

Chairman's Statement

Right On

TRACK

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SOLID PERFORMANCE IN 2005

Notwithstanding the interest rate environment and property market conditions, the HKMC achieved another year of solid financial results after the record high set in 2004. Profit after tax in 2005 was HK\$600.6 million. The return on shareholders' equity was 13.6%. The capital-to-assets ratio improved to 12% in 2005. The Corporation declared a final dividend of HK\$250 million or HK\$0.125 per share, representing a dividend payout ratio of 41.6%. These results were achieved through the Corporation's proactive approach in its main business activities of mortgage purchase, mortgage insurance, debt issuance and mortgage securitisation.

Mortgage purchase

During the year, the HKMC purchased a total of HK\$2.9 billion worth of mortgages from its pool of Approved Sellers, including banks, the Government and developers. With the loan-to-deposit ratio for the banking sector at a low of around 57% and the improved performance of mortgage loans, banks were generally disinclined to unload their mortgage loans. However, due to liquidity and balance sheet management considerations, more banks have been in discussion with the HKMC to explore the sale of mortgage loans to the Corporation.

In November 2005, the Corporation launched a special scheme under the Fixed Adjustable Rate Mortgage Programme to offer fixed rate mortgages beyond 5 years to a maximum of 10 years, the longest fixed-rate mortgages available in Hong Kong. The promotion

of fixed rate mortgages has always been one of the priorities in the HKMC's product development, and this initiative brought about a win-win situation for the benefit of homebuyers, banks and the Corporation. This new product is a good demonstration of how the Corporation found a niche in the market condition to lock in funding to meet the demands of the homebuyers and offer attractive interest rates to cushion them from interest rate volatility. In 2005, the Corporation received over \$100 million in applications from homebuyers for fixed rate mortgages. Following the initiative of the HKMC, a few banks have also subsequently joined to offer fixed-rate mortgage products to their clients.

Mortgage insurance

The HKMC's Mortgage Insurance Programme (MIP) experienced record high growth during the year, with the total number of applications rising by 10% from 17,300 cases in 2004 to around 19,000 cases in 2005. This compares with the stagnant growth in the mortgage market during the year. Insurance cover issued for mortgage loans totalled HK\$18 billion in 2005. The penetration ratio of the MIP rose from 8.5% in 2002 to 20% in 2005. The success of the MIP is reflected in the very strong results in 2005 that contributed earned premium of HK\$101 million to the corporate profit.

The MIP has played a significant role in promoting homeownership in Hong Kong, especially with the mortgage insurance covering up to 95% loan-to-value ratio. The successive broadening of the product features of the MIP has helped to extend the proportion

Chairman's Statement

of buyers who can be eligible for MIP coverage. Data from the Housing Authority show that the home ownership rate for permanent housing has increased from 52% in 1999, when the MIP was first introduced, to the current level of 57%. The average size of the mortgage loans covered by the MIP is about \$1.9 million, demonstrating that the programme is particularly helpful to first-time buyers. Moreover, over 80% of the MIP loans are from the secondary property market, indicating that the MIP helps to promote liquidity of properties in the secondary market, where homebuyers do not get to benefit from the subsidy that may be available from developers in the primary market.

Debt issuance

The HKMC continued to spearhead the development of the local debt market through the issuance of debt securities and mortgage-backed securities to fund its mortgage purchases and redemption of maturing debts. For the fifth year, the Corporation is the most active corporate debt issuer in the Hong Kong dollar market.

In 2005, the Corporation issued HK\$5.1 billion debts under its Debt Issuance Programme and Retail Bond Issuance Programme, consisting of plain and structured notes with tenor of 1 to 15 years. The retail bond issue was the first time the Corporation issued debt denominated in US dollar as well as Hong Kong dollar. The total debt outstanding at end-2005 was HK\$28 billion.

The Corporation also issued HK\$1 billion mortgage-backed securities (MBS) under the Bauhinia Mortgage-Backed Securitisation Programme. This brings the total MBS issuance by the Corporation to HK\$11.2 billion since 1999. The Corporation is by far the most active promoter of the MBS market in Hong Kong.

CORPORATE GOVERNANCE

Good corporate governance leads to better corporate performance and more sustainable long-term growth. The Corporation is committed to maintaining a robust and sensible framework of corporate governance for the prudent and effective management of the Corporation. The Corporation has benchmarked its corporate governance practices, to the extent applicable, against the Code on Corporate Governance Practices issued by The Stock Exchange of Hong Kong Limited in November 2004 for compliance by listed companies.

In 2005, the Corporation completed a review of its internal codes and standards to ensure that they are fully aligned with the latest developments in corporate governance practices. In addition, new standards on computer and information security were introduced to ensure that all staff were aware of the necessity and importance of maintaining the confidentiality and integrity of the Corporation's information assets. This Annual Report includes a report on the implementation of corporate governance practices in the Corporation.

PROSPECTS FOR 2006

The property market in Hong Kong appears to be in a consolidation phase, while the interest rate environment is uncertain, with the peaking of the interest rate cycle in the United States yet to be seen. The mortgage price war abated in the latter part of 2005 but seems to be re-igniting in 2006, which would squeeze the interest margins of mortgage lenders.

The HKMC remains very committed to its role to promote the development of the secondary mortgage market in Hong Kong, which will help to enhance the stability of the banking sector through its role as a liquidity provider to the banks, promote wider homeownership, and facilitate the growth and development of the debt market and securitisation market in Hong Kong. With the change in market conditions and the evolving needs of the banking sector and the homebuyers, the Corporation will continue to meet their needs through product refinement and innovation.

On 1 January 2007 the new capital adequacy rules under the Basel II framework will take effect. Many banks are enhancing their capacity to be more proactive in their balance sheet and risk management, and some are considering the disposal of some of their assets. The HKMC stands ready to meet such needs to contribute to banking stability in Hong Kong.

Apart from its purchase activities, the Mortgage Insurance Programme of the Corporation will continue to be a key element of the Corporation's business strategy. The Corporation plans to enhance its credit risk assessment process by seeking access to credit information in the consumer credit database. This will help to streamline the underwriting process and allow more efficient and responsive service in vetting the insurance applications from homebuyers.

In closing, I would like to thank my fellow Directors, Management and all staff for their hard work during 2005. I am sure the Corporation will rise to the challenges in 2006 and continue to serve its stakeholders with commitment and competence.



Henry Tang

Chairman