



The Hong Kong Mortgage Corporation Limited  
香港按揭證券有限公司



*Annual Report 1997*

一九九七年年報

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*As a pioneer institution,  
the HKMC provides an  
important piece of  
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secondary mortgage  
market in Hong Kong.*

# Chairman's Statement



*The incorporation of The Hong*

*Kong Mortgage Corporation*

*Limited (HKMC) in March 1997 marked an*

*important milestone in the development of the*

*residential mortgage market in Hong Kong.*

The incorporation of The Hong Kong Mortgage Corporation Limited (HKMC) in March 1997 marked an important milestone in the development of the residential mortgage market in Hong Kong. Hong Kong ranks among the strongest and most efficient primary mortgage markets in the world, with a very low delinquency rate. There are now clear advantages for the development of a healthy secondary mortgage market to enhance the liquidity of mortgage assets and to broaden the funding source for mortgage loans. As a pioneer institution, the HKMC provides an important piece of market infrastructure to kickstart and promote the development of a secondary mortgage market in Hong Kong.

The establishment of the HKMC in 1997 could not have come at a more opportune time. In October 1997, the Government announced its long term housing strategy which aims at achieving a 70% home ownership ratio by the year 2007. A substantial increase in the supply of new housing units to attain this target will in the long run underpin a rising demand for mortgage loans. On the other hand, the already high concentration of mortgage loans on the balance sheets of banks constrains their credit and risk appetite in mortgage lending. Following the Asian financial turmoil in the second half of 1997, the banking sector generally have felt an even greater need for a reliable avenue to offload their mortgages in order to manage more

## Chairman's Statement

effectively the concentration and liquidity risks inherent in mortgage business.

Seven months after its incorporation, the HKMC formally commenced operation in October 1997 as scheduled. Marking this occasion was the signing of the Master Sale and Purchase Agreement and the Master Mortgage Servicing Agreement with the first batch of Approved Seller/Service providers involving eight banks on 20 October 1997. The first block of mortgage purchase followed suit. HKMC purchased a total of 526 loans involving HK\$650 million from four Approved Sellers in November.

Following the successful completion of the first purchase, the HKMC has been purchasing mortgages according to a regular programme. Indeed, an important competitive edge of the HKMC over ad hoc mortgage securitization deals by banks is the regular and predictable presence of the Corporation as a buyer of residential mortgages. By end-March 1998, the Corporation has purchased/committed to purchase HK\$3.2 billion of floating rate mortgages, well on target to build its mortgage portfolio up to HK\$10-15 billion by end-1998. The Corporation has also tried out new approaches in buying mortgages from Approved Sellers, launching its first tender for mortgage purchase in February 1998. The net required yield on mortgage purchase established in the tender provides a useful benchmark in pricing the private placement deals.

For the HKMC to achieve this business target, it needs a steady and stable stream of funding. In January 1998, the HKMC set up a HK\$20 billion Note Issuance Programme under which the Hong

Kong Monetary Authority (HKMA) serves as the arranger, custodian, agent and operator. This is similar to the programmes arranged by the HKMA for the Mass Transit Railway Corporation and the Airport Authority. As the market making system for the Exchange Fund Bills and Notes covers the notes issued under the Programme, the HKMC papers enjoy a high degree of secondary market liquidity. This will enhance their attractiveness to investors and hence help to lower the Corporation's borrowing cost.

HKMC has issued two tranches of 3-year Notes under the Note Issuance Programme by 2 April 1998 with favourable results. Reflecting the strong demand for the HKMC paper and the creditworthiness of the Corporation, there was an oversubscription of over five times in both issues, with a narrow spread of about 50 basis points over the corresponding Exchange Fund Notes.

With a view to broadening the investor base, the HKMC will establish a separate Hong Kong dollar debt issuance programme using the conventional underwritten approach which targets mainly institutional investors. In time to come, the Corporation also plans to set up a multi-currency Euro Medium-Term Note Programme to tap funds in the international capital markets.

To ensure that the HKMC can proceed with its mortgage purchase business smoothly, the HKMA, through the Exchange Fund, has provided a HK\$10 billion revolving credit facility to the Corporation since January 1998. The facility is not intended for use as a regular funding source. Rather, it provides short-term financing to the Corporation to bridge



the gap between the purchase of mortgage loans and the issue of debt securities, in case unfavourable conditions in the capital market disrupt funding activities. The credit facility is also a demonstration of the Government support for the HKMC.

an attractive enhancement of yield above those of Exchange Fund Notes. To the originating banks, their partnership with the Mortgage Corporation to promote fixed rate mortgages provides an extra source of steady fee income and a new avenue for marketing their banking products to the mortgage borrowers. To the HKMC, it will help to diversify our mortgage portfolio to include a good mix of floating and fixed rate mortgages.

Within a short time span, the HKMC has geared itself up as an important force propelling the development of the secondary mortgage market in Hong Kong. We expect to meet more challenges as we move forward and are equipping ourselves for those challenges. In accordance with our business plan, we will introduce a mortgage securitization programme in the second phase of the Corporation's business. We will start the preparatory work for this programme once we have established our operational system and the debt issuance programme on a firm footing.

HKMC launched a six-month pilot scheme on 18 March to promote fixed rate mortgages. The initial response is encouraging. By end March 1998, the two banks participating in the scheme have approved in principle 96 loans involving an aggregate amount of HK\$154 million. Outside the scheme, a number of property developers have teamed up with banks to offer fixed rate mortgages to buyers of their property, suggesting that our scheme has served as a useful catalyst in promoting fixed rate mortgages in Hong Kong.

In pursuit of our objective in promoting the development and liquidity of the residential mortgage market in Hong Kong, the HKMC has also made significant efforts to promote fixed rate mortgages in Hong Kong. We believe that the development of fixed rate mortgage products will bring significant benefits to Hong Kong. To the home buyers, it provides an additional choice of mortgage finance that can protect them from adverse movements in interest rates. To the investors, the issue of fixed rate debt securities by the HKMC to fund the purchase of fixed rate mortgages provides an additional source of high quality and liquid Hong Kong dollar assets with

The HKMC has experienced a busy and successful start-up year in 1997. In this first annual report, I would like to pay tribute to my fellow Directors on the Board for their invaluable advice and contribution, without which the HKMC would not have been able to achieve so much within such a short time. I would also like to thank the Executive Directors and the staff of the HKMC who have worked extremely hard to develop the business plans and put them into implementation. The Board and the Management of HKMC look forward to working closely with the banking community and the capital market participants to develop a healthy and robust secondary mortgage market in Hong Kong.



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1. **The Honourable Donald TSANG, JP** *Chairman*  
*Financial Secretary*
2. **Mr. Joseph YAM Chi-kwong, JP** *Deputy Chairman*  
*Chief Executive, Hong Kong Monetary Authority*
3. **The Honourable Ronald Joseph ARCULLI, JP** *Director*  
*Partner of Woo Kwan Lee & Lo, Solicitors*
4. **Mr. Alex AU Mo-cheung** *Director*  
*Managing Director and Chief Executive Officer of*  
*Hung Kai Finance Company, Limited*
5. **Mr. Norman CHAN Tak-lam, JP** *Executive*  
*Deputy Chief Executive,*  
*Director*  
*Hong Kong Monetary Authority*

