

For information
on 7 March 2011

Legislative Council Panel on Financial Affairs

Reverse Mortgage Pilot Scheme

Purpose

This paper briefs Members on the Reverse Mortgage Pilot Scheme that the Hong Kong Mortgage Corporation Limited (HKMC) plans to launch around mid-2011.

Background

2. According to the Census and Statistics Department, the proportion of the population aged 65 and over is projected to rise markedly from 13% in 2009 to 28% in 2039. With the ageing society, there are increasing concerns about the standard of living of the elderly and the need for reverse mortgage is getting more attention. Some concern groups and think tanks called for the introduction of reverse mortgage in Hong Kong.

3. Therefore, the HKMC conducted a study on reverse mortgage last year and commissioned a research agency to do an opinion survey. The survey interviewed 1,005 elderly people, and showed that around 44% of the respondents supported the introduction of reverse mortgage in Hong Kong and almost a quarter of the respondents indicated that they would consider participating in such a scheme.

4. Given the results of the opinion survey, the Board of Directors of the HKMC has decided to launch a pilot scheme of reverse mortgage around mid-2011. The Pilot Scheme will help to lower the risks faced by lenders of reverse mortgage, thereby encouraging the lending banks to provide such loan product to the elderly. Through the reverse mortgage, the elderly can receive a fixed amount of supplemental cash every month to improve their quality of life while continuing to reside in their own homes. The elderly may also apply for a lump-sum loan withdrawal under certain conditions. Upon the death of the elderly, the estate of the elderly can choose to repay the reverse mortgage within a certain period of time and redeem the property with a preferential right. Otherwise, the bank may dispose of the reverse mortgage property and use the proceeds to repay the outstanding loan principal and the accrued interests of the reverse mortgage. If there is a shortfall, it will be borne by the HKMC. The estate of the elderly is not liable for such shortfall. But if the proceeds exceed the outstanding loan balance, the surplus will be given to the estate of the elderly.

Reverse Mortgage Pilot Scheme

Purpose

5. The Reverse Mortgage Pilot Scheme is a voluntary financial arrangement aiming to provide an additional choice to the elderly so that they can use their self-occupied properties as collateral to apply for reverse mortgage from banks. They can then obtain a steady amount of cash every month (i.e. annuity payment) to improve their quality of life, while living in their own homes.

6. The Pilot Scheme will operate on the basis of prudent commercial principles. It is not a safety-net or social welfare measure and does

not involve any Government subsidy. Reverse mortgage is merely a particular type of collateralised loan arrangement. It is not an investment tool, therefore there will not be any investment loss.

Key Model

7. The Pilot Scheme is targeted at people aged 60 or above, who own self-occupied properties. Under the Pilot Scheme, the borrowers can choose to receive monthly annuity payments over a fixed period of 10, 15 or 20 years or over their whole life span. Even when the fixed period of annuity payments has expired, the borrowers can continue to stay in the properties until they pass away. They can redeem their properties any time by repaying the reverse mortgage loan and terminate the reverse mortgage, and if needed, they can also rejoin the Pilot Scheme in future. The key eligibility criteria are set out as below:

Eligible borrower(s)	Aged 60 or above with self-occupied residential properties (The reverse mortgage borrowers will continue to be responsible for the on-going property maintenance as well as the settlement of rates, government rents and management fees, etc)
Maximum number of co-borrowers	2 persons (can be spouses, siblings or unrelated parties) The annuity payment will depend on the age of the younger borrower when there are 2 borrowers.

Property status	All owners (as joint tenants) of the subject property must join in as mortgagors and borrowers under the reverse mortgage while all borrowers under the reverse mortgage must be owners of the subject property
Maximum property value for calculation of the loan amount	HK\$ 8 million (For properties with value of over HK\$ 8 million at origination, the relevant reverse mortgage loan will be calculated the same as that for a property of HK\$8 million.)
Property age at loan origination	50 years (Properties of over 50 years will be considered on a case-by-case basis.)

Annuity Payment

8. The amount of annuity payment that an elderly borrower receives is subject to four factors, namely the age of the borrower, the term of annuity payment that the borrower chooses, the value of the underlying property and the interest rate level.

Annuity Payment Levels

9. In brief, the older the borrower at the origination of the loan, or the shorter the term of annuity payment chosen by the borrower, or the higher the value of the underlying property, the higher will be the amount of annuity payment. Once the amount of the annuity payment is determined at the time of

loan origination, it will not change even though the property price might drop or the interest rate might increase thereafter. This ensures a steady and reliable flow of funds for the elderly to improve their quality of life. If the property price goes up, the borrower can refinance with a new reverse mortgage based on the higher property price and receive a higher annuity payment. Banks will charge administrative fees comparable to those for conventional mortgage loans (e.g. legal fee for the loan drawdown and administrative fee for property disposal).

