Financial Review

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The Government and the Hong Kong Monetary Authority rolled out further demand management measures and a sixth round of macro-prudential measures, including raising the stamp duty on both residential and non-residential property transactions in order to forestall the build-up of property market exuberance amid a prolonged low interest rate environment. The residential property market thus saw signs of softening, but property valuation remained highly stretched in 2013. Property transactions remained subdued after falling sharply in the second quarter of 2013, with the increase in flat prices decelerating further. The gap between rental yield and interest rate also shrank considerably, making property investment less attractive. However, the overall residential property prices still increased by 7.7% over the year.

Income Statement

Financial Performance

The Corporation continued to achieve solid financial position in 2013. The profit attributable to shareholders for 2013 was HK$982 million, a decrease of HK$143 million or 12.7% compared with 2012 **(Table 1)**. Accordingly, return on equity was 10.4% (2012: 12.4%). The reduced profitability was mainly due to rundown in loan portfolio and reduced contributions from the mortgage insurance business. Return on assets remained stable at 1.9%. Due to the reduction in operating income, the cost-to-income ratio increased to 18.1% (2012: 15.4%). The capital adequacy ratio remained solid at 21%, well above the minimum requirement of 8% stipulated by the Financial Secretary.

Table 1

Summary of financial performance	2013 HK$ million	2012 HK$ million
Operating profit before impairment	**1,064**	1,203
Profit before tax	**1,068**	1,211
Profit attributable to shareholders	**982**	1,125
Return on shareholders' equity	**10.4%**	12.4%
Return on assets	**1.9%**	1.9%
Cost-to-income ratio	**18.1%**	15.4%
Capital adequacy ratio	**21.0%**	20.2%

Net Interest Income

The net interest income for the year declined 19.7% to HK$652 million (2012: HK$812 million), which was mainly attributable to a reduction of HK$7.4 billion in average loan portfolio as a result of normal runoff during the year. The net interest spread reduced to 1.3% from 1.4% in 2012, and the net interest margin dropped to 1.4% from 1.5% **(Table 2)**.

Table 2

Net interest income	2013 HK$ million	2012 HK$ million
Net interest income	**652**	812
Average interest-earning assets	**46,430**	55,747
Net interest margin	**1.4%**	1.5%
Net interest spread on interest-bearing liabilities [1]	**1.3%**	1.4%

[1] Net interest spread on interest-bearing liabilities = Return on interest-earning assets - Funding cost on interest-bearing liabilities

Net Mortgage Insurance Premiums Earned

In general, the residential property market remained stagnant with thin sales volume following the Government's introduction of another round of demand-side management measures in February 2013. The implementation of the Residential Properties (First-hand Sales) Ordinance in April 2013 added to the slowdown in the primary property turnover, although property developers gradually got used to the Ordinance and started to accelerate their sales of new property projects towards the end of the year. For risk management purposes, the Corporation further tightened the eligibility criteria of the MIP in early 2013. After the revisions, only mortgage loan of property with value at HK$4 million or below remains eligible for the maximum LTV ratio of 90% whereas property with value above HK$4 million and below HK$4.5 million is eligible for MIP cover up to HK$3.6 million, being 80% to 90% LTV, and property with value at HK$4.5 million or above is only eligible for the maximum LTV ratio of 80%. The cap on the value of properties under the MIP remains unchanged at HK$6 million. In tandem with the development of the property market, mortgage lending also showed a visible decline, hence new mortgage loans drawn down in the residential property market decreased to HK$159 billion from HK$192 billion in 2012. New business underwritten under the MIP dropped to HK$13.3 billion from HK$22 billion. The net premiums earned after commission expenses decreased to HK$337 million from HK$363 million a year earlier amid slower housing turnover. Taking into account the write-back of provisions for outstanding claims of HK$9 million (2012: a write-back of HK$13 million), the net premiums earned decreased by 8% to HK$346 million.

Other Income

Other income rose 28% to HK$297 million (2012: HK$232 million). The net gain on disposal of investments was about HK$136 million (2012: HK$90 million), which was mainly a result of rebalancing the investment portfolio. A dividend income of HK$89 million (2012: HK$90 million) was received from listed investment securities, consisting of ABF Hong Kong Bond Index Fund, ABF Pan Asia Bond Index Fund and a real estate investment trust. The Corporation also recorded an exchange gain of HK$72 million (2012: HK$30 million), primarily due to the revaluation of the US dollar and renminbi exposures from deposits and high-grade debt investments.

Operating Expenses

The Corporation continued to maintain stringent cost control to contain expenses and improve operating efficiency. Operating expenses rose 7.2% year on year to HK$235 million, but this was HK$32 million less than the budget. Staff costs, which accounted for 61.3% of total operating expenses (65.3% in 2012), were well contained at HK$144 million (2012: HK$143 million). Premises rentals and related costs increased by HK$10 million to HK$39 million, due to office relocation and rental expenses.

Allowance for Loan Impairment

Asset quality remained strong, with the delinquency ratio staying at 0.05%. Taking into account the development of the residential property market and local economic conditions, a collective assessment for loan impairment of HK$4 million was written back in 2013, according to the approved prudent provisioning policy. During the year, loans written off were HK$0.5 million (2012: Nil) with a recovery of HK$2 million (2012: HK$2 million).

Financial Position

Loan Portfolio

During the year, the Corporation purchased Hong Kong loan assets of about HK$3.2 billion (2012: HK$0.9 billion). After accounting for the prepayments and repayments during the year, the outstanding balance of the loan portfolio recorded a runoff of HK$6.8 billion, leaving an outstanding balance of HK$22.3 billion.

Investment Securities

The Corporation adopts a prudent, low-risk approach in managing its surplus funds and investment activities in accordance with the Board's investment guidelines. As at 31 December 2013, the total investment portfolio was HK$12.4 billion (2012: HK$15.1 billion), which included HK$3.9 billion of available-for-sale investments and HK$8.5 billion of held-to-maturity investments. There was no impairment loss from the investments.

Debt Securities Issued

In 2013, the Corporation issued HK$18.2 billion of debt securities under the MTN Programme. All the non-Hong Kong dollar debts issued under the MTN Programme were swapped into Hong Kong dollars or US dollars for hedging purposes. As at 31 December 2013, the total outstanding balance of the debt securities decreased by HK$5 billion to HK$31.4 billion from a year earlier. The reduction mainly reflected a low level of loan purchases amid abundant liquidity in the local banking sector.

Key Off-balance Sheet Exposure

Mortgage Insurance

The Corporation operates the MIP on a risk-sharing basis with the approved reinsurers. At the end of 2013, the total risk-in-force was about HK$14.4 billion (2012: HK$16.6 billion), of which HK$2.4 billion (2012: HK$2.8 billion) was ceded to the approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Corporation decreased marginally to HK$12 billion (2012: HK$13.8 billion). Of this exposure, the excess loss of HK$1.2 billion of risk-in-force was hedged through the excess-of-loss reinsurance arrangement to reinsure the middle layer risk exposure, while the Corporation retains a portion of the total risks comprising the first-loss and residual risks.

The provision for outstanding claims accounted for 0.3% (2012: 0.3%) of the retained risk-in-force at the year-end. The delinquency ratio remained healthy at 0% (2012: 0%).

Dividends

At the Annual General Meeting held on 7 April 2014, the shareholders, having considered the financial performance and the capital requirements for business development, approved an ordinary dividend of HK$0.25 (2012: HK$0.375) per share, representing a dividend payout ratio of 50.9% totalling HK$500 million. In addition, the shareholders approved a special dividend payout of HK$1 billion from the accumulated earnings of the previous years.