## Board of Directors



- |  |                        |   |                                      |
|--|------------------------|---|--------------------------------------|
| <p>6. <b>Mr. Eddy FONG Ching, JP</b><br/><i>Certified Public Accountant and<br/>Senior Partner of Coopers &amp; Lybrand</i></p>  | <p><i>Director</i></p> | <p>11. <b>Dr. The Honourable David LI Kwok-po,<br/>LLD (Cantab) JP</b><br/><i>Chairman and Chief Executive of<br/>Bank of East Asia Limited</i></p> | <p><i>Director</i></p>               |
| <p>7. <b>Mr. Tom HSIAO Yao-hin</b><br/><i>Director of Tokyo-Mitsubishi<br/>International (HK) Limited</i></p>  | <p><i>Director</i></p> | <p>12. <b>The Honourable NGAN Kam-chuen</b><br/><i>Senior Manager of the Kwangtung Provincial Bank</i></p>  | <p><i>Director</i></p>               |
| <p>8. <b>Dr. HUANG Chen-ya</b><br/><i>Medical Practitioner</i></p>   | <p><i>Director</i></p> | <p>13. <b>Mr. Andrew SHENG Len-tao</b><br/><i>Deputy Chief Executive,<br/>Hong Kong Monetary Authority</i></p>                                      | <p><i>Executive<br/>Director</i></p> |
| <p>9. <b>Mr. Rafael HUI Si-yan, JP</b><br/><i>Secretary for Financial Services</i></p>   | <p><i>Director</i></p> | <p>14. <b>Mr. Dominic WONG Shing-wah, JP</b><br/><i>Secretary for Housing</i></p>   | <p><i>Director</i></p>               |
| <p>10. <b>Mr. Edwin LAU Chi-kit</b><br/><i>Assistant General Manager &amp; Head of Personal<br/>Banking of The Hongkong and Shanghai Banking<br/>Corporation Limited</i></p> | <p><i>Director</i></p> | <p>15. <b>Ms. Anna WU Hung-yuk, JP</b><br/><i>Solicitor and Senior Partner of<br/>Robert W.H.Wang &amp; Co.</i></p>                                 | <p><i>Director</i></p>               |





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secondary mortgage  
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# Directors' Report



*The Directors are pleased to present their report of*

*The Hong Kong Mortgage Corporation Limited*

*(the “Company”) together with the audited financial*

*statements for the period ended 31 December 1997.*

**T**he Directors are pleased to present their report of The Hong Kong Mortgage Corporation Limited (the “Company”) together with the audited financial statements for the period ended 31 December 1997.

## **Principal Activities**

The Company was incorporated in Hong Kong as a limited liability company under the Companies Ordinance on 3 March 1997. The principal activities of the Company are (i) to purchase portfolios of mortgages or other loans, pursuant to predetermined prudent and stringent purchasing criteria, secured by residential properties situated in Hong Kong from institutions authorized under the Banking Ordinance of Hong Kong (“Authorized

Institutions”); (ii) to raise financing for its purchase of mortgages through the issuance of debt securities in the capital markets; and (iii) to securitize mortgage portfolios by way of issuing mortgage-backed securities to investors.

## **Results and Appropriations**

The results for the period ended 31 December 1997 are set out on page 23 of the annual report.

The directors do not recommend the payment of a final dividend, and recommend that the retained loss of HK\$20,252,000 at 31 December 1997 be carried forward.

## **Reserves**

There has been no transfer to or from reserves during the period.

## **Fixed Assets**

Details of the movement in fixed assets during the period are set out in Note 9 to the financial statements.

## **Share Capital**

Details of the movement in share capital of the Company are set out in Note 10 to the financial statements.

## **Directors**

The Directors of the Company were appointed on 19 March 1997 and up to the date of this report are as follows:

Hon Tsang Yam Kuen, Donald, *Chairman*  
Mr. Yam Chi Kwong, Joseph, *Deputy Chairman*  
Mr. Sheng Len Tao, *Executive Director*  
Mr. Chan Tak Lam, Norman, *Executive Director*  
Hon Arculli, Ronald Joseph, *Director*  
Mr. Au Mo Cheung, *Director*  
Mr. Fong Ching, Eddy, *Director*  
Mr. Hsiao Yao Hin, Tom, *Director*  
Dr. Huang Chen Ya, *Director*  
Mr. Hui Rafael Junior, *Director*  
Mr. Lau Chi Kit, *Director*  
Dr. Hon Li Kwok Po, David, *Director*  
Hon Ngan Kam Chuen, *Director*  
Mr. Wong Shing Wah, Dominic, *Director*  
Ms. Wu Hung Yuk, Anna, *Director*

In accordance with Article 109 of the Articles of Association, all those directors who are not Executive Directors shall retire but shall be eligible for re-election.

## **Directors' interests in transactions and contracts**

The Company has entered into the following transactions with the Hong Kong Monetary Authority:

- (a) A Facility Letter dated 1 April 1997 pursuant to which the Hong Kong Monetary Authority agreed to make available funding of up to HK\$9,000,000 to the Company; and
- (b) A Deed of Reimbursement of expenses dated 30 April 1997 pursuant to which the Company agreed to reimburse to the Hong Kong Monetary Authority a sum equal to the aggregate amount of the expenses actually incurred and paid by the Hong Kong Monetary Authority in the promotion, formation and incorporation of the Company before 31 December 1997.

Certain of the Directors are deemed to be interested in the above transactions for the reasons stated below. Mr. Donald Tsang is a public officer holding the office of the Financial Secretary of the Hong Kong Special Administrative Region Government (the "HKSAR Government"). Mr. Rafael Hui is also a public officer holding the office of the Secretary for Financial Services and his

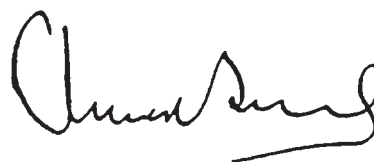
consequent reporting line is to the Financial Secretary of the HKSAR Government. Mr. Joseph Yam is the Monetary Authority; Mr. Sheng Len Tao and Mr. Norman Chan are his officers. The Hong Kong Monetary Authority conducts operations in relation to the Exchange Fund under the delegated authority from the Financial Secretary of the HKSAR Government as Controller of the Exchange Fund. Hence, Messrs. Donald Tsang, Rafael Hui, Joseph Yam, Sheng Len Tao and Norman Chan are deemed to be interested in the Facility Letter and the Deed of Reimbursement of expenses entered into between the Company and the Hong Kong Monetary Authority.

Except for the transactions as described above and the transactions with a related party as disclosed in Notes 13 and 16 to the financial statements, the Company has not entered into any contract, commitment or agreement with any other company in which any of the Company's directors or members of its management has an interest, either directly or indirectly; nor has the Company made any arrangement to enable any of the Company's directors or members of its management to obtain benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

### **Auditors**

The financial statements have been audited by Arthur Andersen & Co. A resolution for their reappointment as auditors for the ensuing year is to be proposed at the forthcoming annual general meeting.

On behalf of the Board of Directors



**Donald Tsang**

*Chairman*

Hong Kong,  
26 February 1998.

## Management Team



*Back – From Left to right: Ms Pamela Lamoreaux and Mr Philip Li  
Front – From Left to right: Mr Peter Pang, JP and Ms Susie Cheung*

