/the Government on the application of the 70% mortgage cap by the banking sector on their clients and the consequence and sanctions, if any, for not adhering to the cap; and

4. are mortgage loan applications by civil servants subject to the 70% mortgage cap in the same way as other applicants? If there is any relaxation of the 70% guideline, what factors are being taken into consideration?