10. In 2010, the HKMC prepared a preliminary proposal on annuity payment levels. After further public consultation, the HKMC introduced in late February 2011 certain enhancements under which a single borrower of a reverse mortgage loan will receive a higher monthly annuity than two joint borrowers (around HK\$200 to HK\$500 more a month per HK\$1 million of property value). Details are set out at Annex. Based on overseas experience, the reverse mortgage applicants are about 70 years old on average. According to the annuity table, a 70-year-old couple have a property of HK\$2.5 million and they choose a life-annuity plan, they will receive a monthly annuity payment of HK\$7,000. If the applicant is a 70-year-old singleton, he will receive a monthly annuity payment of HK\$7,750.

Lump-sum Loan

11. In addition, the borrowers may apply for a lump-sum withdrawal of their annuity to meet certain specific expenditures, with consequential downward adjustment to the monthly annuity level. The lump-sum loan can be used to fully repay the existing mortgage of the property, or to pay for medical expenses and major property repairs. The maximum loan amount of the lump-sum loan will be 50% of the residual actuarial value of the borrower's reverse mortgage, while the minimum loan amount will be 15% of the residual actuarial value of the reverse mortgage, or HK\$100,000, whichever is higher.

Therefore, if the residual actuarial value of the reverse mortgage is HK\$1 million, the borrower can draw a lump-sum loan of up to HK\$500,000 and not less than HK\$150,000.

Risk Factors

12. There are three key risk factors affecting a reverse mortgage:
 - (a) Volatility of property price: If the property market or the building condition of the property significantly deteriorates, the value of the property will also drop. So it will be more likely that the realised value cannot cover the outstanding loan balance (including the principal, interests and premium, etc). The volatility of the property price in Hong Kong is quite high. For instance, during the financial crisis in 1997, property prices dropped by a half within 12 months;
 - (b) interest rate level: When the interest rate rises, the accrued interest on the reverse mortgage loan will increase and so the chance that the realised value of the property cannot cover the outstanding loan balance will be higher. The interest rate in Hong Kong is currently at a very low level and could rise markedly in the long run, posing a real interest rate risk; and
 - (c) life expectancy: If the life span of the elderly participating in reverse mortgage is longer than the average life expectancy of the Hong Kong population, the outstanding loan balance will become much higher than otherwise.
13. Given the complexity of the reverse mortgage product and associated risks, no bank has offered such product in Hong Kong so far. In

order to promote the development of reverse mortgage in Hong Kong, the HKMC plans to launch the Pilot Scheme with the HKMC acting as the insurer to bear the risk of shortfall in property price.

Pre-sale Counselling and Rescission Period

14. The HKMC is in discussion with the Law Society of Hong Kong to explore a pre-sale counselling arrangement for the elderly by independent professionals so that the elderly and their family members can well understand their rights and obligations before taking out a reverse mortgage. In addition, the HKMC will organise promotional activities to raise public awareness and understanding of reverse mortgage.

15. Under the Pilot Scheme, a six-month rescission period will be provided. If a borrower terminates and repays the reverse mortgage within the rescission period, the insurance premium will be waived.

Way Forward

16. The HKMC is actively discussing with different stakeholders (including banks, professional groups, and relevant government departments) to finalise the details and launch the Reverse Mortgage Pilot Scheme in mid-2011.

The Hong Kong Mortgage Corporation

28 February 2011

Annex

Annuity Payment Levels

For every HK\$ 1 million of the property value, the monthly annuity payment levels for borrowers with entry age at 60 or 70 are as follows:

Term of Annuity Payment	Amount of Monthly Annuity Payment (HK\$)			
	Singleton		Two Persons	
	60 years old	70 years old	60 years old	70 years old
10 years	3,700	5,100	3,300	4,600
15 years	2,800	3,800	2,500	3,500
20 years	2,400	3,300	2,100	3,000
Life annuity	2,000	3,100	1,800	2,800

If the property is worth HK\$8 million, the monthly annuity payments will be eight times the above figures:

Term of Annuity Payment	Amount of Monthly Annuity Payment (HK\$)			
	Singleton		Two Persons	
	60 years old	70 years old	60 years old	70 years old
10 years	29,600	40,800	26,400	36,800
15 years	22,400	30,400	20,000	28,000
20 years	19,200	26,400	16,800	24,000
Life annuity	16,000	24,800	14,400	22,400