### **Management Team**

**Mr. Peter Pang, JP**

*Chief Executive Officer*

**Ms. Pamela Lamoreaux**

*Senior Vice President (Operations)*

**Mr. Philip Li**

*Senior Vice President (Finance)*

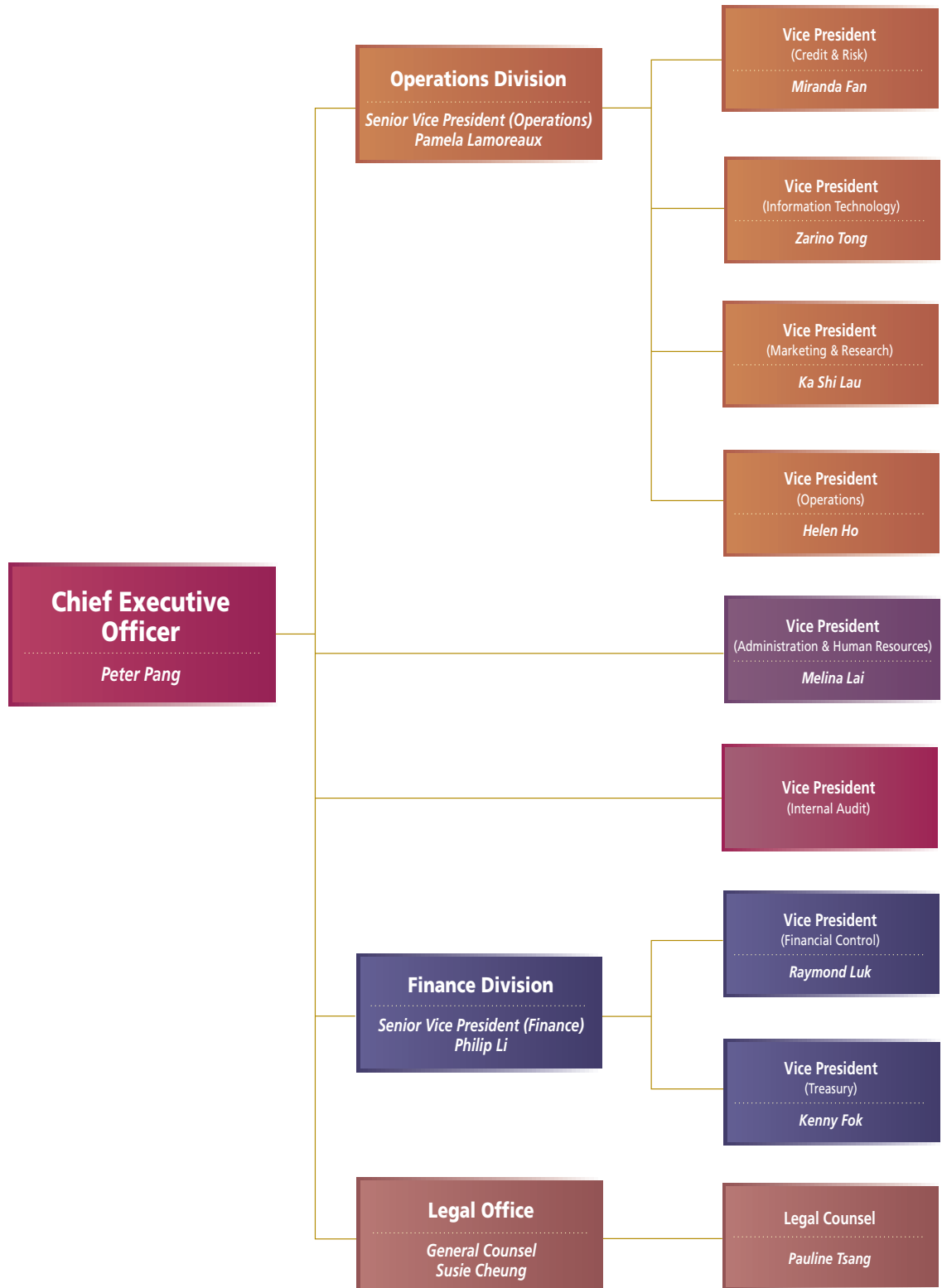
**Ms. Susie Cheung**

*General Counsel*

# Organisation Structure

As at end March 1998

## The Hong Kong Mortgage Corporation Limited Organisation Chart





*A first priority of the Corporation in 1997 was to put in place the policy, procedures, and legal documentation for its mortgage purchase programme.*

# Business Overview



*The HKMC was established with the primary objective*

*of promoting the development of the secondary*

*mortgage market in Hong Kong. The Corporation*

*operates on prudent commercial principles.*

## **Objectives**

The HKMC was established with the primary objective of promoting the development of the secondary mortgage market in Hong Kong. The Corporation operates on prudent commercial principles. Over time, its operations should bring significant benefits to Hong Kong in terms of improving banking and monetary stability, facilitating the development of the local debt market and promoting home ownership.

## **Business plan**

The Corporation is building its business in two phases.

### **Phase I :**

the purchase of mortgage loans for its own retained portfolio with funding obtained primarily through the issuance of unsecured debt securities. The spread between the mortgage yield and its funding cost provides steady income to the Corporation.

### **Phase II :**

the packaging of mortgage loans from its own portfolio and from the approved institutions into mortgage backed securities (MBS), guaranteeing the timely repayment of principal and interest in exchange for a guarantee fee and possibly a handling fee as well.



**Purchase of Floating Rate Mortgages**

A first priority of the Corporation in 1997 was to put in place the policy, procedures, and legal documentation for its mortgage purchase programme. Prior to the commencement of business in October, the Corporation had developed, in consultation with the Hong Kong Association of Banks and the Deposit-taking Companies Association, the purchasing criteria for floating rate mortgages (see Box 1) as well as the Master Mortgage Sale and Purchase Agreement and the Master Mortgage Servicing Agreement. These two Agreements provide the legal framework for the purchase and servicing of the mortgage portfolio. Under the present arrangement, authorized institutions in Hong

Kong which intend to sell mortgages to the HKMC need to become Approved Sellers of the Corporation and enter into both Agreements as they are also expected to act as Servicers of the mortgage loans which they have sold to the HKMC.

The mortgage purchase programme formally commenced on 20 October 1997 with the signing of the Master Mortgage Sale and Purchase Agreement and the Master Servicing Agreement with the first batch of Approved Sellers involving eight banks. The number of Approved Sellers further increased to 16 by end-March 1998. A list of the Approved Sellers is at Annex A.

The building of the mortgage portfolio picked up speed since the first block of mortgage purchase, involving HK\$650 million purchased from four Approved Sellers in November 1997 through the placement approach. The second block of mortgages, involving HK\$1 billion, was purchased through tender on 5 February 1998. The tender was 1.45 times oversubscribed with bids totaling HK\$2.45 billion. The average accepted yield of the tender was Best Lending Rate (BLR) plus 17 basis points, which was considerably above the announced minimum net required yield at BLR. The average accepted yield of the tender provided a benchmark for subsequent purchase of mortgages from Approved Sellers through private sales.

**Box 1: Mortgage Purchasing Criteria for Floating Rate Mortgages**

<b>Outstanding Principal Balance at the cut-off date</b>	Maximum : HK\$5,000,000 Minimum : HK\$ 300,000
<b>Maximum original loan size at origination</b>	HK\$8,000,000
<b>Maximum loan-to-value ratio at origination</b>	70%
<b>Maximum debt-to-income ratio at origination</b>	50%
<b>Minimum seasoning</b>	6 months
<b>Maximum original term to maturity</b>	30 years
<b>Remaining term to maturity</b>	Maximum : 29.5 years Minimum : 3 years
<b>Maximum sum of "original term" and "age of property at origination"</b>	40 years

Up to end-March 1998, the HKMC had purchased/committed to purchase a total of HK\$3.2 billion floating rate mortgages. For 1998 as a whole, the Corporation plans to acquire between HK\$10 billion to HK\$15 billion mortgages through a combination of tenders and private placements. The key indicators in Box 2 show that the mortgages which have been purchased by the HKMC are of good quality.



**Box 2: Key Indicators of Mortgage Portfolio (as at end-March 1998)**

• average loan-to-value ratio at origination:	64.6%
• estimated weighted average current loan-to-value ratio:	51.7%*
• weighted average debt-to-income ratio:	37.4%
• loans overdue for more than 30 days:	Nil

\* end-February 1998 figure

### **Pilot Scheme to Promote Fixed Rate Mortgages**

With a view to promoting diversification of mortgage products and hence consumer choice, the HKMC signed an agreement with two Approved Sellers to launch a pilot scheme for promoting fixed rate mortgages on 18 March 1998. The framework of the Pilot Scheme is set out below.



#### **(a) Pre-commitment to Purchase**

The HKMC has given a pre-commitment to the two designated banks to purchase from each of them up to HK\$250 million of the eligible fixed rate mortgages. The banks will originate fixed rate mortgages at an interest rate to be specified by the HKMC from time to time. The mortgages will be purchased on a loan by loan basis soon after origination.

#### **(b) Mortgage Rate**

Based on the funding cost of the inaugural debt issue, the interest rate of the first batch of mortgages has been fixed for the first three years at 10.5%. This rate may be changed from time to time by the HKMC.

The borrower is given a choice at the end of the 3-year period either to refix the mortgage rate for another term at the then prevailing fixed rate or to convert the mortgages to floating rate. To protect the HKMC from the prepayment risk, a fee will be charged on pre-payment.

**(c) Eligibility Criteria**

The main eligibility criteria are as follows :

- maximum loan  
size at origination : HK\$4 million
- maximum loan-to-value  
ratio at origination : 70%
- maximum debt-to-income  
ratio at origination : 50%
- tenor – maximum : 25 years  
minimum : 10 years
- maximum sum of “original term”  
and “age of property at  
origination” : 40 years

The initial response to the scheme was encouraging. As of end-March 1998, the two participating banks had received over 3,000 enquiries. 96 loans involving an aggregate amount of HK\$154 million had been approved

in principle, of which 6 loans involving HK\$13 million had been drawn down. Notwithstanding the downward adjustment in BLR on 30 March 1998, the two banks had continued to receive new applications, albeit at a slower pace. The pilot scheme had also served as a useful catalyst in promoting fixed rate mortgage products. More than ten banks had indicated their interest in participating in the scheme and a number of property developers had teamed up with banks to offer fixed rate mortgages to buyers of their property. The HKMC will review the market reception to the scheme and its operation before deciding whether and when to increase the amount for buying fixed rate mortgages and/or appointing additional participating banks.

**Debt Issuance**

HKMC’s substantial mortgage purchase programme requires efficient fund raising through debt issuance. For the year 1998, the Corporation needs to raise a minimum of HK\$7 billion to fund the mortgage purchase target of HK\$10-15 billion. The Corporation adopts a step-by-step approach in developing its debt issuance capability starting with raising funds in the Hong Kong dollar debt market. After building a track record in the local market, the Corporation will consider tapping the overseas capital markets. In time to come, the Corporation is expected to become one of the most active issuers in the Hong Kong dollar debt market.



### **Hong Kong Dollar Note Issuance Programme**

On 6 January 1998, the HKMC signed an agreement with the Hong Kong Monetary Authority (HKMA) to appoint the latter as the arranger, custodian, agent and operator of a HK\$20 billion HKMC Note Issuance Programme. Under the Programme, the HKMC Notes, which are denominated in HK\$50,000, will be cleared through HKMA's Central Moneymarkets Unit (CMU) and will qualify as eligible securities for repo under the Liquidity Adjustment Facility operated by the HKMA. The HKMC Notes will also be covered by the existing market-making

arrangements for the Exchange Fund Bills and Notes which will greatly enhance their liquidity in the secondary market. The Programme is an important vehicle for the HKMC to raise funds to support its mortgage purchase programme. It will also provide a useful benchmark for other HK\$ debt securities the HKMC will issue in future.



HKMC's inaugural issue of HK\$500 million three year notes under the Note Issuance Programme was successfully tendered on 11 March 1998. The issue was very well received by the market, with an oversubscription rate of 5.44 times. Reflecting the high credit standing of the HKMC, the average accepted yield on the three year paper was 8.43%, only 52 basis points above the yield on the corresponding Exchange Fund Notes. Following the success of the first issue, another issue of HK\$500 million three-year notes was

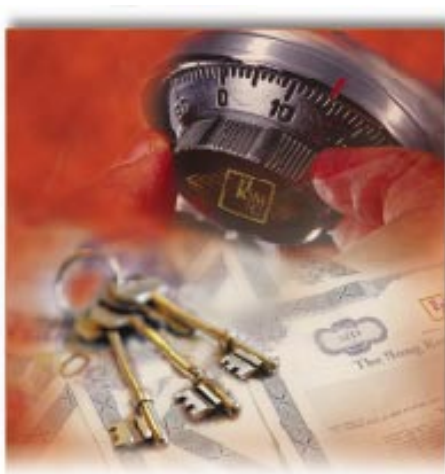


tendered on 1 April 1998. The results were again very encouraging, with an oversubscription rate of 5.54 times and an average accepted yield of 8.58%, which was 50 basis points over the yield on the corresponding Exchange Fund Notes. Part of the proceeds of the fixed rate funds raised through these issues were set aside for funding the purchase of fixed rate mortgages under the Pilot Scheme. The balance was swapped into floating rate through interest rate swaps, achieving a sub-HIBOR cost of fund to finance the purchase of floating rate mortgages.

### **Hong Kong Dollar Debt Issuance Programme**

While the Note Issuance Programme provides an important source of low cost funding for the Corporation, it has limitations in terms of investor base, timeliness of issue and product diversification. To supplement the Note Issuance Programme, the Company will develop an additional Hong Kong Dollar Debt Issuance

## Business Overview



Programme using the conventional underwritten approach which will target at the institutional investors. It also aims to have a high degree of flexibility in terms of product features, form of offer and a reasonably liquid secondary market for its debt issues.

### ***Mortgage Backed Securities***

The Corporation will issue mortgage-backed securities (MBS) in its second phase of business when the Corporation has acquired a sizeable amount of mortgages in its portfolios and when its operational systems become more established. The MBS programme will help to further broaden the funding source for mortgage financing and diversify investment products in the local debt market.

### ***Multi-currency MTN Programme***

In time to come, the Corporation also plans to set up a multi-currency Medium-Term Note Programme to tap funds in the international capital markets.

### ***Revolving Credit Facility from the Exchange Fund***

On 23 January 1998, the HKMC entered into an agreement with the HKMA through which the Exchange Fund provides a HK\$10 billion revolving credit facility to the Corporation. The credit facility demonstrates the support of the Government as the shareholder of the Corporation. It also provides a fallback for the Corporation to obtain short term funds to bridge the gap between the purchase of mortgage loans and the issuance of debt securities, in case fund raising activities are temporarily disrupted by adverse market conditions.



### ***Promotion of Corporate Profile***

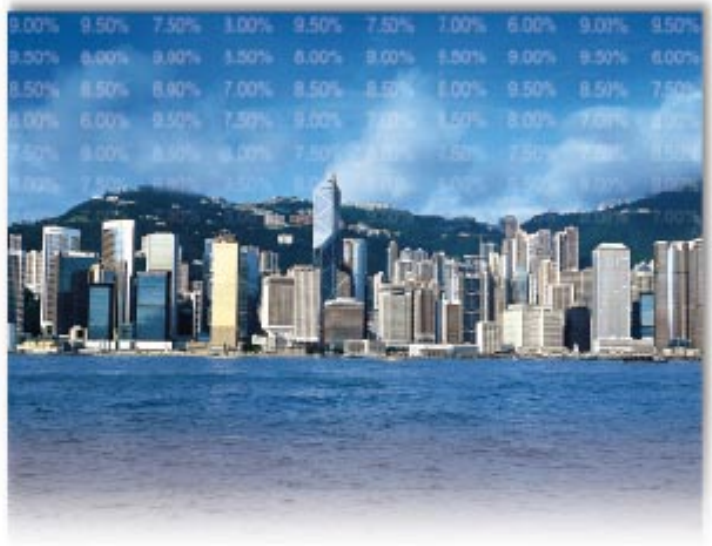
The HKMC is a pioneer institution in Hong Kong's secondary mortgage business. To ensure that the Corporation's business plans and operations can be understood by the banking sector, investors and the general public, the Corporation had conducted various presentations, seminars and other promotional exercises. Separate training



programmes had been provided to Approved Sellers and Servicers to familiarize them with the operations of the Company.

**Staffing**

The Corporation is committed to building up a strong team of professionals with expertise in secondary mortgage business. The recruitment exercise has proceeded smoothly. Of a total establishment of 60, 56 had been filled by the end of March 1998 (see Box 3). As part of staff development, a number of training courses on financial products and on managerial skills are being organized.



**Operating Systems**

Consistent with the Company’s policy to automate its day to day operations in a cost effective manner, the HKMC has developed various operating systems for handling mortgage purchase, capturing and analyzing data pertaining to the mortgage loans for risk management purposes as well as handling treasury operations.

**Box 3: Establishment of the HKMC**

<b>Chief Executive Officer</b>	1
<b>Chief Operating Officer / Senior Vice President / General Counsel</b>	4
<b>Vice President / Legal Counsel</b>	9
<b>Manager</b>	11
<b>Associate</b>	18
<b>Secretary / Assistant</b>	17
<b>Total</b>	60

## Report of the Auditors

ARTHUR  
ANDERSEN

***Auditors' report to the shareholder of  
The Hong Kong Mortgage Corporation Limited  
(Incorporated in Hong Kong with limited liability)***

We have audited the financial statements of The Hong Kong Mortgage Corporation Limited (the "Company") on pages 23 to 33 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

***Respective responsibilities of directors and auditors***

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

***Basis of opinion***

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

***Opinion***

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31 December 1997 and of its loss and cash flows for the period then ended, and have been properly prepared in accordance with the Companies Ordinance.

*Arthur Andersen & Co.*

Hong Kong,  
26 February 1998

## Profit and Loss Account

*For the period ended 31 December 1997*

	Notes	From 3 March 1997 (the date of incorporation) to 31 December 1997 HK\$'000
<b>INTEREST INCOME</b>		
Mortgage portfolio	3	5,531
Cash and short-term funds		12,823
<b>TOTAL INTEREST INCOME</b>		<b>18,354</b>
<b>OTHER EXPENSES, NET</b>		<b>(1)</b>
		<b>18,353</b>
<b>OPERATING EXPENSES</b>	4	<b>(38,605)</b>
<b>OPERATING LOSS BEFORE TAXATION</b>		<b>(20,252)</b>
<b>TAXATION</b>	12	<b>—</b>
<b>OPERATING LOSS FOR THE PERIOD</b>		<b>(20,252)</b>



# Balance Sheet

As at 31 December 1997

	Notes	1997 HK\$'000
<b>ASSETS</b>		
Cash and short-term funds	5	307,502
Interest and remittance receivables	6	5,035
Prepayments, deposits and other assets	7	2,657
Mortgage portfolio	8	650,066
Fixed assets	9	18,347
		<b>983,607</b>
<b>LIABILITIES</b>		
Accounts payable and accrued expenses		3,859
<b>SHAREHOLDER'S EQUITY</b>		
Share capital	10	1,000,000
Retained loss		(20,252)
		<b>979,748</b>
		<b>983,607</b>

Approved by the Board of Directors on 26 February 1998 and signed on behalf of the Board by:

Directors:   
**Chan Tak Lam, Norman**  
*Executive Director*

  
**Sheng Len Tao**  
*Executive Director*

## Cash Flow Statement

*For the period ended 31 December 1997*

	Notes	From 3 March 1997 (the date of incorporation) to 31 December 1997 HK\$'000
<b>NET CASH OUTFLOW FROM OPERATING ACTIVITIES</b>	11	<b>(671,119)</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of fixed assets		(20,709)
Purchase of corporate club debentures		(670)
Net cash outflow from investing activities		<b>(21,379)</b>
<b>NET CASH OUTFLOW BEFORE FINANCING FINANCING</b>		<b>(692,498)</b>
Issue of ordinary share capital	10	<b>1,000,000</b>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>		<b>307,502</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	5	<b>307,502</b>

# Notes to the Financial Statements

## 1. Organisation and Operations

The Hong Kong Mortgage Corporation Limited (“the Company”) was incorporated on 3 March 1997 as a limited liability company under the Companies Ordinance and is also a public sector entity. It is 100% owned by the HKSAR Government through the Exchange Fund and has an authorized and paid-up capital of HK\$1 billion divided into 1,000,000,000 shares of HK\$1 each. All of the shares are beneficially owned by the Financial Secretary of the HKSAR Government as Controller of the Exchange Fund.

The Memorandum of Association of the Company empowers it to purchase portfolios of mortgages or other loans secured by residential properties situated in Hong Kong from the Authorized Institutions. The objectives of the Company, which allow it to hold, sell, transfer, dispose of and deal in such portfolios and to finance, take part in and promote the incorporation of special purpose vehicles, have been designed to enable the Company to securitize its assets from time to time.

## 2. Principal Accounting Policies

### Basis of preparation

The financial statements have been prepared in accordance with the provisions of the Hong Kong Companies Ordinance and generally accepted accounting principles in Hong Kong.

#### a. Interest recognition

Interest income due on performing mortgage portfolio and bank deposits is accrued on a time-apportioned basis.

#### b. Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation.

Depreciation is calculated on the straight-line basis at annual rates estimated to write off the cost of each asset over its expected useful life.

The annual rates are as follows:

Leasehold improvements	Over the unexpired period of the lease
Furniture and fixtures	Over the unexpired period of the lease
Computers and related software	33-1/3%
Office equipment	33-1/3%
Motor vehicle	25%

### c. Foreign currencies

The books and records are maintained in Hong Kong dollars. Transactions in other currencies during the period are translated into Hong Kong dollars at exchange rates prevailing in effect at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into Hong Kong dollars at rates of exchange in effect at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

### d. Deferred taxation

Deferred taxation is provided under the liability method, at the current tax rate, in respect of significant timing differences between profit as computed for taxation purposes and profit as stated in the financial statements, except where it is considered that no liability will arise in the foreseeable future.

Deferred tax assets are not recognised unless the related benefits are expected to crystallise in the foreseeable future.

### e. Operating leases

Leases where substantially all the rewards and risks of ownership remain with the leasing company are accounted for as operating leases. Rental payments under operating leases are charged to the profit and loss account on a straight-line basis over the period of the relevant leases.

## 3. Interest Income

Interest income from mortgage loans represents the Company's Net Required Yield calculated on the outstanding principal balance of the mortgage loans on an accrual basis.

Interest income from cash and short-term funds represents interest earned from time deposit with banks.

## Notes to the Financial Statements

### 4. Operating Expenses

	1997 HK\$'000
<b>Staff costs</b>	
salaries and benefits	15,365
<b>Premises and equipment</b>	
rental of premises	3,671
others	<u>1,201</u> 4,872
<b>Depreciation</b>	2,362
<b>Consultancy fee</b>	7,670
<b>Preliminary expenses</b>	3,445
<b>Directors' emoluments</b>	—
<b>Auditors' remuneration</b>	10
<b>Other operating expenses</b>	4,881
	<b>38,605</b>

### 5. Cash and Short-term Funds

	1997 HK\$'000
<b>Cash at banks</b>	4,375
<b>Time deposits with banks</b>	303,127
	<b>307,502</b>

### 6. Interest and Remittance Receivables

	1997 HK\$'000
<b>Interest receivable from mortgage portfolio</b>	2,631
<b>Interest receivable from time deposits with banks</b>	734
<b>Loan instalments, in transit, from the Servicers</b>	1,670
	<b>5,035</b>

## Notes to the Financial Statements

### 7. Prepayments, Deposits, and Other Assets

	1997 HK\$'000
Office rental deposit	1,725
Corporate club debentures	670
Others	262
	<b>2,657</b>

### 8. Mortgage Portfolio

	1997 HK\$'000
Unpaid principal balance of mortgage portfolio	<b>650,066</b>

With the predetermined purchasing criteria, the Company purchased 526 residential mortgage loans from various Authorized Institutions in November and December 1997 with an aggregate principal value of HK\$653,613,000. During the period, the aggregate mortgage principal repayments amounted to HK\$3,547,000.

The mortgage portfolio has a weighted average maturity of 15 years on a contractual basis, without taking into account any prepayment of the mortgage loans. Final maturity of the mortgage portfolio is in the year 2021.

## Notes to the Financial Statements

### 9. Fixed Assets

	Leasehold improvements HK\$'000	Furniture and fixtures HK\$'000	Computer & related software HK\$'000	Office equipment HK\$'000	Motor vehicle HK\$'000	Total HK\$'000
<b>Cost</b>						
Additions during the period	5,950	1,117	11,827	1,276	539	20,709
<b>Accumulated depreciation</b>						
Charges for the period	969	157	962	207	67	2,362
<b>Net book value</b>						
Ending balance as at 31 December 1997	4,981	960	10,865	1,069	472	18,347

### 10. Share Capital

	1997 HK\$'000
<b>Authorized, issued and fully paid 1,000,000,000 ordinary shares of HK\$1 each</b>	<b>1,000,000</b>

The Company was incorporated on 3 March 1997 with an authorized share capital of HK\$1,000 divided into 1,000 ordinary shares of HK\$1 each. Two subscribers' shares were allotted at par on the same date with a paid up capital of HK\$2 to the Financial Secretary of the HKSAR Government as Controller of the Exchange Fund and Mr. Joseph Yam holding as nominee on behalf of the Financial Secretary.

On 25 April 1997, pursuant to an ordinary resolution of the shareholders, the authorized share capital of the Company was increased to HK\$75,000,000 by the creation of 74,999,000 ordinary shares of HK\$1 each. On 14 May 1997, 74,999,998 ordinary shares were allotted at par for cash to the Financial Secretary of the HKSAR Government as Controller of the Exchange Fund.

## Notes to the Financial Statements

On 4 October 1997, the authorized share capital was further increased from HK\$75,000,000 to HK\$1,000,000,000 by the creation of 925,000,000 ordinary shares of HK\$1 each. On 11 October 1997, 925,000,000 ordinary shares were allotted at par for cash to the Financial Secretary of the HKSAR Government as Controller of the Exchange Fund.

The Company intends to use the proceeds of the above funding for its general working capital or for any other purposes permitted by its Memorandum and Articles of Association.

### **11. Notes to the Cash Flow Statement**

Reconciliation of operating loss to net cash outflow from operating activities:

	<b>1997 HK\$'000</b>
<b>Operating loss</b>	<b>(20,252)</b>
<b>Purchase of mortgage portfolio</b>	<b>(653,613)</b>
<b>Proceeds from mortgage principal repayment</b>	<b>3,547</b>
<b>Depreciation</b>	<b>2,362</b>
<b>Increase in interest and remittance receivables</b>	<b>(5,035)</b>
<b>Increase in prepayments, deposits and other assets</b>	<b>(1,987)</b>
<b>Increase in accounts payable and accrued expenses</b>	<b>3,859</b>
<b>Net cash outflow from operating activities</b>	<b>(671,119)</b>



## Notes to the Financial Statements

### 12. Taxation

Hong Kong profits tax has not been provided for since the Company incurred an operating loss in the period.

The amount of unrecognised net deferred tax asset at 31 December 1997 was as follows:

	1997 HK\$'000
Tax asset associated with operating loss carried forward	(3,916)
Tax liability associated with accelerated depreciation allowances	1,171
Unrecognised net deferred tax asset	(2,745)

### 13. Related Party Transactions

In April and May 1997, the Company borrowed an unsecured loan of HK\$2,500,000 under the Facility Letter dated 1 April 1997 entered into between the Company and the Hong Kong Monetary Authority, out of a total facility of HK\$9,000,000 for its working capital purposes. The loan was repaid in May 1997. There was no outstanding balance with the Hong Kong Monetary Authority as at 31 December 1997.

During the period, the Hong Kong Monetary Authority paid certain expenses on behalf of the Company in accordance with the Deed of Reimbursement of expenses dated 30 April 1997. As at 31 December 1997, all such amounts had been reimbursed.

### 14. Capital-to-Assets Ratio

To ensure that the Company is managed in a prudent manner, the Financial Secretary of the HKSAR Government has issued guidelines in respect of the minimum Capital-to-Assets Ratio ("CAR") to be maintained by the Company. The minimum CAR stipulated in the guidelines is 5%.

As at 31 December 1997, the CAR was 99.6%.

**15. Capital Commitments**

	1997 HK\$'000
<b>a. Capital commitments</b>	
Capital expenditure contracted for but not provided in the financial statements in respect of:	
Development costs of computer software systems	8,640
Acquisition of personal computers and miscellaneous software	425
	<b>9,065</b>
<b>b. Operating commitments</b>	
Operating lease commitments at 31 December 1997 amounted to \$20,264,000. Such operating commitments at 31 December 1997 payable in the next twelve months, analysed according to the period in which the lease expires, was as follows:	
Land and buildings expiring in the second to fifth years	<b>8,685</b>



**16. Subsequent Events**


On 6 January 1998, the Company executed a Programme, Agency and Operations Agreement with the Hong Kong Monetary Authority in its capacity as arranger, agent and operator in relation to a HK\$20,000,000,000 Note Issuance Programme.

On 27 January 1998, the Company obtained a credit facility amounting up to HK\$10,000,000,000 from the Exchange Fund through the Hong Kong Monetary Authority.

The Company intends to use the proceeds of the above funding for its general working capital or for any other purposes permitted by its Memorandum and Articles of Association.

# Calendar of Events

Date	Events
3 March 1997	Incorporated as a limited company under the Companies Ordinance
19 March 1997	Appointment of the Board of Directors
27 March 1997	First meeting of the Board of Directors
11 October 1997	The HK\$1 billion capital was fully paid up
20 October 1997	<p>Ceremony officiated by Mr. Donald Tsang, the Chairman of the Board of Directors to mark the commencement of business</p> <p>Signed the Master Mortgage Sale and Purchase Agreement with eight approved Sellers</p>     

Date	Events
7 November 1997	<p>Purchased the first block of mortgages for HK\$650 million from four Authorized Institutions</p>  
11 November 1997	<p>Conducted "Doing Business with the HKMC" seminar for all Authorized Institutions</p>
6 January 1998	<p>Established the HK\$20 billion Note Issuance Programme which the Hong Kong Monetary Authority is the Arranger, Agent and Operator</p> 
27 January 1998	<p>A HK\$10 billion Revolving Credit Facility was provided by the Exchange Fund</p>
5 February 1998	<p>First tender for mortgage purchase was held</p>
12 March 1998	<p>Issued the HK\$500 million inaugural note issue under the Note Issuance Programme with 8% p.a. coupon due March 2001</p>  
18 March 1998	<p>Signing ceremony to launch Fixed Rate Mortgage Pilot Scheme with Chase Manhattan Bank and Dao Heng Bank</p>
2 April 1998	<p>Issued the second note issue of HK\$500 million under the Note Issuance Programme</p>

## Annex A

# List of Approved Seller / Servicers

*As at end March 1998*

1.	Asia Commercial Bank
2.	Bank of East Asia
3.	Chase Manhattan Bank
4.	Chekiang First Bank
5.	Dah Sing Bank
6.	Dao Heng Bank
7.	First Pacific Bank
8.	Hongkong Chinese Bank
9.	International Bank of Asia
10.	Kwong On Bank
11.	ORIX Asia Limited
12.	Overseas Trust Bank
13.	Shanghai Commercial Bank
14.	Standard Chartered Bank
15.	Wing Hang Bank
16.	Wing Lung Bank

# HKMA Survey on Residential Mortgages in Hong Kong

## Executive Summary

1. With a view to obtaining updated information on the characteristics and performance of residential mortgage loans in Hong Kong, the Hong Kong Monetary Authority (HKMA) has recently conducted a comprehensive survey on the residential mortgage market, similar to the one carried out in September 1994.
2. A total of 39 authorized institutions, which account for approximately 95% of total outstanding mortgage loans extended by all authorized institutions in Hong Kong, participated in the survey<sup>1</sup>.
3. A comparison of the 1994 and 1997 survey findings are presented in Table 1 below :

**Table 1 : Comparison of the 1994 and 1997 Survey Findings**

	September 1994	September 1997
Average outstanding amount	HK\$0.8 million	HK\$1.3 million
Outstanding loan to valuation (LTV)* ratio	53.3%	52.0%
Property age - for properties less than 10 years	68.2%	56.4%
Contractual life	183 months	221 months
Months of seasoning	23 months	19 months
Remaining contractual life	160 months	202 months
Occupancy status - owner occupied	97%	92.9%
Interest payment method	96% were floating rate mortgages.	92.0% were floating rate mortgages; 0.1% were fixed rate mortgages; and the rest were staff mortgage loans and loans with hybrid interest rate structure.
Spread of floating rate mortgages over BLR	129 basis points on average	59 basis points on average
Loans delinquency ratio - overdue for more than 60 days	0.43%	0.20%
- overdue for more than 90 days	0.13%	0.10%

\* Valuation refers to appraisal value at origination or refinancing.

<sup>1</sup> Of these 39 authorized institutions, 16 were only able to provide the statistics based on samples in certain parts of the survey.

## HKMA Survey on Residential Mortgages in Hong Kong

4. The salient findings of the 1997 Survey are highlighted as follows:
  - (a) the ratio of outstanding loans to property value (assessed at loan origination or refinancing) averaged 52.0%<sup>2</sup> as at end-September 1997, lower than the ratio of 53.3% at end-September 1994 and substantially below the maximum LTV ratio (at origination) of 70%;
  - (b) the mortgage loans were on average seasoned for 19 months. During this period (February 1996 to September 1997), the property price index compiled by the Rating and Valuation Department rose by over 50%, suggesting that the current LTV (i.e. the ratio of outstanding loans to current property value) should be considerably lower on average;
  - (c) reflecting the high quality of mortgage loans in Hong Kong, the loan delinquency ratio (measured by the ratio of mortgage loans overdue for more than 90 days to total outstanding mortgage loans) was only 0.10% as at end-September 1997, lower than the corresponding ratio of 0.13% as at end-September 1994; and
  - (d) in part reflecting keen competition for mortgage business in the first three quarters of 1997, the average spread of the mortgage rate over BLR narrowed to 59 basis points as at end-September 1997, compared with 129 basis points as at end-September 1994.
5. Section I of the Report presents the findings on the characteristics of the residential mortgage loans. Section II describes the performance of the loans and Section III highlights the lending policies of the authorized institutions.

### Coverage of the Survey

The survey covers Hong Kong dollar denominated mortgage loans for residential properties in Hong Kong, other than those for flats in the Home Ownership Scheme and the Private Sector Participation Scheme.

#### Section I - Characteristics of Residential Mortgage Loans

##### Overview

As at end-September 1997, a total of 383,370 outstanding residential mortgage loans<sup>3</sup>, involving an amount of HK\$493 billion, were reported by the 39 authorized institutions (AIs) participating in the survey<sup>4</sup>.

<sup>2</sup> As the mortgage loans were on average seasoned for only 19 months, the ratio of original loan amount to property value at loan origination or refinancing should be fairly close to 52.0%.

<sup>3</sup> The total stock of private domestic units (excluding those in the Home Ownership Scheme and the Private Sector Participation Scheme) was 911,240 as at end 1996 in Hong Kong. The survey findings suggested that roughly 42% of these units had outstanding mortgages. A similar ratio (40%) was recorded in the survey conducted in 1994 (Source: Hong Kong Property Review 1997, Rating and Valuation Department).

<sup>4</sup> As at end-September 1997, the outstanding amount of loans to professionals and private individuals to finance the purchase of private residential properties stood at HK\$473 billion (Source: HKMA Monthly Statistical Bulletin, January 1998). The larger figure recorded in the survey was due to the broader coverage of the survey, which included also residential mortgage loans extended to corporate borrowers. Besides, a few submissions were based on records as at end-November 1997.

# HKMA Survey on Residential Mortgages in Hong Kong

### Outstanding Mortgage Loan Size

As at end-September 1997, the average outstanding amount per loan was HK\$1.3 million, an increase of 62.5% over the corresponding figure of HK\$0.8 million as at end-September 1994. The increase in loan amount was largely attributable to a rise in property prices.

### Outstanding Loan-to-Valuation Ratio

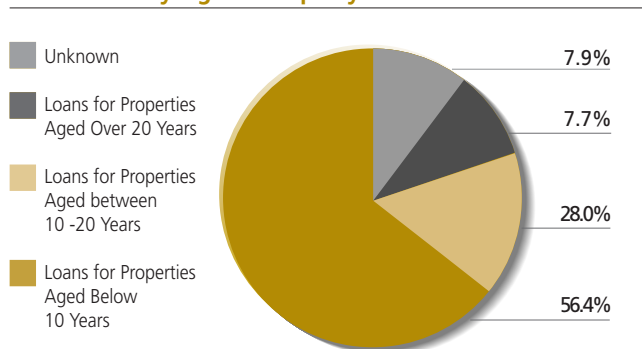
The average ratio of outstanding loan to property value (assessed at the time of loan origination or refinancing) was 52.0% as at end-September 1997<sup>5</sup>, lower than the ratio of 53.3% as at end-September 1994 and considerably below the maximum LTV ratio at origination of 70%. Apparently some borrowers ploughed back part of their capital gains as they traded up the property market.

### Life of Properties and of Mortgage Loans

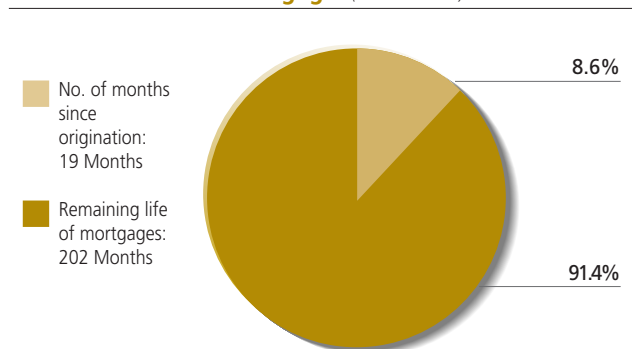
56.4% of the total outstanding loans were mortgaged on residential properties aged below 10 years as at end-September 1997. Those between 10 and 20 years old accounted for 28.0%, while properties over 20 years old accounted for only 7.7%.

In terms of the contractual life of the mortgage loans, the average was about 221 months (or 18.4 years). They were on average seasoned for about 19 months (or 1.6 years), with a remaining contractual life of 202 months (or 16.8 years). By comparison, the mortgage loans as at end-September 1994 were on average seasoned for 23 months. The shortening of the seasoning period was due to a substantial increase in new loans during the early part of 1997.

**Breakdown by Age of Property**



**Contractual Life of Mortgage** (=221 Months)



<sup>5</sup> Unless otherwise specified, ratios and average values quoted in this report are weighted by the outstanding amount of mortgage loans. This has the effect of assigning a higher weight to more recent mortgages which involved a larger amount relative to older mortgages.

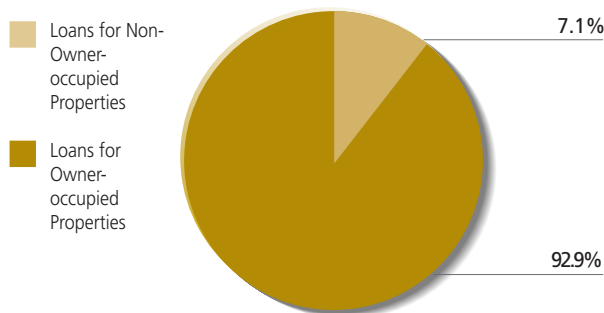


# HKMA Survey on Residential Mortgages in Hong Kong

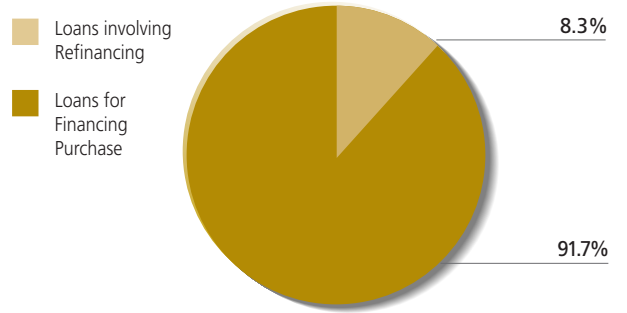
## Occupancy Status and Loan Purpose

An overwhelming proportion (92.9%) of mortgage loans were reported to be owner-occupied. Others were loans involving non-owner occupied properties, probably for investment purposes. Broken down by loan purpose, 91.7% of total outstanding loans were for financing the purchase of flats. Refinancing loans accounted for 8.3%.

### Breakdown by Occupancy Status



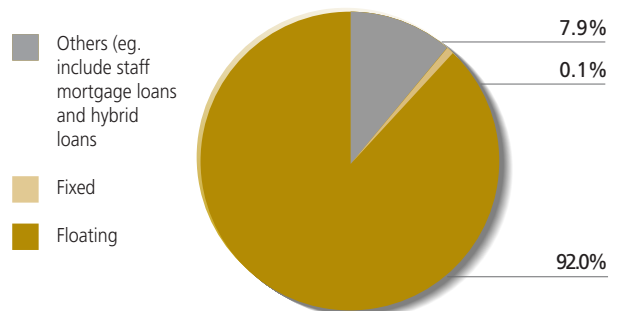
### Breakdown by Loan Purpose



## Interest Payment Method

Loans on floating rate terms continued to account for an overwhelming proportion of the outstanding mortgage market. As at end-September 1997, 92.0% of the outstanding mortgage loans were arranged on floating rate basis and fixed rate loans accounted for under 0.1% of the total. Staff mortgage loans and loans of a hybrid nature<sup>6</sup> accounted for 7.9% of the total outstanding loans.

### Breakdown by Interest Payments



With respect to floating rate loans, around 70.9% involved a repayment scheme under which interest rate adjustment was made to the monthly instalment amount. Around 29.1% involved a repayment scheme under which adjustments to mortgage rates were made to the repayment period, leaving the mortgage instalment amount unchanged.

Virtually all (99.9%) of the floating rate mortgages were based on the Best Lending Rate (BLR). The remaining (0.1%) were set with reference to HIBOR or deposit rates. The average spread of the mortgage rate over the BLR narrowed substantially from 129 basis points as at end-September 1994 to 59 basis points as at end-September 1997, partly reflecting the keen competition among banks for mortgage business in the early part of 1997.

<sup>6</sup> These refer to loans which are not of straightly floating or fixed rate nature, examples include loans which are fixed for the first 2 years at a certain rate and then floating in accordance to an index until maturity.

## HKMA Survey on Residential Mortgages in Hong Kong

### Scheduled Payment and Prepayment

In the first nine months of 1997, scheduled contractual principal payment of mortgage loans was about 4.4% of total outstanding loans. The amount of partial prepayment and complete prepayment were equivalent to 2.7% and 21.4% of total outstanding loans respectively. The latter was 11.1 percentage points higher than the corresponding figure of 10.3% in 1994, partly reflecting the active trading in the property market in the early part of 1997.

### Section II - Performance of Mortgage Loans

Table 2 shows the loan delinquency ratio during the period from September 1994 to September 1997. As at end-September 1997, the loan delinquency ratio, measured in terms of loans overdue for more than 90 days as a percentage of total outstanding loans, stood at 0.10%, lower than the corresponding figure of 0.13% as at end-September 1994. Notwithstanding the correction in residential properties in the second half of 1994 and 1995, the loan delinquency ratio remained low in these two years, at around 0.20%.

The delinquent loans reported as at end-September 1997 were on average seasoned for 22 months. The average loan-to-valuation ratio of these loans were 62.8%, 10.8 percentage points higher than the market average of 52.0%. Mortgagee actions (in the form of repossession of the property) generally took place about 11 months after the loans were overdue for one month. In all default cases, the loan amount was fully recovered.

**Table 2 : Number and amount of delinquent loans as a % of total outstanding loans**

Number of days from payment due date		September 1994	End 1995	End 1996	September 1997
31-60 Days	Number	NA	0.60%	0.51%	0.43%*
	Amount (HK\$million)	NA	0.59%	0.48%	0.40%*
61-90 Days	Number	0.16%	0.17%	0.14%	0.12%
	Amount (HK\$million)	0.30%	0.20%	0.13%	0.10%
91-120 Days	Number	0.04%	0.07%	0.07%	0.04%
	Amount (HK\$million)	0.05%	0.08%	0.10%	0.04%
Over 120 Days	Number	0.07%	0.11%	0.10%	0.06%
	Amount (HK\$million)	0.08%	0.12%	0.11%	0.06%
Loan delinquency ratio measured in terms of amount of loans overdue for:					
over 60 days		0.43%	0.40%	0.34%	0.20%
over 90 days		0.13%	0.20%	0.21%	0.10%
No. of reporting authorized institutions		32	29	35	39

\* Only 38 AIs have submitted delinquent loans data with payment overdue between 31-60 days.

# HKMA Survey on Residential Mortgages in Hong Kong

## Section III - Lending Policy of Authorized Institutions since 1994

Table 3 below summarizes the lending policy of the reporting institutions.

Table 3 : Summary of Lending Policy\*

Lending Policy	1994	1995	1996	1997
<b>Maximum Loan to Valuation Ratio (%)</b>				
- Small to Medium Flats	68.8	69.5	69.7	69.7
- Luxurious Flats	58.0	62.2	66.9	61.1
<b>Maximum repayment period (Years)</b>				
- Small to Medium Flats	20.4	23.0	26.1	27.3
- Luxurious Flats	19.7	22.8	25.9	27.4
<b>Spread over Best Lending Rate (%)**</b>				
- Small to Medium Flats	1.75-2.50	1.75-2.25	0.75-1.75	0.00-1.00
- Luxurious Flats	1.75-2.50	1.75-2.50	0.75-1.75	1.00-1.75
<b>% of reporting AIs accepting equitable charge</b>				
- Small to Medium Flats	86.5	97.4	94.9	94.9
- Luxurious Flats	85.7	97.2	94.6	91.9
<b>Maximum ratio of instalment to income of borrowers</b>				
- Small to Medium Flats	49.5	50.3	50.4	50.4
- Luxurious Flats	48.5	50.1	50.3	50.7
<b>% of reporting AIs requiring income verification</b>				
- Small to Medium Flats	100	100	100	100
- Luxurious Flats	100	100	100	100
<b>% of reporting AIs requiring employment verification</b>				
- Small to Medium Flats	62.2	57.9	56.4	56.4
- Luxurious Flats	63.9	59.5	57.9	57.9
<b>% of reporting AIs which conducted other credit test</b>				
- Small to Medium Flats	43.2	47.4	48.7	50.0
- Luxurious Flats	42.9	47.2	48.6	51.4

Table 3 : Summary of Lending Policy\* (continues)

Lending Policy	1994	1995	1996	1997
% of reporting AIs which valued property by independent valuation agents				
- Small to Medium Flats	81.1	81.6	82.1	84.6
- Luxurious Flats	88.6	89.2	89.5	92.1
% of reporting AIs which require life insurance				
- Small to Medium Flats	8.3	5.4	5.3	5.3
- Luxurious Flats	8.3	5.4	5.3	5.3
% of reporting AIs which require fire insurance				
- Small to Medium Flats	100	100	100	100
- Luxurious Flats	100	100	100	100
% of reporting AIs requiring standard documentation				
- Application form	94.6	92.1	94.9	94.9
- Offering letter or loan agreement duly accepted by customer	94.6	94.7	94.9	94.9
- Other standard documentation	70.3	71.1	69.3	71.8
% of reporting AIs which imposed penalties /restrictions on complete prepayment	100	100	100	100
% of reporting AIs which imposed penalties /restrictions on partial prepayment	86.5	86.8	87.2	89.7
% of reporting AIs which imposed other policies on residential mortgages #	65.7	63.9	62.2	64.9
Value above which property is classified as luxurious flats (HK\$MILLION)	5.9	7.4	9.0	11.8
Gross floor areas above which property is classified as luxurious flats (sq. ft)	925	925	1,000	1,000

\* Figures were calculated using simple averages.

\*\* Most common range reported by the AIs.

# For example, some banks charge higher interest rate or even decline to grant mortgages if there is tenancy agreement in place.

## HKMA Survey on Residential Mortgages in Hong Kong

### **Maximum Loan-to-Valuation Ratio and Maximum Repayment Period**

The maximum loan-to-valuation ratio remained close to 70% for small to medium flats and 60% for luxurious flats in the past few years. But the maximum repayment period has lengthened to around 27 years. A number of authorized institutions have been more flexible in terms of the property age, and used the sum of property age and the contractual maturity of the mortgage loans as a cap, which were generally set at 40 years.

### **Maximum Ratio of Instalment to Income of Borrowers**

With the exception of a few authorized institutions which allowed a 55% ratio, most authorized institutions adopted a 50% limit. Some authorized institutions have slightly different limits for small and medium flats and luxurious flats.

### **Classification of Luxurious Flats**

The dividing line for luxurious property in value terms rose from an average of HK\$6 million in 1994 to around HK\$12 million in 1997, reflecting the increase in property prices. In terms of gross floor area, the dividing line remained close to 1,000 square feet.

### **Prepayment Penalty**

All authorized institutions participating in the survey enforced some form of penalty on complete prepayment, mostly in the first year since the origination of the loans. Penalty on partial prepayment seemed to have become more prevalent.

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